Standing Committee on the Alberta Heritage Savings Trust Fund Act

10:03 a.m.
[Chairman: Mr. Ady]

MR. CHAIRMAN: Hon. members, I'd like to call the meeting to order. We'd like to welcome the Provincial Treasurer and his deputy, Mr. Allister McPherson, with us this morning.

Yesterday I neglected to acknowledge the effort that our legislative clerk made in preparing for the investigative visits and also the preparation of all of the background material that you've been given in your binders. I appreciate the work that she's done, and also I'd like to express appreciation to our vice-chairman for leading the investigative visits in view of the fact that the chairman couldn't be in attendance.

We'd like to invite the Provincial Treasurer to give us a brief overview of the report and any comments that he thinks would be helpful to us, and then we'll turn the time to the committee for questions.

Mr. Treasurer.

MR. JOHNSTON: Mr. Chairman, I appreciate the opportunity to discuss with colleagues of the Legislative Assembly the heritage savings trust fund. You've already introduced my friend and adviser Allister McPherson, who is primarily responsible for the day-to-day operations of the fund and, I must say, I think handles that responsibility with a great deal of care, diligence, and respect, in the private sector certainly. So I'm glad that Allister is here to assist me to deal with those questions which are perhaps beyond my understanding and to receive some insight as to how the exchange takes place between elected people in the context of the heritage fund. It's very helpful for us to understand how that's moving. As a matter of fact, I think it is fair to say that as a result of our discussions in this committee, for example, we are attempting to do some things in this report that are important.

First of all, as we indicated in last year's budget, this report is not a glossy document. Consistent with our view that we should downsize or reduce the cost of publications in government, we are attempting to take some lead in this particular report, and we have left the hard copy, glossy format for one of more modest proportions. I think that's fitting and in line with the environmental concerns that all of us share.

Secondly, we have attempted to provide more specific disclosure on some of the assets in the heritage fund. In doing so, we have attempted to fulfill full information reporting requirements, both as suggested by the Auditor and, moreover, as suggested by this committee and our colleagues in caucus and cabinet. In doing so, this year you'll see some adjustments to valuations in particular, market values being show parenthetically, confirming I suppose both the need for information which I think has flowed from this committee but also the point that many of the assets which are included in the heritage fund menu have a value in fact higher than their book value, both of those being, I think, confirmed and displayed here in this particular disclosure. So we're attempting to include and to modify the disclosure.

With respect to discussion items, first of all let me say that the fund has stabilized and always will be stabilized at the $15 billion amount. Some people continue to say that the fund has reduced in value. That is not true. The fund is worth exactly $15 billion. That's shown by footnote to the balance sheet. It includes both the financial assets of over $12 billion and the fixed or the deemed assets of about $3 billion. So roughly on that basis you have a split in the makeup of the assets held by the heritage fund. This disclosure is required because, of course, the legislation that sets up the heritage fund requires us to disclose in this fashion, but the heritage fund itself is not reduced in value. Secondly, there has been a shift in assets, however, both within the financial assets certainly -- and we can discuss that, I'm sure, in more detail -- but also within the various classifications of assets, from the financial assets to the deemed assets. Accordingly, if we're going to build something of importance in the capital projects division, that source of money comes from the financial side of the balance sheet. The financial assets are reduced and the capital assets are increased accordingly because the source of funds for the construction of these unique projects, which I think sets Alberta aside from other provinces in terms of what it can achieve through the heritage fund, is paid for from financial assets.

This year in the financial statements of the heritage fund several important items are noteworthy. I think we indicated last time we met that the privatization of Alberta Government Telephones, or Telus, did take place, and most of the economic impact does show up in these financial statements for the year ended March 31, '92. These two Telus privatizations, I guess, were the two largest privatizations of government assets ever undertaken and ever completed, and accordingly the income from the gain on those assets is reflected in these statements. There were two issues, as you well know; the second one was in December of '91. At the same time there were some valuation adjustments. Some of the assets in the heritage fund had been revalued to bring them closer to their market value or, in terms of a permanent write-down, to reflect the permanent change in the value of the asset. That, I think, follows our discussion with the Auditor and confirms with him both his and our view that some of these assets had to be adjusted. Therefore, in this year's adjustments you'll see, for example, adjustments to our shares in Pacific Western Airlines. I'm only noting a couple of them, not to be complete but only to note that we are making those adjustments. Number one, PWA, and number two, the Husky upgrader in particular: there are write-downs of these assets.

Now, one might ask why is it if there's write-down on an asset of the proportions you saw in Lloydminster, which I think is close to some $80 million or $90 million, that in fact the assets of the heritage fund do not shrink. Well, it's very simple, because of course any write-down you may take in an asset is deducted from the transfer to the general revenue fund. Therefore, if you pick up a considerable amount of money, as we did this year in the sale of Telus, and you net that to the disposition or the write-down on an asset, of course you will net the amount to the general revenue fund. So I'm simply making the point here that there have been pickups in asset values consistent with what we have expressed before in this committee, and that has taken place by the securitization of that asset: taking it from the heritage fund, putting it back in the market in some form, and selling it into the hands of the investor. Secondly, we've recognized some economic adjustments in some of our assets by writing down those assets to close to market value in accordance with sound accounting principles and sound economic reasoning.

Let me note, then, the transfers to the general revenue fund. As I've indicated, the transfer of all income, including capital gains and the disposition of assets, goes to the general revenue fund. Accordingly, over the course of the life of the heritage fund we have transferred something close to $14 billion into the general revenue fund. This money is used for relief of taxation from the Alberta consumer, the Alberta citizen, and to ensure that the highest services are provided to Albertans whether it's in health or education. Clearly, this money is an important source of revenue for the province, and again it's unique to any government in Canada. The income stream totals about $1.2 billion, $1.3 billion and is subject, obviously, to the market conditions of interest rates and subject to any pickup in valuation of the disposition of the asset or, of course, to write-downs. But there we must be very clear that this is an important part of the financial resources, the total revenue of the general revenue fund. This asset continues to generate enormous amounts of money for us in the general revenue fund to be used to diversify the economy, to reduce taxes, and to maintain a high level of programs. This year the transfers are noted in the statements. We can review those more fully, but in a general sense this is an important part of the transfer to the general revenue fund.

Let me also say, Mr. Chairman, that I've provided to you and have included in this statement the market values of our commercial investment division. The commercial investment division usually is an important discussion item here because there is some concern about why the heritage fund would invest in equity. I'm sure we can explore that more fully from the significant questions asked by members of the committee. We have provided in this statement a breakdown of the commercial investment division -- I think it's on page 53 -- based on the generic categorization of the investments, but I understand, Mr. Chairman, that you are willing to provide to members a specific breakdown of the commercial investment division based on the actual shares held. There was a pickup in value in the commercial investment division, and I'm sure that at some point we can explore pickup in values in other assets as well.

10:13

Finally, let me say that with respect to investments in the Canada investment division, investments and advances to other provinces, despite some myths that circulate about these investments, they are very strong investments. They pay a rate of return that is probably higher than you can make in any other market instrument, and certainly they're an important part of our investment strategy. They generate a lot of money for the heritage fund and, therefore, a lot of money for Albertans. Some of those will start to become due in '94. I think some may have a first redemption in '93, but a lot of them still continue out into 2000. So as an integral part of the full funds to the general revenue fund from the heritage fund, these investments are very strong and well performing, and as we indicate, they have a pickup in asset value of about a hundred million dollars or so. In that case the market value is higher than the book value.

Let me turn, then, to where we are. There is some uncertainty, of course, in the money markets presently. I think all of you noticed that the European community in particular had some excitement with respect to currency relationships, particularly to the deutsche mark, and that caused a flurry of activity, particularly in the Italian lira and the London pound sterling. Of course, as you know, interest rates in Europe tend to be higher than they are in other parts of the world, and accordingly you saw some runoff in the Canadian dollar as investors moved out of Canadian dollar assets into probably demarked assets to pick up on the yield and to pick up the certainty in the currency. That caused a run on our own Canadian dollar and caused to some extent a pickup in the short-term interest rates.

I've always mentioned that the spread between Canadian dollar assets and U.S. dollar assets is significant to us in Alberta because investors in the North American market look at the cost of investing in particular assets. So if you look at the current market structure, you'll see that the spread between Canadian dollar investments and U.S. dollar asset investments are in fact quite extensive. Presently, for example, the yield in T-bills is 480 basis points, and in some cases the spread between U.S. and Canadian dollar bonds is as high as 500 basis points. That's far too high, in our view. Therefore, we can expect a reduction in the U.S. interest borrowing rates, and I would expect that over time in the near term you'll see a reduction again in the Canadian rates. This last 2 percent hike last week was simply to stabilize the Canadian dollar, and I think you'll see that come down because the spread between Canadian and U.S. dollar bonds is far too high. Today our T-bills are trading -- I think, Allister -- about 7.65 percent, and a U.S. T-bill is trading somewhere in the area of about 3.8. So you can see that the cost of borrowing is far cheaper in the United States. The yield is far higher here, so you could see some pickup as dollars come back into Canadian dollar assets because the yield is there, but the uncertainty in the currency I think is causing most investors to be wary. Therefore, you have a soft Canadian dollar, although it did pick up yesterday. Therefore, that equates into returns on the heritage fund.

As we have said before, we have about $5 billion in cash in the heritage fund. On December 15, '92, when the second instalment on Telus takes place, another $500 million will come into the heritage fund. So you can see that the fund is very liquid. There's a lot of cash on hand, $5.5 billion in cash in place, so we have a lot of flexibility in terms of how to move that money around. However, with flexibility goes exposure to shorter and lower interest rates, and therefore some of the pickup on our investments on interest rates may be lower on the short side and on the cash side than they have been historically.

However, we have included for your consideration some of the calculations on the rates of returns of other assets of the heritage fund, and you'll notice that in one case there's an 18 percent pickup because, of course, we had a disposition of Telus. Generally speaking, those yields I think are quite positive for the heritage fund. I think they're as good as most investment portfolios, and we'd be glad to pursue that in more detail, Mr. Chairman, as time warrants. Nonetheless, I've given you my outlook with respect to interest rates. I think they'll stay down and come down as inflation is under control. Of course, we made a considerable pickup on our portfolio over the course of the last year because I think we're weighted towards bonds, and interest rates coming off gave you a capital pickup, obviously, and secondly, because we disposed of certain assets through the privatization process, including Telus and including the Alberta Municipal Financing Corporation, where there's also a pickup. Those obviously added to the current year's income, to the current yield calculation, and to the overall yield of the investments in the heritage fund themselves. I think the managers of the fund have been very prudent in the way in which they handled that investment.

Finally, Mr. Chairman, we say again that the heritage fund is a very unique part of our fiscal plan. Looking back on the history of this fund, I think it was the right decision to set it up, to take the nonrenewable resource revenue, to put it into this fund to have an opportunity to diversify our economy, to deal with very important assets such as Syncrude, such as Lloydminster, to be able to develop those resources more fully, to take additional risk inside the heritage fund without really loading debt onto the back of our general revenue fund, and to be able to do things that are very unique both on the natural resource side to stimulate the diversification of the forestry sector and to expand on the health and social sector as well.

I must say that I note with interest in the deemed assets section the evolution of the Rutherford scholarship fund. My goodness, who would think that fund would be able to generate that much opportunity for young Albertans to go to advanced educational institutions. I think the numbers show that approximately 71,000 students have benefited from the Rutherford scholarship fund. About 8,000 students in the current year received heritage scholarship trust fund scholarships. That fund started at $100 million in about 1981. Guess what? It's worth about $188 million today, still continuing to generate scholarship money for young Albertans to go to advanced educational institutions, still integral in its value, and I think the kind of thing that we should be doing with the resources of the heritage fund. That's one of the prime examples of how the heritage fund has helped in a so-called economic growth strategy which involves and of course focuses upon our most valuable resource; that is, the people of Alberta.

There are a lot of these examples that we could point to. I think there's a sense of pride that must ebb from all of us as you look at this financial statement, this fund, and that sense of pride I think in part distinguishes us from other Canadians with respect to how we handle our assets and what sorts of things can be achieved through the heritage fund to advance our economic and social interests in Alberta.

Accordingly, Mr. Chairman, I look forward to the discussion again today, to being able to participate and to listen to the advice and counsel from members of the committee and, whenever possible with my own limited ability, to answer any of the questions which may be forthcoming.

Mr. Chairman, I appreciate the opportunity of being here again today.

MR. CHAIRMAN: Thank you, Mr. Minister.

The Member for Westlock-Sturgeon.

MR. TAYLOR: Thank you. I didn't think I was at the top of the list. I'm so confused here.

A question on the Prince Rupert terminal which we just recently toured. I notice the write-up mentions that part of the financing came from general revenue and part from the heritage trust fund. The general revenue: the fact that they had to write it down to zero isn't mentioned. But so what? That does leave the fact that we do have the heritage trust mortgage bonds which are finally starting to pay off. My understanding is that the minister is negotiating rescheduling the mortgage bond payments over a longer time. As I read the Ridley contract, it means that if we do not take our full bite of interest and principal, it just leaves an amount left over for the Ridley partnership consortium, five of which are nongovernment, to dig their hands in. So why, after writing down the general revenue fund investment, would you consider easing up on the heritage trust fund investment when we're finally getting our principal and interest?

10:23

MR. JOHNSTON: I'm not too sure I fully understand the question, I must say, but I can deal with the heritage fund, the nature of the investment in the Prince Rupert facility.

MR. TAYLOR: I understand they want to stretch out the payments and that you were considering that.

MR. JOHNSTON: I don't know that, but what we can say, though, is that we have had some problems with this business. It was set up to allow western grain to be shipped to Pacific Rim countries. Most people at the time considered it to be a prudent investment. They concluded that the number of shipping days were reduced by one or one and a half days in terms of accessing those Pacific Rim markets, and there seemed to be a view that the jam was taking place in the access to Vancouver port facilities. I think all of us understand that backdrop. There were obviously start-up costs that were implicit in the entity. However, this year I think we can say that I'm sure the terminal has now proven to be a technical success. There's no doubt about the technology that's involved. There's no doubt that the throughput of the plant is there. In fact, we expect to ship a record throughput of about 5.3 million tonnes of grain. That's the highest level ever. In fact, the design capacity of that terminal is far below that. I think it's someplace in the area of about 4 million to 4 and a half million tonnes. So we're picking up a considerable amount of throughput. That equates to more revenue for the Prince Rupert terminal consortia and therefore equates to a fairly certain income stream coming back to the heritage fund to repay the interest and the principal on our $100 million or so investment.

So I don't know. Maybe Allister can give me a more detailed update on the one subset of your question: is there going to be a stretching out? I don't see why we would stretch them out at this point, particularly because the income is coming in this year: full activity, interest payments are going to be made. There were some payments last year. We expect that that will continue as grain shipments to the east are positive and volumes are up. The technical aspect of the terminal is plus; it's producing and working.

I should note that the only reason I could think of for a change in the principal repayment would be to deal with some of the cracks that are now appearing -- and I'm sure you saw them -- in the terminal hoppers, whatever they're called: those cylindrical things that store the grain; silos, I guess. Accordingly, if there is a call for new investment, that will be one of the first charges against the cash flow stream, because there is a priority ranking of how the cash flow from the terminal is allocated: operating costs, capital replacement, et cetera. I don't now anticipate too much problem with this asset. Therefore, I don't think there's been an evaluation adjustment this year on the Prince Rupert terminal in the case of the heritage fund.

MR. CHAIRMAN: Do you have a supplemental?

MR. TAYLOR: I'm sorry; a supplemental. It jumps around a little. I think you've always been very tolerant.

The answer that you see no reason to extend the date unless it's for improvements on the project is a very good one, and I'm going to hold you to that in case they do want to extend it out.

The second one is with respect to the AEC. In listing the investment at $175 million -- it's probably somewhere, but I couldn't find it -- would you have at your fingertips what value you gave to the oil and gas rights in the government's capital investment of $175 million that you gave AEC to kick-start it way back? Remember, it was a deal put together where they got the exclusive right to develop Suffield and a few other areas. There was a deal. Do you have a record of what the dollar value of the leases were that you put in?

MR. JOHNSTON: No.

MR. TAYLOR: You gave them a zero value, did you?

MR. JOHNSTON: I have no record.

MR. TAYLOR: Oh, you have no record. I see. Gee whiz, you were in charge. So there's no answer on that one. Okay.

I hope it's not a supplemental. Could I ask the minister to write me a note when he finds the record? He refuses to answer.

MR. JOHNSTON: We have no record of that.

MR. TAYLOR: Don't give me that crap. There's . . .

MR. JOHNSTON: Mr. Chairman, the member asked: do I have a record? The answer is no. Do we have a split at the time of the sale of shares? No.

MR. TAYLOR: But you've got down a $175 million investment, and I want to know what portion of that was the oil and gas leases of the province.

MR. CHAIRMAN: Hon. member, the Treasurer is telling you he doesn't have the information.

MR. TAYLOR: Well, I don't mind getting a no answer. I just don't want him saying when the media talks to him that he didn't understand the question. I wanted to make it very, very clear.

MR. CHAIRMAN: He's clear, but let's . . .

MR. TAYLOR: That's all. I just wanted to make sure he's . . .

MR. CHAIRMAN: Order please. Let's be clear we're not holding this for the benefit of the media, hon. member. So move on to your final supplementary.

MR. TAYLOR: The final supplementary. On the very front page, as the minister has mentioned, assets of $1.1 billion of Alberta Mortgage and Housing have been disposed of. The proceeds were used to pay the full face value of AMHC debentures held by the heritage fund, which is very good. What I'd like to know is: how many debentures are still left, if any, held by the heritage trust fund in this organization, and what is the value of the assets that are held against that debenture? In other words, is it possible that we've got all the money we're ever going to get and the rest is a write-off?

MR. JOHNSTON: Well, Mr. Chairman, in this case I may have to follow up with respect to the amount of bonds that are in the heritage fund at this point from AMHC, but we can make that available to him. That's not a problem. However, the principles are important. Two principles have in fact been noted, and they are the following.

First of all, there have been some criticisms over the past few years about the value of assets in the heritage fund, particularly the Crown corporations. Accordingly, this past year we have privatized Telus, AGT, and we have privatized some of the debentures of the Alberta Municipal Financing Corporation. I don't think anyone is surprised in the case of Telus to see a pickup in value. I've discussed that already, and it simply confirms that the assets of the Alberta investment division wherein we've advanced to Crown corporations money from the heritage fund have a value greater than the book value. We've confirmed that both in Telus and with respect to the Alberta Municipal Financing Corporation.

Secondly, in the case of Alberta Housing Corporation we also redeemed assets into the heritage fund from the Crown corporation. Now, what has to be important here and should be noted is that in fact the assets inside the heritage fund are at least worth their cost, the value shown in the heritage fund itself, because of course they are guaranteed by the government. Now, it doesn't matter where the investment, the underlying asset goes as long as the government's guarantee is behind that security, that debenture. Then of course the debenture is worth its book value at a minimum, and it continues to pay the income stream because it's guaranteed by the general revenue fund or by the government itself. So in this case what we did is simply securitize the asset in the Crown corporation, and when the cash was generated inside the Crown corporation, the money was transferred to redeem the debentures inside the heritage fund. So that moved from an illiquid asset to a more liquid asset. Accordingly, we said we were going to do that, and that's what we have essentially done, but it does not matter what the underlying asset is with respect to the Crown corporation because the government's guarantee applies, and when that guarantee applies, you could hold an asset in the heritage fund or in a financial institution in Toronto. You have to guarantee to pay that debt both on interest and principal, and that's what we have done. So there's no valuation adjustment, and it's irrelevant what the underlying asset value was because of course that's covered by the general revenue fund. What we are doing in the Alberta Mortgage and Housing Corporation is moving from debentures and bonds inside that corporation to pay down the assets in the heritage fund. We've done just that.

Mr. Chairman, I'd like to point the member to page 25, which has a very detailed financial summary of the book value, the market value of all bonds held, and therefore I don't have to follow up with respect to a note because it's included in the display for you. You'll see that AMHC has a book value of $1.8 billion and a market value of $1.9 billion, confirming what I have said: that in fact the market value of those bonds is higher than the book value, and therefore there's no loss at all in the heritage fund with respect to those Crown corporation investments.

MR. CHAIRMAN: Ponoka-Rimbey.

MR. JONSON: Mr. Chairman, thank you. With respect to one of my favourite topics, which is Vencap, I am pleased to note that in 1992 it appears that Vencap had a profit of $5.5 million, if I'm correct. That's a considerable increase over the previous year. Could the Provincial Treasurer identify what accounted for that shift in direction?

10:33

MR. JOHNSTON: Well, Vencap has gone through a certain rethink, Mr. Chairman, and we have listened carefully to recommendations from this committee in particular. You'll note that we've made some investments in external consultants who have advised us with respect to certain assets inside the heritage fund, and those expenditures for consultants in part were for review of the Vencap equity investment.

Vencap has, I think, made some moves inside its own structure to improve the share performance of the company. Last year when I was here, I think the Vencap shares were trading about $2.25, and today they're probably trading somewhere close to $3.50 on an average basis. That's because the company has stepped out into the market to acquire both its own shares, the float, reducing the volatility of the stock and then allowing it to grow and improve. They've also acquired some of the debentures which were outstanding as well. Accordingly, the stock has performed I think better because there's less stock out there to divide into the revenue. Secondly, the company I think has taken some losses on some of its assets over time but has improved its position by some pretty good investments this past year.

Finally, Mr. Chairman, we are looking at Vencap in the context of the heritage fund. There are recommendations coming to us from this committee which suggest that we should probably ask the venture capital company to pay back some of the heritage fund money. I think to date they've paid something like $8,000 on the capital. However, they've paid considerably more in interest, something close to, I think, $50 million, if my memory is at all accurate. So the heritage fund has received a benefit on the $200 million investment but we have not received our capital back, and under the agreement to set up Vencap, as you well know, the principal repayments really don't start to get large until sometime after 2001 or someplace in there, again from memory.

So we've listened to the advice of the committee. We're doing some work inside the company under the lead of Peter Elzinga, the minister of economic development. We're trying to improve the heritage fund position following some of the recommendations from this committee, and we're in the process of continuing to review that over the course of the next few months to see if we can adjust some of the details of the original setup agreement.

MR. JONSON: Supplementary question, Mr. Chairman. I think that certainly what appears to be the improved financial position of Vencap in one sense has to be greeted with favour in terms of the security of the heritage savings trust fund's investment in Vencap. However, my question to the Provincial Treasurer would be: has this been done, however, at the expense of moving away from Vencap's mandate, which was supposed to be that of true venture investment, diversifying the Alberta economy? Maybe it's just a symbolic case, but I remember that last year there was some adverse publicity to investing in a very conventional Texas Fried Chicken chain, and some of the other moves that you described, Mr. Treasurer, seem to be designed to secure the money in Vencap. But I do have to ask: is it still able to perform or has it really done anything lately to perform that function of diversifying the economy?

MR. JOHNSTON: Well, I guess if you ask for an opinion, you may get one. This is a very difficult issue for us in government because of course it may well be that we set the company up with too much money to begin with. If you look at the marketable securities and the current assets of the company, it's got about $200 million, although it has invested pretty well close to that in venture capital assets as well, and has paid us about $50 million, $60 million in interest. So the company has performed fairly well.

I have some concerns about the way in which the company is operating, and we've expressed these to the chairman and to some of the directors and managers of the company. Number one, it acted as an investment bank to some extent when it dealt with the Sherritt Gordon investment. I think we've discussed that here, and I've discussed that with the company. It was one of the more profitable investments that Vencap made.

Secondly, I think there are some concerns about whether or not some of the investments are to diversify the economy in Alberta. I guess you can always second-guess somebody else, but there may well be some question about whether or not they were the traditional kind of venture capital investments.

Finally, there is the question about why you would take the heritage fund money from Alberta and invest it in American assets. I mean, all of these I think are reasonable questions to pursue, and I would perhaps suggest to you to pursue them with Mr. Elzinga, who has the lead responsibility. They are questions that I have asked as well, and they are, I think, certainly concerns that we have.

What's happened with the venture capital field, though, is that venture capital has gone through an interesting change. For a while there was not much venture capital money being put out. There were so-called guardian angel kinds of investments taking place, where big entities would take big chunks of high-tech companies. Now it appears that the venture capital activity is starting to pick up again, and there is more call on venture capitalists for investment, because of course the '80s had the LBO and the MBO kind of view as to how to restructure companies by loading the company with debt off the junk bond market and hopefully selling off some of the assets to garner back some equity. I think people now view that as probably being a bit difficult and certainly not the strategy of the '90s with respect to restructuring entities, and as a result investors are looking more towards venture capitalists for these kinds of patient restructuring dollars.

Accordingly, I might suggest that over the course of the next few years you might see a pickup in demand for venture capital investments. If there is a pool of money in Alberta such as Vencap Equities, you would expect that that would bring its own demand for venture capital money to Alberta. I hope that is what the outcome is. I would rather see venture capitalists coming to invest in Alberta because the venture capital money is here as opposed to this company seeking out niche markets in other parts of the world in particular, even though they argue economic benefit comes back to Alberta. I would rather see the hard investment take place here and the economic growth take place inside our province.

We are pursuing this, and we watch this fairly carefully. I think there may be some additional losses next year in some of their investments, but that's what you expect in a venture capital activity, no question.

MR. JONSON: Thanks, Mr. Chairman.

MR. CHAIRMAN: The Member for Edmonton-Meadowlark, followed by Bow Valley.

MR. MITCHELL: Thank you, Mr. Chairman. I'm interested in knowing what the comparison is between the amount of money that the heritage savings trust fund earned -- I use that term loosely -- on its investments -- and I use that term loosely -- in the four Crown corporations versus the amount of money that those four Crown corporations were subsidized by the general revenue fund. I would just add to that that it's interesting to note that the Alberta Mortgage and Housing Corporation has an unfunded deficit of $387 million after having received $43 million from the general revenue fund. So while the Treasurer can brag about a $1.3 billion earnings figure on the heritage savings trust fund, in fact from what we can garner from this material, he would have to legitimately reduce that by $430 million, it would seem to me, unless he wants to continue with this circular accounting that inflates his return to the general revenue fund by subsidies from the general revenue fund. How much did you lose in the Crown corporations versus how much did you say you made on them?

MR. JOHNSTON: Well, Mr. Chairman, we didn't lose anything on Crown corporations in the heritage fund. As I have pointed out to the member at least eight times over the course of the last few years, in fact the Alberta Mortgage and Housing Corporation could have borrowed anywhere. It could have borrowed off the Toronto financial markets, from individual Alberta investors, from New York, Zurich, et cetera. That company, because it's a Crown corporation with guarantees from the government, would have to pay the interest on its debentures. So if there's a commitment to pay the interest, notwithstanding where the debentures are held, we would have to make that principal and interest payment. That's exactly what governments have to do. They can't default on their payments. They can't default on their commitments. To default, as we did in Alberta in 1930-something, causes you a tremendous black mark on capital markets. So there will not be any default. Therefore, the commitment is clear that the government has to make the interest and principal payments on these debentures issued by Crown corporations of all kinds. It just makes common sense to me and I think to all Albertans: if the payment of interest has to be made, why don't we keep that payment inside Alberta?

Now, we've adopted that strategy in a couple of cases. We've adopted it with respect to the heritage fund, wherein we issue debentures from the heritage fund to Crown corporations to capture that economic rent. The interest paid goes back to the heritage fund. It works for Albertans, becomes part of the heritage fund investment income.

10:43

Secondly, we've done it with Alberta capital bonds. The Alberta capital bonds are a similar vehicle, whereby Albertans have said, "Look, if you've got to pay interest, why don't you pay it to us?" We have well over $2 billion in Alberta capital funds outstanding. We pay interest to Albertans. They get the economic benefit. They get the consumption potential. They pay some income taxes on it. By jinx, that makes a lot more sense to me than paying it to investors in New York or Zurich.

So despite the cynicism from the member, it is clear that this income is real income inside the heritage fund. It is clear that the government has to make that payment, and I wish it were clear in his own mind as to how this accounting took place. I've tried with some patience to explain it to him over the past few years. I understand the difficulty he has with it. I understand that he'd like to find some holes in the heritage fund, but you know what? There aren't many there, Mr. Chairman.

MR. MITCHELL: One of the black holes in the heritage fund is the Alberta Mortgage and Housing Corporation, Mr. Chairman, which has lost over $3 billion in the last 10 years.

My second question relates to liquid cash financial assets, which the Treasurer has pegged at about $4.8 billion. I wonder whether the Treasurer could indicate to us what he is earning on that $4.8 billion versus the interest that he is paying on an average $4.8 billion worth of debt held by this province. My point is, of course, that there's a strong argument -- and we're making that argument -- that he should collapse, he should sell, heritage savings trust fund assets in order to pay off debt because he's making less than he's paying on his debt.

MR. JOHNSTON: That probably isn't the case over the past year, Mr. Chairman. In fact, in the past year -- March 31, '92, which is under consideration here -- I would expect that the yield inside the liquid assets, the financial assets, would have been higher than the borrowing costs, far higher.

MR. MITCHELL: What does “I would expect” mean? Do we have an answer? Do we know what we're making, or don't we know what we're making? We would have expected that the loan guarantee to NovAtel was going to be okay too. What are we making?

MR. JOHNSTON: Well, Mr. Chairman, NovAtel has nothing to do with the heritage fund, as the member well knows. He's dragging the red herring across the trail again without much success. I can tell you and confirm clearly that the investments in the liquid portion of the heritage fund were greater than the borrowing costs. Is that clear enough?

MR. MITCHELL: My third question would be: why does the Treasurer persist in denying the direction of the Auditor General by continuing to note the value -- and that's a loosely used term, of course -- of deemed assets. The Auditor General year after year after year cannot give the heritage savings trust fund a clean audit statement because he is concerned and states that the presentation of deemed assets is not in accordance with generally accepted accounting principles.

MR. PAYNE: This is the member's “when all else fails” question.

MR. JOHNSTON: Yeah. Well, Mr. Chairman, I always say to my colleagues that I like to have that provision there because it distracts the member. So he always has to ask this question, as my colleague points out, and again he's asked this, going back five years as well.

Mr. Chairman, let me be very clear about what it is that's in the heritage fund. We are very proud of the deemed assets of the heritage fund, and it is these deemed assets that cause the Auditor to qualify the financial statements of the heritage fund alone -- only the heritage fund. He says that, in his mind, the deemed assets should be accounted for in a different fashion. Well, that's fine; he can have that view. We've discussed it here before. My view is that I'm directed by the legislation, which says: You shall disclose the deemed assets and account for them in the following way; you must show the $3 billion that the deemed assets reflect in the balance sheet. We've done that by way of footnote, and I'd be glad to run through the deemed assets section. I could take about an hour and a half to do just that, Mr. Chairman, but I know that that probably isn't what the member wants. However, those deemed assets are clearly part of the investment of the heritage fund, clearly the important engine of difference between Alberta and other provinces of Canada, and clearly have afforded us a diversification, bar none, in Alberta.

Moreover, as I have mentioned, Mr. Chairman, the heritage deemed assets include the Rutherford scholarship fund, which has increased from $100 million to close to $200 million; the medical research fund, which has increased from about $300 million to $500 million, conducting what I think to be the important parts of any industrial cum economic strategy: investment in human capital, in the young people of this province through a scholarship fund; investment in medical research facilities, including the development of a medical research facility here in Edmonton which is without comparison anywhere in Canada; and encouraging the kind of intellectual endeavour that in my mind ties together both the social policy and an economic policy. That's why the deemed assets are an important part of the heritage savings trust fund's total assets of $15 billion.

Now, this Legislature has debated that principle. This Legislature has changed the principle under which the investment cap is on the capital assets. The Auditor has continued to say -- well, he hasn't continued. I should say that at one point he accepted this disclosure, early on in his career, to not qualify the report. We changed the disclosure to some extent, and then he qualified it. He and I haven't been able to reconcile that in terms of his position, but I can live with his qualification. Nonetheless, Mr. Chairman, that qualification applies only to the heritage savings trust fund. It does not apply to the valuations at all; it applies only to that disclosure. Everything else is accounted for. There are no other qualifications with respect to this report, and everything else that has been disclosed in this report is confirmed by his analysis and audit.

At the same time, Mr. Chairman, he does not qualify, as a result of this qualification, the consolidated financial statements of the government. They are without qualification. So it really isn't material, is the point I'm making, to the overall financial disclosure.

MR. CHAIRMAN: The Member for Bow Valley.

MR. MUSGROVE: Mr. Chairman, the Alberta Mortgage and Housing Corporation Mortgage Properties Inc. sold about $237 million worth of Alberta Mortgage land, real estate, and housing assets that they no longer needed for social housing. Is this divestment of properties completed, or are there still some properties that the province has to deal with?

MR. JOHNSTON: Well, Mr. Chairman, I would say in a general way that the policy is that we would like to exit a larger percentage of our investment in mortgages or other kinds of housing programs. First, a note on the economic circumstances. I think it is safe to say that there's a considerable amount of supply available by financial institutions, by the private sector right now for mortgages. There's a lot of money in deposits; there's a lot of competition out there. Therefore, it's time for the government to exit that investment, to be away from the provision of mortgages unless they are for a particular niche or social need where other private-sector investors aren't found. So we have over the past few years started moving out of our mortgage portfolio, and disposing of both the regular, conventional mortgages and some of our so-called CHIP and MAP file mortgages has to some extent been accomplished. We are still in the process, though, of continuing to do more. We would exit fully the investment of mortgages if at all possible.

Secondly, Mr. Chairman, we have set up a company called Mortgage Properties Inc., which is dealing with the disposition of certain assets which have a very difficult mortgage portfolio attached to them. You may well have heard about the one in west Edmonton which is a $60 million to $65 million asset, and the reason it's being sold is that it was foreclosed under the CHIP and MAP program, brought back into the Mortgage and Housing Corporation subsidiary, and is being disposed of. So when these dispositions take place and we unwind our investment, then of course more cash will be available in the housing corporation to retire the debentures owed to the heritage fund.

MR. MUSGROVE: Well, in that Alberta Mortgage and Housing has been restructured, there have been a lot of assets sold. In the 1991-92 budget there was an $87 million investment. Could the Minister explain what that was used for?

MR. JOHNSTON: What? The cash generated? Could I just have a clarification on that? I'm sorry, Mr. Chairman.

MR. MUSGROVE: Well, in the current mandate, in the heritage trust fund 1992 budget an $87 million investment was utilized for what?

10:53

MR. JOHNSTON: The housing corporation?

MR. MUSGROVE: Yes.

MR. JOHNSTON: Well, the housing corporation, Mr. Chairman, still conducts some programs. Every year we look at the Mortgage and Housing Corporation budget on an operating basis and capital budget. That's reviewed by Treasury Board. In doing so, we match their objectives with the government's objectives with respect to the housing needs. They still have a play with respect to some of the social housing programs. I think there's a play with respect to native and rural housing, for example, and there are some senior citizen rental accommodations, not being comprehensive but in some way talking to some of the programs which are still being conducted by Alberta Mortgage and Housing Corporation. Those are still ongoing and still require funds. So every year the corporation and its board approves a capital budget, and that capital budget shows that there's a certain call on its money for these programs. It also has revenue driven by its current portfolio of assets, and we simply subtract one from the other and net them out. If the corporation ends up with a large cash balance from the disposition of the mortgages, as it did in the last couple of years, those go to the heritage fund, net of what it requires to operate it.

We still, however, are advancing some debentures from the heritage fund to Alberta Opportunity Company, to Ag Development Corporation, and to AMHC, I believe, to allow it to continue with some of these programs that I noted.

MR. MUSGROVE: In some of the discussions that I've had with the department of housing over social housing, or low-cost housing as we call it, they're saying that they're restricting the amount of low-cost housing and further, to the benefit of people needing low-cost housing, they would supplement housing from private industry. Is that the policy now that we're taking with . . .

MR. JOHNSTON: Mr. Chairman, I should be a little careful. I mean, the member is asking me to describe housing policy, and one of our colleagues probably is more capable and qualified to talk about that. But that's essentially it. If we find a certain area either of population or region that has to be assisted because of economics driven by the market not providing assets or resources to build housing, then we have to move in and assist. That's what Alberta Mortgage and Housing Corporation does.

Now, you could argue that you could wind down AMHC, take all the social housing out of it, and put it into the general revenue fund budget. That's probably on the agenda sometime ahead, because why would you have a corporation doing social housing programs? It's probably more appropriate for it to be debated here and through the general revenue fund a major expenditure take place. But we've got into some of these programs historically, and I think I said when I appeared here before that you have to look at some of these programs in the context of when they were set up. Housing in particular through the late '70s, early '80s was in crisis in Alberta, so we had to move because the market wasn't responding. Some of the social programs were layered on top of the economic programs, and now as the economic programs end, the social programs continue inside the same entity because they have the people and the infrastructure to deliver those programs. Over time I would expect those would come back into the general revenue fund, but we're continuing those programs.

I think, though, that really the need for AMHC is much different now than it ever has been. In particular, the market is corrected to the extent that mortgages are at two-decade lows. I mean, up until last Thursday you could get a short-term mortgage for somewhere close to what? Six and a half percent perhaps. Therefore, the need for the government to be in this business probably isn't as clear and as urgent. Therefore, we're moving away, and the private sector is moving back in.

MR. CHAIRMAN: The Member for Edmonton-Calder.

MS MJOLSNESS: Mr. Chairman, it's well known, and the Treasurer had alluded to this earlier, that moneys are transferred from the heritage trust fund to the general revenue fund and in some cases vice versa, to some degree anyway. Now, the Treasurer in his Budget Address stated that he was forecasting the transfer of money from the heritage trust fund to general revenue to be at $1.465 billion. In fact, it has ended up being short of that by $83 million. So I'd like to ask the Treasurer to explain why the actual transfer to the general revenue fund was $83 million lower than he forecasted and what implications this has on the general revenue fund for '91-92.

MR. JOHNSTON: Taking them backwards, of course, implications are that the general revenue fund has $83 million less.

MS MJOLSNESS: Can the Treasurer please explain why he was out in his forecast?

MR. JOHNSTON: The reason for that, of course, is that we had reflected in our forecast certain privatizations which would take place, and we didn't achieve the numbered target on those privatizations. Nonetheless, there are considerable asset transfers from the heritage fund to the general revenue fund, the result of privatization. I think the number is close to $500 million, Allister, if I'm not mistaken, which was based on the privatizations of Telus and Alberta Municipal Financing Corporation. But, at the same time, there were some writedowns in asset valuations that I referred to already, and those that I've disclosed are netted from that transfer.

So in the combination of trying to forecast what you might get from a privatization and to forecast losses on the realization of the writedown of assets, you obviously get into some kind of a difficult situation. We have to give the best forecast we can, and actually it's not that far off considering the dimensions of the problems we had.

Secondly, Mr. Chairman, you had interest rates moving fairly rapidly on us, and of course as you move into a liquid position, your income stream is reduced because you're playing the short-term security as opposed to the long-term security. In part, we ended up with more liquid assets than we expected and could not put them out to work as rapidly as we would have liked to generate the kinds of yields that we were generating on the balance of our portfolio.

So it's a combination. Number one, the realizations on the disposition of privatization did not attain as many dollars as we at one time thought we could achieve. Secondly, we had some valuation adjustments inside the heritage fund in respect to assets now held by the fund: writedowns. Number three, we had a capital market, an interest rate market, which moved downward very rapidly, causing us to have less yield on our liquid assets. All three of those.

MS MJOLSNESS: Okay. Well, the Treasurer had stated earlier that the heritage trust fund had not reduced in value. However, I think it's clear that it's a declining source of revenue for the general revenue fund. For example, it's losing ground to inflation, and we know that the Treasurer in his wisdom has sold off some of the profitable assets of the heritage trust fund, like AGT. The amounts of money available to transfer are declining. So I would ask the Treasurer what specific action he is taking to offset the decline of moneys available to transfer to the general revenue fund. If this is a continuing trend, how is he going to deal with this?

MR. JOHNSTON: Well, Mr. Chairman, I agree with the member on one point; that is that as a result of legislative policy of this Legislature, the heritage fund transfer is 100 percent of the income stream including capital gains and disposition of assets to the general revenue fund. Therefore, inflation, although it's running only about 1 to 1.2 percent in Alberta right now, does erode the fixed assets to some extent. How much an erosion of course is a question, but we're now in a new set of assumptions with respect to inflation.

Inflation is essentially very, very low, all-time low inflation, as I've said before. Probably overall in Canada the inflation rate through '92 will be somewhere around 1.7 to 2 percent, and Alberta will probably be much lower than that. So I presume we could probably afford a 1 percent erosion of our assets if that was the only thing we did and if we had the income security in the general revenue fund to assist us to reduce taxes to maintain programs and to diversify the economy. Now, that's the trade-off that's taking place.

However, what I do not accept from the member is that the value of the heritage fund is eroding as rapidly as she suggests. In fact, we have demonstrated quite clearly through market initiatives that in fact the assets of the heritage fund are far above the $12 billion to $15 billion that are reported here. We have disclosed for you where those asset valuations can pick up. For example, the heritage scholarship fund asset has a cost of $100 million, has a book value of $200 million, add plus $100 million. In the case of Alberta Energy Company we have a pickup there of about $200 million. In the case of investments in the Canada investment division in bonds of other provinces, we have a pickup of about $200 million. In the case of other assets, including Syncrude, we have pickups of a considerable amount of money. In the case of the commercial investment division we have a pickup of about $100 million and some. I mean, what is the number so far, Mr. Chairman? Are you keeping track? I mean, it must be very close to a $700 million to $900 million pickup in value at the market value, and that's why we're disclosing for the Member for Edmonton-Calder. If she reads the second column showing the market side, she'll see that the market value is higher than the cost.

11:03

Now, I don't want to give her an accounting lesson, Mr. Chairman, but she knows that accountants have one thing in mind: they want to record it at cost. They don't give a damn about the market value. They won't give you any imputed value in market value, so you have to go back and take the market valuations of the fund, look at the asset itself, and then say: "Well, my goodness. You mean to say that these assets are worth more than the book value?" I'm saying yes. The assets in the heritage fund are worth more than the book value, about a billion dollars more at least. We have shown you in the case of Telus -- $500 million, Allister? -- a pickup in value. Five hundred million dollars is a lot of money to me. Maybe not in Edmonton-Calder, but it's a lot of money in Lethbridge, I'll tell you. Two hundred million dollars, Alberta Municipal Financing Corporation: that's still a lot of money in the south. Jack, you and I know that that's important for us in irrigation, in some of those projects, low taxation in particular. Two hundred million dollars in that alone. Right away you've got $700 million. That's still big money where I come from. It may not be much in Edmonton-Calder. It may not be much for her, but I tell you, the assets are integral to this fund, are there, and are far larger in value than in fact the costs of the assets.

Now, I've given that speech too many times. I get emotional, Mr. Chairman, because I am so committed to this fund, unlike the opposition members. This is an important part of our fiscal plan. It strengthens our economy, and to deny the importance of it, as the opposition party does, I think is just unfair.

MR. CHAIRMAN: Thank you.

Supplementary. [interjections] Order please.

MS MJOLSNESS: Mr. Chairman, I'm not talking about the value of the fund, which the Treasurer is going on at great length about. I'm talking about the source of revenue for the general revenue fund. There is a big difference there. I mean, you can't take book value or market value and pour that estimated value into the general revenue.

MR. JOHNSTON: But I can, Mr. Chairman. That's precisely the point: you can.

MS MJOLSNESS: Mr. Chairman, I'm surprised that earlier the Treasurer talked about book value in calculating his estimated figures in terms of transferring money into the general revenue fund. I don't know how he can calculate book value in that.

My last supplementary, Mr. Chairman. There is a declining source of revenue for the general revenue fund, and he's even stated that in the annual general report. I'd ask the Treasurer once more: is he satisfied with that? What is he prepared to do to turn that trend around and increase the revenue source of the heritage trust fund?

MR. JOHNSTON: Well, Mr. Chairman, I've already outlined a very comprehensive plan whereby we are going to maximize return to the heritage fund by improving its investment portfolio, and we have done that. I mean, the numbers confirm that over the nine-year period, three-year period, or last year period the rate of return on the heritage fund is probably as high as you'll find in investments of this type on the pure asset side. Now, we have some assets that don't yield a return because they're under construction, such as the Lloydminster upgrader. We don't get a yield on that until it's built, but heaven knows how many jobs are generated by that and what sort of long-term economic benefit comes back to the province. It's got to be very strong and very positive.

So on that basis alone, because we have a mixed portfolio, one of a pure income strain to generate the money for the general revenue fund that the member talks about -- that's driven by two components, being interest or yields made on investments -- and the second income stream, which is disposition of assets. That is the securitization of assets inside the heritage fund. Now, we have done that over the past couple of years and will continue to do it, I'm sure, in the future. We can take any of the assets in the heritage fund right now and securitize them. We can sell it into the private sector, where it belongs, use that cash for kinds of investments such as diversification.

What we've done, Mr. Chairman, is take the money from AGT, for example, which was privatized and sold back to the private sector where it belongs, and used that money to build the Lloydminster upgrader. I know that my friend Mr. Cherry likes that investment, and in fact it is going to add value to a resource which cannot be exploited fully in this province -- that is, the heavy oil -- generating jobs, economic growth, and developing that resource to its maximum benefit. All of that is done inside the heritage fund. So you can take a single performance criterion and apply it to the heritage fund, and you may do better elsewhere; I agree. But this is a mixed criteria: one of greater return -- that's the one criterion that the legislation speaks to -- and enhancing, diversifying, and improving the Alberta economy is the second criterion.

So we look at both criteria in terms of judging and evaluating our investment decisions, and you must look at both criteria in terms of evaluating and judging the results. The results stand, Mr. Chairman. We're giving full information about the value. The rates of return are strong, and the diversification continues in this province, because of course over these past two years Alberta has been the only province in Canada with a positive economic growth rate as opposed to other provinces administered by other parties that have a very negative economic future.

MR. CHAIRMAN: The Member for Lacombe.

MR. MOORE: Mr. Chairman, I've been enjoying this today. It's very informative, and you get the true facts out on the table.

I've long been an advocate of restoring the flow of royalty money into the heritage trust fund or leaving a portion of the interest revenue with the heritage trust fund to maintain the financial stability at present-day dollars or at its peak. Where are we sitting right now with that either way, flowing money from the royalties back in or leaving some of the interest revenue in the fund to maintain long-term financial stability of the fund?

MR. JOHNSTON: Mr. Chairman, the Member for Lacombe and I agree on that point, that it would be to the advantage of subsequent generations and I think to the financial integrity of the government if we could allow some of the resource revenue or interest revenue to stay inside the fund. I think as an objective he and I share the same view, and I think many Albertans would concur that we should try to protect and let this asset grow.

As I have said, though, on other occasions, Mr. Chairman, the current situation in the general revenue fund is that oil and gas royalties in particular have not performed to the extent that we thought they would, and accordingly we have gone through two economic shocks on the royalty side: first of all, when the oil price fell dramatically in July of '82 below $10, and then as recently as February of this past year, when the price of natural gas fell at the same level. About 50 percent of the price was eroded by the markets, and therefore the gas price was down. So, in combination, if you look out, you'd have to see a pretty substantial pickup in both the oil and gas revenue forecasts; that is, the royalties, in particular, back to the province. Otherwise, you would simply be saving on one hand and generating debt on the other: saving in the heritage fund and generating additional deficits in the general revenue fund.

Until you see a balanced budget, I don't think it's possible for us at this point by policy to suggest that you should leave more money in the heritage fund. I think on principle the Member for Lacombe and I agree, but the economic imperatives, generally the revenue of the general revenue fund, are such that it's nearly impossible for us to leave more money in the heritage fund because of the current fiscal situation in the general revenue fund.

MR. MOORE: Supplementary, Mr. Chairman, on this same area, looking at various investments that are doing well, like Syncrude. Vencap made a little more money this year; I want to deal with that in my next supplementary. Using Syncrude as an example, when are we going to bring back into the heritage trust fund the money that's invested in ventures like that which are now standing on their own feet? The heritage trust fund played its role and made it possible for these things to develop, maintained them through their growing years. Now that they're in the black, when are we contemplating taking this back into the fund, reinvesting it in some other area, and doing the same thing over again?

MR. JOHNSTON: Mr. Chairman, you're right. During the year ended March 31, '92, Syncrude in fact generated a tremendous amount of money for the heritage fund and the general revenue fund. That was because the price of oil, as you'll recall, through the Gulf crisis shot up considerably, and the royalty regime is such that it generates almost pure money once the price of oil goes over $25. Therefore, you saw a fairly large pickup. Allister probably has the numbers there, but the income in '91-92 and '90-91 was about $120 million: $82 million and $43 million. So you've had a fairly considerable pickup in the income stream of the Syncrude investment. Accordingly, we agree again with the Member for Lacombe.

The Minister of Energy and I have had considerable discussion on this point, and we believe that it should be sold. We should sell our Syncrude investment into the private sector, into the market where it belongs, and let the market discipline then decide how it operates it both in terms of new investment, expansions, et cetera. Rates of return for that would be such that the investor would find it an attractive investment.

11:13

We have in fact shopped the company around the world, and we have a couple of interested parties now looking at it. We hired a company called Morgan Grenfell essentially to shop the company for us. By the way, those fees are reflected in the heritage fund costs of operating. Morgan Grenfell I think is still pursuing a couple of targeted investors, and we would like to dispose of the Syncrude investment. However, Mr. Chairman, I think it's prudent to say that we would probably want to dispose of the asset at a value greater than its carrying cost to the province. Otherwise, the Member for Edmonton-Calder may make the point again that our assets are below the market value, but they're not. I mean, we think that the market value of Syncrude is about what is shown here.

Secondly, Mr. Chairman, other owners of Syncrude equity through the joint venture ownership structure have disposed of parts of their ownership as well. Most recently Petro-Canada, I believe, disposed of theirs, and I think it's quite commonly understood that many of the other owners are trying to shop their interests.

Accordingly, there are a lot of people shopping their interest in Syncrude right now, and therefore there's a soft market, as you can expect.

Finally, Mr. Chairman, you have to have a fairly buoyant view as to the price of oil over the current year or two years to substantiate an investment in Syncrude, but I think the price of oil is fairly predictable right now, and most people can now generate a so-called investment deck or model to substantiate the investment.

So, number one, we agree. Number two, we're in the process of talking to a lot of people worldwide about the market. Number three, Syncrude is a very attractive investment. It is in fact what the heritage fund should be doing: taking the cash that's available, exploiting natural resources that are here in Alberta, adding value to them and adding value to our own jobs and diversification, and then at some point spinning that asset off into the private sector. That is the ongoing strategy of the heritage fund. It's one that we're already pursuing and following, as we have said, in terms of our privatization plans, and it's one which I think meets the test and needs of Albertans as you apply the heritage fund to our long-term economic growth strategy.

MR. MOORE: Final supplementary, Mr. Chairman. It's on page 54 that I have a concern: the financial statement regarding Vencap. There are two points in there that concern me. One is that here in 1992 they start repaying the money that we loaned them in start-up capital, and it goes through to, I think, the year 2013 before we recover our investment. Now, is there anything in there that says we can recapture that money sooner than that, or are we tied in totally to 2013 with the Vencap investment? The other one in there is: provided "an option to purchase . . . 4,000,000 special shares at $1." That concerns me because that's just another $4 million unless we can flip it overnight and realize a big profit overnight. If it's just investing $4 million long term somewhere down the road, we're going to show an increase.

All these options -- we should be able to flip it overnight and make a 100 or 300 or 500 percent profit. Hopefully, that's the way that's being viewed, not as just another injection of $4 million.

MR. JOHNSTON: Mr. Chairman, I have touched on Vencap in part. I'd be pleased to perhaps review more specifically the elements of the transaction with Vencap. Now, let me say that under the status quo -- the Member for Lacombe has referred to page 54, which I think details the retirement schedule and the terms of the agreement with Vencap. Nonetheless, there are some elements of the current arrangement or agreement with Vencap that could be examined.

Now, remember that Vencap is a publicly traded company, and therefore you're not dealing just with a board. You're dealing with shareholders who have invested their dollars in this company under some understanding that the current deal stays in place, so you can't change these contracts unilaterally. They have to be negotiated, and I think it's fair to say that there are two sets of responsibilities. I think the government's responsibility is to maximize its benefit from the venture capital investment. Likely most people would agree that Vencap probably had too much money when it was first set up, and it still at this point does not need $200 million because it really hasn't used all of the money. It could probably give back some portion of that $200 million and still operate very effectively. In fact, it is probably the largest venture capital fund in North America, and it has not fully used the money from the government. We overestimated it; let's face it. We should have given them less money to start with.

However, the terms of the agreement are there as well, so in any negotiation if you say to the directors, "We want some of that money back because you're not using it," they will say to us, "Well, you have to, in exchange for that, give us something on your side." So the government has a responsibility if it wants to acquire back some of the cash that Vencap has, which is a recommendation of this committee, that we have to also be agreeable to doing something else, and that doing something else falls into, for example, the 4 million shares that we can buy. It may well be that that overhang can be removed, and therefore that stabilizes the market value of the stock. We could simply say that we would give up that $4 million. We could probably deal with the so-called golden share which is involved here, or we could change the ownership structure to allow more single ownership or foreign ownership of the company. All of these are possibilities that are there as well. I think those are the major items that we could deal with. We could also look at a retirement schedule for the money which the heritage fund has invested there. So these are some of the aspects that are on the table.

What has happened, though, is that Vencap has hired their own consultants to look at these elements, we have hired our own consultants to look at these elements, and we have now come to some view about what is a reasonable trade-off between them. At some point -- I would imagine over the course of the next little while -- we will probably strike this balance and find a way to change some of the original agreements. I think this review is appropriate in light of the economics, in light of what the company has done, and in light of what the heritage fund sees as its need for that $200 million which has been advanced to the venture capital company.

That's the rough framework, and so again the Member for Lacombe and I aren't far apart.

MR. PAYNE: Mr. Chairman, the Provincial Treasurer, in his opening remarks and then later in response to a question from the Member for Edmonton-Calder, quite properly pointed out that the heritage fund investments' market value is greater than its book value, and it's quite appropriate for the Treasurer to draw the members' attention to that fact of heritage fund life. However, I think it's also appropriate that the members spend some time examining those investments for which the market value is somewhat less than book value. I would ask the members to turn to page 25 and refer them to the table, comparison of book and market values of heritage fund investments, with specific reference to the Nova debentures and the Nova common shares, wherein the aggregate difference between market value and book value is something in the order of $20 million; that is to say, the current market value or the reported market value is $20 million less than the book value. I'm sure I speak for some of the members of the committee in asking the Provincial Treasurer if he could shed some light onto that glaring exception to the general rule that heritage fund investments' market values of course do exceed book value by and large.

MR. JOHNSTON: Mr. Chairman, let me say that I would expect that if these assets are held by the heritage fund in five or 10 years from now, you'll see a much different display. I would imagine that the valuation of Nova investment in the heritage fund will enhance its investment many times over over the course of the next decade. The reason for that is very simple. First of all, last year the Nova Corporation went through a re-examination of itself. It operated in three different areas. It said to itself: what about splitting Nova as a company into two separate parts, one being the pipeline and transmission side, one being the petrochemical side? They looked at that very carefully and in fact came close to making a deal, and the deal at that point had the shares valued at about 10 to 10 and a half dollars. In fact, though, during the course of last year the shares traded I think as high as $12. In fact, one share issue was done at $10. Remember that this is a convertible debenture we hold here;

we can convert into shares at some point the common stock of the company, and we get interest on the investment through that period. So as the stock goes up, so goes our convertible debenture, but we get the income stream out of it.

11:23

The second thing the company did was to look around and decide if that met with the long-term strategy, and they concluded through 1991-92 that it was not going to split its entity into two parts. It was going to maintain itself as it was: one company in two different kinds of business, pipelines and chemicals. I guess they saw that the core competency of the firm was such that they could exploit both of these avenues quite nicely inside the framework of one entity. But that caused some disruptions on the market side, and of course there was some reluctance of the investor for a while to buy the stock, and it traded down considerably. I think at March 31, '92, it was trading probably towards $7 as opposed towards $10 as it was before.

Secondly, the company also took significant hits. It wrote down its assets by about $600 million as I recall, evaluating down its investment in certain assets. Finally, it changed its management. Now, that's quite a sizable dynamics for any company to absorb. Accordingly, the stock did not perform well, and therefore when we asked the outside consultant for this evaluation -- this isn't just our number; this is done by an outside consultant -- he said as of March 31, '92, because of all of these factors we think you should at least show a reduction in the market value of your asset below the $150 million. Now, that is not a capital impairment. That is to say, that is not a long-term reduction in the asset value. Right now the stock is trading over $8.50. Therefore, whatever this value was, $131 million, you can be assured that the valuation's up again, and I think the company is on stream. Its gas sale volumes are up. Its petrochemical -- some expansion's going to take place in the Red Deer area by debottlenecking and expansion of those petrochemical plants. I think it has rethought its own investment strategy, and I say again that within a decade or so, when you come back and look at this investment, you'll see that the right-hand column, the market column, in my mind may well be twice as large as the cost of the investment. It's a part of diversification. It's a very important asset for us in Alberta.

MR. CHAIRMAN: Prior to a supplementary I wonder if the minister could just shorten his answers a little bit. I have quite a number of members who are perhaps not going to get on.

MR. JOHNSTON: I take your advice, Mr. Chairman. I just want to be comprehensive and full in my answers.

MR. CHAIRMAN: Thank you.
Supplementary.

MR. PAYNE: Well, Mr. Chairman, this is one member who appreciates a fulsome and comprehensive answer. I hope that's not an inappropriate constraint on the Treasurer.

Mr. Chairman, I'd like to shift gears, then, from our Nova investment to Telus. The report before the committee indicates that the fund is slated to receive $435 million at the end of this calendar year as a result of the Telus share offering. I'm wondering: can the Provincial Treasurer tell the committee what's happened to the other $435 million worth of Telus Corporation common shares that were sold in calendar '91? How much of it went to cover the cost related to the Telus share offering and so on?

[Mr. Moore in the Chair]

MR. JOHNSTON: I think I can do that, Mr. Chairman. Let me say that the principle is very clear for us. What we do is transfer to the general revenue fund any increase above the book value. So if you have a book value of a dollar which represents the debentures in AGT, we sell them for $1.50, and then the 50 cents goes over to the general revenue fund. We always maintain the core capital in the heritage fund. Now, in December '91 the province completed its second offering. I guess that's probably the one we can refer to, at least, and if there's any more information, I'll be glad to get it for you. The facts in the offering were that it was an approximate $896 million offering. We sold 58,000 shares. The shares sold to Albertans constituted about 82 percent, some $700 million-plus. It was done on a $7.50-$7.50 split, and that's the $7.50 December '92 payment that the member refers to. In fact, that $435 million will come to us December 15 and go right back into cash. The costs of the issue were about $31.3 million, and the net gain to the heritage fund on that particular issue was $190 million. Those are the facts, and we can, of course, provide additional information if so required.

Just by way of a footnote, Mr. Chairman, I note that Nova Scotia has done a privatization as well, and it claims that this is the largest privatization issue done. In fact, that's not the case. If you look at the total amount of dollars done by the issue, Telus Corporation one and two are still the two largest issues ever done, but the reason Nova Scotia can claim it as a larger issue is that it had more shares. That's not really material. The question is: how much money did you receive from the marketplace? In this case Telus one and Telus two were the two largest issues done on a dollar value basis.

MR. PAYNE: Well, I'm sure that's a very interesting footnote, but I would like to get back to the body of the text. Once this $435 million payment from Telus is made in December '92, will the heritage fund have any further involvement of any kind in Telus?

MR. JOHNSTON: Well, I know the member isn't confusing the issue. The money doesn't come from Telus, of course; it comes from off the market.

The second point is that any further interest -- I have to be very careful. First of all, the heritage fund, I guess, Allister, has some shares in the commercial investment division. We're holding some there. I think we put -- was it a million shares? I just forget the number; Allister can tell you that. There are some Telus shares held in the commercial investment division because they're good shares, with good growth potential and a high yield. Allister will give you that number: 463,000 shares. So we own 463,000 shares of Telus right now.

[Mr. Ady in the Chair]

Of course, I think under the legislation which sets up the privatization of Telus, there is a so-called golden share as well in Telus, which mostly deals with the matters of the bylaws of the company, not so much with the economic performance of the company.

MR. PAYNE: If I could, Mr. Chairman. Just that last piece of information from Mr. McPherson. Does it appear in our report?

MR. JOHNSTON: No, we'll have to circulate that to you. The chairman will give you a breakdown of our commercial investment division holdings.

MR. PAYNE: Including the Telus?

MR. JOHNSTON: Telus is in the commercial investment division holdings.

MR. PAYNE: That would be much appreciated.

MR. JOHNSTON: Mr. Chairman will do that right away.

MR. PAYNE: Thanks, Mr. Chairman, and thanks to the Treasurer.

MR. CHAIRMAN: Edmonton-Beverly, followed by Lloydminster.

MR. EWASIUK: Thank you, Mr. Chairman. I would think my question is in a little different direction. I think the integrity of the fund itself, or at least the perceived lack of integrity, perhaps, of the fund itself -- and I say "perceived". The Treasurer's figures indicate that the fund is maintaining its $15 billion level, and yet we have economists in the province who would argue with that figure. I think the perception -- and again I'm saying it's a perception -- in the community, in the province is: what is there in the heritage trust fund? What is the future growth of the fund? I know this gives the Treasurer an opportunity to sort of unwind on this one, but I do want to be able to say to the people of this province that yes, there is a fund and yes, its integrity is intact. You may want to respond to that now, and I have other questions on this line of questioning.

MR. JOHNSTON: Mr. Chairman, just to understand it, is the member saying: what is the general future of the fund? I have some trouble just decoding this. I can talk extensively and perhaps too long about the future of the fund.

MR. CHAIRMAN: To the member, I think you need to focus your question a little better. It's really broad. Could you restate it so that the minister can zero in and give you a direct, focused answer?

MR. EWASIUK: I mentioned that there are some economists that argue with the minister as to the actual value of the fund on his projections. The projections that I have seen suggest the fund is actually worth somewhere in the vicinity of $9 million to perhaps $10 million. The perception in the community is that it's probably worth less. I want some indication from the Treasurer so that I as a member of this Legislature should be able to provide some assurance to the community that yes, indeed there are moneys in the fund.

MR. JOHNSTON: Again, Mr. Chairman, this is relatively the same theme the Member for Edmonton-Calder has developed. I'd be glad to go back over this for the Member for Edmonton-Beverly and simply confirm several points. First of all, I always get a great deal of excitement from some economists who look at the heritage fund and say: "You know, guess what? If that government hadn't ended the royalty payment into the general revenue fund and kept it all in the heritage fund, the heritage fund would have had $50 billion in it." Well, that's quite a revelation by these economists who come to this conclusion. At the same time, the general revenue fund would probably have a debt somewhere close to $30 billion. I mean, that kind of economic nonsense doesn't really help us in terms of pursuing the public policy questions that surround both the fiscal integrity of the province and the way in which the heritage fund articulates with that fiscal strategy.

11:33

Secondly, a lot of economists look at the heritage fund and say, "Well, the rate of return was probably not as good as you should expect from assets of this sort." Again I say to these people who have never been in the private sector or have never had to make these kinds of investment choices that they'd better be very careful about how their analysis works, because again this investment in the heritage fund is driven not solely by rates of return but is driven by an opportunity to expand and enhance the economic fortunes of Alberta and therefore there are two kinds of tests applied when you use the dollars in the heritage fund to expand and to diversify our economy. One is the rate of return; will it generate a reasonable rate of return for the heritage fund? Secondly, will it diversify and strengthen the Alberta economy? I've already indicated to you that some of the assets which are inside the fund right now do not generate that rate of return until they are completed. So in the case of, for example, Lloydminster, as I referred to, you may have $200 million or $300 million or even $400 million tied up in this asset that doesn't generate any cash flow until its construction, but in the meantime you're diversifying the economy and adding a present value to a resource that would otherwise be zero because you couldn't exploit it, couldn't develop it. So these economists tend to look at things, I think, through different kinds of glasses than I would. I have had discussions with them, and we have had this debate considerably.

Finally, Mr. Chairman, some say that the assets in the fund are overvalued because of course, as the Member for Edmonton-Meadowlark also points out, you have to consider the Crown corporation side of it. Well, to me it's like looking at an apple that has perfect symmetry. On one side there's a bruise, but the rest of the apple is perfect, and therefore you condemn the entire apple because it's got a blemish on one side. Everyone knows that you can simply sever that asset and look at the good part of the apple and still enjoy it. Really in the case of the heritage fund the assets, as I have said time and time again, can be securitized. They're not blemished by the losses in the Crown corporations. These assets add real intrinsic value that we could take to the market any time we want and privatize, commercialize, securitize at at least their book value because we have the guarantee of the government behind it. Therefore the value, as I have pointed out time and time again, even today, of assets in the heritage fund is far above the $12 billion financial assets, is far above the total $15 billion of assets because, of course, we have pickup in market value from a lot of assets. We have disclosed that for the reader of the financial statements to see what the market values are.

The Member for Calgary-Fish Creek points out that Nova is down about $20 million, but overall, simply referring to the same page, you can see that the pickup in value on that page alone shows that the financial assets are up about $600 million, and the deemed assets including the two scholarship funds, which are the only ones that are noted here, are up about $300 million. My goodness, if you add $600 million and $300 million, that comes pretty close to a $900 million pickup on those assets alone above the book value of the heritage fund showing that the market value of these assets is far stronger, far greater above the assets in the heritage fund. So anyone who says that the valuation isn't there just doesn't know what he's talking about. Moreover, Mr. Chairman, nowhere in the comments from the Auditor will you see any question about the valuation of the assets. He agrees with the valuation of the assets. He's looked at his external evaluation and said, "Yes, that's about right."

I don't know why either the two members or their research staff continue the same theme. I've answered the question already. I'd be glad to do it again though, Mr. Chairman, because I know it takes a lot longer for the members of that party to understand this issue.

MR. EWASIUK: Mr. Chairman, I think the situation is that there is a feeling that the investment is overvalued in some cases, and I think this is really part of the problem. In fact, Esso industries has written down their value in Syncrude, yet the government continues to insist that their investment in Syncrude is worth some $518 billion. Now, I think this is the case in point: is in fact Syncrude worth $518 million to the heritage trust fund, or should it be written down to something more realistic?

MR. JOHNSTON: Well, Mr. Chairman, we have had a discussion on Syncrude. We have had some very significant and in-depth evaluations of the company. We know roughly what the company is worth. Sure there's got to be a ban somewhere, but in my mind the company is fully worth the $500 million or so that the heritage fund has invested in it. The member has already pointed out that the income stream has increased from about $20 million and some to $80 million last year and about $40 million this year. If you have any hope at all that the price of oil is going to stabilize about its current level of $21-something, you will see that the income stream of Syncrude continues to be a very positive income stream.

Moreover, unlike other oil investments, this has an infinite potential. An oil well going into the ground could be calculated by most engineers to have a reserve life of X number of years. When that ends, then your asset is gone. In the case of this asset what we're doing is improving the technology all the time, improving the costs of operating, improving the way in which we extract that very vital resource. The total amount of oil in that area, according to some geologists, including my good friend Mr. Yurko, is close to 1 trillion barrels of oil. Well, in my mind that's pretty close to an infinite supply. This Syncrude production is a technology world renowned and will continue to exploit that resource over at least a 30-year period, if not more, and continue to revitalize the investment inside, and that's what the company is doing.

I can't tell you or confirm that Esso has written down its investment in Syncrude. I don't know the answer to that, but we have said that there have been some companies, some in desperate financial shape perhaps or difficult financial shape, who have been shopping their investment including Petro-Can. Petro-Can took another $600 million or $700 million hit in its own investments this past year. Other companies, including PanCanadian, have been trying to shop their investment as has Amoco. All of these companies are going through a worldwide restructuring, and therefore they see this asset as being outside the normal course of business and are divesting it. So we have a heavy selling pressure. On the short term we may get a price fluctuation which is more down than up. In my mind the income stream from this asset is positive and will substantiate the value as shown here. I say again that over time we will dispose of this asset into the private sector and we will get the cash back as we have indicated.

Now, a final note on valuations. We have adjusted our valuation of the Lloydminster upgrader, and we did that in some discussion with the Auditor. The Auditor, Mr. Salmon, looks at a variety of the assets which we have disclosed here. Those which he thinks have to be adjusted, we look at very carefully. He suggested to us that we should evaluate or adjust down the value of the Lloydminster upgrader. I must say that I am not in full accord with him, but I accepted his recommendation at this point. I don't think it's appropriate for us to adjust the asset valuations until the plant starts to operate, but I know that the province of Saskatchewan, when it had a change of government, evaluated its asset, and I think the federal government also evaluated its investment in the Lloydminster upgrader. So we followed by writing off, I think, our share of the cost overruns.

I must say that that doesn't really square in my mind with the real reality of accounting for these kinds of investments. I think you'd have to see some experience before you adjusted it, but we did come to the view that to accommodate the Auditor and to work with him to solve the disclosure problems, we'd adjust the Lloydminster upgrader. However, having said that, you must expect that he's also looked at the Syncrude investment as well. He did not ask us to evaluate that one down.

MR. EWASIUK: Well, my final question then, Mr. Chairman, is also in the same vein of the overvaluation of some of our assets; for example, the loans that have been made to the Ridley Grain company, Millar Western Pulp, and to Vencap.

MR. JOHNSTON: Excuse me. What company?

MR. EWASIUK: Ridley Grain, the terminal at Prince Rupert; Millar Western Pulp; and Vencap. A total of some $450 million has gone to these three. I've seen the projected value of other economists. They've written down the value of these by some $190 million to something like $260 million. My question to the Treasurer would be: if indeed we were going to liquidate these three operations, how much money would the heritage trust fund in fact receive, if there are in fact buyers for these projects, for these groups?

11:43

MR. JOHNSTON: Mr. Chairman, the hon. member is getting the facts wrong. There's no provision in these accounts for writing down the asset valuations. If he has some unique understanding of these assets that I don't have that would suggest that we have to write them down by $160 million, he should give it to me, but there's no substantial evidence to support that position. I mean, why would you write down an asset that's doing the following: number one, paying the interest on your investment? All of these are doing exactly that. Vencap is paying the interest. We've talked already about the Prince Rupert grain terminal. In fact, the throughput is up. The profit is up. It's paying the interest. In the case of Millar Western, it's paying the interest under the terms of the agreement.

Now, the first test. In most banking circumstances if the loan interest is in arrears or being accrued, then you have to make a provision for loss. Well, I'm making it very clear here, Mr. Chairman, that in these three instances that the member refers to, there is no loss of income as to the agreement, as to the investment, and I've confirmed that already. Secondly, are the companies making principal repayments as agreed to by schedule? In the case of Ridley terminal, yes; Prince Rupert, yes; Vencap, yes. Not large, I agree, but they're making payments under the agreed terms of reference. In the case of Millar Western the answer is yes.

So in all circumstances these entities are continuing to operate. They have positive cash flows now. Perhaps it is not a positive cash flow in the case of Millar Western, but it has in fact had a difficult pulp year. Nonetheless, the companies are sound, going concerns, paying the interest, and meeting the capital requirements. So there's no logical reason to evaluate these assets downward, and there is no pressure on us to do so by external evaluations. Is that clear enough?

MR. CHAIRMAN: Thank you.

The Member for Edmonton-Meadowlark.

MR. MITCHELL: Thank you, Mr. Chairman. I appreciate the one question greatly. The Treasurer told me in answer to my earlier question that in fact his debt costs on $4.8 billion worth of debt were lower than his earnings on $4.8 billion worth of cash and financial assets. I look in the annual report and note that in fact the earnings as a percentage of financial assets and cash values are about 8.5 percent. A quick perusal of the Treasurer's own financial reports indicates that very, very quickly you can find $4.8 billion worth of debt considerably higher than 8.5 percent. There's $1.9 billion between 8.6 and 9.4 percent. There's $1.2 billion at 10.75 percent. There's $250 million at 10.7 percent. There's $800 million at 10 percent. There's $700 million at 9 percent. My point is that in fact there is easily found $4.8 billion worth of debt which is costing this Treasurer considerably more than he's making on the $4.8 billion worth of assets in the heritage trust fund: a strong argument to sell the one to pay off the other and to make up the difference in lost interest.

MR. JOHNSTON: Mr. Chairman, that is not a different question. That's the same question that I've answered. The member of course uses both faulty reasoning, which is common, and faulty methodology, which is to be expected, because he uses it to reinforce his point. The point is that the cash that the heritage fund has is invested at a higher marginal rate than the average cost of borrowing, and that's in fact what's happened. We have a very large bond portfolio. In some cases the liquid assets of the fund are producing well over 10 percent and the cost of borrowing is below that, at the margin.

So he should go back and do a little more homework with respect to his methodology, which as you said is very quick and probably on the back of a matchbook, not even an envelope. In fact, his reasoning is just as driven by one objective: he wants to satisfy one point of view. Well, like other economists across the way if you want to satisfy one point of view, you can make the numbers and make the story work to satisfy the hypothesis, but that is not good, sound thinking. I would expect the member, who I usually hold in high esteem, would do a little better than just what he's done today.

MR. CHAIRMAN: The Member for Lloydminster.

MR. CHERRY: Thanks, Mr. Chairman. To the Treasurer. I just wanted to talk about my pet project for a little while, and that's the Lloydminster biprovincial upgrader. A week ago the committee went on a tour of the upgrader, and the comments I heard were that everyone was quite pleased to see the project, especially with it 99 percent completed.

I want to go back to the original agreement whereby there were three governments involved plus Husky. The approximate share of this province's expense was around $320 million for I think it was somewhere around 24 percent of the total project. We all know that there were overruns in it, overruns up to roughly $400 million. Two overruns: the first of course was when all the parties participated in it; the second was when Saskatchewan refused to participate in it.

One of the things that always bothers me, Mr. Treasurer, is the provincial E and H tax of 7 percent, which the Saskatchewan government certainly took to the tune of about $40 million, their original investment, around 17 percent, and then refused to put any further dollars into it. One of the strong questions that I put to them was: on the original agreement why didn't we change the 50-50 input into the feedstock for the upgrader? I would think that, you know, fairness is fairness, and if it's not fair to put money into the project, then it's not fair to have the feedstock go into it at a 50-50 rate. I know you were in on the negotiations, and maybe you could elaborate a little bit on it for me.

MR. JOHNSTON: Well, Mr. Chairman, this does have une longue histoire, as they say. It's a long story which goes back some time, back to the days, for example, when the current Premier was the Minister of Energy, when I guess the first idea here developed. In line with western co-operation or the need to maximize the economic benefit to Alberta, Saskatchewan, Manitoba, and B.C. some thought was given to securing this asset to develop and exploit the heavy oil which was in abundant supply in the member's area. It was important for our strategic economic growth but had to be refined to a first level so it could go into the normal refinery system. So under this umbrella of western economic co-operation we decided to build this plant on Saskatchewan's side. There were some questions raised at that time as to why, with the supply of heavy oil mostly from Alberta, it would be built in Saskatchewan, but it was part of this overall context of regional co-operation.

Secondly, the project had, to say the least, a stutter start. It went through three or four negotiations before it came together. I think Allister and I in particular and, as I recall, Grant Devine and Don Mazankowski and Mr. Price from Husky finally put this deal together in Regina one Sunday afternoon, and it was done with the intention of developing the resource and getting the project under way. Over the course of the life of the project the cost had increased in two numbers above the cost of the expected capital investment, the first of $170 million and the second of $190 million.

Now, the Saskatchewan government says, and this is their interpretation, that they were committed to invest only to the extent of the first capital draw. However, they did commit and pay part of the second capital draw, the $170 million overrun. When the third $190 million came to be called, the Saskatchewan government said that they could not participate for a variety of reasons which included: one, they did not have the resources, and two, they didn't believe they had an obligation to participate beyond the first capital call. To some extent the contract was silent on that point, but at the time I think everyone believed that if you're into the deal, you're into the deal to its completion, and governments don't usually back away from these kinds of commitment.

11:53

I have had extensive discussions with the Premier of Saskatchewan, with the minister responsible, and with the gentleman responsible for Crown corporations all to no avail, and Saskatchewan refused to pay its portion of the $190 million overrun. Accordingly, the other provinces and the federal government had to step in and pick up that portion. We went through a protracted period of trying to negotiate how Saskatchewan would participate or not participate in the various kinds of equity that make up the structure of the company, but we finally came to a conclusion that it's better to get the deal done and get on with making the project work than spend too much time trying to lever or exact more money from the Saskatchewan government. Accordingly, Alberta and the federal government and Husky Oil put in not only their own contribution to the $190 million overrun but also Saskatchewan's portion, and to some extent these participants will get that paid back from the entity as it generates an income stream from the so-called class A shares, and that will repay us before Saskatchewan participates to recover its equity.

All in all, Mr. Chairman, it was a difficult period and in part was because the government has changed in Saskatchewan. I think the Saskatchewan government does have quite a bit of economic benefit, as the member points out, in terms of the share of the feedstock, it does collect the sales tax on the assets being invested, and it does escape the second call on the overruns. Those are the facts. I'm not attributing any values or views as to why it happened, just trying to recount the facts as best I can.

MR. CHERRY: Thank you, and a supplementary on the same subject of course. The property tax on the upgrader is a provincial tax again. Again we go back to the original agreement stating that because of the proximity of the city of Lloydminster itself and the

RM of Britannia -- I think it's Britannia; I hope it is -- they have a responsibility to each one to see that the tax is shared fairly. The information I have is that there's a problem there again, that the municipality will not be fair about the taxation with the city of Lloydminster. I wondered if you could shed some light on it at all.

MR. JOHNSTON: I really can't, Mr. Chairman. I'm not too familiar with the way in which municipal taxation impacts on this particular project. I understand there's some sort of a pooling arrangement. It might be better to pursue that with the Minister of Energy certainly.

I think it is also accurate to say, though, that in terms of input costs Alberta probably provided about 60 percent of the capital input in terms of provisional supplies and equipment and manpower. So we did get an economic benefit during the construction period, and we will get an economic benefit through the operation period because our oil will go to that as well. Surely I know the member is concerned about it, but I think the city of Lloydminster, whether it's on the Saskatchewan or Alberta side, will also generate a large share of the economic benefits from this plant. I think that's really what we're talking about. To some extent I think the view is held that there's an invisible line between Alberta and Saskatchewan, but there's a lot of respect at Lloydminster, and through co-operation with the Saskatchewan governments at the municipal level and provincial level I'm sure that we can find a way to make this project work to maximize our own economic benefits both in Alberta and Saskatchewan. That was the intention. There were some potholes along the way, but I think we smoothed most of them over, and I think we have to expect that we'll have significant economic impact positively for that region.

MR. CHAIRMAN: Our time is almost gone, but we could entertain one question from the Member for Westlock-Sturgeon, who's next on the list.

The Member for Westlock-Sturgeon, one question and no supplementary because of the time.

MR. TAYLOR: I have one, and I don't think it was covered in the Lloydminster thing. Does the minister feel that the Alberta government is adequately protected with the overrun, or did the minister expect an overrun on the building of the upgrader?

MR. JOHNSTON: With respect to the overruns I have to say that we did not expect the second overrun of $190 million. When we put the first overrun in place, all governments asked the owners/builders: do you in fact believe this to be the last call? They said: yes, this is it. Then when they came back with $190 million I think all of us were quite surprised and perhaps, to quote the Leader of the Official Opposition, shocked and appalled. Accordingly, we asked for some fairly careful scrutiny with respect to that $190 million investment. Secondly, though, I think because the project is now 99 percent complete -- in fact it's generating oil right now as well as coking materials -- you can expect that it is going to be completed under the $190 million additional or second overrun. So I think you can confirm that that's a pretty good number now.

Finally, though, there will be an additional call. We have to find a way to provide the Alberta government share of the operating costs. Obviously a plant of this size with very large throughput costs and work in progress and inventories has to be financed in some fashion. Under the terms of the agreement we have agreed to finance part of that working capital provision. We're in the process of doing that right now, which will allow it to finance its working capital, get its inventories up, and start its throughput production. When that's finished, it will pay that back of course. That's the only other call on the government that I can contemplate right now.

MR. CHAIRMAN: Thank you. We appreciate the minister appearing before the committee and his answers. We appreciate Mr. McPherson accompanying him and the assistance that he's been.

MR. WOLOSHYN: Mr. Chairman, could I have a point of order? I understood from our organizational meeting yesterday that we would go through with the questions and two supplementaries each, and after that, time permitting, we would tack on extra questions. I gave you an indication very early that I wanted to be on the list. Since then two members have had additional questions and I haven't been able to pose mine. In view of the, shall we say, digression from what we had agreed to yesterday -- and I'm not faulting the movers; this is an oversight on the Chair's part -- I would ask if we could perhaps invite the Treasurer to come back for further questioning at another date.

MR. CHAIRMAN: That's at the call of the committee. However, in fairness, hon. member, those people had come back in prior to you signaling that you wanted to be on the list.

MR. WOLOSHYN: Mr. Chairman, I beg to differ. I had signaled you before the hon. Member for Westlock-Sturgeon even left. With that, I'll make my signals a bit more obvious in future.

MR. CHAIRMAN: The Chair apologizes if that happened, but I didn't see you signify an intent to question.

MR. WOLOSHYN: The point is: could we then consider inviting the Treasurer to come back? I do believe that other members of the committee would be most interested in additional question.

MR. CHAIRMAN: Okay. Thank you.

The Chair would entertain a motion for adjournment and would advise the committee that we will reconvene at 2 p.m., when the Hon. LeRoy Fjordbotten, the Minister of Forestry, Lands and Wildlife, will appear before the committee. The Member for Lacombe.

MR. MOORE: I move we adjourn.

MR. CHAIRMAN: Thank you. All in favour? Carried.

[The committee adjourned at 12:01 p.m.]