Resource Wealth: Opportunities and Challenges

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Thank you for joining me here today. I know you are in the middle of elections so it is a busy time.

I was asked to speak today about the challenges and opportunities of resource wealth. I will focus on economies that are resource-dependent using the threshold of 30% of GDP coming from resource extraction.

Discovering resources in your Territory can be the equivalent of winning the lottery, but can there be too much of a good thing?

The challenges of resource wealth have been studied. These challenges have been referred to in the academic literature as the *paradox of plenty* or *the resource curse*.

The most obvious examples are places like Sierra Leone or Liberia and blood or conflict diamonds. Oil in Africa is also commonly associated with erosion of democracy, corruption and conflict. There is certainly a stark contrast with developed and more democratic economies such as that of Alberta or the NWT.

However, before getting too high on our collective horses, we need to look at examples like Norway for real democracy and development that benefits current and future generations. There is still quite a gap to close for Alberta and the NWT in that regard.

Today I want to look at Alberta as a case study of petro-politics and the paradox of plenty and tell a story that is not often heard outside of Alberta. Then I want to look at how Norway has avoided a number of those traps. Finally, I will explore where the NWT sits and what can be done to maximize the return to people in the territories and minimize the risks.

The Paradox of Plenty

There is a fair bit of literature on The Paradox of Plenty, looking at the challenges associated with the kind of revenue and pressure that comes with resource wealth. Common key challenges associated with resource wealth that emerge from the literature are:

- Boom and bust economy (volatility)
- Inequality
- Less reliance on taxes

- Less democracy
- Regulatory capture
- Dutch disease

I will explain each of these in turn and then look at how our three case studies compare by these measures.

Boom and bust economy (volatility)

Resource booms are not cheap, the cost of living is usually driven up dramatically. Population influxes put pressure on existing infrastructure and social services, industry requires more infrastructure, housing becomes scarce, housing prices and rents go up, and land prices go up. For people on fixed incomes or in low-wage jobs outside the resource sector, these changes can actually make them worse off.

Inequality

The gap between the *haves* and *have-nots* often widens with resource wealth. It also widens gender inequality and intergenerational inequity. Resource extraction is still a male dominated business with few women represented in the higher wage jobs or at the executive level. Resource booms often drive the gender gap wider.

Intergenerational equity - Savings and the next generation. Governments with resource wealth have great temptation to use the wealth for increased spending or lower taxes, both of which may help their short-term political futures. The next generation is often given short shrift. Peter Rutland, a U.S. scholar, recently noted that resource wealth also poses a hefty moral hazard: "The society (and its leaders) start to think that it is richer than it really is, and fritters away the energy rents in excessive consumption or infrastructure investment."

Less reliance on taxes / Less democracy

Resource wealth comes with a high risk that governments will use that wealth to cut taxes to gain short-term election advantages. This comes with the risk of making the government and the economy increasingly reliant on resource revenue for ongoing expenditures. It undermines the government's reliance on the citizenry and tax base for expenditures. As per the common refrain: there is *No representation without taxation.*

Common results of tax cuts in resource rich jurisdictions include:

Low voter turnout,

Long-reining demagogues (political regimes) (Alberta 30 years of the same party)

Highly centralized governments.

According to Terry Karl, who teachers at Stanford University, "*A state's dependence on resource dollars, changes both the governed and quality of governance.*" Resource revenue not only detaches the government from duly representing its citizenry but produces a citizenry "less likely to demand accountability from and representation in government."

Regulatory capture

Another consequence of becoming beholden to resource extraction corporations is the undermining of balance and accountability in the regulation of the industry.

Both environmental regulation and monitoring become watered down and balanced in favor of industry.

Dutch disease

Reliance on commodity exports drives up the dollar. This is good for the exporter of commodities but not for those exporting manufactured goods that are competing with American and other countries in the markets. It undermines the competitiveness of the manufacturing and value-added sectors. The high Canadian dollar has been associated with weakening the position of manufacturing across Canada. The long term effect of this can be a de-industrialization, and de-diversification, further reinforcing the dependence on the resource commodity.

Alberta is a good illustration of the paradox of plenty.

Alberta, like the NWT has high average incomes and lower unemployment compared to the rest of Canada. Certainly for those in the resource economy, life looks good. However, average incomes mask differences – if Bill Gates walks into a bar, the average wage would be in the millions and no one better off.

A Leger marketing poll at the height of the boom in Alberta asked Albertans, "Are Albertans benefiting from the boom?" The majority said "Yes." Then the poll asked, "Are you benefiting from the boom?" The majority said "No." And 17% said they were worse off.

Obviously, the resource boom is costing many Albertans more than it is giving them. This section will explore how Alberta fares on each of the key indicators of the Paradox of Plenty.

Boom/Bust Volatility: A 2010 report by the C.D. Howe Institute disclosed that Alberta has the most volatile government revenues, with the most predictable of results: "Volatile revenues can lead to the inefficient provision of government services" and "stop-go" fiscal policies.[6]

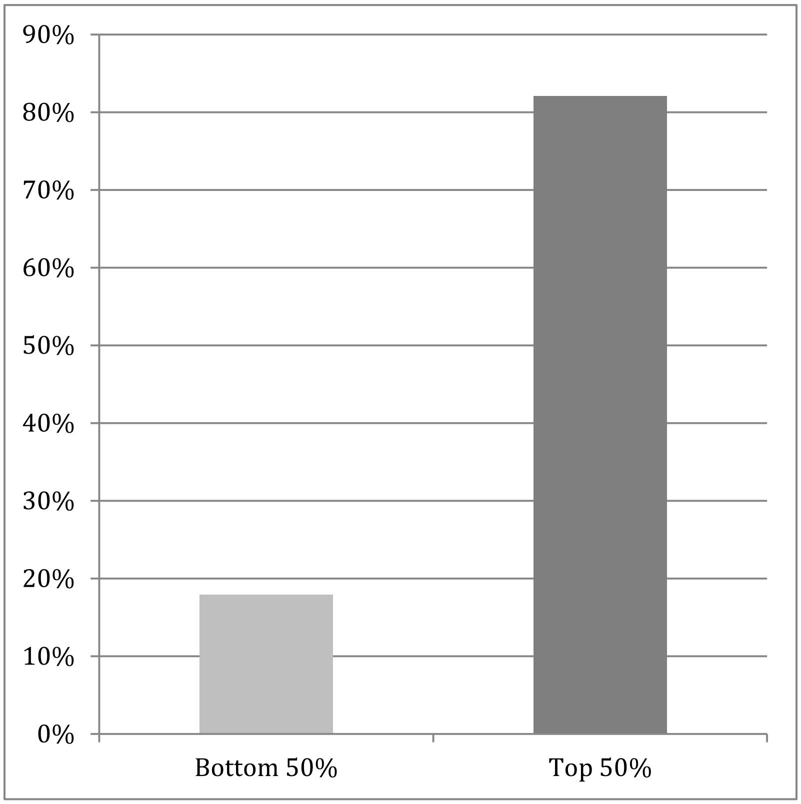
Inequality It is important to look at inequality and poverty intensity.

Alberta has amongst the richest rich and the poorest poor. Though the province has fewer people living in poverty than in other provinces and territories, those living in poverty are in much deeper or more intense poverty. Alberta has consistently had the lowest welfare rates and minimum wage rates in the nation. Alberta's rates are show the biggest gap to the poverty line.

Alberta has the highest percentage of working poor using a food bank in the nation.

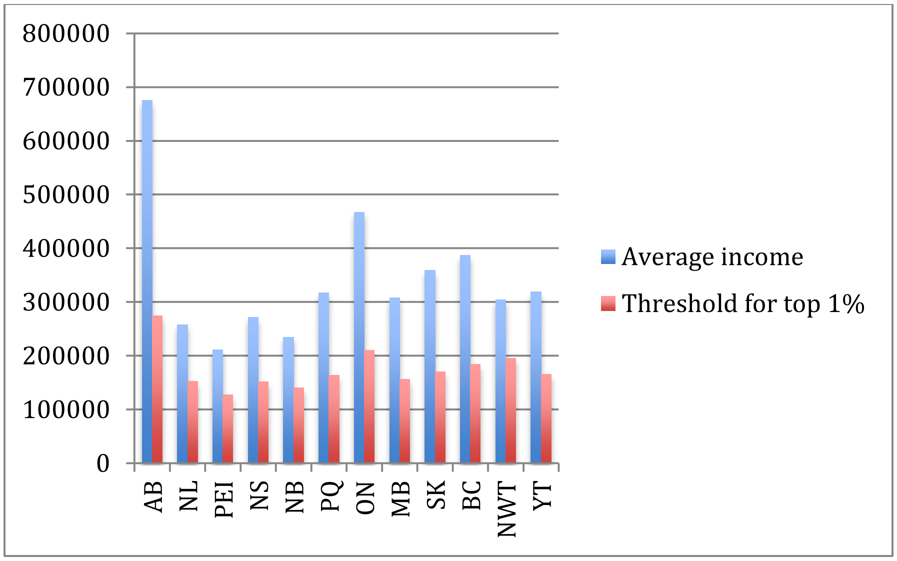
Alberta’s income is very unequally distributed.

SHARE OF EARNINGS ALBERTA HOUSEHOLDS



Social spending is down From 1989 to 2008, Alberta’s spending as a portion of GDP shrank 40 percent. Alberta’s economy has grown 76 percent more than population and inflation in the past 20 years.

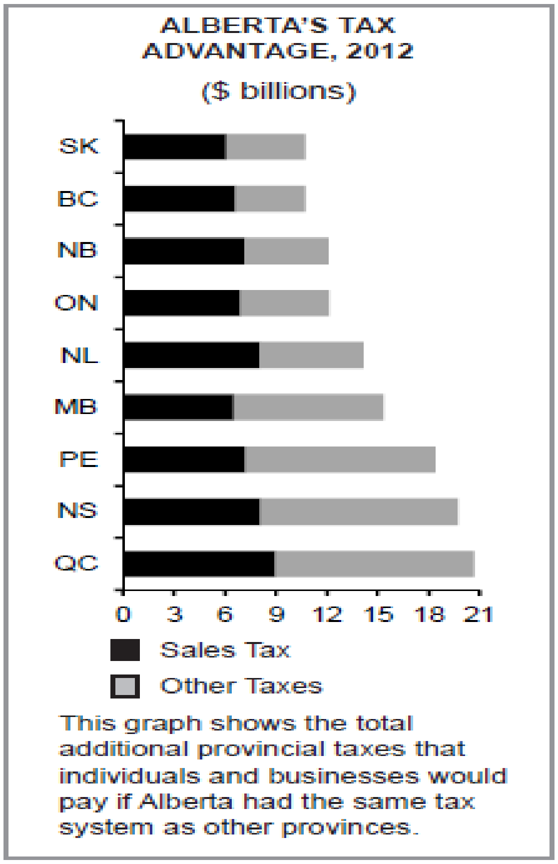
ALBERTA’S TOP 1% ARE THE RICHEST



Alberta's Gender gap is the widest in the nation – it has the largest gap between men and women's wages.

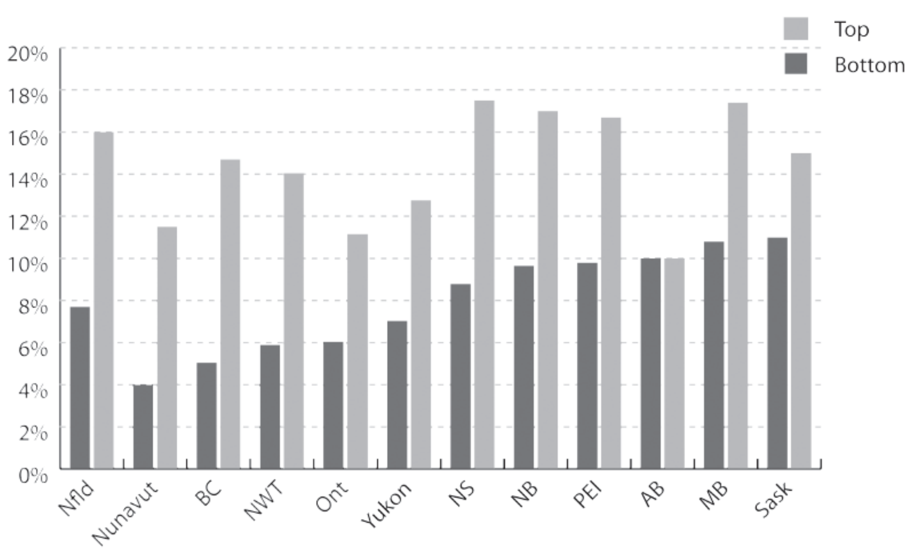
Intergenerational equity– When it was established, the Alberta Heritage Savings Trust Fund directed 30 per cent of all hydrocarbon revenues to the savings account. But subsequent governments consistently reduced those targets and failed to meet them, even failing to protect the fund from inflation. Between 1987 and 2006, the government failed to contribute to the fund and it lost value. Today, it is still faltering while the rainy day fund has evaporated into budget deficits driven by artificially low taxation levels.

Taxes Alberta has cut taxes dramatically, and uses almost all of its resource wealth to fund current expenditures. It has been running deficits and using up its rainy day fund at an alarming rate. This is despite the fact that the province could collect 10 billion more in taxes today and still be the lowest tax jurisdiction in the nation (this by the government's own estimates). To get to the average of other provincial tax rates, Alberta could collect $16 billion more today.



Flat tax: Alberta also has a flat tax which as you can see here means that the lowest tax bracket pays some of the highest taxes in the nation and the top tax bracket pays by far the lowest.

FIGURE 6 | 2006 Federal and Provincial Tax Rates
Brackets and Surtaxes and Top Marginal Tax Rates for Individuals



Source: http://www.cra-arc.gc.ca/tx/ndvdls/fq/txrts-eng.html

Corporate taxes: Corporate taxes have also been cut, meaning that corporate profits more than doubled their share of Alberta's economy from 1989 to 2008, rising from 9.6 percent to 22.6 percent. After recovering from the recessionary dip, profits are well on their way back into the stratosphere.

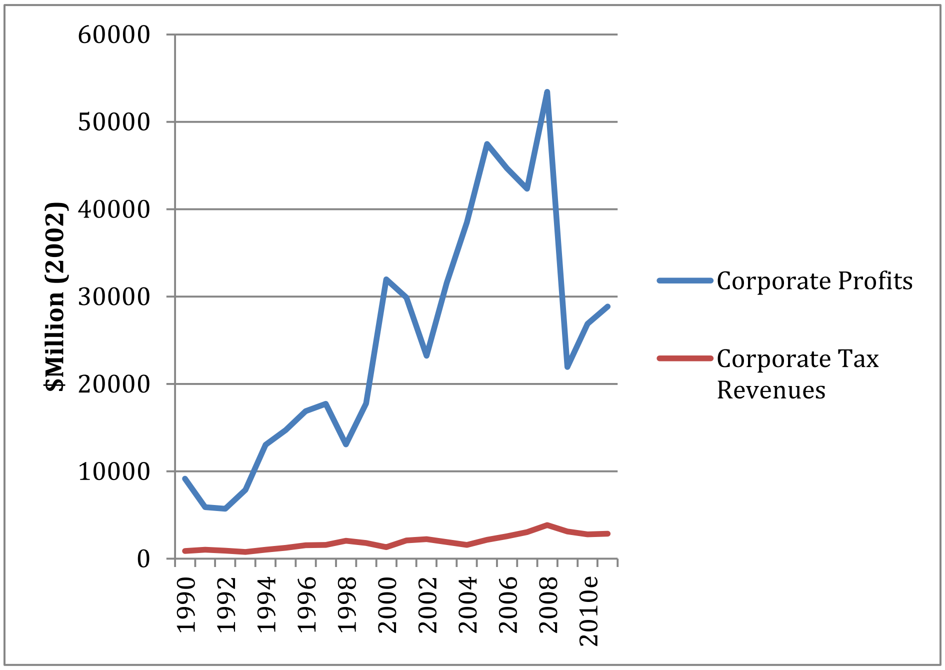


FIGURE 9 | Equity Oil and Gas Extraction and Support Activities in $billlions adjusted for inflation

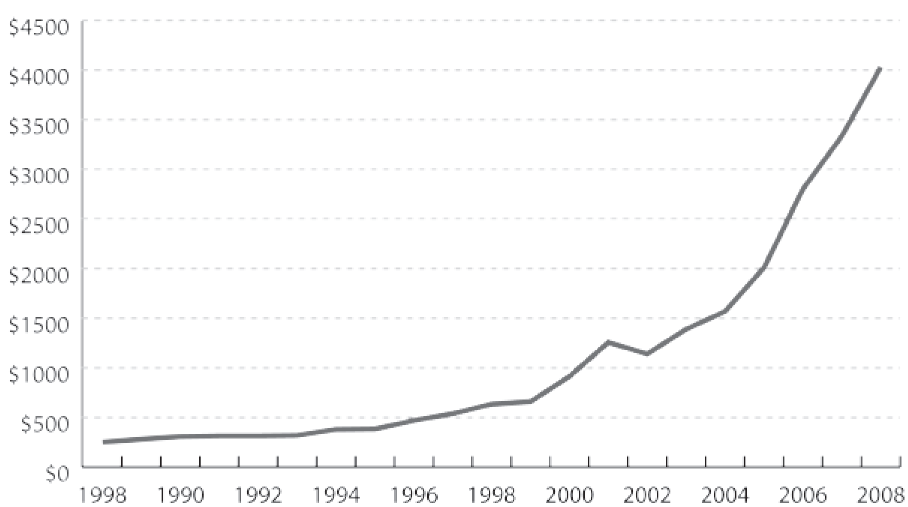
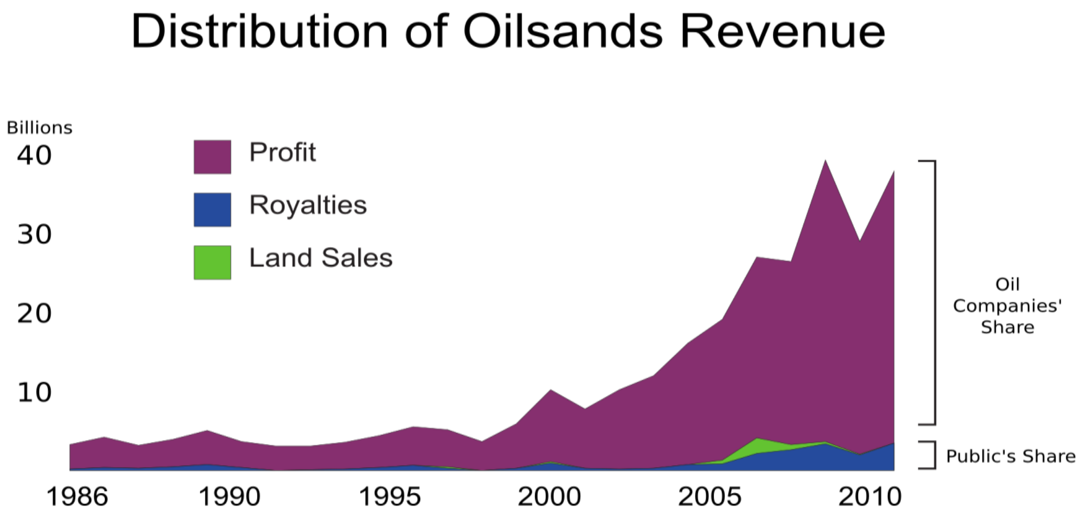


Table 1: Changes in selected fiscal indicators in Alberta, 1989-1993 vs. 2004-2008				
	1989-1993 **Five Year Average** **(per capita, 02 $)**	**2004-2008** **Five Year Average** **(per capita, 02 $)**	**Change** **(per capita, 02 $)**	**Change (%)**
Health Care	2,061	2,563	502	24.35%
K-12 Education	1,248	1,276	28	2.28%
Post Secondary	819	1,014	195	23.87%
Social Services	1,546	1,032	-514	-33.26%
Personal Income	28,214	37,041	8,828	31.29%
Corporate profits	2,923	13,290	10,367	354.68%

Royalties: Studies have shown that Alberta has foregone over a $100 billion in revenues just by failing to meet its own revenue capture targets. Just a note, a report I did in 2007 with the UofA shows that 96% of the worlds oil has been nationalized and half of what is left is in Alberta. There is nowhere else for them to go.

Reminder what royalties are – Steel mill has to buy the steel, oil and gas and mining companies do not have to buy their oil. Royalties are the price of the public charges the extraction company for the resource. Royalties are not a tax. They are the value of the resource to the public. Lougheed had a target of capturing 35% of royalties, Klein modified that to 20 % then it was eliminated all together. Alberta's conservative governments have failed to reach those targets consistently. Currently the province is capturing just a little above 10%.



Democracy - Voter turnout is a key indicator of democracy. Alberta has had the lowest voter turnout in the nation in recent elections.

Year	%
2008	40.6
2004	44.7
2001	52.8
1997	52.8
1993	60.2

Another measure of democracy is the disconnect between public opinion polls and government policy. Seventy-one per cent of Albertans believe that the Government of Alberta should suspend new oilsands approvals until infrastructure and environmental management issues have been addressed in areas affected by oilsands development. This included first nations: “The cumulative impacts of oil sands development has all but destroyed the traditional livelihood of First Nations in northern Athabasca watershed,” Chief Alan Adam contended in a statement, adding that aboriginal rights have been threatened and ignored.

Regulatory capture Environmental regulation and monitoring – Alberta spent ten times more on drilling incentives and even at one point marketing and advertising it oil and gas sector than on the entire environment ministry.

whistleblowers in Alberta face more than being ignored -- much more.

From denying science and defaming scientists:

- In 2007 Energy and Utilities Board government agency hired spies to infiltrate a landowners organization and report back to them and the proponent.
- in 2009, Peter Lee and Dr. Kevin Timoney published a scientific report that dared suggest that "physical and ecological changes that result from oilsands industrial activities" are "detectable." Hard to believe anyone would disagree, but a section head at Alberta Environment accused them of lying and fudging the data -- an action that resulted in a retraction and an apology from attorney general's office.
- David Swann, before being elected he had been medical officer of health in Palliser Health Region. He spoke out about climate change. He was fired.
- Dr. John O'Connor raised flags about unusual cancers in Fort Chipewyan, downstream of the oilsands industry. The Alberta government consistently denied that cancer rates were elevated, while Alberta government employees quietly "assisted" Health Canada in pursuing charges against O'Connor at the Alberta College of Physicians and Surgeons. The college rejected all charges against Dr. O'Connor, including an ominous-sounding one: "engendering a sense of mistrust in government." The Alberta Cancer Board ultimately released a study confirming higher-than-expected levels of rare cancers and recommended a monitoring program.

Norway the Exception

- **Higher taxation**
- **Higher royalties**
- **Higher social spending**
- **Less inequality**
- **Savings for the current and next generation**
- **No Dutch disease**
- **Value added**
- **More democratic with higher voter turnout**

Oil is on the decline, passed peak but they have a lot to show for it:

Norway has about $600 billion in the petroleum fund, strong economic growth and low levels of inequality.

Dutch disease This was avoided by keeping the resource money out of the economy. All resource revenues are put into a stand alone 'Pension Fund' that is invested outside the country in ethical investments. Norway also heavily focused on value added so that they are selling refined products not oil, This would be similar to the NWT selling diamond rings not diamonds.

High Taxes: Amongst the highest spending to GDP rations in the OECD, Considered a high tax regime.

Royalties – According to OECD data Norway leaves companies with 22 per cent of net revenue, while Alberta "generously" allows companies a haul of 53 per cent. Since the 1970s, Norway as a matter of policy has collected between 70 per cent and 80 per cent of the resource wealth generated from their oil industry through public ownership, corporate taxes twice as high as Canada, and a special tax on oil profits.

Public ownership – initially majority or total public ownership – still collect a lot of the revenues through ownership shares. Norway also required that foreign companies train Norwegian workers, transfer proprietary technologies to their state-owned oil company Statoil, and in some cases even hand over producing oil platforms free of charge after a predetermined period.

Beyond economics, Norway is an obviously fortunate place to live. It is routinely ranked number one in the world on the Human Development Index, is the world's best-governed nation according to the Democracy Index, and is the best country in the world to be a mother.[1] Beyond economics, Norway is an obviously fortunate place to live. It is routinely ranked number one in the world on the Human Development Index, is the world's best-governed nation according to the Democracy Index, and is the best country in the world to be a mother.
And in spite of being the world's third largest exporter of crude oil, Norway is ranked number three in the world on the Environmental Performance Index. Canada is thirty-seventh (behind Nicaragua, Albania and Colombia).

The NWT

Resource curse or opportunity – about three key questions:

- Are we maximizing the returns? Taxes and royalties
- Are we minimizing the negative impacts – the curse of plenty
- Are we using the revenues to benefit current and future citizens.

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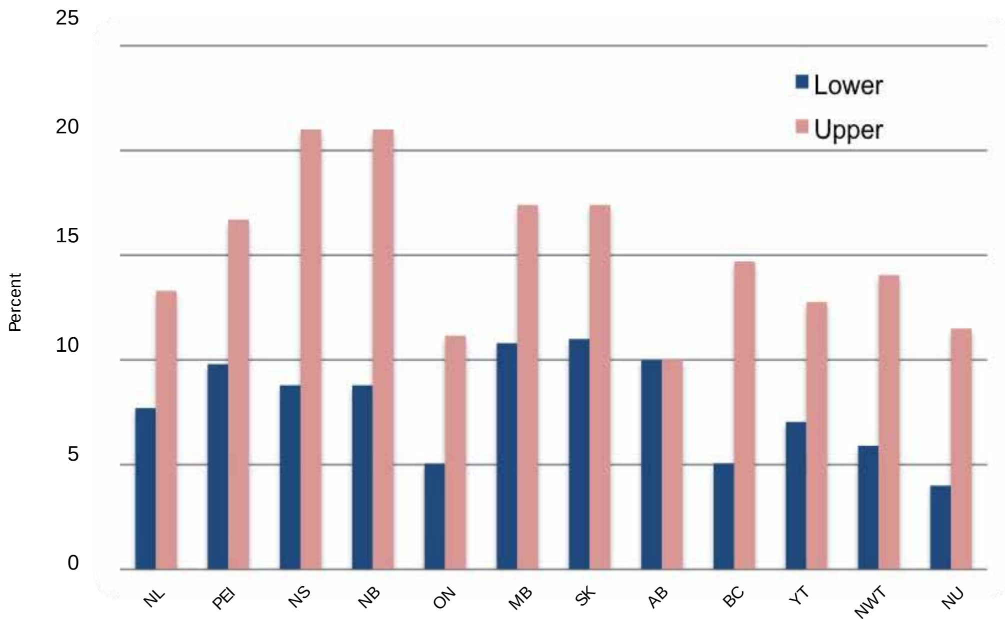
[1] Material in this section is drawn from: Oil Wealth: Should Norway Be the Canadian Way? How did Norwegians get so petro-smart? The Tyee sent Mitchell Anderson there to find out. First of his reports. By Mitchell Anderson, 25 Jul 2012, TheTyee.ca

The paradox: Like Alberta, the NWT has high average incomes, and a fast growing economy. However, Industry, Tourism and *Investment minister* Dave Ramsay said: *any investment* in the *NWT* is good *investment*, indicating a lack of balance and fertile ground for analysis of the resource curse.

Are we maximizing the returns?

The Alternatives North publication in 2009 found that there were revenue options not being pursued. A resource tax was one of the key items not yet taken up.

FIGURE 12 | Provincial/territorial tax bracket comparison



Source: Government of Canada, Provincial/territorial tax rates for 2012, http://www.cra-arc.gc.ca/tx/ndvdls/fq/txrts-eng.html#provincial.

A look at provincial and territorial tax brackets shows that thee are six jurisdictions with a tax rate that is higher for the top income tax bracket than the NWT. This leaves plenty of room for higher tax rates.

This does not include the coming changes: Quebec's personal combined top marginal income tax rates could spike to as high as 55.22% (from 48.22%) in 2013 if the Quebec government proceeds with tax proposals made by the new minority Parti Québécois (PQ) during its election campaign platform. The PQ also proposes to increase the tax rate on capital gains and dividends.

The new Ontarian tax bracket on those whose taxable income exceeds $500,000. On income above this threshold, the tax rate will increase to 12.16% for 2012 (from

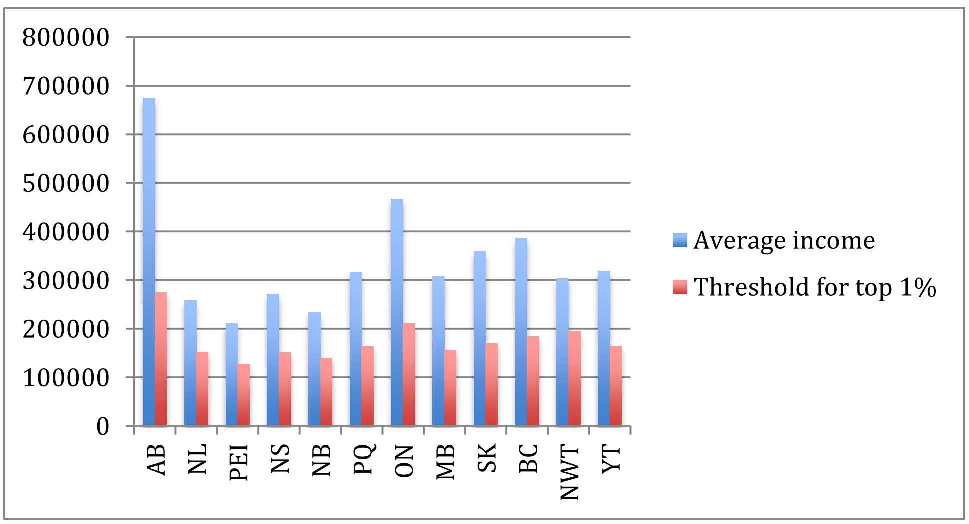
11.16% in 2011) and to 13.16% in 2013. When the Ontario surtax of 56% is added to this tax rate, it will bring the Ontario rates to 18.97% in 2012 and 20.53% for 2013.

Are we minimizing the risks?

Boom/bust - housing shortages, growing infrastructure deficit, which is currently estimated at $3 billion over the next five years. Budget document states that there are increased costs challenge us at every turn.

Volatility – in the budget document, the government says "We are investigating the possibility of a Revenue Stabilization Fund, similar to that in other provinces, to more actively manage sharp increases and decreases in revenues." This was recommended to the government years ago but has not yet been done. It would mitigate some of the volatility associated with resource dependence.

Inequality – Top 1% The NWT is not nearly as unequal as Aberta in that their top 1% is not as rich. However, the threshold to get in to the top 1% is still quite high indicating that though there is less extreme wealth at the top, overall, the top 1% are very wealthy (third highest in the nation).



Current generation- Not just those on fixed incomes but the working poor are being negatively impacted by the booming economy and high cost of living. This is especially the case in housing affordability and housing quality.

Positive – The government has committed to continuing the policy of indexing taxes and fees to inflation where possible and practical. Steady and stable indexing avoids large painful adjustments in the future and ensures that income tax brackets are not eroded by inflation. It is critical to ensure that minimum wages and social assistance rates are also indexed.

Next generation - savings

The legacy heritage fund is waiting for devolution. There is no need to wait, it could be implemented immediately with the implementation of a resource tax today. This could capture over $100 million in revenues annually.

Devolution is not a magic silver bullet – Alberta has control of resource revenue and saves almost none. Devolution will mean that the Federal government will not be giving the same kind of transfer payments. Also, it makes the NWT government very vulnerable to pressures to spend those funds today.

Democracy – voter turnout has been falling in the NWT Voter turnout in Monday's territorial election was the lowest in the territory since 1999, which is the earliest year Elections NWT has data available. About 57 per cent voted in 2007's election, 69 per cent voted in 2003, and 70 per cent voted in 1999's election.

Regulatory capture

There are big challenges with regulatory capture in a smaller jurisdiction with such high stakes mining. Devolution would only make these pressures higher as at the national level, the diamond industry is a smaller player in a larger mix if industry interests. At the territorial level, the government is dealing with a much smaller number of companies and the power dynamics are different.

The statement mentioned earlier by the Minister of Industry, Tourism and Investment Dave Ramsay - *any investment* in the *NWT* is good *investment* - is clearly indicative of a direction that does not include saying no to a project where the environmental and social stakes are too high.

There are two really big pressure in terms of regulation in the NWT : regional board levels and timelines. These pressures are from industry and the federal government.

The federal government has been directly interfering in timelines and pressuring regulatory board on behalf of the corporations.

Aslo, regional structures are under pressure. As many of you know there are regional co-management land and water board that have recently been established and are in the nascent stage. These are under review with pressures for them to be centralized.

This is indicative of the kind of risk associated with regulatory processes and that the NWT will not be immune to this aspect of the resource curse.

Closing

Alberta is a clear cautionary tale. The NWT is vulnerable but there is an alternative path.

At the Fortune minerals hearings yesterday in *Behchokö*, a first nations member of the Tlicho said, “Diamond mining just puts money into the pockets of people from the South and brings differences for our families and communities between haves and have-nots.” Over 40 community members spoke about alternative futures for their community.

I will end just by saying that it is clear the any resource development is not necessarily a good thing. Without the right social and tax frameworks, it can mean an erosion of an already compromised existence for many. It is critical to ensure that there is a solid framework in place to protect the people against the risks of the resource curse and ensure that if the development goes ahead, it is for the benefit of all, not the few.