

"The Heritage Fund today is a pale shadow of its former self, in both purpose and value."



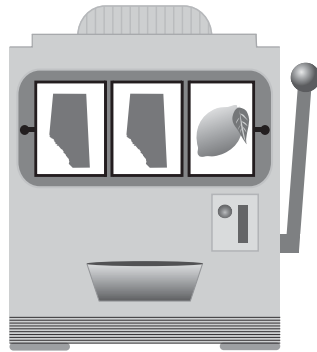
The Heritage Savings Trust Fund, once the symbol of Alberta's wealth and promise, is losing its lustre. In 1986, the value of the fund was the equivalent of 95 per cent of provincial spending; now, it's down to 50 per cent. This year, it lost 11 per cent of its value, or well over \$1-billion; and over the past three years, with over \$12-billion of investments, including \$6-billion on the stock markets, it barely made any money at all.

You might excuse the Klein government. Stock markets are not doing well, and the popular mythology is that everybody who has played the markets over the past couple of years has lost money, but that over the long term—say, 10 or 20 years—they will get it all back and more. Certainly that's Revenue Minister Greg Melchin's view. When asked about the poor performance of the Heritage Fund, he said the government is sticking to its guns and "focusing on the long-term, not quarter-to-quarter or year-to-year." (His attitude smacks of Energy Minister Murray Smith's stance on electricity prices: eventually, if we wait long enough, electricity prices will come down.)

If Melchin wants to do that with his own money, that's his business. But to speculate on the stock markets with public money, that's public business. The Heritage Fund's mandate and operations have changed radically in the last five years, and the people who own the fund—the citizens of Alberta—have had little to say about it. Public involvement in directing the fund has been limited to simplistic public surveys, and Albertans have not indicated that they want to change how the fund is managed.

Yet the Klein government has done just that. The fund today is a pale shadow of its former self, in both

purpose and value. When set up in 1976, the fund's purpose was three-fold: to save for the future; to strengthen and diversify the Alberta economy; and to improve the quality of life for Albertans. Accordingly, investments were made in the oil sands and agriculture; parks, irrigation systems and hospitals were built; and loans were made to other provinces. The fund invested in the Alberta economy through the Alberta Energy Company, the Alberta Opportunity Company and small business loans. It invested in Alberta-based companies.



The shift to stock market investments began in earnest five years ago. In 1998, 12.6 per cent of the fund's assets were in the stock market; now, 53 per cent are. Billions of the fund are invested outside the province. Of the \$6-billion the fund holds in stocks of individual companies, only 21 per cent is invested in Canada. And of the \$870-million in real estate holdings, 75 per cent are in Ontario.

This move away from Alberta investment has not been financially successful. Under the previous strategy, most of the fund was in stable, fixed-income investments, and it turned profits of over \$1-billion annually in 11 of the 13 years from 1984 through 1996—money that went to health, education and other programs. Since 1998, with increasing proportions of the fund in the volatile stock market, profits have been much lower. Despite Klein's rhetoric that

government can't pick winners and losers in business, his government is into the stock market big time. And what is the market if not picking winners and losers?

Because fund profits are stripped away to boost general government spending each year, stability is critical. The losses of the 2002/03 fiscal year came at a bad time. Alberta's health and education systems need more money, because the costs of health care and public education are increasing. There is a distinct possibility that the province will borrow to build infrastructure for its new Capital Plan.

The Alaska Permanent Fund is instructive here. Like the Heritage Fund, it was started in 1976 and has had about \$12-billion deposited into it. But Alaska plays money much smarter. First, the Alaska fund is inflation-proofed, which means the first priority every year is growth at least to match the inflation rate; second, citizens spend the profits through annual dividends rather than government spending the profits; third, unlike Alberta, where politicians manage the investment of the fund, Alaska turned fund management over to an independent body; and fourth, the operations of Alaska's fund can be changed only through public referendum. End result: through the fiscal magic of inflation-proofing and compound interest, Alaska's Permanent Fund is worth over \$30-billion, almost three times the value of Alberta's Heritage Fund.

Nobody gave the Alberta government a mandate to gamble with the Heritage Fund the way they are doing. Melchin may be correct—the markets will likely eventually turn up and profits will return. But the broker should have asked his clients if that's how they want their money invested. Brokers who don't ask are often fired.

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