CANADIAN CENTRE FOR POLICY ALTERNATIVES-SK

Saskatchewan Notes

Volume 4: Issue 3 - June 2005

Going, going...gone? The Disappearance of Resource Royalties in Sasktachewan

by John W. Warnock

Saskatchewan is a hinterland province in the North American Prairies. Historically, the primary economic activity has been farming and ranching, but farm net income has always been very low, and this sector has contributed little to provincial government revenues. From the very beginning, governments recognized that the development of the resource extraction industries was necessary to provide a decent level of infrastructure, as well as health, education, and social programs.

Natural resources are a free gift of nature. In Canada, they are owned by the government who acts on behalf of the public at large. Under the Constitution, natural resources are a responsibility of the provincial governments, and aside from forestry, are non-renewable. Thus, governments must be concerned about the needs of future generations when permitting the extraction and use of these resources. Governments need to do everything they can to maximize the public's share of the economic surplus, or economic rent, from resource depletion.

Governments need to do everything they can to maximize the public's share of the economic surplus, or economic rent, from resource depletion.

Until 1982, Saskatchewan Governments made steady progress in the development of non-renewable resource industries. They also increased the public's share of the economic rent. Since then, the general policy direction was reversed, and successive governments have reduced Saskatchewan's share of the economic rent. Furthermore, since 1991, there has been no political debate about resource policy. Decisions are made by the government and the industries involved behind closed doors, and the public is presented with the finished product. Current policy stresses the exploitation of Saskatchewan's natural resources by large transnational corporations that are owned and controlled outside the province; increased dependence on the U.S. market; and maximized returns on resource extraction for private investors, not the general public.

Government policies on resource extraction

T. C. Douglas and Woodrow Lloyd's CCF Governments (1944-64) created the framework for natural resource development. The Mineral Taxation Act of 1947 determined that natural resources belong to the people, that the Provincial Government manages their development, and that the government has the right to establish and change previous governments' resource royalty rates.

The theory of "economic rent" from resource extraction and use was set by classical liberal political economists – particularly John Locke, Adam Smith and David Ricardo. Economic rent is created by applying labour to natural resources. It is described by economists as the surplus over and above the cost of the extraction process, including a normal rate of return on invested capital. In a capitalist economy, where private firms extract the resources, there is a struggle between the industry and the government over the share of economic rent. Governments have used several techniques to extract the public's share of the economic rent, including a flat rate per volume of extracted resources, fees for either the lease or purchase of land rights to access resources, the sale of mineral rights, *ad valorem* royalties applied to sales, *ad valorem* royalties applied to profits, state marketing boards that monopolize the resource sales, and state joint ventures with private firms. Today, the world trend is once again the development of natural resources, such as oil and gas, by state-owned corporations. Saskatchewan has applied all of these approaches.

The evolution of Saskatchewan policy

The Douglas CCF Government faced the reality that there were no sources of capital within the province to develop resources by state-owned enterprises. Out of necessity they adopted a policy to encourage private corporate investment through low royalties, an active policy of government support for private development, and government investment guarantees. The policy was successful, but it resulted in large public subsidies to private corporations, with little return from royalties, fees and taxes. This policy was continued by Ross Thatcher's Liberal Government (1964-1971).

Allan Blakeney's NDP Government (1971-82) attempted to increase the public's share of economic rent. Oil royalties were raised substantially, and the Saskatchewan Oil and Gas Corporation, a Crown Corporation, was established. When the government moved to gain a larger share of the economic rent from potash extraction, the large transnational corporations refused to co-operate. As a result, the Blakeney Government "nationalized" about 40% of the industry and created the Potash Corporation of Saskatchewan, a Crown Corporation.

The NDP Government marginally raised uranium royalties. However, they created the Saskatchewan Mining and Development Corporation (SMDC), a Crown Corporation, which owned 50 percent of the new uranium mines at Key Lake, Cigar Lake and Cluff Lake. In the coal industry, SaskPower, another Crown corporation, developed mines at Souris Valley and Poplar River. All of the economic rent from the Crown ownerships went to the general public. Thus, the government's share of resource extraction rose significantly, and royalties provided about 35% of the government's revenues at Souris Valley and Poplar River.

In the 1991 provincial election, the NDP pledged to raise royalties on natural resource extraction back to the Blakeney Government's levels. Once in office, they rejected their pledge and continued the Devine Government's policy. . . Since then, they have steadily reduced the extraction royalties on non-renewable natural resources.

Grant Devine's Progressive Conservative Government (1982-91) reversed this policy and lowered the royalties on oil and gas and other minerals. They privatized the coal mines, Sask Oil and the majority of the Potash Corporation. In co-operation with Brian Mulroney's Federal Government, the Tories also privatized SMDC to create the Cameco Corporation. During their term, the Lloydminister Heavy Oil Upgrader was created, where 75% of the capital was provided by the governments of Alberta, Saskatchewan and Ottawa, with Husky Oil as the controlling partner. Royalties and revenues fell, there were regular budget deficits, and the provincial debt ballooned, but private investors were happy.

In the 1991 provincial election, the NDP pledged to raise royalties on natural resource extraction back to the Blakeney Government's levels. Once in office, they rejected their pledge and continued the Devine Government's policy. They completed the privatization of Sask Oil, SMDC, PotashCorp and sold the province's equity in the Husky Upgrader. Since then, they have steadily reduced the extraction royalties on non-renewable natural resources.

Royalties received from the extraction of non-renewable natural resources

It is difficult to determine economic rent because private firms refuse to disclose their internal operations to governments. The difficulty increases when firms are large transnational corporations that engage in intra-corporate transfers and payments. Nevertheless, we can approximate the rent by reviewing trends in the share of royalties and fees collected by the government as a percentage of the industry's sales. Around the world, several countries extract natural sources through either state-owned corporations or joint ventures with private firms. It is common for private corporations to relinquish 50% of the resource's sales to the host country.

Petroleum industry

Between 1975 and 1983, royalties ranged between 40 and 65% of industry sales, with an average of 50%. Between 2000 and 2003, the share of the sales fell to 16%. Recently, Lorne Calvert's NDP government reduced royalties.

Natural gas industry

Natural gas royalties have been low, with royalties well under 10% of sales. Royalties are now about 15% of sales, but the Calvert Government announced there will be further royalty reductions. The majority of Western Canada's natural gas is shipped to the United States and Eastern Canada.

Potash industry

Provincial potash royalties peaked during the Blakeney Government. Between 1975 and 1981, they averaged 21% of sales and fell to 9.5% between 2000 and 2003. The Calvert Government recently approved additional royalty and tax reductions.

Uranium industry

It is reported that government subsidies to the industry have often exceeded royalties. With the Blakeney Government, they were at 4 to 5% of sales, rose slightly under the Devine Government, and fell to 3 or 4% under the Calvert Government. Despite price and profit increases for extraction companies in 2005, our government reduced royalties.

Coal industry

In the past, royalties were low – under 1% in some years of the Blakeney government. With the Devine Government they were between 14 and 18% of sales and are now at about 11%.

Other minerals

For industrial minerals, precious and base metals, royalties have been very low. In 2002 and 2003, industrial mineral rates were under 5%, for precious and base minerals, under 3%, and for clays and quarriable materials, under 2%.

Conclusion

Since 1982, royalty reductions have been welcomed by Saskatchewan's large corporations, but the revenue losses have created serious problems. Devine's Government responded with budget deficits and increases to the provincial debt, while Romanow and Calvert's NDP Governments balanced the budgets by cutting programs, introducing gambling, increasing user fees, and off loading costs. Property taxes rose to the highest level in Canada because municipality and school board grants were cut. If the royalties had remained at their previously high levels, the government would have had an additional $2 billion to spend in 2003.

If the royalties had remained at their previously high levels, the government would have had an additional $2 billion to spend in 2003.

Since 2001, the international price for the majority of resources has increased. Resource extraction corporations report record sales and profits. Around the world, governments are increasing their control over resource industries. Industry analysts state that about two-thirds of the world's oil resources are now under state-owned enterprise control. Russia is re-nationalizing its oil industry. Libya and other Middle East countries with state-owned oil industries demand over 80% of sales from private companies. Venezuela and Bolivia are re-establishing their state-owned oil and gas industries and will demand 50% of sales in any joint venture. China is also signing favourable contracts with the world that ensure high resource royalty rates from sales.

Saskatchewan's government is moving in the opposite direction. Several reports conclude that our royalties are among the world's lowest. Right now, with high quasi-monopoly international prices for oil and gas, and an increase in extraction volume, Saskatchewan is obtaining additional revenues. However, our share of these one-time sales of non-renewable resources continues to decline, and we are not planning for our future needs. The public must demand more from government, and a serious public debate on resource policy is necessary.

John W. Warnock *recently retired from teaching political economy and sociology at the University of Regina. He is author of* Saskatchewan: The Roots of Discontent and Protest (2004) *and is a research associate for the Saskatchewan Office of the Canadian Centre for Policy Alternatives.*

The Canadian Centre for Policy Alternatives - Saskatchewan (CCPA-SK) is an independent, non-partisan research organization dedicated to promoting economic and social research of importance to Canadian and Saskatchewan citizens.

If you would like more information about CCPA-SK or to be on our electronic distribution list for **Saskatchewan Notes,** please contact us to begin your subscription.

Canadian Centre for Policy Alternatives-Saskatchewan
#105 - 2505 11th Avenue, Regina, SK. S4P 0K6
Phone: (306) 924-3372
Fax: (306) 585-5177
Email: ccpasask@sasktel.net
Website: www.policyalternatives.ca