A Question of Future Prosperity:

Transforming Natural Resource Wealth into Citizen Well Being Through the Northwest Territories Heritage Fund

Sarah Daitch, Alyssa Schwann, Andrew Bauer, Andre Dias & Julia Fan Li

"Each generation will reap what the former generation has sown"

- Chinese Proverb

The Northwest Territories (NWT), Canada's largest territory, holds significant natural resource potential, most of which is undeveloped. Facing a potential resource boom in minerals, oil and gas, the territory's government is considering how this finite source of wealth can be harnessed as an engine for development and prosperity. On April 1, 2014 the Devolution Agreement took effect, which transferred control of a portion of resource royalties from the federal Government of Canada to the territorial Government of the Northwest Territories. In 2012, new legislation created a Heritage Fund for the territory, establishing the world's newest sub-national sovereign wealth fund. This fund aims to bank part of new resource revenues for future generations – but, what governance measures and regulations will be required to ensure the Fund benefits citizens? In February 2014, several authors of this paper co-published a policy report, A Question of Future Prosperity: Developing a Heritage Fund in the Northwest Territories (Briones et al. 2014) *outlining key recommendations for the Fund's implementation. Members of the Legislative Assembly tabled this report in the NWT Legislature, pressing the NWT Finance Minister to commit a higher proportion of revenues to the Fund, and to establish rules for fund management and governance. This paper presents the next phase of an ongoing case study in a public policy research initiative – one that supports regional citizen decision-making on resource governance in Canada's North. The next steps of effective fund governance, oversight, and accountability require analysis, discussion and meaningful public engagement to ensure the retention of resource wealth in the public's interest.*

Introduction: Natural Resource Funds

Natural resource funds, a type of sovereign wealth fund, are increasingly popular: more than thirty of the world's fifty-eight currently active funds have been established since 2000, while more than a dozen new funds are being considered (Bauer, 2014a). Natural Resource Funds are a

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growing trend for oil-, gas- and mineral-rich countries as a vehicle to transfer and save a portion of resource revenues. Canada's Northwest Territories (NWT), rich in non-renewable resources, established the NWT Heritage Fund through legislation in August of 2012. In a recent survey of all identified natural resource funds in the world, the NWT's fund was listed as one of the newest and the smallest operational fund in the world (Bauer, 2014a). Although the NWT fund currently is modest in size, a resource revenue windfall is on the horizon. This paper explores the governance measures and regulations that are needed to build agreement on the fund's objective and to establish strict rules for fund deposits, withdrawals, investment strategy, transparency, and oversight. Successful strategies from funds that have benefitted citizens are examined, including Norway, Chile, Alaska, and Ghana, and their approaches considered within the unique context of the NWT. The issues and options explored in this paper are designed to inform decision-making and to position the NWT Heritage Fund as a world class tool to manage mineral revenues in the public's interest.

The Lessons of History

Throughout the last century, Canada's Arctic has experienced a number boom-bust cycles, which have forever altered the land. This is one consequence of reliance on single-industry natural resources (Briones et al. 2013). Single-industry economies, including the whaling industry, fur trade, gold rush, and recent non-renewable natural resource initiatives, have defined these cycles (Pretes 1984). Periods of rapid economic growth, followed by even faster decline, are an outcome of the North's economic dependence on a few natural resources whose value and availability are prone to fluctuations. More recently, petroleum extraction and mining initiatives have been the driver of boom-bust cycles. For instance, from 1999 to 2003, rising commodity prices and the start of production at the Ekati and Diavik diamond mines increased the sector's economic contribution to the NWT by 173%; when prices collapsed during the global financial crisis from 2007-09, the sector contracted by 37% (NWT Bureau of Statistics 2014).

What's more, in the case of non-renewable natural resources, availability is finite and depletion inevitable. A clear example of the risk of a single-industry economy is the abandoned mining town of Pine Point, NWT; the closure of the town's mine led to a parallel shutdown of its community. Today, all that remains are the outlines of the roads that once connected Pine Point's twelve hundred residents, and an altered landscape that can no longer yield minerals nor sustain a community (Irlbacher-Fox 2013).

The NWT's new Heritage Fund represents an opportunity for the territory to move beyond the past struggles of many Canadian provinces to manage oil and mineral revenue windfalls and develop a culture of public savings from resource revenues (Simpson, 2011). The NWT Heritage Fund could provide a mechanism to move past boom-bust cycles, and to preserve a finite source of wealth for future generations. This paper examines key policy considerations for the territorial government as it implements fund governance, management frameworks, and legislation. Drawing lessons from best practices in fund development from other jurisdictions,[1] recommendations are outlined which support the NWT Heritage Fund's primary objective: to save for the benefit of future generations. We also explore whether additional objectives might be considered, in order to best allocate resource wealth to the Fund.[2] Additionally, continued public outreach and consultation are highlighted as critical tools needed to achieve support and accountability over the long-term. The viability and success of the NWT Heritage Fund ultimately depends on broad public support, in combination with transparent oversight.

The NWT: Devolution and the Quest for Intergenerational Equity

During the last few decades, Canada's Northwest Territories have undergone massive social and political change. The NWT has evolved from a domain of the Hudson's Bay Company, to a region controlled by a federally appointed commissioner in Ottawa, transitioning to an elected legislative assembly in 1979, and finally to a province-like jurisdiction distinguished by both devolution and the incorporation of Indigenous peoples' rights into a constitutional base (Irlbacher-Fox & Mills 2007; Hamilton 1994). A recent and important step in this political maturation was signaled by devolution, which took effect in the NWT on April 1, 2014. Among other things, the devolution agreement allows the NWT, and Aboriginal governments, to retain a portion of mineral and onshore oil and gas royalties, in addition to territorial corporate income tax, while taking on control and administration for lands and resources from Canada's federal government. In short, the GNWT can now retain the lesser of 50 percent of resource revenues (defined as mineral, oil, gas and water-related revenues) or 5 percent of the Gross Expenditure Base (an amount between $70-100 million per year)[3] (GNWT 2013b).

This marks the first time that the GNWT collects royalties and other resource revenues on public lands; the fiscal strategy for Devolution includes an agreement to share a quarter of the GNWT's share of resources with Aboriginal governments who have signed on to the Resource Revenue Sharing deal, established between GNWT and NWT Aboriginal Governments (GNWT 2014).

The operating budget of the GNWT in the 2012-2013 fiscal period was $1.4 billion (CAN)[4] (GNWT 2012a). Both the costs of providing services and costs of living are high in the NWT, given its vast geographic region and low population density[5] (Canadian Institute for Health Information 2013). The primary source of funding for the three territorial governments is provided through an annual unconditional transfer from the federal government, known as Territorial Formula Financing (TFF). The formula reflects the principle that territories should be able to provide residents with public programs and services comparable to those offered by provincial governments at comparable levels of taxation. In 2013-2014, the TFF transfer to the GNWT was $1.121 billion, or about 75 percent of its revenue. The remaining approximately 25 percent of revenues captured from taxes and fees.[6] Under Devolution, the NWT retains 11.5 percent of corporate income tax. In theory, once the cost recovery phase is over and the NWT starts collecting significant corporate income taxes (over a decade from now), that windfall has the potential to rise to the hundreds of millions per year, as the North opens to development. However, under TFF, for each dollar the territory raises itself through taxes, approximately 70 cents are removed from the federal transfer. In other words, even if corporate income taxes rose significantly, much of the revenue would be clawed back. This aspect of the agreement has raised debate amongst citizens, observers and legislators about the equity of the existing resource royalty regime. For example, an economic analysis done by experts for the Gwich'in Tribal Council found that the current Resource Revenue Sharing agreement does not reflect principles of equalization fairness. However, the report concluded that Devolution under these terms would be beneficial, though not optimal (Irlbacher-Fox 2012; GNWT 2011). In spite of ongoing discussions in the NWT about the devolution deal's shortcomings, including the 5% cap and clawback provisions in the Resource Revenue Sharing agreement, NWT Legislators voted 17-1 in favor of Devolution on June 5, 2013.[7] It is possible that a future review of the Resource Revenue Sharing agreement could result in renegotiating the agreement to reduce the clawback.

The Resource Revenue Sharing agreement is a deal struck under a royalty regime that sells resources located in the NWT relatively cheaply by global standards, informing the question that continues to be debated by citizens, elected leaders and analysts: Is the NWT getting a fair deal for its resources?[8] For example, in 2011, less than $100 million was collected in royalties on NWT exports worth over $2 billion, though exact figures are unavailable in Canada (Government of Canada - Natural Resources Canada 2011; Irlbacher-Fox 2012).

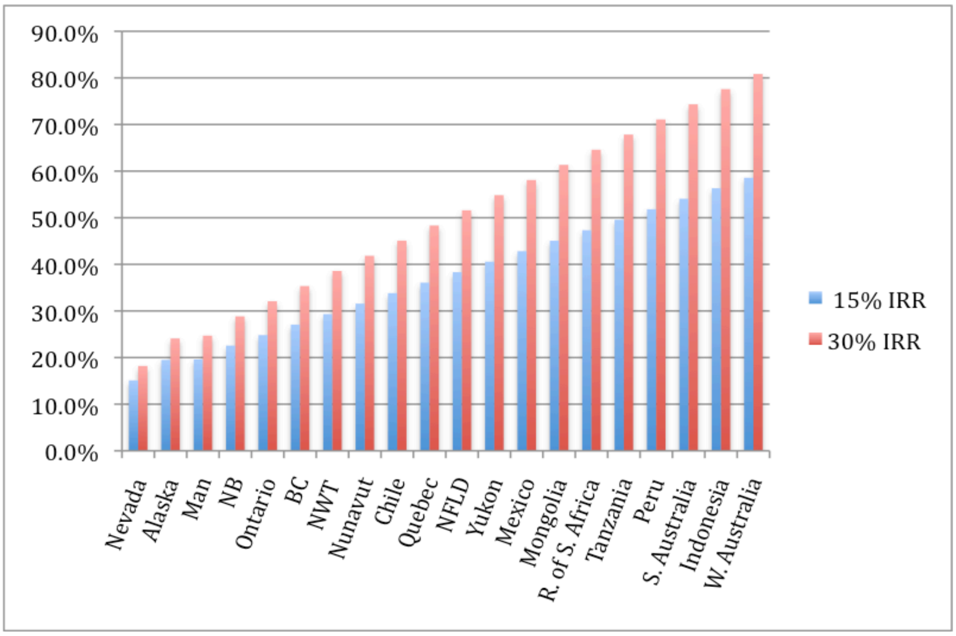

Figure 1: Government take from mining across the globe, comparing average effective tax rates across jurisdictions for projects with 15% and 30% real internal rate of return (IRR) before tax.[9]

As outlined in Figure 1, the combined federal-territorial 'government take' in the NWT is low by global standards. Since 2003, Canadian jurisdictions have implemented tax rate reductions of a larger magnitude than any other major mineral-producing jurisdictions, while retaining general corporate tax deductions and tax credits for the mining sector (Government of Canada - Natural Resources Canada 2011). In fact, Duanje Chen and Jack Mintz of the University of Calgary's School of Public Policy argue that Canada's mining-tax system should be modernized, and provinces should eliminate these preferential and wasteful tax breaks for the mining industry. In their analysis, provincial treasuries cannot afford these tax breaks, and neither can the Canadian economy as a whole (2013).[10]

In spite of being low by global standards, mining and oil taxation in the NWT - at approximately 26.5% - is similar to the Canadian average. In the NWT, both mines and oil wells pay out royalties according to a sliding scale based on how profitable an operation is. For mines, the first $10,000 is royalty free. Beyond that, the first $5 million in profits pays a rate of five per cent, which increases by one per cent per $5 million in profits. The top rate companies can be expected to pay is 14 percent for any mine that clears more than $45 million per year. These rates are higher than those seen in Alberta (Alberta operates at a rate of 10% provincial tax), but lower than rates used in eastern provinces such as Newfoundland and Nova Scotia, which have tax rates at 14% and 16% respectively (Windeyer 2014).

With Devolution, the GNWT gains the power to change royalty rates. Member of Parliament for the Western Arctic Dennis Bevington has stated that the first priority should be to switch from a net royalty scheme to a gross royalty scheme to address perceived shortcomings. Finance minister Michael Miltenberger has confirmed that rates will be up for review, stating that "We're not rushing out to put additional taxes on anybody … but after April 1, we'll be having a discussion on the structure of our resource economy," (as cited in Windeyer 2014). However, the territorial government - citing the already high cost of doing business in the NWT - is reluctant to increase royalty rates.

Non-renewable extraction has a significant impact on the NWT economy, especially given the small population of the territory (just over 43,000 residents) and GDP (approximately $3.5 billion). The mining, oil and gas sectors represent about 30% of territorial GDP, with diamond mining representing half of that total (NWT Bureau of Statistics 2014). How much of that income stays in the territory is another question, and one that will continue to be debated in the NWT (GNWT Legislative Assembly Hansard March 14, 2013).

The question of fairness aside, based on the most current estimates the GNWT is likely to benefit in 2015 from an additional $45 million dollar windfall per year in the short-term, given the Resource Revenue Sharing agreement with Aboriginal Governments.[11] This amount is likely to grow over time as the Gross Expenditure Base increases, however, the windfall is not expected to exceed $65 million in the foreseeable future. In preparation for this modest windfall, the issue of how to manage the additional revenue responsibly and effectively has become central to public debate.

The Role of Natural Resource Funds in Retaining Public Benefits from Extraction

Resource-rich regions across the circumpolar north and around the world are recognizing the socio-economic and environmental risks associated with long-term economic reliance on finite mineral and petroleum resources. In response, many governments, such as Alaska and Norway, have established funds to protect some of the wealth generated in periods of growth, to both preserve use for periods of decline, and for the benefit of future generations (Natural Resource Governance Institute & Columbia Center for Sustainable Investment 2014d).

Norway provides a well-known example of a successful Sovereign Wealth Fund. Though oil production began in 1970, a plan for savings was only established twenty years later, with the implementation of their Savings Fund – the *Government Pension Fund-Global*. Early on, a decision was made to invest in urgent spending needs, such as education, social services, and infrastructure, with the position that oil wealth should be used to develop a qualitatively better society with more equality (Norwegian Asset Management Department 2013). Transfers to the fund began in 1996, following these primary investments (Drohan 2013). The fund has strict rules, including regular, comprehensive and independent internal and external audits. Further, it is one of most transparent funds in the world.

The NWT, with a vast landscape containing diamonds, gold, silver, copper, zinc, oil and gas, holds a potential resource wealth that has attracted interest from investors, oil and mining companies (Conference Board of Canada 2013). The development of these resources promises to make Canada's North more accessible, with significant economic, social, and political implications (Irlbacher-Fox & Mills 2007). A concern expressed by the NWT citizens and leaders is what the economic and social future holds once extraction has been exhausted, and how the territory can use resource revenues to invest sustainably over the long-term for the benefit of its future generations. While a range of policy choices exist to invest in future generations, the GNWT has chosen to save a portion of its resource revenues through a Heritage Fund.[12]

Northern Mining Projections: How Can Minerals Be More Than Just a Boom?

The NWT has huge resource potential. According to the territorial government, there are an estimated 90 billion barrels of undiscovered recoverable oil, 1,670 trillion cubic feet of recoverable natural gas, and 44 billion barrels of recoverable natural gas, along with proven deposits of rare earths, cobalt, bismuth, zinc, lead, copper and silver, all of which are in various stages of development (GNWT 2012b; The Conference Board of Canada 2013). In 2011, the NWT produced over $2.1 billion (Canadian dollars) in total mineral shipments, a staggering total for a jurisdiction with a population of only 43,000 residents. There are currently four operating mines in the Territory, including the Ekati Diamond Mine, Rio Tinto's Diavik Diamond Mine, De Beers' Snap Lake Diamond Mine, and Cantung Tungsten Mine, while four other mines are pending production: Canadian Zinc's Prarie Creek, Gahcho Kue Diamond Mine, Avalon's Nechalacho Rare Earth Metals, and Fortune Mineral's NICO site (Personal Communication, September 29, 2014, NWT and Nunavut Chamber of Mines).[13] Economic growth in the NWT is expected to rise by 1.3 percent in 2014, 2.5 percent in 2015, and 7.9 percent in 2016, driven largely by resource development (Conference Board of Canada 2013). The Heritage Fund offers a timely opportunity for the NWT to capture wealth from this forecasted economic growth, and to mitigate the risk of the 'boom and bust' cycle which often characterizes economies dependent on non-renewable natural resources.

Lessons from Other Jurisdictions

Policy makers in the NWT can draw a cautionary lesson on how to address boom bust economies from the Island of Nauru, a clear example of recklessly wasted natural resource wealth. Nauru, an island nation in the South Pacific, was transformed in the 1970's through phosphate mining. The island went from one of the world's poorest nations into one of its richest on a per capita basis. In 1973, its GDP peaked at $178 million dollars, or $25,500 per citizen (in 2005 dollars). However, overconsumption and poor revenue management quickly erased this expansion and, by 2007, its GDP had shrunk to less than $19 million dollars, or $1,900 per citizen (Bauer 2014a). The economy has never recovered, and the government remains fiscally troubled (Bauer, 2014a). Mining further caused serious environmental consequences: 80 percent of the island's land was stripped and 40 percent of its marine life killed (Shennon 1995).

Drawing on lessons from Nauru and other similar cases, some governments have established funds to sustain wealth from non-renewable natural resources. In some jurisdictions, the establishment of a wealth fund arises out of legitimate concerns about the potential impacts that large, volatile, and exhaustible natural resource revenues have on the stability of an economy. In other regions, fund establishment comes from a desire to promote transparent and accountable management of expected revenue flows. Another common objective for establishing a fund is to build an endowment for future generations or the elderly. However, natural resource funds are not always established with the public or national interest in mind. In some countries, for example Azerbaijan, natural resource funds enable governments to avoid public scrutiny or bypass formal oversight (Bauer, 2014a).

The NWT Heritage Fund: Legislation (Act), Current Status, and Opportunities

In preparation for new resource royalties flowing from Devolution, legislation allowing for the establishment of an NWT Heritage Fund was passed in 2012, based on the framework of the Alberta Heritage Fund (GNWT 2013b).[14]

In the fall of 2013, the NWT's Ministry of Finance undertook public consultations on the budget in seven regional centers in the territory. At these public consultations, the NWT's Ministry of Finance proposed that 5 percent of resource revenues be placed into the fund, or approximately $2.25 million (as of 2013) (Wohlberg 2013), while 95 percent would be earmarked for infrastructure investment and servicing the GNWT debt (GNWT 2013a).[15] This sparked a healthy public debate over the appropriate deposit amount for the fund, given other perceived pressing needs, such as funding infrastructure or servicing debt (Wohlberg 2013).

On February 10th 2014, MLA Wendy Bisaro tabled the public policy report *A Question of Future Prosperity: Developing a Heritage Fund in the Northwest Territories* (Briones et al. 2014) in the NWT Legislative Assembly, in order to press the Minister of Finance to commit more than 5 percent of revenues to the fund, and to introduce legislation to administer it. Following the debate, the Minister of Finance announced that a 25 percent share of the GNWT royalties from the extraction sector will be allocated to the new Heritage Fund. Regulation was passed in 2013 prior to the NWT Fund beginning to accrue significant revenue (Northwest Territories Heritage Fund Regulations 2013).

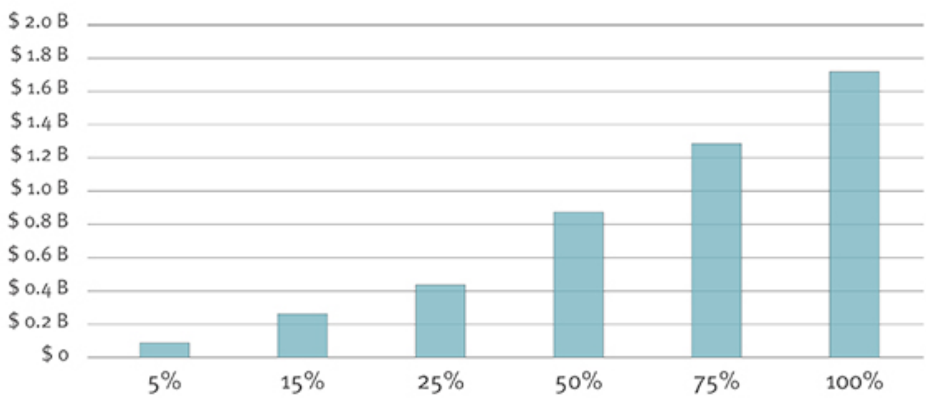

Figure 2: Predicted Size of NWT Heritage Fund in 20 years if annual average royalties are 45 million (75 percent of $60 million) and the fund achieves a 5 percent rate of return.

The predicted size of the Fund, at a 25 percent deposit rate, could result in approximately half a billion dollars in twenty years (Figure 2). The authors project a 5 percent rate of return based on benchmarks set by other public savings funds. One benchmark used was the Canada Pension

Plan's average annual return of 7 percent over the last ten years (Canada Pension Plan Investment Board 2014). However, recognizing the Canada Pension Plan as a much larger sized fund with a long-term investment mandate, whereas the NWT Heritage Fund is smaller and could have multiple mandates, the authors also considered Chile's two lower-risk natural resource wealth funds as benchmarks for the NWT. Chile's Economic and Social Stabilization Fund made an average return of 3.6 percent in USD from July 2013 – July 2014 while Chile's Pension Reserve Fund made an average return of 4.67 percent during the same time period (Government of Chile Ministry of Finance 2014). To project a growth rate for the NWT's fund, the authors averaged the Canada Pension Plan's average annual return over ten years with the returns from the two Chilean funds from 2013-2014. The resulting projection, as illustrated in Figure 2, was a 5.09 percent annual return for the NWT fund, assuming that moderate risk will be taken for the fund's investment strategy.

Early Engagement: Building Relationships for Research in Public Policy

Throughout the public policy initiative that led to this paper,[16] citizen and government engagement was a strong objective guiding the research methodology. Three approaches to consultation were undertaken: 1. Roundtable discussions with industry, government, Aboriginal governments and other stakeholders; 2. Public dialogues; and 3. Open discussion and exchange with the GNWT.

In August of 2013, a Northern Roundtable was hosted[17] in Yellowknife, which focused on critical issues facing the natural resource industry within the NWT. Participants included Aboriginal government and community leaders, elected leaders of the GNWT, representatives from the mining industry, representatives from municipal and federal government, natural resource management experts, and non-profit organizations. The NWT's newly legislated Heritage Fund emerged as an area of developing public policy that could benefit from further research and consultation.[18]

In February 2014, the public policy report, "A Question of Future Prosperity: Developing a Heritage Fund in the Northwest Territories" was launched. The report was a response to perceived gaps in the current proposal for fund governance structure and called for clear deposit rules, a strong investment mandate, and adequate transparency and oversight. Key recommendations sought to inform how mineral revenue management in the NWT could be improved, taking into account the unique circumstances and context of the territory. The six key recommendations made were (Briones et al. 2014):

1. Establish clear fund objectives to achieve a dual objective of savings and stabilization. Allocate more than 5 percent of annual resource royalties to the Heritage Fund.
2. Set up a statutory framework for deposit and withdrawal rules.
3. Appoint a Supervisory Council to oversee the Heritage Fund.
4. Develop a robust investment mandate.
5. Establish strong Fund governance, including transparency mechanisms.
6. Continue citizen engagement to ensure public support and the long-term viability and success of the Heritage Fund.

Since the report's launch, the GNWT has implemented the first of these recommendations, and is considering others, which are outlined in greater detail in this paper.

Roadmap for the Future: Four Key Issues for Fund Implementation

As a follow up to earlier public dialogues and consultation, in May 2014, the authors were invited by the Legislative Assembly of the NWT Committee on Priorities and Planning to discuss the recommendations for the fund's implementation. In preparation for upcoming debate on new legislation and regulation, fund oversight and governance were discussed with the Committee in greater detail. Topics of discussion included: the importance of establishing a clear objective for the fund; developing an investment strategy; and governance rules.

In May 2014, citizens were also welcomed to participate in a public dialogue.[19] Attendees expressed concern about transparency, specifically outlining the need for an audited report issued separately from the regular consolidated statements to the Assembly. It was important to people that these statements be available in easily accessible language and contain clear and transparent information about fund activities. Contributors to the public dialogue session recognized that a strong NWT Heritage Fund has the potential to build up capacity for oversight in the territory. As previously outlined, through the Resource Revenue Sharing agreement, Aboriginal governments will also be inheriting new resource royalties at a rate of 25 percent of the territorial government's share. The key principles of strong natural resource revenue management highlighted in this paper will therefore also be of interest to Aboriginal governments, as they decide on the management of the new royalties.

Work with the NWT Committee on Priorities and Planning and the public has reinforced the need for further research, policy development, and drafting of legislation in the following four key areas: 1. Establishing a clear fund objective; 2. Clarify fund deposit and withdrawal rules, including the need to legislate the existing informal agreement for 25 percent allocation of resource revenues to the Heritage Fund; 3. Establish robust transparency and oversight mechanisms, including appointing a Supervisory Council to manage the Fund; and 4. Strengthen citizen engagement.

The rules pertaining to how a fund is managed are critical to its long-term success. Research into best practices[20] indicates that there are three key factors in developing a successful Heritage Fund, ensuring strong internal controls from the beginning. First, establish clear fund objectives; second, define clear operational rules for the fund in line with these objectives; and third, develop a clear and robust governance and oversight structure. A defining principle of a successful Sovereign Wealth Fund is a sound governance framework containing a clear division of roles and responsibilities (International Working Group of Sovereign Wealth Funds 2008). Through establishing a strong governance structure that has independent oversight of the Heritage Fund and a clear division of responsibilities, a robust system of checks and balances can be ensured.

Authority should be provided to governing bodies to exercise objective, independent, and effective judgment, in order to prevent the use of the Heritage Fund for political goals that are not aligned with public interest. The Government, the fund owner, should provide oversight to determine fund objectives, such as broad policy purposes and the investment mandate. However, operational and political separation should be maintained in order to limit political interference into investment decisions of the Fund.

Issue 1: Establishing a Clear Fund Objective

Though the Ministry of Finance indicated that the Heritage Fund has been established purely for savings, our work with the public and Legislative Committee indicated that there is not yet consensus within the NWT about the objective of the Heritage Fund. Views reported to our research team ranged from savings for saving's sake, to creating a fund for investment in specific infrastructure projects (such as telecommunications), and generating a culture of savings, autonomy and long-term vision in the NWT. Economic stabilization, however, is also an important consideration, for which a separate fund for the singular purpose of economic stabilization could be established in the future.

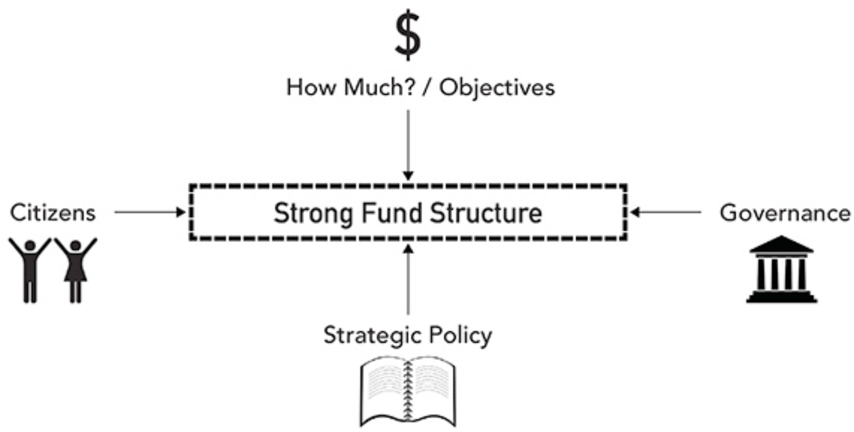

Figure 3: Getting it right from the beginning to maximize the success of the Heritage Fund.

Fund Objectives: Savings, Spending and Fiscal Stabilization

The current objective of the fund outlined in the *Northwest Territories Heritage Fund Act* is vague. The Act describes the fund's purpose as "to ensure that future generations of people of the Northwest Territories benefit from on-going economic development, including the development of non-renewable resources," (2012: 3). The fund's objective needs to be clarified, as the investment strategy and rules all flow from clear fund objectives. These objectives could address one or several of the following:

a) Expenditure stabilization: To prevent "booms and busts" in the medium term.

b) Saving for future generations: Savings will smooth the increase in spending when there is a mineral boom until there is enough capacity to spend effectively, thus preventing waste and inflation. Savings will further provide an endowment for future generations, though it is important to keep in mind that investment in education and infrastructure also provides an endowment for future generations. Precautionary savings further makes the NWT less dependent on the Federal Government.

c) Earmarking mineral revenues for development: Resource revenues can be allocated to specific strategic projects, provided that the fund itself doesn't spend the money directly but that the outflows go into the budget.

d) Protecting mineral revenues from mismanagement: By putting the money in a fund, and subjecting it to a high degree of transparency and oversight, the money can be protected from mismanagement.

A fund objective must be clear. This will guide all other aspects of managing the fund, supporting sound revenue management to ensure that the correct balance is struck between saving natural resource revenues for future generations, and spending current revenues on projects with long-term benefits.

Issue 2: Clarify Fund Deposit and Withdrawal Rules - Including the Need to Legislate the 25 percent Allocation of Resource Revenues to the Heritage Fund

As of June 2014, this deposit commitment from the Minister of Finance, though on the public record, remains an informal agreement (NWT Hansard, February 11 2014). Neither the fund's purpose, nor many of the rules governing the Fund and its deposit rate have been clarified in legislation or regulation. It will be crucial that the government formalize its commitment to a 25 percent deposit rate through legislation or regulation. The remaining 75 percent of resource revenues are allocated for two other targets for investment proposed by the NWTs Ministry of Finance: debt repayment and investment in infrastructure (GNWT 2013c).

Establishing clear deposit and withdrawal rules are critical. For instance, the GNWT's legislation has set a 20-year minimum deposit amount during which withdrawals from the fund are not permitted. The establishment of minimum deposit amounts, outlining the timing of deposits, combined with strict withdrawal rules will support a fund's long-term success. Without these elements, the fund's capacity as a tool to generate wealth for future generations is limited.

Once the legislated twenty-year term has ended, the NWT faces a number of options for how much should be withdrawn from the fund, how the money should be spent, and what it should be spent on. Drawing from the history of both missteps and successes of other natural resource wealth funds, the authors look to lessons from Alberta's post 2013 fund withdrawal rules, where the principal remains in the fund, and only interest on the principal can be withdrawn. (Revenue Watch Institute & Vale Columbia Center 2013). As interest is likely to be volatile, the authors propose that following the twenty-year period, the NWT withdraw a five-year average of interest (less inflation) while leaving the principal entirely in the fund. It is prudent that this interest be spent by government through the budget rather than diverting revenues directly to any initiative outside the budget, as the budget provides a transparent and well audited mechanism.

The authors suggest that withdrawals from the fund's interest be earmarked for a limited number of key underfunded priorities in the NWT. To reach specific development outcomes, it is most effective for the fund to focus on a small number of underfunded priorities. For instance, returns from Chile's Pension Reserve Fund are only to be used to pay for pension and social welfare liabilities (Revenue Watch Institute & Vale Columbia Center 2013). The most pressing pro-development programs or projects that are systemically underfunded in the NWT should be determined through government analysis and citizen input. For example, from its natural resource wealth fund, Texas uses a three-year running average of interest rates to fund education. These funds must be allocated to university capital equipment, scholarships, student services, research, or library books, as overseen by the Board of Regents and University of Texas Investment Management Company (Revenue Watch Institute & Vale Columbia Center 2013).

Examples cited in the NWT during this research process included education and municipal infrastructure, however, it will be up to government and citizens to identify underfunded priorities to earmark for the fund's interest following the twenty year period.

The development legacy that could flow from the Heritage Fund's interest rests heavily on the GNWT's ability to establish and follow clear rules. Alberta's Heritage and Savings Fund demonstrates the risk when fund rules can be ignored, particularly if they are not clearly established, or if exceptions allow for significant departures from the rules (The Fraser Institute, 2013). As there were no rules governing minimum resource revenue deposits into Alberta's Fund, regular contributions to the Alberta Fund were suspended from 1987 until 2005 and minimum required contribution deposit rules were established only in 2013 (Revenue Watch Institute & Vale Columbia Center 2013c). Enacting strong deposit, withdrawal, and investment rules will help mitigate potential risks.

Issue 3: Establish Robust Transparency and Oversight Mechanisms – Including Appointment of a Supervisory Council to Oversee the NWT Heritage Fund

A key recommendation in the policy report (Briones et al. 2014) was expanding the Secretariat of the Fund to form a Supervisory Council. The Supervisory Council would provide independent expert finance directors, and be composed equally of representatives of various government authorities, legislators, Aboriginal Governments, financial experts, academics, and civil society, to oversee the fund on behalf of the government. The majority of members must have security of tenure and be completely independent of the government for this model to work effectively. This Supervisory Council would replace the Secretary of the Financial Management Board and report directly to the Minister of Finance, as well as to the Legislative Assembly. Successful funds are not only an outcome of good fiscal policy; they are facilitated by robust internal controls, supervision, public oversight, and transparency. For the Supervisory Council to be successful, qualified individuals must be appointed, with a strictly vetted job description process, to avoid the risk that the council could be a channel for nepotism and patronage. The Supervisory Council should include diversity of representation from independent representatives of the public as well as financial experts. Further elaboration by the authors, in consultation with the GNWT, is being undertaken to support regulation in this area.

NWT's Current Fund Governance Model

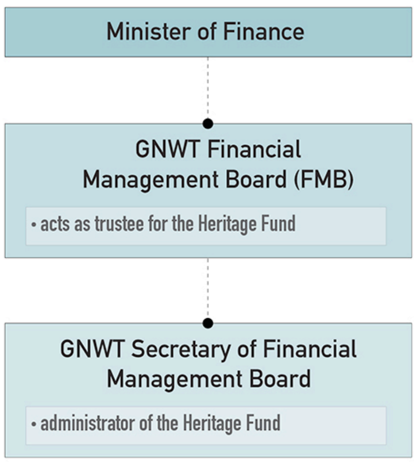

Figure 4: Existing Structure of the NWT Heritage Fund's Governance

The NWT Heritage Fund is currently managed by the GNWT Department of Finance. GNWT Legislation states that the Financial Management Board is authorized to act as trustee of the Fund (GNWT 2012c). The Financial Management Board, composed of Cabinet Ministers and Chaired by the Minister of Finance, is responsible for monitoring the performance of the Heritage Fund and, on an annual basis, for directing and supervising the Secretary of the Financial Management Board. The Secretary, a member of the public service, is responsible for carrying the administration and maintenance of the Heritage Fund as directed by the Board.

The Need for Clear Rules and Independent Oversight of Natural Resource Funds

The current structure of the NWT Heritage Fund's governance omits an independent layer of oversight and lacks third party separation from the government. However, best practice in fund management suggests that a separate operational management entity, with full delegation to manage investments under a strict mandate, be appointed (Bauer 2014a). Given the small amount of revenues deposited into the Fund to date (as of February 2014), a separate independent oversight entity may be costly to implement at this time, though the Supervisory Council could be established to meet the growing size and importance of the fund as royalties accumulate (such as in a five-year plan). In the immediate term, a minimum of two additional independent observer members should be appointed in order to provide independent assurance: one to the Financial Management Board and one to the Secretariat.

Some of the world's most successful natural resource funds, including Norway, Chile, and Alaska, have independent oversight bodies. Chile, Ghana, and Chad all provide excellent examples of oversight bodies, which can inform building an oversight body in the NWT. For example, in Chile, a law established a new Advisory Financial Committee for Fiscal Responsibility Funds (AFCFRF) to advise the Minister of Finance on investment regulations and decisions related to Chile's two sovereign wealth funds (Schmidt-Hebbel, 2012). The Ministry of Finance selects six independent members, usually academics, from the local community of macroeconomists and financial experts; their overlapping tenure is two years. The Secretariat of the AFCFRF is part of the Ministry of Finance. AFCFRF members discuss financial developments and their implications for the performance of the funds, evaluate fund management, and issue non-binding recommendations about fund investment policy and regulation to the Ministry of Finance. AFCFRF publishes an annual report on the funds' financial results and the Committee's investment policy recommendations to the Minister. Their report is separate from the Ministry of Finance's report. In addition, the fund is externally audited to international standards, with reports available to the public (Schmidt-Hebbel, 2012).

Another relevant model can be found in Ghana. In 2011 the Parliament of Ghana passed the Petroleum Revenue Management Bill, which established a Public Interest and Accountability Committee (PIAC) (Bauer 2014a). PIAC represents the only legislated petroleum revenue management oversight body consisting entirely of civil society members and as such, is completely independent. The 13 civil society members who make up the committee include representatives of the unions, traditional chiefs, journalists, lawyers, chartered accountants, and religious groups who are appointed by the Minister of Finance for two to three year terms. PIAC is mandated to monitor and evaluate compliance with Ghana's Petroleum Revenue Management Act, to provide a platform for public debate on whether revenues are being used to advance development priorities and to provide an independent assessment of the management and use of the petroleum revenues. The PIAC has already demonstrated effectiveness towards good mineral management - in 2011, it found an unpaid surface rental bill from a major oil field, pressuring government to act (Bauer 2014a).

A third pertinent example is Chad's oil revenue oversight mechanism. The Collège de Contrôle et de Surveillance des Ressources Pétrolières (the Collège), is a multistakeholder oversight committee for Chad's oil wealth (Gary & Reisch 2005). It approves disbursements from Chad's fund and oversees the management and use of revenues from the Chad-Cameroon pipeline. The Collège is a nine person joint government-civil society body established to monitor the use of Chad's oil revenues. Supported by four technical staff, it has the authority to exert its control by verifying the alignment between production volumes and deposits into the Chadian accounts, by ensuring that revenues are allocated according to the law, and by participating in the preparation of budgets for expenditures of petroleum revenues. The Collège has leveraged important pressure on government; for example, in 2005 its report highlighted wells and schools that were paid for but not completed. The Collège has successfully attracted attention to mismanagement of public funds, pressuring government to address these issues (Gary & Reisch 2005).

Lessons from Other Oversight Bodies for the NWT

Concerns have been expressed in the NWT that an oversight board would be expensive to operate, that it would be difficult to find qualified members to sit on the board, and that there is a risk of political patronage appointments from the Legislative Assembly. In this regard, Chad provides a strong model for the NWT, wherein for their Collège oversight committee, hiring technical staff helped to offset the knowledge losses that occurred as trained members rotated out, every two years. The NWT may want to consider hiring supervisory council support staff, such as an economist or a tax expert, similar to staff hired to support Chad's Collège. Training by outside organizations provided for supervisory council members was important for both Chad and Ghana. Organizations such as the Natural Resource Governance Institute and the World Bank offer training to increase effectiveness for newly formed fund oversight groups in developing countries. Ghana's fund provides a useful model to avoid political patronage appointments, whereby specific organizations and groups are identified for representation and selections must come from these designated groups.

Independent oversight from government provides assurances of integrity that internal controls alone cannot provide. Nearly all of the world's top rated natural resource wealth funds, including Alaska, Chile, Ghana, and Norway, have independent oversight. Funds that have been noted to not serve citizen interests as effectively, such as Libya, Equatorial Guinea, and Qatar, do not have independent oversight. To illustrate, the Libyan Investment Authority lost much of a $1.2 billion dollars investment in equity and currency derivatives following the 2008 financial crisis, partly the result of a lack of independent oversight (Bauer 2014a). In the NWT, the financial stakes are much smaller. However, for the government and citizens, it is an opportune time to carefully consider which model of independent oversight can best incentivize the government to comply with its own rules to meet long term Fund objectives.

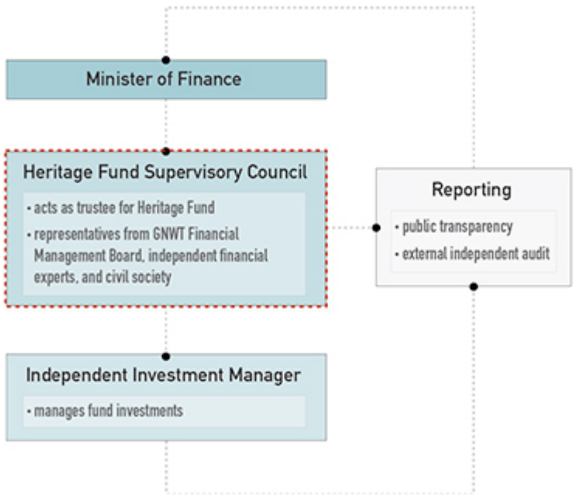

Figure 5: Proposed Fund Governance Structure with Supervisory Council

With the deposit amount to the NWT's Fund now decided, though still requiring legislation or regulation, the government of the NWT has important decisions to make regarding governance and transparency. Though the current Fund holding is modest at just over $500,000 (Wohlberg 2013), this is the perfect time to instill good governance to ensure the Fund's long-term success. Once revenues begin accumulating, it is easy to lose sight of the Fund's mission and objectives.

Deposit and Withdrawal Rules – Cautionary Example of Alberta's Heritage Fund

If similar funds in Alberta and Alaska are compared to the NWT Heritage Fund, there are differences in operations, management, and transparency and oversight. Each box represents a regulatory standard, essential for promoting consistent use and safeguarding of resource revenues. Green represents the existence of regulation while the red boxes highlight regulatory gaps in fund governance. Alberta did not have strong deposit and withdrawal rules, making their contributions ad-hoc, depending on the government whims of the day (of note, as of 2013 they standardized their deposit rules going forward).

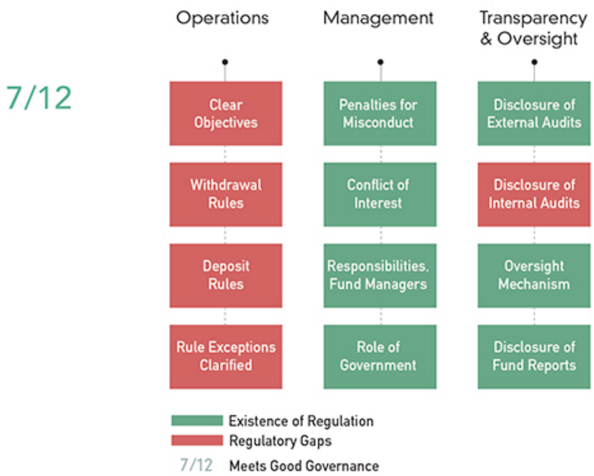

Figure 6: Alberta Heritage Fund pre-2013: Good Governance and Gaps in Regulation

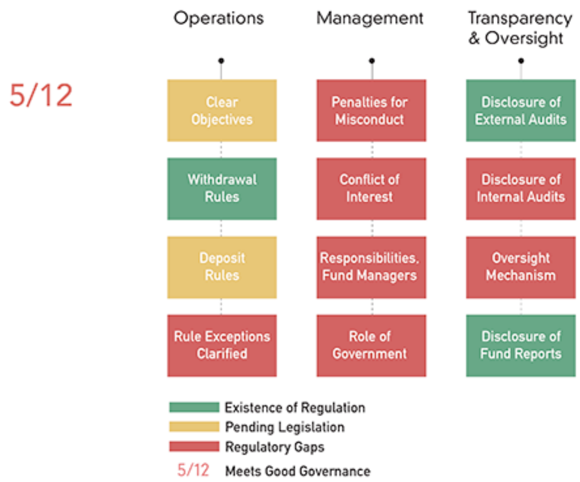

Figure 7: NWT Heritage Fund: Good Governance and Gaps in Regulation

The GNWT's fund was analysed with the same criteria. There are multiple red boxes, largely as the fund is nascent and the GNWT is in the decision making process about rules and regulations. The yellow colored boxes represent areas which have provisional decisions made, but which have not yet been written into policy or legislation. These regulatory gaps are discussed in the following section.

To illustrate further, if Alberta had followed Norway or Alaska's governance rules, they could have generated more wealth. For example, instead of the $9.1 billion saved from 1982-2011, using Alaska's governance rules, Alberta could have saved $42.4 billion. Using Norway's governance rules during the same time period, Alberta would have accrued $121.9 billion, securing a legacy for future generations.

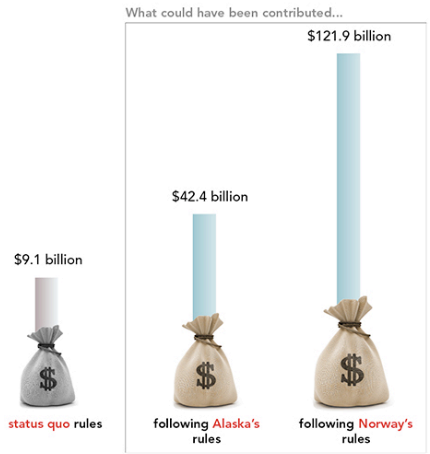

Figure 8: The Potential of the Alberta Heritage Fund (Adapted from Murphy & Clemens 2013)

Strong governance rules will directly affect the wealth that a fund has the potential to generate. Alberta's Heritage and Savings Fund demonstrated the risks when fund rules are ignored, particularly if the rules are unclear. Alaska, on the other hand, has been evaluated as a strong example of good governance. For instance, the public is very engaged with the fund and see direct benefits from it[21] (Murphy & Clemens 2013).

In summary, a framework regulating what goes in and out of the fund will help assure the preservation of wealth over the long-term.

Auditing and Reporting

Under the current structure of auditing and reporting, the Heritage Fund will be summarized in a separate notes section but will not be audited separately from the rest of the GNWT budget. To comply with global standards, an internal audit would need to be reported back to the Ministry of Finance and the Legislative Assembly, while an external audit would be reported to the Supervisory Council, who could use the report to generate asset allocation recommendations to the Minister of Finance and Legislative Assembly. Both audits would be publicly available on a government website. Quarterly internal and annual external audits from the investment manager are critical for assessing compliance with governance and investment rules, and making recommendations to improve the fund's effectiveness. Publicly accessible documentation would give assurances to the people of NWT that resource revenues are being used effectively and responsibly. Transparency further ensures "fiscal policy consistency, more efficient public financial management, and can help prevent fiscal crises. It can also improve the private investment climate and help build trust between the government and the public" (Toledano & Bauer 2014).

To engrain transparency within the management of the NWT Heritage Fund, regular public reporting (through online access and other forums such as public meetings, in easily digestible formats) should include the following: fund size, fund managers, significant fund activities and transactions, deposit and withdrawal amounts, returns on investments, types of assets permitted for investments, and types of assets invested in. This can help build confidence amongst the people of the NWT that resource revenues are being used effectively and responsibly.

Issue 4: Strengthen Citizen Engagement

A Heritage Fund is a new concept to most residents of the NWT. Although the GNWT has held public consultations on the Heritage Fund in 2013, ongoing public education and engagement will be important in order to promote public awareness (GNWT 2013e). Continued communication can help equip residents with the skills and knowledge to act as independent overseers to benefit the Fund and its future. Public oversight, beyond the independent body of the Supervisory Council, can be an important force that can help ensure the government follows its own rules and principles to meet the Heritage Fund's objectives. The more the public understands and supports the long-term objectives of the Fund, the more it will hold current and future governments to account to protect the integrity of its original purpose. The viability and success of these funds depends on the public's support for them. For example, Norway enjoys broad public support as a point of national pride and, in Alaska, support is retained through the paying of annual dividends to each citizen (MacKinnon 2013).

Conclusion: Conditions for Tomorrow's Prosperity

On April 1, 2014, NWT citizens gained greater control over their lands and resources for the first time since confederation. As non-renewable resources are discovered and developed in the territory, one of the government's priorities is to foster well-being for future generations. The future success of the legislated NWT Heritage Fund will depend on strong governance, broad public support, and an effective system of checks and balances to ensure that mineral wealth benefits NWT citizens today and tomorrow. Lessons must be learned from past development and from success and failures alike. The landscape continues to change, opening up new pressures for resource extraction. Northern communities are at the front lines of extreme developments and dramatic environmental implications. For these communities, cultural identity – and survival – is at stake. Furthermore, despite enormous mineral deposits, abject poverty persists in Indigenous communities near lucrative mine sites in the NWT (Irlbacher Fox 2012). Challenges in attaining high quality education, accessing health services, and securing nutritious foods persist. A major challenge is how to harness increased economic, development, and research interests to include and benefit those who reside in Canada's North. The ability of northern territories to absorb the potential benefits of increased economic activity in the region is closely linked to building strong human capital, with a foundation of high quality education systems (Smits, Bertelsen, Justinussen 2014). Building human capital, including the capacity for resource revenue management aligned with global standards, is pivotal to transcending historical cycles of "boom and bust." Localizing decision-making and providing accountability, transparency and oversight in managing resource revenues will improve the likelihood of transforming mineral riches to citizen well being in Northern communities.

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Notes

1. These best practises in fund development are based on the Santiago Principles, a set of voluntary good governance guidelines for sovereign wealth funds (International Working Group of Sovereign Wealth Funds 2008).

2. There is not yet a clearly articlated objective for the NWT Heritage Fund in either the 2012 Act or Regulations (GNWT 2012c). Fund objectives can range from include savings for future generations; growing a pool of precautionary savings; earmarking resource revenues for specific development projects; or smooth spending of resource revenues over the long-term (Bauer 2014a). In the case of the NWT, the Heritage Fund could also serve to build a culture of savings, autonomous from Canada's federal government.
3. Although 5% of the current gross expenditure base would amount to a maximum of 70 million in resource royalties per year for the NWT, this maximum could increase over 10 years, if the gross expenditure base increases.
4. Nearly 60 percent of the GNWT's operating budget is spent on education, health care, social services, housing, policing, and corrections, while another 13 percent is allocated to municipal and government infrastructure.
5. For example, health expenditure per capita is greater in the territories. In 2013, the total health expenditure per capita in the Northwest Territories was expected to reach $10,686. This is nearly double that of other regions, such as Quebec ($5,531) or British Columbia ($5,775). (National Health Expenditure Trends, 1975 to 2013.)
6. In 2012-2013, approximately 8% of these taxes and fees were corporate tax and 8% were generated from personal income tax (GNWT 2014 http://www.fin.gov.nt.ca/taxation/revenues/index.htm)
7. Member of the Legislative Assembly for Dehcho, Michael Nadli, was the sole MLA to vote against the Devolution agreement on June 5, 2013 (Edwards 2014).
8. For example, during the debate in the NWT Legislature on the Devolution agreement, Weledeh Member of the Legislative Assembly Bob Bromley stated, "Our resource royalty regime is no better than it's ever been, and despite several objective reviews by different parties, including some by the federal government, all concluding our royalty rates are set too low. And despite imminent devolution, there appears to be no intent of this government to protect the public interest as our most valued resources are extracted and shipped off. Consider, for example, that as the federal Minister of AANDC admitted only Monday in Ottawa, the total revenues paid to Canada throughout the life of Giant Mine were $4 million, a royalty rate similar to what is collected today from diamond mining" (GNWT, June 5 2013: 2850).
9. This chart is adapted from Natural Resources Canada, June 2011 bulletin on how Canada's mineral tax regime compares to other mineral rich jurisdictions. Details of how the model of comparision was developed can be found at http://sead.nrcan.gc.ca/prod-prod/2011-eng.aspx.
10. In addition to minerals, Canadian provinces' royalty rates for oil and gas are low by global standards. In 2012, for instance, Alberta collected one tenth of the revenue per barrel of oil equivalent in taxes and royalties compared to Norway (Anderson 2014).
11. This figure is based on the Government of the Northwest Territories Department of Finance's revenue projections, generated using average resource royalties over from 2008-

2013 of 120 million dollars per year. This amount will vary from year to year based on mineral revenue flows.

12. Different vehicles for investment in future generations include: Heritage Funds, physical infrastructure, health care, human capital, governance systems or financial assets. An in-depth examination of which mechanism for investment is optimal for the NWT is outside the scope of this paper, though it should be noted that the Government of the NWT has developed a Capital Plan for Infrastructure as one tool to invest for the future (http://www.maca.gov.nt.ca/home/for-community-governments/community-government-toolkit/infrastructure-planning/).

13. The NWT and Nunavut Chamber of Mines confirmed that the four NWT mines pending production are in an advanced stage – this means that they have completed pre-feasibility studies or completed or nearly completed environmental approvals processes, and are raising funds for mine construction (Personal Communication, September 29, 2014).

14. NWT citizens have been discussing the idea of a natural resource wealth fund for almost a decade. For example, Yellowknife based civil society organization *Alternatatives North* has advocated for setting up a wealth fund since they commissioned the Pembina Institute to produce a policy report on the topic in 2006 (Taylor 2006). The organization also provided submissions during the GNWT's 2013 budget consultation process, and actively participated in the Action Canada task force public dialogues (Alternatives North 2013).

15. The current consolidated debt level in the GNWT and twenty-five public agencies is $337.9 million.

16. Action Canada is a national fellowship program for promising Canadians, selecting between 15-20 young Canadian professionals each year. The program enhances Fellows' leadership skills, broadens their understanding of Canada and its policy choices, and builds an exceptional network of leaders for our future. Throughout the year Fellows work in teams on public policy projects related to an annual theme. The 2013-2014 theme focussed on Canada's North.

17. The roundtable was hosted by our public policy research team: Jesika Briones, Sarah Daitch, Andre Dias, Julia Fan Li, Martin Lajoie, and Alyssa Schwann.

18. In November 2013, the authors facilitated a public dialogue, held in Vancouver BC, to discuss the future potential of the NWT's Heritage Fund. The session brought together natural resource wealth fund directors, sovereign wealth experts, and NWT Members of Legislative Assembly (MLAs), to understand best practices in fund management and discuss how experiences in other jurisdictions might inform the development of the Fund. The authors further engaged with individuals and groups, through interviews and consultations including: Sovereign Wealth Fund experts, members of the non-renewable resource industry, the GNWT, federal and local government officials, Aboriginal government, academics in the NWT and other parts of Canada, non-profit organizations, representatives from Norway's Ministry of Finance, and leading financial journalists.

19. The purpose of the dialogue was to share the research and hear from the public; to discuss with the public how governance and investment of the Fund could best benefit

the NWT and its future generations; and to discuss the important role of the public in the process. The event was held at the Prince of Wales Northern Heritage Centre in Yellowknife on May 27th 2014.

20. As defined by the Santiago Principles (International Working Group of Sovereign Wealth Funds 2008).

21. It is important to note that the Alaska Permanent Fund model may not be applicable in the NWT, as the benefit provided in Alaska is in the form of a citizen dividend, or cash to residents. However, Alaska provides a strong example of a transparent and accountable fund (Revenue Watch Institute & Vale Columbia Center 2013).

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