ERIN WEIR
for Saskatchewan NDP Leader

Resource Royalties

Collecting a Fair Return

Saskatchewan's Non-Renewable Resources

Non-renewable resources belong to the people of Saskatchewan. Royalties are the price at which we sell these resources.

For too long, the provincial government has provided loopholes that allow companies to extract our resources without paying appropriate royalties. These concessions are not needed, particularly since the increase in commodity prices over the past decade has created huge windfall profits for resource companies.

Closing loopholes would allow us to collect substantially more revenue without changing existing royalty or tax rates. For a decade, Erin has consistently made the case in writing and on television for a better public return from Saskatchewan's non-renewable resources.

Since non-renewable resources will eventually be exhausted, we should save at least a portion of royalties for future generations. Over time, a savings fund would convert volatile resource revenues into a steadier stream ofinvestment income.

FIXING THE SASK. PARTY MESS

The Sask. Party is making a bad situation worse. It is currently reviewing uranium royalties to replicate previous giveaways to oil and potash companies. Erin would:

- Stop the Sask. Party's behind-closed-doors review of uranium royalties, which is setting the stage for a giveaway to uranium companies.

- Remove the Sask. Resource Credit, which allows uranium companies to subtract 1% of their production from royalties. Doing so would increase annual uranium revenues by $10 million.

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Potash Royalties

"... over the past quarter-century, dramatic reductions in provincial royalty rates have facilitated a massive expansion of Saskatchewan's oil and gas sector. However, this growth has not increased provincial oil and gas revenues.

On the contrary, lower royalty rates have meant significantly lower royalty revenues. In effect, Saskatchewan people financed industry expansion during the Devine and Romanow periods by forgoing millions of dollars of royalty revenues every year. The Calvert government's royalty reductions will increase this transfer of funds from the people of Saskatchewan to oil companies."

Erin Weir

2003 *Commonweath* **Article**

Baseline Assumptions

The last provincial budget projected potash sales of 10.2 million K_2O tonnes at an average price of $761 per K_2O tonne in the 2012-13 fiscal year. The government's most recent quarterly financial report did not change those assumptions. All three of the major potash producing companies report a gross margin or gross profit of $300 per KCl tonne, which is equivalent to $500 per K_2O tonne. These figures suggest that the industry will generate a gross profit of $5.1 billion from sales of $7.8 billion this fiscal year.

The provincial budget also projects that these established producers will invest about $2 billion, 120% of which can be written off in calculating Saskatchewan's Potash Production Tax. That deduction and some smaller deductions reduce taxable gross profits to about $2.5 billion or $250 per K_2O tonne.

Royalty Rates

The Potash Production Tax consists of a base payment and a profit tax of 15% on the first $60 of gross profit per K_2O tonne plus 35% of additional profit. Crown royalties are about 2.3% of sales: $180 million in 2012-13.

Profit Tax Holiday

Tonnage in excess of the average sold in 2001 and 2002 is currently exempt from the profit tax. Since that average was 8 million K_2O tonnes, 2.2 million will be exempt this year. Ending this holiday would increase revenues by $165 million in 2012-13 (i.e. 2.2 million*$60*15% + 2.2 million*$190*35%) and more as potash sales expand.

$165 million in 2012-13

Royalty Deduction

Currently, Crown royalties are deducted from the base payment but half are added back to the profit tax. In effect, half of Crown royalties are subtracted from the Potash Production Tax. Removing Crown royalties from the formula would increase revenues by $90 million (i.e. half of $180 million).

$90 millon in 2012-13

Resource Credit

The Sask. Resource Credit allows companies to subtract 1% of the value of sales from Potash Production Tax payments. Eliminating this credit would recoup $80 million (i.e. 1% of $7.8 billion).

$80 million in 2012-13

Investment Writeoff

Limiting the writeoff to 100% of the amount actually invested would recoup $140 million (i.e. 20%*$2 billion*35%).

$140 million in 2012-13

Potash Revenues

The budget and first quarter financial report project $705 million of potash revenue in 2012-13, including both Potash Production Tax and Crown royalties. Closing the above loopholes would collect a further $475 million (i.e. $165 million + $140 million + $90 million + $80 million) for a total of $1.2 billion. Because resource royalties and taxes are deductible in calculating corporate income taxes, the additional $475 million of potash revenue would reduce provincial corporate taxes by $55 million (i.e. 12%) and federal corporate taxes by $70 million (i.e. 15%). As a result, total provincial revenues would increase by $420 million and bottom-line corporate profits would decrease by $350 million.

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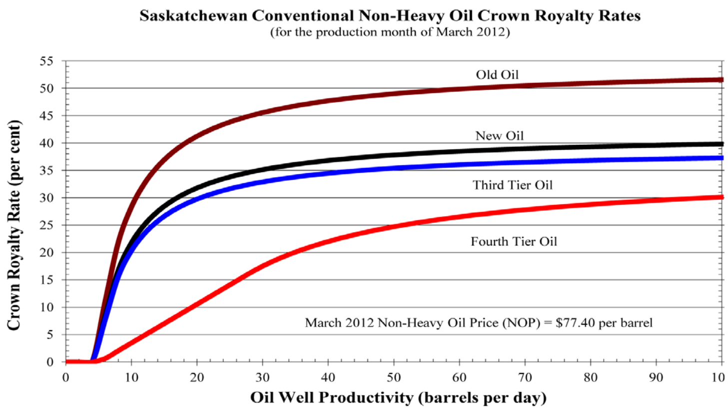
Oil Royalties

Baseline Assumptions

The Government of Saskatchewan's first quarter financial report reduced the 2012-13 forecast for oil royalties from $1.6 billion to $1.4 billion, but did not provide new projections for production or for the average Canadian-dollar wellhead price. A better baseline for calculation is 2011-12, when the province collected $1.5 billion in royalties from $12.6 billion of oil production. On average, the provincial government charged companies 12% of the oil's market value (i.e. $1.5 billion/$12.6 billion).

Royalty Rates

As shown in the chart, royalty rates depend on many factors, including a well's vintage, productivity and location. However, only wells that produce very little - fewer than 10 barrels per day for older wells and fewer than 25 barrels per day for newer wells - would have royalty rates of only 12% at current prices. Saskatchewan's overall royalty return is that low because loopholes allow oil companies to avoid paying the official royalty rates. If companies actually paid these rates, the people of Saskatchewan could collect at least 20% of our oil's value.



Resource Credit and Surcharge Discount

The Saskatchewan Resource Credit allows companies to subtract from royalties 1% of the value of oil produced. The credit is 2.5% for many wells drilled between 1998 and 2002. There is no credit for wells drilled since then, but these wells pay a resource surcharge of only 1.7% of sales instead of the usual 3%. A majority of oil extracted from Saskatchewan enjoys this 1.3% discount. Eliminating it and the credit would recoup $165 million of revenue (i.e. 1.3% of $12.6 billion).

Horizontal Drilling Incentives

The Government of Saskatchewan provides a 2.5% Crown royalty rate and 0% freehold tax rate on the first 37,754 barrels extracted from every non-deep horizontal well. This incentive's cost is extremely difficult to estimate without statistics on the rate and volume of production from horizontal wells. A reasonably good new well produces more than 100 barrels per day at an average wellhead price of $80 per barrel. A royalty of 2.5% - as opposed to 30% - forgoes $20 per barrel (i.e. $80*(30%-2.5%)), which is $750,000 dollars per well (i.e. $20*37,754). Since 1,904 producing horizontal oil wells were drilled in Saskatchewan in 2011, the incentive's annual cost could conceivably approach $1 billion. The provincial government should disclose more information to allow a better costing.

Enhanced Oil Recovery Projects

Enhanced Oil Recovery projects enjoy their own royalty regime: 1% of gross revenue before project payout and 20% of operating revenue thereafter on Crown land, or 0% before project payout and 8% of operating revenue thereafter on freehold land. This incentive will become more costly as thermal methods are increasingly used to extract heavy oil.

Revenue

Removing incentives for new drilling may moderate the pace at which Saskatchewan's oil reserves are depleted. Even assuming a 10% decline in volume, that would result in $11.3 billion of production at current prices. Collecting 20% of this amount would yield royalty revenue of $2.3 billion, a gain of $800 million relative to the baseline of $1.5 billion. Even with these incentives in place, revenue from the sale of Crown leases has not materialized. Budget 2011-12 estimated Crown land sales of $436 million for that fiscal year, but they actually amounted to $236 million. The first quarter financial report forecasts only $128 million for 2012-13. If removing incentives halved this figure, $65 million would be deducted from the gain of $800 million. Since royalties and lease payments are deductible in calculating corporate income tax, additional oil revenue of $735 million would reduce provincial corporate tax revenue by $90 million (i.e. 12%) and federal corporate tax revenue by $110 million (i.e. 15%). As a result, total provincial revenues would increase by $645 million and bottom-line corporate profits would decrease by $535 million.

Erin’s Plan to Close Loopholes

In the Potash Production Tax system, end the exemption of all tonnage above the average sold in 2001 and 2002, scale back the 120% investment writeoff to 100% of actual investment, stop the deduction of Crown royalties, and remove the Saskatchewan Resource Credit. These measures would have increased provincial revenues by an estimated $420 million in 2012-13.

In Saskatchewan’s oil royalties, remove horizontal drilling incentives, the special deal for enhanced recovery projects, the Saskatchewan Resource Credit, and the Resource Surcharge discount. These measures would have increased provincial revenues by an estimated $645 million in 2012-13.

Savings Fund for Future Generations

Establish a provincial savings fund for non-renewable resource revenue.

Since non-renewable resources will eventually be exhausted, royalties are one-time proceeds from selling a public asset. At least a portion of royalty revenue should be set aside for future generations.

One way to save for the future is to repay existing debt. After Saskatchewan’s General Revenue Fund debt is paid off, we should establish a separate trust fund for non-renewable resource revenue.

This fund would be independently managed and pay an investment return to the provincial treasury and/or directly to Saskatchewan residents. But the government could not dip into the principal to cover ongoing expenses.

A particularly successful model is Norway’s sovereign wealth fund, which has accumulated half a trillion dollars in two decades. Examples closer to home include the Alaska Permanent Fund and Alberta Heritage Fund. Premier Blakeney established the Saskatchewan Heritage Fund, which was removed by successor governments.

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Party Resolutions in Support of Erin’s Plan

1

Provincial Convention Resolution, 1995

Be it Resolved that the NDP will establish a more equitable return on our resources such as potash and oil.

2

Provincial Convention Resolution, 1989

Be it Resolved that the NDP will increase oil royalties to compensate for the losses in revenue and increases in expenditures made by the Devine government.

3

Provincial Convention Resolution, 2001

Be it Resolved the NDP government will undertake a partnership with the mining, oil and gas industry to continue having a pragmatic approach to royalties and tax changes.

4

Provincial Convention Resolution, 2012

Be it Resolved that a Saskatchewan New Democrat government would undertake a review of potash royalty rates to ensure a competitive royalty regime for potash in Saskatchewan while delivering a fair return to Saskatchewan taxpayers to invest in strong public services.