ECONOMICS, IDEOLOGY, AND ELECTIONS:

The Political Economy of Saskatchewan Oil Royalties in the 1980s and 1990s

Erin M. K. Weir

University of Regina Undergraduate

PEF Essay Contest Submission

Due on March 1, 2002

Introduction: Historical Overview and Thesis

During the first quarter of the twentieth century, the glimmer of golden wheatfields attracted thousands of settlers to Saskatchewan. The province grew rapidly from its inception in 1905 until 1914, when the outbreak of World War I stemmed the tide of immigration. The volatility of grain prices during and after the war wreaked havoc on Saskatchewan's economy and gave rise to political protest movements based on the belief that prairie farmers were being exploited by eastern institutions. Despite this turmoil, Saskatchewan entered the second quarter of the century with a population approaching one million, temporarily making it the third largest Canadian province. The combination of general economic depression, collapsing commodity prices, and severe drought during the 1930s hit Saskatchewan harder than any other province, and fueled a second wave of political radicalism that produced the Co-operative Commonwealth Federation (CCF), which won power provincially in 1944.

During the third quarter of the century, North America's post-World War II industrial growth did not give rise to a significant manufacturing sector in Saskatchewan. Instead, the provincial economy was oriented towards the production of raw materials that were sold as inputs to industry located elsewhere. During the 1950s and 1960s, both the socialist CCF and the free enterprise Liberal Party supported this transition as a means of diversifying Saskatchewan's economy and reducing its dependence on agriculture. The principal political debate surrounding the development of natural resources was whether it should be led by the state or dominated by business. Recognizing the importance of private capital to either approach, both parties kept provincial royalties low and co-operated with resource companies. During the 1960s, it became apparent that natural resources were no economic panacea and that Saskatchewan's resource economy was as reliant as its wheat economy on volatile external markets. In particular, Saskatchewan's potash industry was devastated by an overexpansion engineered by Premier Ross Thatcher's Liberal government (1964-1971) and by New Mexico potash producers who controlled the levers of American protectionism. This and other problems helped the New Democratic Party, the CCF's successor, regain power in 1971 under the leadership of Allan Blakeney.

As Saskatchewan entered the fourth quarter of the century, the tables were finally turning in its favour. Commodity prices were generally high during the 1970s, but, most importantly, oil prices skyrocketed in 1973 as the Organization of Petroleum Exporting Countries stopped or reduced oil exports to the countries that had supported Israel during the Yom Kippur War. Prices jumped again in 1979 as a result of Ayatollah Khomeini's Islamic Revolution in Iran. In economic terms, the black gold of Saskatchewan's oil fields was beginning to blot out the golden glimmer of its wheat fields, although grain prices were also strong during this period.[1]

Premier Blakeney's government (1971-1982) moved to capture a greater share of the windfall revenues created by these oil price shocks. During the late 1970s and early 1980s, the Government of Saskatchewan collected nearly half the value of crude oil produced in the province in royalties. The rising price of oil, combined with this dramatic increase in royalty rates, pushed provincial oil royalties, which had never exceeded $20 million per year before 1973, above $200 million in 1977 and above $350 million in 1979.[2] The Blakeney government used these growing revenues to finance its ambitious social democratic agenda.

The opposition Liberal and Conservative parties cried foul, accusing the NDP of expropriating wealth that rightfully belonged to individual entrepreneurs and of stifling private sector development in Saskatchewan. Resource royalties, of which oil royalties have always been the most significant by far, became a major political issue during this period. Not surprisingly, when the Conservative Party won the 1982 election under Grant Devine, it slashed petroleum royalties.[3]

In opposition, the NDP charged that the Conservative government (1982-1991) was giving away

[1] This account of Saskatchewan's economic history and its impact on the province's politics is consistent with Howard Leeson (ed.), *Saskatchewan Politics: Into the Twenty-First Century* (Regina: Canadian Plains Research Centre, 2001), John Richards and Larry Pratt, *Prairie Capitalism: Power and Influence in the New West* (Toronto: McClelland and Stewart, 1979), and other books.
[2] Appendix A and Saskatchewan Energy and Mines, *Mineral Statistics Yearbook 1999* (Regina: Government of Saskatchewan, 2001), Table 1-1-5, pp. 11-12.
[3] James Pitsula and Ken Rasmussen, *Privatizing a Province: The New Right in Saskatchewan* (Vancouver: New Star Books, 1990), p. 58.

Saskatchewan's publicly owned resources at firesale prices. It pointed out that Premier Devine's deficit budgets could have been balanced if royalty rates had been maintained at the levels set by the Blakeney government. But when the NDP took office in 1991 under the leadership of Roy Romanow, it did not raise oil royalties. In fact, it cut resource royalties substantially during the 1990s.[4]

With both the government and the opposition supporting a policy of very low royalty rates, the issue of oil royalties dropped off Saskatchewan's political agenda. But the petroleum sector continues to be a pillar of the provincial economy and oil revenues remain a significant component of the provincial budget, whether or not this is reflected in current political debates. The political economy of Saskatchewan's petroleum royalties is therefore a topic worthy of special study.

While different royalty structures have been employed at different times by different governments, an effective petroleum royalty rate may be expressed by measuring the value of royalties collected by the Government of Saskatchewan as a percentage of the net value of Saskatchewan oil sales. Between 1975 and 1982, the Blakeney government kept this rate at a mean value of 46%. The rate fluctuated from a low of 38% for 1977 to a high of 62% for 1982. Between 1983 and 1991, the Devine government's mean rate was 22%. Rates ranged from a high of 35% for 1983 to a low of 14% for 1989. Between 1992 and 1999, the Romanow government maintained a mean rate of 14%, with a high of 16% for 1997 and a low of 12% for 1998.[5] The Devine and Romanow governments have dramatically reduced Saskatchewan's oil royalty rates from the levels that prevailed under the Blakeney government. Together, they reduced the effective rate from 62% in 1982, when Blakeney lost office, to 13% in 1999 as the twentieth century drew to a close.

Why did both the Conservative government of Grant Devine and the NDP government of Roy Romanow systematically reduce Saskatchewan's oil royalty rates throughout the 1980s and 1990s? The Devine government's rate reductions are not particularly surprising given that it represented the right

[4] Appendix A.

[5] Ibid. The mean rate for each government was calculated by summing the annual rates and dividing by the number of years (i.e. all years were weighted equally.)

of Saskatchewan's political spectrum. However, the left-right divide on this issue makes the Romanow government's espousal of Devine's policy all the more shocking. Romanow did not simply accept the level of royalties that had prevailed under Devine, but reduced it further. This fundamental reversal of such a deep-rooted NDP position cries out for an explanation.

What elements motivated two parties that supposedly occupied opposite sides of the political spectrum to carry out the same policy with respect to oil royalties? This paper will examine three sets of factors. First, it will analyze the economic tradeoffs involved in setting royalties at various levels. Secondly, it will assess how ideological change altered the way in which these economic factors were and are perceived by decision makers. Thirdly, it will identify electoral considerations that have influenced political parties towards a low-royalty policy regardless of their ideological stripe. This paper will thereby combine the methodologies of economics and political science with the public choice school's economic analysis of democracy to explain why oil royalties were depressed by two consecutive Saskatchewan governments.

Section I: Economic Factors

Economic factors are a logical starting point in seeking an explanation of the oil royalties set by the Devine and Romanow governments. Both governments frequently cited economic constraints to justify their public policy decisions. They often argued that their hands were tied with respect to a variety of issues because of the precarious nature of Saskatchewan's public finances. Likewise, both Premiers repeatedly put forward the notion that globalization has rendered the provincial government impotent in the area of economic policy. Devine was not completely dependent on these arguments because budgetary austerity and *laissez faire* economic policy were ultimately consistent with the principles of the Conservative Party. By contrast, Romanow had to rely heavily on these contentions in explaining why his government was not implementing the social democratic program to which the New Democratic Party is committed.

Whether or not arguments that the government can not pursue left-wing policies due to economic constraints are seen to be generally valid, they clearly do not apply to the question of oil royalties. If anything, the Government of Saskatchewan's fiscal difficulties were all the more reason to maintain revenues by not reducing royalties. Notions of the mobility of capital and inter-jurisdictional competition in a globalized economy do not fully apply to the oil industry because its location is determined by geological and geographical realities.

The classic economic justifications for right-wing government policies do not hold up in the case of reducing oil royalties. In order to illustrate the tradeoffs actually involved in setting royalty rates at various levels, this paper will construct a simple model of oil royalties in Saskatchewan. The model consists of two actors, the oil industry and the provincial government, and two time horizons, the short term and the long term. There are four variables: the net price of oil, the marginal cost of producing oil, the royalty per unit produced, and the quantity of oil produced.

The first two variables are exogenous to the model in that they are outside the control of either actor. The net price of oil is determined by world markets and by the cost of transporting it to the point of sale. The net price is therefore unaffected by the quantity of oil produced in Saskatchewan. To the extent that the price received by Saskatchewan sellers differed from the world price during the 1970s and early 1980s, it was because of federal price regulations, which were also beyond the Government of Saskatchewan's control.

Likewise, the marginal cost of producing oil is determined by physical realities that are outside the control of the industry and government. Petroleum is a classic "increasing cost industry" because firms exploit the best and cheapest oil pools first, but must move on to less lucrative reservoirs to increase the quantity produced.[6] Costs are also pushed up as output rises because increasing demand for leasing rights to land, specialized equipment, and the labour of oil workers drives up the lease fees,

[6] Curtis Eaton, Diane Eaton, and Douglas Allen (eds.), *Microeconomics*, Fourth Edition (Scarborough, Ontario: Prentice Hall, 1992), p. 291.

rental expenses, and wages payable. The marginal cost of producing oil therefore rises as the quantity produced increases.

In the short term, these two variables can be treated as fixed because they are determined outside the parameters of the model and must be taken as given by the actors in the model. In the long term, however, price and marginal cost must be considered as variable, since they can be altered by global markets, international politics, federal energy policy, technological developments, and other factors.

It must be acknowledged that this model is an extreme simplification of reality. The net price of a unit of oil is a function of the price for which it can be sold, which depends on its grade (heavy, medium, or light),[7] and the cost of transporting it to the point of sale, which depends on where it is produced. The concept of a single net price for all of Saskatchewan's oil production is therefore not entirely accurate. However, the prices of different grades of oil are closely related to each other and transport charges constitute an almost insignificant fraction of the gross value of oil sold by Saskatchewan (about 0.1% throughout the period examined by this paper.)[8] It therefore seems reasonable to abstract from these details and treat the net price of oil as being uniform for the purposes of the model.

The marginal cost of producing oil has been treated as an increasing function of the quantity of oil produced. For the sake of simplicity, it has been drawn as a straight, upward sloping line in the diagram below. In reality, the relationship between marginal cost and quantity produced is almost certainly not linear. Determining the precise shape of the marginal curve would require a detailed study of Saskatchewan's geology and the markets for inputs to the process of petroleum extraction. Given that Saskatchewan's geology is not completely known and the behaviour of factor markets can not be precisely predicted, such a study would be impossible to complete.

Saskatchewan's royalty structure is complex and has changed over time. It consists of much

[7] Energy and Mines, *Mineral Statistics*, Table 2-1-1, p. 17.
[8] Ibid., Table 2-1-4, pp. 73-74.

more than a simple fee per unit of oil produced. However, an effective royalty may be calculated by dividing the proceeds of the Oil Royalty and Production Taxes by the amount of oil produced in a given period. The provincial government receives revenue from the industry by other means such as land rentals and bonus bids. However, revenue raised through these means has constituted only a fraction of the revenue raised through the Oil Royalty and Production Taxes throughout the period being considered.[9] Land rentals and bonus bids, along with the corporate taxes paid by oil companies and the income taxes paid by their employees, can be subsumed in the marginal cost curve faced by the industry, provided it is understood that some of the industry's production costs are, in fact, payments to the provincial government.

In this model, the quantity of oil produced reflects two principal abstractions. The first involves ignoring the distinction between different grades of oil. This assumption has already been explained as it relates to price. The net price and net value of sales relate to the quantity of oil sold, while marginal cost and royalties relate to the quantity produced. Bringing these variables together requires a second assumption: that the volume of production equals the volume of sales in any given year. This assumption is commonly made in market analysis and is rarely completely accurate, but it is valid in this model because, during the period under review, Saskatchewan's oil production and sales were in the millions of cubic meters, while the difference between the two was in the thousands of cubic meters. Graphing production against sales reveals no noticeable difference between the two.[10]

The important point is that these simplifying assumptions be made explicit. The purpose of the model is not to paint a detailed picture of Saskatchewan's petroleum sector, but rather to illustrate the tradeoffs made by governments in setting oil royalties at different levels. Any generalized model requires that some details be discarded in favour of the crucial elements. A more complex model might yield slightly different results, but would illustrate the same basic market forces and policy options.

[9] Ibid., Table 1-1-5, pp. 11-12.
[10] Ibid., Graph 2-1-4, p. 75.

In the absence of royalties, the oil industry will produce oil up to the quantity where the marginal cost of producing it equals its price with the aim of maximizing profit. In other words, the cost of the last unit of oil produced will equal the price for which it can be sold. Pushing production beyond this point would mean producing some oil that costs more to produce than it can be sold for. Allowing production to fall short of this point would mean not producing some oil that could be sold for more than it costs. Assuming that the oil industry strives to maximize its profits, it will produce the quantity of oil for which marginal cost equals price.

Because the price is the same for all units of oil sold, and the cost of production equals the sale price only for the last unit of oil, almost every unit of oil is produced at a cost somewhere below its price. In fact, oil pumped from rich and accessible reservoirs is produced at a cost far below its price. Certain producers therefore derive economic rent from geographic factors that do not reflect the contribution of either labour or capital to the process of petroleum extraction.

A clear distinction must be drawn between the economic concept of rent just described and the accounting concept of profit as a firm's revenues minus its expenditures. The accounting concept of profit is already included in marginal cost as payments to investors for their capital and to managers for their entrepreneurial expertise. Economic rent represents windfall earnings over and above this standard type of profit.

The imposition of royalties is an attempt by the provincial government to capture a share of the economic rents inherent in petroleum production. Royalties change the oil industry's basic profit-maximizing calculation by lowering the return it receives on each unit of oil produced. The net price for which it can sell a unit of oil is effectively reduced by the amount of the royalty. This new price faced by firms may be referred to as the "producer price." Under a regime of royalties, the industry will produce oil to the point where marginal cost equals this producer price. If the royalty equals the net price, then no oil will be produced, since there would be no profit to be had even in producing small quantities of oil at a negligible marginal cost.

Given the price for which oil can be sold and the marginal cost of producing it, each actor in the model makes a decision. The government sets the oil royalty at a value between zero and the net price of oil. Based on the resulting producer price, the oil industry determines how much oil to produce. The amount of new drilling the industry will undertake is closely related to this.

The combination of these basic variables produces a set of composite variables. The net value of oil produced in Saskatchewan equals the net price multiplied by the quantity produced. Total royalty revenues collected by the Government of Saskatchewan equal the royalty per unit multiplied by the quantity produced. The oil industry's total expenditures in Saskatchewan equal the sum of the marginal costs of each unit of oil produced. The economic rent accruing to the oil industry is the sum of the differences between the producer price and the marginal cost of each unit of oil. The "royalty rate," referred to previously and subsequently in this paper, is equal to the per unit royalty divided by the net price, which is the same as total royalty revenue divided by the net value of production.

Numerical Diagram of Saskatchewan's Petroleum Sector

The Basic Variables: The Composite Variables:

Note: The numerical values of the variables in this diagram nearly approximate the historical statistics for 1984. The diagrams were drawn by the author.

How does the oil royalty imposed by the government affect these composite variables? If the government sets royalties at a low rate, then the producer price will be nearly the same as the net sale price and the industry will produce a large quantity of oil close to what it would have produced without royalties. Since each unit of oil produced adds to the industry's total expenditures and to the economic rent accruing to it, both of these variables will be high. By contrast, royalty revenues will be low because the government will collect very little per unit of oil. The most extreme scenario would be for the government to set the royalty at zero, in which case oil would be produced all the way to the point where marginal cost equals net price, industry expenditures and rents would be maximized, and the government would receive no royalty revenue.

A second option is to set royalties at a moderate rate. Since the producer price would be significantly below the net sale price, the industry would produce a more moderate quantity of oil. The industry's expenditures and rents would therefore be at a moderate level. But government revenues would be high because it would collect significant per unit royalties on a significant volume of production. In any given period, there is one royalty rate that corresponds to a particular level of output that will maximize provincial revenues. The per unit revenue gains of increasing royalties beyond this point would be more than offset by reduction in the number of units. Likewise, the revenue gains of reducing royalties below this point would be more than offset by the fall in the royalty per unit. For the purpose of maximizing government revenues, there is an optimal moderate rate.

The third option is high royalty rates, which would drive the producer price far below the net sale price. Only a small quantity of oil would be produced, with industry expenditures and rents at correspondingly low levels. Government revenues would also be low because, despite the high royalty per unit of oil, very few units would be produced. The extreme case would be a royalty equal to the net price of oil, which would prevent any oil from being produced, leaving the industry's expenditures and rents, and the government's revenues, at zero. Conceptual diagrams illustrating the distinction between low, moderate, and high royalties are shown in Appendix B.

In the short term, the rational tradeoff appears to be between low and moderate royalty rates. Low rates maximize the oil industry's generation of economic activity at the expense of government revenues. Moderate rates maximize the government's revenues at the expense of industry activity. High rates depress both government revenues and industry activity.

Might it be possible to combine the benefits of low and moderate rates, without making a tradeoff between the two? The Devine government attempted to do exactly that in July 1982 by announcing a three-year royalty exemption for production from new wells.[11] The idea was to allow Saskatchewan to benefit from the economic activity associated with new development, while continuing to collect royalties on previously established production. Oil companies were able to circumvent this system by restricting production from their existing wells and drilling new wells into the same fields, thereby reducing their royalties payable, while producing the same oil as before.[12] This practice contributed to an unprecedented amount of new drilling during the following three-year holiday,[13] but robbed the government of revenues.

The larger the differential created between royalties on new and old wells, the greater the incentive for companies to drill superfluous new wells to evade royalty payments. This problem would have been even larger during the Devine period had the royalty holiday not been combined with a substantial cut in the royalty rate applied to existing production.[14]

A further problem relates to how long a new well is considered to be "new" for the purposes of calculating royalties. If a short exemption is provided, the government will not sacrifice much revenue, but the incentive for increased economic activity will be small. A longer exemption will allow companies to recoup their investments quickly and thereby create a strong incentive for expansion in

[11] Colin Thatcher, *Backrooms: A Story of Politics* (Saskatoon: Western Producer Prairie Books, 1985), p. 221-222.
[12] Lesley Biggs and Mark Stobbe (eds.), *Devine Rule in Saskatchewan: A Decade of Hope and Hardship* (Saskatoon: Fifth House, 1991), p. 20.
[13] Appendix A.
[14] Thatcher, *Backrooms*, p. 221, and Biggs and Stobbe, *Devine Rule*, p. 20.

the petroleum sector, but at great cost to the government. The basic tradeoff between industry activity and government revenues therefore prevails and can not be avoided through a creative royalty structure.

This tradeoff is borne out by the historical data. Between 1975 and 1982, the Blakeney government maintained royalties at moderate-to-high levels, making royalty revenues very high, but depressing industry activity. Despite rapidly rising net sale prices, which drove up the value of Saskatchewan's oil sales, the quantity produced was stagnant. The annual volume of oil output in Saskatchewan fluctuated between seven and ten million cubic meters, compared with between fourteen and fifteen million per year from the mid-1960s to the early 1970s, when royalties had been very low.[15] Oil drilling was more volatile, but no higher than it had been during the 1960s and early 1970s.[16]

Between 1983 and 1999, the Devine and Romanow governments maintained royalties at low levels. Saskatchewan's oil production increased fairly steadily from below ten million cubic meters in 1983 to above twenty million in 1999. Given that sale prices fluctuated up and down throughout this period, much of the increase in output must be attributed to the regime of consistently low royalties. Drilling remained volatile, but rose to higher levels. During much of the 1980s and most of the 1990s, more than a thousand new wells were drilled in Saskatchewan each year.[17] However, as has been shown previously, government oil revenues were dramatically lower than they had been under Blakeney.

Clearly, the choice between low and moderate royalty rates involves a tradeoff between industry activity and royalty revenues. This tradeoff was addressed by Economics Professor Eric Kierans in his *Report on Natural Resources Policy in Manitoba* (1973):[18]

---

[15] Appendix A and Energy and Mines, *Mineral Statistics*, Table 2-1-4, pp. 73-74 and Table 1-1-5, p. 11.

[16] Appendix A and Energy and Mines, *Mineral Statistics*, Table 5-2-1, p. 207.

[17] For an account of the oil boom created by Devine's royalty cuts, see Don Baron and Paul Jackson, *Battleground: The Socialist Assault on Grant Devine's Canadian Dream* (Toronto: Bedford House, 1991), pp. 41-44.

[18] Lorne Brown, Joseph Roberts, and John Warnock, *Saskatchewan Politics: From Left to Right, '44 to '99* (Regina: Hinterland Publications, 1999), p. 106.

> To be satisfied with the new jobs created and to forego the surplus and profits inherent in the development of its own endowment is hardly the mark of a strong government. It accepts the role of "hewers of wood and drawers of water" for its people when they are capable of much more. That role provides wages and salaries and little else. The profits, which direct and finance the future, belong to those who have been invited in and this capital formation does nothing for priorities in [other] fields.

As the former President of the Montreal Stock Exchange, Kierans is no left-wing radical. Despite his business background, he recognizes that provinces, as the owners of their natural resources, should demand more than the jobs created through private exploitation of this public endowment. He also recognizes the need to invest money extracted from resource companies into other industries to build a modern and diverse economy.

Kierans's argument is particularly relevant to Saskatchewan's petroleum sector. The oil industry's expenditures may be divided into payments to the factors of production. The rents paid for land accrue to the provincial government. The wages paid to labour are received by oil workers. The interest paid to capital and the profits received by the companies go almost exclusively to firms headquartered outside of Saskatchewan.

While land rents accrue directly to the government and other payments are taxed to varying degrees, these revenues represent only a fraction of the industry's expenditures and pale in comparison to what could be raised by optimizing royalties. The notion that Saskatchewan people derive a significant benefit from the jobs created and wages paid is tenuous. Statistics Canada's data reveals that, in 1994 (the last year for which the relevant publication breaks this information down by province), the petroleum and natural gas industry employed only 623 "production and related workers" in Saskatchewan, paying out wages and salaries of only $31 million, which amounted to about 1% of the marketable value it produced in Saskatchewan that year.[19] These figures would be even lower if natural gas, which is not the topic of this paper, were removed from the data. The fact that oil companies are headquartered outside of Saskatchewan robs the province not only of interest and profits, but of wages

[19] Statistics Canada, *The Crude Oil and Natural Gas Industry*, catalogue no. 26-213-XPB (Ottawa: Government of Canada, 1994), Table 1, p. 15.

as well. Saskatchewan received only 7% of the wages paid in Canada by the petroleum and natural gas industry in 1994, even though it produced 11% of the value of the country's oil and gas output.[20] Furthermore, oil workers must be transient due to the nature of their occupation and therefore may not even reside in Saskatchewan.

Given the applicability of Kierans's argument to Saskatchewan's oil industry, it is almost incontrovertible that the balance should be tilted in favour of provincial revenues and against industry activity. The people of Saskatchewan would clearly be better served by hundreds of millions of dollars in additional revenues than by dozens of additional well-paying jobs. It would even make sense for the government to raise oil revenues by hundreds, or even only tens, of millions of dollars and then simply pay those oil workers who become unemployed as a result their former salaries out of government coffers. Even if one third of the oil jobs that existed in 1994 were lost, the cost of fully replacing the lost wages would be only $10 million. In the short term, the relevant economic factors clearly militate in favour of moderate, as opposed to low, royalty rates.

It should be noted that the above conclusion was drawn using classical economic assumptions about the responsiveness of the quantity produced to changes in the price faced by producers. An institutional view of economics, taking into account other structural determinants of oil production, would give rise to an even stronger case for maintaining royalties at higher levels because it would be possible to significantly increase revenues without discernibly reducing the volume of production or the economic activity associated with it.[21]

Moving this model into the long-term time horizon changes its dimensions in two important ways. First, the net price of oil and the marginal cost of producing it are now subject to change. Since petroleum is an "increasing cost industry," the global price of oil will tend to rise over time. This process is subject to major fluctuations. In the 1970s, for example, an artificial reduction in the global

[20] Ibid.
[21] Such an analysis is suggested, though not wholly embraced, in Biggs and Stobbe (eds.), *Devine Rule*, p. 21.

supply of oil pushed up prices very rapidly. In the second half of the 1980s, the discovery of significant quantities of offshore oil on the Alaskan coast and in the North Sea depressed prices. While the overall marginal cost is driven up by the depletion of low-cost reservoirs and the shift to more expensive ones, the marginal cost for reservoirs of the same quality will be reduced by technological developments in the form of better drilling and recovery equipment and techniques.

Secondly, the fact that oil is a non-renewable resource must be taken into account. Saskatchewan's supply of oil is finite. Each unit of oil produced this year necessarily reduces future oil production by one unit. In fact, because recovery methods improve over time, depleting a reservoir today may actually yield fewer units of oil than would depleting the same reservoir in the future. Reducing the current quantity of production is not necessarily undesirable, because it increases the stock of oil available for future production. In the case of the petroleum sector, foregoing economic activity in the present will increase economic activity in the future.

These facts significantly alter the tradeoff faced by the Government of Saskatchewan in setting royalty rates. It should consider not only the balance between royalty revenues and economic activity during the current year, but the return it receives for the depletion of its stock of oil over many years. As the proprietor of Saskatchewan's oil, the provincial government may sell each unit of it only once. An effort should therefore be made to command the highest possible price for each unit.

Because global trends will increase the price of oil relative to the price of other goods as time passes, while technological developments will reduce the marginal cost of producing it, the economic rent associated with the production of Saskatchewan's oil will grow at a rate well above inflation. The growing gap between net price and marginal cost will increase the amount of economic rent associated with oil production and, therefore, the amount of royalties that can be collected for its production.

High royalties were dismissed in examining only the short-term factors, but are much more attractive in the long term. Their advantage is maximizing the royalty charged on each unit of oil produced. Oil that can not be profitably extracted at this high royalty rate is left in the ground until the net price increases enough and the marginal cost of producing it falls enough to make its production economical. This type of regime maximizes the return that the province receives for the depletion of its non-renewable resources over the long term.

As was explained earlier, the hinterland character of petroleum production in Saskatchewan reduces the benefits of oil industry activity to this province. The fact that current economic activity must be traded against future economic activity because of the finite nature of the resource eliminates or nearly eliminates the supposed benefits of increasing the present volume of oil production.

The long-term tradeoff is not between low and moderate royalties, but between moderate and high royalties. Moderate royalties maximize current revenues, but at the expense of future revenues. High royalties maximize the return that the province will ultimately receive for the depletion of its finite of supply of oil, but reduce its revenues in the short term. Either option is preferable to low royalties. Moderate royalties allow the province to reap higher revenues, while depleting its stock of oil at a slower rate. High royalties leave current revenues unchanged, but conserve vastly more oil for the future.[22]

An argument frequently made against higher royalties is that, even if they are theoretically desirable, they are impractical because Saskatchewan must remain competitive with Alberta's royalty regime. This argument implies that there is a finite amount of capital in western Canada's oil industry for which Saskatchewan and Alberta must compete. This simply is not true. If Alberta lowers its royalties, there will be more investment in its petroleum sector, but not necessarily at Saskatchewan's expense. Profitable operations in Saskatchewan will not be abandoned simply because more profitable opportunities exist in Alberta. Instead, more capital will enter the industry, so that all profitable opportunities are exploited. What happens in Alberta does not change the basic fact that the oil industry will produce oil in Saskatchewan to the point where marginal cost equals the producer price. Obviously, higher royalties reduce the producer price and thereby reduce the quantity produced, but this

[22] Appendix B.

has nothing to do with Alberta's royalties. In any case, the supposed need to stay competitive with Alberta does not explain the depths to which Saskatchewan royalty rates have plunged recently. Statistics Canada data shows that Saskatchewan oil and gas royalties, as a percentage of marketable production value, were actually lower than Alberta's royalties in 1999 and 2000.[23]

A second common argument against higher royalties is that Saskatchewan's proven reserves of oil are much higher now than they were during the 1970s. Indeed, Saskatchewan's known reserves have moved from less than 100 million cubic meters and falling in the early 1980s to more than 150 million cubic meters and rising at the end of the 1990s.[24] Since more than 20 million cubic meters are being produced per year, this implies significant new discoveries every year.[25] The argument is that the Blakeney government was desperate to maximize Saskatchewan's return on its oil because it thought that very little remained, but that discoveries since then have mollified this concern. While the discovery of more oil may delude people into forgetting that it is a non-renewable resource, it does not alter the fundamental tradeoffs. Obviously, Saskatchewan is better off with a large stock of oil than a small stock of oil, but the stock is finite in either case, and the rationale for maximizing the return received on its depletion remains valid.

To some extent, these changes in reserves are like self-fulfilling prophecies. By pursuing a low-royalty policy that ignores the fact that Saskatchewan's stock of oil is limited, the Devine and Romanow governments stimulated more exploration and the consequent discovery of a larger proportion of Saskatchewan's stock of oil. In some eyes, this increase in proven reserves may retroactively validate the decision to pursue a low-royalty policy. But ultimately, none of this has actually increased the quantity of oil in Saskatchewan. The stock remains finite, but more of it has been discovered.

[23] Statistics Canada, *The Crude Oil and Natural Gas Industry*, catalogue no. 26-213-XPB (Ottawa: Government of Canada, 1994), Table 1, p. 15, and Table 3, p. 21.
[24] Saskatchewan Mineral Resources, *Annual Reports* (Regina: Government of Saskatchewan, 1978-1983) and Saskatchewan Energy and Mines, *Annual Reports* (Regina: Government of Saskatchewan, 1984-2001).
[25] Appendix A.

A third objection to higher royalties relates to the replacement of depletion allowances on federal tax for oil companies with a resource allowance as part of the National Energy Program.[26] The old depletion allowance permitted oil companies to count provincial royalties as a deduction from federal taxes payable. Under this system, part of Saskatchewan's petroleum royalties were effectively paid by the federal government, rather than by the oil industry. The new resource allowance is a lump- sum deduction that is not sensitive to royalty rates. The full burden of provincial royalties in excess of the allowance is therefore borne by the industry.

The argument is that the producing provinces were able to push royalties to artificially high levels at the expense of the federal government under the old system, but that this is no longer possible under the new system. There is no doubt that the absolute maximum level of provincial royalties was higher under the old federal tax regime than under the new one. But it is doubtful that this theoretical maximum has ever been obtained. Perhaps the 62% oil royalties that prevailed in Saskatchewan in 1982 would not be possible today, but royalties could be vastly higher than they are. The fact that a slightly lower ceiling has been placed on the maximum royalty rate attainable is no justification for dropping royalties to the abysmally low levels that have prevailed under Devine and Romanow.

While some arguments can be marshalled in support of almost any royalty rate, it is clear that the rational long-term economic tradeoff is between moderate and high rates. Even if only short-term factors are considered, the balance obviously falls in favour of moderate royalties and against low royalties. Economic factors do not provide an explanation for the low-royalty policy pursued by the Devine and Romanow governments. On the contrary, they provide an almost incontrovertible case for higher royalties. In explaining the convergence of the Devine Conservatives and the Romanow New Democrats in favour of low oil royalties, one must look beyond the purely economic sphere to ideological and electoral factors.

[26] Bruce Doern and Glen Toner, *The Politics of Energy: The Development and Implementation of the NEP* (Toronto: Methuen Publications, 1985), pp. 323 and 328-335.

Section II: Ideological Factors

Economics can never be completely objective. Objectivity implies a detachment of the observer from the object of his or her observation. When human society, and behaviour within it, is the subject of study, this condition can not be met.

Economic analysis is inevitably coloured by political ideology. The above analysis of the economic factors pertinent to Saskatchewan oil royalties attempts to present and justify its assumptions in a balanced and intellectually honest manner, but some other observers would undoubtedly cast these same factors in a radically different light.

Explaining the low-royalty policy pursued by the Devine and Romanow governments therefore requires more than an analysis of the basic economic tradeoffs involved. The political ideologies espoused by decision makers in Saskatchewan's public sector must be assessed. The Blakeney government clearly saw the economic factors in roughly the same way as they have been laid out in this paper. What ideological changes caused the Devine and Romanow governments to see these factors in substantially different terms?

This paper will identify four relevant ideological changes, all of which are broadly associated with the political movement referred to as neo-conservativism, or as the New Right, during the 1980s and as neo-liberalism during the 1990s. First, and perhaps most importantly, this ideological trend changed the mainstream view of the state's role in the economy. Secondly, it undermined Saskatchewan's collectivist spirit. Thirdly, it gave rise to a political culture based on a very narrow view of government deficits and an obsession with eliminating them. Fourthly, it convinced many that a transition is in progress from the industrial economy of the twentieth century to the "new economy" of the twenty-first century, and that public policy must embrace this new economy or be left behind.

There is no doubt that Grant Devine and his chief lieutenants fit into this political mould. Throughout their time in office, but particularly during their second term, they publicly espoused these principles and deliberately associated themselves with US President Ronald Reagan and British Prime

Minister Margaret Thatcher, the most powerful exponents of this ideology.[27]

Whether Romanow can be placed in the same category is debatable. Some political scientists have argued that he is purely a neo-liberal.[28] Others have argued that he and his principal deputies subscribed to neo-liberalism in the economic sphere, but were more progressive on social issues.[29] This view places them in the camp defined by the British Prime Minister Tony Blair's "Third Way," a movement with which Romanow has publicly identified himself. A third view is proposed by Howard Leeson, a Saskatchewan political scientist who served as Romanow's Deputy Minister in the Blakeney government and as a Deputy Minister in the Romanow government. He characterizes Romanow as a "red tory" whose political views are defined more by concepts of ethnicity and community than of class or economics.[30] Apologists for Romanow within the NDP have shamelessly asserted that his politics were completely consistent with those of Premier Tommy Douglas, albeit applied to changed circumstances.

This last interpretation is baseless and has not been defended by any serious academic. The previous three interpretations differ on where Romanow stood with respect to social policy or community values, but they all allow that, in the economic sphere, Romanow broke away from the social democratic tradition of the CCF-NDP and embraced, or at least accepted, the neo-liberal paradigm. The entire debate over the extent to which Romanow can be classed as a neo-liberal is not germane to this paper. The important point with respect to petroleum royalties is that he accepted, whether grudgingly or gleefully, the economic aspects of neo-liberalism. The way in which neo-liberal ideology affects the formation of economic policy is therefore relevant in explaining why both the Devine and the Romanow governments depressed Saskatchewan's oil royalties.

During the post-war period from the late 1940s to the late 1970s, it was generally accepted in

---

[27] Pitsula and Rasmussen, *Privatizing a Province*, pp. 2, 56, and 96.
[28] Brown et al., *Left to Right*.
[29] Jocelyne Praud and Sarah McQuarrie, "The Saskatchewan CCF-NDP from the *Regina Manifesto* to the Romanow years," in Lesson (ed.), *Saskatchewan Politics*, p. 163.
[30] Howard Leeson, "The Rich Soil of Saskatchewan Politics," in Ibid., p. 9.

the western world that the government is a legitimate actor in the economy with a positive role to play. The experience of World War II had revealed the immense capacity of the state to plan and execute the mobilization of material resources on a grand scale, while Cold War competition against Soviet socialism provided a further impetus for western governments to reform capitalism in a more socially just direction. The stagflation of the 1970s discredited the ability of governments to manage economies through Keynesian methods. The collapse of communism in 1989-1991 discredited the socialist alternative in the eyes of many and thereby allowed governments to roll back the post-war welfare state.[31] Neo-liberalism restored the nineteenth-century ideal of the minimal state. The appropriate role of government is seen as protecting private property, providing a few essential services, and cheering on private business from the sidelines.

In 1979, John Richards, an economist who had been an NDP Member of the Legislative Assembly in the Blakeney government, and Larry Pratt, a political scientist, published *Prairie Capitalism: Power and Influence in the New West*.[32] The first paragraph of its introduction describes it as “a study of regional political economy. Its focus is on the provincial governments of Alberta and Saskatchewan and their development policies during the rise of the post-war resource industries of oil, natural gas, and potash in western Canada.” The most prominent theme in this introduction is “the province as entrepreneur.”[33] This terminology simply would not be used to describe government economic policy today.

If the provincial state is seen as the seller of the province’s natural resources on behalf of the citizens who own them, then a policy of higher royalties is easy to justify. The government has a duty to maximize the long-term return that Saskatchewan people receive for the depletion of their finite supply of oil.

[31] This basic analysis of the emergence of neo-liberalism is presented in Stephen McBride and John Shields, *Dismantling a Nation: The Transition to Corporate Rule in Canada*, Second Edition (Halifax: Fernwood, 1997) and many other books.
[32] Richards and Pratt, *Prairie Capitalism*.
[33] Ibid., p. 3.

Conversely, if the province is seen as a night-watchmen state, then Crown ownership of resources is viewed as an aberration produced by the particularities of Canada's British heritage. The government should only charge royalties that are "fair" to the private firms that wish to operate in the petroleum sector. Above all, governments should avoid "distorting resource development" by seeking "to ensure a minimum return to the provinces from the extraction of their resources."[34] In other words, the provincial government's duty is to stay out of the way of private capital.

The second major impact of neo-liberalism was to undermine Saskatchewan's sense of collectivism. Kierans's argument for higher royalties in Manitoba was based on the mildly collectivist notion that economic policy should be aimed at shaping the whole structure of the provincial economy and achieving broader provincial priorities, rather than simply furthering the immediate material self-interest of certain individual citizens.[35]

The notion that oil, along with other natural resources, is owned in common by the people of Saskatchewan is crucial to the economic analysis that led the Blakeney government to raise royalties. But this idea does not fit particularly well with neo-liberal individualism.

Saskatchewan's collectivism was tied to a sense of nativism and a consciousness of the province's status as a hinterland economy. One of Blakeney's arguments for extracting revenues from the oil companies was that they were predominantly American owned.

The 1980s and 1990s corresponded to moves away from this spirit of collectivism and nativism. The Devine government proclaimed Saskatchewan "Open for Business" to private firms from any jurisdiction.[36]

The Romanow government was somewhat less bellicose on this question, but quickly developed a cosy relationship with the multinationals, subsidizing the investments of Cargill and Intercontinental

[34] Yul Kwon, "Neutral Taxation and Provincial Mineral Royalties: The Manitoba Metallic Minerals and the Saskatchewan Uranium Royalties," *Canadian Public Policy*, Vol. IX, No. 2 (1983), p. 189.
[35] See the Eric Kierans quote above in this paper.
[36] Pitsula and Rasmussen, *Privatizing and Province*, Baron and Jackson, *Battleground*, and Biggs and Stobbe (eds.), *Devine Rule*.

Packers in Saskatchewan, and removing the limits that the Devine government had imposed on foreign ownership of privatized crown corporations. The Romanow government supported Macmillan Blodel's takeover of Saskatchewan Forest Products and praised Weyerhauser as a "good corporate citizen" when it subsequently took over Macmillan Blodel.[37] These actions are obviously inconsistent with a policy of squeezing revenue out of oil companies on the grounds of their foreign ownership.

A third product of the shift towards neo-liberalism was a political culture defined by a narrow conception of public deficits and an obsession with eliminating them. Intuitively, it would seem that a desire to balance the budget would lead governments to favour higher royalties as a means of generating revenues. However, the process of fighting deficits was as important to the neo-liberal strategy as the objective of eliminating them. A credible case can be made that the Devine government deliberately ran deficits during its first term by lowering oil royalties and eliminating the gas tax to create fiscal problems that would mobilize public consensus for program cutbacks to which it was ideologically predisposed.[38] In *The Triumph of Politics*, David Stockman, a Reagan advisor and self-described "radical ideologue" of the right,[39] argues that conservative governments should do exactly this, using the popular revenue-cut side of their program to create a fiscal crisis that necessitates the unpopular expenditure-cut side of their agenda.[40] Furthermore, by saddling Saskatchewan with a large public debt, the Conservative government reduced the subsequent NDP government's capacity to reverse its privatization of public assets and elimination of public programs.[41]

The Romanow government clearly did not engineer Saskatchewan's fiscal problems for political purposes; it inherited them when it took office in October 1991. Nevertheless, it did seek to create an atmosphere of public deference during the first part of its mandate by playing up the province's

[37] Brown et al., *Left to Right*, pp. 60-61.
[38] Biggs and Stobbe (eds.), *Devine Rule*, pp. 31-32.
[39] David Stockman, *The Triumph of Politics: Why the Reagan Revolution Failed* (New York: Harper & Row, 1986), p. 14.
[40] Ibid., pp. 44-78.
[41] Biggs and Stobbe (eds.), *Devine Rule*, pp. 31-32.

financial problems. In November 1991, the Government of Saskatchewan appointed the Financial Management Review Commission, which applied unprecedented public accounting practices to Saskatchewan's books. It concluded that Saskatchewan's debt stood at $8.9 billion, about twice the amount shown by the Devine government's accounting.[42] Romanow repeatedly alluded to the "fifteen-billion-dollar debt" that he had inherited from Devine, making no distinction between accumulated operating deficits, the costs of capital spending on public infrastructure, and self-financing investments made by crown corporations.

The presence of fiscal problems against which to crusade was and, to some extent, still is a centrepiece of neo-liberalism. The struggle to balance the budget gave governments a free hand to raise revenues and cut expenditures by any means necessary. Deficits sustained the neo-liberal movement and built consensus behind its agenda. The ideological and political utility of deficits may actually have made governments less aggressive in searching for new revenues to eliminate them. This is not to say that Saskatchewan's oil royalties were depressed as part of some vast political conspiracy, but rather that governments may have found it advantageous, both in terms of implementing their agendas and of retaining public support, to allow their financial problems to fester, rather than swiftly dispatching them with higher royalties. The increasing scrutiny and criticism that the Romanow NDP faced after Saskatchewan's budget was finally balanced in 1995 reveals the political cost of winning the war on deficits. Since it was the Devine government that created Saskatchewan's financial problems and the Romanow government that solved them, this argument is obviously more applicable to the former administration than to the latter.

A separate, but related, point is that the political conception of deficits changed with the coming of neo-liberalism. During the post-war period, deficits were seen as undesirable, but not fatal. It was recognized that large capital expenditures must be financed over a number of years. It was acceptable to run deficits to soften the impact of recessions. Balancing the economy was seen to be more important

[42] Brown et al., *Left to Right*, p. 55.

than balancing the budget. Deficits were placed in a broader economic context. By contrast, neo-liberalism conceives of deficits in narrow accounting terms. Borrowing money is always bad no matter what it is used to finance or the circumstances under which it is borrowed.

The economic view of deficits was particularly appropriate to Saskatchewan. As a smaller jurisdiction, it does not have the capacity to finance its capital projects in one budget year as national governments arguably can afford to do. Also, Government of Saskatchewan revenues are, and have always been, heavily influenced by volatile commodity prices. To reduce public spending in the name of balanced budgets as commodity prices drop would only compound the damage done to the provincial economy by the falling prices.

But the Romanow government embraced and advocated the neo-liberal view of deficits. While its *Balanced Budget Act* only requires that the budget be balanced over a four-year cycle, the political consensus that it created holds that a deficit in even one year is a mortal sin.[43] In reality, however, the fiscal facts remain unchanged. It is simply impractical for a small province whose revenues are dependent on volatile commodity prices to equalize revenues and expenditures in every single fiscal year.

After the budget was balanced, the Romanow government circumvented its own rhetoric on deficits by moving money into and out of its Liquor and Gaming Fund from year to year rather than posting significant surpluses and deficits in the General Revenue Fund. This practice came under fire from the Provincial Auditor and the Official Opposition, so the Liquor and Gaming Fund was replaced with a Fiscal Stabilization Fund used designed to perform exactly the same function.[44] Needless to say, the new fund has also been subjected to criticism. These accounting gimmicks used to create the appearance that Saskatchewan's budget is balanced every year may be less than honest in that they distort what is actually taking place in the province's finances, but they are ultimately as harmless as

[43] Michael Rushton, "Public Finance in Saskatchewan: 1980-2000," in Leeson (ed.), *Saskatchewan Politics*, p. 266.
[44] Saskatchewan Finance, *Budget Estimates*, 2000-2001 (Regina: Government of Saskatchewan, 2000).

they are meaningless.

Oil royalties have become a much more substantive outlet for Saskatchewan's need to be able to run deficits in some years. In many respects, maintaining lower oil royalties is similar to running a budget deficit. Both are basically means of sacrificing future revenue to promote current economic activity. It is now unacceptable for the government to do this through the General Revenue Fund, but it is able to do it through oil royalties, since deficits are now defined in purely accounting terms. Losing a quantity of oil worth a million dollars ultimately costs the Government of Saskatchewan as much as borrowing a quantity of money that will cost a million dollars to service and repay, but this is not immediately recognizable.

Low oil royalties are an extremely inefficient alternative to budget deficits. The cost of giving away large quantities of oil at firesale prices is much higher than that of running modest deficits. An additional unit of provincial government expenditure creates many more jobs and much more economic activity in Saskatchewan than an additional unit of oil industry expenditure. This is because, as was explained previously, oil companies are predominantly headquartered outside of the province and they use only a tiny fraction of the proceeds derived from their operations in Saskatchewan to employ people in this province.

The fourth major effect of neo-liberalism has been to convince people that the industrial economy is giving way to a "new economy" based on information. The notion that governments can not plan and manage this "new" economy as they did the "old" economy is used to reinforce the neo-liberal vision of the minimal state. Resource industries are seen to be obsolete and not worthy of being the focus of public policy.[45] This sharply contrasts with the 1970s, when natural resources were seen as putting the "new" into New West. "New economy" rhetoric diverts attention from the money at stake in the petroleum sector, and presents advocates of higher royalties as living in the past.

[45] Brett Fairbairn, "Economic Development and the New Role of Government," in Leeson (ed.), *Saskatchewan Politics*, pp. 295-318.

Neo-liberal ideology has characterized the economic visions and policies of both the Devine and Romanow governments. This political creed radically altered their perception of the relevant economic factors. The state was seen more as a facilitator of private activity in the petroleum sector than as legitimate actor on behalf of all Saskatchewan residents. Saskatchewan people were seen as individuals participating in a global economy, rather than as a group whose interests are incongruent with those of foreign oil companies. The politics of deficit militated against swiftly raising revenues through higher royalties. After the budget was balanced, the economic stimulus of low royalties became a substitute for the stimulus of deficit financing. Focus on the "new economy" diverted attention away from the petroleum sector and other resource industries, allowing advocates of higher royalties to be characterized as old-fashioned.

The Government of Saskatchewan's changing ideological perception of oil royalties is reflected by its alterations to the department responsible for administering them. The Annual Reports of Blakeney's Department of Mineral Resources reflected its goals of generating government revenues and ensuring Saskatchewan people a fair return on the depletion of their natural resources. For example, the opening note by Jack Messer, the Minister of Mineral Resources, in the Department's 1977/78 Annual Report ends with the following sentence: "I submit that through the diverse undertakings recorded in this report, the department has once more proven itself an efficient steward of the province's non-renewable resources - our peoples' birthright."[46]

The Conservatives reconstituted this department as Saskatchewan Energy and Mines. While this was partly a semantic reorganization, semantic changes are not necessarily unimportant. "Saskatchewan Mineral Resources" stressed the finite and non-renewable nature of the resources under the department's jurisdiction. The name therefore implied a long-term perspective. By contrast, "Saskatchewan Energy and Mines" emphasized the economic activity generated by the exploitation of those resources. The new name implied a more short-term concern with the level of industry activity.

[46] Mineral Resources, *Annual Report 1977-78*, p. 3.

This may seem to be a subtle point, but the government deliberately chose to change the department's name when doing so required the passage of a bill in the Saskatchewan Legislative Assembly.

Even under the Conservatives, however, the layout of the Annual Report, if not the Deputy Minister's introduction, reflected the Department's role as a collector of royalties.[47] This was changed during the Romanow years. The "Finance and Administration Division," which controlled the "Mineral Revenue Branch" that had previously occupied the first and most prominent part of the report, was shuffled to the back of the document, behind those divisions engaged in supporting industry activity.[48] When a list of the Department's principles was added to the opening page of the report, "service to our industry clients" was at the top of it.[49]

Recently, the NDP government of Premier Lorne Calvert, Romanow's successor, merged the Department of Energy and Mines with the Department of Economic Development to create a new Department of Industry and Resources. This organizational change reflects a further move in the direction of promoting resource production for the sake of short-term economic development, rather than maximizing royalty revenues over the long term.

Section III: Electoral Factors

So far, this paper has assumed that Saskatchewan governments have basically attempted to serve the public interest. It has examined the economic tradeoffs involved in setting oil royalties at different levels and the way in which the rise of neo-liberal ideology has altered the Government of Saskatchewan's perception of these factors. While it has been critical of the implications of neo-liberalism, characterizing them as distortions of the true public interest, it accepts neo-liberalism as being a coherent set of principles to which many Saskatchewan politicians have genuinely subscribed.

A fundamentally different view of politics is articulated by the "public choice" school of

[47] Energy and Mines, *Annual Report 1982-83* through *1989-90*.
[48] Energy and Mines, *Annual Report 1993-94* through *Annual Report 2000-2001*.
[49] Energy and Mines, *Annual Report 2000-2001*, p. 3.

economists, which now includes many political scientists as well. It argues that politicians rationally pursue their self-interest in the same manner as other individuals. The goal of politicians is to advance their careers by winning re-election. Electoral considerations are therefore the prime determinant of public policy.

Taken to the extreme, this “economic analysis of democracy” is excessive and unrealistic in its cynicism. However, even idealists must acknowledge that democratic politicians constantly take electoral factors into consideration. Principled politicians must win re-election in order to carry out their programs. Public choice analysis is therefore worth considering even if it must be taken with a grain of salt.

Four major electoral factors militate in favour of low oil royalties in Saskatchewan. The last three of these factors emerged during and after the 1980s and are, therefore, especially pertinent in explaining why the Devine and Romanow governments departed from the Blakeney government’s royalty policy. The first factor is that the benefits of royalty revenues are spread over a broad base, while the benefits of oil industry activity are more narrowly concentrated. The benefit accruing to any individual Saskatchewan resident from an increase in oil royalties is very small. Because of the increase in government revenue, he or she will pay slightly less in personal taxes or receive slightly more in public services. While the total combined benefits for everyone in the province are very large, it is not a vote-determining issue for many individuals.

On the other hand, while the total benefit to Saskatchewan of low royalties is significantly smaller, it is more concentrated. Those who hold well paying jobs in the oil industry, their families, and other residents of towns in the “oil patch” greatly affected by the level of industry activity will cast their votes almost exclusively on the basis on the government’s royalty policy. In electoral terms, low oil royalties win many more votes than they cost, even though they are bad public policy from the perspective of the province as a whole. These extra votes matter in the Saskatchewan’s polarized two-party system. For example, in the 1986 election, in which the NDP won more votes than the

Conservatives but took fewer seats, two thousand votes, properly distributed would have put the NDP over the top.[50] In the 1999 election, in which the Saskatchewan Party (the Conservative Party's successor) won more votes but fewer seats than the NDP, a similar number of votes would have made the difference.

The second major electoral factor is that the rural-urban split in Saskatchewan politics has increased the electoral importance of "oil patch" constituencies. During most of the post-war period, Saskatchewan politics was defined by a sharp ideological cleavage between the socialist CCF-NDP and the free enterprise Liberals or Conservatives. Elections broke down along left-right lines. To some extent these lines corresponded to the geography of province, but there was no rural-urban split. In fact, many of the NDP's strongest seats were in the predominantly rural "red square" in the eastern parkland region of Saskatchewan.

Parts of "red square" first abandoned the CCF-NDP in the Conservative landslide of 1982. A pronounced division between rural and urban areas first appeared in the 1986 election, with rural constituencies voting Conservative and urban ones voting NDP. This continued into the 1990s and was particularly stark during the 1999 election, in which the NDP won twenty-five urban seats, the two northern seats, and only two rural seats. By contrast, the Saskatchewan party won a whopping twenty-six rural seats and no urban seats, leaving the Liberal Party holding an urban seat, two rural seats, and the balance of power.

While the rural-urban split may have been engineered by the Devine government's strategy of winning rural votes (which typically control a disproportionately high number of seats because of rural depopulation) and writing off urban votes, its continuation has been facilitated by the rise of the neo-liberal consensus. The new political division between city and country has replaced the traditional split between left and right.

The prominence of this rural-urban electoral divide has inflated the importance of those

[50] Biggs and Stobbe (eds.), *Devine Rule*, 11-12.

constituencies which are themselves rural-urban splits, containing both sizeable rural areas and small cities.[51] Given that the larger cities, Regina, Saskatoon, Prince Albert, and Moose Jaw, are strongly NDP and the purely rural areas are solidly Saskatchewan Party, elections are decided in these mixed constituencies. As it turns out, most of the constituencies in the oil patch are rural-urban splits.

Some of the predominantly rural oil-patch constituencies, like Thunder Creek, Wood River, Cypress Hills, Cannington, and Moosomin, as well as Kindersley, which recently became a city, have consistently supported the Conservatives and their Saskatchewan Party successors, and are probably electoral writeoffs for the NDP. On the other hand, oil-patch constituencies that are rural-urban splits, like Lloydminster, Battleford-Cut Knife, Rosetown-Biggar, Weyburn-Big Muddy, and Estevan were won by the NDP in the 1995 election, but lost in 1999.[52] With the exception of Rosetwon-Biggar, which is now held by the Saskatchewan Party's leader, these are winnable seats for the NDP. If the NDP government deliberately tried to win over these constituencies with low royalties between 1995 and 1999, then it clearly failed to do so.

However, the striking congruity between the battleground of rural-urban constituencies where Saskatchewan elections are decided and the oil patch, where royalty rates are a vote-determining issue, provides a strong electoral motivation for both parties to cast themselves as advocates of low royalties. This motivation was not nearly as strong during the Blakeney period, when no rural-urban split existed in Saskatchewan.

A third major electoral factor is the move toward brokerage politics in Saskatchewan as ideological divisions have been undermined. Historically, Saskatchewan political campaigns could be characterized as contests between socialism and free enterprise. Both sides would move to the centre

---

[51] These constituencies were classified as "rural" in the preceding description of the 1999 provincial election.

[52] The identification of constituencies as being in the "oil patch" is based on the classification provided by Murray Mandryk, "Calvert's Kyoto Decision is Right for the Province," *the Leader-Post*, February 20, 2002, p. B7 and the author's referencing of a map of Saskatchewan oil fields against an electoral map of the province.

during elections in an attempt to capture the middle ground, but the choice was reasonably clear. The appeals were to universal ideologies that largely cut across geographic, ethnic, and gender lines. Obviously, particular geographic regions and ethnic groups were more receptive to certain messages, but campaigns were not crafted around them. This universalist type of electoral strategy was facilitated by the fact that Saskatchewan's population was relatively homogenous in that it consisted almost exclusively of small-scale farmers, wage labourers, and independent businessmen of European ancestry who shared broadly populist political values and basically conservative social values.

The diminishing ideological distinction between Saskatchewan's political parties and the growing diversity of Saskatchewan society have changed the nature of electoral campaigns in the province. Rather than seeking to rally people around a common ideology, all parties began running on platforms aimed at winning over many different segments of society in a variety of different ways. The 1999 election platforms of both the NDP and the Saskatchewan Party covered a wide range of motherhood issues, vaguely promising to lower taxes, while at the same time enhancing healthcare, improving education, repairing highways, and getting tough on crime. They sought to appeal to a wide variety of different interest groups without putting forward anything very controversial.

Low royalties are a component of this brokerage strategy that appeals to the oil patch. It is instructive that, during the 1982 election, Devine's promise to lower oil royalties was never mentioned as part of the Conservative Party's province-wide campaign. Instead, it was made at rallies in the Lloydminster and Estevan regions, and in corporate boardrooms.[53] Clearly, this was an appeal to the economic interests of a particular group, rather than to the political principles of a broad base of Saskatchewan voters.

The fourth major factor relating to the public choice school is the cosy relationship between the oil industry and Saskatchewan's political elites during the 1980s and 1990s. As Devine's first Minister of Mineral Resources, Colin Thatcher was the prime advocate of massive royalty reductions and

[53] Biggs and Stobbe (eds.), *Devine Rule*, p. 18.

oversaw the department's reorganization as Saskatchewan Energy and Mines. In his memoirs, he records how Gary Lane, a fellow Cabinet Minister, vehemently opposed his proposed royalty holiday on the grounds that it would cost the government far too much money. But cabinet passed Thatcher's proposal because "those who had any connection with the oil industry were all supportive."[54]

The links between the Romanow government and the oil industry were not so despicable. However, the ability to get along with the industry was a criterion frequently cited by Romanow in the appointment of Ministers of Energy and Mines. Furthermore, a number of NDP cabinet ministers retired from politics to highly paid positions in the oil industry, including Romanow's Deputy Premier, Dwain Lingenfelter.

Equally importantly, oil companies have made themselves among the principal financiers of Saskatchewan's political parties.[55] Prior to the 1980s and 1990s, parties were less dependent on this type of financing because they could raise significant funds from within their membership bases and could run campaigns using volunteer labour in place of paid advertising. A dramatic drop in political participation rates has made it much more difficult to do either of these things. Oil money has become an important ingredient in successful political campaigns in Saskatchewan. Politicians are naturally reluctant to alienate those who finance their campaigns. This makes the governments they compose unlikely to aggressively raise oil royalties.

A public choice analysis of Saskatchewan oil royalties suggests that the desire to win votes in the oil patch helped propel the Devine and Romanow governments toward a policy of low oil royalties. The importance of these votes was elevated by the fact that oil-patch constituencies were among the most important battlegrounds in provincial elections defined by a rural-urban split. The appeal to the oil patch fit into a brokerage strategy necessitated by the end of ideology and the diversification of Saskatchewan society. All of this was compounded by connections between oil companies and Saskatchewan's political elites, both on an individual level and in terms of party financing.

[54] Thatcher, *Backrooms*, p. 221.
[55] Mandryk, "Kyoto Decision."

Conclusion: Summary and Implications

The development of natural resources has been central to Saskatchewan's economy and politics throughout the post-World War II period. The issue came to head during the 1970s in the face of skyrocketing oil prices. The provincial government of NDP Premier Allan Blakeney aggressively moved to capture the windfall revenues that were being generated in Saskatchewan's petroleum sector. The right-wing opposition parties criticized this policy and, when the Conservative Party, under the leadership of Grant Devine, routed the NDP in 1982, it quickly and dramatically reduced the province's oil royalties. Despite having decried these royalty cuts while in opposition, the NDP reduced royalties further after returning to power in 1991 under Roy Romanow.

The relevant economic factors give credence to Blakeney's regime of higher royalties, particularly if they are examined over a long-term time horizon. In explaining the rejection of this policy by both the Devine Conservatives and the Romanow New Democrats, one must look beyond economics to ideological and electoral factors. The rise of neo-liberalism distorted the mainstream view of the economic tradeoffs inherent in setting royalty rates. This ideology militated in favour of low royalties. Developments in the nature of Saskatchewan's electoral politics also created a strong incentive for politicians to depress rates. The result has been disastrous for Saskatchewan. Rational economic analysis and the public interest have been sacrificed on the alter of neo-liberal ideology and electoral opportunism.

The arguments made by this paper must not be taken out of context. It does not allege that this dramatic reduction in royalties, carried out and maintained over two decades, was caused by any one of the factors identified. Its argument is based on the premise that many different factors must have been pushing in the same direction to overcome the powerful economic case for higher royalties and to motivate two parties from antithetical political traditions to adopt the same policy on this issue. It would be a futile exercise to try to document the motivations of the huge number of politicians and civil servants responsible for depressing Saskatchewan's oil royalties. The best one can do is to identify the broad structural factors that were contributory causes.

What have low oil royalties cost Saskatchewan? By the late 1990s, the province's annual volume of oil production was more than twice what it had been during the late 1970s and early 1980s. The amount of money it was collecting per cubic meter produced was substantially less in 1990s dollars than the Blakeney government had collected in 1970s and early 1980s dollars. The price at which the Government of Saskatchewan sells petroleum to the oil industry has fallen, while the net price for which the industry can market this oil has risen.[56]

The precise value of the revenues forgone can not be calculated because it is unknown how much oil would have been produced annually under a higher royalty regime. Clearly, the lost revenues are in at least the tens, if not the hundreds, of millions of dollars per year. An attempt to estimate the cost of the Devine government's royalty reductions was made by Mark Stobbe in *Devine Rule*. He determined potential royalty revenues by simply multiplying the royalty rate that prevailed during Blakeney's last year in office by the value of Saskatchewan oil production during each of Devine's years in office. The amount of revenue actually collected by the Devine government was then subtracted from these potential amounts to determine the amount of revenue forgone in each year. As Stobbe admits, this is not entirely fair, since maintaining royalty rates at the heights they achieved at the end of Blakeney's last term would not have allowed the value of Saskatchewan's oil production to be as high as it was under Devine. Stobbe simply concedes that the actual amount of revenue forgone is necessarily less than his estimates, without endeavouring to make his estimates more realistic.[57]

In an attempt to construct more defensible estimates, this paper concedes that the royalty rates in excess of 60% that were briefly achieved by the Blakeney government would not have been possible during the 1980s and 1990s, and takes the Devine government's initial royalty rate cuts as a given, calculating potential royalties by multiplying the value of oil sales by 30%. Appendix C compares the forgone revenues computed using this level of potential revenues to Saskatchewan's actual budget

---

[56] Appendix A.
[57] Biggs and Stobbe (eds.), *Devine Rule*, pp. 21-22 and 298.

deficits.

Since higher royalties would reduce production, this method implies that a royalty rate somewhere in excess of 30% could have been maintained during the mandates of Devine and Romanow. This is a very cautious estimate since the Blakeney government was able to maintain a mean royalty rate of 46% between 1975 and 1982. Even the Devine government maintained a rate above 30% in 1983 and 1984, while its royalty holiday was in effect. The revenues actually forgone are therefore probably higher than this paper's estimates.

However, even using these very conservative figures, it is clear that the Devine government's deficits would have been much lower had deeper oil royalty reductions not been made after Thatcher's initial cut. The colossal deficit of fiscal year 1986/87 would still have been a major problem, but other deficits would have been substantially lower. Given that the cost of every dollar of deficit is compounded by interest charges, which were very high during the 1980s, the overall government debt run up by Devine could have been vastly reduced by a more sensible royalty policy.

Even taking Devine's recklessness as a given, the Romanow government could have balanced the budget faster and less painfully had it raised royalties to more moderate levels, rather than reducing them further. After that, higher royalties would have given it the funds to implement a social democratic agenda, to significantly reduce personal taxes, or to rapidly pay down the provincial debt. In 1999/00, for example, the Government of Saskatchewan's total revenues were \$5.8 billion.[58] Capturing an additional \$518 million in oil royalties would have added substantially to its fiscal capacity.[59]

What are the implications of this? The first and most obvious one is that Lorne Calvert, Romanow's successor as Leader of the NDP and Premier of Saskatchewan, should raise oil royalties, particularly now that the Government of Saskatchewan is facing renewed financial difficulties.

As a case study, this paper is specific to oil royalties in Saskatchewan, but its analysis and

[58] Government of Saskatchewan, *Budget Estimates*, 2001.

[59] Appendix C.

conclusions are at least partially applicable to other circumstances. Similar trends are apparent in Saskatchewan's potash and natural gas sectors, which, taken together, come close to being as economically significant as its petroleum sector. If this paper's conclusions about oil royalties can be applied to potash and natural gas royalties, then the total cost to Saskatchewan of low resource royalties is even greater.

Petroleum is important in other provinces as well, most notably Alberta, which enjoys a far more lucrative endowment than Saskatchewan. The higher quantity and quality of Alberta's oil output ensures it a larger return in absolute terms. However, Albertans are also being shortchanged in terms of current revenues and long-term returns by a comparably low royalty regime. In embarking on the development of offshore oil reserves, the maritime provinces and British Columbia should take the Saskatchewan experience as a cautionary tale. The goal is not to pump out oil, but to make money doing it. If governments can not command a fair return for the extraction of their citizens' non-renewable resources, then they should be prepared to leave them in the ground for another day.

APPENDICES

APPENDIX A: STATISTICAL SURVEY OF THE PETROLEUM INDUSTRY’S ACTIVITIES AND THE GOVERNMENT OF SASKATCHEWAN’S ROYALTIES, 1975-1999

Year	Price of Oil (net $/meter^3)	New Drilling (# of wells)	Volume of Sales (cubic meters)	Value of Sales (net dollars)	Royalties (dollars)	Effective Royalty (dollars/cubic meter)	Royalty Rate (see below)
1975	$ 43.05	105	9,382,740	$ 403,907,675	$199,891,756	$21.30	49.49%
1976	$ 49.66	146	8,894,016	$ 441,692,772	$183,713,732	$20.66	41.59%
1977	$ 59.22	342	9,734,366	$ 576,459,293	$218,317,505	$22.43	37.87%
1978	$ 71.27	721	9,623,333	$ 685,824,036	$267,769,247	$27.83	39.04%
1979	$ 77.41	935	9,362,205	$ 724,706,658	$359,957,584	$38.45	49.67%
1980	$ 92.37	1,068	9,313,094	$ 860,217,108	$386,014,992	$41.45	44.87%
1981	$110.44	541	7,409,153	$ 818,247,751	$333,859,653	$45.06	40.80%
1982	*$145.87*	*685*	*8,128,176*	*$1,185,627,621*	*$736,626,565*	*$90.63*	*62.13%*
1983	$172.82	1,333	9,525,593	$1,646,184,947	$567,896,912	$59.62	34.50%
1984	$173.13	2,129	10,758,420	$1,862,590,400	$603,045,712	$56.05	32.38%
1985	$194.22	2,766	11,540,923	$2,241,450,754	$613,378,645	$53.14	27.37%
1986	$ 98.93	772	11,706,129	$1,158,119,534	$238,815,876	$20.40	20.62%
1987	$124.35	713	12,064,258	$1,500,231,079	$291,514,823	$24.16	19.43%
1988	$ 83.94	1,015	12,242,407	$1,027,582,865	$170,780,468	$13.95	16.62%
1989	$106.19	307	11,626,032	$1,234,573,414	$177,127,145	$15.24	14.35%
1990	$131.61	538	12,226,004	$1,609,037,090	$240,657,567	$19.68	14.96%
1991	*$ 95.37*	*478*	*12,415,109*	*$1,184,048,282*	*$205,983,593*	*$16.59*	*17.40%*
1992	$105.27	489	13,323,870	$1,402,570,663	$210,080,436	$15.77	14.98%
1993	$ 98.29	977	14,979,262	$1,472,375,278	$224,394,456	$14.98	15.24%
1994	$109.22	1,072	17,193,933	$1,877,935,494	$252,763,029	$14.70	13.46%
1995	$122.31	1,398	18,736,530	$2,291,733,989	$341,655,272	$18.23	14.91%
1996	$148.30	1,842	20,923,077	$3,102,880,297	$461,244,599	$22.04	14.88%
1997	$122.32	2,681	23,418,853	$2,864,483,191	$471,669,748	$20.14	16.47%
1998	$ 83.59	729	23,186,096	$1,938,110,523	$234,643,830	$10.12	12.11%
1999	$140.73	1,118	21,734,118	$3,058,659,275	$400,439,207	$18.42	13.09%

NOTES ON APPENDIX A

Provincial Governments:
Years in which the governing party and Premier of Saskatchewan changed are italicized. The period from1975 to 1982 is the NDP Premiership of Allan Blakeney. 1982-1991 is the Conservative Premiership of Grant Devine. 1991-1999 is the NDP Premiership of Roy Romanow.

Meaning of Headings:
Year = calendar year
Price of Oil = mean sale price of a cubic meter of Saskatchewan oil net of the cost of transporting it to market
New Drilling = number of oil wells completed in Saskatchewan for either exploration or development
Volume of Sales = number of cubic meters of oil sold by Saskatchewan producers (is very close to the number produced)
Value of Sales = gross dollar value of oil sold by Saskatchewan producers minus the cost of transporting it to market (equals the "Price of Oil" multiplied by the "Volume of Sales" and is very close to the gross value of sales)
Royalties = dollar value of Oil Royalties and Production Taxes collected by the Government of Saskatchewan
Effective Royalty = mean dollars collected by the Government of Saskatchewan per cubic meter of oil sold
Royalty Rate = "Royalties" as a percentage of "Value of Sales" (is the same as "Effective Royalty" as a percentage of "Price of Oil," but may be slightly different due to rounding)

Source:
All figures are from Saskatchewan Energy and Mines, *Mineral Statistics Yearbook 1999* (Regina: Government of Saskatchewan, 2001): "Price of Oil," "Volume of Sales," and "Value of Sales" are from Table 2-1-4 (pp. 73-74); "New Drilling" is from Table 5-2-1 (pp. 207-208); "Royalties" are from Table 1-1-5, pp. 11-12; "Effective Royalty" and "Royalty Rate" were calculated by the author from the previously cited figures.

APPENDIX B: CONCEPTUAL DIAGRAMS COMPARING LOW, MODERATE, AND HIGH ROYALTIES

APPENDIX C: OIL ROYALTY REVENUES FORGONE BY THE DEVINE AND ROMANOW GOVERNMENTS, 1983-1999

Calendar Year	Potential Royalties	Actual Royalties	Forgone Royalties	Fiscal Year	Actual Budget Deficit (Surplus)
1983	494	568	-	1983/84	331
1984	559	603	-	1984/85	380
1985	672	613	59	1985/86	579
1986	347	239	108	1986/87	1,232
1987	450	292	158	1987/88	542
1988	308	171	136	1988/89	324
1989	370	177	193	1989/90	378
1990	483	241	242	1990/91	363
1991	355	206	149	1991/92	846
1992	421	210	211	1992/93	592
1993	442	224	218	1993/94	294
1994	563	253	310	1994/95	(119)
1995	688	342	346	1995/96	(1)
1996	931	461	470	1996/97	(369)
1997	859	472	387	1997/98	(21)
1998	581	235	346	1998/99	(18)
1999	918	400	518	1999/00	(53)

Note: All figures, other than years, are in millions of dollars. Potential, actual, and forgone royalties have been calculated by the author in the manner explained on page 36 of this paper using the data from Appendix A. The deficit figures for fiscal years 1983/84 through 1990/91 have been taken from Biggs and Stobbe (eds.), *Devine Rule*, p. 297. The 1990/91 deficit is an estimate as opposed to an actual figure. The deficit figures for the remaining fiscal years were taken directly by the author from Saskatchewan Finance, *Budget Estimates*.

BIBLIOGRAPHY

Baron, Don and Paul Jackson. *Battleground: The Socialist Assault on Grant Devine's Canadian Dream*. Toronto: Bedford House, 1991.

Biggs, Leslie and Mark Stobbe (eds.). *Devine Rule in Saskatchewan: A Decade of Hope and Hardship*. Saskatoon: Fifth House, 1991.

Brown, Lorne, Joseph Roberts, and John Warnock. *Saskatchewan Politics: From Left to Right, '44 to '99*. Regina: Hinterland Publications, 1999.

Doern, Bruce and Glen Toner. *The Politics of Energy: The Development and Implementation of the NEP*. Toronto: Methuen Publications, 1985.

Eaton, Curtis, Diane Eaton, and Douglas Allen (eds.). *Microeconomics*, Fourth Edition. Scarborough, Ontario: Prentice Hall, 1992.

Kwon, Yul. "Neutral Taxation and Provincial Mineral Royalties: The Manitoba Metallic Minerals and the Saskatchewan Uranium Royalties," *Canadian Public Policy*, Vol. IX, No. 2 (1983): 189-199.

Leeson, Howard (ed.). *Saskatchewan Politics: Into the Twenty-First Century*. Regina: Canadian Plains Research Centre, 2001.

Mandryk, Murray. "Calvert's Kyoto Decision is Right for the Province," *the Leader-Post*, February 20, 2002, B7.

McBride, Stephen and John Shields. *Dismantling a Nation: The Transition to Corporate Rule in Canada*, Second Edition. Halifax: Fernwood, 1997.

Pitsula, James and Ken Rasmussen. *Privatizing a Province: The New Right in Saskatchewan*. Vancouver: New Star Books, 1990.

Richards, John and Larry Pratt. *Prairie Capitalism: Power and Influence in the New West*. Toronto: McClelland and Stewart, 1979.

Saskatchewan Energy and Mines. *Annual Reports*. Regina: Government of Saskatchewan, 1984-2001.

Saskatchewan Energy and Mines. *Mineral Statistics Yearbook 1999*. Regina: Government of Saskatchewan, 2001.

Saskatchewan Finance. *Budget Estimates*. Regina: Government of Saskatchewan, 1992-2001.

Saskatchewan Mineral Resources. *Annual Reports*. Regina: Government of Saskatchewan, 1978-1983.

Statistics Canada. *The Crude Oil and Natural Gas Industry*, catalogue no. 26-213-XPB. Ottawa: Government of Canada, 1994 and 2000.

Stockman, David. *The Triumph of Politics: Why the Reagan Revolution Failed*. New York: Harper & Row, 1986.

Thatcher, Colin. *Backrooms: A Story of Politics*. Saskatoon: Western Producer Prairie Books, 1985.