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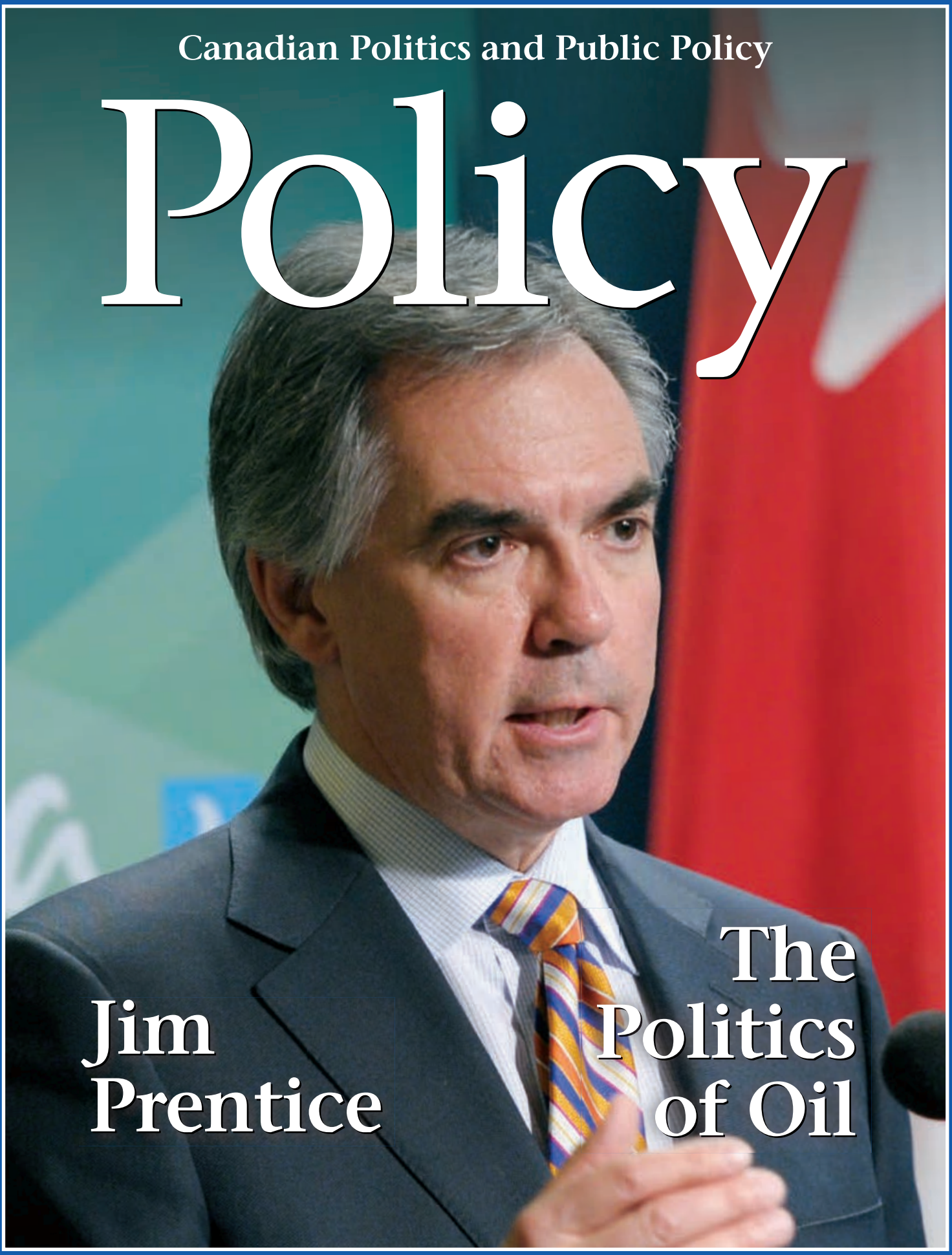

Jim Prentice

The Politics of Oil

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Policy

Canadian Politics and Public Policy

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Alberta Premier Jim Prentice: His budget is where the price of oil becomes the politics of oil. *Policy* photo

In This Issue

3 From the Editor: The Politics of Oil

COVER PACKAGE: THE POLITICS OF OIL

6 Q&A: A Conversation With Jim Prentice

12 **Jack M. Mintz**
The Prentice Pre-election Budget: A Time of Tough Decisions

15 **Robin V. Sears**
Joe Oliver, Canadian Voters and the Fiscal Ouija Board

17 **Douglas Porter and Robert Kavcic**
Oil and the Economy in Nine Charts

20 **Velma McColl and Ross Belot**
How Shifts in Global Markets Should Shape Canada's Energy Strategy

FEATURES: CANADA AND THE WORLD

22 **Anthony Wilson-Smith**
Solving the Riddle of Russia: Who Blinks First?

25 **Gil Troy**
Israel Votes: Is Bibi the Only Grown-up in the Room or the Devil Incarnate?

28 **Andrew MacDougall**
The British Election that No Party Wants to Win?

31 **Patrick Gossage**
Words and Occasions: The Power of Great Speech

34 **Mark Entwistle**
The New Cuban Reality: Where Does Canada Fit?

37 **Barry Prentice and Graham Parsons**
Freedom in Western Grain Movement: Why the Revenue Cap Needs to Go

40 **David Lindsay**
Right-Sizing Canada's Transportation System: A Critical 21ST Century Policy Challenge

Cover: Government of Alberta photo

From the Editor / L. Ian MacDonald

The Politics of Oil

Welcome to our special issue on the politics of oil. The plunging price of oil has hit everything from fiscal frameworks and budget forecasting, to the Canadian dollar and the central bank interest rate. The conversation isn't just about the price of oil, but its impact on politics and public policy, and in an election year at that.

For example, when Jim Prentice was sworn in as premier of Alberta last September, the price of oil was $93 per barrel. It's since been as low as $44 before settling in the low-$50s. Every $5 drop in the price of oil is $1 billion less for the Alberta Treasury. Suddenly, Alberta is looking at a deficit of $7 billion a year over the next three fiscal years, and a first round of program spending cuts of $2 billion a year. There may be more to come in Prentice's first budget, as he addresses both the cyclical and structural nature of the deficit. On the one hand, Alberta has the lowest taxes in the country, on the other, as Prentice tells us in a Q&A, "the highest cost of public services."

We met at his office at the Alberta Legislature in mid-February. He covered a lot of ground in a half-hour conversation, including prospects for the Keystone XL and Energy East pipelines, which face different political obstacles in the US and Canada, as well as Alberta's record on the environment and climate change.

In terms of Prentice's budget, it's pretty clear that rather than voting on it on the Legislature, he'll be taking it to voters in a spring election. "We will take some tough measures that will impact every person in this province," he says. "It would be irresponsible not to give them the final say in terms of whether they agree with that or not."

But he adds: "Alberta is a tough, resilient place. We will get through this."

Jack Mintz, head of the Policy School at University of Calgary, considers the choices and trade-offs Prentice faces in his first budget in March, one that will likely lead to a spring election in Alberta in April.

Plunging oil prices have had a similar effect on the fiscal framework in Ottawa—where every $5 drop in oil also costs the feds $1 billion in revenues. The Harper government is still determined to balance the books in fiscal 2015-16, while it also announced in the fall update $4.6 billion in new family spending. The budget update was based on $81 oil. That was only last November, but it was in another era.

Balancing the books and handing out goodies, while income is shrinking, is something you shouldn't try at home. But as Contributing Writer Robin Sears notes: "The Government of Canada is on a different fiscal planet than you are." He adds: "This government appears to be hoist on an exquisitely painful petard of its own making."

Then BMO economists Douglas Porter and Robert Kavcic take a look at oil and the economy in nine charts which graphically illustrate the importance of oil to the Canadian economy, notably the producing provinces. As they write: "Oil and gas directly accounts for 24 per cent of GDP in Alberta, 22 per cent in Newfoundland & Labrador and 15 per cent in Saskatchewan."

Velma McColl and Ross Belot write that shifts in global markets should shape a Canadian energy strategy, a work in progress from the Council of the Federation, with a plan forthcoming this summer from the provincial and territorial premiers.

Contributing Writer Anthony Wilson-Smith leads off our Features section and looks at the riddle that is Russia, and its propensity for strongmen at the helm, from the czars to the current leader, Vladimir Putin. Wilson-Smith was *Maclean's* first Moscow correspondent in the Gobachev era.

Israeli elections are never about small issues, as Gil Troy writes on the looming March 17 vote in Israel. But in some ways this one may be about Bibi Netanyahu, and whether he has overstayed his welcome. A professor of history at McGill, Troy is a leading authority on American and Israeli politics, and acclaimed author of 10 books.

In Britain, they're having an election on May 7 that as, Andrew MacDougall asks, "what if no party wanted to win?" Or at least, no party won. The possibility of a hung parliament seems quite real as the ruling Conservatives wave goodbye to their coalition partner, the LibDems, while Labour struggles with an unpopular leader, Ed Miliband. The fringe parties such as the Scottish Nationalists may be playing a larger role in a "Humpty Dumpty parliament."

Patrick Gossage considers words and occasions—the power of great speeches to influence events. He offers three case studies: John F. Kennedy, Pierre Trudeau and Brian Mulroney.

There's a new game in town in Havana, and former Canadian ambassador Mark Entwistle asks where Canada's opportunities lie in the rapprochement between Cuba and the US.

Finally, in a trading nation that relies overwhelmingly on transportation to get its commodities to market, Barry Prentice and Graham Parsons look at Canada's grain handling and transportation system, in which rail remains indispensable. And David Lindsay looks at the historical policy challenge of "right-sizing" Canada's transportation system. P

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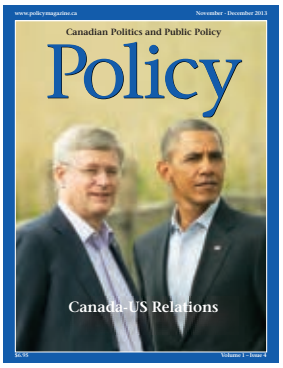

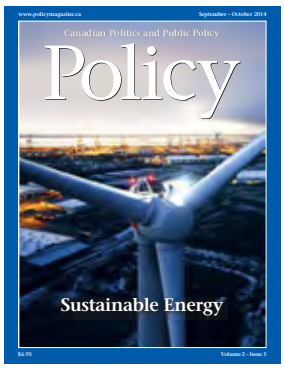

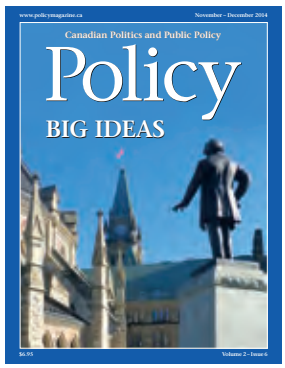

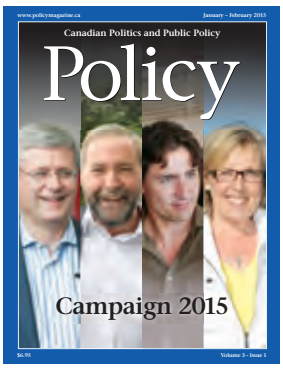

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Alberta Premier Jim Prentice in conversation with *Policy* Editor L. Ian MacDonald at the Premier's office at the Alberta Legislature on February 17. *Policy* photo, Mike Storeshaw

Q&A: A Conversation With Jim Prentice

Nowhere in Canada has the plunging price of oil impacted politics more than in Alberta. Every $5 drop in the price of oil costs the Alberta Treasury $1 billion. Alberta Premier Jim Prentice discusses the challenges of oil politics in a wide-ranging Q&A with our Editor.

Policy: On the day you announced for the PC leadership last spring, oil was $115 a barrel and the day you were sworn in as premier in September it was $93, it's been as low as $44 and is now in the low $50s. This isn't what you signed up for but it is what you've been handed. What are your thoughts on coming into this?

Premier Jim Prentice: Well, it's a challenging question.

Policy: How has this changed your agenda for government, let me put it that way?

Jim Prentice: It's had a dramatic impact on the immediate challenges we face as a government. I don't think it changes the long term imperatives of what Alberta needs to do and it will speak about some of the changes that need to take place in our province.

I think, put simply, the precipitous drop in the cost of oil has underscored the need for

some structural changes in Alberta; it's underscored the need for market access, and underscored the need for economic diversification.

In all those respects it's been reinforcing of the views I've had of the future of the province and what we need to do. It has clearly had an effect on immediate priorities, on how we've gone about the budget process and some of the challenges that we face as a government to maintain core government services in the face of a precipitous drop in our revenue stream.

Policy: Every $5 in the drop of oil is $1 billion less for the Alberta Treasury, as you know better than anyone. You're now looking at a $7 billion deficit in the next fiscal year and $21 billion over three years. Is this a cyclical deficit or a structural deficit, or perhaps a combination of both?

Jim Prentice: Let me put it this way, Alberta has been through commodity price cycles before. There have been at least six in my professional life. This one, however, is different. It results from over-supply, which has ripened into a price war and as a result the fall has been more precipitous and will be longer in duration than other commodity price cycles that we've seen. Higher oil prices will inevitably return but the advice we're receiving from all the energy and financial analysts to whom we've spoken is that high prices will not return for the next two-to-three years.

What it has disclosed is a structural imbalance in terms of Alberta's public finances. Your question is a good one. The way in which we need to deal with the circumstances that we're in is with a long-term financial plan that deals with the underlying problems in Alberta's public finances and addresses the long-term structural imbalance that we've built up.

The origin of that imbalance is pretty clear. We have had the best of everything in terms of our public services. We have had the highest cost of everything in terms of our public services, including wages and salaries. Virtually anyone who works in public service in Alberta is more highly paid than other people in Canada.

"On the one hand, we've had the highest cost of public services and on the other, we've had the lowest taxation regime of anyone in Canada, with a competitive tax advantage on virtually every tax accruing to Alberta in every single incidence of taxation."

On the one hand, we've had the highest cost of public services and on the other, we've had the lowest taxation regime of anyone in Canada, with a competitive tax advantage on virtually every tax accruing to Alberta in every single incidence of taxation.

You can only keep those two things going at once without bankrupting yourself if you have a plugged number in the budget which has been oil revenue and it's produced somewhat of a roller coaster in terms of public finances.

My sense is that the public in Alberta have reached the point where they want to see that change. So someone needs to deal with that structural imbalance.

Policy: They say every crisis presents an opportunity, is this an opportunity for tax reform? For example, Alberta has a 10 per cent flat tax, where everyone else has marginal rates. How much of the deficit would be eliminated if you went to a marginal tax rate and have you run the numbers? Or is that a good conversation?

Jim Prentice: We're having conversations about things in Alberta that were unimaginable a long time ago. I don't think that Albertans want to give up the tax advantage that we have. It's something I feel strongly about. Alberta has a tax competitive advantage over virtually every other jurisdiction in North America. Albertans understand that and they want to maintain that.

So we're trying to make some of the changes that need to be made to address this structural imbalance, but we're also pretty adamant that we want to maintain Alberta's competitive tax advantage.

We currently have no sales tax. Albertans are adamant they don't want to see a sales tax. We currently have corporate income taxes, personal income taxes, excise taxes on gasoline, sin taxes on cigarettes and tobacco, the absence of health care premiums. All of these things amount to a significant tax advantage that we intend to maintain.

Policy: Speaking of a sales tax, you allowed that to go up as a trial balloon that didn't last very long. Jack Mintz of the University of Calgary School of Public Policy has written that every 1 per cent of an HST would bring in $1 billion. Five per cent would bring in $5 billion, which would balance your books, given your $2 billion of spending cuts, including a 5 per cent pay cut to your cabinet, including yourself. That would balance the books. But that's off the table, isn't it?

"I don't think that Albertans want to give up the tax advantage that we have. It's something I feel strongly about. Alberta has a tax competitive advantage over virtually every other jurisdiction in North America. Albertans understand that and they want to maintain that."

Jim Prentice: Albertans don't want a sales tax, they've been clear about that. It's not a universal view but it's overwhelming. Last summer in the leadership race I made it very clear I don't support a sales tax.

As the price of oil bottomed out, somewhere around $45 a barrel, I said publicly we needed to have a frank discussion with people in this province about what the alternatives were. If somebody felt

a sales tax was an alternative, this was their moment to speak up.

I encouraged the debate, and I said I stood to be educated, and Albertans almost overwhelmingly said, "No, thank you". This is something that is held pretty deeply among Albertans who are not economists.

Policy: So, this dog will not hunt.

Jim Prentice: Albertans feel very strongly about this issue. I don't want this to be misinterpreted. Across the province people have been strong about the circumstances that we're in and people have said two things:

We want to see government lead; we want to see a compression on government spending. We will shoulder the responsibility, but we want to see government doing the same thing. They've also been clear they don't want to see a sales tax.

Policy: In doing your budget numbers, where do you see the price of oil and how do you see it going forward?

Jim Prentice: We have a team of people who have a pretty solid record of projecting oil prices going forward and we receive a lot of independent advice. Currently, projecting as of today for oil prices for the 2015-16 year at $61 per barrel, WTI prices, increasing to $68 in the year that follows in 2016-17 and increasing to as high as $75 the following year.

One thing I have done as I've travelled and been to Washington, New York, Houston and Toronto, I've field-tested the assumptions people are making about oil prices. They seem to be broadly accepted that those were the price levels we're looking at.

Policy: There's a pretty strong sense out there that rather than bring your budget to a vote in the Legislature, you'll put it to the people in a spring election. What's your sense about seeking your own mandate in an early election rather than waiting for 2016?

Jim Prentice: We do need an election eventually. In the legislation that we have in place, there needs to be an election by the window of March of 2016. The legislation does permit an earlier date. Clearly when that provision was put in place, no one contemplated the financial situation we're in now.

"Alberta is a tough, resilient place," says Prentice. "We will get through this." *Policy* photo

> *"I think Albertans need to have a say in that I think they need to be consulted. At the end of the day it will take some tough measures that will impact every person in this province. It would be irresponsible to not give them the final say in terms of whether they agree with that or not."*

This is the most serious revenue decline this province has seen since 1986, producing economic consequences in our province that we have not seen in a generation. I think Albertans need to have a say in that I think they need to be consulted. At the end of the day it will take some tough measures that will impact every person in this province. It would be irresponsible to not give them the final say in terms of whether they agree with that or not.

I've not chosen when an election will happen but I do think a premier and a government facing these kinds of exigent circumstances needs to have the strong support of Albertans.

Policy: If you wait till 2016, you could be campaigning in a mild recession. CIBC, your former bank, has come out with a report forecasting a 0.3 per cent downturn in GDP and unemployment peaking at 6.8 per cent.

Jim Prentice: There's a range of expert opinions. The Conference Board of Canada was the first to say Alberta would slip into a recession and now CIBC is essentially saying the same thing. It's a technical discussion in one way because what we are seeing in Alberta is a pronounced drop off in economic activity. Whether it's a technical recession or not, economists will determine, but we're seeing very serious consequences.

Policy: We've already seen a significant downturn in the oil patch with, for example, Suncor and Cenovus making significant job cuts and spending cuts.

Do you worry about a multiplier effect on the supply chain and a collateral hit on real estate markets, both residential and commercial? And is there an upside to this? Former Suncor CEO Rick George has called it a "cleansing effect" in the oil industry.

Jim Prentice: Alberta is a tough, resilient place. It's a conservative, free enterprise, hard working province and we will get through this. I actually have enormous confidence about Alberta's future. This is a price war that we're in and it will test us to be sure, it will have some significant economic consequences for us.

It will also have some positive effects in terms of the labour market in the province in that it will allow us a bit of a breather to get caught up. At the end of the day, we'll all be seeing a lower level of economic activity and lower levels of income and these are things we'll have to grapple with.

Policy: Let's talk about pipelines and start with Keystone XL. A year ago when you were at CIBC you made a notable address to the Manning Conference in Ottawa in which you said Keystone would not be approved on President Obama's watch and it was time to look past this president to a new one in January of 2017.

But in your speech to the US Chamber of Commerce in Washington on February 4, you said: "I've long been an advocate for the Keystone pipeline and for its approval by the US government. In my view this project is in the best national interest of our two countries." You called the delay "confusing for Canadians". Of course you have a different role now as premier, but where are you coming out on it?

Just on nomenclature, the president calls it the tar sands, not the oil sands, and it drives people around here crazy. He ignores the report of his own State Department in terms of direct and indirect employment numbers. They say Keystone will create 42,000 jobs, and he says only a few thousand. What's your sense of all that?

Jim Prentice: I've just come back from a very extensive trip to Washington. I believe it's in Canada's best interest and in the best national interest of the United States. The president should approve it. He says he will not; he says he will veto the bill from the Congress.

I take him at his word that he will do that and from there it continues to move through the US political system with this very complicated interplay between the president and the Congress. I think from there it continues to move through the US political system.

> *"Alberta is a tough, resilient place. It's a conservative, free enterprise, hard working province and we will get through this. I actually have enormous confidence about Alberta's future."*

> *"Five years ago I would have said the American public doesn't appreciate the importance of Alberta and Canada, but today my sense is that they do. I've seen a profound change that we should not underestimate, and a willingness to integrate the North American energy marketplace."*

Policy: It's not even about pipelines or even the oil sands anymore, is it? It's about Washington gridlock and Washington politics.

Jim Prentice: I think it turns very much on politics in Washington. It requires a lot more discussion. If there's a silver lining to what we've all been through on the Keystone debate, it's that the level of bipartisan support in Washington is the highest I've ever seen it. I would add that the respect and appreciation for Alberta and Canada is higher than I've ever seen it, and I found even when I was a federal minister that it was sometimes hard to be heard in Washington, and people in Washington did not appreciate the importance of Alberta and Canada's oil production to the United States economy. That clearly now is understood. When you go to Washington today there's no doubt that people appreciate that.

Our province of Alberta exports 2.5 million barrels of oil to the US every day, this is 50 per cent more than Saudi Arabia exports into the US market.

Alberta has become the largest supplier of US imports and so people now understand that we have more bipartisan support, the president remains opposed, so we will see how that goes.

Policy: Do you think the Americans understand how important we are to them as suppliers of energy? For example, a single pipeline company, Enbridge, transports more oil to the US than the Saudis do.

Jim Prentice: Five years ago I would have said the American public doesn't appreciate the importance of Alberta and Canada, but today my sense is that they do. I've seen a profound change that we should not underestimate, and a willingness to integrate the North American energy marketplace on both sides of the border. I'm heartened by that, I think that's a positive thing. We shouldn't underestimate how important that is in terms of the next president.

Policy: For years we've been talking about transporting oil to tidewater in terms of diversifying our markets. The US accounts for 99.4 per cent of our oil exports and 100 per cent of our natural gas. Seven years ago when you were in Mr. Harper's cabinet, he famously declared that Canada would be the next energy superpower, yet none of that new transport infrastructure has been built. What's your sense of where we're going on that?

Jim Prentice: We have to build export

infrastructure. Alberta needs pipelines in every direction. The current circumstances we're in have underscored the need to achieve tidewater access. I say that because, whether its low prices or high prices, international prices are still better prices.

We need to access tidewater, whether it's into the Atlantic Basin from Saint-John or the Pacific Basin on the West coast. That's how we'll get the highest value for our resources; we'll need to get international prices.

> *"We have to build export infrastructure. Alberta needs pipelines in every direction. The current circumstances we're in have underscored the need to achieve tidewater access. I say that because, whether its low prices or high prices, international prices are still better prices."*

I think the Keystone saga has underscored that reality for us as Canadians and certainly for us as Albertans. This government is more committed than ever to pipeline access.

Policy: What about the demand side and the business case for new pipelines, in the midst of a global oil glut? Energy East would add 1.2 million barrels a day, Keystone 830,000 barrels, Northern Gateway 550,000 barrels, the twinning of Kinder Morgan another 500,000. We're talking about 3 million barrels per day of new capacity. Do you see, in the long view, that much demand in the Asia-Pacific markets and the EU?

Jim Prentice: Yes, I do. Clearly, demand has softened over the course of the last year but I would take issue with your use of the word glut, I don't think there is a glut of supply.

The supply imbalance is actually very modest, less than 2 per cent over supplied, but it's produced a 60 per cent price drop. The world market is 93 million barrels a day and it will find itself back in balance. The drop in prices is having the exact effect that people predicted. People are taking production off. It will be back in balance sometime in the next 18 months. At that point, prices will continue to rise again. Alberta in the meantime will continue to produce more oil.

We enter this year producing just over 3 million barrels of oil a day, and we'll exit the year producing closer to 3.5 million barrels of oil a day, notwithstanding low prices.

Policy: What about Energy East as a nation building project across six provinces from Alberta to New Brunswick? The conversations you've had with Premier Wynne and Premier Couillard, and all the other issues of First Nations participation and social licence. I sometimes wonder if the CPR would have been built in this kind of a conversation.

Jim Prentice: The CPR was for sure built in a simpler era… These are all the challenges that linear infrastructure projects face and we're not the only ones that face them, it's the same in the United States. I went down to both Quebec City and Toronto and met with Premier Couillard and Premier Wynne and had a frank discussion about the Energy East project. They both stood their ground in front of media in their respective capitals. They indicated that they were not trying to regulate upstream oil and gas activity in Alberta and that's Alberta's responsibility. When they spoke about carbon emissions, they were concerned about the pipeline.

I think there's a way for us to have a constructive relationship and Premier Couillard and I spent a lot of time together, and I think we can work together as partners in terms of climate change issues. I'm looking forward in April in going to the conference that he's hosting. I've also committed to going to the conference that Premier Wynne will have.

As you know, we are in the process of renewing and revitalizing Alberta's environment and climate change policies. Our intent is to be a constructive partner. One of the principles that will be founded on is to be a constructive partner nationally and internationally in terms of climate change.

Policy: What about Alberta's leadership role in the federation? And what about the prospect of a Canadian energy strategy coming out of the Council of the Federation later this year?

> *"There's a way for us to have a constructive relationship and Premier Couillard and I spent a lot of time together, and I think we can work together as partners in terms of climate change issues."*

Jim Prentice: We'll see where that goes... I've never been an outspoken advocate for a national energy policy. Alberta does a fine job of regulating its own oil and gas industry and I think we have climate change policy in particular that we've never received much credit for which we are, in many ways, best in class.

We can discuss that, nationwide we need to work together and the Energy East pipeline is an illustration of that. It's a pipeline project that will drive prosperity across the country. The real jobs created will come from a facility such as the refinery and port in Atlantic Canada and in Ontario where many of the components will be fabricated, so the benefits are shared across the country.

Policy: Two questions on the environment, one is on Alberta's record and perhaps you don't receive enough credit, and Alberta needs to do a better job of telling its story, as you said in Washington early in February.

The story of averted emissions, $500 million in the clean tech fund, the tax on large emitters, the Canadian Oil Sands Innovation Alliance and shared R&D across the oil sands, more than $1 billion committed to carbon capture and storage.

Jim Prentice: An illustration of that is when I was in Washington and one of

the people I met said, "The president of the United States is now talking about the importance of policy changes for the venting and flaring of methane. Is Canada going to be able to keep pace?"

I said, "For heaven sakes the World Bank based its global initiative around best practices on venting and flaring and methane on Alberta's regime". We have among the very tightest regimes in the world in that area and are regarded as best in class, but again, no one appreciated just how far-sighted some of the environmental policies we've had are.

Policy: Let me ask you one overarching question on climate change. You were the Environment minister at Copenhagen in 2009 and as you've said, you have the scars to show for it. President Obama and China have agreed on asymmetrical goals on GHG emissions by 2030. The Americans would reduce their emissions by 26-28 per cent below 2005 levels and the Chinese would have a free ride until 2030 and then they would start to reduce them. It's an interesting concept of partnership. How achievable is that when it's not clear we're going to make our Copenhagen targets of 17 per cent below 2005 levels by 2020?

Jim Prentice: You're speaking of our targets, the Chinese targets or American targets?

Policy: Mr. Obama's target, is this going to be the conversation in Paris?

Jim Prentice: The conversation in Paris will focus on common but differentiated responsibilities, which is to say that everyone needs to do their share. But everyone has a different economy; even Canada and the United States have very different economies. The US will have an easier time making their Copenhagen target because they have more low hanging fruit in terms of areas where they can reduce their emissions. In our case as Canadians, a lot of our capital infrastructure is much newer, so it becomes harder to achieve that same target. And China is vastly different yet again, and so the policy framework in any international treaty has to respect that different economies have different assets, and different opportunities, and different challenges.

It's certainly true of Alberta, which has an emission profile that's certainly different than other provinces in Canada and certainly different than the United States. Having said that, we are making very significant intensity reductions in terms of the energy industry and we're doing things that no one else in the world has done, such as phasing out our coal burning plants, and investments in CCS.

Policy: Final question, you've bought yourself this 1956 white Thunderbird convertible. Was this something on your bucket list?

Jim Prentice: Probably like most guys from Alberta I love cars, I've always loved cars.

Policy: Cars and hockey, you said.

Jim Prentice: Cars and hockey. I had been looking for a T-Bird for about 10 years, I enjoy going to the Barrett-Jackson auction in Arizona. It was a bit of a family event in that I was there with my son-in-law and we were specifically looking for a T-Bird. I didn't go there saying I must buy one, but exactly what I had been looking for came up, so I bought it. P

The Calgary-based oil patch has been through boom and bust cycles before, with significant impacts on Alberta's fiscal frameworks. *Policy* archives photo

The Prentice Pre-election Budget: A Time of Tough Decisions

Jack M. Mintz

As Alberta Premier Jim Prentice points out in this issue of Policy, Alberta has weathered the cycle of boom-and-bust before. But Prentice is, undeniably, facing some difficult fiscal trade-offs as he also lays the political groundwork for an election. Respected economist Jack Mintz, who has played a more official advisory role on fiscal matters in the past, provides a blueprint for how Prentice can navigate the unexpected economic landscape of $50-a-barrel oil.

In late March, the Prentice government will present its first and critical budget, providing an economic manifesto for the next Alberta election. With a 50 per cent decline in oil prices and a potentially $7 billion deficit, the Alberta government will introduce stark measures including revenue increases, spending cuts and debt financing, none of which is popular. This is, however, the price of governing, as some tough decisions must be made.

Albertans are preparing for a fundamental debate about fiscal planning, culminating in an election that is expected to follow after the budget presentation.

Prentice has been clear that Albertans have expected high quality public services and low taxes. To plug the gap between spending and tax revenues, the province has relied on volatile oil and gas natural resource revenues, resulting in booming surpluses or busting deficits.

Spending has been pro-cyclical, aggravating the macro conditions affecting the province. During downturns, the province cuts spending to make up shortfalls. In the good times, spending ramps up in part to make up for earlier tight budgets.

Politicians afraid to cut spending affecting current voters will let deficits ride for a long time hoping that high oil prices will eventually return, putting Alberta in the black. This happened in the Getty years after 1985, as oil prices collapsed, resulting in the highest deficit and debt per capita in the nation by 1993. Ralph Klein cleaned up the books with major spending cuts to eliminate the deficit by 1995, retiring the debt by 2005.

However, once debt was eliminated, the province no longer had a fiscal anchor for planning purposes. Spending ramped up from $7,400 per capita in 2004-05 to $11,000 per capita by 2013-14, the highest per capita level in Canada except for two small provinces, Saskatchewan ($12,000) and Newfoundland & Labrador ($13,300). Alberta was in surplus despite its spending spree, but putting little into saving accounts.

With the collapse in oil prices in late 2008, it was "déjà vu all over again". The Stelmach government, faced with a yawning deficit, did not cut spending much, instead running down net financial assets from $27 billion in 2009 to $9.7 billion by the end of 2013. Even though Saudi Arabia supported the return of oil prices to $90-$100 per barrel after 2010, the Stelmach and succeeding Redford governments failed to stop financial bleeding.

This roller-coaster approach to fiscal planning could have been avoided if the province had built up a substantial endowment over the years, which would provide stable financing with stable distributions from the fund. Peter Lougheed started the trend with the Alberta Heritage Fund and several other funds for long-term investment. Ralph Klein did not put much money into saving funds but in retiring the provincial debt he did pay off the mortgage, which is just as good as saving. Between 1994 and 2007, 30 per cent of natural resource revenues were devoted to saving or debt reduction.

> *"Prentice has been clear that Albertans have expected high quality public services and low taxes. To plug the gap between spending and tax revenues, the province has relied on volatile oil and gas natural resource revenues, resulting in booming surpluses or busting deficits."*

Various financial planning commissions were appointed over the years, recommending the same message of fiscal discipline and a commitment towards saving. I chaired a fiscal commission in 2007 that argued the same principles. We suggested the province should put aside a portion of revenues into a saving account before deciding on spending and taxes, which could accumulate to $100 billion by 2030. With a four per cent distribution rule, the province would have $4 billion per year to close the gap between revenues and taxes on a stable footing.

That proposal, made at the height of the boom, was overcome by the 2008 financial crisis. However, the Redford government did make a commitment to savings by dedicating a portion of revenues to a saving account, a little-appreciated but important change in fiscal planning. The Prentice government has so far indicated it would retreat to an earlier approach of saving a portion of the surplus after making spending and tax decisions. However, surpluses disappear if spending ramps up or taxes are reduced. This is not a commitment to saving.

Perhaps Albertans don't wish to leave a Norwegian-style fund in the hands of politicians. Some concern has been raised that the fund would be a target for the federal government to raid but defensive arguments can be easily made.

Canada would gain from less pro-cyclical macro-economic planning in Alberta so that booms are not accompanied by spending spurts and busts aggravated by spending cuts. Alberta also faces significant health and pension unfunded liabilities associated with an aging population as well as natural resource revenues failing to keep up with a growing economy. Other resource-rich provinces should also establish similar funds, a trend set by Alberta.

> *"Canada would gain from less pro-cyclical macro-economic planning in Alberta so that booms are not accompanied by spending spurts and busts aggravated by spending cuts."*

Whether the Prentice government will deal successfully with long-term financial planning in the upcoming budget is unclear. With a massive deficit that will continue for several years to come, Alberta has a big short-run problem. Prentice has already signaled a balanced approach with $2 billion in revenue increases, $2 billion in spending cuts and the balance in debt financing, perhaps staged over three years.

However, good planning should consider not just the short-run but

putting in policies that could have beneficial long-run consequences. Spending should emphasize investments in physical and human capital. Tax reform should put more emphasis on taxes less harmful to the economy.

Alberta's health system, accounting for two-fifths of program expenditures, has provided mediocre performance at relatively high cost. Similar to Ontario, Alberta could push for measures that would create more competition in the public-funded system, such as developing further primary care and clinics offering specialized services. The province could reform its purchasing of services by adopting a better auctioning approach to make contracting-out prices more competitive.

> *"Studies have shown that compensation levels, somewhat above the rest of Canada about a decade ago, are now well above public sector salaries in other provinces today. Certainly, one can expect Alberta to reduce labour costs that ultimately account for over half the budget."*

Similarly, education reforms are possible. Alberta's average undergraduate tuition fees for full time students ($5,730 in 2014-15) are one of the lowest in Canada compared to Ontario ($7,539). When students cover a bigger portion of education costs, students demand better teaching. Education efficiencies can be achieved by better use of school buildings over a year.

The largest spending faced by Alberta is employee compensation, including academic, school and health sectors. Although some argument can be made that salaries are generally high in Alberta as in the private sector, Alberta competes in the Canadian market for public servants, doctors and teachers. Studies have shown that compensation levels, somewhat above the rest of Canada about a decade ago, are now well above public sector salaries in other provinces today. Certainly, one can expect Alberta to reduce labour costs that ultimately account for over half the budget.

Meanwhile, infrastructure spending is critical for long-term growth but greater reliance on user fees should be made to improve efficiencies, whether at the provincial or municipal levels. Major highway expansions, including ring roads and the Fort McMurray-Edmonton highway, should be financed by tolls to price congestion as well as achieve a better distribution of the population in an urban area.

And then there are taxes. The province should not just increase revenues but keep in mind long-term growth prospects. With the "flat" tax of 10 percent on personal incomes above $17,500, Alberta has been able to attract skilled labour, making it less necessary to offer high compensation for private or public workers. The corporate income tax at 10 per cent puts Alberta in the middle of the pack of OECD countries in terms of competitiveness even though it is the lowest in Canada. Yet, a greater tax advantage that could help diversify the economy can be realized by relying less excessively on income taxes.

Certainly, some room exists to raise existing consumption taxes on tobacco, cigarettes and fuel. A re-instated health premium related to the cost of Medicare and providing for better registration control could be considered. Other user fees related to infrastructure, as mentioned above, would be appropriate from a long-run perspective. Unfortunately, these levies hit low-income Albertans the hardest—the province could use some of the new revenue to provide a refundable low-income tax credit to help the poor.

> *"An Alberta sales tax of two per cent harmonized with the federal GST would raise $2 billion dollars at very little administrative or compliance cost, since it is just changing the rate of an existing tax."*

Premier Prentice has already ruled out a general sales tax in Alberta, which is perhaps a pity. Compared to other tax hikes, even the health premium, this is by far the best option in the long run. An Alberta sales tax of two per cent harmonized with the federal GST would raise $2 billion dollars at very little administrative or compliance cost, since it is just changing the rate of an existing tax. Almost 10 per cent of the revenues would be collected from visitors and non-resident workers. Alberta could also make a case for one-time federal transition payment that could be as much as $1.2 billion. With a higher rate, Prentice could lower personal taxes by expanding the exemption as well as introduce a refundable low-income tax credit.

Albertans are strongly opposed to a sales tax. However, as recent polls have shown, a personal tax increase or new Alberta health premium receive less than 20 per cent support, not much more favourable than a sales tax. Perhaps this reflects that Albertans are generally against any tax increase and believe that spending cuts are the best way to achieve a balanced budget.

Whatever happens, this blockbuster budget could put the province on a new path for long-term growth with a better fiscal plan. Let's see what the political process will produce. P

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Joe Oliver, Canadian Voters and the Fiscal Ouija Board

Robin V. Sears

Prime Minister Harper and Finance Minister Joe Oliver at the G20 Summit in Australia last November. At the time, the government's fall fiscal forecast was based on $81 oil.
PMO photo, Jason Ransom

National budgets are almost always entirely political, not fiscal, documents. That is especially true of budgets delivered before an election. As veteran political strategist and policy sage Robin Sears writes, the upcoming Harper-Oliver budget—delivered under the fudge-inducing duress of an oil-price crash that followed some pricey marquee election promises—will be especially so. And somewhere, Allan Blakeney will be chuckling.

American sage Yogi Berra offered powerful truths about many things in life, including, "It's tough to make predictions, especially about the future." An exception is national budgets. Today, they are entirely predictable.

They deliver whatever the government that confects them decides they need to deliver. Budgets in developed democracies today have an increasingly tenuous connection to the health of the public "fisc", or its ailments. They are almost entirely political, not economic, documents, and, with the present Conservative government, made up more of pictures and slogans than numbers, fictitious or real.

There may have been a time before politicians and their officials learned how to do expensive digital tricks with numbers, when budgets actually reflected national economies' harsh realities. The claim of finance ministers the world over that they resembled household budgets was always a stretch. It's simply insulting nonsense today.

Two overwhelming factors drag budgets closer to aspirational fiction than fiscal reality. First is the speed with which market realities can shift with little warning, as the Tories have seen twice on their watch. In 2008, Prime Minister Stephen Harper was soon humiliated by his election campaign statement, just days before an election, that the market collapse in what became the Great Recession was a "buying opportunity". Only six months ago, our government was happily coasting toward an election supported by vote-buying goodies, funded by $100 oil. Even after oil prices collapsed in the fall, Ottawa was still projecting a $1.9 billion surplus in the November fall update, and $4.6 billion in new family spending in 2015-16 alone, based on $81 oil.

The second reality is that national budgets are infinitely more elastic than yours. Imagine that you have just had a five per cent increase in your rent or mortgage, or a five per cent pay cut. You could buy cheaper wine and drink less of it. You could leave the car at home and take the bus or subway. But most Canadians would struggle to cut their expenditures by that amount overnight.

The Government of Canada is on a different fiscal planet than you are. It can run up $160 billion in new debt, as it did to stimulate the economy from 2008-14. Don't try that at home.

You could try to tell your car leasing company you'll pay them next month, or Loblaws that you'll let them know when they can expect money for this month's groceries, or your bank that you're cutting the interest rate on your credit card by 10 per cent this month—but I wouldn't recommend it.

Governments do it to their employees, creditors, and fiscal partners all the time.

So a slide of $10 billion in revenue, what may well be the gap between what Joe Oliver thought he had to spend in November and the actual cash in Ottawa's till come April, can be disappeared by Finance department boffins with a few keystrokes.

This government appears to be hoist on an exquisitely painful petard of its own making. In late October, 10 days before the fall update, it announced cheques to millions of Canadian families—income splitting of up to $2,000 for couples on their tax returns, and an increase in the Universal Child Care Benefit from $100 to $160 per month, with the first seven months enhanced benefits of $420 arriving all at once in July, just weeks before the writ drops for the October election. It could do so because of the prevailing narrative of balancing the books and achieving a surplus in fiscal 2015-16.

In those halcyon days, only six months ago, the big policy debate among the parties in Ottawa was how to spend the surplus. That was another era.

How governments almost always get away with bribing voters with their own money in an election year is one of the eternal wonders of democracy. I digress.

The problem for the Harper Conservatives was that the crash in oil prices and the impact on Canada's GDP and tax base mean that money is flowing into government coffers at a much slower rate than planned. For every $5 drop in the price of oil, Ottawa is out $1 billion. And oil has plummeted about $50 since last summer, leaving Ottawa $10 billion short.

If this were you or I, we'd have already explained to our indulged children that the promised summer camp was not going to happen this year. Oh, and with the loonie plunging to 80 cents, the family vacation would be in PEI this summer rather than Maine.

> *"For every $5 drop in the price of oil, Ottawa is out $1 billion. And oil has plummeted about $50 since last summer, leaving Ottawa $10 billion short."*

The government faces no such pain—at least not immediately. It merely gives its fiscal Ouija board a shake and, just like that, the books are "balanced." In a pinch, the Harper government can use the $3 billion contingency reserve, intended for natural disasters, to avoid the political disaster of breaking its promise to balance the books. Now this type of political shell game with the public fisc is not an infinite or a permanent solution—as governments from Argentina to Ontario have discovered to their cost. Debts are not forever delayed, payments cannot be deferred for long.

The Harper government has become especially adroit at fudging, concealing or delaying the announcement of both revenues and expenditures, to give it the greatest possible flexibility to nudge the bottom line in one direction or another. Mysteriously, in late January, the government was forced to concede that its "fee income"—not to be confused with taxes, you understand—had generated an additional $3.4 billion. This came as a result of Liberal finance critic Ralph Goodale's clever hunch that there was more gold in the dramatic hikes to passports, national park permits and dozens of other government user fees than had been reported. He was right.

Veterans complained loudly when it was revealed last year that more than $800 million of budgeted assistance had not been spent. In his final humiliation before his demotion, Veterans Affairs Minister Julian Fantino attempted to claim there was no reason to be concerned, that it was simply money that was somewhat late in being spent. The governmental equivalent of "the cheque's in the mail," one supposes.

Oliver and his boss can fiddle the numbers in the 2015 budget without anyone being able to scream blue murder. But if the price of oil stays in the ditch, and the Canadian economy slides back into recession over this coming winter, either he or his successor will face a much more painful number crunching challenge a year from now.

Allan Blakeney, one of the greats among Canadian premiers, had a rule of thumb that he suggested every smart government should follow. Blakeney had been raised in the rigorous school of fiscal management that was and is the Saskatchewan Department of Finance.

This was the small group of men and women created in the near-bankruptcy inherited by Tommy Douglas when he took office during the Second World War, following a depression-era that left the province's finances in dire straits. They had to struggle hard to clean up the mess and never forgot the painful lessons. They were passed to legendary mandarins Tommy Shoyama, Al Johnson, Wayne Wouters and many other Saskatchewan exports to the federal civil service.

Blakeney used to say that every incoming government, in its first budget, had to do serious financial housekeeping, cutting expenditures and trimming revenue claims to reflect reality. Why? Because, as he would drolly observe to young staffers, every government's final pre-election budget is full of nonsense.

Oliver's speech laying out his budget claims will be this government's last, as well. Blakeney will be watching from above, no doubt listening to the tall tales with his dry chuckle. P

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Oil and the Economy in Nine Charts

Douglas Porter and Robert Kavcic

As Finance Minister Joe Oliver discovered while trying to formulate his first budget at the confluence of early election spending and an unforeseen oil crash, economics and politics don't always reconcile. To the extent that economic factors can be foreseen, BMO's Douglas Porter and Robert Kavcic are among the nation's leading forecasters. Here's their latest read on the impact of oil on the economy; invaluable intelligence in an election year.

The Canadian economy's reliance on oil was certainly no secret before November, 2014. But the OPEC meeting in Vienna at which the organization declined to cut its output, sending oil prices crashing, exposed in brutal short order the degree to which the national economy as well as those of oil producing provinces—Alberta's in particular—are vulnerable to market fluctuations. Amid the uncertainty, there are facts we can marshal, along with some well-informed assumptions.

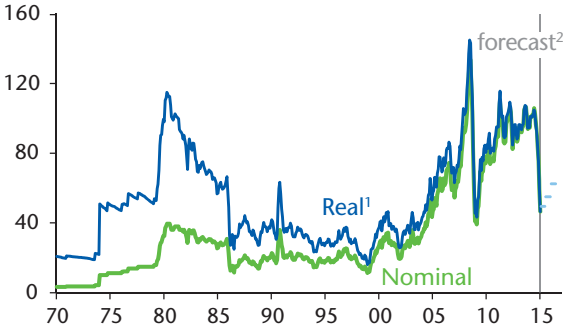
- The plunge in oil prices of more than 55 per cent in just over six months is the third deepest correction in such a short period of time in the past 45 years.
- Our economic forecast now assumes that prices will remain on the defensive through the first half of this year and average just $52 (WTI) in 2015. While we see a partial rebound next year, our working assumption has been trimmed to $65 for 2016.
- These levels compare with an average price of $57 over the past 40 years, measured in today's dollars.

Chart 1: Crude Prices Collapse

(US$/bbl)

Crude Oil – WTI

40-year average price in today's dollars: US$57



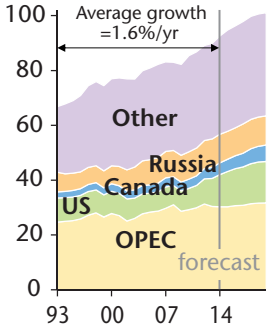
[1] January 2015 US$ [2] [nominal] half-year averages

- While a variety of factors have conspired to undercut prices, including a roaring US dollar, the dominant factor has been on the supply side.
- Global supply rose by 2.0 per cent last year, above the long-run average growth rate of 1.6 percent.
- Notable gains have come from the US (again the world's largest producer), Canada (now the fourth largest) and Iraq (reaching record levels of 4 million bpd by December).
- Fully 8 of the top 10 producers are now reporting output well above their own 20-year trend. Only Iran and Mexico have seen production declines.

Chart 2: Global Oil Production: Gathering Speed

Crude Oil (mmbpd)

Supply



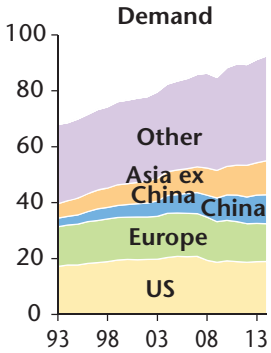
Top Producers	2014	1993-2013 Average
US	11.7	8.1
Russia	10.4	8.2
Saudi Arabia	9.7	7.8
Canada	**4.3**	**3.0**
China	4.1	3.5
Iraq	3.3	1.8
Iran	2.8	3.3
UAE	2.8	2.1
Kuwait	2.8	2.1
Mexico	2.8	3.3
Global 2014	**93.2**	**+2.0%**

[1]Includes products Source: International Energy Agency

- Softer-than-expected global growth has also played a role in oil's weakness. Even with global GDP growth of just over 3 per cent in 2014 (similar to what is expected in 2015), oil demand only rose 0.8 per cent.
- That divergence between 2 per cent supply growth and 0.8 per cent demand growth swung the overall oil market from a balanced (or even tight) market a year ago, to an over-supplied market of more than 1 per cent (i.e., more than 1 million BPD).
- What caught the market completely off-guard, and thus the steep plunge in prices, was the fact that OPEC (i.e., Saudi Arabia) refused to step in to balance the market. Recall that prices were still around $75 prior to the late-November OPEC meeting.

Chart 3:
Global Oil Demand: Losing Momentum

Crude Oil (mmbpd)



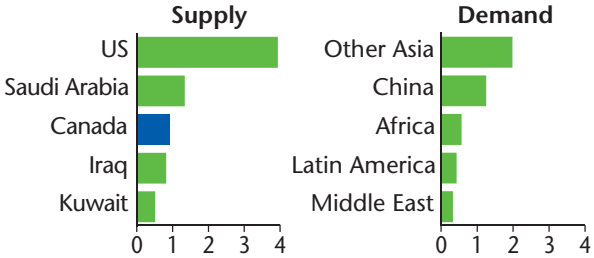
Top Consumer	2014	1993-2013 Average
US	19.0	19.2
Europe	13.5	14.9
Other Asia	12.2	8.3
China	10.3	6.1
Middle East	8.1	5.8
Latin America	6.8	5.2
Russia[1]	4.8	4.1
Africa	4.0	2.8
Global 2014	**92.5**	**+0.8%**

[1]Former Soviet Union Source: International Energy Agency

- Zeroing in on just the past four years reveals the crux of the issue for the oil market, and the mismatch between supply and demand.
- US production has seen an amazing turnaround, with output surging nearly 4 million bpd, taking it back to levels not seen since the early 1970s and reversing more than three decades of declining production.
- Meantime, Canada has been quietly churning out solid gains as well, which in fact have been underway since the early 1980s.
- On the flip side, demand growth remains muted and confined to the emerging markets. Note that oil consumption is now lower in the industrial world than it was 20 years ago.

Chart 4:
What Has Changed?

Crude Oil (2010-14 chng: mmbpd)



Source: International Energy Agency

- The net effect on the global economy of the deep dive in oil prices is still a matter of debate. While we would agree that it is, on balance, a positive for global growth, the benefits may be a bit more tempered this cycle because: 1) most major central banks don't have room to cut interest rates meaningfully (which normally provides the positive second-round effects); and, 2) a number of oil producers will face immediate strains.
- The most obvious strain will be on Russia, which is facing a very serious recession in 2015.
- On the flip side, almost all of the industrialized world will benefit from the oil price slide, especially the big importers in Japan, India and China. Canada and Norway are the outliers on this front.

Chart 5:
Winners and Losers of Low Oil?

Net Trade in Oil & Products – 2014 est. (% of GDP)

Winners: Net Importers		Losers: Net Exporters	
Turkey	6.2	Saudi Arabia	42.9
Japan	5.1	Venezuela	36.4
India	5.1	Russia	13.5
Eurozone	3.0	Iran	13.1
China	2.8	Norway	9.8
United States	1.2	**Canada**	**3.5**
United Kingdom	0.6	Mexico	1.0

- The decline in oil prices is a net negative for the Canadian economy, likely cutting 0.5 per cent from real GDP growth in 2015.
- Oil & gas extraction directly accounts for just over 6 per cent of GDP, and roughly 2 per cent of total employment. But, the true footprint is larger after accounting for support activities and spinoffs to other related sectors (manufacturing, transportation, etc.)
- Capital spending in the oil patch will feel the most direct hit, with many 2015 budgets slashed by 20 per cent-to-30 per cent. This accounts for a third of all private non-housing related capex.
- Lower oil prices mean lower incomes and corporate profits, which will cut Ottawa's tax revenues by about $5 billion.

Chart 6:
Oil Industry – How Big?

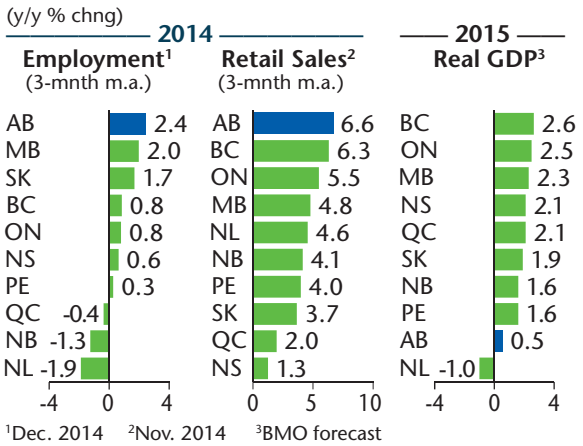
Share of Total – 2014 estimates (percent)

Oil & Gas Extraction	GDP	Employment[1]	Capital Spending[2]	Est. Net GDP Impact[3]
Canada	6.2	2.2	34	-0.5
Alberta	24	7.4	64	-3.0
Saskatchewan	15	5.0	30	-1.0
Nfld. & Labrador	22	7.1	23	-2.0
United States	1.7	0.7	8	+0.5

[1]Natural resources sector [2]Private non-res. business investment
[3]Impact over the next year

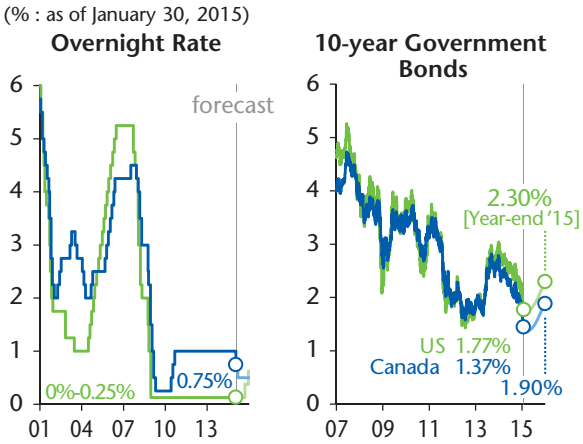
- The most dramatic impact may well be the reshaping of the regional economic growth landscape.
- Oil & gas directly accounts for 24 per cent of GDP in Alberta, 22 per cent in Newfoundland & Labrador and 15 per cent in Saskatchewan.
- Growth in Alberta is expected to stall (0.5 per cent in 2015) after a strong outperformance in recent years. Interprovincial migration flows to the province are likely to be cut by about two thirds from recent levels, while Calgary's housing market is already in the grips of a correction.
- The fiscal impact in these provinces is likely in the $8 billion range.
- Most other provinces benefit from lower oil prices and the associated weakness in the Canadian dollar. Ontario GDP growth should top the national average for only the second time in 13 years.

Chart 7:
Regional Outlook: The Changing of the Guard



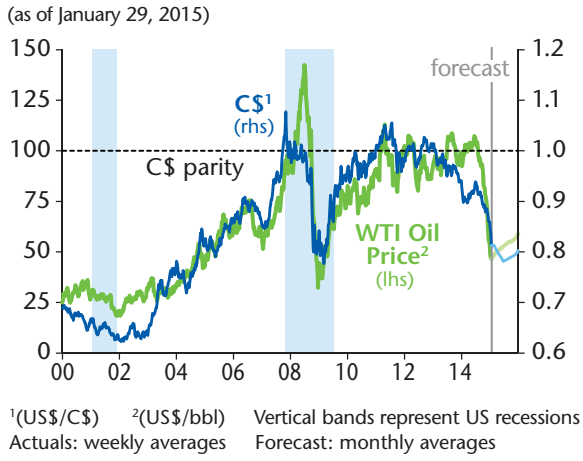
- After cutting interest rates 25 basis points to a Bank rate of 0.75 per cent, Governor Stephen Poloz said that, "The drop in oil prices is unambiguously negative for the Canadian economy".
- The cut was sold as an "insurance" move, should the expected offsetting positives (consumer spending, exports, business confidence) take longer to develop, or develop with less vigour.
- The Bank assumed $60 oil in the accompanying outlook, but sub-$50 oil could trim another quarter point from growth in the first half of 2015, further delaying the closing of the output gap, which is now pegged at the end of 2016.
- Barring a quick rebound in oil prices or clear evidence that strong US demand is lifting other sectors of the Canadian economy, another rate cut is possible in March. The last one was a surprise. Another one wouldn't be.

Chart 8:
Bank of Canada: Another Rate Cut Possible



- The loonie is arguably the biggest loser from the slide in oil prices, now moving above the $1.27/USD (79 US cents) mark for the first time since the financial crisis.
- A $10 move in oil prices typically swings the loonie by about 3-5 cents.
- Barring a sudden rebound in oil, we look for the currency to weaken further to around $1.30/USD (77 US cents) by mid-year.
- Diverging monetary policy prospects for the Bank of Canada (easing) and Federal Reserve (preparing to tighten) will also apply pressure. P

Chart 9:
Oil's Impact on the Loonie



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How Shifts in Global Markets Should Shape Canada's Energy Strategy

Velma McColl and Ross Belot

A robust Canadian energy strategy will look to the future and capitalize on our diverse energy assets, clean technologies and services in a dynamic North American and global marketplace. As provincial and territorial premiers prepare to announce a pan-Canadian energy strategy later this year, it is worth examining a few global trends affecting our options. McColl and Belot focus on crude oil, examining how global trade flows suggest we need more than pipelines and infrastructure to maximize returns from our raw resources.

In Canada, the public debate on energy has been largely reduced to pipeline infrastructure and "getting fossil fuels to tidewater." The fate of the Keystone, Northern Gateway, Energy East, Kinder Morgan and a growing list of other pipelines are regularly front page news. As provincial and territorial premiers define a Canadian energy strategy this year, they need to consider how to create a balanced approach for the country, taking into account a far broader range of issues as well as diverse geographies, energy resources and aspirations. They must also be alert to changes in the global energy landscape and mindful about where Canada fits.

While there have always been suspicions that the Canadian energy strategy was simply a way for Alberta to advance a fossil fuel export agenda, the premiers have been working for the last three years to create a framework that includes not only access to markets but also energy innovation, renewables, clean technology, energy efficiency, labour needs and a broader set of export opportunities.

Ontario and Quebec have joined Manitoba in pushing to include climate change rules and initiatives to lower Canada's carbon footprint. While Western premiers may quibble on the details of carbon policy, they also understand that Canada's energy brand has been damaged by international perceptions that we are a climate change laggard. Increasingly, all parties understand that Canada's ability to sell energy into a global market requires serious environmental policies.

> **"At risk is whether we will achieve our potential as an energy superpower or, as it relates to petroleum, become an energy colony whose energy assets are largely isolated in a changing global market."**

There are many energy and climate change milestones in 2015—not to mention a federal election—and policy makers need to lift their eyes and look at global trends while developing our responses. This article looks narrowly at factors affecting fossil fuels, particularly as the country feels the pinch of low oil prices and benefit from the rise of Asian demand for energy in all its forms. At risk is whether we will achieve our potential as an energy superpower or, as it relates to petroleum, become an energy colony whose energy assets are largely isolated in a changing global market.

The National Energy Board (NEB) projects that, by 2035, hydrocarbons will continue to be a dominant form of energy powering Canadian life. Over the next 20 years, we will see dramatic growth in renewables and more distributed electricity systems. We will be developing highly energy efficient homes and offices, and our transportation systems will see more and more electric and alternative fuel vehicles. But these shifts will not eliminate fossil fuels.

Whether we want to admit it or not, today Canadians consume 1.5 million barrels of oil per day (MBD) and 7.5 billion cubic feet (BCF) per day of natural gas. Alberta and Saskatchewan are Canada's petroleum powerhouses, with BC seeking to take advantage of shale discoveries and become a global player in liquefied natural gas (LNG). Atlantic Canada and possibly the Arctic also have a stake, through offshore resources. Our most populous provinces, Ontario and Quebec, are consumers of Canadian and imported crude and also import refined products.

Canada needs to find a way to get its own petroleum resources out of the country. Existing pipelines and rail fit the bill for now but more infrastructure is needed over the next 20 to 30 years. Some in the environmental community are calling for Canada's fossil fuels to remain in the ground, and it's true that

some of it may not be produced for economic reasons. However, we must also be realistic that reducing our production unilaterally would not affect global trade flows for crude. Other countries can supply what we would not. It is imperative that leaders in business, government and First Nations communities broker ways to build infrastructure acceptable to Canadians.

Petroleum is traded around the globe and it flows in four primary streams—crude oil and the three major products of refining: gasoline, diesel and heavy products including fuel oil, asphalt and petroleum coke. These liquid products move in an efficient network of pipelines, rail, barges, vehicles and tankers that travel—mostly in only one direction—from source to distribution points all over the world. It happens so seamlessly that most of us don't even know or think about how our fuel arrives. However, where these products move counter flow to crude, opportunities develop for refining interests to gain competitive advantage and in-crease margins. This is significant for Canada because the majority of the crude oil we produce now is exported as raw material while at the same time, we import re-fined products for domestic use at premium prices.

The United States, Russia and Saudi Arabia are all vying for the title of largest crude oil producer in the world, with each producing nine to 10 MBD. China is fourth at four MBD. Canada is fifth. The other part of the equation is who is refining the product. The US is the largest refiner in the world at 18 MBD of crude oil, followed by China at 13 MBD, then Russia at six MBD and Saudi Arabia, at roughly three MBD, is seventh.

Each of these countries has implemented national policies to position themselves for future oil production, infrastructure and markets. Interestingly, each is heavily investing in refining infrastructure with the full knowledge that the world is currently long on refining capacity but they are prepared to take the risk and compete as long term, low cost suppliers. Part of the calculation is that, even in a highly competitive market, there will be increased margins, tax revenue and job creation that will benefit their domestic economies.

That's the global backdrop. Here in North America, the variations in trade flows for crude oil have also been significant over the last 10 years. First, there is the US shale oil revolution, which accounts for the majority of the increase in US production from nine MBD of crude oil in late 2014, up from just over five MBD in 2004. Though the US has nearly doubled production and decreased imports by 30 per cent, the US still imported seven MBD of crude oil in 2014, more than 40 per cent from Canada. The biggest change is that the US now imports very little European or West African crude, significant suppliers just 10 years ago. Canada is exporting roughly the same volumes today but the US will become increasingly energy self-sufficient and likely decrease imports further.

> ***"So how have these external factors affected Canada? We now have a vulnerable Eastern Canada refining sector with limited access to Canadian crude by pipeline. And there remains a need for large volumes of refined product to be imported into Ontario and Quebec."***

In 2011, the US became a net exporter of refined petroleum products for the first time since 1949, with a surplus that grew to two MBD by late 2014, more than all of Canada's demand for refined fuels. This export surplus will continue to grow as new fuel efficiency regulations take hold and more US refining capacity is developed for both shale oil and converting heavy oil to higher value diesel and gasoline. Much of this surplus refined product is being pushed into European markets, though Canada is importing more US product too.

Canada now has limited refining capacity at a time when the US and other energy superpowers are expanding and exporting. There are now only four refineries in Quebec and on the East Coast, taking offshore crude and exporting into shrinking US import markets. Our most economic refineries are in Alberta though they are landlocked with limited ability to export, and little access to new infrastructure for refined products in sight. We are also disadvantaged since oil sands upgrading facilities are pushing light crude into a US market saturated with shale oil. Contrast this to the US, which has positioned itself with strategic access to low-cost crude, especially our oil sands, and invested in refineries to export product globally, primarily through the US Gulf Coast. The economics and trade flows are changing.

So how have these external factors affected Canada? We now have a vulnerable Eastern Canada refining sector with limited access to Canadian crude by pipeline. And there remains a need for large volumes of refined product to be imported into Ontario and Quebec.

The point is not to call for a Canadian policy on petroleum refining. However, this example serves as a cautionary tale and a reminder to leaders across the country that in all aspects, Canada's energy strategy must look outward to rapidly changing market conditions, particularly in the US. We must be prepared to debate our options in a changing global landscape. We risk missing out in other areas as well. The US, China and others are shaping a worldwide market for renewables and clean technology exports.

If Canada wants to be taken seriously, our energy strategy must be more than a five-year plan to get pipelines approved. A meaningful strategy would place Canada as a leader in markets for crude oil, electricity, LNG, renewables, clean technologies and refined products. And our plan must address climate change, implementing low carbon policies and carbon pricing.

We urge premiers to push beyond the status quo and be nimble enough to write a balanced energy strategy that sees the changing trends of today and prepares us to be global winners decades down the road. P

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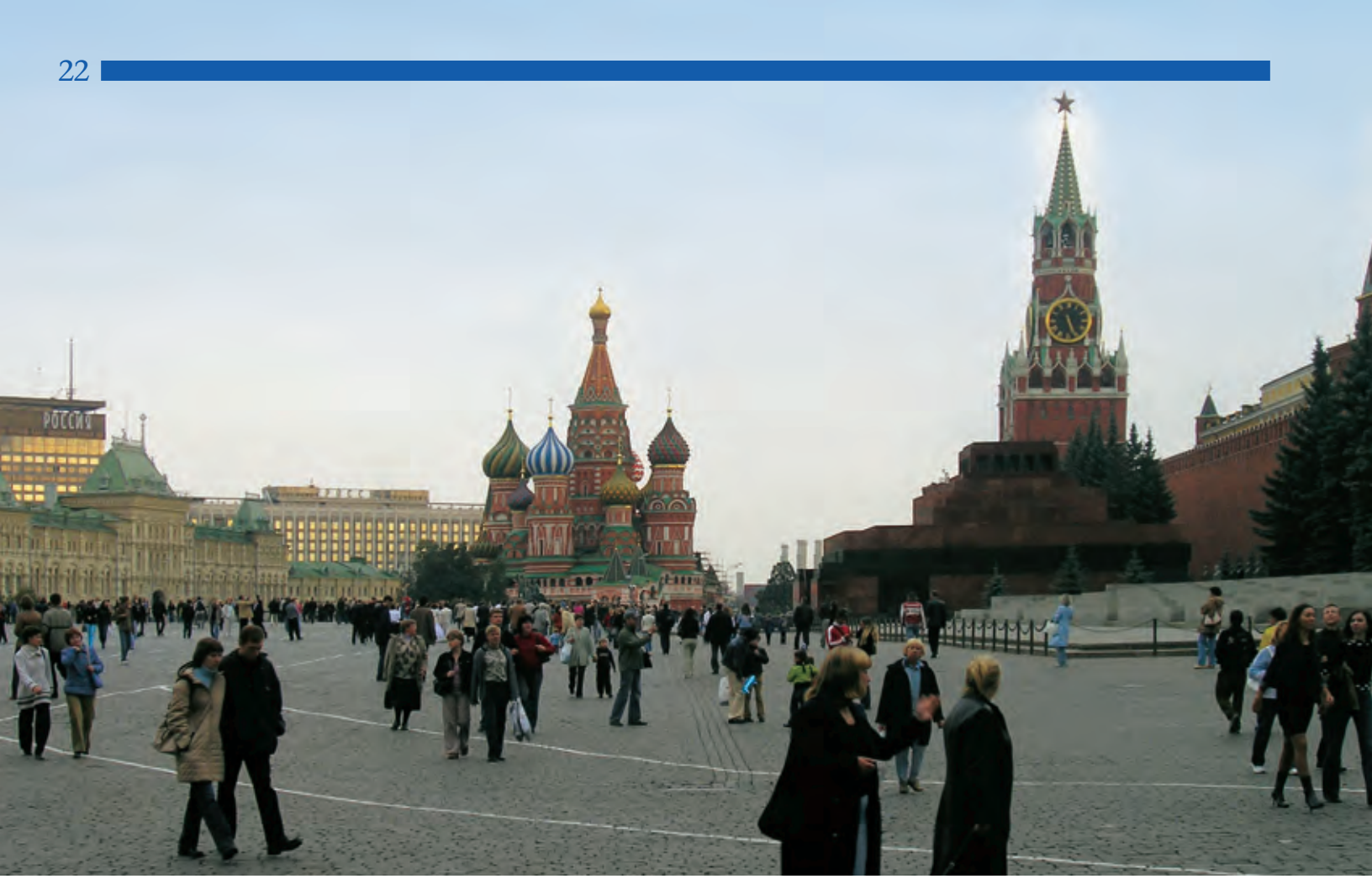

Moscow's Red Square, St. Basil's and the Kremlin—seat of power in Russia from the czars, to the Soviets to the current strongman, Vladimir Putin. Wikimedia, Alex Zelenko photo

Solving the Riddle of Russia: Who Blinks First?

Anthony Wilson-Smith

Not only have the West's post-Soviet dreams of a liberal, democratic Russia dissolved in a morass of corruption and autocracy; Vladimir Putin's expansionism and tanking oil prices have made Russia a prime candidate for next basket case of Europe. Former Maclean's *Moscow Bureau Chief Anthony Wilson-Smith looks at the geopolitical state of play, and sees hope in an upcoming Arctic Council meeting in Iqaluit.*

A quarter century ago, as the Soviet Union lurched toward dissolution, one of the people chronicling its fall was Russian journalist Artyom Borovik. His television show *Vzglyad*—which mocked Mikhail Gorbachev's government—was watched by as many as 100 million people a week. Fluent in English, the result of a childhood in New York with his Soviet diplomat father, he also had a large following in the West. Artyom was energetic, engaging, crusading in his beliefs—and despairing about his country's future even as he applauded ongoing changes. "Russians," he once said, "talk about

how we like democracy, but we *really* like a strongman who tells everyone what to do—and makes the rest of the world pay attention."

Within a decade, Vladimir Putin had become leader of a reconstituted Russia, and was on his way to providing evidence of that observation. Artyom had little chance for I-told-you-so: he died in March, 2000, shortly after Putin came to power, in a plane crash that many believe was caused by sabotage. (Artyom made powerful enemies almost as easily as he made friends). And 15 years later, Russia continues to evoke bafflement, anger and concern abroad—all the more so as its internal troubles deepen.

It's tempting at times for Western countries to wish Russia ill. Some efforts in that direction are fully deserved, such as Canada's suspension of almost all diplomatic discussions, along with economic sanctions that European Union countries placed on Russia because of its annexation of Crimea and actions in Ukraine. But no one should wish on Russia an economic collapse of the scale that some analysts now forecast because of falling prices for the country's prime export, oil. For one, Morgan Stanley recently revised its economic forecast for Russia, calling for a downgrade in the already-suffering economy from 1.7 per cent shrinkage to negative 5.6 per cent. It also forecast that, instead of a mild recovery in 2016, the Russian economy will shrink even further.

History shows that Russia—as both a stand-alone nation and centrepiece of the old Soviet Union—tends to become more bellicose in the face of challenges at home. Successive Communist rulers spent heavily on the military at the expense of a steadily worsening economy. When Gorbachev took power, and introduced widespread reforms in an attempt to reverse course, he was lionized in the West, but detested at home because he was seen as having diminished his country's place in the world.

By the end of the Soviet Union, its leaders had given up trying to hide the reality of chronic food and housing shortages, factories producing nothing of use, rural villages still without electricity, and a currency of nonsensical value. Because the ruble did not trade freely on currency exchanges, its value was pegged absurdly high. By the late 1980s, a ruble formally worth $2 Canadian could be bought for about 10 cents by foreigners living in Moscow who were willing to chance going *na lyeva* (trading on the black market.)

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Today, the problems are clear to all. The global fall in oil prices of more than 50 per cent in the last year has driven a deep hole into the middle of Russia's economy. The measures the government has undertaken amount mostly to efforts to buy time in the hope that oil prices rise again. Steps recently introduced by Finance Minister Anton Siluanov include spending $22 billion (US) to prop up banks and major state companies, $2.7 billion to keep pensions in line with the spiralling inflation rate, and $700 million for agricultural aid. As it taps into $385 billion in government reserves, the government is gambling that oil prices will rise before it exhausts that money. Since December, the reserve has dwindled by $36 billion. Last month, the governor of Russia's Central Bank said that the country has lost about $160 billion in annual revenue because of the decline.

Despite stop-gap measures, the effects of falling oil and mounting inflation are clear. *The New York Times* recently reported that last year food prices rose more than 15 per cent. Some staples, like sugar, rose up to 40 per cent. The overall inflation rate was 11.4 per cent and expected to be at least as high this year. Those challenges have led Putin and the country's bankers to play a high-stakes game of yo-yo with interest rates in attempts to prop up both the ruble and the banks. Six weeks after interest rates were increased from 10.5 per cent to 17 per cent to prop up the ruble, the central bank chopped the rate back to 15 per cent because of pressures on the overall financial system. In the same period, the government said it would commit $23 billion to bail out troubled banks.

"Russia is now at roughly the halfway point of a modernization program focusing on fighter aircraft, air defense, submarines, ships, strategic nuclear weapons and intelligence."

But one area where Russia continues to spend—and build—is its military. After neglect in the 1990s, Russia has been overhauling its armed forces. Its military budget two years ago was $90 billion—which puts it behind only China ($188 billion) and the US ($640 billion), according to the Stockholm International Peace Research Institute. That represents more than double the amount it spent a decade previously. Russia is now at roughly the halfway point of a modernization program focusing on fighter aircraft, air defense, submarines, ships, strategic nuclear weapons and intelligence.

For all that, Russian military might is only a shadow of what it was in the peak days of the Soviet Union. But it is enough to concern neighbours, as well as a reminder of Russia's legitimate worries about rising ethnic ten-

sions within its own borders and just beyond. Westerners often make the mistake of thinking of Russians as homogenous. In fact, based on the 2010 census, the country includes more than 190 ethnic groups and almost one in every four people—22.3 per cent—is of a background other than ethnic Russian. Moscow continues to fret over tensions in former Soviet republics to its south, especially in the North Caucasus region as well as in Afghanistan.

At the same time on the economic front, the Morgan Stanley forecast identifies three serious short-term risks:

- A further weakening of the ruble and increase in inflation if Moscow makes "special deals to help particular banks and companies."
- The introduction of capital controls.
- The imposing of further sanctions on Russia that could "trigger rating downgrades and index exclusion." That would cause the ruble to fall even more and inflation to rise further.

Looking ahead, the question is who blinks first? Logic says that Western countries, including Canada, the United States and members of the European Union, need to see some sort of concession from Putin before they lift existing sanctions that are part of Russia's problem. Some would argue that came in February, with the announcement of an agreement between the leaders of France, Germany, Ukraine and Russia aimed at ending ongoing fighting in eastern Ukraine between forces of that country and Russian-backed separatists. But even as that raised hopes, it is a fragile accord—and one that carries over it the shadow of Washington's willingness to send weapons to Ukraine to provide support against the separatist forces. (Canada also expressed willingness to consider some form of enhanced support.)

Overall, Putin's track record—and that of his country—suggests that Russia will continue a foreign policy built on truculence—and, potentially—as it has in Ukraine—the use of military force to preserve what it sees as its traditional sphere of influence.

President Reagan and Vice President and President-elect George Bush meeting with General Secretary Gorbachev on Governor's Island in the shadow of the Statue of Liberty on December 7, 1988. National Archives and Records Administration

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One indicator of the direction in which things are heading will come in April, when Russia attends a meeting of the eight-member Arctic Council in Iqaluit hosted by Canada and including Nordic countries and the United States. Canada, Denmark and Russia all lay claim to overlapping sectors of the Far North—including ownership of the North Pole. Russia's newly-minted ambassador to Canada, Alexander Darchiev, has taken a conciliatory approach to the meeting, saying it will provide an opportunity to "compromise" in discussing approaches to the region. But Russia has also been rebuilding some old Soviet air bases in the region and deploying more aircraft and navy.

All of which shows that even as more attention is focused on the Middle East and the growth of radical Islamist terrorist groups, Cold War tensions persist. For Russia, ironically, the way out of its present economic fix could lie in the Middle East. Saudi Arabia, which holds a fifth of the world's oil reserves, has given some indications it might be ready to reduce the flow of oil and thus see prices increase if Putin were prepared to abandon support for Syria's President Bashar-al-Assad. Under Putin, Russia has positioned itself as a key player in the Middle East—and sees Syria's Assad as a key figure in the fight against Islamic State (ISIS) and Al Qaeda-backed groups.

The irony is that on this key issue, Western countries, including Canada and the United States, share the goal of keeping ISIS and Al Qaeda in check. By that measure, the Arab aphorism that 'the enemy of my enemy is my friend' should bring Russia and the West closer. But there is little indication that will happen. As Putin once said, "Sometimes it is necessary to be lonely in order to prove that you are right." He may not be in the right, but Putin and his country are increasingly lonely. P

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Prime Minister Benjamin Netanyahu and his wife Sara attend the Ethiopian Sigd festival in Kibbutz Ramat Rachel in Jerusalem, marking the Ethiopian immigration to Israel. Flickr photo

Israel Votes: Is Bibi the Only Grown-up in the Room or the Devil Incarnate?

Gil Troy

Israeli elections are never about small issues. The current campaign, fraught with overheated rhetoric, oversized characters and last-minute alliances, is really about one question: Is Benjamin Netanyahu's era at the helm of Israel over? Respected political historian Gil Troy reminds us that the one larger-than-life idea that is bigger than Bibi, win or lose, is Israel itself.

Two videos frame the upcoming Israeli elections on March 17. The first, released by the incumbent Prime Minister Benjamin Netanyahu's Likud party, sets up Netanyahu as a kindergarten teacher, casting his rivals as squabbling pre-schoolers. The second, released by *Eretz Nehedaret* (It's a Wonderful Land), Israeli television's leading satirical show, casts the various opposition candidates as characters in *Star Wars*. All

seek to unseat the evil Caesar from Caesaria. Netanyahu has a vacation home in Caesaria, an ancient Roman city now surrounded by lavish beach houses. The campaign, with multiple parties and overheated rhetoric, is often playing as a mystery series that will reveal whether Israeli voters believe Netanyahu is the only grown-up in the room or the devil incarnate.

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In truth, while pundits and spinmeisters the day after will probably use such black-and-white rhetoric to proclaim misleadingly clear conclusions, the results seem destined to be more muddled.

For starters, Israel's hyper-democratic political system is famously fragmented, and, it seems, only getting more so. The electoral fight is for a 61-vote majority in the 120 member Knesset. No party has ever won a majority on its own in Israel's 67-year history. Still, whereas the leading parties used to get 40 or even 50 seats, the polls show the two leading parties averaging between 22 and 26 seats, which makes the parties and the eventual prime minister hostages to the whims of minor parties while guaranteeing muddied results.

Moreover, so far, this has been a most uninspiring campaign, a campaign of big egos not sweeping ideas, of postures not principles. Stav Shaffir, a firebrand from the opposition Labour Party, recently lamented that under Netanyahu, Israel's sweepingly optimistic anthem, *HaTikvah*, which means The Hope, will soon be *HaYeush*, which means The Despair.

"Netanyahu has been the defining leader of this decade, and of Israel's third generation—not the David Ben-Gurion and Golda Meir founders, not the Yitzhak Rabin and Moshe Dayan fighters, but the post-1948 heirs, born in a free, democratic Jewish State."

So far, the hottest campaign issue has been Netanyahu's planned address to the United States Congress, and the resulting blowback from President Barack Obama and some Democrats. Characteristically, despite the prime minister's stated intention to jumpstart a conversation about Iran, the focus in Israel has been on how much damage insulting Obama might cause and how much of Netanyahu's motivation stems from the mid-March election.

Netanyahu, known by friends and foes alike as "Bibi," has been prime minister since March 31, 2009, and also served for three years a decade earlier, from 1996 through 1999. Having also served as ambassador to the United Nations, foreign minister, finance minister, and opposition leader, he has far more governmental experience than any of his rivals. Netanyahu has been the defining leader of this decade, and of Israel's third generation—not the David Ben-Gurion and Golda Meir founders, not the Yitzhak Rabin and Moshe Dayan fighters, but the post-1948 heirs, born in a free, democratic Jewish State—and tasked with shaping Israel in the 21st century as a stable, maturing, sophisticated high-tech center still committed to its Jewish mission of preserving tradition and inspiring the world.

In many ways, Netanyahu represents Israel's two sides. Especially as finance minister, he modernized the economy and helped Israel become the Start-Up Nation, inventing modern-day miracles and attracting nearly a billion dollars in venture capital in 2014 alone. But in his suspicion of the world, in his sensitivity to anti-Semitism, in his fears of the future, he also represents the scarred Jew, the persecuted Jew, the Jew who has not just seen the worst humanity can offer, but has experienced it.

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Steeped in Jewish history and Jewish suffering by his historian father, reinforced in that anguish when his charismatic older brother, Yoni, was murdered while heroically freeing dozens of Israelis from the hands of German terrorists in the famous 1976 Entebbe Raid, Bibi Netanyahu has good reason to worry. Outsiders may mock his constant warnings about Iran going nuclear, but the 20th century has taught Jews—and most sentient human beings—that totalitarian dictators calling for a people's destruction and seeking weapons of mass destruction must be taken seriously.

And while outsiders may only see Israel's military, economic, and social strengths, he and his people are well aware of Israel's vulnerabilities, with an Arab Spring that quickly turned gloomy, with a Palestinian national movement still more committed to destroying a Jewish state than building a Palestinian state, with ISIS spreading terror throughout the Middle East, Syria enmeshed in civil war, Lebanon dominated by Hezbollah, Jordan often worried about Islamist upheaval, and Egypt still traumatized by its bout of Muslim Brotherhood leadership.

Despite growing criticism in Europe and on the far left, most Israelis understandably feel burned by previous concessions made to the Palestinians. Until someone explains—or better yet, Palestinians show—why a new round will produce the peaceful results Oslo, the Southern Lebanon withdrawal and the Gaza disengagement failed to achieve, most Israelis will share Netanyahu's peace process pessimism.

In such an environment, it takes an extra effort to hope, and the headline remains that, faced with such foes, Israel remains democratic, optimistic, dynamic.

Still, election campaigns often pick at national scabs, with various parties offering differing Band-Aids. According to the latest polls, the opposition leader, Yitzhak Herzog, has convinced a majority of Israelis that Netanyahu is tired, that his ideas are stale, that it's time for new blood. As of this writing, Netanyahu's party is averaging about 25 seats in the polls, which means less than a quarter of the electorate wants him back. But Herzog so far has failed to convince a majority of Israelis that he and his party are the answer.

When Netanyahu first called the election, Herzog was looking strong. He struck a deal with Tzipi Livni to have his Labour Party and her HaTnua Party run together as the Zionist Union. Voters approved of the marriage, and the two parties together polled far more seats than they each had individually. However, Livni's political dowry—a rotation agreement if they win whereby she would serve two years after Herzog's two years—reinforced many fears that Herzog is too nice and too weak for Israel's tough domestic politics and tougher neighborhood. In the *Star Wars* spoof, Herzog as Luke Skywalker waves around his light saber—only to see it go limp when he joins with Livni.

Other players on the scene represent other tribes of Israel. HaBayit HaYehudi (The Jewish Home), led by Naftali Bennett, is the party of the national religious and the settlers. He is to Bibi's right but also is Bibi's closest ideological ally. Recently, seeing those voters as the easiest to woo, Netanyahu has been targeting Bennett and his party, desperate to boost his vote totals. Avigdor Lieberman of Yisrael Beiteinu (Israel's Our Home), represents the million plus Russian Jews who moved to Israel, once freed from Soviet totalitarianism.

The great hope of the last election, Yair Lapid, of Yesh Atid, (There Is a Future), is looking a bit stale, and the once-heralded newcomer of this election, Moshe Kachlon of Kulanoo (All of Us), has not attracted the same critical mass of voters Lapid attracted last time. Two other groups are also represented—Israeli Arabs and ultra-Orthodox Jews. Together, all these parties reflect Israel in all its multi-dimensionality and complexity. But trying to put a coalition together to reach 61 seats may require the kind of miracles Moses relied on when crossing the Red Sea or drawing water from a rock.

The true miracle, of course, will be on Election Day itself. If all 19 previous elections are any indication, the day will be peaceful. The participation will be extensive—still averaging two-thirds. And Israeli democracy will continue not only to survive but to thrive. Israel, the day after, will neither be "Bibi's Israel" if he wins nor "No longer Bibi's Israel" if he loses, just as Canada after the elections will be neither "Stephen Harper's Canada" nor "Justin Trudeau's Canada," but a diverse, pluralistic, delightfully messy mix. **P**

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The UK Parliament at Westminster. What if they had an election and nobody won? A hung Parliament on May 7 is a real possibility. Flickr photo

The British Election that No Party Wants to Win?

Andrew MacDougall

The British election set for May 7 remains up for grabs, with David Cameron's Conservatives and Ed Miliband's Labour polling within a margin of error, both in the low 30s. The question Canadian Londoner Andrew MacDougall has is, why would anyone want to win? With the Lib Dems, UKIP, SNP and the Greens all claiming enough support to guarantee a thorny coalition negotiation and a likely conundrum for the Queen, governing may present more headaches than it's worth.

What if there was an election that no party wanted to win? An absurd thought to be sure, but given the headache that awaits the victor of the United Kingdom's election on May 7, the question bears asking. Trouble lurks everywhere: a re-elected Conservative government would be forced to face down a potentially ruinous referendum on Europe, while a Labour government would have to do its own delicate dance with the resurgent nationalists in Scotland. Both issues

threaten to tear the parties—and potentially the nation—apart.

Does victory represent a poisoned chalice?

If early campaigning efforts are any indication, the major parties are all too eager to sip from the cup and acquire the headaches of power. The election campaign is certainly in full swing. David Cameron and the Conservatives have narrowed their focus to the economy, while Ed Miliband's band of Labour brothers have tried to frame the election as a battle between needy workers and greedy bankers.

Each party is looking to press its advantage, using all of the tools available. The parties' social media channels are clogged with partisan attacks and fundraising appeals are being issued seemingly by the hour.

If the tactics have a decidedly foreign feel, there's good reason. Both Labour and the Conservatives have imported key players from Camp Obama to help them over the line: Miliband has tapped the US president's long-time advisor David Axelrod, while Team Cameron, although led by Australian strategist Lynton Crosby, is supported by Jim Messina, a veteran of both Obama presidential campaigns. Their impact has already been felt; indeed, it is Messina who has been messianic over the need to preach the economy.

By economic metrics, Prime Minister David Cameron should be sprinting to victory. Growth has returned to the British Isles, unemployment is down, and the recent slump in oil prices is finally providing relief to the family pocketbook. The prime minister also holds a significant advantage over Miliband on the all-important leadership question. And yet he trails in the polls.

With personal negative ratings near historic lows for a British politician, Miliband—a sort of hybrid of Stéphane Dion and Michael Ignatieff—has survived a number of missteps to hold onto a slim margin over Cameron with mere weeks to go before the writ is dropped. The lead makes even less sense when you consider the context in which Miliband is operating: with a hostile press and a restive backbench unsure of his mettle or resonance with the public, Miliband has too often had to divert his assault from Cameron to shore up his rearguard.

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Meanwhile, Liberal Democrat leader Nick Clegg faces the loss of over half of his party's seats, collateral damage of partnership in a coalition government that has seen its policy victories overshadowed by defeats on key issues such as student tuition and electoral reform. Long a protest party, the Liberal Democrat experience of governing has exposed a team of idealists to the brutal truths of government. To govern is to choose and, given the choice, one expects a significant number of Lib Dems would rather not have had the experience.

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And yet the Liberal Democrats could find themselves in exactly the same position come May: junior partners in a coalition government. While they might end up with the same role, the cast of supporting characters has changed significantly.

Clegg's role as the leader of an insurgent outsider party in 2010 has now been firmly eclipsed by a new generation of leaders. In Nigel Farage's United Kingdom Independence Party, Alex Salmond's Scottish Nationalist Party, and Natalie Bennett's Greens, the fringes of British politics have never been more mainstream.

While Salmond tasted bitter defeat in last September's Scottish referendum, resigning his premiership, his expected return to Westminster at the head of a parliamentary delegation that could boast upwards of 50 seats (from its current six) threatens to wreak havoc on a prospective Labour government. The spectacular collapse of Labour's support in Scotland leaves the party facing annihilation in their traditional heartlands north of Hadrian's Wall.

This leaves voters facing the troubling question of who would speak for the unity of the supposedly United Kingdom.

With Cameron already shut out in Scotland, bar a lone MP clinging to a border constituency, and Miliband facing a similar fate, the Union is under threat. What appeared to be a decisive referendum result last autumn could instead morph into pretext for a prolonged—and perhaps fatal—round of constitutional wrangling. Prime Minister Cameron's ham-fisted attempt to capitalize on the Scottish referendum result by pursuing so-called "English votes for English laws" has demonstrated to all just how tricky reforming a jerry-rigged UK constitution will be.

Add in UKIP, the Greens, the Ulster Unionists and the Plaid Cymru from Wales to the strengthened SNP, and voters could wake up to a Humpty Dumpty parliament. The latest es-

timates have these "fringe" parties taking over 100 seats in the 650 seat House of Commons, making the 326 seats of a majority government a distant prospect for either Labour or the Conservatives.

No matter the result, the party with the most seats come the morning of May 8 will face a challenge finding a combination that will produce a stable governing coalition.

Stability is, of course, something the broader business community craves, as the economic recovery that is currently the envy of Europe is not yet assured. Both main parties have committed to balancing the country's books in the next Parliament (albeit to varying degrees and through differing policy tools) and markets will be looking for reassurance that there will be no fiscal recidivism.

Will Labour be able to pass an economic program that pleases the Scottish nationalists, their most likely coalition partners? Would they want to? Will David Cameron need to rely on multiple fringe parties to pass his budgets? And, if yes, at what cost to policy files like immigration and foreign affairs? The policy possibilities are endless.

And then there's Europe.

Long an Achilles heel for UK Conservatives, Europe has once again been planted firmly on the political agenda by the rise of Nigel Farage and his little Englanders. As a result, Cameron has been forced to tack to the right and re-emphasize his commitment to an in-out EU referendum, a policy pledge that poses significant risk to Britain's economic future by fueling uncertainty in the service industries so critical to the UK economy.

Nigel Farage and UKIP have enjoyed nothing short of a meteoric rise since last May's European elections, with their positions on European legislation (too intrusive) and EU free movement policies (too liberal) resonating with voters in communities who either feel disenfranchised or are struggling to adapt to a globalized world.

As a result, UKIP has captured their first two seats in Westminster through the defections, and subsequent re-elections, of two former Conservative MPs, Douglas Carswell and the aptly named Mark Reckless. But by-elections are one thing, a general election another.

No one is quite sure how a UKIP vote at 18-20 per cent would translate at the national level. Farage and his team are thought to be targeting approximately 20 seats, largely in southeast England (where they go head-to-head with Conservatives) but the party has also demonstrated an ability to eat into Labour's vote in the North. Best estimates project 5-8 seats for Farage, but it's how the UKIP will split the voting in other constituencies that have analysts guessing.

But Farage isn't alone in complicating electoral projections.

> ***"With trouble looming between Greece and the Eurozone, and with a revanchist Vladimir Putin showing no signs of abandoning his quest for Novorossiya, an inward-looking Britain risks being sidelined diplomatically at a time when it can least afford it."***

The recent surge of Green support (they currently hold one seat at Westminster) to 10 per cent has thrown another spanner in the works, this time for Labour. With SNP killing them in the North and Greens eating into their support in the South, Labour is caught in a pincer movement. Despite a policy platform that can best be described as lunacy (amnesty for terrorists and ballooning the deficit), Green Leader Natalie Bennett had demonstrated an ability to attract left-wing voters exhausted by government austerity. Just how her vote will combine with UKIP to split constituencies in the South of England is unknown.

Were this enormous electoral complexity unfolding in a vacuum, it would be one thing. But with trouble looming between Greece and the Eurozone, and with a revanchist Vladimir Putin showing no signs of abandoning his quest for Novorossiya, an inward-looking Britain risks being sidelined diplomatically at a time when it can least afford it.

The global community will need Britain. The question becomes: will Britain have enough time to pay attention to the global community?

So, how does the United Kingdom avoid the instability and unpredictability coming its way this election?

With a majority apparently out of the cards, David Cameron and Ed Miliband can only hope to gain enough support to be able to form a coalition with Nick Clegg's Liberal Democrats, the only partner who wouldn't be anathema to either party's base.

Campaigns still matter, and the numbers could shift. Will voters warm to Miliband enough to produce a majority? Will enough UKIPers vote Conservative to swear off Labour? Will Labour find its feet in Scotland and blunt the advance of the SNP?

One thing is certain: the post-election period promises to be filled with twists and turns as the various parties make their bids to lead. Her Majesty Queen Elizabeth could be presented with multiple proposals.

The coalition negotiations between Cameron and Clegg following the 2010 election took five days.

Negotiations following this election could stretch to five weeks, and no one is expecting the next government to match the outgoing one, lasting five years. P

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The power of words: "What would be said of a generation of North Americans that found a way to explore the stars, but allowed its lakes and forests to languish and die?" Brian Mulroney on acid rain, in an Address to a Joint Session of the US Congress, April 1988. PMO photo

Words and Occasions: The Power of Great Speech

Patrick Gossage

In the past near-century of instant mass communication, great politicians have proven the power of words to transcend division and shatter boundaries; to capture and change history. With Canada facing a defining moment in reconciling new threats to national security while protecting our civil liberties and respecting our differences, now would be the time for a great speech. It hasn't come from Stephen Harper, or anyone else.

From Winston Churchill's, "We shall fight on the beaches" to John F. Kennedy's, "Ask not… " to Ronald Reagan's, "Mr. Gorbachev, tear down this wall," great speeches have proven effective in buttressing national will, inspiring generations and helping shift geopolitical reality.

Why is it that great speeches by Canadian leaders are so rare? Is it that our prime ministers have never had a Ted

Sorensen, who wrote nearly all of Kennedy's memorable speeches?

Kennedy had a moral, political and intellectual soul mate in Sorensen, the shy Nebraskan who perfectly captured the cadence and voice of the 35th president. Their relationship and the process of writing two of Kennedy's most important speeches is perfectly captured by journalist and Carleton University professor Andrew Cohen in his book *Two Days in June*. The first, a carefully crafted convocation address at the American University, set an agenda for East-West détente and arms control. The second, the very next day, was a TV address from the Oval Office on civil rights, written in the context of breaking news. Cohen's book should be required reading for the writers typing and spelling away in today's political offices.

Cohen recounts the circumstances of Kennedy's June 11,1963, address to the nation announcing a civil rights bill the very day Governor George Wallace tried to prevent the integration of the University of Alabama with his "stand in the schoolhouse door" dare. Sorensen was severely tested as he had only a few hours to write before the telecast, forcing Kennedy to ad lib the closing.

Sorensen wrote: "If you were black instead of white would you accept the status quo?"

"In his 1988 address to the US Congress, Mulroney made a powerful case on the issue of acid rain."What would be said of a generation of North Americans," he asked, "that found a way to explore the stars, but allowed its lakes and forests to languish and die?"

Kennedy's closing ad lib was powerful: "I am asking for your help in making it easier for us to… provide the kind of equality of treatment which we would want for ourselves."

"It's instructive to remember that great speeches take an occasion where there is a threat and appeal to our best values and instincts, our sense of fairness and justice. In Canada, they often call for unity in a bilingual, multicultural country."

It's instructive to remember that great speeches take an occasion where there is a threat and appeal to our best values and instincts, our sense of fairness and justice. In Canada, they often call for unity in a bilingual, multicultural country.

Prime Minister Brian Mulroney rose to the occasion in introducing the Meech Lake Accord in the House of Commons in 1987: "The agreement represents the best features of a vital federal system, one which I believe responds to Canadians in every corner of the country. It reflects a spirit of partnership—not one of endless federal-provincial struggles." Then he quoted Laurier, our first accomplished orator: "The governing motive of my life has been to harmonize the diverse elements which compose our country," words inscribed on the base of Laurier's statue in Montreal's Dominion Square.

We could stand hearing that kind of oratory now. Again, in his 1988 address to the US Congress, Mulroney made a powerful case on the issue of acid rain."What would be said of a generation of North Americans," he asked, "that found a way to explore the stars, but allowed its lakes and forests to languish and die?" Three years later, he signed the Acid Rain Accord with the first President Bush.

Stephen Harper also rose to the occasion in his 2008 apology to native Canadians for residential schools, widely regarded as his finest moment in the House: "The burden of this experience has been on your shoulders for far too long," he declared. "The burden is properly ours as a government, and as a country. There is no place in Canada for the attitudes that inspired the Indian Residential Schools system to ever prevail again. You have been working on recovering from this experience for a long time and in a very real sense, we are now joining you on this journey." What's been missing since is meaningful progress on First Nations issues, from education to women.

Harper also showed an appropriate sense of occasion after the October 22 shooting of Cpl. Nathan Cirillo at the National War Memorial and the attack on Parliament Hill. In the House, he asserted that an attack on "our institutions of government" was an attack on the country and its values. Then he laid down a marker on Canada's role in the US-led coalition fighting the Islamic State with a memorable phrase: "We will not be intimidated, Canada will never be intimidated."

"Stephen Harper also rose to the occasion in his 2008 apology to native Canadians for residential schools, widely regarded as his finest moment in the House: "The burden of this experience has been on your shoulders for far too long," he declared. "The burden is properly ours as a government, and as a country."

But in a January 30 speech in the Toronto suburb of Richmond Hill, he heated up the rhetoric and cooled

a sense of larger purpose: "Through their deeds, these jihadists have declared war on Canada and with their words, they urge others to join their campaign of terror against Canadians... violent jihadism is not a human right. It is an act of war."

There is no denying that many Canadians are apprehensive in the wake of the murder of two Canadians soldiers in uniform on their home soil, the horrors of massacres in Paris and the IS beheadings. Harper seized on this to use a style of wartime rhetoric that left no doubt as to the government's intention. So, while not a great speech, it was certainly one of the more important he has given. He strongly outlined the threat and the legislative actions that would be taken to meet it. And even the most jaded pundits agree that he meant it.

But Harper's rhetoric was overheated and it missed being a great speech because it only passingly referred to a fundamental Canadian value that almost seemed threatened by the "war" against jihadists—our respect for differences in culture and religion. The beleaguered Canadian Muslim communities needed reassurance. They didn't get it. Indeed, they were offended by Harper's direct reference to pro-jihadist activity taking place in mosques.

Sorensen had one rule: "If someone is offended, cut it." Good advice.

How easy it would have been for Harper to elevate his speech by referencing Canada's "promise" of a country where different cultures and religions live in mutual respect and support. He could have recognized their abjuration of radical jihadism and the critical role of Canada's Muslim community in preventing the radicalization of its youth. He could also have stressed the multicultural essence of modern Canada.

In his television address to Canadians in 1970 announcing the War Measures Act in answer to a real organized threat to Quebec, Pierre Trudeau was careful to set a wider social context

"Of course my name is Pierre Elliott Trudeau. Elliott was my mother's name." Pierre Trudeau in the climactic speech of the first Quebec referendum at the Paul Sauvé Arena in Montreal, May 14, 1980. Robert Cooper, PMO

that was missing in Harper's speech 45 years later: "The kidnappers claim they act as they do in order to draw attention to instances of social injustice… Every government in this country is well aware of the existence of deep and important social problems. And every government, to the limit of its resources and ability, is deeply committed to their solution. But not by kidnappings and bombings."

There is general agreement that Trudeau's referendum speech at the Paul Sauvé Arena in Montreal in May 1980 was certainly one of the great Canadian speeches of the post-war era. Trudeau's speeches, his words and delivery, were important turning points in the first Quebec referendum. He represented the pride and vibrancy of the Canadian option.

I was in the Prime Minister's Office when Trudeau disappeared to 24 Sussex for two days and wrote that speech, then memorized it. Trudeau turned René Lévesque's comment that he was not a real Quebecer because of his mother's name into the most powerful part of his speech: "Of course my name is Pierre Elliott Trudeau… the Elliotts came to Canada more than two hundred years ago."

His attack on Lévesque's "contemptuous argument" was devastating. He listed PQ Quebec ministers like Pierre Marc Johnson and Louis O'Neill: "Are they Quebecers, yes or no?" He named Inuit and native leaders: "Are they not Quebecers? They've been here since the stone age." He then quoted Laurier: "My countrymen are not only those in whose veins run the blood of France… (they) are all those people whatever their race or colour who the twists and turns of fate, or their own choice, have brought among us."

His memorable finale built on "the world is watching us… these people in Quebec… want to split it up? They want to take it away from their children? They want to break it down? NO. That's our answer… we won't let this country die."

One of the failures of Canada that the world is watching, and has been for some time, is how we treat our aboriginal population. We can only imagine what a Ted Sorensen would produce if a prime minister decided to give a major speech on a new relationship with First Nations.

Sadly, unless we greatly underestimate Justin Trudeau and his advisers should he become prime minister, a great speech from our current political leadership that meets the challenging issues of our time seems unlikely. P

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Central Havana, a skyline dominated by the dome of the National Capitol Building, modeled on the US Capitol. With detente between Havana and Washington, US business and tourism will return to Cuba, which Canada has never left. Flicker photo Gabriel Rodríguez

The New Cuban Reality: Where Does Canada Fit?

Mark Entwistle

The United States and Cuba are now on a path toward normalizing relations. Canada, with its historic ties to the island, both pre- and post-revolution, is perfectly positioned to take advantage of the changes already transforming the Cuban economy. But, as former Canadian ambassador to Cuba Mark Entwistle writes, it will take more than a million tourists a year to get this country a seat at the table.

On December 17, 2014, presidents Barack Obama and Raúl Castro made history the old-fashioned way by each taking a politically bold step in the face of their own domestic obstacles. They agreed to try to create a new and more normal relationship between their two countries, the United States and Cuba.

It was a disruptive act that has created a new Cuba equation. Despite the thorny

issues and challenges, there is evolution and movement.

That equation has different variables. There are multiple actors who are now colliding with each other. Beyond the protagonists, the United States and Cuba, these include Canada, other Latin Americans, Europeans through the EU, Spain bilaterally, the Chinese, the Russians, and others. Each party is feeling its way through unknown territory.

Cuba has its own sovereign views about its own economic development priorities. US business will want to have a look at a market that is new and even exotic for them. Canadian business is not accustomed to seeing our American neighbours in Cuba. All will have to adapt to an evolving situation.

Where does Canada fit in to the new equation?

Canada's engagement with Cuba has deep historical antecedents.

> ***"The Royal Bank of Canada and the Bank of Nova Scotia financed the sugar industry, had dozens of retail branches across Cuba and imposing bank headquarter buildings in downtown Havana. These granite echoes of the past are still there, taking up whole city blocks, with the names of the banks etched across their facades."***

After building the Canadian transcontinental railway, William Cornelius Van Horne turned his attention to doing the same thing with the Cuba Railway Company in the early 20th century. He went to Cuba to personally oversee work on the Cuban railroad. Canada was a major player in the financial services sector, including banking and insurance, in the decades before the Cuban Revolution in 1959. The Royal Bank of Canada and the Bank of Nova Scotia financed the sugar industry, had dozens of retail branches across Cuba and imposing bank headquarter buildings in downtown Havana. These granite echoes of the past are still there, taking up whole city blocks, with the names of the banks etched across their facades, and, in the case of the old Bank of Nova Scotia Building, the floral emblems of the Canadian provinces inlaid in the tiled entrance hall. Several Canadian insurance companies, some long gone through M&A activity, dominated the insurance business.

> ***"Cuba has its own sovereign views about its own economic development priorities. US business will want to have a look at a market that is new and even exotic for them. Canadian business is not accustomed to seeing our American neighbours in Cuba. All will have to adapt."***

Canada was the only country among the post-war Western democracies not to break diplomatic relations with Cuba after the Revolution, despite considerable pressures. And, along with Mexico, the only country in the Western hemisphere to stay in Havana. There were some years in the 1960s and 1970s when diplomats from Ottawa were quite alone in Cuba, in a foreign community comprised of representatives of the countries of the Soviet bloc, the Soviet-era trading bloc COMECON and an assortment of national liberation organizations.

Later Canadian breeding stock formed the basis of the new revolutionary cattle industry. Cuban buyers came to Canada regularly to buy cattle, bull semen and seed potatoes. The Cuban fishing fleet searched for cod in the great Atlantic fishing banks off Canada's East Coast and called into the port of Halifax. Cubans stopped briefly in Gander, Newfoundland going to and from the Soviet Union and Eastern Europe. Religious sisters from Quebec populated the Catholic orders of Cuba.

These days, over a million Canadians go to Cuba every year as tourists, and while most stay put on the beach with drink in hand, many others explore deep into Cuban culture. These thousands of points of contact forge a level of personal connection that seems at times unnatural between a people of the North and a Latin Caribbean people.

> ***"Canada was the only country among the post-war Western democracies not to break diplomatic relations with Cuba after the Revolution, despite considerable pressures. And, along with Mexico, the only country in the Western hemisphere to stay in Havana."***

But what does this unique and special relationship really mean now? There are two defining aspects.

The circumstances of the Canada-Cuba relationship are, indeed, genuinely unique. And 60 years of a relationship provide perspective, understanding and knowledge about the nature of being Cuban, for those who wish to seek it out; this is an asset and comparative commercial advantage.

But there is a corresponding mythology that was a long dominant assumption of Canadian foreign policy toward Cuba to the effect that this special relationship—based on the perception in Cuba that Canada had taken a courageous stand in defence of the legitimacy of the Cuban state—would engender a special influence with the Cuban government. But it is

a myth, of the kind that can take hold so deeply in the Canadian self-image. Cubans respect Canada, and the history of the relationship, but that does not give Canada a free ride. Privileged relationships, with privileged access and dialogue must be earned and then renewed systematically.

It is ironic that the South Korean equivalent of Export Development Canada just announced a 60 million Euro line of credit to the Cuban central bank to support Korean business in Cuba, and is actively negotiating a sales contract insurance facility. South Korea does not even have diplomatic relations with Cuba and is half a planet away in Asia; Canada is a three and a half hour plane ride away and EDC responds only passively to opportunity in Cuba on a case-by-case basis. Can the Koreans see a strategic investment in an evolving market that we do not see on our own doorstep?

The corollary of the myth of special treatment is the relative absence of Canada from the Cuba opportunity. There are lots of traders, there are exceptions, there is the fundamental place of Sherritt in Cuban nickel and power generation, but, in general, the opportunity to earn and renew privileged access has not been taken up. I don't think the leaders of Cuban tourism have ever truly understood how the tour operators and air carriers can be so efficient at moving large volumes of Canadian citizens to Cuba and back, and yet there is so relatively little historic Canadian investment in the development of Cuban hospitality infrastructure. With the exception of Sherritt, there is no other big ticket Canadian strategic investment project in Cuba.

A cautionary tale for Canadian business was the recent revelation in the French press that the large French telecom service provider Orange had entered into an agreement last July, secret until now, to provide extensive services to help develop the domestic Internet system in Cuba. That important relationship could have been with a Canadian company in an area where we have tremendous expertise and global reputation.

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There are those outside Cuba who assume that we are on an inextricable path to repeat the past and that the power and volume of eventual US capital will inevitably create renewed economic dominance and push out other foreign business partnerships. This would be a misreading.

There will be a place for US business in an evolving Cuba, for certain, and American companies have strong and natural historic and geographic advantages. High brand recognition for consumer products, lower transportation costs, more convenient servicing and so on.

But the Cuba of 2015 and beyond is a much different nation than the one that existed in the late 1950s. While a developing country starved of capital resources, it is a more mature Cuba, more independent and formed by the history of the last six decades. The assumptions and expectations of the Cuban people about the value of their sovereign assets have changed.

History provides different kinds of precedents. One is related to the overwhelming presence of the United States in the economic history of Cuba spanning two hundred years. And the corollary lesson for the generations of the revolutionary period is that such dependence is not healthy for the country, a lesson that is now deeply ingrained in the Cuban psyche.

But a second precedent is related to the diversity of foreign interests that have always been at play in the history of Cuba. Cuba is an assimilator culture, and Havana has always been a cosmopolitan port city, even if always a little battered by the storms and sea. The Cubans will look for what they need from a variety of sources. And the foreign businesses which have been there over the past 20 years have learned and adopted the model of partnership, where they work jointly with a Cuban partner on everything that is done. There will be a need for some considerable adaptation from American business as they begin to re-engage because that concept of partnership symbolizes the economic future of Cuba, where national assets will be properly valued, even as they are developed.

Both Americans and Canadians will discover and rediscover things about Cuba. For the Americans, that Cuba is not an empty vessel to be filled as desired, but a bustling and already quite crowded space of people, Cubans and foreigners, looking for opportunities that can work. For Canadians, that they must compete head-on to provide the best options for Cuban economic managers looking for affordable solutions.

If Canadian banks funded the sugar industry at a time when there was so much concentration of business and land ownership in American hands, there is no reason why they and other Canadian businesses cannot be part of the future development of Cuba, in a diversified mix of partners.

But Canada needs to take a strategic decision to be at the Cuban table to play. P

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CP photo

Freedom in Western Grain Movement: Why the Revenue Cap Needs to Go

Barry Prentice and Graham Parsons

Last winter's grain transportation crisis focused the nation's attention on Canada's grain handling and transportation system in a way that exposed many of its long-standing problems without exploring either their causes or the potential solutions. Barry Prentice and Graham Parsons advise that, first, the revenue cap, which imposes a limit on railway revenue from grain transportation, has to go. Then, they suggest that Canada get rid of the new Fair Rail for Grain Farmers Act.

In the 20th century, Western Canada's grain handling and transportation system (GHTS) allowed Canada to create an agricultural economic relationship with Europe that was the envy of the world. Advanced steam locomotives crossed the mountains in the West and the Canadian Shield in the East, overcoming terrain and distance, while grain elevators kept grain dry and segregated to meet market and travel requirements. Rail and elevator networks brought new technology to

thousands of Prairie communities, and the region thrived.

As the 21st century unfolds, agricultural exports continue to play a major role in Canada's economic growth, and market opportunities are emerging that could dramatically increase grain exports by 2050. The world's growing population will require food, fertilizer and energy resources from Western Canada, and our dependence on a financially strong railway network will be no less important to our economy in the next 85 years than it was in the 20th century. Whether Canada can move increased amounts of grain through its export supply chain in the years ahead will depend on achieving an internationally competitive price, and reliable and timely delivery for grain from farm gate to port.

However, efforts by successive Canadian governments to manage the export movement of grains through the 20th century did not serve western Canadian farmers well. Regulation by the federal government, and its agent the Canadian Wheat Board, of marketing, transportation and storage of grain led to efficiency losses, massive investment deficits and large government subsidies.

Remnants of the old command-and-control regulatory framework remain. Specifically, the Maximum Grain Revenue Entitlement Program (revenue cap), first introduced in 2000, is still in force. It creates a ceiling on the total railway revenues that can be earned from moving grain by rail in any crop year, based on volume and length of haul. The revenue cap applies to revenues earned by CN and CP on non-US-bound export shipments from Western Canada routed through the West Coast ports of Vancouver and Prince Rupert, and eastern ports of Thunder Bay and Armstrong.

Although initially viewed as a modern approach that stepped away from the strictly regulated Crow's Nest regime, and later the *Western Grain Transportation Act*, the Revenue Cap has now reached a point of diminishing returns for farmers and the broader GHTS. The cap is hurting the efficiency, growth and productivity of the system, by limiting the investments and innovation, technology and capacity required to competitively move Canadian grains and other products to world export markets.

"Whether Canada can move increased amounts of grain through its export supply chain in the years ahead will depend on achieving an internationally competitive price, and reliable and timely delivery for grain from farm gate to port."

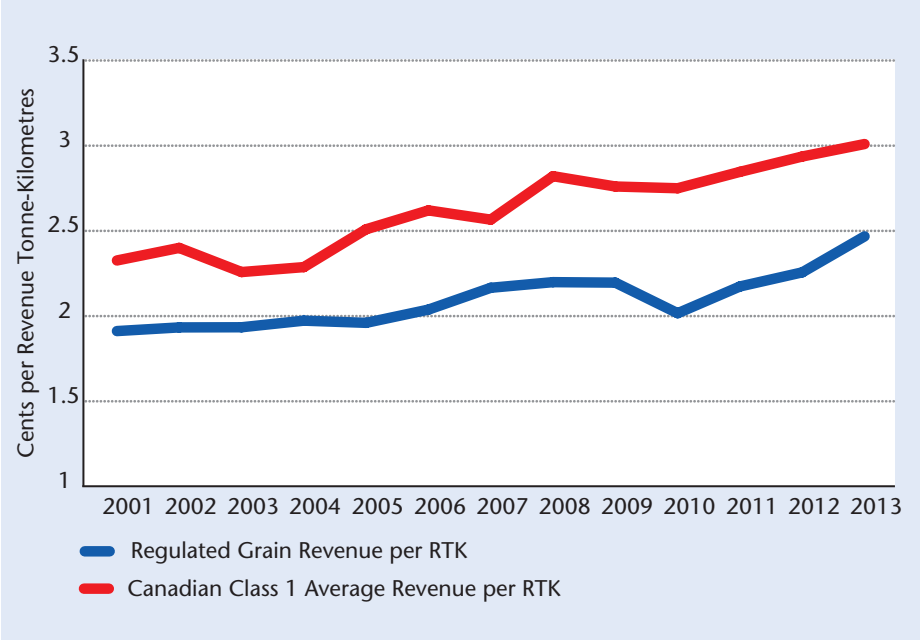
The capacity and efficiency of the GHTS have improved significantly over the years, thanks to investments throughout the system. Hopper cars have replaced box cars, trains are now driven by diesel-powered locomotives, and other innovations, such as large grain elevators and bulk ocean carriers have been brought on-line, increasing grain throughput across the system.

All commodity shippers share the benefits of the railways spending on operations, maintenance, and investment in infrastructure, technology and capacity. However, the Revenue Cap does not cover the full costs of moving grain, so other commodity shippers have to make up the difference.

Figure 1 shows the growing gap between the average rail freight rate for grain and that of all commodities from 2001 to 2013. Over this period, grain revenues per tonne-kilometre increased by 14 per cent, less than half the rate of increase for all commodities. Grain rates have also not kept pace with inflation, as measured by the Consumer Price Index. Grain railway regulation creates a cumulative revenue deficit for rail investment and GHTS efficiency in Western Canada.

Although Canada's two Class 1 railways make large annual capital in-

FIGURE 1: Average Freight Rate vs. Regulated Grain Rate. Canadian Class 1s – Canadian Operations



Source: Railway Association of Canada

vestments in efficiency, capacity and productivity—in 2013, they invested some $1.8 billion back into their networks—the Revenue Cap removes the incentive for railways to invest and introduce innovation that can provide efficiency gains throughout the GHTS.

For example, the GHTS needs investment to address the aging fleet of government-owned hopper cars. Between 1972 and 1994, the federal and Prairie provincial governments and the Canadian Wheat Board purchased some 16,500 hopper cars, with a capacity to carry 4.3 million tonnes of grain. However, the number of serviceable cars is falling year after year—dropping 38 per cent over the last decade alone, to around 8,366 cars. If this fleet is not replaced quickly, the capacity of the GHTS to move grain will be dramatically reduced.

> *"Under the current regulatory regime, railways are effectively prevented from replacing government-owned hopper cars with modern ones. New hopper cars would immediately increase the capacity and efficiency of grain movements throughout the GHTS."*

New hopper cars are shorter, can carry more grain, and allow for additional cars to be carried by a unit train. But with a price tag ranging from $75,000 to $95,000 per new car, the cost of replacing the fleet is estimated between $630 million and $800 million. Under the current regulatory regime, railways are effectively prevented from replacing government-owned hopper cars with modern ones. New hopper cars would immediately increase the capacity and efficiency of grain movements throughout the GHTS.

> *"Freeing western grain movements from the arcane regulatory approach of the past is essential to Canada's international competitiveness. The Revenue Cap—first introduced as a temporary measure 15 years ago—lies at the heart of the failures of Canada's grain handling and transportation system, and stands as a threat to its continued health."*

The Revenue Cap also creates a disincentive for railways to move grain in containers. Containerization provides a means of segregating and shipping exact quality specifications to buyers, which the market rewards, and is of particular value to farmers of specialty crops.

The large inventory of empty backhaul containers moving through Western Canada en route to Asia could provide important additional capacity to address the periodic surges and super surges in grain export demand. However, the railways' costs are higher for container movements, so the rates charged to load grain into containers on the Prairies must be higher too. The extra revenue earned from moving containerized grain shipments also eats up the Revenue Cap more quickly. Ultimately, this forces the increasing number of shippers who want to move their grain in containers to ship their product to the ports by other means, where it can be transloaded into containers.

The regulation of grain transportation in Canada is unique. Unlike all other commodities transported by rail through commercial arrangements that reflect market-based principles, the federal government has intervened continuously and, too often unsuccessfully, in the transportation of grain by rail. The latest intervention is the *Fair Rail for Grain Farmers Act* and its associated regulations, which stipulate minimum volumes of grain that must be moved during the peak shipping season by Canada's two Class 1 railways. These regulations, combined with the Revenue Cap, mean that the government now regulates price and quantity while also owning an aging and diminishing fleet of hopper cars.

Freeing western grain movements from the arcane regulatory approach of the past is essential to Canada's international competitiveness. The Revenue Cap—first introduced as a temporary measure 15 years ago—lies at the heart of the failures of Canada's grain handling and transportation system, and stands as a threat to its continued health.

First, western Canadian farmers have lost market share and incomes because the GHTS is inefficient. Second, delays in investment to modernize the GHTS or to introduce innovation mean that inefficiencies will continue to persist, and farmer incomes will be reduced. Third, to the degree that grain transportation does not pay its full costs, other commodity shippers must. Therefore, the Revenue Cap acts like an export tax on all non-agricultural products.

Free markets work to create system efficiencies. In the end, Western Canadian farmers have more to gain from recovering their share of a growing world grain market than from whatever perceived protection Canada's current regulatory system has to offer. P

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The Port of Vancouver, Canada's principal transportation gateway to the Pacific Rim. Shutterstock photo

Right-Sizing Canada's Transportation System: A Critical 21ST Century Policy Challenge

David Lindsay

Transportation infrastructure takes a long time to build, and shifting trade patterns make it challenging for transportation capacity to keep pace. That's why we need to better analyze the existing transportation system as a whole—to find solutions, we need to better understand the problems. Together we need to look at how to expand capacity, improve flexibility and maintain the economic efficiency of our system.

"If some countries have too much history, we have too much geography."

Prime Minister Mackenzie King
House of Commons, 1936

Mackenzie King was on to something—Canada's immense geography, in large part, explains our economic history. Our fish, fur and forests led explorers up our waterways and into the heartland of the continent. The building of the Canadian Pacific Railway and the St.Lawrence Seaway were huge, visionary projects. Transportation corridors opened up the country and enabled people to get to our resources and helped get our resources to people in

markets around the world. Having adequate transportation helped build Canada and adequate transportation will continue to be needed for Canada to achieve its economic potential as a trading nation.

The great Canadian historian Harold Innis developed what he called a "staple thesis" asserting that the export of natural resources of staples such as fur, fish and forestry from Canada had an impact on not only our economy but our social structure and our political institutions.. Professor Donald Creighton and political economist W.A. Mackintosh of Queen's University also studied the relationships among our economy, our geography and our political structures.

During the last 25-plus years, as the importance of the high-tech economy grew, the significance of Canada's transportation system hasn't had the same attention. But, considering that Canada is a trading nation—an export economy with a wealth of natural resources transported across long distances to access world markets—it's a debate we need to re-engage.

The federal government is now undergoing a review of the Canadian Transportation Act, as it does roughly every 10 years. This is an important step but nowhere near enough. We need a much deeper and much broader policy reflection on ways to expand the capacity, improve the flexibility and maintain the economic efficiency of our transportation system. We need to bring together the best data and the best minds to see if our current transportation system is an enabler or a barrier to our potential growth.

The goal is an extensive and far-reaching review, and that's not always easy. Politicians often look for short-term fixes or tinkering at the margins. Using health care as an example, the desire to find ways to get best value for money and to effectively and efficiently deliver health care can get sidetracked because of the immediate financial pressures, some new medical miracle or the short-time horizons of electoral cycles. Instead, whether it is health care or transportation, what we need is a deeper collective policy debate with a long-term view.

> ***"We need a much deeper and much broader policy reflection on ways to expand the capacity, improve the flexibility and maintain the economic efficiency of our transportation system."***

We've had these kind of wide-ranging discussions before. In the not-too-distant past, the Macdonald Royal Commission of the 1980s paved the way to free trade and competitive tax policies. In the 1990s, there was a wide-ranging public policy discussion on how to avert the brain drain and enhance our innovation economy. We need that type of public policy focus on Canada's transportation needs. Past deliberations have tended to focus narrowly on urban infrastructure such as giving cities a portion of the gas tax or the importance of public transit. What is needed now is to tackle the policy question of how to create a world-class 21st century transportation system as a linchpin of our export economy.

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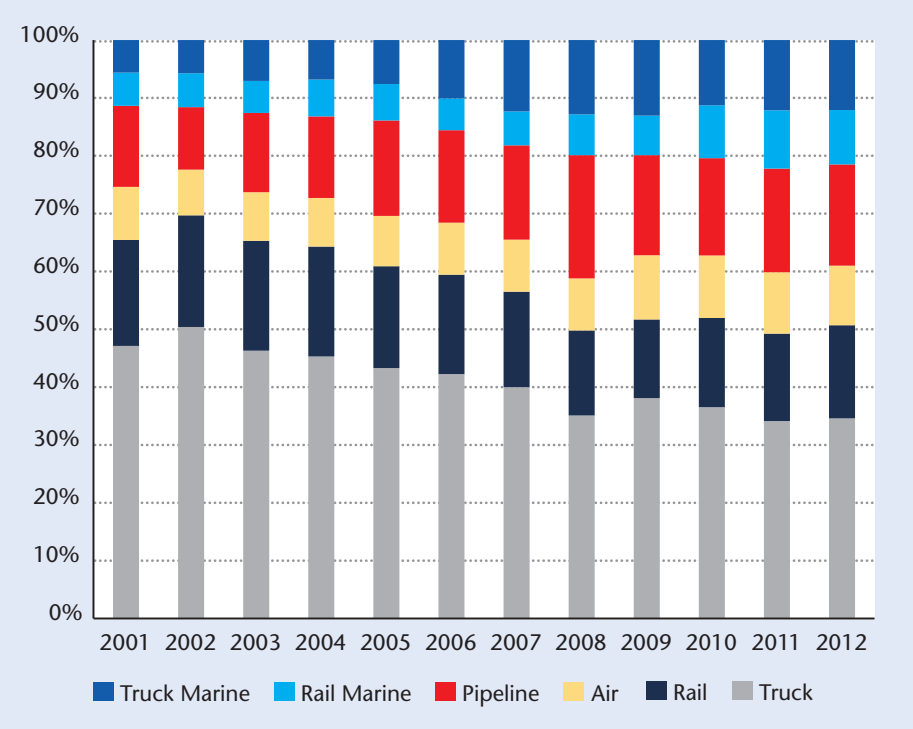
The Conference Board of Canada is already taking up that challenge. It has launched a strategic review of the country's transportation system and is collecting the vital data required to assess the current state of play. Already it has made some interesting discoveries. For example, when looking at the trend lines for exports and imports

FIGURE 1: Canadian Exports by Mode of Transport. Share of Total Value



Source: The Conference Board of Canada

first by tonnage and then by value, it found a surprising dichotomy. By weight, our exports surpass imports. However that reverses when it comes to dollars per tonne, whereby imports are worth much more. This difference suggests we are exporting more bulky commodities using elevators, terminals and railcars dedicated to specific commodities which may not be needed by our imports and can exacerbate a "backhaul problem"; an imbalance in transport flows or the challenge of getting often empty equipment back to an area of demand. How does this impact the efficiency of our transportation network?

The Conference Board also found that in 2002, 70 per cent of the value of exports was purely by surface mode, such as trucks and trains. Now, as marine transport has become more important, it's down to 50 per cent, a large shift in a short period of time because of our growing trade with countries other than the United States. Yet arguably, our transportation system has not grown to accommodate that change. When there are bottlenecks at the Vancouver port, are we jeopardizing our reputation as reliable suppliers in the world market? Do we have what it takes to be an export superpower and take advantage of the growing number of trade deals such as the Canada-Europe free trade agreement or a Trans-Pacific Partnership?

Transportation infrastructure takes a long time to build, and shifting trade patterns make it challenging for transportation capacity to keep pace. That's why we need to better analyze the existing transportation system as a whole—to find solutions, we need to better understand the problems. Examining the data and developing policy solutions based on evidence rather than emotion is the only way to ensure that Canada has an efficient and economically competitive transportation system.

And there is a lot of emotion in the transportation debate. As the old adage goes, "Where you stand depends on where you sit". What is in the best economic interests of grain shippers might conflict with others such as the potash or forest industries. The most efficient and profitable way for a carrier to operate might not be optimal for a shipper. There is also the best interest of society in general to consider. Balancing the interests of individual carriers and individual shippers, while keeping an eye on the larger public good, is not an easy task.

> ***"In the forest industry we used to ship more than 80 per cent of our products south to the United States but those shipments are now closer to 60 per cent. Forest products are now Canada's largest export to China and our sales to the Pacific Rim continue to grow."***

Many of our resource industries are located in far-flung communities and single-industry towns that are captive to a single form of transportation—if they cannot get their goods to international markets via a robust and reliable transportation system, the town can shut down. Again, we need to accommodate the huge distances in Canada. It takes an average of 1,500 kilometres to transport grain from Saskatchewan to tidewater. In Australia, it averages just 400 kilometres. Canada needs a transportation network that serves the vast geography of our country so we can compete with smaller countries, more densely populated nations or countries with much shorter distances to ports.

Many of the key transportation assets in Canada were traditionally owned by government but Ottawa has privatized or commercialized CN, Air Canada and our airports, and replaced ownership with oversight and regulation. No one is calling for the government to again take over control of our transportation infrastructure. However, with the challenges of distance, we need the public sector to work with private interests to truly understand the challenges and issues from all perspectives.

Governments must be part of any broad policy discussion about the economic opportunities and economic challenges now facing Canada and where the transportation system fits in. Together we need to look at how to expand capacity, improve flexibility and maintain the economic efficiency of our system. We need seamless access across borders. We need flexibility and surge capacity. We need interconnectivity and an ability to be nimble. We need to right-size the transportation system to unlock Canada's economic potential and get our products to market in a reliable way.

We have already referred to our longest serving prime minister, Mackenzie King, but we should also take inspiration from our first prime minister, Sir John A. Macdonald. His National Policy knit this country together by building railways to accommodate east-west trade flows despite the fact that north-south was, and still is to a lesser degree, the natural flow. Nearly a century and a half after the completion of the CPR, the east-west flows have become more important than ever with the growing economic importance of Asia. In the forest industry for example, we used to ship more than 80 per cent of our products south to the United States but those shipments are now closer to 60 per cent. Forest products are now Canada's largest export to China and our sales to the Pacific Rim continue to grow.

Our challenging geography made Canada, and our geographic distances remain a challenge today. Our resource sector helped build this country and the resources of Canada will continue to be in demand well into the future. So let's be as bold and visionary as our forefathers and have a public policy debate on ways to "right-size" the transportation system. Job creation and prosperity for Canada depend on it. P

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