Canada, energy superpower or supermarket?

Pierre-Olivier Pineau
Associate professor at HEC Montréal
Published in Spanish in ***La Vanguardia Dossier***, January-March 2011 (www.vanguardiadossier.com)

As the world population and consumption grow, Canada's large natural capital will increasingly appreciate in commercial value, due to the associated increased demand for natural resources. With its small and educated population, political stability and large open spaces, Canada could place itself as a key world player, supplying not only energy, minerals and agricultural products, but also technology and other goods and services. Furthermore, its lower exposure to negative climate change consequences and its distance from hostile neighbours will fortify the competitive advantage of Canada over other countries as a "good place to live and do business". However, there are many challenges limiting the rise of Canada as a real superpower. The country could indeed simply become the best "resources supermarket" of the world, without playing any greater role. This article reviews Canada's strengths but also challenges in its possible further rise as an economic superpower.

Energy, minerals and other natural resources

Canada stands at the top of the world with respect to energy production: 1st uranium producer, 2nd in hydropower, 3rd in natural gas, 6th in oil and 14th in coal. It can also sustain these levels for many years to come, due to high levels of reserves, among which the non-conventional oil sands (in Alberta) and shale gas (both in western and eastern provinces). This energy diversity is exceptional, and given the relatively small population of the country (34 million), unrivalled on a per capita basis. It even has a much further diversified natural resources sector with its minerals sector. Indeed, Canada ranks in the top 5 producing countries for potash (a key fertilizer), nickel, cobalt, titanium, platinum, aluminum, zinc, salt and chrysotile (asbestos) – the much criticized mineral still used in the building industry in some parts of the world. In addition, it produces significant amounts of magnesium, lead, gold, copper and silver – within the world top 10 in each case. Finally, with its vast forest and plains, Canada has a large wood and agricultural production and exports wood products, paper, cereals and meat.

But despite the scope of its natural resources sector, the contribution of energy, mines, forest and agriculture to the Canadian economy is not excessive: less than 7% of the Canadian GDP in 2009. The Canadian economy is indeed largely oriented towards services-producing industries, accounting for more than 70% of the GDP. The GDP stood at about 1.5 trillion Canadian dollars (or about 1 trillion euro) in 2009. Even the (declining) manufacturing sector is still almost twice as important as natural resources.

Canada has a very strong financial and banking system – which remained largely unaffected by the 2007-2010 global financial crisis. Five of the 10 largest publicly traded Canadian corporations are financial companies (bank and insurance); the other five are in the natural resources sector (2), telecommunication, transportation and technology (Research in Motion, the Blackberry developer). Many privately held companies are also important in Canada. They are either subsidiaries of multinationals or family owned. One of the most renowned companies among these is the Cirque du Soleil, although it remains much smaller than the largest ones, to be found again in the financial, natural resources and telecommunication sectors.

Strong Canadian institutions, and strong Canadian disputes

Beyond the natural capital of the country and its dynamic service sector, Canada benefits from an "institutional endowment" among the strongest in the world. The public education system is of high quality and universities are much more accessible than in the US, thanks to important provincial government subsidies and scholarship programs. With a universal single payer health care system, health expenditures per capita (in US dollar power purchase parity) are about half the US expenditure level. This brings the hard to quantify, but real, benefit of having a complete population living free of health coverage stress. Companies also avoid the additional cost of having to offer basic health insurance coverage to attract workers. Employment insurance, social assistance and other various social programs help maintain the percentage of the population living in poverty at about 10%, and income inequality is much lower than in the US. The Canadian GINI index is indeed similar to the Spanish level, at 32, compared to 45 in the US (2005 data).

On the political front, Canada's system allows multiple parties to be represented within the federal parliament, from the right-wing Conservative Party (forming the current minority government), to the left-wing New Democratic Party, including the more center-right Liberal Party (official opposition) and the Quebec pro-independence Bloc Quebecois. Similar diversity is usually found in the 10 provinces – except of course for pro-independence parties, only found in the French speaking province of Quebec.

The Canadian constitution, which is still under debate because of important disagreements over the type of recognition the province of Quebec should receive (Quebec asks for a special status among other provinces, due to its linguistic and cultural differences, a concept rejected by most Canadians), is key to understand Canada as a country. It divides areas of power between federal and provincial governments. Provinces, for instances, have control over their natural resources (mineral rights, hydropower, forest...), education policy and management of their health system, among other sectors. They can levy income and sales taxes to the level they want. The federal government also collects income and sales taxes and in return provides collective public good such as the higher level justice system and military services. In order to keep some uniformity across the country, some common health care rules are also set at the federal level, although implementation is left to provinces. Furthermore, some financial transfers are made from the federal government to provinces, to help them provide reasonably comparable levels of public services. Some of these transfer payments are made according to the wealth level of the province, which leads to some redistribution of some financial resources between "have" and "have-not" provinces. For instance, provinces with large tax-based revenues (such as, historically, Ontario) or high natural resources royalties (Alberta) will end up seeing some of their wealth going to other provinces with less governmental revenues (such as, historically, the Atlantic provinces) or high governmental expenditures (such as Quebec). Quebec receives the lion share of these "equalization payments": about Can$ 8 billion in 2010, or 11% of it provincial government budget (about Can$ 70 billion). There are of course lively debates in Canada on the relevance of these transfer payments, with many voices being critical of such transfers. This is particularly true since in recent years, transfers largely resulted in Alberta financing some expenditure in Quebec. Somehow paradoxically, these same critical voices are seldom in favour of the independence of Quebec, which would put an end to such financial handovers.

Provincial disparities are a concern in Canada, and they are indirectly related to the Canadian constitution, which places natural resources under provincial jurisdiction. Although the average GDP per capita is about Can$ 45 000 (about 32 000 euro), it reaches almost twice this level in Alberta (Can$ 80 000, or 56 000 euro), where 10% of the population lives. The GDP per capita however drops to the Canadian average in Ontario and even lower in Quebec (Can$ 38 000, or 27 000 euro), the two most populous provinces, representing about 60% of the population. This means that some provinces contribute financially more to the federal government (through federal taxes) than their proportion of the population. Their political representation, however, is not higher in terms of elected members of the Canadian parliament. This adds to some long-standing frustrations, from Western provinces such as Alberta, related to politics and policies dominated by "Eastern" concerns (mostly from Ontario and Quebec).

These internal frustrations have a direct source in natural resources, more precisely hydrocarbon production, and the wealth associated with them. Indeed, more than 70% of the "liquid hydrocarbons" (crude oil, synthetic crude oil from oil sands and other liquefied petroleum gases such as butane or propane) are produced in Alberta, while more than 75% of the Canadian natural gas is also produced there. Given the fact that all natural resources rights belong to provinces, Alberta collects all the direct benefits from oil and gas production. These benefits come from two sources: the sale of land leases to private oil and gas companies (giving them the right to produce oil and gas) and royalty payments on oil and gas production from these companies. In 2009, these non-renewable resource revenues amounted to almost Can$ 12 billion (8.5 billion euro) for the Alberta government, or 1/5 of its total revenue. The only benefits reaped by other Canadian provinces from this industry are indirect: through higher federal income and corporate taxes collected in Alberta and from the economic activity induced by Alberta's economic growth, which translates for some firms outside Alberta in additional contracts. There are, however, two significant sources of irritation for Canadians: the higher value of the Canadian currency derived from the oil and gas exports (mostly to the US) and the environmental consequences associated to the Alberta oil and gas sector, notably in terms in greenhouse gas emissions (GHG).

The Canadian dollar in most of the recent history has had a much lower value than the American dollar. With an exchange rate at around Can$ 1 = US$0.80 between 1980 and 2000, Canadian products were relatively cheap for US customers and this helped the Canadian export sector. Since 2000, however, the rise of the oil price strengthened the value of the Canadian currency. It is now highly correlated to the price of oil and reaches parity with the US dollar, which hurts all exports from Canada to the US. Indeed, after energy (22% of the value of all Canadian exports), the main Canadian exports are industrial goods (21%) and machinery and equipment (also 21%), mostly from Eastern provinces to the US – which receives 75% of all Canadian exports. With a stronger Canadian dollar, these exports are less competitive and Canadian companies are less profitable. Alberta oil and gas production, through its impact on the Canadian dollar, consequently results in a lower competitiveness for other Canadian goods and services. Although this can be partly compensated by an increased capacity from Canadian firms to invest in productivity-enhancing technologies (by making the acquisition of foreign technologies more accessible), the short term impact is to contribute to the decline of the manufacturing sector and other export-oriented Canadian industries.

The second source of irritation from Alberta comes from its poor environmental record. Indeed, with only 10% of the population and 14% of the Canadian GDP, Alberta is responsible of 33% of all Canadian GHG emissions. GHG emissions are an environmental issue for which the federal government has formal responsibilities, because of international negotiations and agreements. Consequently, contentious questions exist in the development of a Canadian GHG policy, which inevitably will have a proportionally greater impact in Alberta. GHG emission intensities in that province are much higher than the Canadian average: 70 tonnes per year per capita in Alberta against 22 in Canada. For every dollar of GDP in Alberta, about 1.4 kg of GHG is emitted, against 0.6 kg in Canada, on average. Canadian provinces that would be ready for a carbon tax or a cap-and-trade system (such as British Columbia, Ontario and Quebec) systematically face an extremely strong opposition from Alberta.

Implications for the future of Canada

The potential for Canada to use its natural and institutional assets to place itself in a "superpower" position is severely limited by these internal frictions and the decentralization of power embedded in the Canadian constitution. As seen previously, while provincial wealth is partly redistributed, this is often felt more as a source of tension than of unity in the country. Developing a strong Canadian economic and energy policy – to maximize the benefits for Canadians of their natural resources – is a very difficult task that is seldom discussed by politicians, fearing to enter into endless federal-provincial constitutional debates. Furthermore, developing a constraining GHG policy is also politically tricky, because of the strongly diverging provincial interests. Without national unity, it is unlikely that Canada could make its energy and economic importance felt at the international level. Indeed, behind the diplomatic image of a single Canadian position, there are rather 10 different voices speaking, one for each province. Each has a different set of interests, its own message and unequal means to make it heard.

But even more problematic for the rise of Canada as an energy superpower is the choice of letting the private sector, and in many instances the foreign private sector, develop the energy sector. Indeed, except in hydropower, almost all energy companies are publicly traded or privately held companies, which pay low royalties for their exploitation of natural resources when compared to international standards. Even worse, Canadian provinces compete among themselves to attract investors in the oil and gas sector, which results in a race to the bottom in terms of fiscal benefits from the oil and gas production. Over the years, this situation meant that although Canada produced a cumulative 32 billion barrels of oil, mostly in Alberta, it has only saved for future generations about US$ 10 billion in Alberta's "Heritage Fund". To put this in perspective, Norway only produced a cumulative 22 billion barrels in its oil history but succeeded to save in its own sovereign wealth fund more than US$ 400 billion. Even countries such as Libya or Algeria, that have produced less oil than Canada, have been able to save larger financial oil resources for future generations. This approach means that not only is most of the natural resources wealth transferred to private companies, very little of the financial gains are saved for the future. One could argue that given the scope of the remaining natural capital accessible to Canadians, there is no need to save anything. While this can appear attractive, it is hardly sustainable, especially since Canada has increasing governmental and household debt levels, along with high consumption and government expenditures. Instead of becoming increasingly in charge of their collective destiny, Canadians are placing themselves under the control of lenders, with a limited ability to maximize the benefits they obtain from energy resources, due to the lack of direct control they have in the energy sector. The provincial distribution of power, as defined in the Canadian constitution, only creates additional complexities in the search of a solution.

The situation in energy only differs from other natural resources sectors due to the financial importance of the sector: since oil and gas prices have increased significantly over the last 10 years, while consumption continued to be high and growing, more important sources of wealth are found in that sector. But the same absence of national control, Canadian policy and strong environmental framework characterizes all other natural resources sectors.

With increasing pressures to implement constraining environmental rules, notably over GHG emissions, and with the continuation of financial disparities between provinces, a common Canadian voice will be very difficult to emerge. With its market openness, Canada is much more likely to become the world's best "natural resources supermarket", instead of the world most influential natural resources producers. The lack of environmental leadership within Canada will also damage its international credibility. Over the long term, unless it finds an innovative approach to coordinate and settle its multiple disagreements, the Canadian assets will in all probability only contribute to feed natural resources to the world, and little to strengthen the position of Canada as a leading global voice.

Further readings and sources

Canadian Minerals Yearbook (CMY) – 2008, "Statistical Report". http://www.nrcan.gc.ca/smm-mms/busi-indu/cmy-amc/2008revu/stat-stat/statrep-donstat-eng.htm

CIA World Factbook, "Canada". https://www.cia.gov/library/publications/the-world-factbook/geos/ca.html

Globe and Mail – 2010, "Rankings of Canada's top 1000 public companies by profit". http://www.theglobeandmail.com/report-on-business/rob-magazine/top-1000/rankings-of-canadas-top-1000-public-companies-by-profit/article1608779

OECD (2010) *OECD Economic Surveys: Canada 2010*, Paris: OECD.

Statistics Canada – 2009, "Gross domestic product at basic prices, by industry". http://www40.statcan.gc.ca/l01/cst01/ECON41-eng.htm