1. You have been engaged by Prime Minister Harper and Premier Redford as their joint economic adviser to consult with them on strategies to address the immediate socio-economic, and probable political fallout, presented by the current price differential for Alberta oil as well as the new reality – an abundance of natural gas in North America as a consequence of new technologies allowing for the economic extraction of shale gas. Importantly, the Prime Minister and Premier expect your recommendations will promote sustainable growth, and consequently, minimize the boom-and-bust scenarios that have plagued the Alberta economy over the last half century and that today are expected to impact most Canadians.

Your recommendations on strategies should draw upon lessons learnt from the cases and readings (i.e., the Course Syllabus) during similar social and economic disruptions. You should also consider the role of foreign direct investment (FDI) in the Canadian economy, and the role of private-public partnerships to finance any capital-intensive strategies. You might also want to consider whether the amendment to the British North American Act giving the western provinces control over their natural resources should be renegotiated and on what grounds.

You may draw from other materials presented in the lecture slides and/or other relevant, factual knowledge and awareness about the issues you may have.

[15 marks]

Twilight of an energy boom: Alberta's new fiscal challenge

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A squared-off concrete shell sits in a frozen field, a short distance from Highway 63 north of Fort McMurray. It was to be the first building block of the $11.6-billion Voyageur oil sands upgrader [An upgrader is a facility that upgrades bitumen (extra heavy oil) into synthetic crude oil.], which was taking shape in 2008 as the latest megaproject to inject adrenalin into an Alberta economy that was already riding high on its good fortune.

Energy

A half decade later, the concrete shell is still there, but the ebullience [zestful enthusiasm] is long gone. This week, Suncor Energy Inc., the oil sands giant that has partnered with Total SA to build Voyageur, took a $1.5-billion writedown on the project – now at imminent risk of cancellation.

The grey slab has all the subtlety of a giant tombstone. "It has been a depressing derelict standing there for years now," says Wayne Prins, provincial director for the Christian Labour Association of Canada (CLAC), representing vast numbers of oil sands workers, who once saw Voyageur as the next ticket on the endless train of long-term prosperous employment.

The forlorn shell symbolizes the hollowing out of Alberta's hopes and dreams, as it confronts an energy market that has turned dramatically against it. It is a signal of how fast Alberta has fallen, as it tumbles back to the pack of provinces with severe fiscal challenges. The provincial government has just seen $6-billion wiped off its revenues as a result of declining resource income – equivalent to the province's annual education budget.

Alberta has, in the past, seen salvation come in dramatic form: In 1999, it pulled in $2.4-billion in resource revenues. Two years later, $10.6-billion came clattering into a province that was riding a rise in natural gas prices.

But the window appears to be rapidly closing on Alberta's decade-long run, and its dream of being the economic driver of Canada in the 21st century. It may signal the end of the Alberta Advantage that has shifted the economic balance of the country westward. And if Ontario is on the ropes, and Alberta is wobbly, who will lead the country's growth?

Alberta has been here before, at the tail end of energy-fuelled booms that made its people very wealthy, but taught very little about building stable prosperity. Now, it appears to be entering a longer period of more profound decline, and, once again, it is caught unprepared.

"It's amazing how fast it all moved," says David Emerson, the former federal cabinet minister who is now a corporate director and policy thinker...He was part of a recent task force that was charting a new and ambitious economic strategy for the province – and he now has doubts about the fate of that policy road map.

Mr. Emerson and other economic observers were startled by a cascade of developments, led by last fall's projections by the International Energy Agency (IEA) that the United States, the

province's major market, will surge to energy self-sufficiency by 2035, propelled by the country's shale oil and gas boom.

As the U.S. market becomes more daunting, plans for oil pipelines to gain access to growth markets in Asia meet determined resistance, with any prospects for new projects stretching out a decade, if ever. The province seems fated to face continuing steep price discounts, as a captive in an oil-glutted North American market. There is no national consensus on balancing oil sands growth and the environment, and natural gas prices are in the tank for the foreseeable future, as new supply floods the market.

The bottom line: Being the world's third-largest storehouse of proven oil reserves is not quite so attractive when you face a $25 to $42 discount on every barrel you send into the world.

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This new reality may have one positive aspect – a rebalancing of the national conversation, as reflected in last week's meeting of the premiers of Alberta and Ontario. If they had met six months ago, the tone would have been very different: Ontario might have scolded Alberta about the pain of a petro-charged dollar; Alberta could have issued a rejoinder on the oil sands' gifts to the national GDP.

But Alberta Premier Alison Redford and Ontario's premier-designate Kathleen Wynne communicated a sense of being partners in pain, two relatively new leaders saddled with excruciating fiscal pressures, and infused with a desire to learn from each other's troubles. Old debates over "Dutch disease" [below] and climate change have not disappeared, but they are overshadowed by a shared fiscal dilemma.

....

In a Toronto speech, [Premier Redford] emphasized, once again, that all Canadians have a lot riding on Alberta's economic future. A long-term structural decline in the energy industry would touch everything from regional equalization payments to jobs for underemployed workers from other regions.

This week, federal Finance Minister Jim Flaherty expressed concern about the impact of oil price woes on his own budget planning....Like it or not, Canadians' standard of living is directly linked to Alberta's success in selling its energy to the rest of the world.

"Canadians have not developed an acute appreciation of the extent to which our fiscal situation is dependent on the Alberta growth factor and the natural resource revenues," Mr. Emerson says.

He is particularly aware of what's at stake, as part of a talented collection of policy wonks who produced a blueprint for how Alberta could get off the dizzying roller coaster of oil and gas cycles and propel itself toward sustainable economic growth.

The Premier's Council for Economic Strategy... charted a path to divert more of the province's non-renewable oil and gas bounty to such things as advanced technologies, water renewal and clean energy. Diversification has always been an elusive dream in Alberta....The energy economy was booming and there was time and money to put this strategy into place.

....

Michael Percy, professor and past dean of the University of Alberta business school... is most alarmed over the transportation bottlenecks that isolate Alberta from key markets, including the United States. "The IEA did say that every barrel of oil produced in Alberta will be required, it just didn't say how we would sell it," he says.

Capital markets, particularly foreign investors, echo this frustration. Crescent Point Energy Corp., once an energy sector darling, has seen U.S. investors fall from 35 to 22 per cent of its shareholder base in the past year. Oil sands companies say similar factors have kept their stocks depressed, owing in part to a coolness from south of the border that dates as far back as 2009.

"There has been a loss of faith in the economics that are being presented by the producers here,"....Pipeline problems are largely to blame. "They think we have a lot of trapped oil up here in Alberta,"...."They think we're just on the wrong end of the pipe. They think [price] differentials are absolutely going to slaughter us."

....

Of course, any economic fallout from the energy crisis could, in time, be partly balanced by some recovery of manufacturing in Central Canada and the growth of, say, B.C. and Quebec mining or Newfoundland offshore energy. Premier Redford talked of the potential for value-added agriculture, as well as water and wind. But manufacturing, in particular, still faces competitive challenges and draws benefits from the oil and gas industry's spinoffs. And none of these sectors is ready, or large enough, to fill the gap left by a stagnant energy sector. Saskatchewan, the other economic driver in the West, is another commodity-reliant province, much like Alberta.

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To some extent, the sense of urgency is undercut because the economic signals are still contradictory. Out in the field, there is little evidence yet of a slowdown. In 2012, the CLAC represented more than 10,000 workers in the Wood Buffalo region where most of the oil sands is located. That was a new record, surpassing the previous peak of 8,600 in 2008. CLAC expects to add a further 15 per cent in 2013. Worker shortages are acute enough that Mr. Prins suggests a reporter "put down the pen and pick up a wrench."

But elsewhere, the signs of a downturn have already appeared: Talisman Energy Inc. is slashing its office expenditures this year by some 20 per cent. At least some of that will come from cutting jobs, and rumours of impending work force cuts at other companies abound in Calgary. And now, the CLAC's Mr. Prins acknowledges that the spectre of Voyageur is an ominous one.

"It's not altogether doom and gloom, but it's certainly a warning that a slowdown in the industry in general isn't out of the equation."

What's more, Alberta's track record in managing its bouts of economic whiplash is not promising. In the past, when a boom would end, there would be a resolve that hard-headed realism would assert itself the next time around. It never did.....

.... reality hit home in October, he says, when the normally flat differential between the price of West Texas intermediate crude and Western Canadian heavy oil suddenly soared, slashing the per barrel revenue of Alberta producers. "It crashed in the last 90 days and no one saw it coming."

The result is a severe economic challenge, which, he says, might finally force Alberta to face facts. "I see this as an opportunity. We were getting soft and our entitlements were getting big. We were fat, saucy and arrogant and we had to have our chain yanked. "

Mr. Emerson, who ran a Western Canadian bank in the storm-tossed 1980s, also hopes for a new realism, but he knows ingrained behaviours are hard to overcome. And this time, Alberta is facing a large structural adjustment as well as a cyclical downturn. There is still time to make the policy moves – and sacrifices – to build a post-hydrocarbon economy, he believes, but "we are a little late in the game, and we were not prepared for the changes taking place."

1. Dutch Disease (March 7th lecture)

- In economics, the **Dutch disease** is the apparent relationship between the increase in exploitation of natural resources and a decline in the manufacturing sector.
- The mechanism is that an increase in revenues from natural resources (or inflows of foreign aid) will make a given nation's currency stronger compared to that of other nations (manifest in an exchange rate), resulting in the nation's other exports becoming more expensive for other countries to buy, making the manufacturing sector less competitive.
- While it most often refers to natural resource discovery, it can also refer to "any development that results in a large inflow of foreign currency, including a sharp surge in natural resource prices, foreign assistance, and foreign direct investment".

The term was coined in 1977 by *The Economist* to describe the decline of the manufacturing sector in the Netherlands after the discovery of a large natural gas field in 1959.

2. Additional information/assumptions

I. Canada's credit rating is AAA; that of the United States, AA.

II. Assume currently the Canadian $ and the American $ are at par.

III. Note Alberta has the lowest personal income tax rate in Canada prompting some Canadians to establish residency there. Further, due to oil royalties, Alberta, at various times, has refunded to Albertans a portion of the income taxes they paid.

IV. Canada presently has lower corporate tax rates than in the United States.

2. Referencing the *Canadian Automobile Industry case* (Auto Case), explain, in short paragraph format:

a) What possible changes could have occurred within the automotive sector if the Reciprocity Agreement of 1911 had been ratified?

b) What changes did occur within the automobile industry as the result of The Robb Budget?

[Each subsection is worth 2 ½ marks. Each relevant and accurate point will be given a ½ point.]

3. Multiple- choice [Each correct answer is worth ½ mark.]

Please circle your answer choice.

1. In the last two decades of the twentieth century, there was less than 1 million tons of nickel **discovered** in Canada. During which decade, were the major nickel discoveries made in Canada?

(3)

a. The 1950s;
b. The 1890s;
c. The 1940s;
d. The 1920s; or
e. The 1980s.

2. A 'monopoly' exists

a. when there is a single supplier of a good or service and there are no viable substitutes for that good or service;
b. when there is a single buyer of a good or service and there is no other suitable buyers;
c. when a buyer or seller has better information about the technology employed to produce a good or deliver a service;
d. when there are many sellers producing highly differentiated goods or delivering highly differentiated services; or
e. when there are few suppliers of a good or service.

3. The period 1955 – 80 was referred to as the 'buoyant years' in Relentless Change. During this period, the financial condition of Inco:

a. improved for the price of nickel more than doubled and its major nickel-ore discovery in Thompson, Manitoba was in production;
b. was negatively impacted by long and costly strikes almost every three years because it failed to renegotiate a contract with its Canadian unions; in particular, the United Steelworkers of America, without a strike;
c. deteriorated due to its significant inventory and debt carrying costs;
d. improved for the price of nickel more than tripled, worldwide demand for nickel was at an all-time high, and there were still few global producers; or
e. was negatively impacted due to the fact Inco's market share decreased by approximately 50 % despite the quadrupling of the price of nickel.

4. Which economic model best describes the Canadian economy today:

a. a free market economy;
b. a mercantile economy;
c. a capitalist economy;
d. a mixed economy; or
e. an agrarian economy.

5. Where a Crown corporation is used as a 'regulatory tool', it is generally when there exists –

   a. a natural monopoly;
   b. a sensitive industry;
   c. an enforcement need to achieve public policy objectives;
   d. (a), (b) and (c); or
   e. (b) and (c).

6. Foreign Direct Investment (FDI) refers to which of the following:

   a. the purchase by American investors of a controlling stake in Canadian firms;
   b. the inflows of investment into Canada to acquire a lasting management interest in a company other than that of the investor,;
   c. the outflows of investment by Canadians to acquire a lasting management interest in a company other than that of the investor,;
   d. the net inflows of investment into Canada to acquire a lasting management interest in a company other than that of the investor; or
   e. Federal Disclosure of Information, a requirement for Canadian firms.

7. Which of the following is a reason why nations engage in international trade?

   a. Resources are incompletely distributed across the globe.
   b. The climate and terrain of a state.
   c. The skills set of its labour force.
   d. The advantages of specialization.
   e. All of the above.

8. Which of the following are barriers to trade?

   a. currency devaluation;
   b. local content requirements;
   c. corporate income taxes;
   d. all of the above; or
   e. (a) and (b) above.

9. Which of the following statements on the competitive pressures facing Eaton's after Simpsons became Sears partner is **incorrect** based on the facts in the case?

   a. Due to the large capital investment in a new store location, Simpsons-Sears reduced the threat of new retail entrants by carefully analyzing the potential growth of consumer activity for any particular new store;
   b. Simpsons-Sears increased the competitive rivalry within the retail space by engaging a committed workforce through its profit-sharing plan;
   c. Simpsons-Sears increased the competitive rivalry within the retail space by offering customers service improvements, such as installment sales;
   d. Simpsons-Sears recognized the bargaining power of customers in the retail space, and consequently, reduced prices on appliances and furniture; or
   e. Simpsons-Sears increased the competitive rivalry within the retail space through its utilization of an efficient, centralized merchandizing system.

10. Which best describes the "irrational exuberance" demonstrated in the CNR Case?
    a. illogical exuberance;
    b. unfettered exuberance;
    c. incompetency;
    d. lack of accountability; or
    e. arrogance.