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Energy Canada's resource curse: six strategic reasons to escape the 'Staples Trap'

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I. The curse of short-termism

Canada has been both blessed and cursed by its vast resource wealth. The global boom in commodity prices for Canada's energy, mineral, and agricultural exports beams the wrong message to the political class. It tells them thinking and planning for tomorrow is unnecessary when record high global prices and free trade drive Canada's economic development at a frenetic pace. In these circumstances would there be sufficient new benefits from the TPP, if concluded, to stop the haemorrhaging of jobs from a shrinking industrial sector, close the widening productivity gap between Canada and the US and build stronger industries? Many Canadians are of the view that the TPP is likely to be a replay of NAFTA style economic integration with elusive benefits but on a

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vastly scale with similar kinds of risks and too few opportunities for Canada to shine. These suspicions are for the time being irresolvable because the TPP is being negotiated in secret and there is no public scrutiny of the details and the 'final offer' Ottawa has put on the table. It is ridiculous in an information age that there is no hard information available.

Experts can piece together the broad outlines of a deal but all this remains in the realm of conjecture. The need for secrecy and the odour of deal-making has already raised the hackles of the public and the new social movements. None of this is surprising. History is helpful about the fate of trade covenants revealed to the public after the facts. The Multilateral Agreement on Investment fell apart due to the suspicions and secrecy it created in the minds of anti-globalization movement of the late 90s. The process of negotiating a global charter for business created such a backlash among civil society that many governments were forced to withdraw their consent after it had been negotiated and the 'i's dotted. To the astonishment of many experts the mega changes in investment rules, once believed to be unstoppable, collapsed.

Similarly, the blockbuster Free Trade of the Americas collapsed when it became apparent that one set of rules, one economic model for everyone without adequate safeguards would not work for thirty or more nations at different stages of development. The sin of overreach and naïve ambition explains why it failed.

The TPP shares much in common with these earlier initiatives. It is conceived as a grand project of global integration between 12 impossibly diverse countries including Chile, Peru, USA, Canada and Mexico and Asian members comprised of Brunei, Australia, New Zealand, Singapore, Malaysia Japan and Vietnam with conflicting goals and objectives. The structural flaw in design of the negotiating process is that when broad publics are sidelined and excluded from the consensus-building process these visionary market driven projects flounder and fail.

This is one lesson which has not been taken to heart. The politics of trade deals are thus difficult, unpredictable and are not commonsensical. Instead they require countries to make structural change to the most sensitive part of their national regulatory practice, namely, agriculture and food security, intellectual property rights, public health, the environment and foreign investment. The economics of free trade also poses just as many variables against its success. Let us look in a detailed way the super-charged global resource cycle and the TPP grand promise of more free trade and market access for all with manageable adjustment. This exercise in much needed policy analysis illuminates the principal challenge of the free trade developmental model of Canada's global dilemma of being favoured by an abundance of resources and required to labour under the curse of too much of a good thing.

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II. TPP and new regulatory standards

'Short-termism,' the loss of manufacturing competitiveness ('the Dutch disease') and long-term rent-seeking behaviour from the corporate sector has become, by default, the low policy standard post NAFTA. The crushing disappearance of permanent jobs from the manufacturing sector has altered the job prospects of Canadians looking for employment. Twenty years ago, over twenty percent of full-time jobs were in manufacturing. Today, despite incredible resource commodity booms only one in ten workers is employed there. Nor have natural resources provided a large source of employment. The share of jobs in energy industries is less than seven percent, down from ten percent in 1990, and still falling (Cross, *The role of natural resources in Canada's economy*, 2008). Of course, there are benefits for resource rich Alberta and in terms of corporate profits. Regional growth leads the national trend. The skewing of the economy is putting people and the northern model of resource capitalism at risk.

In a special public opinion survey published in February, *EnviroNomics* asked; should the economic benefits from natural resources be shared nationally or should the benefits accrue on a winner take all bases? It reported that 67 percent of Canadians believed that the benefits should be shared nationally to benefit all Canadians whichever province they reside in. Fewer than three in ten Canadians took the opposite view that resources and benefits exclusively belong to the province and should be spent there. This poll shows that Canadians view resources as a 'national public good,' are less provincial in their loyalties than the mainstream media makes them out to be continuing to have a national perspective that transcends a narrow provincialism. Not surprisingly, the outlier was Alberta where 41 percent favour 'national treasure' versus 53 percent who support the winner take all option. The idea of a national energy strategy does have a political base, in fact, and remains a major concern because every resource boom raises the fundamental question how should Canadians distribute the wealth flowing from under the ground?

The private sector has captured this critical policy area of energy and while, not the case in every jurisdiction, it is the perception that shapes and concerns Canadian opinion. Harper's decision to withdraw from the Kyoto Accord mirrors the resource dynamics inside the country.

Over the last forty years, Ottawa has approved every major mega project with the sole exception of the Mackenzie Valley pipeline. Stopped by the Berger Commission in 1977 for twenty years, it is now being built. We are the only country to abandon its international commitments from the Kyoto agreement, a

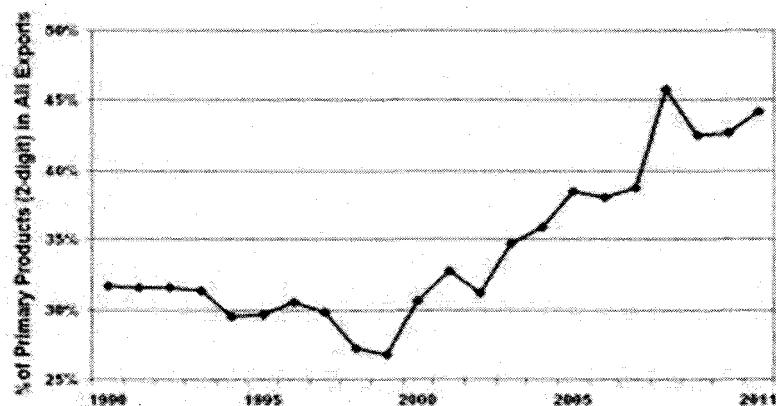
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global standards raising initiative however flawed the performance of other countries may be in this critical domain.

III. Falling prices for crude and the real cost of fixed investments

With natural resource exports jumping from 45 percent of all exports in 2002 to nearly 65 percent in 2008, resources are without question king (Cross, The role of natural resources in Canada's economy, 2008). The downside of the new staples export strategy is that in autumn 2008, with the Canadian dollar appreciating by more than 40 percent against the US greenback, the resource boom collapsed and hundreds of thousands of jobs disappeared from manufacturing industries in Ontario and Quebec.

Table 1
Canadian Primary Exports to U.S.



Source: Stanford, 2012; calculated from *Industry Canada* Strategic database, Trade by Product. Earliest data 1990.

Unlike earlier waves of deindustrialization, with American industry also in turmoil, there is little prospect for recovering many of the better paying positions. In the

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absence of a focused industrial and innovation strategy, the future for Canada's factory economy is grim. Ontario was downgraded in 2010 from a 'have' to a 'have-not' province eligible for federal equalization payments for the first time ever.

Ottawa and the oil and gas industry in Alberta are desperate to exploit Canada's resources by putting new options on the table to ship energy via pipelines to the mid-west US market. Such a strategy is volume-based and dependent on more multi-billion dollar mega-projects. It is driven by 'short-termism,' the very opposite of Braudel's strategy of *the longue duree*, which required Canada to have a set of transformative strategic goals and the requisite institutions to direct market forces. The current energy boom is counter-intuitive because markets are saturated with crude. The glut has driven the price for Western Canada crude to record lows. At the beginning of 2013, Brent West Texas oil was selling for \$115 per barrel approximately compared to bitumen Alberta oil at \$39 a barrel. Alberta's oil-driven economy is hardly viable in these conditions' and the government's oil revenues are down by a billion dollars. Add to this mix that oil production in North Dakota and Texas is at record high levels not seen in two decades. It is predicted that the US will be energy sufficient within five years; yet, the glut in production has not reduced the price of gas at the pumps. Go figure!

The curse is more resource mega projects are on the way because the patterns of resource-centered development repeat themselves driven by Ottawa and the banks and big oil.

Canada's resource sector wants to build more pipelines and the banks see this as terrific investment. Most of these mega projects are designed for the US mid-west and west coast markets and is presently in various stages of development:

- The revised Keystone XL 850,000 barrels per day will ship Alberta's dirty oil to the US.
- Line 9 reversal will send Western Crude to Montreal to be refined. It is opposed by environmental groups, but Harper's new federal rules limit their involvement in the environmental review process.
- West to East pipeline for Irving Oil to facilitate ocean-bound exports to Asia Northern Gateway oil sands bitumen is destined for super tankers to deliver oil in Asia and California.
- Transmountain Expansion is another mega project sending almost one million barrels a day for California.

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— Enbridge Mainline Expansions is a mega deal sending one million barrels per day through pipeline to the US Midwest, Gulf Coast and maybe the eastern seaboard; Finally, in the biggest project of all, the Alberta government has proposed a monster to Churchill and the building of a new pipeline along a Second World War pipeline route through the Yukon and onto Alaska (Van Der Klippe, 2013).

Canada is leapfrogging from one mega-resource project to the next and the oversight role of the central government is weaker than it once was. Inserted in the February 2013 budget, the Harper government has taken on board the idea of one definitive review for each project reducing the regulatory standards to determine the environmental impacts on people, communities and First Nations 'rights and entitlements.' Environmental assessment is taking second place to Ottawa's prioritization of market-driven energy policy.

IV. The pivot of institutions and economic culture

Mainstream economists have long assumed that Canada and the United States operate from a shared rulebook because they are highly interdependent, liberal market economies. Yet studies by John McCallum (1995), Keith Banting and Richard Simeon (1997), John Helliwell (2002), Andrew Jackson (2002), and Daniel Drache (2004) have documented the sharp increase in divergent market patterns and practices in North America. Other economists like Gunnar Myrdal (1957), Albert Hirshman (1958), Paul Krugman (2008) and Joseph Stiglitz (2010) stressed the need to build linkages between the fast growing resource sector and the much weaker and underdeveloped industrial side of the economy. Mel Watkins' restatement of the staples trap has provided critical distancing on the foundational work of Harold Innis (Watkins, 2007). By contrast, neo-liberal cutbacks and the shrinking of redistributive policies and programs favoured private wealth creation to an unprecedented degree throughout the 1990s.

The anchor of Northern model used to be the provision of mixed goods and social programs for working families and individuals, and the general expectation from the public was that the government, using this potent lever, would play a large and significant role in the economy. Canadian public policy at its best is, in the vivid conceptual language of Peter A. Hall and David Soskice, a textbook example of a coordinated market economy not a Hayekian

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liberal variant. The critical difference being the large regulatory role of the state 'rowing and steering' the economy during resource commodity booms (Hall & Soskice, 2001, pág. 8). Canada's unique blend of skilled human resources, a high-wage manufacturing sector, the dynamism of its powerful resource-based export sector, a modern public infrastructure, a robust financial sector, combined with macro-economic stability, low inflation, and a union dominant workplace are a number of the critical elements that have produced a successful export-oriented growth strategy and some of the best Canadian public policy practices.

Since 2000, the predominance of natural resources as well as neo-liberal cutbacks and the shrinking of redistributive policies and programs have favoured private wealth creation to an unprecedented degree. The proactive Canadian state had its wings clipped to a degree that stunned many observers. Dani Rodrik contends that during periods of sharp global competition states are pushed either to cut taxes, implement new labour market reforms and reduce government spending (Canada, UK and US), or to sharpen economic and policy divergence through innovative institutional measures and new spending initiatives, which create new policy spaces (India, China, Brazil, France, Germany) (Rodrik, 2007). Institutions and economic culture are always the independent variables that matter most, and this is certainly true in the Canadian case. Canada's policy space has been redesigned towards the Hayekian end of the spectrum and a policy of conscious drift.

V. The innisian insight

Innis' essential insight, like others of his generation, is that structural imbalances from external demand and price distortions of commodity booms expose our industries and communities to the highly volatile global business cycle. Canada pays too high a price in terms of these externalities. It is at the mercy of price spikes and the boom-bust demand cycle in the US for Canada's rocks, logs, and oil and gas energy staples. When the bubble bursts, Canada is left with a mega debt hangover due to multi-billion, fixed-cost investments that were required for the mega-pipelines. Pipelines are built on the assumption that the world price for oil will rise well above \$100 per barrel, but the unpredictability of global prices coupled with an oil glut in the US market drives down prices. Mega-projects begun in the upside of the cycle are unsustainable economically in the downside. At the end of the nineteenth

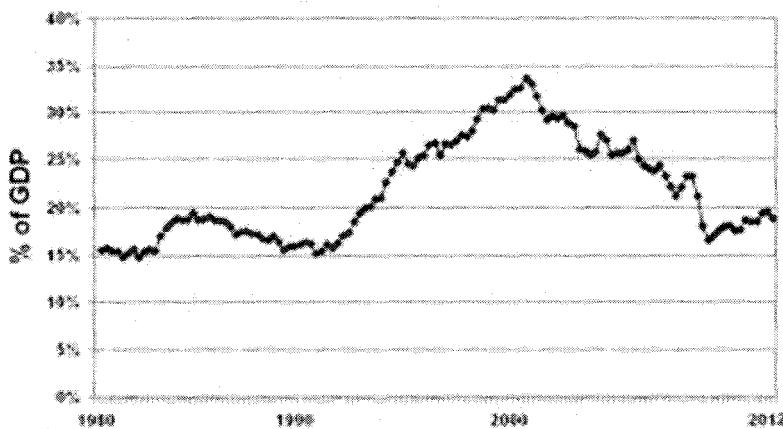
century, the 'animal spirits of the wheat economy' led to a frenzy of unsustainable, but lucrative railway building. However, at the turn of the twentieth century, the three transcontinental lines were bailed out by the government and merged into two.

The current mega oil line projects to carry Alberta's 'dirty oil' to the US were premised on a world price for oil above \$100 a barrel. They are now at risk due to the changing dynamics of the North American energy market. Canadian oil is backing up and Alberta oil sands crude is selling for just under \$40 a barrel (Vanderklippe, 2012).

Innis rightly emphasized that Canada needed an altered trajectory to mobilize its resources in order to build strong industries, deepen its domestic market and create new and better employment opportunities for all. Without a national strategy, investment follows the continental grooves of geography driven by a 'hot' energy sector sucking foreign direct investment into mining, oil and gas, and metals, which lifts stock markets to record highs. Higher prices were a key factor in boosting the exchange rate before the 2008 reversal, which has had a disequilibrating impact on consumer and energy prices that affects all Canadians. An overvalued dollar knocks small- and medium-sized firms out of the competitive race as they are forced to compete at a currency disadvantage too large to be offset by other factors (Cross, *The role of natural resources in Canada's economy*, 2008).

The barriers to a national energy program are the very policies and market dynamics that continue to bend and twist Canada's market behaviour in dangerous ways. Structural imbalances are a threat to the environment and effective regulatory oversight. Canadians need to recognize that the way Ottawa is buying into the staples trap reproduces the imbalance between jobs, the debt hangover and the hollowing out of Canadian industry. Moreover, it sinks any notion of a viable energy policy and instead lets so-called market forces pick the winners. Government has to row and steer the economy, however, Stephen Harper does not see this as his key responsibility. Why do some experts and governments continue to promote what Innis called "the dangers of fluctuations in the staple commodity" as well as the threat of a debt hangover when the resource bubble inevitably bursts? Is it a case of wrong ideas about growth, development and competitiveness? Is it a mentality that does not want to find a constructive alternative to Canada's resource curse – too much of a good thing? Is it a structural problem that Canada is caught between the strains of competitive commodity markets and the power of global commerce? Is it the blind-spot of the good times bubble? Have the powerful special interests of the oil and banking lobby captured the hearts and minds of the political class and mainstream media? Or is it, all of the above?

Table 2
Merchandise Export to U.S.



Source: Stanford 2012; From CANSIM Tables 380-0063 and 228-0002.

The point of entry to any substantive change in Canada is to examine the past and study the historical dynamics. Why in the post-war world did industrial countries abandoned laissez-faire free trade for the welfare state and Keynesian full employment? In the 1980s, Keynesian ideas were jettisoned and public policy adopted the fundamentals of monetarism and global neoliberalism. If the Canadian state cannot 'row and steer' the economy, it is impossible to have national environmental policies and national resource strategies that have realistic goals. The resource boom swamps any viable notion of an effective and comprehensive national energy policy to shift our economy to be less energy profligate.

All of these transformations are political with roots that stem from political power. Today's resource curse is more complex, multi-stranded and transnational than in Innis' day. It is more than commercial dependency on the US market. It has led to a variety of rigidities with crippling consequences for an economy burdened by debt and a shrinking industrial core. It has intensified the conflict between regional needs and local institutions and between local markets supporting indigenous developments and a compliant laissez-faire state. The regional specialization in resource exports has limited the role of central government fragmenting policy space and weakening national environmental standards. The long-term trend is that our

merchandise exports to the US, our largest market, have been falling steadily since 2000. Jim Stanford found that U.S.-bound merchandise exports now equals under 20% of Canadian GDP. (See table 2) Free trade and access to the US market has not reversed the trend; if anything the shift to energy and other staple exports has acted as an accelerator introducing new pressures on Canada's underperforming manufacturing sector. The TPP will be feeding off the super-resource cycle pusing Canada to focus more narrowly on its 'revealed' comparative advantage.

VI. Six elements of the modern staples trap

Six identifiable elements create powerful negative externalities requiring state intervention. If there is no direct mechanism to take them into account or no judicial order to reveal them, then the effects of these externalities will be concealed in the prices of the transactions between Canada and the powerful transacting parties (Boutang, 2012). When you subtract the social and economic environmental costs of growth from the levels of public investment made by Ottawa we have a very different cost accounting of the 'visible benefits from the current and past resource booms'. These externalities add up to a more dangerous staple trap than Michael Porter singled out in his 1992 major report on Canada's competitiveness for Business Council of National Issues entitled *Canada at the Crossroads*:

- 'Dutch disease-' Over-specialization on resources has significant adverse currency effects on manufacturing competitiveness. In a 2013 study, the IRPP found that about a quarter of total manufacturing industries show a pronounced negative relationship between US exchange rate and manufacturing output. Hard hit are labour-intensive and smaller firms such as textile and apparel, machinery, and consumer products.
- De-industrialization- the loss of manufacturing capacity results in the hollowing out of Canadian industry with significant and long-term job loss. Branch plant firms are closed down as production is shifted to the US, Mexico or other low-wage production centres. Small- and medium-sized firms cannot compete with cheap imported goods. Since the 2008 financial crisis, about 400,000 jobs have disappeared from the Canadian economy; less than 20 percent have returned (Drache, 2004),

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- A deliberate federal policy of drift has become a real problem opposing the effective, balanced management of Canada's resource economy. The restructuring process, driven by global competitive pressures, leaves firms to deal with the intensified commercial pressures on a catch-as-catch-can footing. Every province is eager to exploit its resources for much needed cash revenues. Technology transfer, skilling of the work force and access to capital is not co-ordinated between Ottawa and the provinces but is industry driven. Canada needs to plan for what lies ahead when the stunning increase in oil production in North Dakota, Texas and other oil fields has revived the goal of US energy independence (TD Research, 2013).
- Job-killer technology is another negative externality. The intense focus on efficiency gains and increased productivity in many industries has meant companies shed labour as they become more efficient. New hires rates are not adequate to restore employment to 2008 pre-crisis levels. Business benefits from the overall development of society and the educational attainment of its population but Canada continues to be a laggard with no fully developed employment strategy aside from training subsidies requiring very modest buy-in from the private sector.
- Policy capture by the powerful energy lobby is not a new factor by any means, but business advocacy and insider lobbying by energy giants and banks have intensified. Their opposition to a sustainable national energy policy has for the time being succeeded in blocking a national environmental strategy, the litmus test of its power. Canada is in the Republican camp of not doing anything about global warming.
- Despite green shoots of supportive public opinion for a national energy strategy, Canada has a weak notion of strategic stewardship. Ottawa does not have a sovereign wealth fund, like Norway, financed by stocks, bonds and other assets from energy royalties. Canada has not renegotiated a better deal from oil MNCs as Brazil did when it levelled the playing field and forced energy corporations to give the state a larger share of resource revenues from the discovery of massive deep ocean gas reserves off its coast. Alberta's sovereignty wealth fund established in 1976 is the size of a peanut with \$16 billion compared with Norway's created in 1990 and with a clear strategic vision has grown to \$800 billion created in 2012. There are more than a hundred such funds with \$80 trillion in combined assets and Canada as the 7th largest oil producer and 3rd largest global gas producer

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is 'lost in translation.' Ottawa does not believe in the need of a 'war chest' for uncertain times and national developmental goals.

The challenges of the staples trap is to find the way out of deindustrialization, the dangerous debt overload from mega-resource projects and the unprecedented job losses in core manufacturing industries resulting from an over-valued dollar. Some regions fare better with a resource boom, but multiple regions exporting Canada's wealth from the ground can only lead to more imbalances and twisting of markets. Winner-take-all regional economies do not look to Ottawa to co-ordinate national goals and objectives; rather they hide behind a narrow regionalism that Innis was highly critical of. This leaves giant corporations like Enbridge and Vale Mining, which acquired INCO in 2006, in charge of Canada's resource future. Still the public is supportive of reducing CO2 emissions and moving in a green direction. The proof is that in 2012 the BC government has introduced a \$30 per tonne carbon tax on CO2 equivalent emissions¹ (Haddon). California has also introduced a carbon tax. Significantly both Ottawa and Washington have not followed the west coast environmentalists and used existing policy space to be a game changer.

Innis was an institutionalist not a determinist; he assigned primary importance to the policy environment and its set of regulatory institutions. If a government leads from the rear, the outcomes are suboptimal. An out-in-front government can set strategic goals and the appropriate means to achieve them. We need to look at how other jurisdictions unlock the 'trap' of erroneous policies from the past (Drohan, 2012). Take the example of the financial crisis and the need for fundamental reform. Just this month the principal economies in the EU imposed a Tobin tax on all financial transactions that expect to generate \$30-\$40 billion annually. The tax is intended to discourage short-term financial speculation. The EU parliament has imposed strict limits on bankers' bonuses and salaries. Parliament is going to pass a prudential remuneration act capping bonuses across the financial sector. These deviations from orthodoxy or, more precisely, policy innovations stem from a change in power relations.

¹ <http://www.fin.gov.bc.ca/tbs/tp/climate/A4.htm>. In 2013, California has passed legislation to operate the world's second largest cap-and-trade program, next to the one run in Europe. It is also established at a time when similar congressional attempts to curb greenhouse gas emissions have failed.

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VII. Strategy for removing the barriers to a national environmental policy

In Canada, different policy environments are required to mediate the trap and address the imbalances of fixed overhead costs, mountains of debt from the overbuilding, and over investment in unsustainable mega projects when circumstances change. Our culture would be more receptive had the Avro Aero fighter jet not been dismantled in the 1950s and Canada's aerospace industry shattered. With the signing of the Auto Pact in the 1960s these two building blocks would have created the synergy for accepting Ottawa's role in rowing and steering the economy. Still countries that have successfully climbed out of the staples trap have been able to alter economic outcomes when seven conditions are met. First, there is a champion inside the political class such as a latter day Walter Gordon, the former Minister of Finance in the Pearson government and a sophisticated economic nationalist or the powerful economic logic of Eric Kierans, another prominent Liberal minister who grasped the limitations of the boom-bust cycle and the imperative for the state to capture the rents from resource development; secondly, there is a strategic purpose and moral compass for environmental and redistributive goals, more important than ever in a post Kyoto world; thirdly, the country is strategically positioned with a world commodity demanding record high prices such as oil and gas that gives the state the leverage to negotiate new resource revenue sharing with MNCs; fourthly the country has a modern infrastructure to transport energy to world markets; fifthly, public opinion is on side demanding fundamental policy changes; sixthly there has to be credible new ideas to transform 'the resource curse' into a blessing with a strategy to use resources as a driver of domestic growth, competitive industries and high levels of job creation; and, finally, of course, a lot of luck. Timing is key; the optimal moment to introduce a national energy policy is during the commodity boom when the state has optimal leverage with the banks and other resource players.

No country ever has all the ducks lined up, but fresh ideas, strong leadership, correctly chosen timing and a large amount of luck are first among equals. The proposed TPP meets none of the seven criteria to escape the staple trap. Skeptics might venture the opinion that it will create new and dangerous conditions for an economy overspecialized in resources and without any capacity to reshape its competitive advantage in different directions.

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