Inside Policy

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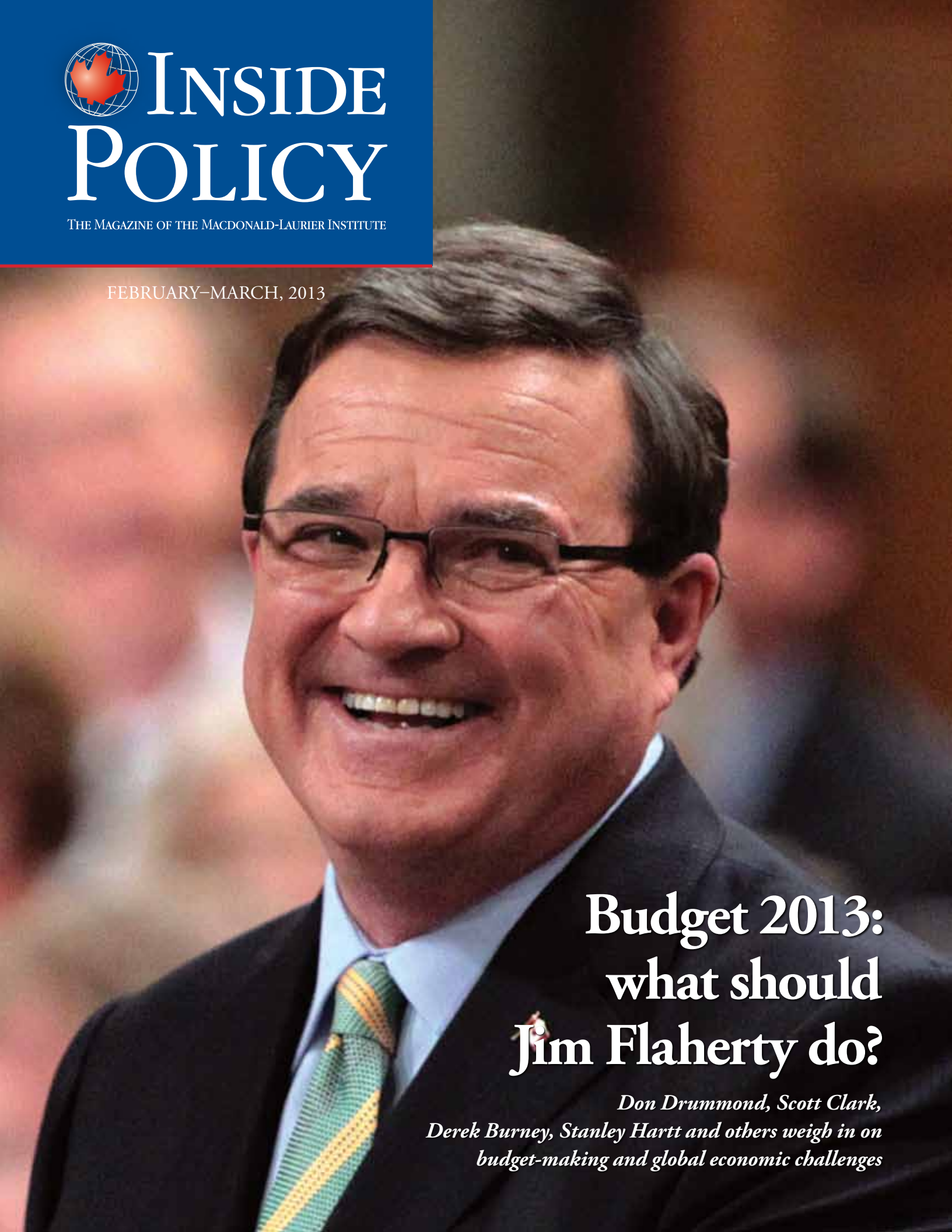

Budget 2013: what should Jim Flaherty do?

Don Drummond, Scott Clark, Derek Burney, Stanley Hartt and others weigh in on budget-making and global economic challenges

INSIDE POLICY

THE MAGAZINE OF THE MACDONALD-LAURIER INSTITUTE

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Editor's message

I am pleased to bring you the first issue of *Inside Policy* magazine for 2013 and the third since the Macdonald-Laurier Institute (MLI) launched the magazine last fall.

With a federal budget coming soon, this issue focuses in particular on some of the fiscal and economic challenges and opportunities confronting decision-makers in Canada's political and business domains. It's interesting to note that one key decision-maker, Jim Flaherty, is now in the top seven in terms of time-served among Canada's 37 finance ministers. In fact, if he serves just 15 more months on the job Mr. Flaherty would move into third place on that illustrious list. (See page 45 for a list of those he can soon pass in the Canadian political history record books.)

In this issue, we present commentaries and analyses from an assortment of distinguished economists, some of whom spent many years crafting federal budgets. Among them: Don Drummond calls upon the government to seize the opportunity to turn budget-making into a more coherent planning process; Scott Clark and Peter DeVries offer advice on how to ensure greater integrity and coherence to the budget-making process; and Stanley Hartt looks at the effect the EU and US debt crises are having on the world economy.

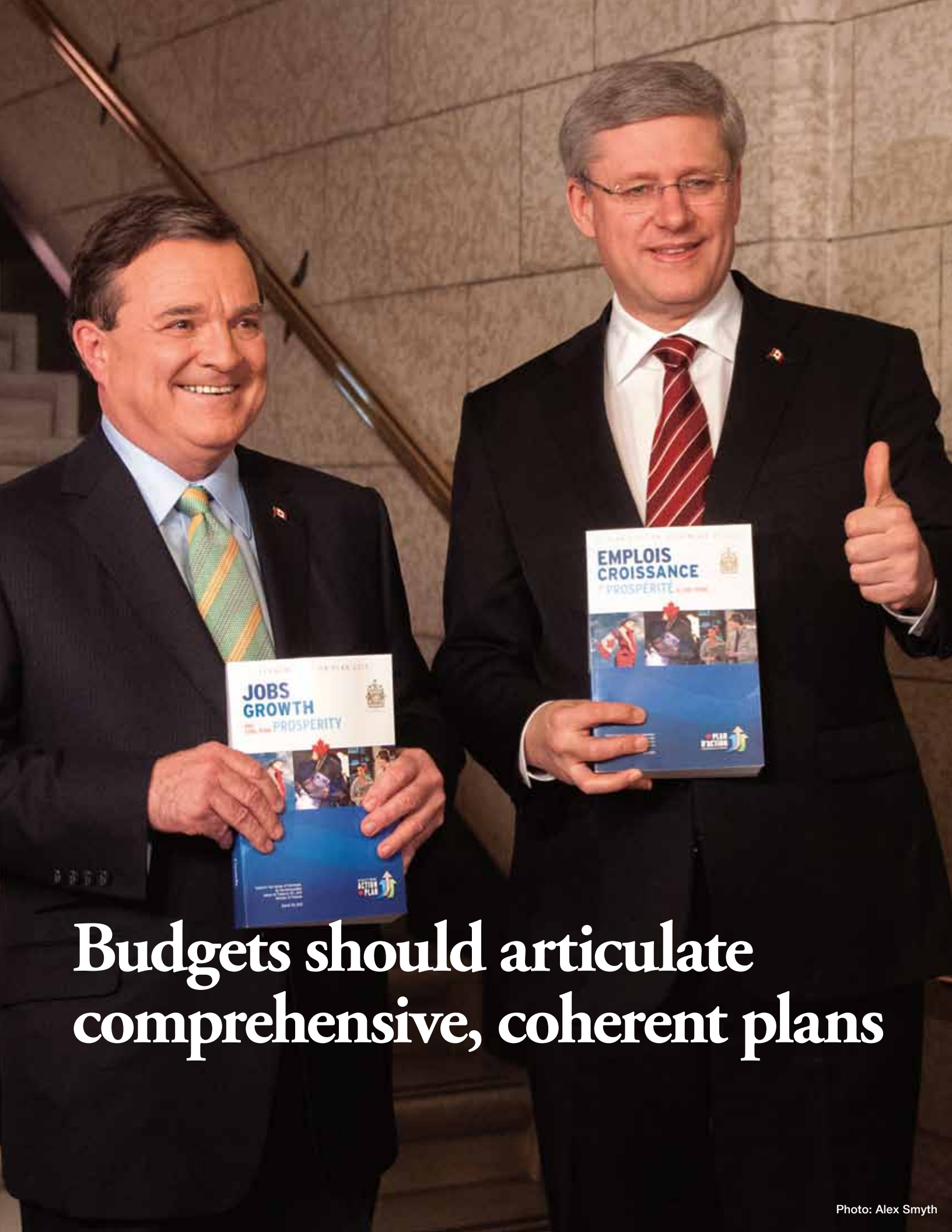
Readers will also find a new section, entitled "Political Perspectives", where we will publish opinions and analyses from those inside the political arena. In this issue, Minister of State for Finance Ted Menzies explains the budget-making process and opposition Finance critics Peggy Nash and Scott Brison offer their respective party's advice to the Government on how to approach today's challenges.

As you can see from the list to the right, there are also articles covering a broad range of issues from international commerce to global security to energy policy. Our continuing goal is to publish insightful analyses from a range of perspectives. Most of the content in each edition of *Inside Policy* will be original commentaries, however we will also bring you a selection of the most relevant MLI analyses and commentaries that have been published elsewhere.

We are grateful to all of the contributing writers for allowing us to share their insights with our audience.

James Anderson

Contents



Budgets should articulate comprehensive, coherent plans

Photo: Alex Smyth

By Don Drummond

Federal budget speculation season is starting to hit full swing. Budgets are typically viewed as vehicles for announcing new initiatives and setting out economic and fiscal prospects. On both accounts the 2013 Budget will likely be a snooze.

The 2012 Budget did the heavy lifting on initiatives to rein in spending and put the budget on track to balance. The November 2012 Economic and Fiscal Update took the hit of announcing a one-year delay in the anticipated return to balance. Monthly fiscal results through October 2012 suggest, if anything, the federal government is doing better in 2012-13 than set out in that Update. While some forecasters have been downgrading their economic outlooks for the world and Canada, incorporating this information should not require large adjustments to the medium-term fiscal forecast because the Update contained significant measures of prudence.

The 2013 Budget will likely, and credibly, confirm the expectation of a return to balance by 2016-17, with only a narrow miss the previous year. Perhaps more importantly, by 2016-17 the federal government will have a net debt-to-GDP ratio of just under 30 percent. This returns the debt burden to the range of the 1960s and 1970s before the recession of the early 1980s, along with rapid spending growth, sent it into a higher orbit, peaking at 68.4 percent in 1995-96.

From a fiscal perspective the Government was astute in acting to contain two of the most serious long-term fiscal pressures facing almost every country. Federal transfers to the provinces for health and post-secondary education have been capped to grow at the rate of nominal GDP (which means they will likely grow in pace with federal revenues) and the age of entitlement for Old Age Security and Guaranteed Income Supplement is being phased up from 65 to 67. Canada's fiscal prospects look promising by our own historical record and are the envy of most other developed countries. Nothing in the 2013 Budget will likely alter that impression.

The likely absence of much "news" in the 2013 Budget presents an opportunity for the Government to use the vehicle for higher purposes. First, the Government could bolster the transparency and accountability of fiscal planning. And second, it could pull the pieces of policy that have been introduced in recent years together into a coherent plan for the economy and the well-being of Canadians.

The Government and Canadians are rightly proud of their fiscal record as Canada stands out as exemplary in the world of fiscal basket cases, especially in the United States and much of Europe. Yet the inputs to the outcomes seem more worrying. Anybody who follows parliamentary matters must be concerned by the frequent comments that parliamentarians do not have sufficient information to evaluate federal government spending. Many are concerned to hear the Parliamentary Budget Office (PBO) needs to go to court to obtain information to evaluate the 2012 cuts.

The extensive use of the Budget Omnibus Bill to put forward legislation that seemingly had little to do with the Budget is also a concern. The 2012 Budget put a lot of focus on the cuts to departments' budgets and provided little explanation on the implications for operations and, more importantly, objectives. The Government could use the occasion of the 2013 Budget to clean up some procedural elements that would bolster the confidence of Canadians and parliamentarians in Canada's fiscal course.

One of the challenges parliamentarians face in scrutinizing spending is that the Budget and the Main Estimates, the latter being the vehicle for setting out details on departmental spending, are often inconsistent. The Main Estimates need to be tabled each year by March 1st and the Budget should be introduced well before that. That timing allows the same economic assumptions to underlie both documents and allows the Main Estimates to reference any spending measures in the Budget. So, ideally, budgets should be tabled in January or early February. Next, as many as possible of the accounting and presentation differences between the budget and the Main Estimates should be eliminated. Failing that, there needs to be a much clearer reconciliation. Otherwise, and as happens now, parliamentarians and any Canadians following fiscal matters get lost trying to translate what are essentially two different languages.

The Government could use the occasion of the 2013 Budget to set out a new policy on Budget Omnibus Bills. There seems to be a consensus, at least outside of Government, that a brief vague reference somewhere among hundreds of pages of budget documents is not sufficient context to ram a measure into the Omnibus Bill. Little scrutiny is then given to the measure. The original intent of the Omnibus Bill was to contain revenue measures where there was some urgency in obtaining Parliamentary approval. The current Conservative Government was far from the first to stretch the protocol to include numerous spending measures. The Government could announce a return to the original protocol and deal with spending changes through Supplementary Estimates and separate legislation. That would take care of the unwelcome surprises.

Finally, the Government could use the 2013 Budget to announce its intentions with regard to the PBO. The current Budget Officer is coming to the end of his 5-year term March 31, 2013 and it is clear his term will not be extended. Will the Government be appointing a new Officer? Will anything be done to provide that Office with greater access to the information required to adequately report to Parliament? Or will the mandate of the Office be curtailed, formally or informally through the choice of the new Officer and through practice? In many respects an underperforming PBO may be worse than not having one.

Enough on the process of how the sausage is made. Now for the meat. And that should revolve around using the 2013 Budget to demonstrate to Canadians there is a comprehensive, coherent and positive plan for the future of the Canadian economy and the well-being of its residents. This Conservative Government has been active on many fronts since 2006 and in many respects there is a compelling overall story to be told. Telling that story would have a number of advantages.

Many Canadians are rightfully concerned about current economic conditions and prospects. While far from the country hit worst, Canada did suffer a serious recession in 2009 and the pace of recovery has been lacklustre. Our traditional economic model of hitching our wagon to the U.S. locomotive is straining as the U.S. drowns in a sea of public and private debt of its own making.

Canadians see the growth axis in the world tilting in favour of the emerging economies, which now account for more than half of the world's output, yet realize we have little economic connection to them other than exporting commodities with little value-added and importing their manufactured goods. They see Canada, along with almost every other developed country, witness a dramatic widening in income distribution with the spoils increasingly going to a few at the top and real incomes falling at the bottom and stagnant in the middle. Even that stagnancy may be threatened as we see wage pressures grow, particularly in the manufacturing sector, in order to compete with the emerging economies with their low wages and rapidly growing productivity. They see a perplexing mismatch in the labour market with significant unemployment despite cries from many employers that they cannot find the workers they need. Canadians worry that our pitiful productivity record of recent decades will not allow us to preserve our traditional wage premiums. They are told immigrants are the answer to our slowing labour force growth but see them struggle to integrate economically and socially. Many individuals are unsettled about their own financial prospects in retirement and are no doubt very confused about the seemingly conflicting reports they hear about Canada's overall readiness for the retirement of the baby boomers.

The 2013 Budget could acknowledge such challenges and concerns and set out a narrative on how the Government is responding. It maintained fiscal sanity in a world of crazies; along with the Bank of Canada, it has preserved low and stable inflation. After a long period of relative inactivity it is engaged in several free trade negotiations. It has literally revolutionized the way capital is taxed, with rates that are now competitive globally. It is beginning to make important changes to immigration selection and settlement. It has taken some preliminary steps to address our innovation gap, although it should realize its proposed changes to the Scientific Research and Experimental Tax Credit have been poorly received. And, it is introducing pooled registered pension plans as a supplementary tool to help Canadians plan for their retirement.

These and many other measures have been described individually, but never tied together as elements of a broad plan. Speeches from the Throne or election platforms are typical vehicles for setting out plans. But, barring the unexpected, there won't be one of either for several years. So why not use the Budget for such a purpose? It even makes sense logistically. Budgets have grown to a standard of hundreds of pages long but there will be little "news" content for the 2013 edition. So why not fill the blank pages with a compelling economic and fiscal storyline?

Comprehensive plans also have internal benefits. They inform Members of Parliament of the reigning Government and bureaucrats where their piece of the action fits into the grand scheme. They then feel engaged and can modify, as required, their programs to best support the overarching goals. The internal, as well as external, benefits were highly tangible from the Mulroney Government's "Agenda for Economic Renewal" of 1984 and the Chrétien Government's so-called "Grey" (largely fiscal) and "Purple" (largely economic) Books of 1994. The current Government could build upon this legacy in 2013, thereby getting one year ahead of the 10-year cycle and taking advantage of the availability of the colour "Blue".

A Plan set out in the 2013 Budget could also allow the Government to address the residual disappointment of many with aspects of fiscal policy in 2012. Many were disturbed over the dominating focus on numbers in last year's budget. The Government was clear on how much money was to be taken out of various programs but much less clear on how that would be done and the implications for operations and the ultimate objectives of the programs. For example, the focus for CBC was on the reduction of its budget. Little was said on what, if any, role the Government envisioned for the public broadcaster and how that might be met with the lower funding. Ideally, policy should start with the objectives. Then there should be a determination of how the objectives could be met in an effective and efficient way. That funding might need to be adjusted to respect fiscal circumstances. But when that is the case, the Government should explain the implications. There is a chance in the 2013 Budget to address such shortcomings from last year. This would be far preferable to watching this play out with the PBO and courts.

As part of a Plan, the 2013 Budget could have a special section addressing retirement issues. The Government has recently stated with some confidence that the introduction of registered pension retirement pools will address any shortcomings of the existing situation. Others, including many of the provinces, are arguing that changes to the Canada/Quebec Pension Plans are in order. The Government has recently made important changes to its own pension plans for Members of Parliament and bureaucrats. There are a lot of moving pieces and likely a lot of confusion for Canadians. The Budget could look ahead to the requirements of a retiring baby boomer generation and describe how the initiatives they have introduced may or may not fit the bill.

A tally of recent tax changes would also be in order. But, it still amazes me how many Canadians, including CEOs, are not aware of how much more competitive our tax system has become. The reaction may be "been there, done that" and to a degree that is true. Without that awareness, Canadians will never reap the benefits from the revenues foregone to get to this state.

At the broadest, macro level, the Budget could set out the strategy for driving the Canadian economy through this global shift away from developed to emerging economies. If not played properly, it could leave the Canadian economy further and further behind because we don't do emerging very well. But, here too, action is underway, including trade deals and trade missions.

In conclusion, the 2013 Budget need not be a staid recounting of numbers and measures. It could raise Canada's game on transparency and accountability of all matters fiscal. And it could tell Canadians a story that would squarely address legitimate questions of where Canada is going as the global tides shift.

Don Drummond is currently Matthews Fellow in Global Public Policy, at Queen's University. From 2000-2010, he was Chief Economist at TD Bank Financial Group. Prior to that he served in the Department of Finance for more than 20 years and held the position of Associate Deputy Minister. He holds an M.A. in Economics from Queen's University.

Restoring integrity to the budget process

By Scott Clark and Peter DeVries

The Minister of Finance will soon be completing his pre-2013 Budget consultations. Over the coming weeks, the media and pundits will begin speculating about what the Minister of Finance will do in his 2013 budget.

Will the government be able to eliminate the deficit in 2015-16, without more spending cuts? How will the government respond to the uncertainty created by the short- and long-term fiscal crisis in the U.S.; the on-going uncertainty over the recession in the EU; and the continuing uncertainty over the future of the EURO area? What impacts will the recession in the U.K. and Japan have, and what about the slowing growth in the major emerging markets such as India and China?

How will the government respond to slowing economic growth and stubbornly high unemployment in Canada? Should the government introduce new initiatives to strengthen economic growth and job creation? Will the government begin a process aimed at simplifying and reforming the tax system? Should the government address the growing fiscal divide between the federal and provincial governments? Should the federal government continue to abdicate leadership in key policy issues of health care, pension reform, Aboriginal issues, education and research, and modernizing Canada's infrastructure?

Mr. Flaherty does not appear to be that interested in any of these questions. He has said that he is quite comfortable with economic growth of around 2 percent or less for 2013, even though this would not reduce the unemployment rate, currently stuck at 7 percent. He has said that the 2013 budget will be a "bare bones" budget.

Mr. Flaherty has also implied that the only objective, on which he apparently wants to be judged, is the elimination of the deficit by 2015-16. Once this has been achieved, Mr. Flaherty can then move on to something else. Given that the next election is likely to be in the fall of 2015, the 2015 Budget will likely show a surplus for 2015-16, since the final outcome for the deficit will not be known until the fall of 2016.

It is now recognized by most observers of the federal budget process, that the integrity and credibility of the process has been seriously erod-

ed in recent years. Less information is now provided to the public in budgets than under previous Liberal and Conservative governments; the authority of Parliament over government spending has been weakened; the understanding of Canadians as to what the government is actually planning to do in the budget has been eroded. Canadians should be concerned not just with the erosion of Parliament's authority, but also ultimately with their own ability to hold the government to account for its actions.

We believe there are a number of actions that need to be taken to restore integrity and credibility to the budget process. They may seem simple and even mundane, but their importance to Parliamentary authority and to Canadians is huge.

What follows are our suggestions.

Fix the Timing of the Budget

Why is the date of the budget so important? It is important because it is critical in determining whether Parliament can adequately exercise its authority over government spending. The issue here is the relationship between the Budget and the Main Estimates.

Under what are referred to as "supply" rules in Parliament, Main Estimates, which detail the Government's spending intentions for the upcoming fiscal year, must be referred to the appropriate Parliamentary Standing Committees for review before March 1st. For the Main Estimates to be relevant, they should be based on the economic and fiscal assumptions in the Budget for that year. This implies that the Budget should be tabled in late January or in early- to mid-February, in order to give the Treasury Board Secretariat time to make the Main Estimates of spending consistent with the economic assumptions and spending decisions underlying the Budget.

Budget 2012, for example, was tabled on March 29, 2012. This meant that Main Estimates of government spending, which were tabled on February 28, 2012, were based on economic assumptions presented in the previous Fall 2011 Update and not those in the 2012 budget. It also meant that the departmental expenditure cuts contained in the 2012 budget were not included in departmental/agency spending estimates submitted to Parliamentary Committees for review.

As a consequence, Parliament was asked in June to approve departmental/agency spending plans for 2012-13 without knowing what they were actually planning to spend. This was not the first time for this to happen. Five of the seven budgets of the government have been tabled after the Main Estimates, thereby making the budget estimates of spending inconsistent with the Main Estimates of government spending. Parliament, as a result, was unable to do its job.

This confusion could be avoided if the government simply committed to tabling its budget before the middle of February. We recognize that the fourth quarter GDP numbers might not be available at the time of the budget. However considerable economic and financial data would be available, and remaining uncertainty could be allowed for in the "risk adjustment" factor included in the budget.

Eliminate Confusion over Government Spending Plans

Fixing the date of the budget is necessary, but far from sufficient to give Parliament the capacity to review government spending and hold the government to account. The fact is, no one in Parliament, or in the government, can tell Canadians what the government is planning to spend.

If the Minister of Finance, who is responsible for setting the overall expenditure framework, and the President of the Treasury Board, who is responsible for overseeing departmental/agency spending, were both asked what the Government intends to spend in the current fiscal year, two different answers would be given. Neither of these Ministers can tell you what the government is planning to spend.

There are a number of simple explanations for these differences.

Budget expenses, for example, are on an accrual basis of accounting while the Main Estimates are on a cash basis. The Auditor General of Canada has raised this accounting difference on numerous occasions. The Standing Committees of the Public Accounts and on Government Operations and Estimates have also recommended that the "Office of the Comptroller General complete its study of accrual-based budgeting and appropriations and report back by March 31, 2013 its recommendations on whether the Government of Canada should pursue accrual-based budgeting in departments and accrual-based appropriations in its financial reporting system."

Pending resolution of the accrual accounting issue, there is no reason why the Main Estimates cannot be made more compatible to the Budget by eliminating other differences.

There are a number of simple changes which if implemented would help Parliamentarians. The Budget forecast of expenses is presented on a gross basis. This means that all revenues received from parties outside the government are included as part of budgetary revenues. This is not, however, the case of the Main Estimates, where some revenues are netted against related spending. For example, the Royal Canadian Mounted Police (RCMP) provides policing services to a number of provinces. Charges for these services are netted against spending by the RCMP in the Main Estimates, but these same charges are classified as part of "other revenues" in the Budget.

The Main Estimates also excludes a number of items that are included as expenses in the Budget. According to the Public Sector Accounting Board, refundable tax credits should be included as part of spending. The tax system is used to determine eligibility and the amount of the benefit. However, the amount received does not affect the taxpayer's tax liability. In other words, the tax system is being used to deliver a spending program. For example, the Canada Child Tax Benefit is classified as part of Children's Benefits and included as spending in the Budget but not in the Main Estimates.

The above two accounting differences explain about $30 billion of the difference between the Budget estimates of spending and those in the Main Estimates.

There is absolutely no reason why the Main Estimates of government spending cannot be put on the same basis as the Budget estimates of spending.

Provide More Details on the Economic Forecasts

The Government has continued the practice, first adopted by the Liberals in 1996, of using the average of the private sector economic forecasts for budget and fall update planning purposes. This arose out of a recommendation made by Ernst & Young that the House of Commons Standing Committee on Finance engage an independent panel to assess the government's economic and fiscal forecasts. Instead, the government chose to survey private sector economists on a quarterly basis and to use the average of their forecasts.

There are a number of issues with this process. First, this was not the recommendation of the Ernst & Young study. They noted that the Department of Finance, with its staff of professional economists, had one of the best forecasting records. Their recommendation centered more around public perception and how to enhance the credibility of the Department's forecasts.

Second, only major economic aggregates are surveyed. The list includes: real gross domestic product (GDP); GDP inflation; nominal GDP; 3-month treasury bill rate; 10-year government bond rate; exchange rate (US cents/C$); unemployment rate; consumer price index; and U.S. real GDP growth. The Department uses the average of these forecasts. Little information is provided on the range of these forecasts, and the reasons for their differences. No information on the components of GDP either on the expenditure side or the income side is provided. This makes any independent assessment of the forecast virtually impossible.

Third, the Department surveys about 15 private sector forecasters. However, very few of these forecasters provide forecasts beyond two years. This introduces an element of bias between the short- and medium-term forecasts. In addition, most private sector forecasters do not possess the models required to undertake comprehensive economic forecasts.

Fourth, in using the private sector average, the Minister of Finance is able to deflect blame for missed forecasts to the private sector. According to the Ernst & Young study, "the Minister and Department clearly must remain responsible for the achievement of the fiscal plan."

Fifth, the Department of Finance disaggregates the real and nominal GDP survey results into its components. How these are allocated can have major implications for the fiscal forecasts, given the different tax rates associated with the various income components. This information is not published, making it extremely difficult to assess the fiscal forecast. Attempts to secure the data through access to information requests have been denied on the basis that the data constitutes a "Cabinet Confidence".

Sixth, the Department will often adjust the average private sector forecasts to introduce "prudence" in order to enhance the possibility of the fiscal targets being met. Originally, the Liberals adjusted the private sector average forecasts (lower real and nominal GDP and increased interest rates). This was criticized by financial analysts as they wanted to see what impact these adjustments had on the fiscal forecasts. Recently, Minister Flaherty has been including a "risk adjustment factor" in his fiscal forecasts. Although the aggregate amount is known, its distribution among the revenue components is not.

To improve transparency and accountability, it is time that the Department of Finance's economic forecasts were used for the Government's fiscal forecasts. These should be compared to the private sector average economic forecasts, with justifications provided for notable differences. Details on the economic forecasts should be provided in the budgets and updates. Any explicit "risk adjustment factor" should be shown separately and not allocated to the various revenue components.

Provide Greater Transparency and Accountability in Budget Planning; Save the Parliamentary Budget Office

During the 2006 election, the Conservative Party promised greater transparency and accountability in budget planning. Unfortunately, this has not turned out to be the case.

As noted above, budget documents now contain less economic and fiscal data than in any budget over the previous twenty-five years. It is simply impossible to adequately assess the economic and fiscal forecast based on the data provided. Requests for information are denied on the basis that the data constitutes "Cabinet Confidence".

Only recently did the Department of Finance release a study on the long-term sustainability of federal government finances — a study that had been promised in 2007. And it did so only after the Auditor General of Canada brought this issue to light. The Department has not released any other analytical studies in the last six years. (This is a major departure from the practice followed previously by both Liberal and Conservative governments.)

However, the information released by the Department of Finance only related to the federal government, even though it promised in 2007 to present analyses on the total government sector. The Auditor General also recommended that the federal government provide long-term sustainability analyses for the total government sector. The International Monetary Fund in its November 2012 report to the Minister also recommended that the Department of Finance publish the sustainability analysis for the total government sector.

To date, the Minister of Finance has refused to do so, even though the analysis exists in the Department of Finance. For some reason the Minister seems more intent on not providing the public with information, rather than engaging Canadians in discussion on critical policy issues.

Given this lack of transparency, the Parliamentary Budget Office (PBO) has proven to be a credible resource to Parliament and Canadians. The term of the current Parliamentary Budget Officer expires

March 25, 2013. The next Officer will need to be someone who understands the budgetary and estimates processes and is willing to stand up to his/her major critics — the Government.

In the 2006 election campaign, the Conservative Party promised an independent office, reporting to Parliament with virtually full access to all relevant information. Once elected, the legislation creating the PBO fell far short of that commitment. The Government has consistently refused requests from the PBO for data it believes it needs to properly fulfill its mandate. It is time that the 2006 election commitment is honoured and that the PBO become an officer of Parliament.

We have never understood the Government's desire to fight with the PBO from its very beginning. In fact, in all of these disagreements with the PBO, the Government's attacks have become personal rather than professional disagreements. The fact is that the PBO has turned out to be right in every disagreement with the government.

These illogical fights with the PBO inevitably end up making the Government look like it has something to hide, has not done the analysis, and cannot be trusted. Both the credibility of the Minister of Finance and the credibility of the Government have suffered as a result.

Stop Throwing Parliament under the Budget "Omnibus"

The two budget Bills associated with the 2012 budget were, to put it mildly, a disgrace and an insult to Parliament and to Canadians. The use of Budget Omnibus Bills has grown to the point that they seriously undermine the integrity and credibility of the budget process and the authority of Parliament. Little information is now provided in the Budget, so it has become impossible in reading the budget documents to fully understand what the government is actually proposing to do. There is a clear lack of transparency and accountability.

There is an urgent need to restore the role of Parliament and its committees in assessing, reviewing, and approving proposed legislation. Without sufficient information and the clear intention of the proposed initiatives, Parliament and its Committees cannot properly assess the budget. Parliamentary debate is stifled, public involvement ignored and the implementation of good public policy prevented.

The budget needs to be much more explicit on the proposed policy initiatives, providing sufficient details and background information on the proposed initiatives for Parliamentary assessment and for a better understanding by the public at large. Budget Omnibus Bills should be restricted to proposed tax changes only and all proposed spending initiatives should be presented either through the Main Estimates or through separate legislation, submitted to the applicable Parliamentary Committee for review.

Provide Leadership for Canada Inc.

According to the Parliamentary Budget Office, the fiscal structure of the provincial-territorial government sector is not sustainable, while that of the federal government is (Fiscal Sustainability Report 2012).

What is emerging is a widening "fiscal divide" between a federal government with its diminished size and sound finances, and provincial governments with growing fiscal imbalances resulting from growing spending pressures (e.g., for health, education, infrastructure) and slowing economic growth and revenue growth. This growing federal-provincial "fiscal divide" is not sustainable. Unfortunately, at the present time Canada Inc. is without economic and financial leadership. Historically, this has been the role of the federal minister of finance.

Conclusion

There are three budgets remaining before the next election. If the Government's forecasts are to be believed and the deficit is on track to be eliminated by 2015-16, then it will be faced, before the election, with the issue of what to do with emerging surpluses in the second half of the decade. These will be important policy and political decisions.

We believe, however, that the above "process" issues are equally important. Implementing these recommendations would help restore integrity and credibility to the budget process and, in doing so, to the government itself. This is something the government needs badly.

C. Scott Clark held senior roles in the Department of Finance, including associate deputy minister (1994-1997) and deputy minister (1997-2000). Peter DeVries was director of fiscal policy at the Department of Finance (1990-2005).

Crafting a budget

By Ted Menzies

Since our Government introduced the Economic Action Plan to respond to the global recession, Canada has recovered more than all of the economic output and all of the jobs lost during the recession. In fact, from the end of the global recession in July 2009, employment in Canada has increased by over 900,000, the strongest job growth among G-7 countries over the recovery.

How did we get there? Through sound fiscal and economic planning and responsible budget-making.

The budget is a blueprint for how the Government wants to set the annual economic agenda for Canada. It sets out our country's economic priorities, and the means by which these goals will be achieved. Of course, the way we do this has changed dramatically since the first budget was presented on December 7, 1867, but the basic principles behind it have changed little since Confederation. In fact, the path towards any budget requires four key steps: i) assessing our economic assumptions; ii) consulting Canadians; iii) accounting for our expenditures; and iv) forecasting our revenues.

1. Assumptions: The budget is usually tabled early in the calendar year and is generally preceded in the fall by the Update of Economic and Fiscal Projections, which provides the context in which the budget's fiscal framework is set. Like previous years, Finance Minister Jim Flaherty and I consult a group of private-sector economists in spring and fall on their forecasts before presenting the budget and fall update.

Basing our economic forecast for budget-planning purposes on the average of private-sector forecasts introduces an element of independence into the fiscal forecast and is supported by multilateral organizations such as the International Monetary Fund. This allows the Government to remain focused on returning to balanced budgets, low taxes, and supporting job creation and economic growth.

2. Consultations: Shortly after the Update, the Prime Minister, the Finance Minister, my cabinet colleagues and I fan out across Canada to consult citizens on their budget priorities.

Just as the technology used in preparing budgets has changed, so, too, have the ways in which we consult. For example, this year I hosted a virtual pre-budget roundtable via telepresence, linking community and business leaders in Vancouver, Toronto, Québec and Halifax. This approach enabled me to exchange ideas with experts while reducing our travel spending.

In recent years, we've also held Online Pre-Budget Consultations to hear from Canadians we couldn't meet in person. In addition, the Minister of Finance and I met with provincial and territorial finance ministers last December to discuss their priorities for the budget.

Also in December, the House of Commons Standing Committee on Finance reported publicly on its own public consultations held across the country each fall since the 1960s. For Budget 2013, committee members submitted 60 recommendations based on the feedback they heard from well over 600 individuals, businesses and organizations.

As a lead up to the budget, the Minister of Finance and I also consult with other ministers and caucus members, as well as opposition Finance critics, to obtain a broad range of views.

All these consultations are critical to ensuring that, at the end of the day, the budget reflects the priorities of Canadians and that the Government maintains its focus on job creation, economic growth and long-term prosperity.

3. Expenses: In any Government budget (like any household one), you will find a summary of how much money goes out and comes in.

In our case, the federal government's expenses are divided into two areas: program expenses and public debt charges. Budget 2012 projected about $245.3 billion in total program expenses in the current fiscal year (April 1, 2012 to March 31, 2013), or $276.1 billion when including interest on debt.

Program expenses consist of major transfers to persons, major transfers to other levels of government and direct program expenses. Of these, transfers to persons made up over 26 percent of projected total expenses in 2012-13, including: Elderly benefits, like the Guaranteed Income Supplement for lower-income seniors; Employment Insurance benefits; and Children's benefits.

Transfers to provincial and territorial governments made up about 21 percent of projected total expenses in 2012-13 and included: the Canada Health Transfer, which provides long-term funding for health programs; the Canada Social Transfer, which supports post-secondary education, social programs, and services for children; and equalization programs, which address economic disparities between provinces.

Finally, direct program expenses include the operating costs of the more than 130 departments, agencies and Crown Corporations that deliver programs and services to Canadians. In 2012/13, Budget 2012 projected that these expenses would represent about 41.5 percent of total Government expenses. They constitute an area that must be consistently reviewed and adjusted to ensure that we continue to deliver value for the taxpayer dollar.

This is in line with our Government's commitment to control the growth in direct program spending and, indeed, Budget 2012 projected that the ratio of program expenses to gross domestic product (GDP) would fall to12.7 percent in 2016/2017 from 14.7 percent in 2010/2011. This will bring these federal expenditures back to pre-recession spending ratios.

The other spending area is public debt charges. Taxpayers pay interest charges on the money borrowed by the Government over the years and not yet repaid. Budget 2012 forecast interest payments to be about $30.8 billion in 2012/13, or about 11.2 percent of total expenses.

4. Revenues: During the current 2012/2013 fiscal year, Budget 2012 projected that the Government would take in $255.0 billion in revenues. Most of our revenue — about 82 percent — came from taxes. Within taxes, there are four main categories: Personal Income Tax accounted for nearly half of Canada's total revenues; Corporate Income Tax, which accounted for almost 13 percent of revenues; the Goods and Services Tax accounted for 12 percent of revenues; and a number of other taxes — such as non-resident withholding taxes, import duties, fuel taxes and duties on alcohol and tobacco — made up the final 8 percent of the taxes the Government collected.

The next area of revenue came from Employment Insurance Premiums. This made up 8 percent of revenues.

The final area of revenue came from the earnings of Crown Corporations, investment income, and the sale of goods and services. These accounted for 11 percent of revenues.

Budget balance

In drafting the budget, we remain focused on ensuring that Government expenditures will continue to be consistent with our objective of returning to budgetary balance by the end of this Parliament.

This is the reason why the Finance Minister has been clear that Budget 2013 will not entertain any new spending schemes but will remain focused on job creation, economic growth and long-term prosperity.

Our Government's objective to return to budgetary balance will maintain Canada's advantage into the future and frees our children and grandchildren from higher taxes tomorrow.

Throughout the year, expenditures and revenues are closely monitored and reported on through the Department of Finance's monthly Fiscal Monitor.

Then, in the fall, the Finance Minister releases the Annual Financial Report, the Government's audited consolidated financial statements. The Report this past October showed Canada's total Government net debt-to-GDP ratio stood at 33.3 percent in 2011 — the lowest level by far among the Group of Seven countries, with Germany the second lowest at 52 percent.

A budget in action

While there are a number of financial documents, they all revolve around a single goal.

Since 2006, the Government has committed to create the right conditions for growth and job creation through a stable, predictable, low-tax environment. In fact, our low-tax plan has reduced the overall tax burden for a family of four by over $3,100.

In drafting the budget, we remain focused on ensuring that Government expenditures will continue to be consistent with our objective of returning to budgetary balance by the end of this Parliament.

When the global economic recession struck, Budget 2009 delivered on a shared G-20 commitment to bolster growth, through the stimulus phase of Canada's Economic Action Plan.

By doing so, the plan helped safeguard jobs and protect families, while making important productive investments to contribute to Canada's long-term economic prosperity.

Budget 2010 helped solidify Canada's economic recovery and sustain our economic advantage, now and for the future, by committing a further $19 billion in federal stimulus in the second year of Canada's Economic Action Plan.

The Next Phase of Canada's Economic Action Plan in Budget 2011 created the right conditions for all Canadians to contribute to and benefit from a stronger economy while gradually returning to balanced budgets without raising taxes or cutting transfers.

Budget 2012 focused on boosting economic growth and job creation — innovation, investment, education and skills — and ensuring sustainable social programs and sound public finances for future generations.

Taxpayers rightly expect value for money from Government. That's why last year's comprehensive review of $75 billion in direct program spending identified many ways to enhance efficiency and effectiveness in Government operations, programs and services. This is all in an effort to return to budget balance in the medium term, a goal we remain on track to achieve.

Budget 2013 will be the next step in our effort to consolidate and reinforce our recovery. It will continue the approach that has helped make our country a world leader.

But Canada is not immune from troubles that originate from beyond our borders. By continuing to focus on jobs, growth and economic prosperity, we will continue to act to maintain stability in the wake of future potential global economic shocks, further strengthen the Government's record of prudent fiscal discipline, and continue to position Canada for long-term prosperity.

Canadians should expect nothing less from their country's budget.

Ted Menzies is the Minister of State for Finance and the M.P. for Macleod, Alberta.

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MODERATOR: JACK GRANATSTEIN


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MAY 9, 2013 AT 7:00 PM

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Government should change course in Budget 2013

By Peggy Nash

In the last year, we have seen mounting opposition to the budgetary policies of the Conservative government across the country. In Budget 2012, rather than move to deal with the serious economic challenges facing so many Canadians, the government chose to attack many of the institutions Canadians hold most dear — slashing health-care funding, eliminating vital environmental protections and weakening Old Age Security. All of this has occurred within the context of the government trying to mask its poor performance by stifling oversight and attacking the Parliamentary Budget Officer (PBO).

But with a new year and a new budget comes a chance for the government to change its course. Will Budget 2013 serve the interests of all Canadians, or plough ahead with an agenda that serves only a well-connected few? New Democrats sincerely hope for the former. We believe that the budgeting process should reflect the values of balance, prosperity and sustainability within a framework of sound public administration.

Since Budget 2012, Canada's economy has continued to underperform. GDP growth has failed to meet the government's own projections. Productivity growth continues to lag behind our southern neighbours. Household debt is skyrocketing and now threatens the financial stability of our banking sector. And Canadians are still waiting for the Conservative government to move forward with a meaningful strategy to create good jobs.

Over 1.3 million Canadians are out of work and hundreds of thousands of others are underemployed or employed in precarious work. Young people, aboriginal peoples and recent immigrants face unemployment rates significantly above the national average and many provinces have double-digit unemployment rates. Meanwhile, services to help the unemployed have been rolled back causing great hardship for those most vulnerable. And it is not surprising that income inequality is on the rise in Canada. However, what is surprising is that the Conservative government is refusing to act on it or to even acknowledge it.

Budget 2013 should include measures to improve our economy across a range of areas: macroeconomic performance and productivity; jobs and skills; economic sustainability; and support for Canadian families. This work should all be done in an open and transparent manner such that its performance may be evaluated by the PBO and the public at large.

Budget 2013 must include measures to improve our macro-economic performance and protect our economy against global economic volatility. A combination of irresponsible tax cuts and job-killing fiscal austerity have increased the federal debt by over $100 billion under Stephen Harper — resulting in the government failing to meet its own projections. This fiscal strategy has also resulted in GDP growth repeatedly failing to meet projections.

While it is essential to balance the budget over the business cycle, it is poor economic policy to enact fiscal austerity in a context of weak economic growth.

Conservative polices, such as reckless corporate tax giveaways have failed to generate the incentives necessary to spur private investment and Canadian businesses are sitting on over a half a trillion dollars in "dead money," because they see no place to invest. In the short-term, the best macro-economic strategy for the government to pursue is to have shovel-ready projects in case the euro zone situation escalates or economic conditions in the United States further deteriorate, coupled with targeted incentives, such as job creation tax credits, that will spur on immediate investment and job growth.

We must act to improve our economic performance over the long run. The government needs to tackle nearly three decades of poor productivity growth head-on. According to the OECD, Canada has had the lowest multi-factor productivity growth amongst all OECD nations, lowering GDP by tens of billions of dollars. The most direct, evidence-based methods to improve productivity are to provide long-term, predictable funding to close Canada's infrastructure gap and reverse cuts to research funding and the scientific community at large, to further boost our productivity growth.

Budget 2013 should include measures to improve our economy across a range of areas: macroeconomic performance and productivity; jobs and skills; economic sustainability; and support for Canadian families. This work should all be done in an open and transparent manner

New Democrats also have broader concerns about the Conservative government's approach to fiscal federalism. From cuts to the Canada Health Transfer and OAS-GIS, to restricting access to Employment Insurance (EI), the government has repeatedly taken actions that have downloaded billions of dollars in costs onto provincial and municipal governments.

This is particularly worrying given the PBO's findings regarding the unsustainable debt level of provincial governments. New Democrats believe that federal budgets must take into account the impact of federal policy changes on provinces and municipalities. It is essential that the government not take a unilateral approach when budgeting,

as it is inappropriate for the federal government to balance its books on the backs of the provinces.

In high unemployment regions, the impact of the country's weak economic performance has been amplified by the government's radical changes to EI, such as eliminating the Extra Five Weeks pilot program, changes to the Working While on Claim pilot project, and changes to the definitions of "reasonable search" and "suitable employment," which have decreased both access and benefits.

These changes are wreaking havoc in the lives of many Canadians. A case in point is the single mother who lost her EI eligibility because she would not search for work in a city 40 minutes away, even though she does not have a car or access to public transportation. Given that access to EI is already at an all-time low, and that EI is a form of worker- and employer-financed insurance, Budget 2013 should reverse these devastating cuts.

The Conservatives' struggles with EI might not have arisen had they previously moved forward with measures to promote job creation and skills training. Canada is currently faced with widely divergent unemployment rates across the nation, with labour surpluses in some areas and skilled labour shortages in others.

Budget 2013 should launch a long-term skills training strategy — created in partnership with provinces and territories, employers, labour and educational organizations — to fill these skilled job shortages. This should also be coupled with financial incentives to encourage voluntary labour mobility to meet both short- and long-term employment needs.

This jobs and skills strategy should place a particular focus on two groups of Canadians: youth and Aboriginal Canadians. Youth unemployment has skyrocketed under the Conservative government with unemployment for young Canadians increasing by 280,000 during the recession, of which only 30,000 jobs have been recovered. These youth are at risk of becoming a lost generation.

TD Bank indicates that unemployment will cost these young Canadians a total of $23 billion in lost wages within the next 18 years. This is a direct result of the Conservative government's fiscal austerity agenda and, as such, the government has an obligation to ensure that youth have access to a national skills program in order to minimize the permanence of the wage scarring.

Along with youth, the government should take immediate action to improve the social and economic outcomes of First Nations, Inuit and Métis Canadians in Budget 2013.

This urgent need for action is best exemplified by a simple statistic: Canada is rated 6th on the UN Human Development Index, however, when First Nations-specific figures are used, the ranking is 63rd.

Two major actions should be taken in Budget 2013 to begin tackling this gap. First, the government should provide equitable, stable funding for all First Nations schools based on the Shannon's Dream motion passed in the House of Commons. Second, the job and skills plan mentioned previously should provide stable funding to help Aboriginal Canadians fill skilled job shortages.

The Idle No More movement has made it abundantly clear that Canadians want their vast resource wealth to be sustainably and responsibly managed. Unfortunately, the approach advocated by the Conservatives is neither sustainable nor in the best interests of future generations.

In Budget 2013, the government should change course and put forward natural resource development policies that are environmentally, socially and economically sustainable to ensure that future generations are left with the benefit of our natural resources — and not just clean-up costs.

The Conservatives' struggles with EI might not have arisen had they previously moved forward with measures to promote job creation and skills training. Canada is currently faced with widely divergent unemployment rates across the nation, with labour surpluses in some areas and skilled labour shortages in others. Budget 2013 should launch a long-term skills training strategy.

Budget 2013 should eliminate the $1.3 billion in fossil fuel subsidies on the books and incentivise industry to capture the benefits of renewable energy and other clean technologies. In addition, it should undo the devastating cuts to fisheries habitat protection, navigable waters protection and environmental assessments, as the long-term implications of poorly planned projects and the destruction of fish habitats could have serious environmental and economic consequences for all Canadians.

Finally, there are important process concerns to be addressed in Budget 2013. A strong, independent PBO is essential to ensuring transparency and fiscal prudence in the budgeting process. To ensure that the PBO can continue to function in the face of Conservative attacks, Budget 2013 should move to make the PBO a fully independent officer of Parliament. The government must also ensure that this essential position is never left vacant.

After seven years of Conservative rule, it is clear that our nation faces major economic and social challenges. In a few short years, Stephen Harper has managed to undermine the social contract that Canadians live by — from a fair approach to fiscal federalism, to employment insurance and environmental assessments. New Democrats will fight to restore this social contract and build a balanced, sustainable, and prosperous Canada. Just as importantly, New Democrats will fight to ensure that Budget 2013 be enacted in an open, transparent and accountable manner.

Peggy Nash is the M.P. for Parkdale — High Park and serves as the Finance critic for the NDP.

Conservatives in search of an economic legacy

By Scott Brison

In the 1990s and early 2000s, Canadian governments made their economic visions the cornerstones of their legacies. Brian Mulroney brought Canada into a free trade agreement (FTA) with the United States. Jean Chrétien and Paul Martin eliminated the deficit. Their decisions, however controversial when first taken, have come to be seen as the lasting accomplishments that they were.

With the FTA, Mulroney's Progressive Conservatives cemented Canada's most important trading relationship. In balancing the books, paying down the debt by $81 billion, and shoring up the Canada Pension Plan, the Chrétien and Martin Liberals laid a strong foundation for our social safety net and secured its sustainability. What, we might well ask, will be the economic legacy of Stephen Harper's Conservative government?

It is a question that is clearly on Finance Minister Jim Flaherty's mind. In a recent speech, he told listeners that he set Canada on a new path with his cuts to the GST in Budget 2006. Without a doubt, the GST cuts altered Canada's economic direction, though not in a way most governments like to trumpet. In combination with a 40 percent increase in government spending in just three years, the Conservatives' cuts to the GST put the country on the edge of deficit well before the financial crisis of 2008. However, Minister Flaherty failed to mention another Budget 2006 measure which has had a major impact on the financial security of Canadians: his decision to loosen mortgage rules in Canada. Sadly, the Harper Government's economic legacy could be a housing bubble.

In 2006, the Conservatives followed the example of the U.S. housing market and allowed American mortgage insurance providers to bring forty-year, zero-down mortgages to Canada. Thousands of buyers locked into decades of expensive interest payments and insurance premiums before they had any equity in their own homes. David Dodge, then governor of the Bank of Canada, made the likely consequences plain to anybody ready to listen. Yet the Conservatives left their new rules on the books for nearly two years, even as the U.S. housing market crashed.

The bubble is a made-in-Ottawa problem, and it is still expanding. Under the previous Liberal government, the maximum amortization period for a residential loan was 25 years, which required a minimum five percent down-payment. Since the financial crisis hit in 2008, the Conservatives have lowered the maximum amortization period three times, from 40 years to 35 years, then to 30 years, and most recently to 25 years. It is an effort to restore the housing market balance that they upset in the first place.

As anybody who has recently tried to buy a house in Regina or sell a condo in Vancouver can attest, the Conservatives' tactics are not working. Much of Canada's housing market remains overvalued, but as both *The Financial Times* and *The Economist* have reported this month, a crash is a real possibility. Record housing prices, combined with flat-lined household incomes, have driven Canadians to take on record levels of personal debt. The average Canadian now holds $1.67 in debt for every dollar of disposable income — the level reached in the U.S. and U.K. just before their housing bubbles burst. Citing concerns over Canada's housing market and levels of household debt, international rating agencies have downgraded some of our largest banks.

The consequences of Conservative mismanagement go beyond the economic. Overvalued houses price people out of the market. Young Canadians and families cannot get a foot on the property ladder; burdened with debt and rent, they find themselves without stability, support, or savings. After seven years of Conservative government, we live in a deeply unequal Canada. Household debt climbs while incomes stagnate. Unemployment and underemployment remain far too common. A generation of young Canadians has no idea whether or not they will ever own a home.

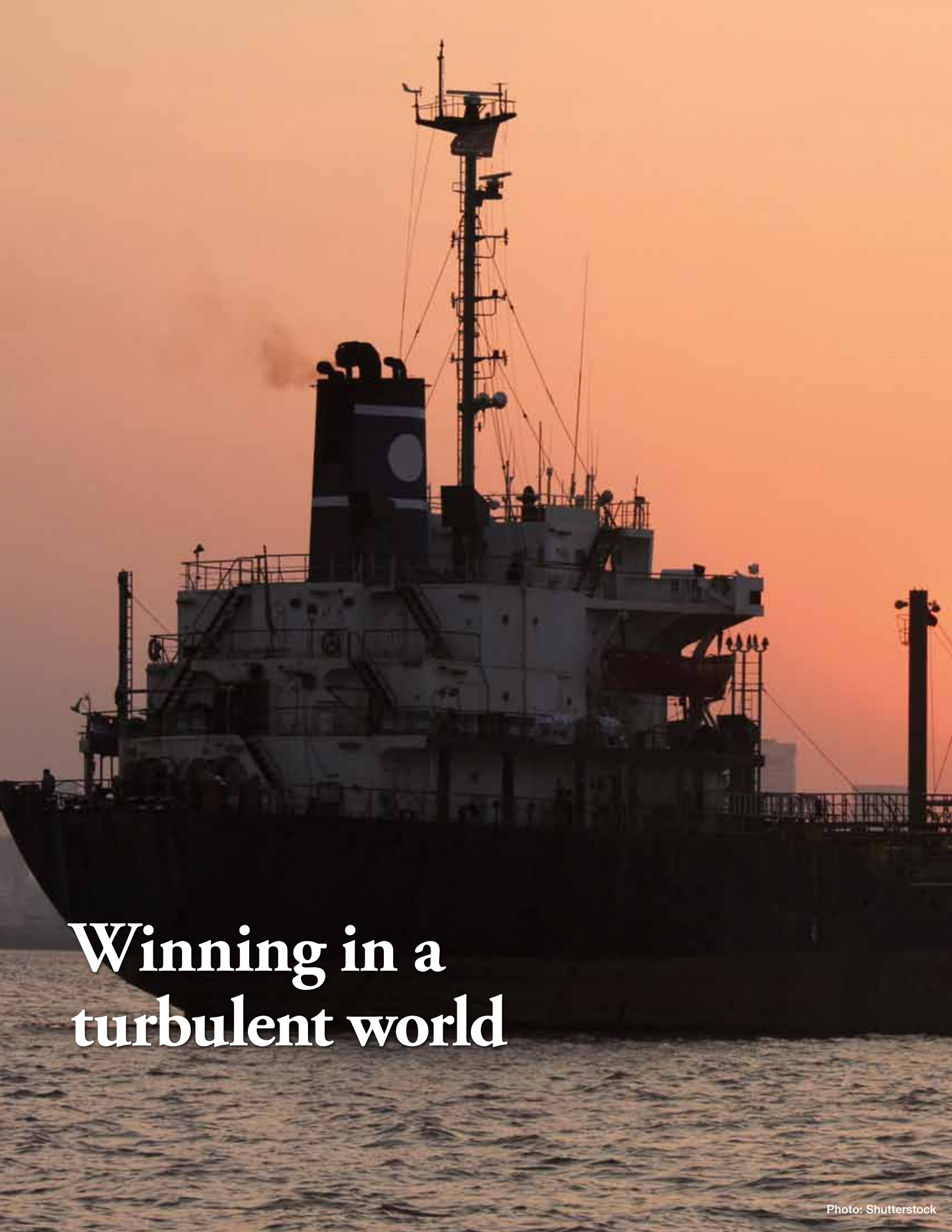
Usually, it takes time and vision to build a legacy. Within months of taking office, and without regard for advice or consequences, the Conservatives changed the rules of the Canadian housing market. They took a major economic decision lightly, even carelessly, and they have spent the past five years trying to reverse it. Today, their talking points do their artful best to imply that they never made it at all. Whatever the Conservatives may feel, the status quo is not acceptable. Five years after the start of the recession, Canadians remain under tremendous financial pressures. The upcoming federal budget provides the government with an opportunity to change course.

Recognizing that the status quo is not working, Canadians want better ways to increase their savings, manage the rising costs of living, and prepare for retirement. They want young Canadians to have more economic opportunities than their parents had — not fewer. They want a government that will cut down on waste and mismanagement. Above all, they want a government that can be trusted to manage the economy competently and avoid reckless policy experiments.

A Liberal government would introduce a real jobs plan to kick-start the economy and address inequality between generations, between regions, and between and non-aboriginal Canadians. We would introduce a dedicated E.I. hiring credit for youth, significantly increase resources for the Canada Summer Jobs Program, and re-open the youth employment centres that the Conservatives closed. To help Canadians increase their savings and prepare for the future, we would introduce a voluntary, supplemental CPP.

Unless Minister Flaherty is satisfied with a housing and personal debt bubble for a legacy, he ought to use Budget 2013 to tackle the financial challenges facing Canadians.

Scott Brison is the Liberal Finance critic and the M.P. for Kings-Hants, Nova Scotia.



Winning in a turbulent world

Photo: Shutterstock

By Derek Burney

The global economy is experiencing a dramatic transformation which many suggest is more vast in scale, scope and speed than that of the Industrial Revolution. It is expected that more than 1 billion new, middle-class consumers will emerge in the next ten years. That is a prospect that raises a host of risks but also significant opportunities, especially for Canada.

We have the means at our disposal. What we need is leadership, focus, changes in attitude and a unique partnership between our private and public sectors that will galvanize those strengths in the national interest.

Canada has an abundance of commodities — everything from energy and minerals to agri-food products — for which the demand is certain to grow, especially in markets where middle-class consumers will expand in record numbers. We also have services, skills and educational capabilities that will be much in demand. Think, too, of tourism and the prospect of exponential growth in that sector for Canada. By 2020, it is estimated that Asia alone will be the source of 400 million tourist trips.

Even under the most pessimistic scenarios — and there are some, particularly given the drop in GDP last year — the Emerging Markets are likely to outperform the developed economies significantly for decades to come. Even if China does "slump" to 7% growth, it will still add $600B to global GDP.

Here is what we need to focus on:

First and foremost, a coherent and comprehensive trade and investment strategy led by government and embracing all stakeholders, focused clearly on where and what our priorities are, and why, among the fast growing Emerging Markets.

By relying heavily on traditional, but now sagging, markets like the U.S. and Europe, Canada's global trade flows have underperformed in recent years. Our share of the world export market fell from 4.5% to 2.5% in the last 10 years; our manufactured goods export market has been cut in half and our trade deficit in the summer was the worst since trade statistics have been compiled.

By contrast, 50% of Australia's exports today are to Emerging Markets; only 8% of Canada's. The Australian government recently released a major study entitled "Australia in the Asian Century" featuring explicit recommendations to ensure its economic future. Many of these proposals would resonate equally well in Canada.

We have, on paper at least, an ambitious trade agenda, having announced our intention to negotiate with some 80 countries. But, with the exception of the ongoing CETA discussions with Europe — not exactly the most promising partner for growth these days — there is little sign of tangible engagement. We need to get on with it, setting priorities and assigning top flight negotiators with clear mandates from the prime minister and cabinet, bolstered by systematic consultations with relevant stakeholders.

We should move beyond a perennial desire for a "special" relationship with the U.S. and shift our focus, in Wayne Gretzky style, more to where the new market opportunities will be. Not to replace but to complement our reliance on the United States. Trade volumes between us have already dropped from 89% in 2000 to 74% in the past decade and are estimated to drop another 10% by the end of this decade. We need to adjust to that reality and, while safeguarding access to the market right next door will always be a major priority for Canada, we also need to negotiate new agreements that will enhance our access to higher growth markets.

We have an ambitious trade agenda, having announced our intention to negotiate with some 80 countries. But, with the exception of the ongoing CETA discussions with Europe there is little sign of tangible engagement. We need to get on with it, setting priorities and assigning top flight negotiators with clear mandates from the prime minister and cabinet, bolstered by systematic consultations with relevant stakeholders.

Not just with the Big Three Emerging Markets — China, India and Brazil — but countries like Indonesia, Turkey, Thailand and Vietnam, among others. Markets where we can be first string — not second string — partners, both as exporters and investors.

In many of the Emerging Markets the "visible" hand of government is a directing and often determining force in all economic affairs. That is why conventional rules for trade and investment and traditional Free Trade Agreements will not be sufficient. We should leverage our comparative advantages shrewdly and selectively — including the access foreign investors have to our resources — and seek custom-tailored agreements in each market. The goal should be to secure and enhance access by all means but, especially in markets where the rule of law is somewhat elastic, we will want not only new agreements but also a highly enriched, expeditious and binding form of Dispute Settlement well beyond that provided by the WTO.

The Emerging Markets have huge reserves of capital and, with our aging population, we are certain to have less savings. So, in order to develop our vast resource base, we will need foreign investment more than ever. Estimates are we will need $650B this decade, much of it foreign.

There has been a lot of talk of late about the merits of foreign investments, or at least of some kinds of foreign investment, notably by state-owned enterprises (SOEs). Recent decisions on CNOOC and Petronas offer some clarity on this issue. Political judgement — the ability to reconcile our economic needs with the political desire to control our destiny — will always be part of the equation. The inclination to use access by foreign investors to our resource base as leverage for broader trade and investment negotiations is also worth considering, especially with countries like China where, as the Prime Minister has stated, there is, at present, a serious imbalance. Above

all, the government should avoid sending signals of uncertainty to capital markets which would only put at risk its solid reputation as the sensible steward of our economy.

Also required is a significant shift in the mindsets of our business leaders, moving out of what Marcel Côté and Roger Miller describe as a "culture of comfort" into a more aggressive and less risk-averse approach to new markets, adopting new joint ventures and new approaches to business success. An approach that demands selective targeting and stamina, taking a long view and not a preoccupation about quarterly returns.

Our business leaders also need to broaden their vision. They should know more about government as well as about business and more about where growth is happening in the world. When it comes to the resource sector, they also need to know better how to interact with NGOs which have much greater influence on public policy.

A long-term perspective and a heavy dollop of patience are essential. Those who are most successful today in Emerging Markets took years, not months, to get there. Companies like Bombardier, Power Corporation, CGI, Manulife and CAE, just to name a few, provide clear lessons for others to emulate. They prove that staying power, nurturing relationships and building networks over time will pay dividends.

We will require new infrastructure to serve these markets. As the veto of the Keystone pipeline demonstrated, we cannot afford to be captive to a single market for anything we export. Equally, we cannot expect to diversify exports of energy if we remain land-locked because of emotional obstacles, endless land claim disputes and procrastination over the construction of pipelines to our East and West Coasts. If we genuinely believe in the national interest and, frankly, if we want a more mature, balanced relationship with the U.S., new pipeline and port infrastructure projects should be national and not simply provincial priorities.

We should never forget that energy development and "Made in Canada" pipelines are essential to Canada's and not just Alberta's future prosperity. Few Canadians realize that, because we have only one outlet for energy exports, Canadian oil sells in the U.S. market at a $30 — $35 per barrel discount. Good for America, for sure. Not so good for Canada. In addition to new pipelines, we also need more upgrading and refining capacity so that Canadian consumers are not at the mercy of world prices or distribution bottlenecks and severe weather conditions in the United States.

Finally, we need to upgrade our approach to education. Technology and globalization are wiping out lower-skilled jobs faster while raising the skill level for new jobs. Our educational institutions are not adapting quickly enough. Children in Estonia from ages 7 to 16 are learning how to develop software code in school. In Canada, many children in that age group can barely communicate in either official language. The answer is not more education, but better, more relevant education.

As Margaret Wente reported recently in *The Globe and Mail* there is a "fundamental conflict between access and quality" in Canada. Governments relentlessly pursue the goal of universal access but the more they provide, the more diluted the standards of quality become. For students, higher education should be about their future career and yet they get little counselling on what their job prospects in this new century might be. Students are encouraged to study whatever they want rather than focus on what our country needs.

Canada is falling behind in the skills race precisely at a time when we can least afford to. Parents, educators, government and business leaders need to convince more young people to pursue science-related careers. Too many are graduating without the applied science and technology skills that are vital to our economic development. We have devalued basic work and training for trades, and even with 7% unemployment, have to import some 400,000 temporary workers annually to fill the gaps. Community College curriculae are often more relevant to our needs than those of our universities.

Canada is falling behind in the skills race precisely at a time when we can least afford to. Too many are graduating without the applied science and technology skills that are vital to our economic development. We have devalued basic work and training for trades.

When people wonder about the rapid success of so many Asian countries, they should realize that education plays a predominant role. In China, more than 1 in 3 new graduates have degrees in engineering disciplines. In Canada, it is 1 in 10.

It is hard to be innovative if you lack the skill sets to develop new concepts. Our human resources are as vital to our future prosperity as our physical resources. If both are better directed, we can have a winning combination.

There is an additional dividend if we revitalize our educational institutions. Many of those new, middle-class consumers mentioned earlier will be looking abroad to educate their children. Canada should be prominent on that list.

Today, we attract less than half the number of foreign students that choose Australia. Education should be a Canadian strength to attract, not repel, the best from the emerging markets, many of whom have skills we need and should be encouraged to stay in Canada after they complete their training. But, emphasizing enrolment numbers over quality will not provide a compelling magnet.

These five suggestions are offered as prescriptions for our future success. We cannot sit back and wait for opportunity to knock at our door. Growth will not come from osmosis. We have to work for it.

Adapted from remarks at the PwC Annual Partners Conference in Ottawa, November 13, 2012. Derek H. Burney is Senior Strategic Advisor at Norton Rose Canada LLP and former Canadian Ambassador to the United States (1989 - 1993.)

The next 25 years

Twenty-five years ago, Canada made a bold decision to drive more international investment to Canada's life sciences sector.

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These investments have changed the lives of millions of Canadians. Over the last 25 years, breast cancer hospitalizations are down by 71 per cent, diabetes by 26 per cent, prostate cancer by 67 per cent and asthma by 46 per cent[1], in part because of innovative medicines.

These results are staggering, but there is more to be done.

In the current CETA trade discussions between Canada and the EU, Canada has the opportunity to strengthen its pharmaceutical IP safeguards and regain its competitive edge.

By supporting CETA, Canadians will benefit from the development of important new medicines, vaccines and innovative health research.

What will the next twenty-five years look like?

[1]OECD Health Data, 2012

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Two debt crises; one big drag on the world economy

Photo: acus

By Stanley H. Hartt

The world is living with the consequences of two contemporaneous, but very different, debt crises, one originating in the southern democracies of Europe and the other impacting the largest economy of them all, the United States of America. The roots of each of these crises can be attributed to the shared political propensity of governments to spend to buy votes, and both certainly place near-term worldwide economic performance in jeopardy, but there the comparison ends.

Greece's ratio of government debt to GDP was the highest among the member states of the European Union at the end of the second quarter of 2012 at 150.3%. Italy (126.1%), Portugal (117.5%) and Ireland (111.5%) followed. The difficult task in these countries is to reduce sovereign debt to a level that would be sustainable on a going-forward basis, and, in Greece's case, the amount of debt which would have to be eliminated to make the rest affordable is so huge that this result cannot be achieved in a short period of time or in a single round of restructuring.

In fact, the best that can be achieved in an environment where devaluation (the old, tried and true manner in which countries and their monarchs deceived their creditors for millennia) is unthinkable as long as the EU is dominated by the fiscal rectitude of Germany and the self-interest of countries like France, which is struggling but keeping its head just above water, is to play for time.

The hard part about over-spending is that it can't be stopped or even slowed without producing nefarious economic and political effects. For the Greek civil servant who insists, in the immortal words of a former Canadian cabinet minister, that he is "entitled to his entitlements" and carries his protest to the streets to signal his displeasure at the prospect of an end to the practice of distributing 13 monthly pay cheques each year until he retires at 55 and begins to receive 13 monthly pension cheques, this is where fiscal policy meets the reality of smashed expectations.

Economists such as Nobel Prize winner Joseph Stiglitz warn that the austerity implied in reducing spending in many at-risk countries at the same time amounts to a "mutual suicide pact." If growth can't be a tool to mitigate excessive debt because stimulus is withdrawn from the economy, the debtor nation can't do much about its problem without external assistance, and that is why successive rounds of "bail-out" financings, coupled with a very significant haircut for banks holding Greece's obligations, tend to make this resemble the old expression about "kicking the can down the road." Time is seized upon as an ally because immediate relief is not available, but the implication is that the uncertainty of the process will linger for the foreseeable time-being.

While the focus of Eurozone watchers is centered, for the moment, on Greece, no one doubts that other economies would instantly be swept into the vortex of uncertainty if the strenuous efforts to stabilize Greek finances were to fail. No country sharing the Euro as a currency, no member of the European Union and, ultimately, no nation that was


Photo: Britannica.com

tied to the complex and integrated global commercial and financial systems would be exempt from the fall-out of a Greek meltdown.

To the casual observer, this is a puzzling assertion. Greece, after all, accounts for only about two percent of the GDP of the EU. It should be easy, they reason, to excise this minute contribution to the region's economic performance without causing any residual harm to the 27-member Union, or even the 17 Euro area governments. What they are forgetting is the damage flowing from institutional discontinuity.

Once a common currency was launched (as an evolutionary consequence of prior visions contemplating a free-trade community which begat a common external tariff, which in turn produced common policies on matters as diverse as fishing and agriculture, employment and social rights, economy, finance and tax, energy and natural resources, among many others, and led, eventually, to an attempt to align the various national currencies in the European Monetary System), the mould was set and it became effectively unthinkable for any member state to revert in a time of crisis to its own currency. Unthinkable, that is, if one wanted to avoid extensive damage to any of the other partners in the highly integrated bloc.

When Canada faced two referenda on Quebec sovereignty, we learned a lot about the concept of institutional discontinuity. Studies showed that the impacts on economic activity, unresolved disputes about the use of the currency, accession to existing trade agreements, shares of debts and assets and even the right to citizenship would harm the economies of both the seceding entity and its former partners in Confederation. Perhaps the most persuasive piece of research on this topic was a paper by John McCallum in the June 1995 edition of the *American Economic Review*, entitled "National Borders Matter: Canada-US Regional Trade Patterns."

> *The best that can be achieved in an environment where devaluation is unthinkable as long as the EU is dominated by the fiscal rectitude of Germany and the self-interest of countries like France, which is struggling but keeping its head just above water, is to play for time.*

The reasons institutional discontinuity has such important consequences are both material and psychological. On the material side, just imagine purchasing a woollen sweater and then calculating how much of the wool represents 2% of the total. Let us say the measurement comes down to the cuff on the right sleeve of the sweater. Cut it off and what happens? The rest of the sweater unravels! This is not just convenient imagery to make a point: the sweater was not meant to be dismembered and that is why the wool on either side of the cut is dependant on the rest of the wool.

So, in the real world, if Greece were to withdraw (on any basis, friendly, assisted or unfriendly) from the Euro and return to the Drachma, it would only be so that the debt crisis currently engulfing that country

could be mitigated by a material devaluation. The German businessman who, two weeks prior, had shipped 50 million Euros worth of goods to a Greek importer calls his customer to see about his account receivable. The Greek debtor can only shrug and tell his supplier that he is in no position to honour the bill for the merchandise! Aggregate this fact pattern over thousands of transactions and the Greek problem has instantly become one affecting even the strongest members of the Union (and anyone else trading with the Euro-poor businesses of the departing member state).

The psychological element is more obvious: to the creditors of sovereign debt, the first question that arises is, "Who's next?" The optimist worries about Portugal, Ireland and Italy. The pessimist worries about everybody.

Because there is no short-term solution in sight, the wary investor will have positioned himself for an indefinite duration to this continuing crisis. No less an experienced investor than George Soros has said that, "This crisis has the potential to be a lot worse than Lehman Brothers". In September, 2008, the venerable New York investment bank was allowed to go bankrupt both because a deal to rescue it by a UK bank was opposed by the British Government and Treasury Secretary Hank Paulson needed to fight back at critics of his "too big to fail" policy which saw US Government intervention as the very source of moral hazard in which greedy behaviour was sanctioned by government largesse. So Lehman was the sacrificial lamb!

But the market reacted with fear, as LIBOR rates spiked and corporate treasurers drew their committed lines to be sure that cash would be available to them in uncertain times. The ripples of that panic were felt around the world. Governments were spurred to emergency action, including in Canada, and financial institutions as well as leading manufacturing companies were propped up with taxpayer dollars.

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Charles Dallara, the head of the Institute of International Finance, an organization that represented the private sector banks in the sovereign debt restructuring in Greece (and a former senior official in the US Treasury under Presidents Reagan and G.H.W. Bush) said in a speech in Ireland in May 2012 that the costs of Greece leaving the Euro were "somewhere between catastrophic and Armageddon". He was referring to the knock-on effects for the rest of the world, not the pocketbook impact on individual Greeks or their government.

So it is no wonder that the Royal Bank's chief economist reported in August, 2012 that corporations other than financial firms in Canada held $256 billion in cash and short-term securities. Bank of Canada Governor Mark Carney has termed this "dead money" but Governor Carney knows perfectly well that the reason the memory of Lehman Brothers lingers in the psyche of corporate treasurers is that no one wants to be known as the business leader who made a bet on a plant expansion or an acquisition just before what became the "Great Crash of 2013"!

If the European crisis is one that requires patience and nurturing, with the ECB and IMF juggling to maintain stability during an extended period of managing the southern European democracies down from the proverbial fiscal ledge, the US debt crisis is quite different. The US economy is big enough and strong enough to cure itself, without intervention from its allies or the international financial institutions. The problem in America can be solved without the same potential impact on the social contract with its citizens as faces Greece, Italy and Portugal. The elements needed for a solution are political will, bi-partisan determination and a reconciliation of the hardening philosophical visions now separating the two principal political formations.

It is a commonplace that the US Constitution was written by nation-builders who wished to avoid, at all costs, the kind of tyranny they associated with the English monarchy from which they had successfully declared their independence. It is no accident or oversight that the legislative, executive and judicial branches of the government were structured to be countervailing forces on each other. The bi-cameral legislature, elected in the case of the House of Representatives, every two years, with Senators serving six-year terms, and only one-third facing the electorate at any one time, was intended to provide a rapid reflection of changes in public mood in the one case, and more enduring representation of the interests of the respective states on the other. The fact that the President is neither responsible to the legislature nor armed with any of the tools which the head of government can use to maintain discipline and promote the passage of his or her agenda in the Westminster model of British Parliamentary government, was just as explicitly the purpose of the framers of the Constitution. In short, they devised a system which would not, and, in their view, should not, work unless there was broad consensus in the country about the measures to be undertaken.

So it should be no surprise that, faced with a debt burden of $16.4 trillion and a legislated ceiling that was technically breached at year-end 2012, Americans should be divided about what to do about it. The House of Representatives is controlled by the Republican Party, and an important segment of its contingent is philosophically allied with what has become known as the "Tea Party" movement, a reference to the roots of the American Revolution which began, among other things, as a protest against unjust taxation. The Republicans take the view that the US does not have a revenue problem, but rather a spending problem. They want to see a plan to begin the difficult steps toward paring spending.

Curbing spending has to begin where the money is. In the US budget, that means entitlements such as Social Security, Medicare, and even the newly-minted Patient Protection and Affordable Care Act (commonly referred to as "Obamacare"), and, reluctantly, also in the Department of Defence.

The Senate, on the other hand, is controlled by the Democratic Party which instinctively shares the newly re-elected President's bias in favour of bigger government, helping the less fortunate by redistributing wealth through the tax system.

The old maxim that "you don't want to watch sausage being made" has been massively ignored by all players in the Washington political arena, as they strut their roles, power and influence to improve their political positions when the dust has settled rather than in any dedicated attempt to contribute to a solution to the nation's problems. Of course some of the divergence of views is legitimate, deeply-held political belief, but much of the posturing appears to be the product of the constitutional structure the framers saw fit to put in place.

A Congressman can be cajoled to cast his or her vote in a particular fashion by promises from the leadership of coveted committee positions, for example, but, essentially, every member of the House and Senate is a political force unto him or herself. Once they have established themselves in their District or State, they can (and do) take positions opposed to their Party's mainstream. Jawboning a consensus is an exercise in countervailing pressures. So, as much as Speaker John Boehner, who leads the Republicans in the House, might wish to meet the President (and his agenda) part way and emerge with a sensible compromise on a combination of revenue raising measures and spending cuts, he is a hostage to the mood of groups within his Conference which gives members the ability to simply refuse to follow their leader.

Add to this mix the fact that the last time (before now) that the statutory debt ceiling had to be addressed, the legislators, wishing to postpone serious spending cuts and revenue raising measures, designed a package of initiatives (labelled the "fiscal cliff") intended to be so horrendous that their implementation would serve as an incentive to spur the legislative and executive branches to accept any package containing less drastic violence to their most cherished objectives. All of this was planned to take effect on December 31, that is, after the election, so that no one would have to "wear" the impacts as a candidate.

What happened was two things: first, the President was elected by a modest but convincing majority, which he, not unsurprisingly, took as a mandate for his interventionist, big government ideals. He successfully used that new mandate to postpone the so-called "sequester" (i.e., the spending cuts) until March 1, while gaining a victory in his cherished objective of ensuring that the richest Americans paid more tax. The only partial victory for Republicans was a redefinition of who was "rich" from $250,000 per annum to $400,000 for a single earner or $450,000 for a two-income family.

But the second consequence was much more serious. The American dream had long been that the children of the poorest of the poor could rise to be successful in whatever field of endeavour they chose, even up to and including the Presidency. This President has exploited a wedge between income classes and succeeded in making the increasing of tax rates, not the elimination of deductions, exemptions and credits, the touchstone of how the rich got to pay more tax. The class divisions are bad enough, but higher marginal tax rates represent a disincentive to new investment and enterprise which is not symbolic but real. The plan of Republican vice-presidential candidate Paul Ryan to raise revenue by removing tax preferences, even while lowering marginal rates, resembled what Canada did in 1988, with significant stimulative effect. The only piece missing in the Ryan plan was the Value Added Tax (which Canadians know as the Harmonized Sales Tax) which would enable America to solve its debt problems but is certain not to happen any time in the near or distant future.

The American dream had long been that the children of the poorest of the poor could rise to be successful in whatever field they chose — even the Presidency. This President has exploited a wedge between income classes and succeeded in making the increasing of tax rates, the touchstone of how the rich got to pay more tax.

When Republicans asked, as a condition of yet again increasing the debt ceiling, that some plan to avoid still more spending, and, indeed, to reduce current spending, be formulated, the President stared them down with the assertion that the ceiling represented money already voted by Congress and spent and should be separated from any consideration of future spending plans. Once again, his recent mandate undermined Republican resistance and they yielded.

America can solve its debt (and spending) problems if it wants to. It needs to want to and there appears to be no consensus in that direction. Most importantly, however, they need to stop making a public bravado of last-minute showdowns and manufactured crises, because sooner or later their creditors will get the message that maybe, just maybe, America will decide it does not want to pay its debts. And when that happens, further credit rating downgrades follow swiftly, and the impact on the world economy can be every bit as devastating, or even more so, than a country or two being summarily dispatched from the Euro.

Those watching market data in hopes of seeing the signs of a true recovery in financial markets (that is of a possible return to the conditions that prevailed before the Global Financial Crisis) should bear in mind the two distinct but weighty anchors represented by the dual debt crises of Europe and America. Slowing growth in the large economies we have come to call BRIC is not unrelated to the uncertainty surrounding the massive buying power represented by the highly developed European and US economies. An exporter needs to consider the financial circumstances of his customer, even when his internal domestic market is growing and generating new levels of domestic demand. In this world of interconnectedness, no country is exempt from economic impacts deriving from the burdens of large debtor nations.

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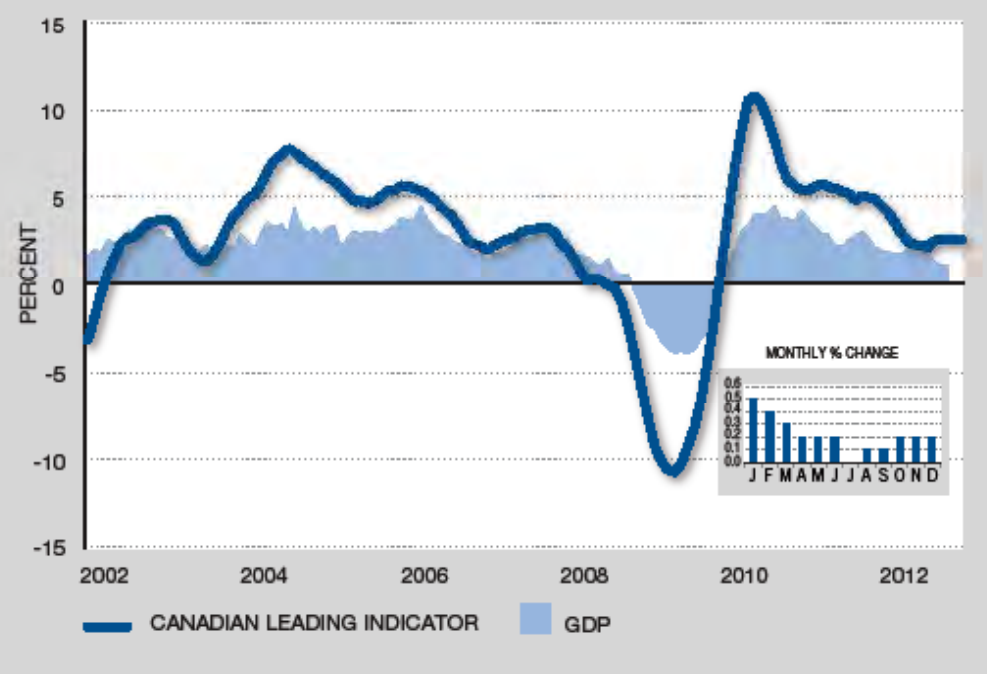
The MLI Leading Indicator

"Look a little ahead, my friends."
SIR JOHN A. MACDONALD

December 2012 leading index

FIGURE 1 Year over year percent change



The Macdonald-Laurier composite leading index rose 0.2% in December, matching its upward-revised gains in October and November. As importantly, the breadth of growth improved significantly. Only one component contracted in December, compared with four declines the month before, while six increased and two were unchanged. The gradual improvement in the leading index, from no growth in July to diffuse gains by year-end, points to a pick-up in economic growth as 2013 unfolds.

The three financial components remained the most consistent sources of growth, rising in unison for the second month in a row. Prices on the Toronto stock market rose for the third month in a row, reversing most of their declines over the summer. The rally has been led by information technology and metals, both of which are up about 20% from their lows in July. The interest rate spread between the private and public sectors narrowed for the second straight month, reaching the smallest gap in over a year, a sign of reduced concern about the risk of lending. Finally, the money supply capped a year of steady expansion with a 0.2% increase.

Commodity prices in December held on to their 1% gain in November. While energy prices continued to soften, prices for forestry products hit their highest level since June 2004. Lumber led the gain in response to further evidence that the US housing market was on the mend after years of decline. Housing starts in the US in December were close to an annual rate of 1 million units, almost double their lowest in December 2009. The recovery in the US housing demand was firmly rooted in a near doubling of household formation over the past year.

The manufacturing sector rebounded from declines the month before. New orders recovered by 0.8%, buoyed by the strengthening US auto market. US auto sales jumped 19% in December, as ongoing replacement demand for a fleet that averages 11 years old was supplemented by vehicles damaged by Hurricane Sandy. The average workweek at factories was unchanged.

The outlook for the overall US economy continued to improve with its leading indicator up 0.2% in December after previous months were revised up. The increase was led by the components related to

the labour and financial markets. These were partly offset by lower consumer confidence and manufacturing orders, the components most affected by the uncertainty surrounding negotiations about the impending US 'fiscal cliff', before a last minute deal was reached.

Labour market conditions in Canada continued to improve, with claims for employment insurance falling 0.5% after a brief setback. This improvement was reflected in the unemployment rate, which fell to a four-year low of 7.1% in December as a result of higher employment.

The housing index was the only component that fell, although the rate of decline eased from 3.1% in November to 1.9% in December. Housing has retreated for six months in a row.

The analytical model underlying this MLI Leading Indicator is the creation of Philip Cross Economics and is used here with his permission.

Leading Indicators

	Jul-12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12
Canadian leading indicator (January 2002=100)	132.5	132.6	132.7	132.9	133.2	133.5
% change	0.0	0.1	0.1	0.2	0.2	0.2
Housing index (January 2002=100)	106.3	105.3	102.4	101.0	97.9	96.0
% change	-0.2	-0.9	-2.8	-1.4	-3.1	-1.9
US Conference Board leading indicator	95.6	95.5	95.5	95.6	95.7	95.9
% change	0.1	-0.1	0.0	0.1	0.1	0.2
FINANCIAL						
Money supply, M1 (millions, 2002)[1]	543,035	546,766	549,609	551,271	552,894	554,198
% change	0.7	0.7	0.5	0.3	0.3	0.2
S&P/TSX stock price index (1975=1000)	11,892	11,803	11,808	11,990	12,119	12,273
% change	-1.6	-0.7	0.0	1.5	1.1	1.3
Interest rate gap	-2.05	-2.03	-2.02	-2.03	-2.01	-2.00
change[2]	-0.01	0.02	0.01	-0.01	0.02	0.01
MANUFACTURING						
Average workweek (hours)	37.6	37.6	37.5	37.6	37.5	37.5
% change	0.0	0.0	-0.3	0.3	-0.3	0.0
New orders, durables (millions, 2002)	26,377	26,185	26,369	26,209	26,413	na
% change	-1.0	-0.7	0.7	-0.6	0.8	na
Commodity price index, all (US dollar terms)	630.2	626.4	626.2	626.0	632.1	632.4
% change	-1.3	-0.6	0.0	0.0	1.0	0.0
Employment insurance claims received	231,128	230,566	229,914	231,320	230,246	na
% change	-0.2	-0.2	-0.3	0.6	-0.5	na
Unsmoothed version	132.3	133.2	133.5	133.2	133.6	134.0
% change	-0.1	0.7	0.2	-0.2	0.3	0.3

1 Deflated by the Consumer Price Index for all items. | 2 First difference.

The Macdonald-Laurier Institute's monthly Leading Economic Indicator series provides unique and valuable insights into the future course of the Canadian economy — giving advance warning of recessions and upturns. The next release date is February 26, 2013.

Photo: Shutterstock

Compared to Canada, U.S. is facing fiscal dip, not cliff

By Brian Lee Crowley and Robert P. Murphy

As news of the deal leaked out, it seemed that the so-called fiscal cliff would be averted. Everyone's taxes are going up, but not by as much as the "cliff" would have required. However, under the deal virtually all of the spending cuts have been postponed for two months, meaning any deficit reduction in the short-term is coming almost exclusively from socking it to the taxpayer. Whether we look at the original fiscal cliff scenario or the stopgap deal, neither tackles fiscal reform as aggressively as Canada did in the 1990s. Americans might like to know that Canada proves you can balance the budget without wrecking your economy.

First the background: By the mid-1990s the Canadian federal government had been running deficits for two decades, with a third of federal revenue being absorbed by interest payments. The international economic situation was dire. Fresh on the heels of the Mexican peso crisis, a *Wall Street Journal* editorial from January 12, 1995 viewed Canada as similarly vulnerable and declared that the U.S.'s neighbor to the north "…has now become an honorary member of the Third World in the unmanageability of its debt problem...it has lost its triple-A credit rating and can't assume that lenders will be willing to refinance its growing debt."

The Canadians retreated from the abyss when the center-left Liberal government tabled their historic budget in February, 1995. Total federal government spending fell by more than 7 percent over two years, while the budget deficit of $32 billion (4 percent of GDP) was transformed into a $2.5 billion surplus. By January 1998, federal employment was down by 14 percent, or 51,000 people. Ottawa ran 11 consecutive budget surpluses beginning in the 1997/98 budget year, causing the total public debt to plummet as a share of GDP. They tightened welfare and fixed their version of social security.

Far from wrecking the economy, in the decade after reform Canada out-performed all the other G7 nations on economic growth, investment, and job creation. In the recent worldwide recession Canada's economic robustness allowed it to weather the downturn better than any other G7 nation. Even in the short-term, the dramatic fiscal austerity in the 1990s was mild in its side effects, merely causing a temporary uptick in the unemployment rate that was quickly reversed.

Since the new deal is celebrated as sparing Americans from the allegedly draconian fiscal cliff, it is instructive to compare Canada's experience with the cliff scenario, as projected by the Congressional Budget Office (CBO) in its August update. It is far more modest than what Canada achieved. (Of course, that means the U.S. outcome under the new deal will be even less impressive, since it doesn't contain even the modest spending cuts of the fiscal cliff scenario.)

The Canadians balanced their budget in just two years. In contrast, the United States—starting with a deficit of 7.3 percent of GDP in 2012—will never balance its budget through 2022, even factoring in the bigger tax hikes and spending cuts in the cliff scenario, not the weaker version in light of the new deal. Canadians cut actual, total federal spending by more than 7 percent in the first two years. In contrast, the fiscal cliff has U.S. government spending falling a mere $9 billion in 2013, a reduction of 0.3 percent. Then total spending will rise again in 2014, so that it ends up higher than in 2012.

The public commentary has largely focused on the cuts to "discretionary" spending, but few people know that by the second year, these cuts will be more than offset by increased spending on "mandatory" programs and interest payments. A drop in federal spending of 0.3 percent in 2013 and higher spending forever after is hardly the vertigo-inducing "cliff" of so much breathless media commentary.

In the cliff scenario, the CBO projection said tax receipts would rise by $478 billion (20 percent) in 2013. That would have been very much counter to Canada's austerity plan, where spending cuts outweighed revenue increases by 5 to 1. Both economic theory and historical evidence suggest that it is much more conducive to economic growth if the government reduces its budget deficit through spending cuts and restraint, rather than taxing more from the citizens. In Canada, once the fiscal situation was righted and growth restored, new spending on social programs and lower taxes both became possible. The new deal reduces the total tax bite, but it also postpones most of the discretionary spending cuts, meaning it is even more lopsided in terms of raising taxes versus cutting government spending.

The recent deal only postpones the tough decisions for a couple of months. In order to make sound policy decisions, Americans must know the facts. Canadians decisively and willingly took on a much more dire fiscal situation and discovered that it was no cliff, but the beginning of fiscal sanity and restored confidence and growth.

In particular, the U.S. government needs to push through much more aggressive cuts in its expenditures if it really wishes to solve its fiscal woes. The metaphor of going over a cliff was always alarmist and wrong. It should be replaced by the image of an athlete getting back into training after a period of self-indulgence and lost discipline. Americans have the chance, not to fall off a fiscal cliff, but to climb out of the fiscal hole they have dug for themselves.

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FORWA


· PROSPÉRITÉ
· PROSPERITY

Leadership matters

By Ken Coates

The divisions within the aboriginal leadership, so strikingly displayed over recent weeks, have been laid by many at the door of Shawn Atleo, national chief of the Assembly of First Nations. His alleged weakness, conciliatory approach to Ottawa and inability to rally the troops have been said to reflect a loss of authority over his constituency.

As Winston Churchill might have said, never have so many been so mistaken about so much.

What is being played out is a momentous political and ideological change within first nations. Shawn Atleo has the thankless task of acting as midwife to the new world, while trying to manage those who sense their power ebbing with the last breaths of the old order.

If aboriginal and non-aboriginal Canadians play their cards right together, within ten years Atleo will be seen as a visionary who was highly effective in advancing aboriginal interests. But, in the interim, the rising tide he is riding is only about evenly balanced against the ebb tide of the old model of aboriginal politics. Outsiders who cannot tell flood from ebb thus misinterpret what they see.

On some things, of course, there is widespread agreement. From National Chief Atleo to the Idle No More protestors via Chief Theresa Spence, all are driven by honest anger about the status quo. But it is the divisions that have caught people's attention more than the consensus.

On the one hand are the inheritors of a tradition of the political and judicial activism that has enjoyed considerable success over the past 40 years.

This group believes strongly that the Crown and Government of Canada must address aboriginal challenges and share political authority with Indigenous peoples and governments. These leaders, such as Pam Palmeter, have a following within the aboriginal community, and offer a vision of legal empowerment, Indigenous sovereignty and "nation-to-nation" negotiations.

The rights-based activist approach, dominant for many years, has certainly had its successes in the courts and in the political arena (e.g., constitutionalization of treaties and judicial recognition of the duty by governments to consult and accommodate aboriginal people in their decisions affecting them) but these alone have not produced the desired and concrete results in the communities.

Like so many activist movements of the last third of the twentieth century, its leaders are re-fighting old battles long since won, while the others are asking how to use those victories to improve their lives in practical ways. With half of aboriginal Canada under 25, first nations are now facing a revolution of rising expectations among the youth (embodied in the Idle No More movement).

This is where the opposing perspective comes in. In contrast to the activist approach, it offers cautious, reasoned, incremental co-operation as the best path forward. This model, embodied in Grand Chief Atleo and his supporters, sees constitutional recognition and favourable Supreme Court decisions, not as ends in themselves, but as tools to be used to leverage better economic and political partnerships with non-aboriginal governments and businesses.

This perspective sees declining value in further political and judicial activism, and rising value in using newly-won powers to gain a negotiated share of Canada's prosperity. In this view Canadian prosperity must be shared more equitably with aboriginal peoples and the tools exist now to make this happen.

Thanks to the practical approach, individual first nations, Inuit and Métis communities have been working with resource companies, local business and regional governments on strategies designed to engage Indigenous peoples in the economy in ways of their choosing. Economic development, job creation, good governance, and major commitments to community education and health care have all been the result.

It is roughly correct to say that leaders of those parts of aboriginal Canada that are making impressive strides with the new practical, results-oriented approach — like BC, Alberta and Quebec — joined Chief Atleo at the table with Prime Minister Harper, while those who are divided (such as Saskatchewan), or have been unable to use the new tools as successfully (such as Northern Ontario and Manitoba), stayed away.

If National Chief Atleo and his supporters, in concert with Ottawa and the provinces, find ways to bring Aboriginal Canadians into greater partnership with other Canadians, especially through the development of Canada's natural resources, everybody wins. If the effort fails, a new round of political and judicial activism will almost certainly ensue, potentially derailing much of the economic growth our natural resources could provide and generating a substantial non-aboriginal backlash.

No politician, leader or activist, aboriginal or otherwise, should rest until the quality of life for Indigenous peoples reaches decent levels. The success or failure of National Chief Atleo's effort to navigate the tides of political change is therefore crucial to the country. To a degree that few Canadians appreciate, the country's economic future might well hang in the balance.

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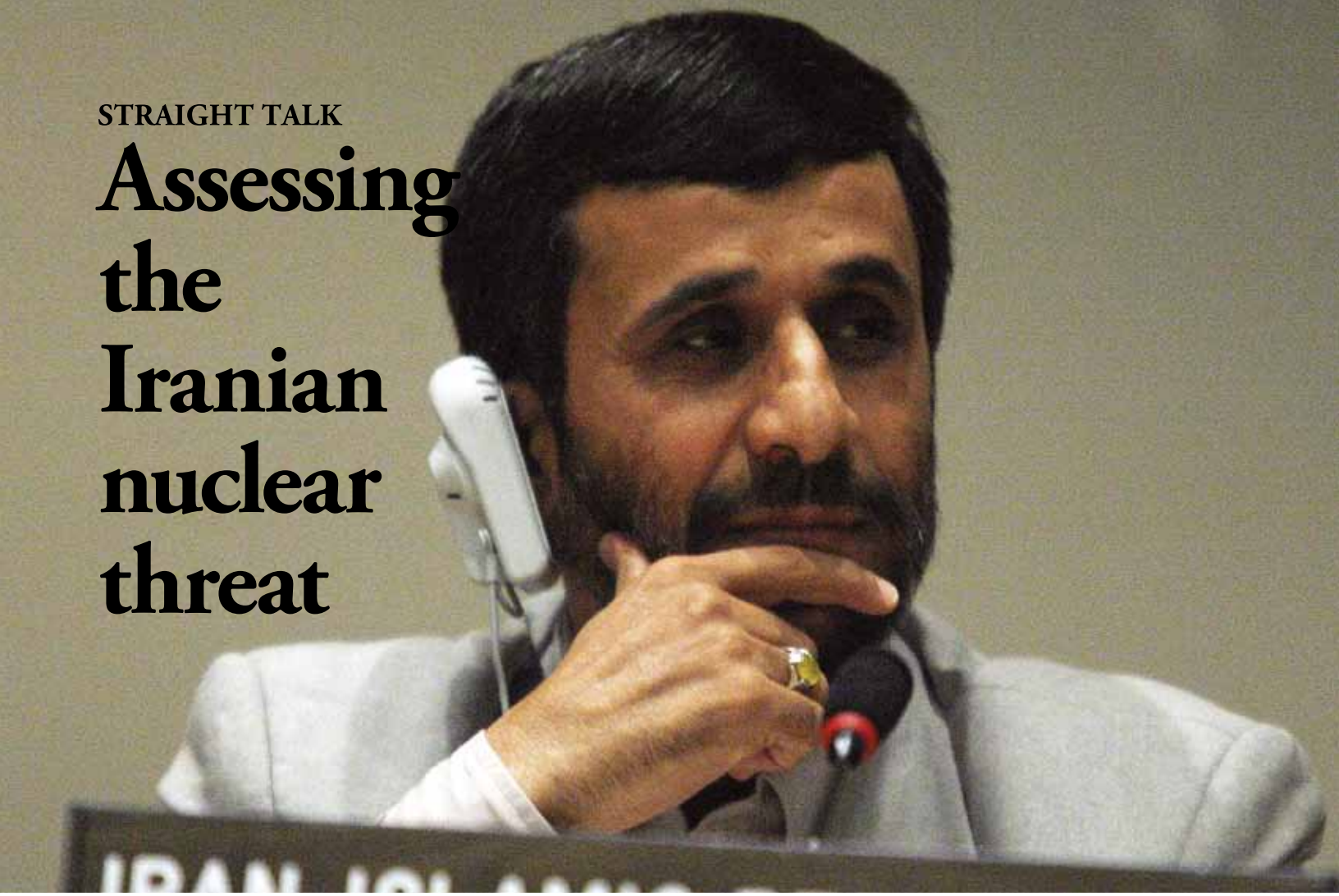

STRAIGHT TALK

Assessing the Iranian nuclear threat

In this instalment of Straight Talk, MLI speaks with Alexander Holstein and Peter Jones about the Iranian nuclear weapons program.

MLI: Let's talk about a nuclear-armed Iran. How likely is Iran to develop working nuclear weapons and, if it does, how likely is it to press the button?

Jones: The American intelligence community's position is that Iran is trying to at least acquire the option to build a bomb or the capability to build one. It hasn't said that Iran is actually trying to build one. Conversely, other countries feel that Iran is trying to build a bomb. But even trying to "acquire the option" is a grey area because it could mean anything from acquiring the basic capabilities but still being a few years away from building a working weapon to being very close to having one. The answer to your question depends on whether Iran wants a working bomb or just the option to build one; and if the latter, how close it feels it needs to be. If it's content with the basic capabilities, the world would be in a more stable situation.

Holstein: I agree. The threat needs to be taken seriously, but not as an imminent existential threat. It could become one in the long-term, particularly when you consider the inflammatory remarks of many leaders within the Iranian regime, particularly the most outspoken ones such as Mahmoud Ahmadinejad. Of course, nobody knows whether Ahmadinejad will still be around if Iran does decide to become nuclear-armed or what the situation will be in the Middle East at that time. I don't think any major military response is required right now. Iran isn't an imminent danger to Israel or any other country in the Middle East.

Iran may or may not develop nuclear weapons, but if it does, it is not likely to fire them itself or to supply terrorist groups because it is risk-averse even though it is also an agent provocateur.

As I understand the Iranians and their objectives, they may be content to get close to having a bomb and then hold back; what some people call the "Japanese option," where everybody knows they are close but have chosen not to cross the line unless pushed. This would fulfill Iran's deterrent requirements without the unpredictable subsequent chain of events — including American and Israeli responses to an actual test, given that both countries have said that they won't allow Iran to have a bomb. It's a more subtle and complicated problem to decide how to live with an Iran that is permanently close to having a weapon, but does not actually cross the test threshold.

Jones: That's probably the right attitude to take towards all of this. If you look at the Iranian regime's actions since the revolution as opposed to its bombastic rhetoric, it tends to be fairly risk-averse. It doesn't provoke a power that can hit back. It may use proxies, but never if it may end up in the line of fire itself. That could change if Iran builds a substantial number of nuclear weapons. And remember that Ahmadinejad's bark may be

worse than his bite. In Iran, the president is not the most powerful figure. Ahmadinejad and his bully pulpit will be gone at the end of his term in August 2013.

Holstein: Yes, I also think the rhetorical bark in Iran is always bigger than the bite, particularly with this type of issue. The biggest threat from Iran is its support of terror groups like Hezbollah, particularly within the region. I don't see Iran doing anything seriously suicidal like acquiring a bomb, attaching it to a missile, shooting it at Tel Aviv or any other Israeli city. Iran is very concerned about self-preservation, in my view.

Jones: Absolutely. That leads to the very interesting question of whether it might "press the button" vicariously by supplying nuclear weapons to a terrorist group. Some people have said that it's a tangible danger but, again, I'm skeptical because the Iranians know that the real trigger finger stands a very good chance of being traced back to them. And even if it couldn't be traced scientifically, any number of countries would simply assume that Iran had supplied the weapons and heap devastating reprisals upon the country. Certainly Iran's sponsorship of terror groups is very serious, but I don't think it would supply nuclear weapons to a terrorist group.

Holstein: I think you're right. Whether Hezbollah or Iran fires an Iranian nuclear warhead it would be traced back to Iran. Even without conclusive scientific evidence, intelligence agencies are pretty good at connecting the dots, particularly when it relates to Hezbollah.

MLI: Let's say that three years from now, Iran has successfully tested a warhead, Khamenei is still the supreme leader and the new president reflects Ahmadinejad in character and lack of political power. Does anything change dramatically for the worse?

Holstein: The biggest change is the possibility of greater proliferation of nuclear weapons in the region, like what happened with Pakistan and India. Saudi Arabia could decide it wants to be openly nuclear-armed. It may even have a secret nuclear program right now. And that's when things get a bit scary, especially if destabilization continues in the Middle East, and we — the West, that is — start wondering who's going to take over a regime with a nuclear arsenal. We don't know what the outcome will be in Syria, Egypt or Libya right now — although I don't think Libya is in as much danger as Syria of a jihadist or al-Qaeda-type regime taking over in a power vacuum.

If the Middle East gets into a nuclear-arms race, we don't know how Israel will react. Israel has the smartest leaders in the world right now, with broad experience and a deep understanding of the region and of running their country. They also understand American thinking — including the limits of what the US will tolerate — because they went to school there and created long-term relationships at the highest levels within the American government. But if Israel launches a military strike against Iran or one of its proxies, especially without American backing, it's very hard to assess how other players in the region will react.

MLI: Peter, how do you feel about that?

Jones: I certainly agree with Alex that one of the biggest problems would be the impact on the regional proliferation of weapons or at least the capability to build them. If some countries decide to acquire nuclear capabilities to deter Iran, it'll take time. You can't just snap your fingers and have a bomb. It has taken Iran more than 20 years. It took Pakistan and others who were really determined several years. So the danger of regional proliferation will play out over decades, and there will be opportunities to try and change its course. On the other hand, most countries confronted with a nuclear-armed neighbour don't build nuclear weapons themselves. They find other ways to ensure their security; they develop a relationship with an established nuclear power. So one great unintended consequence for Iran could be to drive a lot of Arab countries much closer to the US. The Iranian regime says it wants to break the Arab world away from the US when, in fact, it is driving the Saudis towards the US in terms of security.

Proliferation is the biggest concern, but politics can change dramatically in the time it takes to build a nuclear program, so there are opportunities to derail the program. Israel may react with or without American support. Alternatively, countries can seek protection from an established nuclear power, which alters the regional balance of power.

Holstein: Peter brought up an interesting point about the Iranian nuclear program going on for about 20 years. In fact, I believe the initial phase started under the Shah, and I think some documents from the Ford administration supported it.

Jones: That's absolutely true. When the Shah started his "civilian" program, it was quite clearly a cover for a nuclear weapons program—at least to investigate the option of a nuclear weapon. And the US was supportive. I'm talking 30-35 years ago here. When the current Iranian regime came to power after the revolution, it shut the Shah's nuclear program down completely, and only resurrected it during the war with Iraq when Saddam Hussein used chemical weapons and no-one helped Iran as they were supposed to under existing treaties. It's a great example of what I mean about time changing the course of a nuclear program.

MLI: We've touched on the possibility of direct military action if, for example, Iran gave Hezbollah a nuclear weapon or clearly had a working bomb. What effective response can the West make if Iran became extremely aggressive in its posture or its actions?

Jones: The best response is the one you make before Iran actually gets a weapon. After that (in which I include the capability to deliver it reliably), it becomes much more difficult to respond forcibly. The American and Israeli governments have made it very clear that they will not permit Iran to develop a workable weapon. So they are obviously making careful assessments of where they think the Iranian nuclear program is. My suspicion is that if they see Iran making a sprint toward nuclear weapon capability, they will work to stop it before it happens.

MLI: By doing what? A conventional strike on the nuclear facilities? An attack on Iran's infrastructure? Nuclear weapons? What are the options?

Jones: I wouldn't expect the Americans and Israelis to use nuclear weapons unless Iran also had them. But I wouldn't rule out a conventional attack, perhaps even a substantial one. I think also — and only bits and pieces of this have surfaced publicly — a very significant clandestine war has been waged against Iran for many years involving internet viruses, targeted assassinations and explosions at Iranian nuclear facilities. I think that's going to step up a great deal if Iran gets closer to obtaining a weapon, especially if the US and Israel decide that the Iranians are sprinting to the finish line.

MLI: You anticipated my next question. When you refer to stepping up this clandestine war, are the Americans and Israelis already doing everything they can? Do the Secretary of Defense and the Pentagon have a sheaf of further "shovel-ready" options?

Jones: The thing about clandestine activities is that we don't know. The publicly available tidbits indicate a pretty significant set of operations. I assume that the US, Israel and others can play a different deck of cards if they want to take more risk — it's all about risk. How much are you willing to take to achieve an objective? If Washington and Tel Aviv feel Iran is getting close to having a weapon, they may be more willing to take risks and perhaps combine clandestine operations with an overt attack. It's very difficult to be precise if you are an external, independent analyst.

MLI: Alex, what do you think of that?

Holstein: Yes, I agree. This clandestine war is one of the major options for aggressive action. So far, it has indeed been pretty aggressive but its strategic goal needs to be expanded further. Our — again, specifically the West's — long-term strategy should be to undermine the nuclear program and the regime as a whole. Mind you, I'm not sure we can pull it off; I'm surprised we've been this successful with the targeted killings of scientists, the Stuxnet virus and whatever else. I credit much of the success to Israeli implementation because, frankly — from my contacts in the intelligence community and the public record — I'm unconvinced of American capability to conduct a sophisticated, large-scale clandestine operation in Iran that would undermine the regime and sow the seeds of dissent among the people. I find the Central Intelligence Agency completely incompetent, particularly in the region and especially in taking on Hezbollah. Among the many examples I can give you; in November 2012, the agency lost 13 agents in Hezbollah through pure ineptitude and operational carelessness. Nevertheless, we should aim to develop our clandestine capability.

As for air strikes, the Iranians are very clever and have learned from Saddam Hussein in Iraq — putting all your eggs in one basket is an invitation to having that basket blown up in a single strike. All their assets are dispersed and hidden. Because of this adaptation to US/Israeli superiority, it would be very difficult for air strikes to have any impact despite the impressive visual effects. And a major aerial assault on Iran right now would obstruct potential diplomatic success.

Instead, we need to refine the sanctions to provide a safe way for Iran to stop its nuclear program. Right now, the Iranian regime has a diplomatic advantage because it is united. Various countries involved in the negotiations are united (Russia and China support UN resolutions, for example), but that can only last so long. The Iranians feel they can play these countries off against each another to buy the time they need to build functional nuclear weapons. Iran has nothing to gain and much to lose from a humiliating public retreat. The negotiating countries must reassure Iran that they are not trying to undermine the regime — but do exactly that on the clandestine level — so that time stops being Iran's friend. Even extending the possibility of normalizing relations between the US and Iran (coming from me, this is out of left field!) could really throw this regime off, especially since it needs us as the enemy for its own legitimacy, so it could create an interesting dynamic. I say we do this, keeping in mind that we are also pursuing a clandestine program to take it out. So there are carrots and sticks.

It is easier to act successfully before Iran gets a nuclear weapon than after. Preventative primary action may include (potentially ineffective) conventional air strikes and a ramp-up of clandestine activities, for which we do not have the capacity. Far better to stall Iran's nuclear progress and ultimately change the regime through diplomacy supported by secondary clandestine activities.

Jones: I'm in no position to comment on what is happening in clandestine operations right now, but I definitely agree that regime change should be the ultimate objective. I've been in Iran many times over the last 20 years, and certainly life for the common person is very difficult. The average Iranian has no great love for the regime, and a great number of people would like to have a different type of government. You saw this after the 2009 presidential election. On the other hand, and this is important, if we work actively toward regime change, it will complicate our efforts to keep Iran away from nuclear weapons. A major reason Iran is pursuing the nuclear option is because it believes that nuclear capability will help guarantee the survival of the regime. An effort to change the regime could push it to think it needs a nuclear option as quickly as possible, and must not trade it away in negotiations.

MLI: I don't know whether the Arab Spring improved or worsened Iran's geopolitical position, but our conversation raises the possibility that this regime is not as strong as it looks. Can we simply wait for it to crumble through its own domestic weaknesses? Or is that just a head-in-the-sand approach?

Jones: I believe that the Iranian regime will fall the way communist regime did in the Soviet Union. It's illegitimate, doesn't respond to or coincide with the wishes of the people of Iran, and it won't survive.

Even if incoming governments in countries like Egypt don't make us entirely comfortable, the Iranians dislike them even more. Iran has been promising change in the Muslim world under the premise that its revolution was the model to follow. In fact, the Iranian revolution bears no resemblance to the Arab Spring, which was entirely indigenous in the countries where it happened. Those incoming governments have no great love for the Iranians. There's the Shia-Sunni issue, the Arab-Persian issue, among others. And Iran has a particular problem in Syria. If the Assad regime — Iran's only real ally in the Arab world — falls, and it looks

as though it will, we don't know what will replace it, and the situation could be chaotic. So the Arab Spring has weakened Iran's position in the region.

MLI: Alex?

Holstein: Yes, I agree. Syria is the biggest ace in Iran's deck of cards, and it's about to disappear. The Iranians are very concerned about that. President Morsi in Egypt has made a few overtures… but baby steps. There are so many major differences and issues of contention between the two countries that preclude any sudden alliance. Mind you, I do believe that Sunnis and Shi'ites can work together against their perceived common enemies, and that includes Iran. As you know, in the mid-1990s, Ali Mohamed testified in US federal court that he ran security for a meeting between Osama bin Laden (al-Qaeda is Sunni-based) and Imad Mugniyah, the top terrorist with the Shia-supported Hezbollah, where a deal was made to cooperate on operational matters. That said, I don't believe these differences completely prevent Iran and al-Qaeda from cooperating. For example, we know that Saif al-Adel, who is probably al-Qaeda's Number Two, has been in Iran, and travels back and forth across the mountains into Afghanistan and Pakistan with the help of the Iranian revolutionary guard and its intelligence unit. However, I agree on a strategic regional level that the Arab Spring is not a good thing for Iran—and probably isolates it more in the region.

MLI: Suppose the US Secretary of Defense or the Israeli defence minister, having listened in, asks you both to list the key options in point form and identify the one you most recommend. What is your answer?

Jones: My preferred ranking of the options is a combination of diplomacy and clandestine action: clandestine action with the clear intent of preventing Iran from crossing the nuclear red line combined with diplomacy to establish a clear understanding that we could live with an Iran that is fairly close to a nuclear weapon provided we're sure it's not so close that it could cross the line without our knowledge—and it accepts that it cannot cross the line. In return, we reduce sanctions and perhaps even establish diplomatic relations.

I would say to use military strikes only in the case of extreme danger. I don't think it would help at this point and, as we said a moment ago, their effect is likely to be limited. By itself, Israel's ability to take out all the targets and attack them again within several months as the Iranians rebuild is quite limited. That would be difficult even for the US, although it stands a better chance. I wouldn't take the military option entirely off of the table, but things would have to get a lot worse than they are now before using it.

MLI: Okay. Alex?

Holstein: I agree with that, except we should also pursue regime change very carefully. I'd probably use a code name like "Operation Blue Sky" because, again, Peter is right. On the one hand, we have to be very careful not to signal to the Iranians that regime change is the objective. We're too clumsy to conduct ingenious intelligence operations like the Brits did during World War II—although I wish we could. "Operation Blue Sky" doesn't necessarily mean CIA boots on the ground encouraging protests in the street. But instead of going after WikiLeaks, we should use it to reveal information that discredits the Iranian regime. That's how the Russians would play it. I'd "accidentally" let an official-looking paper slip out that says we're going to blow Iran out of the desert if it becomes nuclear-armed. Let Iran know the score in that way. But at the same time, put out a huge carrot that offers an exit route and makes Iran feel the regime is safe, from us at least, and that it's possible to normalize relations.

On the clandestine side, I recommend putting together a special, international intelligence ops task force, certainly between Israel and the US, solely assigned to conduct smart clandestine warfare against Hezbollah and really try to bury it as much as possible. We don't do nearly enough to harass Iran's most valuable terrorist proxy, yet Hezbollah is Iran's ace-in-the-hole if it needs to retaliate against the US or Israel. I'd start in the US because Hezbollah has plenty of cells there that can be taken out through judicial rather than military action, and then target its cells in Latin America.

MLI: Thank you, gentlemen, for this very thought-provoking discussion.

Recommendations:

1) Aim for regime change, but not explicitly.

2) Use a blend of discreet and/or clandestine action and diplomacy to achieve this.

3) Resort to military strikes only if facing extreme danger.

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Unfinished business

Taking stock of Beyond the Borders and Regulatory Cooperation

Launched a year ago the Regulatory Cooperation and Beyond the Border Initiatives are making progress even if they are not generating headlines. The re-election of the Obama Administration, with its commitment to create jobs through doubling trade, offers the promise of more to come. It is easier for people and goods to cross the border and we should see more improvements. While the regulatory thicket remains, its growth is curbed and, in time, we may even see some trimming of the 'tyranny of small differences' that frustrates business and undermines North American competitiveness. While process is often a placebo for real progress, in these initiatives process is progress but for it to take hold we need to see attitudinal change on the part of those who mind the border.

By Colin Robertson

As is usually the case, Canada-US relations remain far beneath the Washington waterline, even more so given the recent elections for the presidency and Congress and the continuing political fixation with America's economic situation.

Yet despite the overflowing US agenda, there has been progress on the Canadian priority of border access and the US effort around regulatory cooperation. In his congratulatory remarks on President Obama's re-election Prime Minister Harper underlined the importance of the initiatives and especially, "putting in place the transportation and security infrastructure necessary to take bilateral commercial relations to new heights and reducing red tape so companies on both sides of the border can create more jobs."

The continuity in policy direction with President Obama's re-election is important. Notwithstanding new players in senior cabinet and sub-cabinet positions we should be able to build on the increasing administrative collaboration and begin to see faster passage at the border and greater complementarity in regulation.

How we got to where we are today

The December, 2011 White House readout of Mr. Harper's conversation with President Obama focused mostly on the current international scene — the Eurozone crisis, the war in Afghanistan and the democratic transitions in the Middle East and North Africa. The US bears the burden of global primacy and every president starts his day with a briefing on the international scene.

It is a reminder to Canadians that when we want something from the Americans we serve our interests best by bringing a helpful Canadian perspective on the international agenda. It establishes our bona fides as a reliable ally and partner. Then we can segue to our 'ask'.

After their discussion the two leaders walked from the White House to the Eisenhower Executive Office to announce to the media 'agreements.' or more accurately 'joint action plans; on perimeter security and economic competitiveness, as well as on regulatory cooperation.'

The Canadian side later offered briefings in Washington and Ottawa accompanied by a briefing document: Beyond the Border: A Shared Vision for Perimeter Security and Economic Competitiveness.

In his remarks, Prime Minister Harper said the plans represented, "the most significant steps forward in Canada-U.S. cooperation since the North American Free Trade Agreement."

Continuing, the PM said: "the key that locks the door against terrorists also opens a wider gate to cross-border trade and travel" and "we are agreed…that the best place to deal with trouble is at the continental perimeter; that smarter systems can reduce the needless inconvenience posed to manufacturers and travelers by multiple inspections of freight and baggage." 'Once cleared, twice accepted' by authorities of both nations, based on inspection at the first point of entry into North America, was the principle of spelled out on the Canadian Government website on Canada's Economic Action Plan.

The Prime Minister reiterated: "What threatens the security and well-being of the United States threatens the security and well-being of Canada."

For President Obama, the agreements were intended to "bring our economies even closer and to improve the security of our citizens — not just along our shared border, but 'beyond the border.' Put simply, we're going to make it easier to conduct the trade and travel that creates jobs, and we're going to make it harder for those who would do us harm and threaten our security. "

"For example," said the President, "some 90 percent of all our trade — more than a billion dollars in trade every single day — passes through our roads, our bridges and our ports. But because of old systems and heavy congestion, it still takes too many products too long to cross our borders. And for every business, either Canadian or American, time is money." Background material released by the Canadian side estimated border inefficiencies impose a direct cost on the Canadian economy of 1 percent of GDP (i.e., $16 billion a year) or roughly $500 for each Canadian.

President Obama promised that "we're going to improve our infrastructure, we're going to introduce new technologies, we're going to improve cargo security and screening — all designed to make it easier for our companies to do business and create jobs."

With an eye on the 2012 campaign, the President drew the link between Canada and small businesses, "which create most of the new jobs here in America. And when they look to export, typically, Canada is one of the most likely places they are to start getting a foothold in the global economy."

The President made a pitch for more Canadians to visit the USA (21.3 million of us did in 2011),"and please spend more money here" — and during 2011 the US Department of Commerce estimates we spent $24 billion during our visits. He concluded, "We want to make it easier for frequent travelers and our businesspeople to travel, and we're going to create a simplified entry-exit system."

Turning to regulatory reform, the President said, "we are going to strike a better balance with sensible regulations that unleash trade and job creation, while still protecting public health and safety… our two nations are going to be going further, streamlining, eliminating and coordinating regulations, slashing red tape, and we're going to focus on several key sectors, including autos, agriculture and health care."

Mr. Harper was equally enthusiastic saying "every rule needs a reason. Where no adequate reason exists for a rule or standard and that rule hinders us from doing business on both sides of the border, then that rule needs to be reexamined." With an eye to Canadian nationalists, he also observed that, "no loss of sovereignty is contemplated by either of our governments."

The December 7, 2011 announcement bookended a process started earlier in the year (February 4, 2011) when the two leaders announced agreement, after another meeting in the White House, on a twofold process: the first part — Beyond the Border — or 'BTB' in the parlance of the negotiators, aims at expediting the passage of people and goods at our border.

The second, known by another acronym 'RCC', shorthand for the Regulatory Cooperation Council, tackles the regulatory thicket — what Michael Hart describes as the 'tyranny of small differences' — that increasingly hampers the flow of commerce.

Achieving secure and better access to the American market, still the largest in the world, has been a goal of Canadian leadership ever since British North America was sundered apart by the American Revolution. The effort by Canadians to gain a rules-based regime dates back to the Reciprocity Agreement of 1854. It has been a see-saw saga of ups and downs as we try to keep the board from tilting against what remains a small, export-dominated economy.

In recent years, we have slipped behind. In a speech (April 2, 2012) Bank of Canada Governor Mark Carney noted that while Canada once generated 4.5 percent of the world export market, we have fallen to 2.5 percent and our manufactured goods export share has halved. The Harper Government's objective is to diversity markets while securing access to our anchor market, the USA.

This latest iteration began when President Obama came to Ottawa in February, 2009. In a visit better remembered for the cookies he took home for his daughters, he asked Canada to join him in a dialogue around energy and the environment while Mr. Harper asked for border access.

Disappointed at the lack of progress on border access promised when President Obama first visited Canada in February, 2009, the Prime Minister prevailed on the President at the G8/20 Toronto summit (August, 2010), arguing that if the President was serious about creating jobs through trade then it should start with its biggest trading partner. The President agreed and the negotiations began that would lead to the February announcement in Washington.

The regulatory exercise, on the other hand, was initiated by the United States, beginning with a December, 2010 visit by a pair of officials from the National Security Council and the Office of Information and Regulatory Affairs (OIRA). It is designed to improve cooperation in four areas: system reliance; regulatory standard setting; product reviews and approval; and managing third country import risks.

It promises to give Canadian and American consumers both more choice and higher confidence in what we eat, drink and use.

Driven by then OIRA Administrator (and once again Harvard professor) Cass Sunstein, the regulatory initiative uses the authority of an Executive Order that requires U.S. regulators, "to the extent permitted by law, to select approaches that maximize net benefits; choose the least burdensome alternative; increase public participation in the rulemaking process; design rules that are simpler and more flexible, and that provide freedom of choice; and base regulations on sound science." This process calls for an ambitious, government-wide "look-back" at existing rules, with the central goal of eliminating outdated requirements and unjustified costs.

President Obama also promised a look at critical infrastructure and cybersecurity.

Infrastructure planning is slowly taking shape around planned pilot projects, initially between Maine and New Brunswick. The Canadian Government has already invested close to half a billion dollars since 2001 with improvements to the highway, port and the bridge crossing (the first in 30 years) between St. Stephen, New Brunswick and Calais, Maine.

It should be a model for the second international crossing planned between Windsor and Detroit, where the Canadian Government has offered a half billion dollars in loan guarantees to Michigan, but this development has been plagued by opposition from the owner of the Ambassador Bridge. The Second Crossing continues to be a cautionary tale in money, politics and the power of special interests.

A year later where are we?

Blogging in the wake of the December 2011 announcement US Ambassador David Jacobson captured the task ahead: "While we believe they are excellent roadmaps to lead us to where the Prime Minister and the President want us to go — more trade, thinner borders and a more secure North America — we will only achieve those goals if we get to work and execute."

On December 14, 2012 the governments jointly released a pair of progress reports. There was acknowledgement that there was still much 'unfinished business' — with further deliverables anticipated in 2013, 2014 and 2015.

There was a brief report of progress on the joint Cybersecurity Action Plan (announced October 26, 2012) for which quarterly updates are promised, although probably not to the public. The first project is a regional resilience assessment of critical infrastructure focused on Maine and New Brunswick to be completed by December, 2013.

Negotiators were behind on some key items — notably the collating border fees and their economic impact and the negotiation of a pre-clearance agreement for the land, rail, and marine modes. These are important, particularly to manufacturers.

But overall, the progress is measurable and positive.

People and goods can now cross with greater confidence that they won't be delayed. The regulatory briar patch remains but its growth has been curbed as regulators on both sides of the border begin to talk to one another. New regulations are more likely to be complementary. Over time, we may even began to weed out some of the differences that have required separate product runs, with commensurate expense to consumers, because of different regulatory edicts, on, for example, the size of the jar for baby food or the ingredients of lipstick.

Let's look at some of the specifics:

From the perspective of the traveller, there are now 'fast-pass' lines at most Canadian airports and major border crossings for those with NEXUS cards. Other trusted traveller programs (CTPAT, PIP, FAST), especially important for truckers, are to be consolidated.

For those travelling by car there is now signage both on the highway and on-line, posting the wait times at some crossings, with more en route.

Passengers traveling by air now have their bags screened by explosive detector systems certified by the Transport Security Administration in pre-clearance facilities in Canada allowing them to enter the US without re-inspection at their transit airport.

A three month entry-exit pilot program, whereby a record of entry into one country becomes a record of exit from the other country began in late October. The CBSA and DHS will exchange data currently collected on our citizens as well as third-country nationals at four ports of entry:

Pacific Highway, Surrey, British Columbia / Pacific Highway, Blaine, Washington; Douglas (Peace Arch), Surrey, British Columbia / Peace Arch, Blaine, Washington; Queenston-Lewiston Bridge, Niagara-on-the Lake, Ontario / Lewiston-Queenston Bridge, Lewiston, New York; and Niagara Falls Rainbow Bridge, Niagara Falls, Ontario / Rainbow Bridge, Niagara Falls, New York.

Binational Port Operations committees have been created at the eight Canadian ports and airports (Vancouver, Calgary, Edmonton, Winnipeg, Toronto, Ottawa, Montreal, Halifax) that provide a U.S. pre-clearance service.

Expedited customs and clearance for low-value shipments is in the works with an expectation of both harmonization and a higher value threshold.

Pilots for pre-clearance based on the principle 'once cleared, twice accepted' have started, based on four criteria: having common advance data requirements for information from importers; sharing advance timely (sic) information prior to loading in a foreign port; harmonizing targeting and risk assessment methodologies; and sharing examination results electronically.

In October, the integrated cargo inspection strategy began at Prince Rupert, British Columbia with a second pilot, likely in Montreal, to begin shortly. The Canadian and U.S. National Targeting Centres

(NTC) will risk-assess all in-transit cargo arriving at the Canadian port and identify the shipments of highest risk. The Canada Border Services Agency will then conduct examinations on behalf of U.S. Customs and Border Protection (U.S. CBP) and also check it for wood packaging and soil infractions. Any contraband or security concerns will be dealt with in Canada. Information will be shared with the U.S. using real-time technology (both images and examination results). Containers will be secured with high-security bolt seals for transit by land through Canada and into the US.

Joint inspection for foreign ships travelling the St. Lawrence into the Great Lakes began in September with inspections focused on increasing vessel safety, security and pollution prevention, and monitoring living and working conditions for workers on the ships.

The Shiprider Program, which first began as a pilot on the Great Lakes in 2005, was expanded in October to shared Canada—U.S. waterways at Vancouver/Blaine and Windsor/Detroit. It allows designated law officers from both countries to transit back and forth across the border to deal with cross-border criminality.

Meat inspection pre-clearance, a Canadian goal since the 'mad cow' debacle that closed the US border to Canadian live cattle in 2003, should begin shortly. It was derailed by the recent e-coli outbreak at the XL Foods facility in Brooks, Alberta.

In terms of other agricultural products, the US Department of Agriculture's Food Safety and Inspection Service (FSIS) is working jointly with the Canadian Food Inspection Agency (CFIA) to implement a pilot project that will consider alternative methods for reviewing import documents prior to the shipments' arrival at the U.S. border and alternative methods for release of shipments that are destined for further processing at an FSIS official establishment.

Both countries promise that they will soon have the single electronic portal for applications to secure the permits required from a host of government departments. One day the forms may even be the same.

On the regulatory front, we have already agreed to harmonize our rules with respect to fuel economy. This builds on a long history of collaboration on national emission standards for new vehicles, much of it originating out of California.

In October, we announced alignment of approvals for tolerances and maximum residue levels in pesticides.

Canadian regulators have also put in place the 'Small Business Lens', a new tool that requires regulators to take into account the impact that new or amended regulations have on small business. US officials are to brief on their own Regulatory Flexibiity Act.

The US side has significantly pushed the envelope on regulatory reform and in May, President Obama signed a complementary Executive Order 'Promoting International Regulatory Cooperation.'

OIRA Administrator Cass Sunstein (who has since returned to Harvard) wrote in the *Wall Street Journal* that it has "a simple goal: to promote exports, growth, and job creation by eliminating unnecessary regulatory differences across nations."

It also established an interagency working group — the mechanism by which things happen in the US Government, putting the onus on US regulators to talk with their Canadian counterparts and, if they cannot achieve a complementary approach, to indicate why not.

Looking Forward

Progress of the various working groups is most easily tracked though the BTB portal on the US Embassy website that, in turn, links to the less easily found but more comprehensive BTB and RCC sites on Canada's Action Plan website.

The reports, while usually written in language that would cure most insomniacs, provide an insight into what is an ambitious agenda with the promise of a simplified, efficient process that will improve Canadian and US competitiveness in key sectors.

In the regulatory area, there are 29 specific initiatives for greater cooperation relating to agriculture and food, transportation, health and personal care products and workplace chemicals, the environment and two cross-sectoral areas — nanotechnology and small business lens. Their work-plans, including sectoral case studies, detail concrete objectives, deliverables and milestones for tangible progress within the RCC's two-year mandate.

One of the benefits of the working groups is that senior officials on both sides of the border are talking to one another. We can take encouragement from language, like this from the Meat and Poultry working group that succinctly sets out their mandate with respect to reducing or eliminating redundant regulations and certification requirements:

is it really required?; is there an alternate way to address the requirement? (i.e., data sharing); for those deemed necessary, can administrative burdens be reduced or eliminated?; elimination of requirement for veterinary signature; certificate 'stickering.'

In 2010, with $33 billion in total bilateral agricultural, Canada purchased approximately 13% of American exports, while Canadian products made up nearly one-fifth of agricultural imports into the American market.

The meat/poultry working group intends to align the framework of the two countries' inspection systems. FSIS and CFIA will formalize an ongoing communication structure on technical and regulatory food safety matters. This includes developing a combined set of objective and quantifiable regulatory performance indicators, which are outcome based. For example, regulators are aiming at a common approach to meat cut nomenclature. Another group is trying to find a way to create a regional approach that would avoid a complete border shutdown in the event of another 'mad cow' situation.

Building on the 'inspected once, approved twice' principle, food safety testing conducted in one country would be acceptable to regulators in

both countries, with cross-utilization of laboratory results by industry and regulators.

The same principle would apply to testing and approval of new veterinary drugs and in December the FDA and Health Canada announced the first simultaneous review and approval of a veterinary drug, Comfortis, used to kill fleas and prevent flea infestation in cats.

Simultaneous new animal drug submissions of the same fundamental data to both countries would be matched by simultaneous availability of drugs to end users.

In the area of health and personal care products like deodorant, industry would have the ability to submit documentation, through the current US gateway, seamlessly to both Health Canada and US FDA with the objective of achieving a complementary review and approval process. For over-the-counter products, like cold medicines, envisaged alignment could include common labeling, especially on directions and warnings statements, and age or weight-based dosing regimens.

In support of good manufacturing practices, there would be sharing of inspection reports of manufacturing facilities for drugs and personal products thus avoiding duplicative inspections in the other country.

A necessary Canadian 'ask' was the preparation of an inventory of border fees and charges. As the US deals with its fiscal situation there will be an effort to find alternate revenue sources. Recall the $5.50 fee levied (October, 2011) on Canadians entering the US by air or sea as 'compensation' for revenue lost under the U.S.-Colombia Free Trade Agreement. We need to be vigilant.

Assessing Progress

Too often process becomes a substitute for policy but in the case of the BTB and RCC, the processes that are emerging are a highly desirable outcome. They will expedite both passage at the border and regulatory requirements. If the process of continuous consultation between officials in various departments on either side of the border takes hold and officials begin to talk to one another as a matter of course then progress will endure.

The creation of the Executive Steering Committee (ESC) of senior officials for the border work is important. Failing to regularize and institutionalize the process will mean that it is more likely to fail to withstand changes in the political administration. Such was the fate of earlier initiatives: the Canada-US Partnership initiated under Prime Minister Chrétien and President Clinton and the Security and Prosperity Initiative of Presidents Bush, Fox and Prime Minister Martin.

The critical factor is trust, especially gaining the confidence of the Americans for whom the terrorist attacks of 9-11 were as epochal an event as the attack on Pearl Harbor. If World War II created what President Eisenhower would later describe in his Farewell Address as a 'military-industrial complex,' then 9-11 gave that 'complex' a security dimension that can be both fearful and hostile, neither of which serves our cross-border relationship.

Fortunately, as the annual Gallup survey illustrates, Americans like us more than any other nation.

Americans views of Canada, 1987—2012: What is your overall opinion of Canada? Is it very favourable, mostly favourable, mostly unfavourable, mostly unfavourable.

Personal relationships between the senior leadership of our military, security and law enforcement are good, especially with the military. Both former Chiefs of Defence Staff (CDS) Rick Hillier and Walt Natyncyzk held senior posts while on exchange with the US Forces, with Natyncyzk doing service in Iraq. The current CDS, General Tom Lawson, comes to the job after having served as deputy commander at NORAD, our binational defence alliance that since 2006 now includes tracking maritime as well as air and space domains.

There were rocky times for our security services in the wake of the rendition of Canadian Maher Arar. As Wikileaks revealed in the conversations between former Canadian spy chief Jim Judd and his US counterparts, the then minority Harper Government was "'taking it on the chin' and pressing ahead' with common sense measures despite court challenges and political knocks from the opposition and interest groups."

While constant vigilance is necessary to protect civil liberties, we both enjoy judiciaries that put the premium on liberty. This has been fortified by robust legislation and regulations around privacy. Throughout the discussions around security, lawyers from the Justice Departments in both countries have been present to ensure negotiators don't cross the red lines raised by Privacy Commissioner Jennifer Stoddart. In late June both Governments released a Joint Statement of Privacy Principles.

The most successful border initiative — the Smart Border Accord of 2001, had the virtue of a well-defined transparent workplan with anchor dates. It responded to a real and immediate business challenge — getting goods and people back and forth across the border after 9-11.

It was supported by Prime Minister Chrétien and President Bush with oversight out of the White House and Privy Council Office and daily management through our Ambassadors, Michael Kergin and Paul Cellucci, and the supporting departments, notably DFAIT and State.

But the critical ingredient was the directing team of Deputy Prime Minister John Manley and Homeland Security Advisor (and later

DHS Secretary) Tom Ridge. This cabinet-level duo kept the civil service focused on delivery of results while providing the necessary high-level political weight to get it done. Importantly they also worked their respective national constituencies. These aspects are missing from the current initiative.

The outcome of these initiatives will not be lost on those in Mexico City, or by the potential partners in the Trans Pacific Partnership and elsewhere. The US bears the burden of primacy. It also bears the burden of being a reliable leader. If you cannot reach an accommodation with Canada, your reliable friend, partner and ally, then with whom can you do a deal?

On the Canadian side this involves the support of business, which needs to be informed and consulted because they are directly affected. The business associations — the Canadian Council of Chief Executives, the Canadian Chamber of Commerce, the Canadian Manufacturers and Exporters all made submissions to the original initiative. They are also a useful conduit to their American counterparts — the Business Round Table, the US Chamber and the National Association of Manufacturers.

It also involves the provinces who share responsibility and, since the Canada-US FTA, an enthusiasm for trade and investment, and, with the Canada Europe Comprehensive Trade Agreement, a direct involvement in the negotiations. The premiers can be remarkably effective advocates with their governor counterparts as we have witnessed.

Then there is the informed public, which deserves to know more about the deal. A government that prides itself on its populist roots ignores the consumer at their peril. The border update specifically commits "to continue public outreach and consultation."

The absence of cabinet-level directorship means a bigger load on our two ambassadors, Gary Doer and David Jacobson. What they may lack in formal diplomatic experience (a bum rap from critics who should know better) they more than make up for in energy and political acuity.

Their jobs are made easier by the decision of Prime Minister Harper to put the implementation teams in PCO and by the President to manage them through the National Security Council and Office of Management and Budget with inter-agency support.

Institutionalization — both BTB and RCC have Executive Steering committees that report to the leaders — will go a long way to create the conditions of change but what also has to happen is attitudinal change on the part of those who mind the border and draw up the regulations.

The regulatory mindset will be the easier challenge. Once the structures are in place for ongoing consultation and the constant exhortation that any differences must be real and significant (e.g., bilingual labeling) we are likely to finally rid ourselves of the 'tyranny of small differences' for the "ongoing systemic regulatory alignment" that the update promises.

What will be more difficult will be persuading those at the border, especially on the U.S side, to moderate the current enforcement mentality that allows no room for 'risk-management'. Until this attitude changes we will not achieve an expedited flow of goods and people.

What is yet to be determined is whether there is sufficient will amongst American leadership to give the top-down instruction to get it done.

Officials need to draw inspiration from Alan Bersin, the Chief Diplomatic Officer for the Department of Homeland Security. Speaking at the Rideau Club in March he talked about making the border more efficient, increasing co-operation between law enforcement and border agencies, improving cybersecurity, and promoting resiliency through common interest.

Bersin, the former US Border Czar, emphasized the need to put aside the false choice between security and trade, and to view economic competitiveness on continental terms, arguing that "unless we make this border more efficient, we cannot actually raise the security profile we share together."

There is another argument that Americans should also consider.

The outcome of these initiatives will not be lost on those in Mexico City, or by the potential partners in the Trans Pacific Partnership and elsewhere. The US bears the burden of primacy. It also bears the burden of being a reliable leader. If you cannot reach an accommodation with Canada, your reliable friend, partner and ally, then with whom can you do a deal?

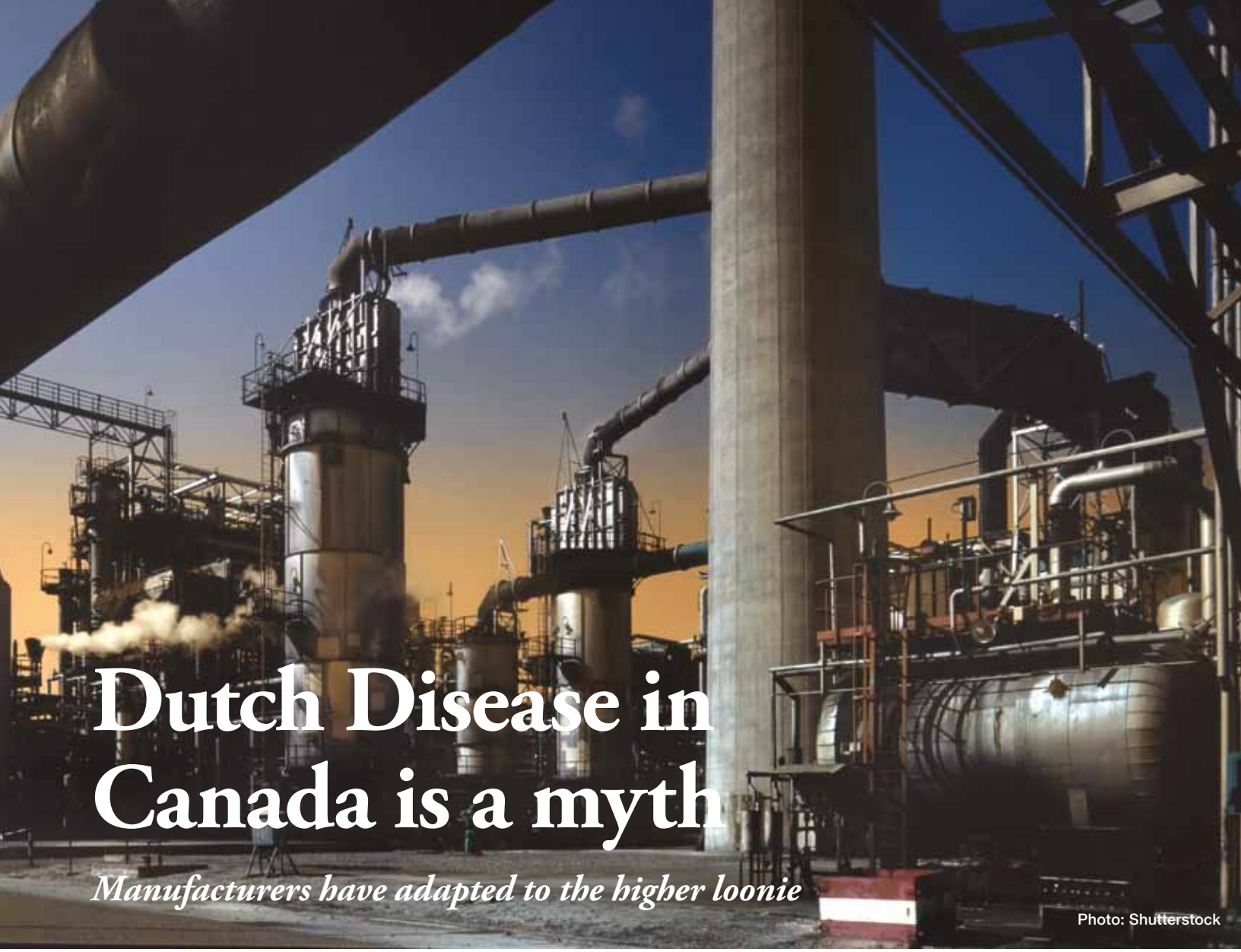
For Canada, of course, these initiatives are the means to an end — improving our capacity to trade. As Brian Mulroney observed at the 25th anniversary celebration of the Canada-US Free Trade Agreement, "For the better part of almost 30 years, four governments of different political stripes followed similar economic policies that generated stable economic growth, solid job creation, sensible public financing, and a more confident national fabric."

We are succeeding. And for Canadians the US will remain our main market.

In commenting on the update reports, Ambassador Jacobson noted that while Canada increased its trade to China by $4 billion in 2011, Canada increased its trade with the USA by $41 billion and two-way trade has increased by 38% — or $181-billion.

Trade diversification makes sense and we should devote energies to it but our main effort should continue to be devoted to the United States.

A former diplomat, Colin Robertson was a member of the teams that negotiated the Canada-US Free Trade Agreement and NAFTA. He is a strategic advisor to McKenna, Long and Aldridge and vice president of the Canadian Defence and Foreign Affairs Institute.



Dutch Disease in Canada is a myth

Manufacturers have adapted to the higher loonie

Photo: Shutterstock

By Philip Cross

One of the hoariest concepts to muddy the public debate in recent years was that Canada suffered from Dutch Disease — the idea that surging revenue from resource exports lifted the loonie to levels that stifled manufacturing.

In a new study released in mid-January by the Macdonald-Laurier Institute, I argued that Canada does not suffer from Dutch Disease. Whatever hurdles the higher Canadian dollar presented, manufacturers have overcome them.

The debate revolves around three questions. Did commodity prices drive the exchange rate? Were manufacturing losses due to the high dollar? And did manufacturers adapt to the higher exchange rate?

There is an emerging consensus that commodity prices explain less than half of the loonie's ascent since late 2002. Among others, the Bank of Canada attributes the largest part of its increase to the generalized depreciation of the U.S. dollar. Since the financial crisis began in 2007, foreign investors have moved $274 billion into our bond markets, seeking a safe haven. So it is more appropriate now to characterize the loonie as the 'Bay Street buck' rather than as a petro-currency.

It is really no surprise that Canada does not suffer from Dutch Disease — turns out, neither did the Dutch. The whole idea of Dutch Disease went off the rails right from the beginning.

Did the exchange rate cause manufacturing losses over the past decade? It is misleading to look at manufacturing as one entity. Over the past decade, manufacturing has been divided into two sectors: one half whose sales increased between 2002 and 2011 and the other half whose sales declined over this period.

The half that expanded was driven by resource-based industries such as petroleum and metals, or capital goods industries supplying the material needed by the investment boom in the energy and mining sectors. So, clearly, some manufacturers benefited from the resource boom, although there is a strong regional pattern to these gains.

Meanwhile, the declining sector of manufacturing was dominated by three industries. The largest losses were in autos and forestry-related, which suffered from the unfolding disaster in the U.S. auto and housing markets, while clothing was devastated by cheap imports from Asia. Clearly, these industries would have suffered irrespective of changes in the exchange rate. This can be seen by the comparable loss of sales for these same manufacturing industries located in the United States.

So overall, the largest manufacturing losses were due to declining markets in the U.S., not the higher exchange rate. Worrying about Dutch Disease in these industries is like your doctor fretting over your cold, while cancer was ravaging your body.

Manufacturers took aggressive action to adapt to the now-decade old reality of a higher dollar. They did this by reducing their dependence on exports, down to 45% of output, and raising their use of imported inputs (such as parts) to 27% of output.

By so doing, manufacturers have reduced their net exposure to exchange rate fluctuations. Ironically, it is the mining industry that is most exposed to changes in the exchange rate, since it exports two-thirds of its output with almost no offsetting use of imported inputs.

The success of these strategies to adapt to a higher loonie is reflected in manufacturing's place in the vanguard of industry growth in the recovery, the third fastest among the 18 major industry groups and ahead of even mining and oil and gas. The recovery of manufacturing has shown impressive depth, with only two industries straggling. One of the largest gains has been in the beleaguered auto industry, which was brimming with optimism at the January 2013 auto show in Detroit.

Surveys of manufacturers find a near-universal buoyancy about its prospects for 2013, even as some continue to wring their hands about the exchange rate. Of course, manufacturers, like any exporter, would prefer a slightly lower dollar, since this would boost Canadian dollar revenues.

Interestingly, about the same percentage of U.S. as Canadian manufacturers cite the exchange rate as an impediment, suggesting it is the Chinese yuan they find most vexing.

It is really no surprise that Canada does not suffer from Dutch Disease — turns out, neither did the Dutch. The whole idea of Dutch Disease went off the rails right from the beginning. The concept began as a theoretical exercise among academics about a resource boom raising a country's exchange rate enough to hamstring manufacturing, after natural gas was discovered offshore from the Netherlands in 1959. But its annual manufacturing output never fell in the early 1960s, and six years after the discovery of its offshore gas fields, its factory output was up one-third.

Researchers looking at the record of other countries with sudden resource booms, notably Britain and Norway with their North Sea oil riches, find little empirical evidence that manufacturing was significantly hampered.

Like most maladies, the best cure for this disease has been the passage of time. It has been a decade since the dollar began its historic appreciation, and six years since it first reached parity with the U.S. dollar. Manufacturers have adjusted and adapted their strategies to this new reality, and are moving forward. It is time the public debate on Dutch Disease caught up to them.

Philip Cross is Research Co-ordinator at the Macdonald-Laurier Institute and former Chief Economic Analyst at Statistics Canada. His study, entitled "Dutch Disease, Canadian Cure: How Manufacturers Adapted to the High Dollar" was released on January 16, 2013. An earlier version of this commentary was published in the National Post on the day the study was released.

Did you know?

There have been 37 Finance Ministers since Confederation. Jim Flaherty has now cracked the top seven in terms of time-served. The longest serving Canadian Finance Ministers are:

1. ***William Stevens Fielding*** *served as finance minister for 20 years under Liberal prime ministers Laurier (15) and King (5). Fielding's service was interrupted by ten years of Conservative government under Borden and Meighen.*
2. ***Paul Martin*** *served as finance minister for 8 years 8 months during the Liberal governments of prime minister Chrétien.*
3. ***George Foster*** *served as finance minister for 8 years 3 months over a very turbulent political period under five Conservative prime ministers (Macdonald, Abbott, Thompson, Bowell and Tupper).*
4. ***Sir Thomas White*** *served as finance minister for 7 years 10 months under Conservative prime minister Borden.*
5. ***Sir Samuel Leonard Tilley*** *served as finance minister for 7 years 8 months under Liberal prime ministers King and St. Laurent.*
6. ***Douglas Abbott*** *served as finance minister for 7 years 6 months under Liberal prime ministers King and St. Laurent.*
7. ***Jim Flaherty*** *has served as finance minister for 7 years during the Conservative governments of prime minister Harper.*

A solution to the Northern Gateway impasse

By Brian Lee Crowley and Ken Coates

The bitter debate over the Northern Gateway pipeline project shows Canadian policy-making at its worst.

A piece of nationally significant infrastructure, the project is currently mired in a toxic mess, assailed by environmentalists, targeted by vote hungry BC politicians, and publicly challenged by many first nations. You could be forgiven for feeling a dreadful sense of déjà vu.

In the 1970s, an ambitious plan was mooted for a natural gas pipeline down the Mackenzie Valley. Aboriginal people and environmentalists protested. Justice Thomas Berger was named to head an inquiry that galvanized opposition to the pipeline, recommending that it be delayed until aboriginal people were ready to participate fully.

Eventually companies created new aboriginal partnership models. Aboriginal communities and governments grew more familiar with the project and innovated by becoming equity partners. While some opposition remained, most in the region supported a pipeline that promised jobs for the North and revenue for aboriginal governments.

But in an object lesson in the perishable nature of opportunity, by the time the project was finally approved, northern gas was no longer competitive with low-cost shale gas closer to markets. The opportunity now appears lost for a generation. If we don't want the same to happen in our efforts to get Canadian oil to the west coast, we need to learn the lessons of the Mackenzie Valley.

For the Inuvialuit (Inuit of the Western Arctic) and the First Nations of the Mackenzie Valley, the pipeline was an unprecedented opportunity. The combination of the pipeline, modern treaties and self-government held out the prospect of overcoming generations of paternalism and poverty. Equity investment in the pipeline, secure revenue, and local jobs were precisely the solutions aboriginal people sought to their problems. Delay put paid to those opportunities for decades to come.

A similar situation is unfolding along the Northern Gateway route. The opportunity is huge, including for aboriginal people. As Thomas Berger said in his inquiry's final report, location is a natural resource. Northern BC's location matters because our oil is more valuable if we can get it to energy-hungry Asian markets. Northern BC is the logical route to tidewater. But unless we respect and build on aboriginal aspirations, the fate of the Mackenzie Valley beckons.

Numerous alternatives are now being floated: rail to the West Coast, a new railway through the Yukon to Alaska, reversal of existing pipelines to eastern Canada, and more. None are as timely, efficient or market sensitive as the northern BC route. For those not viscerally opposed to oil and pipelines, Northern Gateway is the best answer.

Without First Nations' willing participation, however, it is extremely unlikely to succeed. That's not a bad thing. First Nations are deeply concerned about environmental risks; their engagement will help ensure the highest standards of safety, security and emergency responsiveness. They also know only too well that properly managed resource developments, including pipelines, offer the best solution to the employment and governance challenges that they face. First Nations have a judicially and politically recognized voice now in resource development, and they are using it with increasing effectiveness.

The recent indication by the Haisla, on whose traditional territory the pipeline terminus would be built, that they are open to discussions is emblematic of the cautiously entrepreneurial yet environmentally sensitive approach that first nations are now taking. Enbridge and governments are facing tough bargainers all along the Gateway route, as they should. But what is needed now is to find the right way to make aboriginal peoples full participants in development from the outset, not an interest group to be placated once plans have been made.

The way to break the logjam on Northern Gateway, therefore, is to turn it from an outsiders' project resented by mistrustful first nations along the route, into a full partnership between an industry with expertise and capital and newly-empowered aboriginal people and governments. An aboriginal energy corridor across northern BC, for example, could be the conduit for all forms of energy seeking to flow across BC to Asian markets, and majority aboriginal ownership would give first nations the confidence, authority and incentives to embrace responsible development. Best of all, such a powerful equity position removes the seller's remorse that too often afflicts aboriginal agreement to resource development: as owners they would participate fully in all the value created by their involvement and consent.

The Mackenzie Valley Pipeline's proponents had the right model: aboriginal equity and full participation by indigenous groups along the corridor. That project was delayed too long and a vital opportunity was lost. Pipelines vital to Canada's ambition of being a world energy superpower are a fitting place to recognize that aboriginal people have arrived as a natural resource superpower in their own right within Canada. This is the shape of the resource industry in Canada's future.

Brian Lee Crowley (twitter.com/brianleecrowley) and Ken Coates are co-leaders of the Aboriginal Canada and the Natural Resource Economy project at the Macdonald-Laurier Institute (www.macdonaldlaurier.ca), an independent public policy think tank in Ottawa. *An earlier version of this commentary was published in The Globe and Mail on January 3, 2013.*

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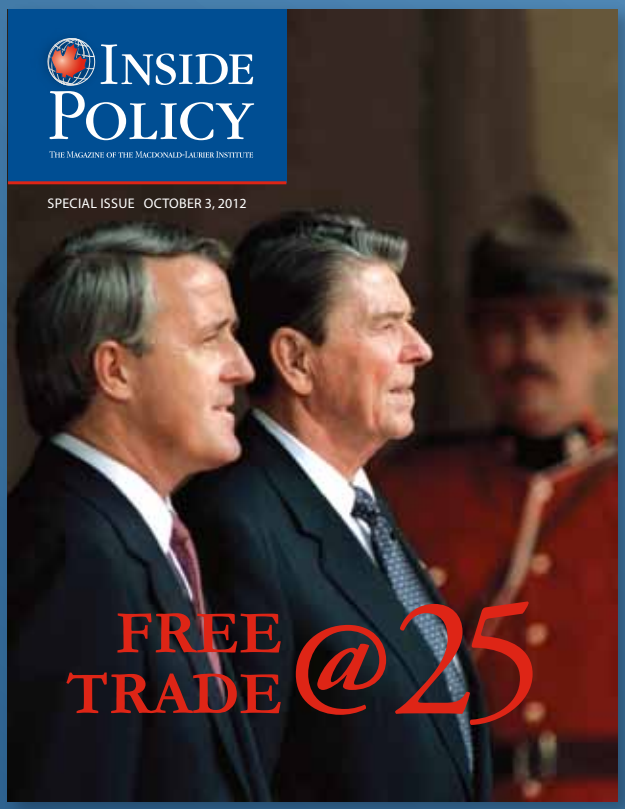

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