THE SASKATCHEWAN ECONOMY OF 2008

The Resurgence of the Resourceful

TD Economics

Special Report

June 4, 2008

TD Bank Financial Group

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Executive Summary

The shift in perception of Saskatchewan's economy recently has been dramatic. Traditionally, the economy has been seen as being driven by "yesterday's" industries of agriculture and mining, suffering from a net out-migration of its young and educated and perpetually locked into have-not status. *Fast forward to today.* Saskatchewan is leading the provinces in terms of economic growth, interprovincial migration has turned around, and those old-economy industries are now being considered tomorrow's source of wealth.

This revival can be chalked up – at least in part – to a series of policy moves over the past decade that has strengthened the business climate, including an improved fiscal position and a more attractive tax regime. However, most of the resurgence can be simply tied to good fortune. Supported by rising demand from China and other developing markets, prices for Saskatchewan's commodity exports have been on fire in recent years. Still, it wasn't until 2007 that Saskatchewan really began to make waves, when prices for crops and potash joined the broad commodity rally.

A commodity diversity rivaled by few

While Saskatchewan conjures up images of vast fields of grain, many Canadians have not fully grasped the size and diversity of the province's resource sector until recently. For one, no other jurisdiction can lay claim to one-quarter of global uranium production and almost a third of world potash output. But the story doesn't stop there. Saskatchewan is Canada's second largest producer of crude oil, third largest producer of both natural gas and coal and has significant deposits of diamonds, gold, copper, zinc and platinum. All together, we calculate that about one-third of Saskatchewan's overall output is driven by commodity-related activities – the second highest relative share in Canada after Newfoundland & Labrador. However, the latter province is heavily geared towards one industry, crude oil.

Not much let up in growth through 2010

The Saskatchewan economy appears to have considerable staying power. The forces of high commodity prices, rising profits and booming investment will continue to drive up household incomes and government revenues, which in turn will be recycled back into the economy and housing markets. The recent rapid uphill climb in crude oil and other commodity prices will probably taper off later this year, as recent speculative activity simmers down and the U.S. dollar gains some traction. However, the diversity of the province's commodity sector will pay its true dividend, as the expected decline in oil prices will likely be offset by further gains elsewhere – notably in potash.

In the 2008-10 period, we project that real GDP growth in Saskatchewan will average 3.5% per year, improving from last year's turnout of just under 3% and about twice the estimated national rate. The rate of unemployment is expected to drift lower, to about 3.5% from its recent range of 4-4.5%. Further net inflows of migrants from other parts of Canada, which should experience only a moderate easing from its recent robust trend, will cushion the drop in the jobless rate.

GDP per capita to soar to 25% above Canada

Despite TD Economics' glowing real GDP growth forecast for Saskatchewan, the projected turnout may still seem low in view of the recent signs of strength at the province's shopping malls and auto dealerships. Keep in mind that real GDP has its limitations as a medium-term performance measure of a commodity-driven economy. This is because it is a gauge of the *volume* of activity and hence doesn't directly capture the income benefits of high commodity prices. A more representative indicator is nominal GDP. And on that count, Saskatchewan's economy is truly booming, with annual growth expected to hold up at a high single-digit rate through 2010.

Based on our estimates, Saskatchewan is not likely to

return to "have-not" status, at least over the foreseeable future. The 10% advantage that the province enjoyed in GDP per capita in 2007 relative to the national average is likely to balloon to about 25% by 2010. Only Alberta will continue to boast a higher standard of living in terms of GDP per capita. Indeed, if Saskatchewan was a country, it would have ranked 5th highest in terms of per-capita GDP among OECD countries in 2007. By 2010, the province could sit as high as third place, above the United States and behind only Luxembourg and Norway.

No longer just a Saskatoon story

Perhaps the best news is that the improved fortunes of resource markets appear to be breathing new life into many communities across the province. No other province west of the Atlantic has faced the challenge of rural depopulation to the same extent as Saskatchewan. Over the past few decades, Saskatchewan's growth has been increasingly driven by one engine – Saskatoon. However, gains recorded in population, employment, housing as well as farm prices over the past few years give hope that the broad-based regional strength has begun to take shape. It is our bet that this trend continues.

Is this period of prosperity sustainable or an illusion?

The economic boom has been fuelling confidence that the Saskatchewan economy may be set for a period of sustained prosperity. Yet the province has been down this path before. In the 1920s, 1950s and 1970s, sharp upswings in agricultural and other commodity prices raised expectations of long-lasting growth that would only be dashed when the commodity boom subsequently faded. Poor decisions were made based on the premise that rapid growth would continue indefinitely. Ultimately, residents were left paying the price when the boom fizzled.

This raises the question of whether Saskatchewan is poised for a similar fate. Certainly, history demonstrates the importance of maintaining realistic expectations. While it is reasonable to expect commodity prices to stay high on average going forward, there is no assurance that this will be the case. Nor has the law of the commodity price cycle been repealed. Perhaps most importantly, even if our medium-term forecasts of continued high prices hold true, there remains much heavy lifting in Saskatchewan to strengthen the long-term growth foundations. By building on recent progress in a number of key policy areas, the province will extend the peaks of commodity price cycles and mitigate the valleys, hence yielding a considerably stronger rate of growth over the long run.

The province can't afford to lose momentum in terms of raising its long-term capacity to grow. Notwithstanding its strong showing in terms of GDP per capita, both productivity and per-capita personal disposable income (PDI) in Saskatchewan continue to sit below the national average.

In terms of policy, there is no single magic bullet. It boils down to effectively leveraging the province's strengths to shore up areas of vulnerability. We cite the list of strengths and challenges on page 20. On the side of strengths, the list includes a diverse commodity sector, low overall business costs, an improving fiscal and tax regime, an innovative and loyal population, a high overall rate of labour market participation and a high trade orientation. On pages 20-32, we discuss the province's challenges, which in no particular order of importance are:

- *Infrastructure Deficiencies* – despite significant investment in public infrastructure over the past decade, there remains a gap between actual spending and needs.

- *Cost competitiveness* – Saskatchewan businesses continue to enjoy a cost advantage over competing jurisdictions, but that edge could erode over the medium term as growth-related cost pressures in the province likely escalate. Despite the moves to lower personal and business taxes in Saskatchewan and maintain a favourable oil and gas royalty regime, there remains unfinished work on the tax side. Saskatchewan must also be ready to respond to emerging trends outside its borders, including further cuts to corporate income tax rates.

- *Diversification* – The province's major goal on this front should not be to move away from commodities over time, but to ensure that diversification occurs around thriving commodity industries.

- *Climate change* – Saskatchewan faces the significant task of addressing climate change and growing environmental sensibilities across North America and around the world. At the same time, we see all the ingredients in place to transform the province into a clean energy powerhouse, which would accomplish the double aim of lowering greenhouse gas emissions and diversification.

- *Education* – Still, the key to long-term diversification of the Saskatchewan economy lies with raising education rates, and notably, those within the province's large and increasingly important aboriginal population. Recent data show that the province still lags behind other Canadian jurisdictions in terms of post-secondary education attainment and has a higher-than-average high-school drop out rate.
- Poverty – while rising incomes in the province has lifted most boats, many residents are getting left behind due in part to the soaring costs of housing. Even smaller communities across the province are wrestling with a shortage of affordable housing and other challenges related to low income.

Limited resources calls for tough choices

In the end, laying the foundation for long-term growth will not come without a price tag. It will require public investments in virtually all areas. Stakeholders across the province – such as municipalities, public sector unions and First Nations – will seek a share of the spoils as they confront their own demands and challenges. Moreover, consideration will also need to be given to future generations, in light of the unsustainable nature of non-renewable resource revenues. Yet public resources will always be limited. According to TD Economics' 5-year fiscal forecast, the province's fiscal position is considerably better than at the time of the March 2008 budget, but a constraint will still be binding.

Balancing all of these priorities will require making tough choices and thinking outside the fiscal box. It means managing growth effectively, choosing taxation tools that are efficient and adopting new ways of delivering services, such as public-private-partnerships. Lastly, working to bring unsustainable cost increases in health care down over time will be critical to ensuring that a broad-based strategy remains on track.

Bottom Line

Saskatchewan is blessed with a mix of commodities that is matched by few jurisdictions in the world. But while the brightening prospects for commodities and other notable strengths give Saskatchewan a considerable leg up, the province's dream of lasting prosperity is unlikely to become reality without stepped-up efforts to address its remaining vulnerabilities. Despite the false hopes in the past, we believe that the province has never been in a better position to achieve the goal of stronger expansion and a growing population over the long haul.

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The recent shift in perception of Saskatchewan's economy has been dramatic. Traditionally, the economy has been viewed as being driven by "yesterday's" industries of agriculture and mining, suffering from a net out-migration of its young and educated, and perpetually locked into have-not status. *Fast forward to today.* Saskatchewan is leading the provinces in terms of economic growth, inter-provincial migration has turned around, and those old-economy industries are now being considered tomorrow's source of wealth. The new monikers of "Saska-Boom" and the "It" province have been popping up in media headlines across the country and in other parts of the world. Others have aptly characterized Saskatchewan's recent resurgence as "the world food basket" transformed into a "commodity superstore."

The economic boom has been fuelling confidence that the Saskatchewan economy may be set for a period of sustained prosperity. Yet the province has been down this path before. In the 1920s, 1950s and 1970s, sharp upswings in agriculture and other commodity prices raised expectations of long-lasting growth that would only be dashed when the commodity boom subsequently faded. These up and down swings have retarded the province's long-term economic development.

HIGHLIGHTS

- **Canada's "commodity superstore" has never been better positoned for long-term prosperity**
- **Just over one-fifth of Saskatchewan's economy is directly tied to natural resources**
- **Agriculture, which had been viewed as "yesterday's" industry now considered a source of wealth for tomorrow**
- **Commodity prices will always be prone to swings, but prices should oscillate around a relatively high bar**
- **The province can extend the peaks of commodity price cycles and mitigate the valleys by addressing its challenges in areas such as infrastucture, skills shortages, poverty and climate change**

Despite the false hopes of the past, we believe that Saskatchewan has never been as well-positioned to enjoy long-term expansion. While the law of the commodity price cycle has not been repealed, there is a growing consensus among forecasters that prices will oscillate around a relatively high bar. Never in its storied past has the province enjoyed such a diverse mix of commodities – one that we believe is unrivalled in Canada and matched by few jurisdictions around the world. For example, there is no other jurisdiction in the world that can lay claim to a quarter of global uranium production and almost a third of world potash output. Add to this an impressive array of other strengths

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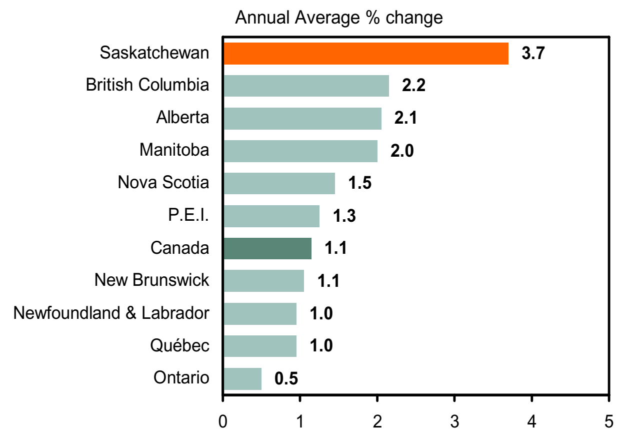
FORECAST GROWTH FOR 2008 REAL GDP



Source: Statistics Canada; Forecast by TD Economics

(i.e., an innovative population, relatively strong productivity growth and high trade orientation chief among them) and the dream of lasting prosperity is clearly within reach.

That being said, it is critical that realistic expectations be maintained. Although the province has made strides in improving its foundations for long-term growth in recent years, there is much heavy lifting that remains. As we discuss on pages 20-32, infrastructure, poverty, skills shortages, an aging population and retaining an advantage in terms of cost competitiveness represent significant challenges. From a government perspective, effectively balancing off these priorities will be no easy feat, since economic growth generates demands for new investment that easily outstrip the growth in revenue coffers. As a result, public funds will need to be allocated carefully and bold new approaches adopted. The good news is that the new provincial government appears prepared to blaze new trails in order to raise the province's economy to the next level.

In the final sections of this report, we discuss two areas of particular opportunity. First, Saskatchewan has all the right tools to move from a province with a competitive advantage in energy production to an energy powerhouse. Second, perhaps the province's greatest challenge is among its greatest opportunity – namely, setting the stage for fuller participation by its youthful aboriginal community in the market economy. Building on the recent progress in both of these areas would provide a considerable payback to Saskatchewan in the form of higher living standards.

Economy picking up steam since 2003

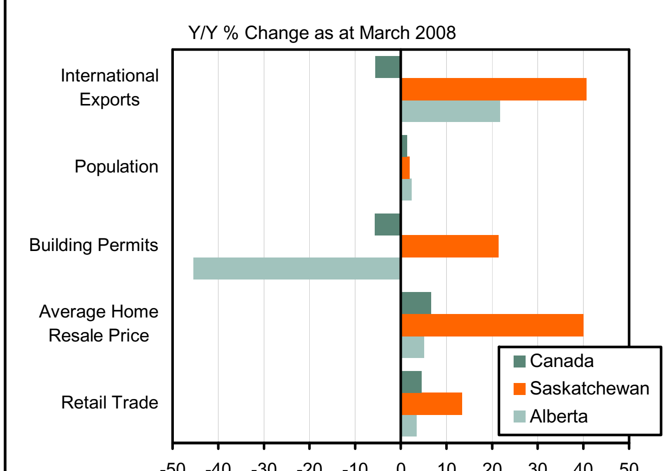
So far in 2008, the Saskatchewan economy has been recording a number of milestones, including first-place rankings among Canadian provinces in terms of gains in retail sales, international exports, total building permits, housing starts and resale home prices. This recent momentum is even more impressive when placed in the context of the province's lacklustre performance – both in absolute terms and relative to other jurisdictions – over the past quarter century. Moreover, one would be hard-pressed to find other provincial or state economies registering accelerating expansion during a time when U.S. housing markets are slumping and the economy Stateside is probably slipping into a recession.

While its success appeared to come out of the blue, the Saskatchewan economy has actually been building up steam since 2003, when global resource markets began to gain considerable traction. Still, Saskatchewan's strength remained largely unnoticed in the shadow of the sizzling performance racked up by its neighbour to the west. By mid-2007, however, the province began to steal the limelight, when momentum in the Alberta economy started to taper off and the pieces to the prosperity puzzle fell into place. We now take a closer look at how the seeds for Saskatchewan's current boom were sown.

A commodity superstore

To a significant extent, Saskatchewan's economic revival can simply be tied to good fortune. In addition to its fertile crop lands, the province is blessed with enormous natural endowments. To many Canadians, Saskatchewan conjures up images of vast fields of grain. And given that the province is home to almost half of Canada's farmland

COMPARISON OF KEY INDICATORS



Source: Statistics Canada

How Does Saskatchewan's Economy Stack Up?

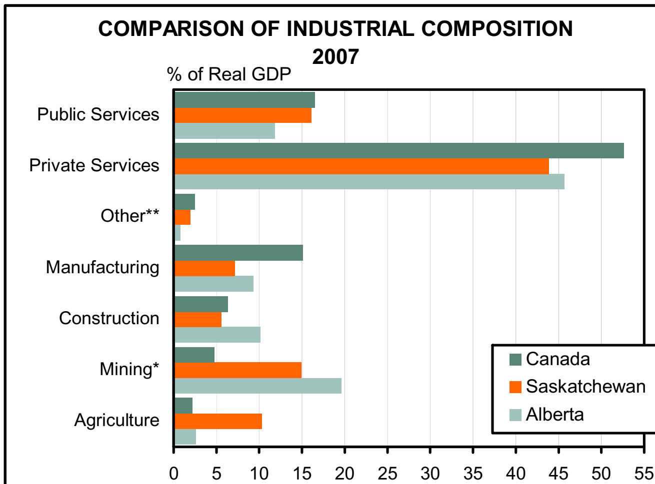
The tables provide a snapshot of how Saskatchewan compares in a number of key economic and labour market indicators. Two commonly used measures of standard of living are real gross domestic product (GDP) per capita and real personal disposable income (PDI) per capita. In 2007, the real GDP measure – which excludes prices – was virtually bang on the national average. However, if producer prices are factored in, Saskatchewan's GDP per capita hovered a sizeable 10% above the national level in 2007. The large run-up in world commodity prices in recent years explains Saskatchewan's favourable position in nominal terms. In terms of real PDI per capita, the province is shown in a weaker light, at only 92% of the national average and 73% of Alberta's level.

Most metrics of labour market activity provide a consistent story of Saskatchewan enjoying better outcomes than the national average but weaker when shown beside Alberta. In terms of education outcomes, however, Saskatchewan lags behind. At 54%, the share of individuals between 25 and 64 with a post-secondary degree or diploma is the second lowest among the provinces, partly reflecting a relatively small proportion with university degrees (17% versus 23% in Canada). Saskatchewan is home to the second highest proportion of aboriginals, after Manitoba. Even though the province has the highest percentage of non-aboriginal residents above 55 years, the large share of aboriginal youths (those below 15 years of age) leaves Saskatchewan with a relatively young population on average.

COMPARATIVE INDICATORS
2007 Estimates (unless otherwise indicated)

	Canada	Saskatchewan	Alberta
Standard of Living			
Real GDP per Capita	39,914	39,624	54,540
Nominal GDP per Capita	46,441	51,327	74,825
Real PDI per Capita	24,965	22,876	31,244
Labour			
Participation Rate	67.6	69.8	74.1
Employment Rate	63.5	66.8	71.5
Unemployment Rate	6.3	4.7	3.4
Demographics			
Median Age	38.8	37.7	35.5
% Pop with PSE*^	60.6	53.9	60.5
% of Pop: Aboriginal^	3.8	14.9	5.8

*Includes university, certificate & diploma programs ages 25-64
^Calculated from 2006 Census
Source: Statistics Canada / Haver Analytics

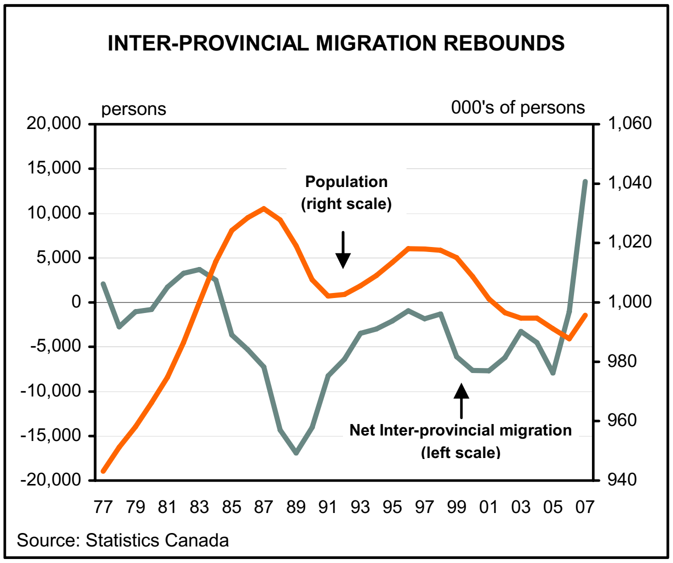


* Includes oil and gas
**Includes utilities and other primary
Source: Statistics Canada, Haver Analytics

Compared to other jurisdictions in Canada, Saskatchewan's industrial mix is among the most geared towards energy and non-energy mining, agriculture, and overall goods production. On page 6, we calculate that the province's overall reliance on commodity industries (i.e., those sectors that are inextricably linked to resources and agriculture) is second highest among the provinces after Newfoundland & Labrador. Still, as we point out, no other provinces enjoy such a diversity of commodity mix as Saskatchewan. Moreover, no other province records a larger share of GDP tied to international exports than Saskatchewan.

In contrast, the province's reliance on manufacturing is relatively low, largely due to its location away from populous markets in the U.S. and Canada. Within the service sector, Saskatchewan has similar orientation as Canada towards public services. It has a smaller bent towards private services than most other Canadian provinces.

and wheat production and two-fifths of canola production, there remains some truth to this perception. What is less recognized, however, is that the province boasts a size and diversity of resources that few jurisdictions can emulate. What's more, these riches blanket the province – from uranium, gold and base metals in the north, to oil and gas, potash, coal and diamonds in the south. More recently, the discovery of a potentially significant coal deposit in the northeastern part of Saskatchewan has added a whole new twist to conventional thinking on the geography of the prov-

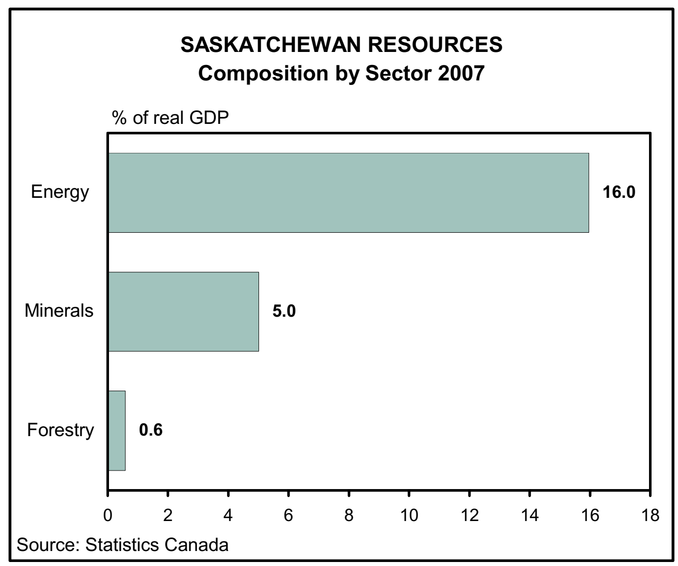


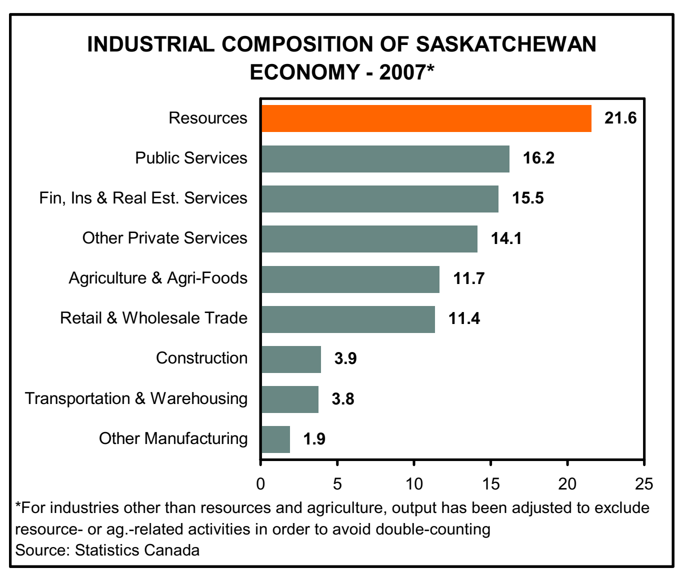
ince's resources. What isn't shown on the map on page 5 is Saskatchewan's large timber supply, which extends across half of the province, and its important network of rivers, that supports the production of hydro-electric power.

In short, Saskatchewan's economic performance is not just tied to agriculture, but to a broad range of commodity-based industries. Consider the following:

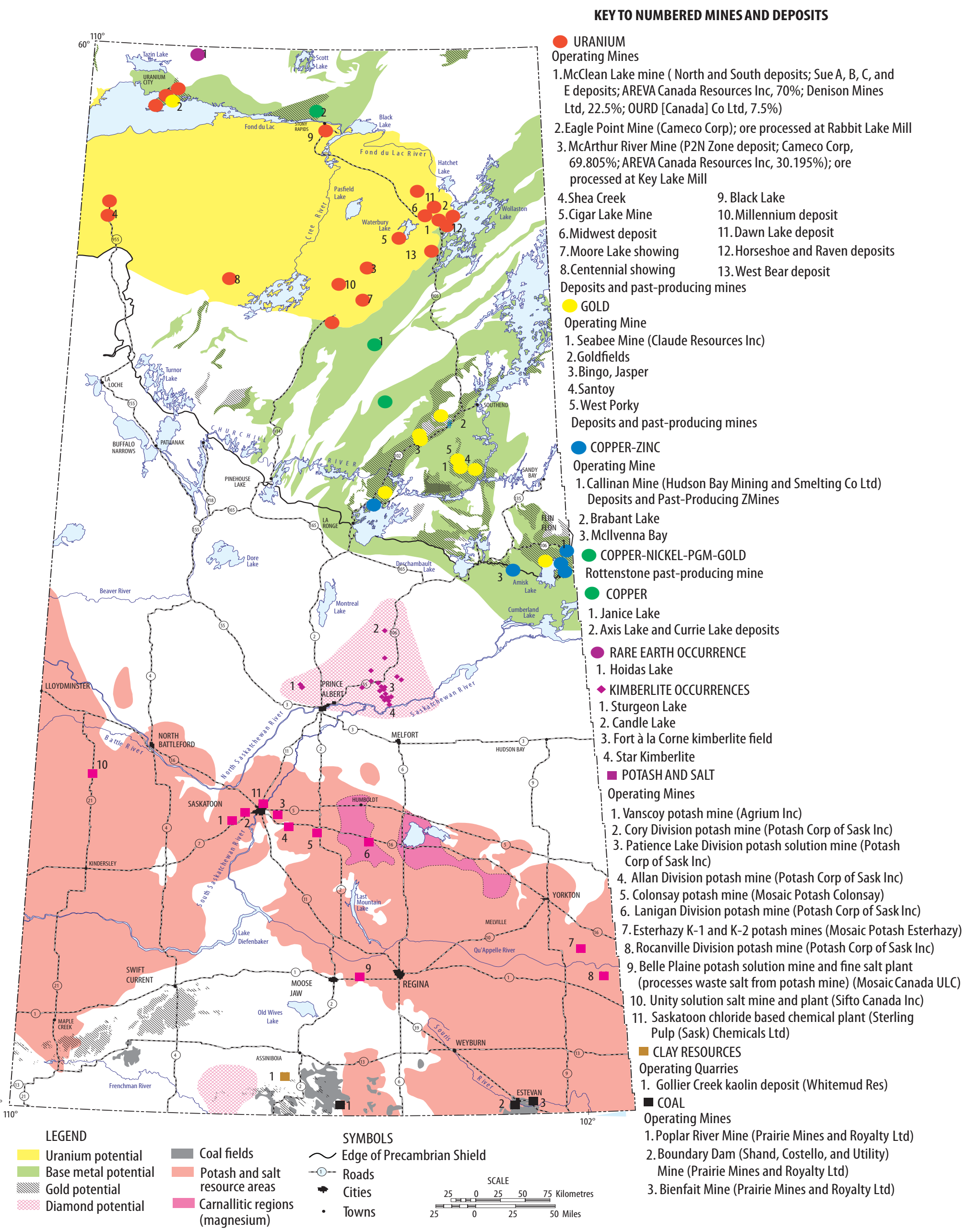
- The resource sector is defined to include the direct as well as the manufacturing and service industries tied to energy, minerals and metals and forestry.[1]
- Based on TD Economics' calculations, the resource sector makes up a sizeable 21% of real GDP in Saskatchewan, representing the largest single contribution among the province's major economic engines. By comparison, the agriculture and agri-food sector (which includes direct and indirect food manufacturing and services industries) comprises about 12% of real GDP.
- Within the resource sector, the energy sector carries the most weight, at 16% of GDP, powered in large part by output of crude oil and natural gas.
- At 5% of GDP, the next largest resource sector is minerals and metals. Based on value of production, potash and uranium are the largest contributors to overall output, making up about three-quarters of non-energy mineral output.
- Uranium and coal are considered "minerals" by most definitions, including that of Natural Resources Canada. However, there is a good argument that given their use as a feedstock for power generation, they could be included within the energy category. Under this broader definition of energy, it has been estimated that Saskatchewan accounts for one-third of Canada's total energy output.
- Rounding out the list, forestry and logging and wood and paper product manufacturing generate just under 1% of the province's real GDP.

Based on the evidence presented thus far, it is fair to say that Saskatchewan's economy is driven by much more than agriculture. And even then, output figures alone don't do justice to the true footprint left by the resource industries in Saskatchewan. In 2007, the resource sector em-

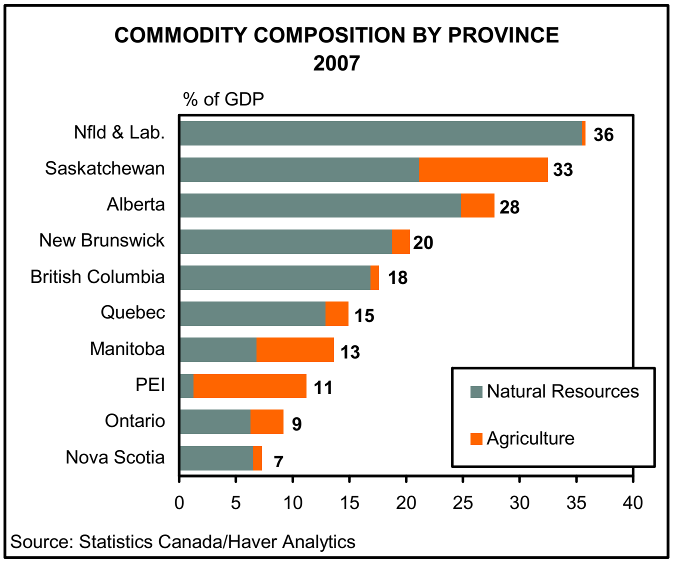




Mineral resource map of Saskatchewan



Source: Saskatchewan: A Mining Journal Supplement (February 2007)



ployed 50,000 people, contributed $4 billion to capital spending and accounted for 9 of the top 25 spots on the list of the province's largest companies by sales, with entities owned by the Saskatchewan government making up about half of the rest. Earlier this year, Potash Corporation – the world's largest fertilizer company – vaulted into top spot on Toronto's S&P TSX in terms of market capitalization.[2] And the benefits to government coffers are significant. Non-renewable resource industries raised $2 billion in direct revenue to Saskatchewan's government in fiscal 2007-08. That figure excludes the substantial corporate and personal income taxes paid by companies and their employees to governments, since those data are not made available.

If Canada has been attracting attention as a global commodity powerhouse in recent years, then the chart above should help to explain why the spotlight has recently been turned up on Saskatchewan. Combining both resources as well as agriculture & agri-food businesses, the province's *overall* reliance on commodity-based industries amounts to a significant 33% of GDP. Although Newfoundland & Labrador (36%) still has a larger commodity orientation, that jurisdiction is highly geared towards one sector – oil and gas. The same is true for Alberta, which ranks third.

Lastly, in light of the fact that a hefty share of Saskatchewan's grains, oil seeds, crude oil, potash and uranium are exported outside the country, the province makes a disproportionate contribution to Canada's overall trade surplus. Last year, Saskatchewan racked up a merchandise trade surplus of $9 billion and made up about one-fifth of Canada's overall trade surplus. Inter-provincially, however, Saskatchewan records a trade deficit of about $3

Stylized Facts: Saskatchewan's Resource Sector

Energy

- 33% of Canadian primary energy production, second to only Alberta*
- Only province in Canada to generate all of crude oil, natural gas, coal, uranium, hydro, wind, wood, and bio-fuels
- Second largest Canadian crude oil producer
- Third largest Canadian natural gas producer
- Third largest producer of coal
- 23% of Canada's proven conventional oil reserves and 6% of natural gas reserves
- Home to two large oil upgraders at Lloydminster and Regina, as well as a large oil refinery in Regina and a smaller asphalt refinery in Moose Jaw

Mining and Metals

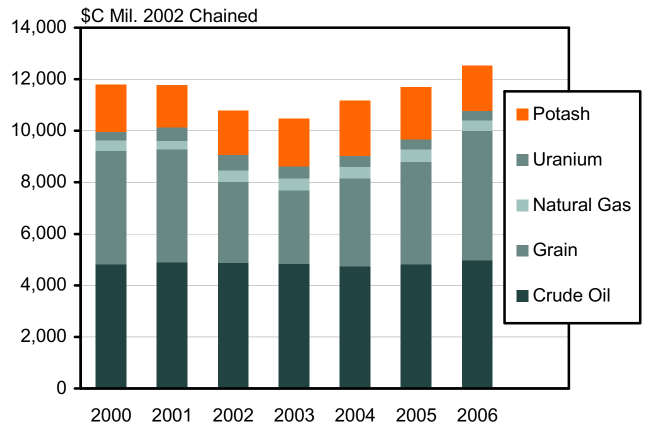
- World's largest producer of potash, with 10 operating mines
- World's largest producer of uranium (1/4 of global output)
- Sufficient potash reserves to supply world needs for several hundred years
- Enough uranium in place to sustain production for another 40 years
- World's largest kimberlite field, with potential for diamond mine being assessed
- Two new gold mines currently under development
- Significant interest in province's endowments of copper, zinc, sodium sulphate, platinum, tandalum, leanardite and kaolin

Forestry

- 23% of land mass is covered by commercial forest
- Generates $750 million annually in revenue among 300 forestry industry firms and 9,000 workers

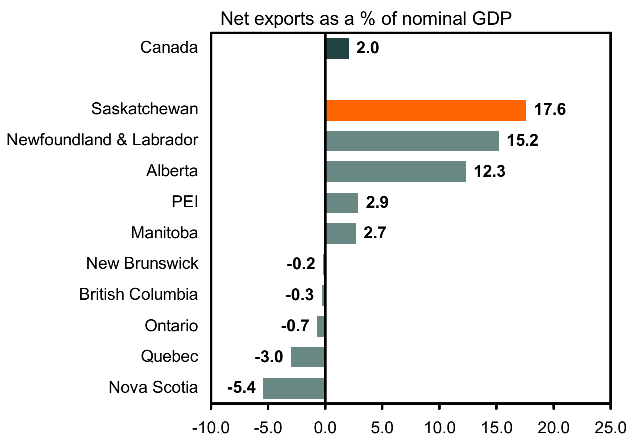
*Includes oil, gas, coal, hydro, wind, wood, uranium and biofuels
Source: Saskatchewan government, Statistics Canada, Canadian Association of Petroleum Producers

SASKATCHEWAN RESOURCE EXPORTS



Source: Saskatchewan Bureau of Statistics

INTERNATIONAL TRADE SURPLUS BY PROVINCE 2007



Source: Statistics Canada

billion with the rest of the country.

1990s a distant memory

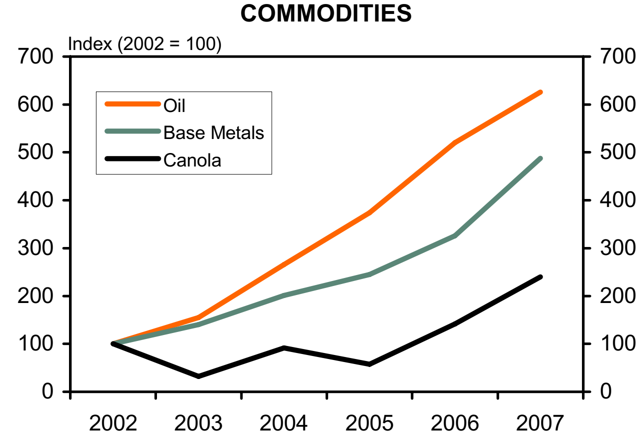
Saskatchewan's formidable commodity position has been evolving for decades. The first settlers from eastern Canada and Europe migrated in droves to the province in the late 1800s and early 1900s, lured by the offer of free land and the potential of improving their quality of life. While the province began producing natural gas and oil in the 1930s and 1940s, respectively, it wasn't until the 1950s to 1970s that new technologies helped uncover much of the province's massive resource wealth.[3]

The development of Saskatchewan's resource sector suffered a major setback during the 1990s and early 2000s, when real (inflation-adjusted) commodity prices tumbled to all-time lows. At the time, the benefits of past discoveries continued to yield rising output in crude oil, natural gas and potash. However, prospects for the future soured, as resource capital investment struggled. Some forecasters were even predicting the eventual demise of resource industries. Others warned that resource-based economies would experience significantly lower growth than those that devoted scarce capital to rapidly-expanding knowledge based industries. Global agriculture prices and demand were also held back by a trend to rising government subsidies and other trade barriers.

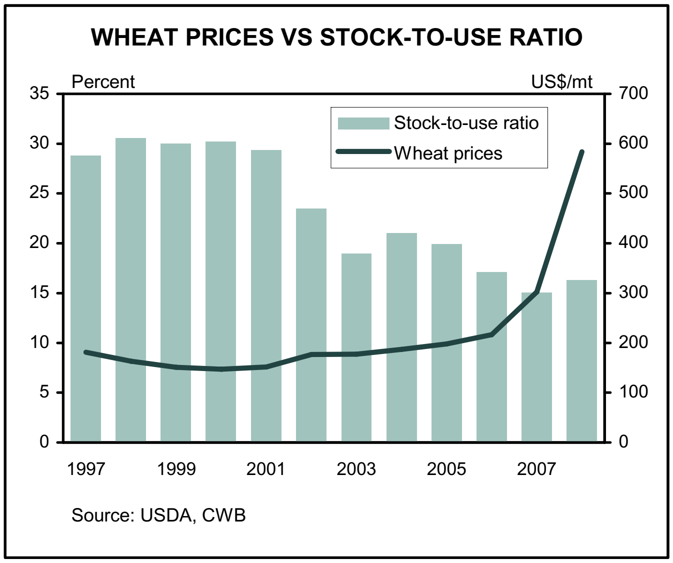
As we know from 20:20 hindsight, those predictions proved to be way off the mark, as prices would ultimately begin to rise starting in 2002. The abrupt change in fortunes of world commodity markets reflected a confluence of factors on both the supply and demand sides of the equation. On the demand front, the rapid industrialization of China, India and other developing economies has triggered a marked pickup in consumption for virtually all commodities. China, in particular, has been accounting for a growing share of global production in virtually all major areas. At the same time, gains of supply of commodities such as crude oil and metals have been slow to adjust to increased demand and high prices, constrained by worldwide production cuts implemented to exploration budgets in the 1990s. Accordingly, supply-demand balances for many commodities have tightened significantly in recent years.

Other global factors also swung in support of commodity prices, including a structural decline in the U.S. dollar and the rekindling of global inflationary pressures that provided a boost to real asset prices. Growing investor enthu-

IMPORTS TO CHINA - SELECTED COMMODITIES



Source: UN Commodity Trade Statistics Database



siasm has also become a major driver of commodity prices. Notably, the commodity market has become increasingly attractive to large institutional investors – such as hedge funds and pension funds – in view of abundant liquidity, declining relative returns on fixed income investments and the launch of exchange traded funds (ETFs). It has been estimated by Barrons that more than $200 billion in investment funds have been directed into commodities worldwide over the past few years.

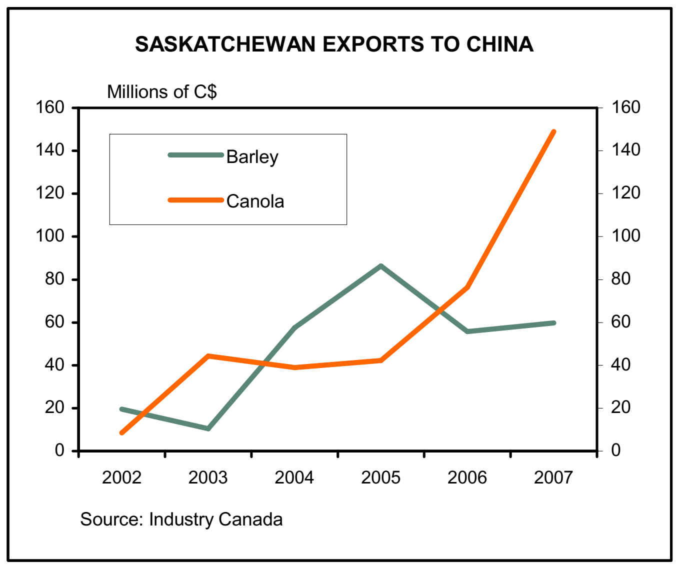
Crop fever turns up the spotlight on Saskatchewan

It didn't take long for rising commodity prices to feed through to Saskatchewan's economy, with real GDP growth doubling from its longer-term average of about 2% to the 3-4% per year range in 2003-05. Yet Saskatchewan's economic revival was still largely unnoticed outside of the province. One of the challenges facing Saskatchewan was that despite the percolating activities in its resource sector, the province's public persona as a "wheat economy" was still entrenched. What's more, wheat and other agriculture prices stood out as one of the few areas – along with forestry prices – that hadn't been participating in the global commodity rally.

That began to change in 2006. It is not the case the world was awash in wheat up until that point. In fact, annual consumption had been steadily outpacing supplies since the early 2000s, partly driven by the increasing appetite of China and other Asian markets. However, a chain of events beginning in the latter part of 2006 have catapulted grain and crop prices into the stratosphere and pulled up longer-term price expectations:

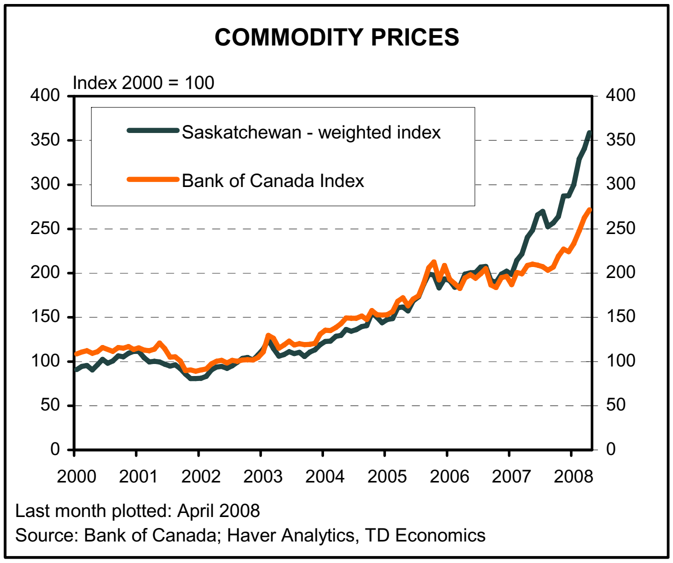
- Corn, and to a lesser extent, soybean prices, were the first to draw significant attention in 2006, when aggressive moves in the United States to spur ethanol and biodiesel production drove up demand for these commodities.
- The high price of corn ultimately triggered a move to increase U.S. acreage devoted to corn at the expense of wheat and other crops.
- Last year's poor growing conditions in the key wheat growing regions of Australia, the U.S., the Ukraine and the Canadian prairies further sideswiped yields and supplies. By the end of 2007-08 growing season, world wheat stocks as a per cent of anticipated use have sunk to their lowest level in modern history.
- Investors and speculators have jumped on the agricultural commodities bandwagon, supported by a declining U.S. dollar.

Accordingly, after remaining at depressed levels through-



INTERNATIONAL TRADE PARTNERS Total Exports as a Share of Destination				
	Canada		Saskatchewan	
As a % of Total	1997	2007	1997	2007
United States	81.8	79.0	51.0	60.8
European Union	5.4	7.7	20.6	17.0
Asia Excl. Middle East	8.0	7.0	6.5	10.1
Chinese Economic Area	1.9	2.7	5.2	4.5
Africa	0.6	0.6	5.9	2.6
Others	2.3	2.9	10.8	5.0

Source: Industry Canada



out much of the 1990s, U.S.-dollar prices for Saskatchewan's major crop exports have soared since mid-2007. Even though prices have fallen back from their highs earlier this year, they remain about 50-100% above their year-earlier level. Even more importantly, the turnaround in crop prices has delivered a double-shot to the province's economic prospects. This is because the market for potash – which is the key ingredient used in potassium fertilizer and considered a critical commodity in addressing the crop shortages – has been pulled up in tandem. Over the past year, potash prices have roughly tripled.

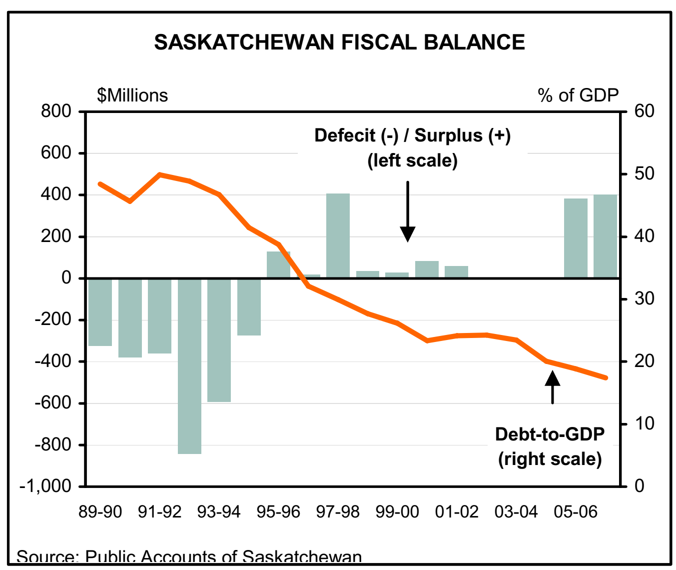
The extent to which Saskatchewan is benefitting from recent commodity price trends is shown in the chart at the top. We have constructed a commodity price index weighted by Saskatchewan's output share of each key area. Based on this calculation, prices have increased by 350% since 2002 and 150% in the last year alone. For comparative purposes, we have included the Bank of Canada commodity index, which is weighted by Canada's output share. That index is up 250% since 2002.

Positive policy moves underpin confidence

Not all of Saskatchewan's current period of revival has been the result of good luck. Policymakers have taken steps to improve the province's business climate over the past 10-15 years, which appear to be bearing fruit. Although we defer much of the discussion on Saskatchewan's progress and remaining challenges to the final section of this report, a few key developments are worth highlighting up front:

Improved government fiscal position – on the heels of a run-up in deficits throughout the 1980s, the government had faced a massive deficit-to-GDP ratio (4%), program spending to GDP (19%) and debt burden (50%). Consistent with this deteriorating picture, Saskatchewan's credit rating had been cut from AA+ in the early 1980s to BBB+ in the early 1990s. With concerns growing that the province might default on its debt, the Premier at the time – Roy Romanow – set out a four-year plan to eliminate its deficit in the 1993 budget. This involved some tough medicine. Taxes and levies were raised, while program spending was cut a cumulative 10% over three years. After achieving its stated goals, successive governments have since maintained a balanced budget. The net debt to GDP ratio has been cut to a mere 14%. As well, the government's credit rating has since been restored to AA.

More favourable business climate – the improvement in the government fiscal position was a key step forward in improving the overall climate for business, since the significant savings in lower interest costs has been recycled back to households and companies in the form of lower taxes. Today, Saskatchewan has the third most favourable business climate among the provinces (as measured by the Fraser Institute) and is home to among the lowest overall costs of living and doing business in Canada. Residents in Alberta and other higher-cost jurisdictions have begun to take note, as evidenced by an upswing in both immigration and business investment. Indeed, Saskatchewan has recorded a net inflow of migrants from Alberta for five consecutive quarters and has had the highest rate of net interprovincial in-migration in Canada for three consecutive



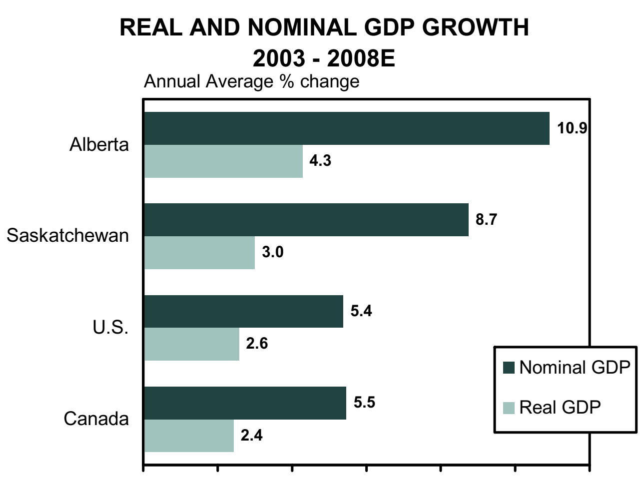
quarters.

Government commitment to improve the business climate – while a more recent development, the new provincial government has been underpinning business and consumer confidence by declaring that Saskatchewan is now "ready for growth". Its goals are clear: to build on some of its recent progress in strengthening the province's economic landscape. As a case in point, both the Premier and Minister for Energy and Resources have said very clearly there will be no increase in oil and gas royalty rates.

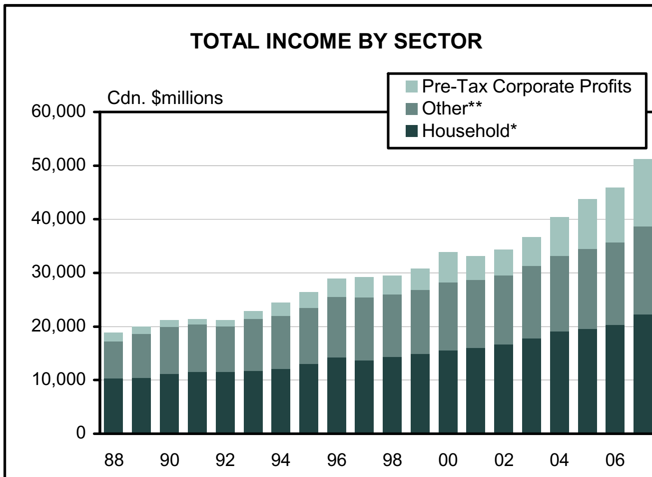
Provincial economy accelerating in 2008

Putting it all together, the combination of a robust and diverse resource base, high prices and an improving business climate are expected to fuel economic growth of 3.7% in 2008, improving from last year's turnout of just under 3%. While undeniably solid, this back-to-back growth performance is not earth-shattering and may lead some to question what all the recent fuss has been about. Certainly, a 3-4% real growth rate seems at odds with the visible strength observed in shopping malls and auto dealerships across the province.

What explains this apparent mismatch? For one, Saskatchewan's improved growth rates are occurring at a time when the bulk of the 60 provincial and state economies are recording weaker growth related to the bursting of the U.S. housing bubble and global credit crunch. In fact, Saskatchewan's real GDP gain in 2008 is likely to be at least three times the national average rate in both Canada and the United States. But more importantly, the real GDP is a measure of production volume that does not fully capture



E - estimate
Source: Statistics Canada / Forecast by TD Economcis



* Includes unincorporated farm and non-farm business income
** Includes Investment Income, CCA, and Taxes less Subsidies
Source: Statistics Canada

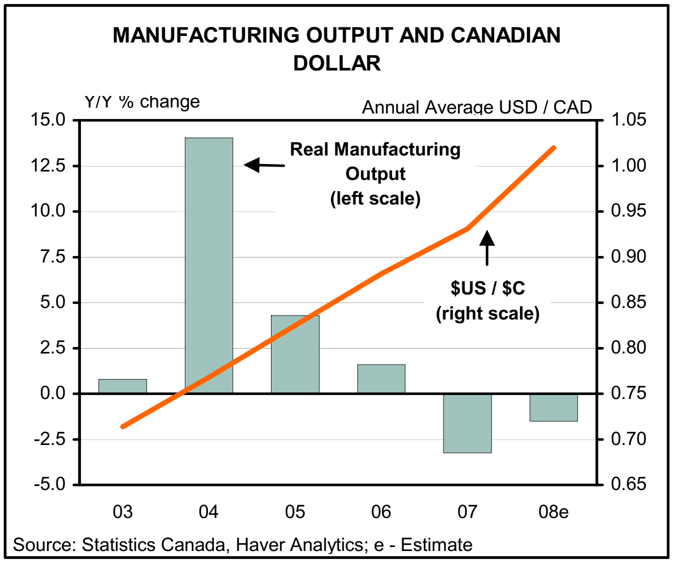
the positive income effect from higher commodity prices. For example, even though resource companies are benefitting from soaring profits and paying higher wages, output is usually slow to respond in part due to the impact of declining production from existing mines. The link is even weaker in the crop sector, where output is more tied to weather conditions than prices.

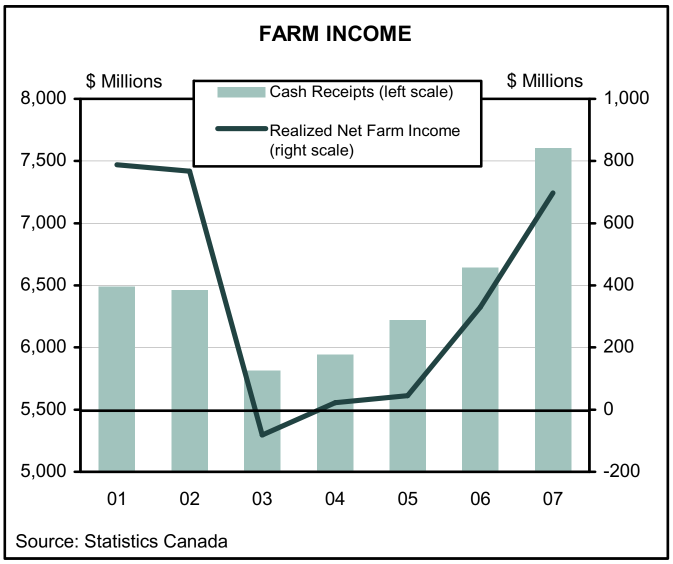
It is for this reason that *nominal GDP* – which directly takes into account income benefits to corporations, farmers, households and governments from the boom in commodity prices – provides a more accurate snapshot of current economic developments in Saskatchewan. Last year, nominal GDP growth tipped the scales at a massive 11%. That increase brought the average gain since 2003 to 8%, which was third fastest among the provinces. And this year, the province is on track to record another outsized gain of 11%.

Not all sectors recording strong growth

It is the rapid growth in nominal GDP that leads us to conclude that the province hasn't enjoyed such a full-fledged economic boom since the 1970s. These forces have set in motion a virtuous cycle of rising profits, government revenues and wages, which have been returned back to the economy through domestic spending and investment. Put another way, the economy continues to be underpinned by resilient commodity markets and its economic structure – which by virtue of its diverse regional trade orientation and commodity mix – makes it less vulnerable to a slump in U.S. demand.

This is not to say that that the sky has been free of





clouds. In the agricultural sector, realized net farm income (i.e., total farm income after deducting the change in the value of inventory) has been improving since reaching a low of -$81 million (loss) in 2003. In 2007, net realized farm income reached $700 million, representing a good year but still below the level recorded in 2002. While crop revenues rose sharply, many farmers continued to struggle in the face of soaring costs for fertilizer, transportation and energy and a high Canadian dollar. Indeed, in the livestock industry, where prices have not participated in the crop rally, the squeeze has been particularly noticeable. Furthermore, the extent to which growers can benefit from these high prices will boil down in large part to this year's weather conditions. Early in the season, there were concerns about dryness, notably in the southwestern part of the province.

Another area of relative weakness has been manufacturing, which in addition to the high Canadian dollar, has recently dealt with the negative impacts of slowing U.S. demand. Real output in the wood products industry has declined by about 50% over the past two years, while the food products industry has recorded marginal advances. Despite the challenging environment, Saskatchewan's overall manufacturing performance has been holding up better than those in most other Canadian jurisdictions, reflecting

Macroeconomic Outlook

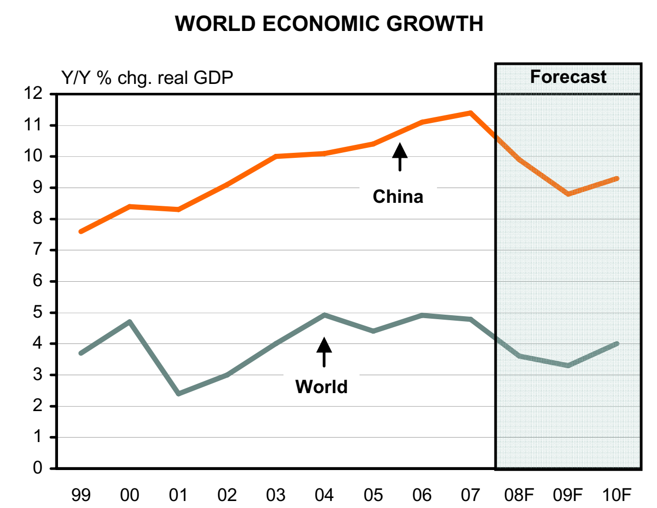
- The U.S. economy is expected to slip into a mild recession in 2008 and see a very pale recovery in 2009. By 2010, growth is expected to return closer to a trend rate of 3%.
- A combination of weak demand from the U.S. consumer, the impacts of weak global credit markets and high currencies in relation to the U.S. dollar is expected to lead to anemic expansions in Japan, the UK and the E.U. (15).
- Even though China, India and other developing world markets will not be immune to the impact of weaker export demand from the U.S. and other major industrialized economies, the expansion will cool off only moderately from their recent frenetic pace. Continued high commodity prices will underpin growth in commodity-oriented developing markets.
- Overall world real GDP growth is projected to slacken from the robust rate of 5% per year in 2006-07 to about 3.5% per year in 2008-09. In 2010, we expect to see a rebound back to about 4%.
- In tandem with the U.S., Canadian economic growth is expected to strengthen modestly in 2009, but remain at a sub-par 1.8%. In 2010, growth is expected to accelerate to 3%.
- The Canadian dollar is expected to drift back down closer to its estimated long-term equilibrium value of about 92-95 US cents over the next 2 years.
- Canadian short-term interest rates are expected to be cut by a further 75 basis points over the remainder of 2008, as the Bank of Canada takes action to mitigate the downside risks to growth. Once the economy begins to recover in the second half of next year, the Bank will take its foot off the monetary accelerator, pushing up short-term rates to 3.25% by the end of 2009 and 4% by the end of 2010.

thriving order books in many areas oriented towards the local economy. Suppliers of machinery and equipment to the booming resource sector, for one, have turned in brisk expansions.

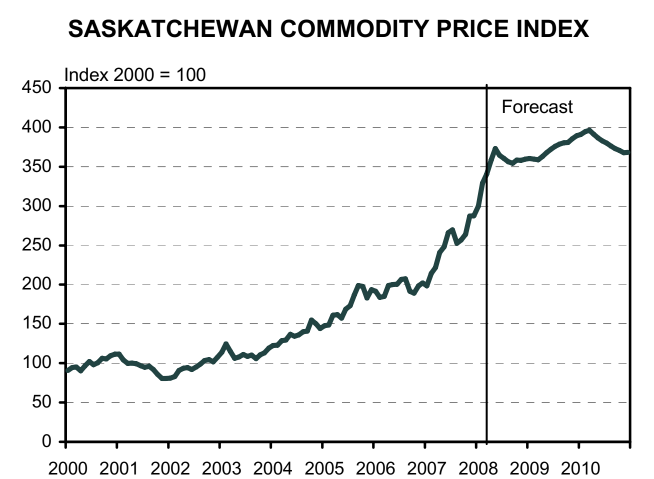
In sum, notwithstanding the fact that some industries are facing a more difficult ride, pockets of softness in the Saskatchewan economy remain the exception rather than the rule. Moreover, as we discuss in the next section, despite the increasing risks to the global economics expansion, we see little stopping the Saskatchewan economy from keeping its solid growth streak alive in the 2009-10 period.

Commodity prices to hold firm through 2010

One of the big stories in 2008 has been the remarkable resilience of commodity markets in the face of mounting global economic risks. While agriculture price cycles have traditionally been less sensitive to economic cycles, energy and metal prices have tended to ebb and flow together with global growth patterns. And even though forecasters such as the IMF have been aggressively scaling back their outlook for global GDP growth in 2008 and 2009, the TD Saskatchewan commodity price index (SCI) has risen by about 50% compared to its year-earlier level.



Source: IMF; Forecast by TD Economics as at March 2008



Last month plotted: April 2008; Forecast by TD Economics

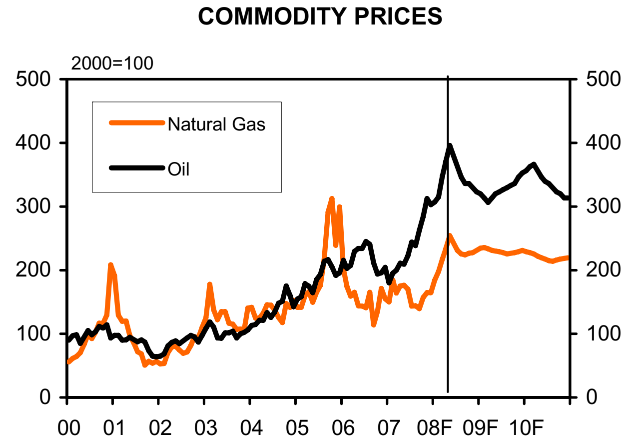
We remain upbeat about the outlook for commodity markets over the medium term. At the same time, however, some of the recent strength in commodity markets is probably temporary in nature for two reasons:

- Prices have been driven higher in part by speculators who are seeking refuge in commodities as a hedge against a falling U.S. dollar and, to a lesser extent, rising global inflation. We believe that some of these highly-cyclical speculative flows will reverse later this year as the U.S. dollar gains some traction and inflation fears begin to ease in tandem with the economy.
- Commodity markets tend to be a coincident or lagging indicator of an economic slowdown rather than a leader. As we highlight in the text box, economic growth is in the process of slowing down markedly from its 5% rate recorded in 2006-07. While the developing Asian markets will continue to grow at a robust clip in the coming quarters, the weakening prospects for the U.S. consumer are likely to put somewhat of a damper on exports from these markets, hence leading to a moderation in growth.

All told, we expect rallies in some of the markets, notably crude oil and metals, to encounter increased headwinds later this year. Nonetheless, the diversity of Saskatchewan's resource mix will continue to exude its benefits, as a pullback in those areas will be counterbalanced by ongoing strength elsewhere, notably potash. Furthermore, wheat and uranium prices have already fallen from the stratosphere. Barring a global recession – which we would attach a relatively small 15-20% probability to – the SCI is expected to fall only modestly in the second half of 2008 and to remain relatively stable on average in the 2009-10 period.

Medium-term outlook by major commodity

Despite declining **crude oil** consumption within the OECD countries so far this year, overall demand for crude has continued to rise on the back of a continued healthy

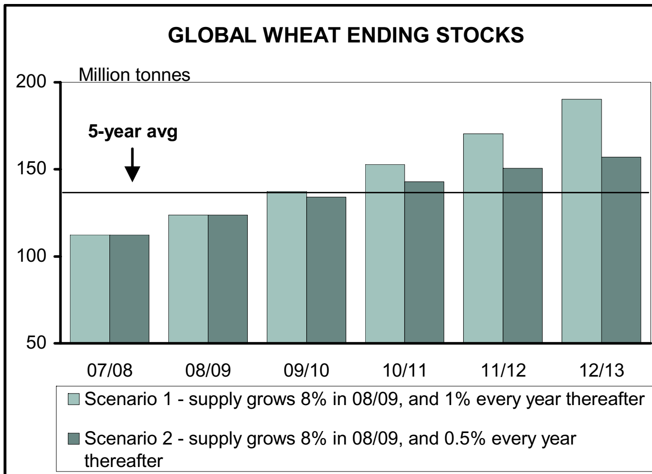


Last month plotted: April 2008
Source: Haver Analytics, TD Economics

appetite within developing countries. But while overall demand has been holding up, the more important driver of this year's near-50% hike in WTI prices has been supply-related factors. In addition to ongoing geopolitical concerns in countries such as Nigeria, Iran, Iraq and Venezuela, the oil market has become increasingly jittery about the long-term outlook for oil supply, with non-OPEC output growth continuing to weaken in 2008 despite high prices. As well, OPEC has appeared satisfied with global market conditions, implying that no change in the cartel's production is forthcoming. Regardless, we believe as much as US$20-$30 of the US$45 per barrel jump in prices over the past three months to be the result of factors that are likely to prove temporary. Look for the global slowdown to become increasingly visible on the demand side, thus alleviating some of the longer-term concerns about inadequate supplies. By early next year, we expect WTI prices to have reached a trough of around US$95 per barrel, before prices strengthen back above US$100 per barrel later next year and into 2010.

In the **natural gas** market, supply-demand fundamentals have tightened significantly this year in response to a return to more seasonal cool weather in the U.S., which has pushed gas in storage to below its 5-year average. Moreover, liquefied natural gas (LNG) shipments to the United States have slowed in 2008, as more attractive pricing in Asia-Pacific and Europe have attracted deliveries. Going forward, we expect Henry Hub prices to ease over the next few years, albeit only slightly. Although this year's weather-related jump in demand is unlikely to be repeated again in 2009 and 2010, declining trends in North American conventional production point to little upside on the supply side. New LNG capacity is targeted to come on stream in the United States next year. But there again, likely project delays and difficulty securing supplies amid global shortages indicate that additions to overall U.S. supply will be limited. Our forecast is for prices to average US$10 per MMBtu in 2009 and US$9.50 per MMBtu in 2010.

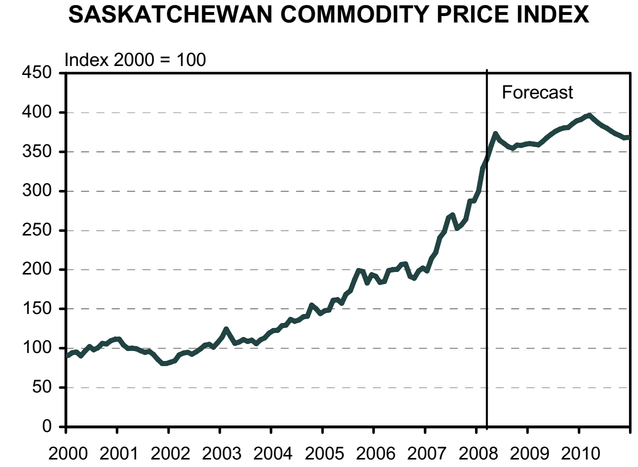
Wheat prices have already pulled back sharply in recent months in response to expectations of an easing in the tight global market situation, as high prices have encouraged increased acreage devoted to the commodity. Still, even if growth estimates for this year's crop of 7-8% range ultimately pan out, world wheat year-ending stocks would remain below their 5-year average. Using a trend rate of consumption growth, it would require at least 1 or 2 more years of moderate production increases just to restore wheat stocks closer to norms. Even then, the high cost of fertilizer and increasing instances of droughts remain significant downside risks to this output scenario. Furthermore, wheat – and oil seeds – will continue to battle with corn for U.S. acreage in light of increasing ethanol output. In this environment, projections are for wheat prices to hold in a relatively high range of US$400-500 over the next 24 months, and for **canola** prices to average US$550. In the livestock market, **hog** prices are unsustainably low and should begin to improve later this year as high U.S. inventories start to reverse course. In the **cattle** market, where inventories on farms are more in line with their longer-term averages, prices are expected to hold reasonably steady over the next few years.



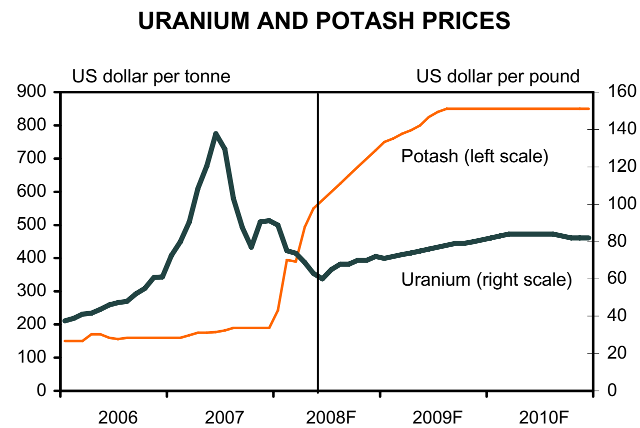
Consumption grows 4% each year 08/09, and 0.7% every year thereafter in both scenarios
Source: U.S. Dept. of Agriculture, Forecast by TD Economics

The recent agreement reached between China and Saskatchewan's **potash** producers, which secured a whopping US$400 per tonne increase in prices, indicated how quickly market conditions are tightening. Production operating rates have risen steadily since the mid-1990s from below 65% to more than 90% this year, as producers have worked to keep up with surging demand from countries such as Brazil, India and China. And with developing markets expected to further ramp up efforts to meet the food requirements of their growing populations and with relatively high crop prices giving farmers around the world an incentive to apply fertilizer to raise output, potash demand growth is not expected to slow meaningfully over the next few years. A number of capacity expansions on tap will help to cushion the impact of the rising demand, but not enough to prevent prices from rising further from current levels. We expect potash prices to reach US$850 in 2009 and to hold relatively steady in 2010.

In the global **uranium** market, fears about a lack of supply in 2007 have been replaced by concerns about surplus production capacity in 2008, thus driving the price down to about half of last year's peak level of US$140. Although many countries around the world, including China, India, South Africa, the U.S., Japan and Russia, remain committed to their nuclear power programs and there are a host of plans on the table to develop new plants, few new projects have actually been started. Meanwhile, all eyes have been on new supplies coming on line in Kazakhstan over the next few years, while output at Saskatchewan's Cigar Lake, after being delayed due to flooding, is expected to flow by 2011. While prices are unlikely to return to their 2007 highs, we see scope for a modest recovery, as nuclear power plants – which had accumulated significant uranium inventories during last year's price spike – return to the market to restore depleted stocks. Our forecasted range of US$70-80 would be more in line with the market's longer-term price expectations of US$90 (as measured by the contract price for deliveries in 24 months or more).



Last month plotted: April 2008; Forecast by TD Economics
Source: Haver Analytics



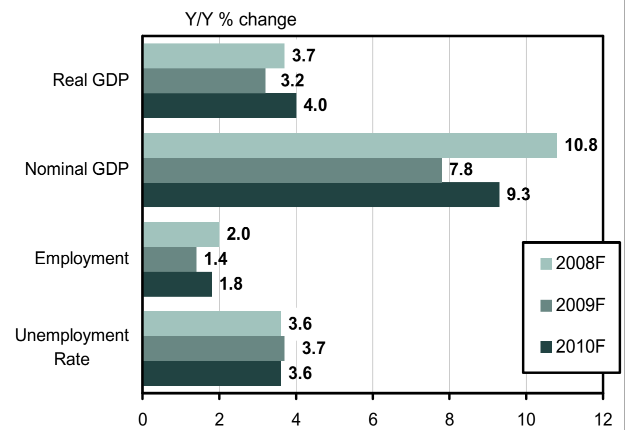
Last month plotted: April, 2008
Source: UxC News, Green Markets, Fertilizer Week America; Forecast by TD Economics

Resource sector to power ahead in 2008-10

The continued high level of commodity prices in the near term will continue to underpin Saskatchewan's growth performance. Under this price profile, corporate profits and exploration and development spending will continue to power ahead. In addition to the Cigar Lake uranium mine, other longer-term capital projects of note include $8-$10 billion in multi-year expansions in the potash industry, and a $4 billion proposed plan to build a poly-generation facility at Belle Plaine. As well, ongoing interest and exploration of potential oil sands, oil shale, shale gas and natural gas in coal (NGC) deposits indicate that new projects may be added to the list in the medium term. Initially, the focus in these unconventional areas will be on assessing the resource and, in the case of oil sands, determining commercial viability of production. The viability of oil shale and NGC, in particular, remain to be demonstrated.

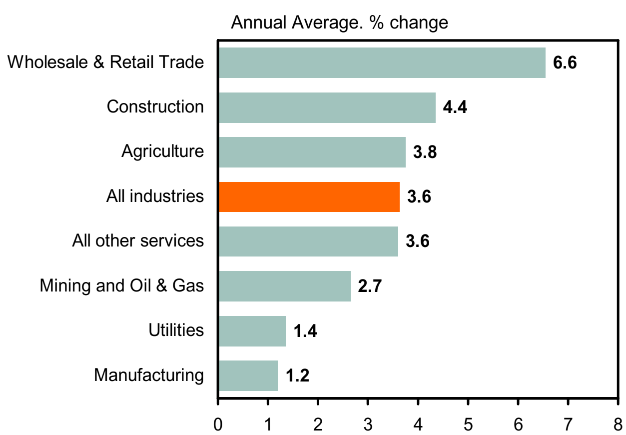
With resource activity expected to remain brisk, most areas of the economy will continue to be pulled along for the ride over the next few years. As we reveal in the exhibit on page 15, the retail and wholesale trade, business

ECONOMIC PROJECTIONS OF KEY INDICATORS



F - forecast
Source: Statistics Canada / Forecast by TD Economics

SASKATCHEWAN REAL GDP BY INDUSTRY 2008-10



Forecast by TD Economics

services and construction industries will continue to top the leader-board in the 2008-10 period. In the agriculture sector, higher prices and increased area devoted to crops should spur a moderate bounce back in crop production following its setback over the past few years. On the flip side, despite some likely relief from a moderately lower Canadian dollar over the next few years, a recovery in overall manufacturing activity appears unlikely before the U.S. economy starts to turn around at the tail end of 2009.

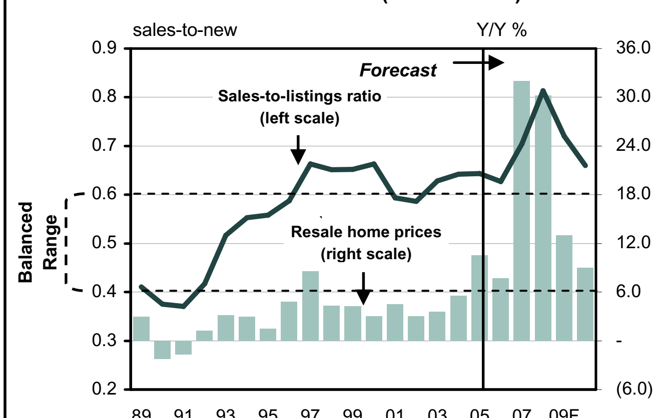
Overall, look for total real output growth to ease from this year's rate of about 4% to around 3% in 2009, before re-accelerating back up to 3.5-4% in 2010. As a result, growth in Saskatchewan is projected to further outstrip expansions in the rest of Canada (2% per year) and Alberta (3% per year) during the 2008-10 period. Even with high oil and gas prices, ongoing capacity constraints and rising costs will continue to take a bite out of growth in Alberta. The recent pace of net inter-provincial migration may be a difficult act to follow going forward, but job opportunities in Saskatchewan will continue to fuel a net inflow of residents from Alberta and other provinces in 2009-10 and help to prevent a sharp drop in the jobless rate.

Home price growth is one area that is likely to taper off following the massive run-up in prices during the second half of 2007 and early 2008. Recently, the sales-to-listings ratio in Saskatchewan has trended downward, pointing to a market in a slightly lower position of excess demand. We expect the market to remain relatively tight going forward, and take comfort from the fact that average affordability levels in the province – while having eroded significantly over the past year – remain considerably more favourable than in British Columbia and Alberta. As such, average resale price growth in the province is forecast to moderate from its average annual clip of 30% in 2007-08 to a still-solid 10% per year in 2009-10.

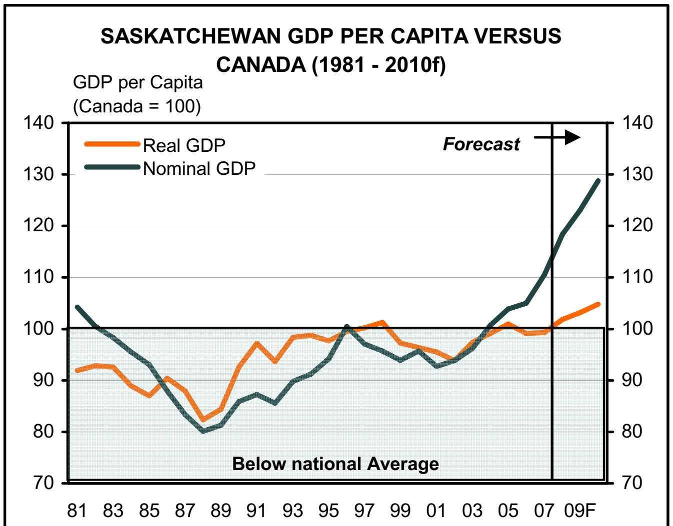
Saskatchewan to remain a have province

One dramatic turn of events in recent years has been Saskatchewan's transformation from a "have-not" province (i.e., one relatively less prosperous than average) to a "have" province. Under the federal equalization formula, provinces with below-average income and revenue-generating capacity receive payments annually. In this year's budget, the Saskatchewan government announced that it would not be receiving payments in the upcoming year. And, based on TD Economics' medium-term forecast, it is

SASKATCHEWAN HOME PRICES & SUPPLY-DEMAND CONDITIONS (1988 - 2010F)



F - forecast by TD Economics
Source: Canadian Real Estate Association (CREA)



Source: Statistcs Canada / Haver Analytics; F - forecast

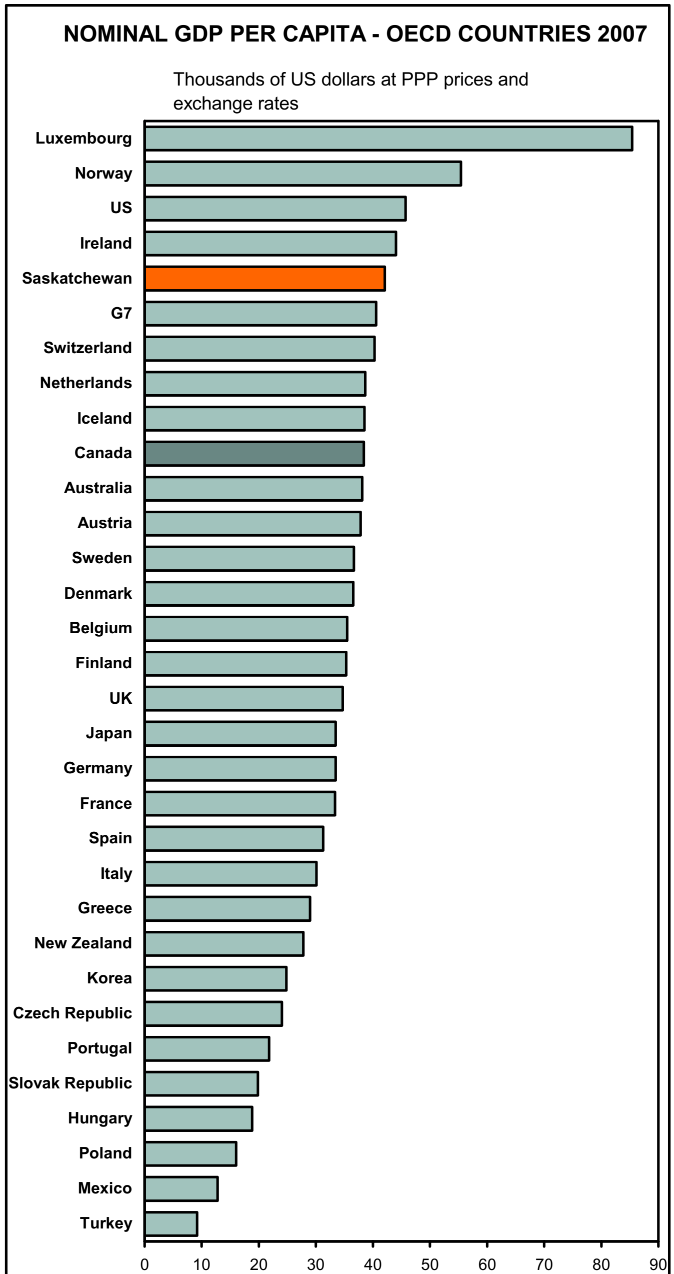
likely that the province will remain in "have" status for the first time on a sustained basis since the 1980s. The impact of high commodity prices and solid economic growth on Saskatchewan's relative income per capita performance is shown in the accompanying chart. In 1987, GDP per capita in Saskatchewan stood at $18,300 or 80% of the national-average level. In view of the brisk GDP gains over the past few years, per-capita income reached $51,300 in 2007 or 10% *above* the national average. Applying our GDP projections, this advantage is on track to rise to roughly 25% by 2010.

Saskatchewan also stacks up well on the international landscape in terms of relative prosperity. Indeed, if it was a country, the province's ranking among OECD countries in terms of GDP per capita in 2007 would be 5th – trailing only Luxembourg, Norway, the U.S. and Ireland. Similarly, based on our forecast, the province is well-positioned to vault ahead of the U.S. and Ireland over the next few years into third spot.

Regional growth gap narrowing … at last!

Perhaps the best news of all is that there have been some early signs that the improved fortunes of resource markets appear to be breathing new life into many communities right across the province. We identify Saskatchewan's 5 major regional markets in the box on page 17. Since 2002, employment and population growth in the central-west region (which includes the hub city of Saskatoon) and in the south-east (with its hub city of Regina) have led the way. However, the surrounding regions of the south-west, central-east and north have also taken part in the job expansion.

This relatively broad based regional growth marks a departure from the trends of recent decades. No other jurisdiction west of the Atlantic has faced the challenge of rural depopulation and decline to the same extent as Saskatchewan. As recently as 1970, more than half of Saskatchewan's residents resided in communities with populations less than 1,000. By the early 2000s, this share had shrunk to one-third, as individuals left farms and re-



Source: OECD

A Regional Snapshot

The province of Saskatchewan comprises 5 regions: (1) the South-east, which encompasses the communities of Regina, Weyburn and Estevan; (2) the South-west, which includes Moose Jaw and Swift Current; (3) Central-east, which is home to Yorkton and Melville; (4) Central west, which includes Saskatoon and Battleford and (5) the North, where Prince Albert and Melfort are located.

As shown in the table below, the relative size of the populations and job markets ranges widely, from 30-32% of the total in the Central-west region to 8-9% in the Central-east. No other province has such a narrow dispersion of jobless rates across the regions perhaps with the sole exception of Alberta.

The industrial structures of the regional markets share some features in common. All regions have at least a 5% employment share in agriculture, which is relatively high, and a low manufacturing presence when stacked up against the Canadian average. The South-west and Central-east record the highest shares of their job markets in goods-producing industries, at 35-40%, with about half attributable to agriculture in both cases. At the other end of the spectrum, goods-sector employment makes up only one in five jobs in the Central-east region, while public services (including health and education) and wholesale and retail trade account for about 43%.

Over the past few decades, growth in the Saskatchewan economy has been disproportionately enjoyed by the Central-west region, led by its hub city of Saskatoon. Between 1990 and 2002, this region recorded a cumulative employment gain of about 11%, which was almost five times the 2.6% gain posted in the province as a whole. Saskatoon – the hub of Central-west Saskatchewan – steadily emerged throughout the 1990s as a leading city for mining and fabrication. The University of Saskatchewan became successful in spawning world-class research and spin-off companies in areas such as agriculture bio-technology, nutraceuticals and food processing. The development of the Canada Light Source Synchrotron in the 1990s was a major step forward for the research community in the city. According to the Conference Board, Saskatoon has among the most diverse economies in Canada, trailing behind only London, Ontario.[4]

COMPARING REGIONS IN SASKATCHEWAN

	CW	CE	SW	SE	N
Population					
Level - 2007 (thous.)	299	85	101	278	235
Share of Total	30.0	8.5	10.1	27.9	23.5
% Change 1990 - 2002	4.6	-13.0	-10.5	-1.2	2.1
% Change 2003 - 2007	2.4	-4.3	-3.3	0.8	0.1
Employment					
Level - 2007 (000's)	164	41	54	149	93
Share of Total	32.7	8.2	10.9	29.7	18.5
% Change 1990 - 2002	10.8	-10.6	-9.1	5.1	0.0
% Change 2003 - 2007	9.0	10.1	3.6	3.1	1.6
Housing Prices					
Avg. Ann. Growth 03-07	10.6	9.9	15.1	4.4	9.8
2008 YTD	58.6	32.3	41.6	-2.0	60.9

Source: Statistics Canada, Canadian Real Estate Association
Author's Calculations

EMPLOYMENT BY SECTOR AS A SHARE OF TOTAL
2007 Average

	Sask	SE	SW	CE	CW	N
Agriculture	8.8	4.8	19.0	4.9	17.0	12.6
Other Primary*	5.2	4.9	6.5	3.9	7.0	6.6
Construction	6.4	6.6	6.4	6.1	6.8	6.2
Manufacturing	6.1	5.4	6.0	7.1	4.7	6.0
Private Services	25.8	26.6	19.7	26.6	24.4	27.2
Public Services	47.7	51.7	42.7	51.4	40.3	41.3

*Includes Utilities and Forestry
Source: Statistics Canada, Author's Calculations

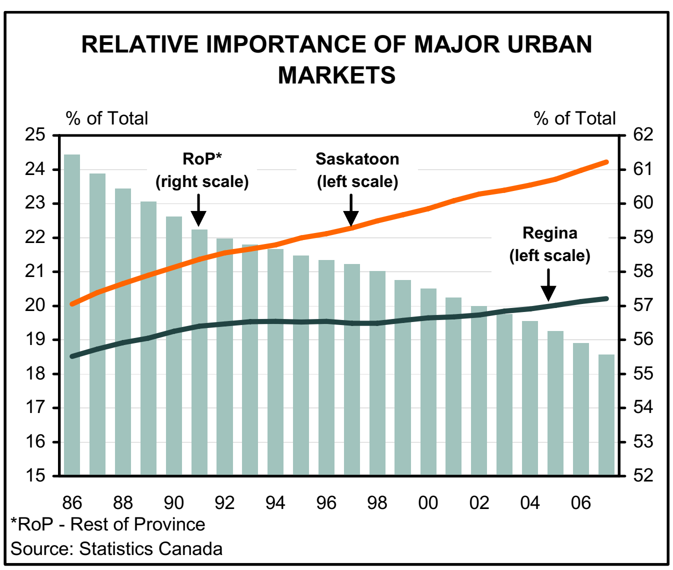
Over the 1990-2002 period, the only other region to register employment growth was the South-east, at 5%. While some areas of the regional economy continued to grow over the period – including private services – the overall pace of expansion during the 1990s was hurt by government spending cuts in the first half of the decade, which dealt a blow to Regina, and weakness in the agriculture and resource sectors. Still, with declines of 9-11%, it was the Central-east and South-west regions that encountered the greatest difficulties over the period, as declining employment on farms and depopulation wreaked havoc on industries across the board. Although the North also experienced the same issues, the growing population of aboriginal peoples helped to cushion the blow, leaving employment flat over the 1990-2002 period.

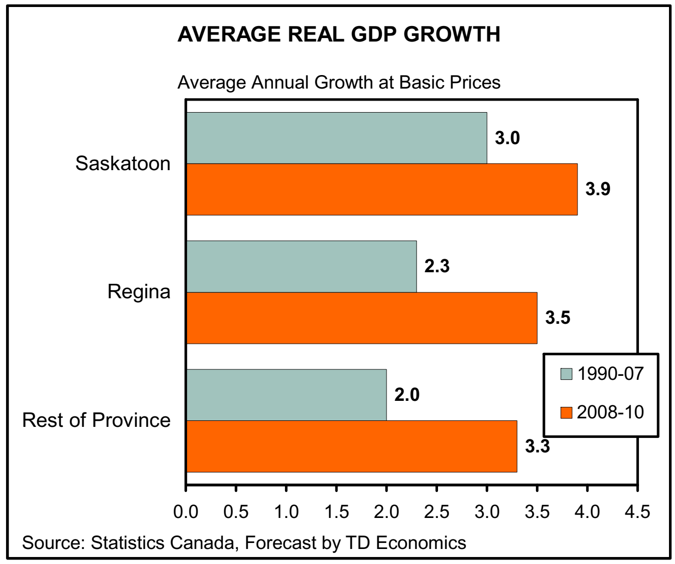
The job figures since 2003 indicate that the resource boom has started to spread economic benefits across the province. All regions have recorded gains in employment since 2003, led by Central-east (+10%) and Central-west (+9%). The revival of uranium exploration in the North along with ramped up diamond exploration and oil and gas investment is helping to repopulate communities that had virtually shut their doors. In the South, potash as well as exploration and development activities tied to the massive Bakken Formation have been a catalyst for reversing some of the recent trends in that region. In terms of population, there are also some early signals that the rate of depopulation in the Central-east and South-west has slowed and has actually reversed in the North and South-east.

serves for the job opportunities arising in Saskatchewan's urban areas as well as Alberta and B.C.

While urban areas across the province have benefitted from this shift, increasingly Saskatchewan's growth had been driven by one engine – Saskatoon. The city overtook Regina in terms of population in the mid-1980s and continued to widen the gap in the first half of this decade. In the 2006 Census, Saskatoon was only one of two of the largest 10 centres in the province to record population growth of 3% or more. (The other market was Corman Park, which is located nearby Saskatoon). Since 1987, the city's job market has risen by more than one-third while the province as a while recorded a relatively flat showing. We discuss some of the secrets behind Saskatoon's long-term success in the box below.

The 2006 Census data fail to capture the current turnaround being enjoyed by Saskatchewan's smaller communities. Rather, gains in population and employment since 2003 are those that give hope that broad-based regional strength has begun to take shape. There are others. For the first time in a generation, average farm prices in Saskatchewan are rising at a double-digit clip, which attests to the firming economic conditions in and around the smaller communities. Furthermore, housing markets have picked up sharply in virtually all regions. In smaller centres, the increased housing activity has been driven to some degree by expatriate Albertan and B.C. residents lured by attractive affordability. Indeed, some smaller communities located close to major cities, are running out of serviced lots because they can't keep up with demand. It is our bet that while the larger markets of the central-west and south-





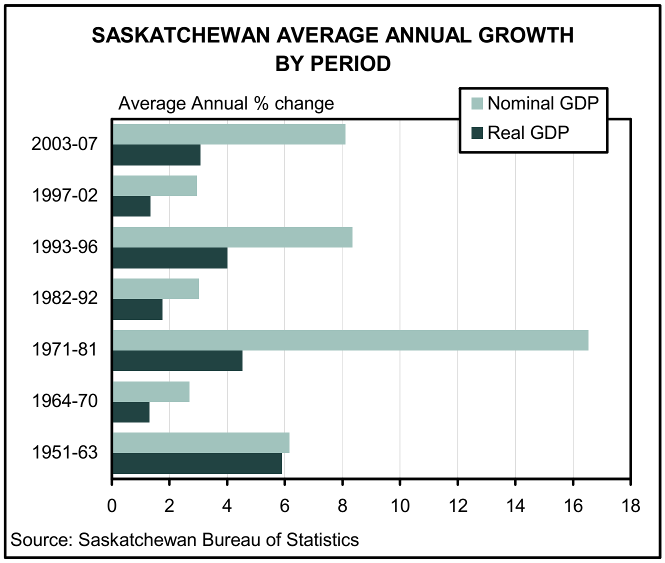
east will continue to drive overall growth in Saskatchewan, significant benefits of resource investment and buoyant commodities will raise the tide of all regions.

Is this period of prosperity sustainable or an illusion?

The economy appears headed in the right direction over the next few years. Still, the most pressing question of all is whether the current boom in Saskatchewan will represent a 4-5 year spurt or will the prosperity take on a longer life. This question is certainly justifiable. Over the past century, Saskatchewan has recorded three commodity-driven booms – in the 1920s, 1950s and 1970s – all of which proved to be temporary in nature. Each resulting bust would trigger an extended reversal in population flows, leaving the overall count today at the same level that was recorded in the 1930s.

In his book *False Expectations*, author Dale Eisler wrote that the propensity of Saskatchewan to follow an economic rollercoaster goes well beyond the commodity-based nature of the economy and into the psychology of the residents.[5] According to Eisler, people in Saskatchewan have always thought that they were in the "Promised Land" – a belief tied to the early settlers who were lured there in hopes of finding a better life. Accordingly, each time the economy enjoyed a cyclical boom, poor decisions were made based on the premise that the rapid growth would continue indefinitely. Ultimately, individuals were left paying the price for their earlier decisions when the economy later fizzled.

This raises the question of whether Saskatchewan is



poised to suffer a similar fate. Indeed, recent prognostications have been striking a familiar chord. During the economy's take-off in the early 1950s, a number of forecasters – including then Premier Douglas – predicted that the population could double from 800,000 to 1.5 million by the early 1980s (ultimately, the population edged up to 930,000).[6] In 2008, a similar optimism that the province may be poised for a long-term population boom has re-emerged.

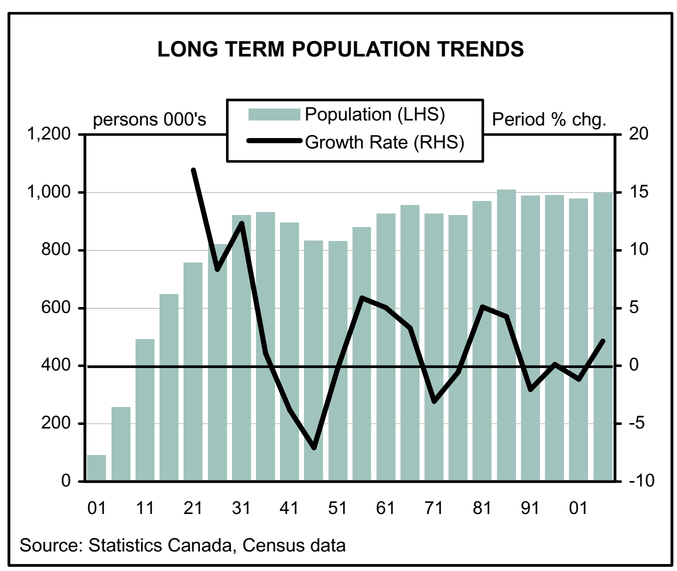
Although it is always important to set ambitious objectives, history has clearly demonstrated the need to maintain realistic expectations. It may be reasonable to expect commodity prices will remain relatively high going forward, but there is no assurance that this will be the case. Nor has the law of the commodity price cycle been repealed. Saskatchewan's economy, similar to others that are heavily oriented towards commodities, will always be prone to swings in economic conditions. As we discuss on page 25, despite some progress in diversifying its economy in recent years, it is undeniable that Saskatchewan remains heavily tied to commodities and the vagaries of resource markets.

TAKING THE ECONOMY TO THE NEXT LEVEL

Even though economic cycles will remain a natural part of the Saskatchewan economy's evolution, the province has a huge opportunity to both extend the peaks and mitigate the valleys, hence yielding a considerably stronger rate of growth over the long run. With respect to pulling off this feat, there is no single magic bullet. It boils down to effectively leveraging the province's strengths and addressing its key vulnerabilities, which have been highlighted in the box on page 20 in no particular order of importance.

Put simply, the strengths listed below will give the province a considerable leg up. One in particular is the innovativeness that has been demonstrated within the province. Saskatchewan has been home to many firsts in Canada. Important pioneering feats include universal health care, the opening up of the first cancer agency, the first province to complete construction on its segment of the Trans-Canada Highway, and development of the first heavy-oil upgrader.[7] In some cases, innovation was driven by sheer necessity. The farm sector, for example, has experienced many setbacks, which have included low prices, the closure of cattle exports to the U.S. following the BSE outbreak in 2003, drought, and rising costs. In response, farmers have increased farm sizes, adopted new technologies and techniques, in some cases turned to off-farm income and significantly diversified their product mix in order to remain viable. The province prides itself on being innovative by nature, and this will continue to be a critical element in meeting the tall challenges before it.

Related to innovation, gains in labour productivity have been the key contributor to a rising standard of living in Saskatchewan over the past quarter century. In the chart on the next page, we show a decomposition of real GDP per capita growth in 1981-2006 into its four main elements – work intensity, demographic factor, employment rate and labour productivity. In Saskatchewan, productivity growth (i.e., real GDP per hour worked) accounted for two-thirds of the total over the period, whereas in Canada it was closer to one-half.



Strengths and Challenges

Strengths:
- Diverse resource sector
- Innovative/loyal population
- Large share of aboriginal youth in population
- Low cost of doing business
- Low unemployment
- High labour-market participation
- Proximity to Alberta
- High trade orientation
- Improved fiscal position
- Strengthened tax regime

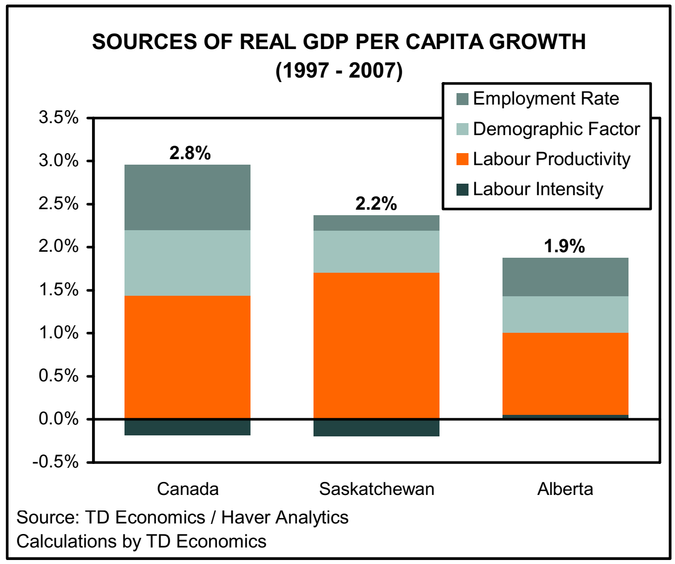
Challenges
- Diversification
- Proximity to Alberta/Cost competitiveness
- Infrastructure Deficiencies
- Poverty
- Labour shortages/Education
- Aging population/health costs
- Climate Change
- Allocating scarce public resources

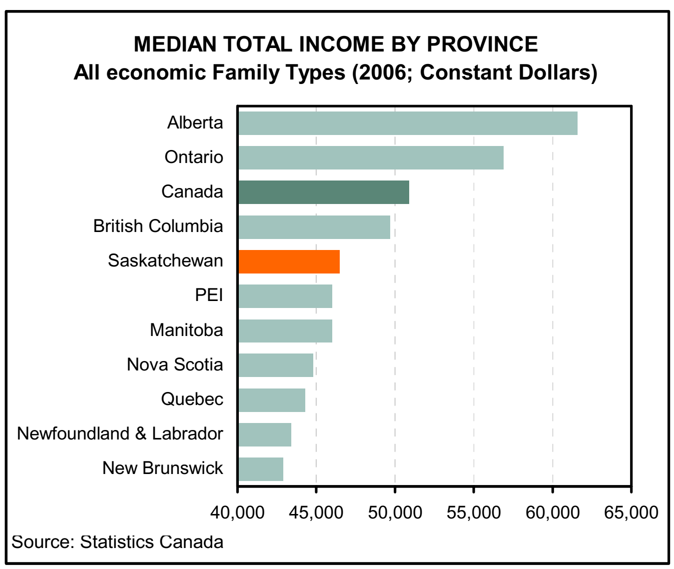
Yet, the province can't afford to lose momentum on this front. Notwithstanding respectable productivity gains on a trend basis, Saskatchewan's productivity *level* remains below the national average. And since productivity is a key driver of household income gains, personal disposable income (PDI) per capita – which is a measure of the household sector that includes the income of farms and unincorporated business – also sits below the Canadian benchmark. In terms of median household income, Saskatchewan currently ranks fourth among the provinces with an 8% disadvantage relative to Canada.

Lastly, a key incentive to move forward with the to-do list is to narrow the competitive gap with Alberta. Saskatchewan's proximity to Alberta has usually been regarded as one of its greatest challenges given the large net losses of investment and people over the years that have only started to turn around recently in the wake of the current economic boom. A frustration for Saskatchewan residents is that despite its tradition of placing relatively high against other Canadian provinces in many economic measures, it has usually been compared only to its high-flying neighbour to the west. At the same time, however, we have also included "location" on the list of strengths, since the competitive pressure from Alberta has forced Saskatchewan to begin cleaning up its backyard over the past decade, not to mention providing considerable opportunities for enhanced cooperation and trade.

Work to close the infrastructure gap

The first area of vulnerability is infrastructure. Underinvestment in the province's system of roads, highways, water & waste-water facilities and sewers during the 1970s, 1980s and early 1990s has generated significant deficiencies. According to Statistics Canada, the province's $9 billion system of public infrastructure averages about 17 years of age, which – along with Nova Scotia and Manitoba – is the oldest among the provinces.[8] In Saskatch-

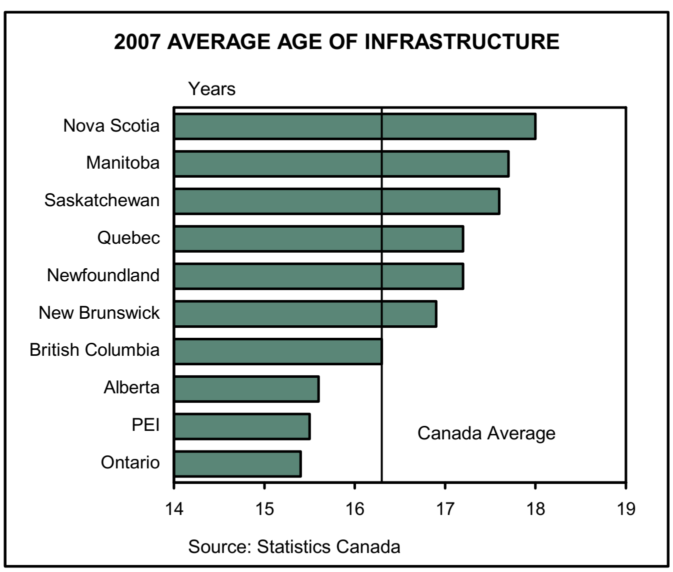


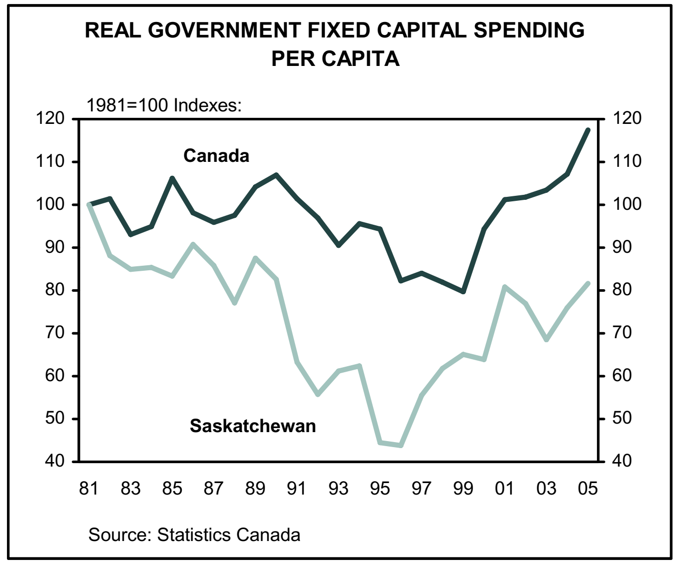


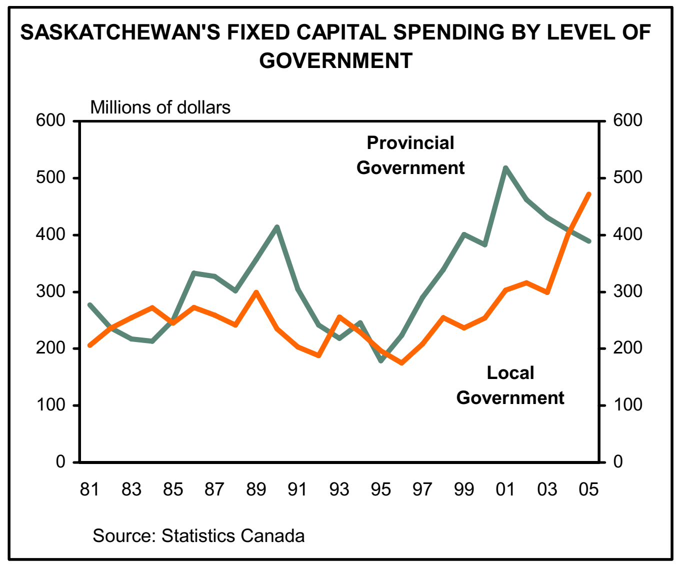
ewan, a significant part of the challenge faced is its sizeable road system, which on a per-capita basis is the longest in Canada. While the province's roads and bridges are older than the national average, its overpasses and wastewater plants were somewhat younger.

That being said, governments in the province have been making up some lost ground in recent years, with help from new grants from the federal government, including a share of the federal gas excise tax. The turning point was in the mid-1990s, when government capital spending started to get ratcheted up following the long period of retrenchment. In fact, the level of total government fixed capital spending has doubled since 1995, thus reducing the average age of infrastructure modestly from its peak of 19.4 years in 2000.[9] But even with this dramatic increase in funding, estimates in the province continue to peg the gap between actual spending and needs at a sizeable $500 million per year.

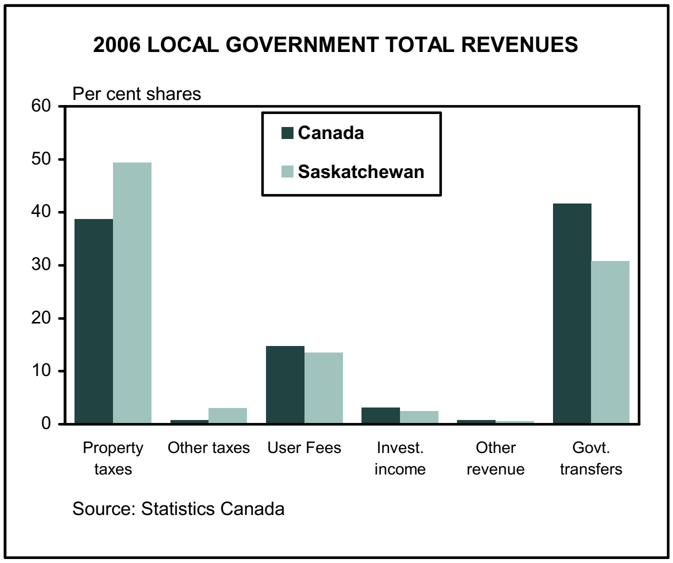
Citing infrastructure as among the greatest roadblocks to longer-term economic sustainability, the provincial government stepped up in its 2008 budget with a $1 billion investment for fiscal 2008-09, which will earmark capital outlays across an array of areas, including roads, health care facilities and educational institutions. Developing infrastructure strategies during a period of economic boom is not easy. Calls for new outlays are being heard around the province. Yet efforts to accommodate these needs during a period of significant private-sector demand for construction workers can result in cost over-runs, further exacerbating the challenge of narrowing the infrastructure gap.







One of the most daunting challenges facing Saskatchewan is ensuring that municipalities have adequate tools and flexibility to address the surging growth challenges before them, since they are directly responsible for more than half the region's public infrastructure. On the positive side, a breakdown of capital funding by government shows that municipal investment has risen briskly in line with that of the province since the mid-1990s. But there remain risks to the sustainability of these recent trends. Similar to the story in other provinces, municipal infrastructure funding is heavily reliant on property taxes and grants from the provincial and federal governments. The challenge of funding a large share of infrastructure on the property tax base is that – unlike sales and income taxes that



grow in line with the economy – those revenues don't increase automatically with rising home prices. Rather, property tax increases are set each year by the local government and are, hence, a target of public resistance. Grants place municipalities at the whim of changing priorities at the federal and provincial levels.

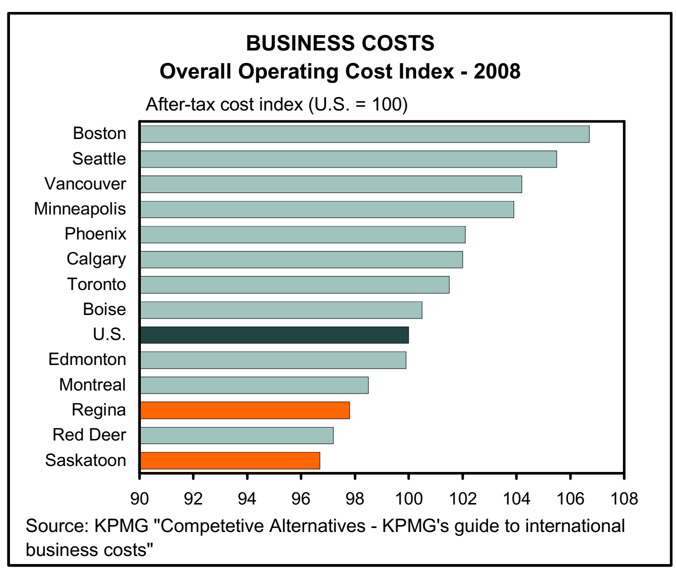
Recently, local governments received some good news when the Province provided them with a 15% increase under its revenue-sharing program, about twice the 7% rate committed to in the 2008 budget. Still, municipal grants in Saskatchewan continue to be provided on an ad-hoc basis, which has made long-term capital planning difficult.

Currently, the Saskatchewan Urban Municipalities Association (SUMA) is working with the provincial government to come up with a new formula for revenue sharing. In addition to providing cities with a longer-term arrangement, we would urge the Province to consider passing on additional powers to tax. Such a move would help to raise accountability of the system and provide local governments with additional revenue tools with which to meet the soaring demands. If this course is pursued, tax tools must be chosen on the grounds of efficiency and their potential to achieve other goals simultaneously. For example, a local gasoline tax could be a useful instrument to help pay for road maintenance and construction and to address pollution. In general, municipalities in Canada do not make adequate use of user fees in funding services, although we do note that Saskatchewan local governments raise a somewhat larger share of their revenues from user fees than their Canadian counterparts.

In Ontario, Quebec, B.C. and Alberta, governments have increasingly been using public-private-partnerships (P3s) in their arsenal for procuring and financing infrastructure. This is one area that we've also supported. Critics of P3s point to the fact that since the government can borrow at a cheaper rate and that the private sector needs to make a return on investment, the regular public model is cheaper. But while true, this objection ignores the fact that P3s have the potential to generate overall *net* benefits through limiting cost over-runs and improvements in service. In any event, it appears likely that P3s will get a closer look in Saskatchewan over the next few years. Not only is the new government showing some interest in this approach, but the federal government is likely to establish private-sector involvement as a condition for federal grants in certain cases. We have argued that the B.C. model for P3s is one worth taking a close look at.

Continue to build on cost competitiveness edge

Saskatchewan markets have traditionally enjoyed a cost advantage over competing jurisdictions. However, this advantage has been under pressure, at least in the North American context. According to the annual KPMG business cost survey, Saskatoon and Regina enjoyed only a slight 2-percentage-point cost edge compared to the U.S. benchmark in 2008 – well below its advantage of some 20% about a half decade ago.[10] This deterioration can be chalked up largely on the run-up in the Canadian dollar. And while business costs in Saskatchewan have remained competitive with those in Alberta and Canada as a whole, this advantage could erode over the next few years given



2008 TAX RATE COMPARISON ^			
	Canada	Saskatchewan	Alberta
Personal Income Tax			
Lowest	9.7	11.0	10.0
Highest	16.1	15.0	10.0
Personal Amount	9,263	8,945	16,161
Corporate Income Tax			
General	13.0	12	10.0
M&P *	11.8	10.0/12.0	10.0
Small Business			
Rate	4.5	4.5	3.0
Threshold	426	500	460
Capital Tax			
General	0.1	--	--
Financial Institutions	2.7	3.3	--
Retail Sales	6.9	5.0	--

^ Simple average calculation
* Saskatchewan's CIT rate is reduced by 2 ppts based on the share of national income allocated to the province
Source: 2008 Alberta Budget

the likelihood of above-average increases in housing prices and rents. Indeed, growth can be a double-edged sword.

On the tax side, Saskatchewan has done an admirable job in keeping up with low-tax Alberta on a number of fronts, and hence, has managed to increase its edge against the rest of the country (see table). A number of important achievements made by Saskatchewan on the tax front include:

- The third lowest top personal income tax rate among the provinces;
- At 5%, Saskatchewan's retail sales tax is the lowest of the 9 provinces that have one;
- Full elimination of the general capital tax on July 1, 2008;
- Significant cuts to the general corporate income tax (CIT) rate, with a further reduction to 12% on tap for July 1, 2008;
- Payroll taxes which are used in a number of other jurisdictions are not applied in Saskatchewan;

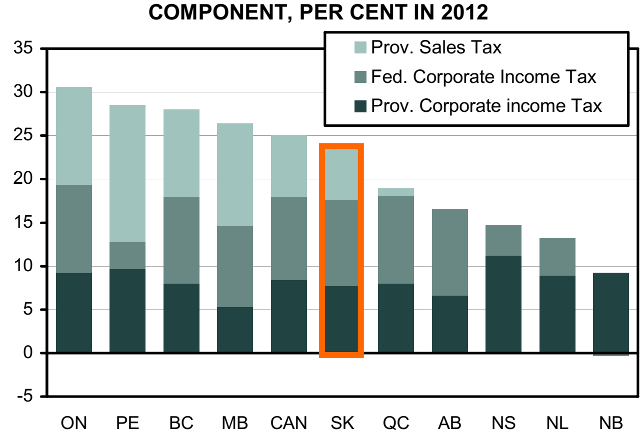
There have also been some positive developments recently in the resource sector. The new provincial government has consistently said that it will not be raising royalty rates on oil and gas. This approach followed Alberta's decision in 2007 to hike its royalties effective January 1, 2009, and only increases the appeal of investing in Saskatchewan's oil patch. Comparing royalty regimes is not easy, since it is dependent on many factors (i.e., grade of oil, volume of production, market price, when the well was drilled, etc.). However, it is fair to say that Saskatchewan's overall royalty regime – which was considered to be slightly higher than that of Alberta's before the changes – will be competitive after January 1, 2009.

These moves have helped to bolster Saskatchewan's position as a favourable place to do business. Still, there remains unfinished work. While Saskatchewan's tax rates are low from a Canadian perspective, sizeable tax differentials remain with Alberta. The province will eliminate the general corporate capital tax, but continue to levy a hefty tax on financial institutions. Relative to larger Canadian jurisdictions, the province remains competitive in terms of tax burden on overall business investment. However, on an international basis, Saskatchewan's marginal effective tax rate (METR) on capital investment – along with provinces west of Quebec – is at the high end of a list of 37 industrialized countries. On the plus side, Canadian provincial METRs will benefit from cuts to the federal CIT rate over the next few years.

Since tax competiveness is a moving target, Saskatchewan must also be prepared to respond to changes that are occurring elsewhere. Recently, the federal government has been urging provinces to cut their general CIT rates to 10%. Alberta and Quebec have arrived there already, B.C. will move there over the next few years and some other provinces (i.e., New Brunswick and Manitoba) could follow suit. It is important that Saskatchewan not fall behind in the race.

There is a big opportunity for Saskatchewan to vault ahead of many of its major competitors in terms of business taxation. A major reason for the relatively high taxation on business investment in provinces west of Quebec

METR* ON NEW BUSINESS INVESTMENT BY COMPONENT, PER CENT IN 2012



* Excludes resource and financial sectors and tax provisions related to R&D. Includes measures as of Feb. 2008 - May not add up due to rounding
Source: Department of Finance Canada, Budget 2008

is the fact that the retail sales tax is applied to business inputs. As we noted, Saskatchewan levies the lowest sales tax rate among the 9 provinces that have one. However, the federal government has estimated that if Saskatchewan transformed its retail sales tax into a value-added tax (through such means as tax harmonization or a hybrid approach such as in Quebec), the province's METR would be shaved by a sizeable 7 percentage points, providing a major boost to the economy's long-term potential to grow. The concern of such a reform is that it would broaden the base of taxation to many services, hence shifting some $400 million in burden to households. However, this shift is only superficial since businesses would ultimately pass through their tax savings.

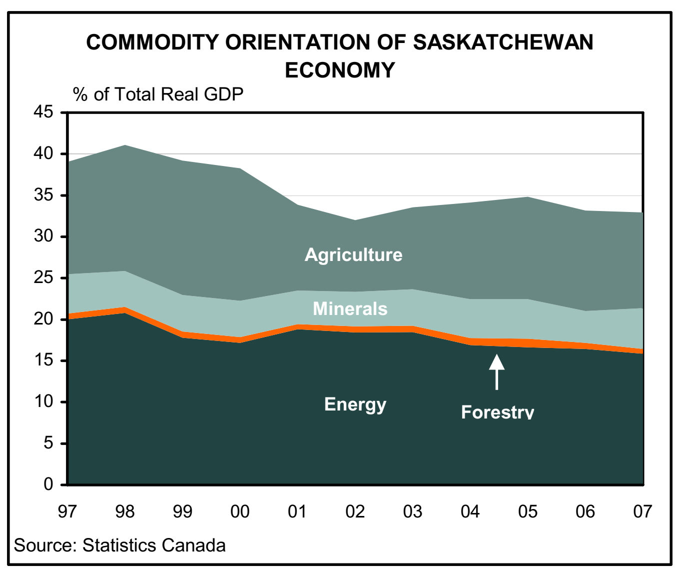
Measures to improve tax competitiveness need to be complemented by actions to spur trade opportunities and reduce regulation. In 2006, Alberta and B.C. entered into a framework deal to knock down inter-provincial trade barriers. The Saskatchewan government has indicated that it has some concerns about participating in the agreement, notably its impact on the government's ability to provide tax incentives or on the activities of the province's important Crown Corporations. One possible solution would be to proceed by taking smaller steps rather than a quantum leap. There may be other opportunities for cooperative arrangements with both Alberta and other Canadian provinces.

While Saskatchewan is among the least reliant on the U.S. market for trade, exports to the south are nonetheless an important lifeline. Saskatchewan's exporters have enjoyed increasing access to the U.S. market since NAFTA was put in place. But recently there have been some setbacks. On June 1, 2007, the U.S. government not only implemented a charge on cross-border traffic entering the country, but there are two bills before Congress that would impose new inspection fees on imported food. Furthermore, mandatory Country of Origin Labeling (COOL) legislation on beef, lamb and pork among other food products is poised to become law on September 30, 2008, which is tantamount to a non-tariff trade barrier and will raise costs for Canadian farmers. The federal government also needs to lobby for a reduction in international trade subsidies on agriculture and increase its focus on developing international trade agreements. Lastly, the cloudy future of the Canadian Wheat Board (CWB) – which holds a monopoly on western exports of wheat and barley – is another area of uncertainty in the agriculture sector. Earlier this year, the federal government pressed ahead with efforts to end the CWB monopoly on barley sales, and thus, give farmers the option of selling the commodity independently. The government had passed a simple cabinet order to achieve this goal, but the courts struck down the move. In February, the government lost the appeal. Thus, in order to move forward, the government will need to receive Parliamentary approval. Opposition parties do not support the move, raising questions about whether the law will pass and on its timing.

According to the Fraser Institute, Saskatchewan is considered to have the third most favourable business climate among Canadian jurisdictions.[11] One area that was flagged as a concern was the cost of regulation. According to the CFIB, Saskatchewan businesses pay almost $900 million per year in order to comply with government regulations.[12] Regulations with respect to the provincial sales tax, Workers Compensation Board and Occupational Health and Safety Act have been identified as the three most burdensome areas. In an attempt to improve the competitive climate, the provincial government recently overhauled the province's labour laws, which included essential services legislation and reforms of the Saskatchewan Labour Relations Board.

Use resource strength to build a more diverse economy

Since the mid-1990s, Saskatchewan has achieved some diversification away from agriculture and resource-based industries. Since 1997, the economy's GDP share attributable to commodities, both direct and indirect, has fallen



from 39% to 33%. This drop has been broad based across the resource sector (down 4 percentage points) and agriculture (down 2 percentage points). A closer look shows, however, that the diversification took place in the late 1990s. Over the past five years, the overall share of commodity-based industries has remained relatively stable, reflecting an improvement in commodity market conditions. And over the next three years, we wouldn't be surprised to see a rise in the overall commodity importance in the province.

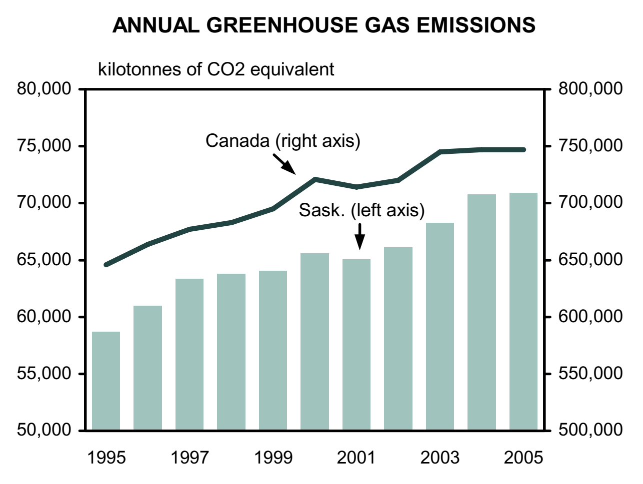
The province's major goal in this area should not be to move away from commodities, but to ensure that diversification occurs around thriving commodity industries over the long haul. Alberta is a good case of an economy that has created the winning conditions for growth by laying down a healthy business climate and witnessing high-tech and advanced manufacturing industries pop up around its flourishing oil and gas sector. And, as already noted, Saskatchewan already boasts diversity within its commodity sector.

In the case of Saskatchewan, we see particular opportunity for the province's energy sector to form the cornerstone of not only diversification, but as a means of achieving longer-term prosperity. Moreover, Saskatchewan faces the significant task of addressing climate change and growing environmental sensibilities in the U.S. and abroad (see text box on page 27). We believe that all the ingredients are in place to transform the province into a clean energy powerhouse, and in turn provide the province with long-term benefits from the export of energy and knowledge accumulation. What it will require is connecting the resource potential (i.e., conventional crude oil, oil sands, oil shale, natural gas, natural gas in coal or coal bed methane, coal, feedstock for bio-fuels and uranium) with the province's solid foundations in research, including the Petroleum Technology Research Centre, the International Test Centre for Carbon Dioxide Capture, the Saskatchewan Research Council (including the new Biofuels Test Centre), and the collective expertise at the provinces universities. Strong partnerships between the public and private sectors will also be critical.

Happily, the province has started to move down this path. One area offering potential is in carbon capture and storage (CCS), which is the process that captures carbon dioxide before it can be released into the atmosphere from a point source such as a coal-fired power plant and injecting it in deep geologic formations. The captured carbon dioxide can then be transported by pipeline to various sites, including producing oil fields where it can be used to improve recovery rates. Indeed, Saskatchewan is already a leader in this area, home to the largest carbon dioxide flood project in the Weyburn oil pool, a project that is operated by EnCana Oil and Gas Partnership. EnCana has sequestered 10 million tonnes of carbon dioxide since the project's inception in 2000 and has raised monthly oil projection rates from the Weyburn Unit by more than 60% as a result of the injection of $C0_2$. Over the 30-year project lifeline, some 200 million barrels of oil is projected to be recovered. (Weyburn is also the site of the world's largest international field research project to study the geological storage of carbon dioxide.) In 2005, a second such project began in the Midale oil pool, operated by Apache Canada. Over the 25-year lifeline of the project, it's expected that 8.75 million tones of $C0_2$ will be sequestered and an additional 45-60 million barrels of oil recovered.

The cost of these new approaches is unquestionably an impediment, as highlighted by the fact that at carbon capture costs of $60-$80 per tonne, the cost of CCS is not presently economical. The federal government has jumped on board as a potential partner, asserting that sequestering carbon could address some 40% of Canada's emissions reduction goals by 2050. In the 2008 federal budget, $240 million was announced for a clean-coal/CCS combined with enhanced oil recovery project in Saskatchewan. Still, with an estimated price tag of $1.4 billion, the project's fate remains uncertain. The provincial government is currently mulling over the investment.

Another potential large-scale energy project is a $4 bil-



Source: Environment Canada

lion poly-generation facility at Belle Plaine, which would use petroleum coke feedstock to produce hydrogen, nitrogen, steam and carbon dioxide for fertilizer production and enhanced oil recovery, along with about 300 MW of electricity. The government of Saskatchewan has agreed to provide $6 million for continued engineering design, matched with a contribution of the same magnitude from partner TransCanada.

Other actions could help to diversify the province's energy base and achieve emissions reduction goals. The province is already a leader in bio-fuels, with three grain-based ethanol production and two biodiesel facilities in operation. A fourth is expected to come on stream later this year. In the short term, ethanol production from grains is under threat from the so-called "food versus fuel" debate, high costs of production, reliance on government subsidies and some question about its overall benefit to lowering GGEs. Still, in light of the ratcheting up of long-term expectations on crude oil prices and a desire to diversify away from fossil fuels, renewable energy sources – particularly those derived from cellulosic ethanol, bio-diesel and solid waste – will remain at the forefront. A Saskatchewan community is also under consideration by IOGEN Corp. for a large scale cellulosic ethanol plant.

The potential for uranium may be the greatest of all. Saskatchewan is home to roughly one-tenth of world's recoverable uranium reserves. Thus, in the event that there is a substantial expansion in nuclear power globally in response to the need to lower greenhouse gases, Saskatchewan's economy would receive a long-term boost that would probably be unmatched in its history. The opportunities for benefits do not stop there. There has been consideration given to moving further along the nuclear fuel chain, beyond the mining stage to refining and enrichment. Recently, there has been talk about a proposal to supply nuclear power to Saskatchewan and Alberta customers, although there remains much number crunching to do before a decision is made. While nuclear power has its disadvantages – notably its high capital cost, long lead times and waste disposal challenges – a foray in that direction would reduce greenhouse gas emissions and help to diversify the province's power supplies away from coal. That's not even to mention Saskatchewan's access to low-cost uranium supplies.

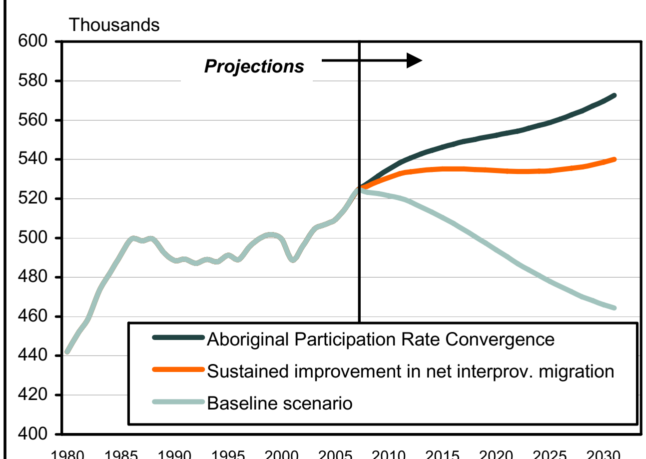
Education, education, education

Saskatchewan's chances of achieving meaningful diversification and long-lasting economic growth depend to a large extent on its ability to address skills shortages. In recent years the problem of an inadequate labour supply has been steadily growing, reflecting the demands of an expanding economy. Had it not been for a burst of new migrants into Saskatchewan in recent quarters, even more businesses would have struggled with staffing. A report released in 2008 by the Canadian Federation of Independent Business estimated that 18,000 jobs were vacant as a result of inadequate skills.[13]

While some of the shortages are cyclical, the pressures on the province's overall talent pool could only intensify further over the long haul. In the chart below, we show a long-term "baseline" or "status-quo" scenario for the province's labour force which builds in Statistics Canada's most recent long-term population projections and participation rates that don't vary much from their recent trends. Keep in mind that in this forecast, the province is assumed to suffer net inter-provincial migration outflows in line with those trends witnessed in 2000-2003 (i.e., prior to the most recent spurt).

Certainly, there are opportunities to circumvent this worrisome trend before it occurs. For one, efforts must be made to create a world-class education system. And, on this count, there are reasons for optimism. Saskatchewan is already blessed with many top-notch higher-learning institutions including the University of Saskatchewan and University of Regina, the Saskatchewan Institute for Applied Science and Technology, the Saskatchewan Indian Institute of Technologies and a number of regional colleges. And post-secondary education (PSE) has received

SASKATCHEWAN LABOUR FORCE

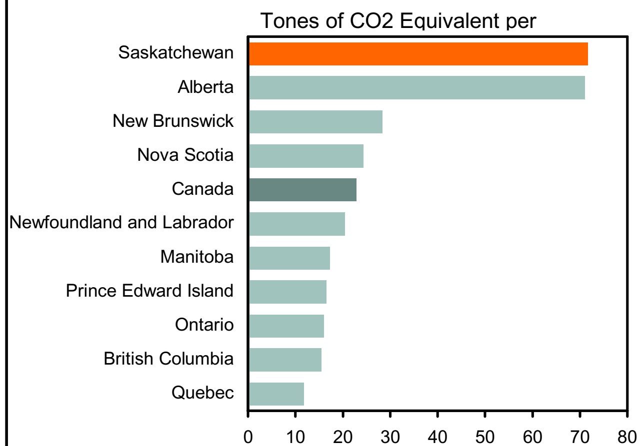


Source: Statistics Canada, Projections by TD Economics.

Province Faces Significant Challenge of Climate Change

While the government's decision on royalties has injected some certainty into the oil and gas sector, concerns about climate change persist. This concern is certainly not unique to Saskatchewan. In other parts of Canada, provincial and federal governments are forging ahead with a patchwork of plans to reduce greenhouse gas emissions, which is creating confusion. However, Saskatchewan faces a particular challenge. Since 1990, it has had the second largest growth in absolute levels of greenhouse gas emissions after Alberta, and is the largest per capita emitter among Canadian provinces. Moreover, its rate of growth in emissions was the fastest among Canadian provinces over the 1990-2005 period. The province's significant coal-fired power generation facilities, its large agricultural sector, and the oil and gas sector are largely responsible for the high levels of emission.

GREENHOUSE GAS EMISSIONS PER PERSON - 2005



Source: Statistics Canada, Environment Canada

The Saskatchewan government has emission reduction targets in place for 2020 that appear more ambitious than either the federal plan or that of Alberta.

- The federal plan sets out to achieve an 18% reduction in GGE intensity by large emitters from 2006 levels by 2010 – a target that will rise by 2% per year thereafter. For the aggregate economy, the federal government is striving for an *absolute* cut of 20% below 2006 levels by 2020 and a 45-65% drop by 2050.
- In Alberta, the government has committed to cutting GGE intensity to 50% below 2005 levels by 2020. The Alberta plan proposes to stabilize and start reducing emissions growth by 2020, and by 2050 to cut emissions by 50% below "business as usual" levels and achieve a 14% reduction below 2005 emission levels.
- The Saskatchewan government has committed to a target of stopping emissions growth by 2010 and to reduce emissions by 32% below current levels by 2020, and by 80% below current levels by 2050.

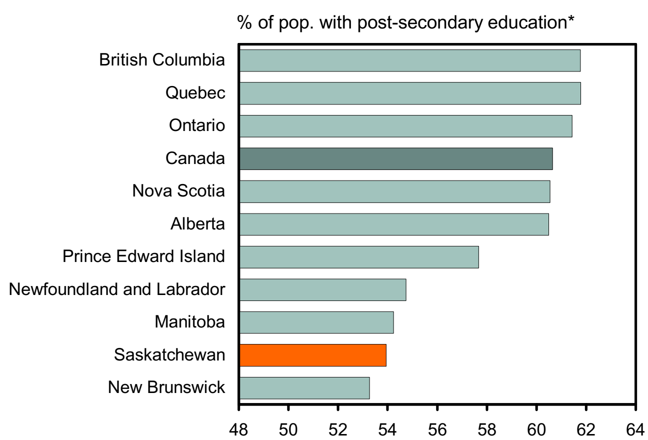
Regardless of how these emerging plans unfold, it appears that at some point there will be efforts to deliberately raise the price of carbon. A price of $30 per tonne is widely considered to be a minimum price that will achieve meaningful reductions in emissions. However, modeling by the National Roundtable on the Economy and Environment (NRTEE) shows that in order to achieve a 45% reduction in emissions by 2050, the carbon price would need to be at least $200 in 2003 dollars. The carbon price will reflect the cost of the last incremental emission reduction action undertaken, and the average cost of emission reduction actions would be lower than this price. In order to put these figures in perspective, Saskatchewan's electrical generation sector with emissions of roughly 16 Mt of $C0_2$ equivalent (assuming no growth in emissions from current levels) would need to reduce its emissions by 7.2 Mt of $C0_2$ equivalent by 2050 to achieve a 45% reduction. If emission reductions cost $30 per ton of $C0_2$ equivalent this would translate into an additional cost of $220 million per year. It would mean an extra 1.1 cents per kilowatt-hour of generation, a 15% increase over 2007's 7.5 cents per kilowatt-hour. At $200 per tonne, the comparable figure would be $1.4 billion annually, doubling current electricity prices. Costs would also be driven up significantly in the oil and gas industry, and all other industries.

significant new funding since the mid-1990s. Over the past five years, both combined grants to colleges and universities and overall funding rose by about one-third. In the 2008 budget, the government provided additional funding for PSE, although the benefits of the new funding were partially offset by a decision to freeze tuition fees for the upcoming year. Provincial spending on the public school system has also risen substantially in recent years.

So far, these investments over the past decade have produced mixed results.

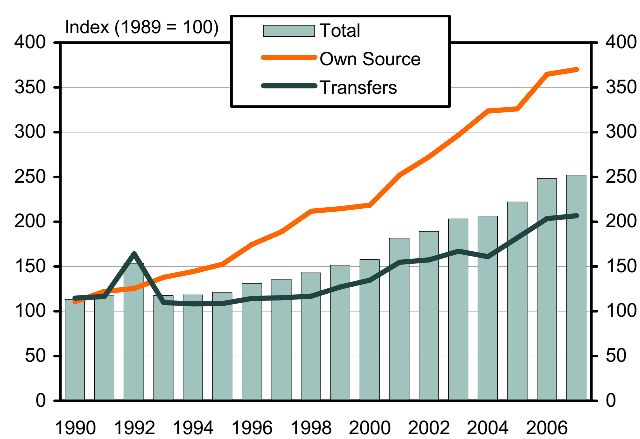
- Over the past half decade, Saskatchewan has recorded a significant increase in its population 25-64 years with a post-secondary degree or diploma. Still, with other jurisdictions enjoying even more significant gains, the province continues to record among the lowest shares of PSE attainment (54%) among the provinces and 7 percentage points lower than the national average. The source of the gap continues to be a smaller share with university degrees, as Saskatchewan actually ranked above the national average in the diploma category.
- High school drop out rates are fourth highest in Canada after Manitoba, Alberta and Quebec.
- In science and math tests conducted by the Pan Canadian Assessment Program (2007), Saskatchewan ranked below average in all areas.

EDUCATIONAL ATTAINMENT BY PROVINCE



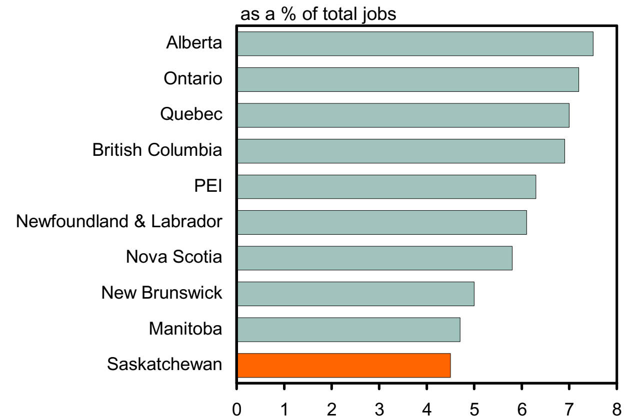
*Ages 25 - 64
Source: 2006 Canadian Census

UNIVERSITY AND COLLEGE REVENUES



Source: Statistics Canada / Calculations by TD Economics

EMPLOYMENT IN NATURAL AND APPLIED SCIENCES



Source: British Columbia Progress Board

- Natural and applied science jobs account for less than 5% of the province's labour force compared to about 7% in Canada as a whole.
- On the flip side, apprenticeship programs have been expanded significantly in recent years.

The solution to the skills challenge will need to involve a multi-faceted approach. **First,** there is a golden opportunity to throw down the gauntlet for residents of other provinces to re-locate to Saskatchewan. Many of these potential migrants – who are often born and raised in Saskatchewan and venture back with skills – will only return if jobs are available, so ongoing efforts to continually improve the business climate are critical. In the second scenario of the labour force profile in the chart on page 26, we show the substantial impact of maintaining *positive* inter-provincial migration of about 5,000 per year. **Second,** stepped up efforts need to be made to boost the share of skilled migrants from other countries. While an attractive location, the province attracts less than its per capita share of international migrants. Through the Provincial Nominee Program, the provincial government has set a target of 2,800 nominations for 2008-09, up 85% from last year. **Third,** increased support for research and development, with the aim of commercializing the research could help to lure highly-educated individuals to the province. In recent years, funding for R&D has increased, but it remains relatively low as a per cent of GDP. **Fourth**, companies should be encouraged to adopt more flexible work arrangements in an attempt to encourage older workers to remain in the labour market. On this front, the elimination of mandatory

SASKATCHEWAN FIRST NATION'S ON AND OFF RESERVE CHARACTERISTICS (2006 unless otherwise indicated)	On-Reserve	Off-Reserve
Population	47,765	43,635
% Change 01-06	9.3	9.0
% of Total Saskatchewan	5.0	4.6
Age Distribution of Group (%):		
0-14 yrs	37.8	40.6
15-64 yrs	58.1	56.9
65+ yrs	4.1	2.5
Median Age	20.0	19.0
Labour Force*		
% Change in Emp Levels 01-06	16.3	27.9
Participation Rate	60.0	67.0
Employment Rate	44.1	54.0
Unemployment Rate	26.3	19.6
Median Income^	26,310	33,880

*Includes only ages 25 to 54
^Median Income data for 2005, full-time full-year earners
Source: Statistics Canada, 2006 Census

retirement in Saskatchewan in 2007 was a move in the right direction. And, **fifth,** the same can be said for women in Saskatchewan's labour force. While the female participation rate in Saskatchewan is in line with the Canadian average, it is some 11 percentage points below that of males.

Growing aboriginal population is an opportunity

Saskatchewan's large aboriginal population represents an important pool of labour for the province down the road. This fact was further corroborated by the results of the 2006 Census. The aboriginal share of the total population was 15%, which represents the second highest provincial share after Manitoba. Particularly striking, due to higher aboriginal fertility rates and outmigration of young non-aboriginals, the proportion of children under 15 of aboriginal origin rose to more than 25%. As such, the proportion of aboriginals in Saskatchewan's young adult population – those between 20 and 29 years – is on track to roughly double from 17% in 2001 to 30% in 2017.[14]

This inevitability has placed increased focus on the historically sizeable gap between aboriginals and non-aboriginals in terms of employment and skill level. On this front, there has been some encouraging news, especially with respect to the job market. The employment-to-population ratio, labour force participation rate and jobless rate have fallen, while the gaps in levels with non-aboriginals have narrowed. Still, as revealed in the table, the differentials remain lofty. The extent of the challenge is more notable when the aboriginal job-market outcomes are compared to those in other Canadian jurisdictions, including Manitoba. For example, the difference in employment rates between aboriginals and non-aboriginals in Saskatchewan's two largest urban markets of Saskatoon and Regina was 14 and 19 percentage points, respectively.[15] In other key markets in the west, the gap was less than 10 percentage points.

In order to estimate the impact on the province's labour force of further improvements in aboriginal participation, we have generated the third scenario on page 26. This profile assumes that the province continues to record positive net inter-provincial migration over the long run as well as a further gradual elimination of the gap in participation rates between aboriginals and non-aboriginals. A report by the CD Howe Institute has estimated that long-term real GDP growth rate for Saskatchewan under this scenario of convergence would rise by 0.3 percentage points per year.[16] Stronger real GDP growth would drive up the capacity for the province to afford public services down the road, including health care.

At the same time, however, other statistics raise doubt on the likelihood that the recent convergence in job-market outcomes will be sustained. Undeniably, the secret to

SASKATCHEWAN ABORIGINAL AND NON-ABORIGINAL CHARACTERISTICS (2006 unless otherwise indicated)	Non-Aboriginal	Aboriginal
Population	811,960	141,890
% Change 01-06	-2.6	9.0
% of Total Saskatchewan	82.5	17.5
Age Distribution of Group (%):		
0-14 yrs	16.6	35.7
15-64 yrs	66.0	60.7
65+ yrs	17.4	3.7
Median Age	41.4	21.7
Labour Force*		
% Change in Emp Levels 01-06	0.0	-0.1
Participation Rate	90.0	70.0
Employment Rate	86.8	58.2
Unemployment Rate	3.2	16.7
Median Income^	39,662	33,500
Education**		
% Less than High School	16.8	38.4
% High School	27.3	22.0
% Post Secondary	55.9	39.6

*Includes only ages 25 to 54
**Includes only ages 25 to 64
^Median Income data for 2005, full-time, full-year earners
Source: Statistics Canada, 2006 Census

fuller participation in the work force – not to mention confronting issues of poverty, which we discuss next – rests with improved education attainment. Yet there was scant evidence of convergence in the 2006 Census data. Although younger aboriginals are faring somewhat better in achieving higher school or some form of PSE relative to the all-aboriginal profile, there has been virtually no convergence in education rates between aboriginals and non-aboriginals among younger age cohorts (i.e., 20-34 yrs).[17]

- In 2006, about two in five of aboriginals in the 20-24 age range had not received a high school degree or diploma.
- In the case of on-reserve aboriginals, the share of those not completing high school is an astonishing 62%. Keep in mind that about three-quarters of the aboriginal population in Saskatchewan live off-reserve.
- In terms of trade certification rates, the gap between Saskatchewan's aboriginal population and the province's non-aboriginals was about 13 percentage points. This gap rises to more than 20 percentage points when a comparison is made to non-aboriginals for the country as a whole.

Given the rising aboriginal share of the population under 15 years, the education gap will only become more of a threat to the province's prosperity in the future. At the same time, the factors behind this all-important issue are complex. According to Battiste (2005), "First Nations Indians have few incentives to remain in school, receive little career related skills training, have high drop out rates from high school and have weak English skills."[18] The report of the Learning Partnership points to a complicated network of factors that lead to the weaker education outcomes, such as eroded families, bonds and skills, poverty and geographical isolation.[19] Nevertheless, studies have shown that when aboriginal students living off reserve complete post-secondary education, they are able to compete with non-aboriginals in the labour market. A report by University of Saskatchewan Professor Eric Howe found that aboriginal males who drop out of high school forgo life-time earnings of more than $500,000 compared with high school completion and $1 million compared with university completion.[20]

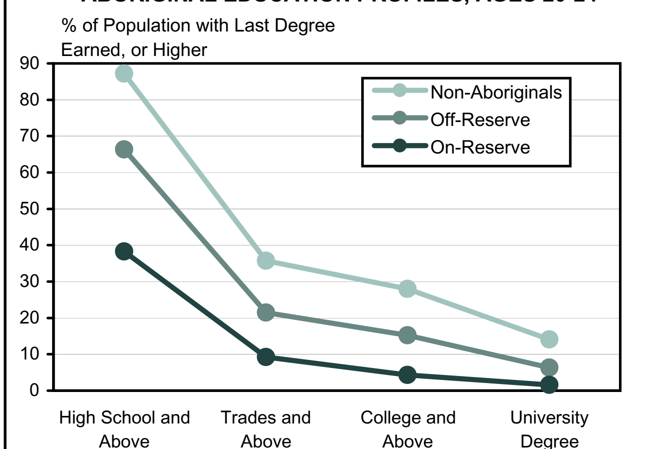
More on-reserve peoples turning to wage economy

A historical barrier to fuller participation of the aboriginal peoples in the labour market has been their resistance to move away from their traditional way of life. However, in recent years, a greater number of communities have been seeking participation in the wage economy through establishing corporations and/or partnerships with industry. The First Nations' involvement in the province's gaming industry is only one of a number of success stories on this front.

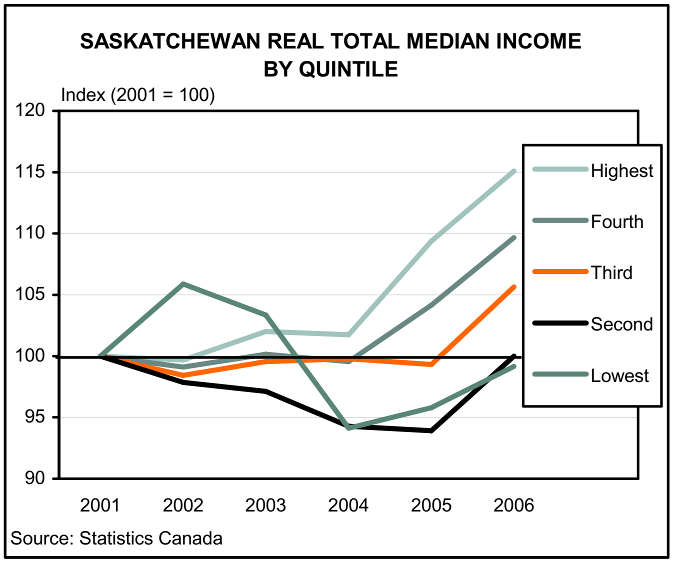
This heightened interest is creating other challenges, however. There have been growing calls by First Nations communities for a share of provincial resource revenues. Even though it is the position of the government and Crown that ownership and control over resource royalties was ceded by First Nations under the Treaties, this is not the opinion of all aboriginal groups in the province. Still, the provincial government is both supportive of the desire of First Nations to benefit from resource development and has recognized its legal duty to consult with First Nations communities prior to embarking on resource projects. Towards this end, the province held a first-ever roundtable conference on May 12-13, 2008 involving First Nations, Metis, and industry representatives with discussion focused on working towards common ground in development of a duty to consult and accommodate policy.

The question of how the benefits from resource development will be provided will be key as the province develops a new policy in this area. It is likely that the province will opt to provide benefits more indirectly through the provision of various programs rather than a direct cut of the royalties. In addition to government funding of programs, First Nations communities will continue to benefit from the establishment of Industry Benefits Agreements, which usually involve increased employment and training.

SASKATCHEWAN ABORIGINAL AND NON-ABORIGINAL EDUCATION PROFILES, AGES 20-24



Source: Statistics Canada, 2006 Census



Alleviate the problem of poverty

It is fair to say that Saskatchewan's strong growth has been filtering down to households in the form of higher incomes. Over the 2001-06 Census period, median total income for economic families grew by 7%, second to only Alberta's 10% growth. And the momentum has since picked up. Over the past year, full-time employment and wage growth in Saskatchewan are up by a healthy 2% and 5.5%, respectively. The recent strength partly reflects the fact that higher paying construction and resource jobs have been accounting for a disproportionate share of the total job creation.

Still, these headline statistics fail to capture the true story under the surface. Most of the income gains have been enjoyed by those individuals in the upper quintiles in recent years, while incomes in the bottom quintiles have stagnated. What the headline statistics also fail to account for is the sharp increase in costs of housing, gasoline and other essentials. Rental vacancy rates in Saskatoon and Regina have plunged to 0.6% and 1.6%, respectively. Still, this is not just a big-city issue. Smaller communities not accustomed to dealing with issues such as housing affordability and homelessness are now quickly becoming familiar with them. What's more, with the economy expected to continue to fire along on all cylinders over the next few years, it is unlikely that these cost-related pressures will recede much over the next few years. Part of the challenge on the housing front is that builders have been turning their attention to satisfying strong demand for owner-occupied housing, thus forgoing new rental projects.

Poverty is arguably the most complex issue facing policymakers due to its self-perpetuating nature. Communities that wrestle the most with poverty tend to post among the highest drop out rates and weak academic performances. As a result, there is a higher propensity to turn to violent crime. Saskatoon and Regina are communities that confront relatively lofty high-school drop out rates and ranked first and second among Canada's major cities, respectively, in terms of overall crime rates in 2006.

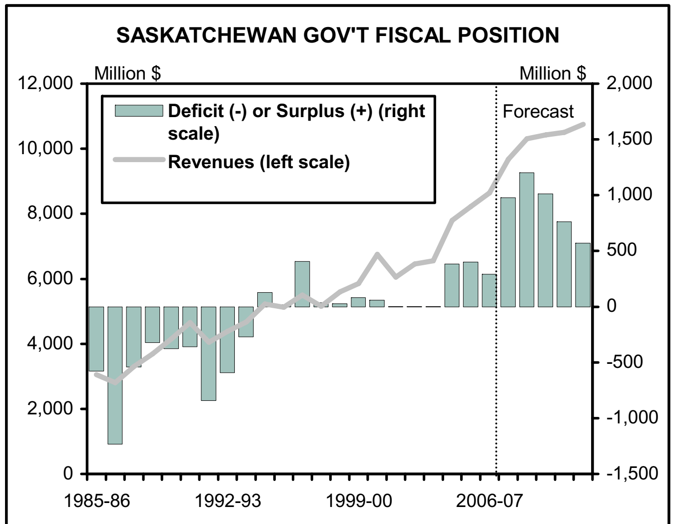
Recently, there have been efforts to chip away at the problem of poverty. The provincial government recently raised the minimum wage to $8.60 per hour and will follow that up with a hike to $9.20 on May 1, 2009. The 2008 budget included measures for homelessness, money for the Neighbourhood Revitalization Housing Initiative and a further $50 million in funding as part of the federal-provincial affordable housing and aboriginal housing agreement. On March 18, 2008, the provincial government announced a task force on housing affordability that will focus on strategies to assist those least able to afford rising housing costs and to encourage the supply of affordable housing. The task force will report its recommendations to the Minister of Social Services by May 30, 2008.

Over the next several years, leaders in the Province will need to continue to set their sights on knocking down many of the roadblocks to higher education and earnings, including lowering the extremely high tax rates at the low ends and supporting education. We discuss this next. The CD Howe Institute has estimated that the marginal tax rate on incomes of $25,000-$40,000 rises to as high as 60%.[21] We have argued in the past that the problem of affordable housing can only be tackled with holistic approaches that lower demand (i.e., raises income for low income individuals) and boost supply. Rent regulations, while providing some short-term relief, inflame the problem over the longer run by lowering the supply of housing. Happily, the new government has indicated that it would steer clear of rent controls.

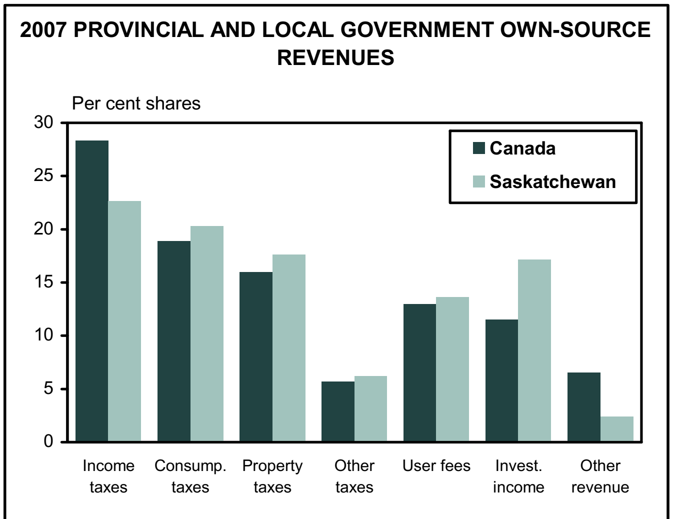
Fine fiscal balancing act

In the end, laying the foundation for long-term growth will not come without a price tag. It will require public investments in education, infrastructure, a more competitive tax environment and poverty reduction. Stakeholders across the province, such as municipalities, public sector unions and First Nations, will seek a share of the spoils as they confront their own demands and challenges. In addition, the government will need to do more than balance current spending and tax priorities. Consideration will also need to be given to future generations, especially in light of the unsustainable nature of non-renewable resource revenues.

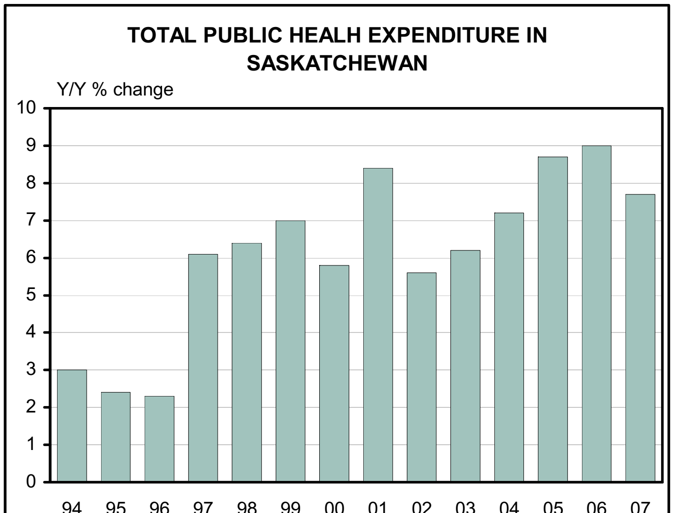
Yet public resources will always be limited. TD Economics' 5-year fiscal forecast (see chart) shows that while surpluses are on track to come in considerably higher than projected in the March 2008 budget, the budget constraint will still be binding. The forecast builds in TD projections on economic growth and commodity prices, while spending figures were those presented in the government's medium-term budget forecast. Putting it all together, we project "status-quo" budget surpluses of $1-$1.2 billion over the next two years, before drifting lower at the tail end of the forecast horizon in line with a tapering off in the level of non-renewable resource royalties. While not insignificant, this flow of black ink will need to be stretched a long way.



Source: Public Accounts of Saskatchewan, TD Economics (forecast).



Source: Statistics Canada



Source: Canada institute for Health Information

Balancing these priorities won't be easy. Strategies will need to be based on tough choices and thinking outside the traditional fiscal box:

- *Manage growth effectively* – there needs to be recognition that the government can't do everything all at once. The recent Alberta experience provided an example of where unbridled expansion of major capital projects and the decision to keep up with the soaring demands for new spending has led to some unfortunate consequences, including escalating construction costs and reduced net benefits. Setting priorities will be necessary.

- *More efficient taxation* – taxes need to be used for more than merely raising revenues. The choice of taxes will help to raise the economy's long-term growth path. Where possible, consumption taxes and user fees should be chosen over levies on income, savings and capital. The 2008 British Columbia budget, which announced a revenue-neutral plan to use the proceeds raised through a new carbon tax to lower income taxes, represents smart taxation. Transforming the provincial retail sales tax to a value-added tax would be a major step forward.

- *More efficient ways of delivering services* – the government must be open to more innovative approaches to service delivery. Public-private-partnerships should be added to the tool-kit in circumstances where it makes sense. The government's extensive inventory of assets, including some 40 different crown businesses under the purview of Investment Saskatchewan, should be reviewed with the aim of disposing of those that do not pass the litmus test of providing value for taxpayer money. Continuous reviews should reallocate spending from low priority to high priority areas.

- *Restrain health-cost increases* – while there is broad support for health investment, working to bring annual spending increases down over time from the current unsustainable trend rate of 7-8% per year would go a long way in freeing up resources.

Above all, greater consideration will need to given to saving for the future. The declining nature of non-renewable resources, the long-term uncertainties with respect to resource demand and development and the rising costs to the treasury of an aging population all provide support to the goal of paying down the province's $7 billion in debt ($11 billion if the debt of Crown Corporations is included) as quickly as possible. Then the focus needs to shift to accumulating net assets for the future. In the 2008 budget, the government established the *Growth and Financial Security Fund (GFSF)*, which is designed to provide financial security from year-to-year and to promote economic development. The province has also set up a debt retirement fund (DRF). Half of any pre-transfer budget surplus is allocated to the DRF. Balances in the GFSF and DRF funds at the time of the 2008 budget were $1.35 billion and $250 million, respectively.

This is a good start, but deposits to the funds are made on an "ad-hoc" basis. In the future, consideration should be given to devising a long-term plan for resource revenue savings. In the CD Howe Institute Commentary, *Greater Savings Required: How Alberta Can Achieve Fiscal Sustainability from its Resource Revenues*, Shell and Busby argue that fiscal sustainability of resource-rich nations is achieved by identifying the highest level of annual government spending that can be financed indefinitely from resource wealth given what is known and expected about the resource endowment.[22] The authors conclude that under the Permanent Resource Income Model, Alberta has, in fact, saved more than enough to date, but must begin an aggressive savings policy if it wishes to sustain a constant level of per capita expenditure in the future. Moreover, in addition to saving out of current revenues, effective investment strategies would be critical to boosting long-term savings. Certainly, models for setting aside money for the future – such as that used in Norway for its petroleum assets and the one that is being developed in Alberta – are worth taking a close look at.

Bottom Line

Saskatchewan is blessed with a mix of commodities that is matched by few jurisdictions in the world. But while the brightening prospects for commodities and other notable strengths give Saskatchewan a considerable leg up, the province's dream of lasting prosperity is unlikely to become reality without stepped-up efforts to address its remaining vulnerabilities. Despite the false hopes in the past, we believe that the province has never been in a better position to achieve the goal of stronger expansion and a growing population over the long haul.

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Endnotes

1. Industry groups were estimated based on the following definitions. Energy is defined to include: oil and gas extraction and support services, utilities, oil and gas and electric power engineering construction, organic chemical manufacturing, petroleum and coal products manufacturing and pipeline transportation. Minerals comprise non-energy mining and support services, fertilizer and other agricultural chemical manufacturing and miscellaneous non-metallic mineral production. Forestry includes logging and wood products and paper manufacturing. Agriculture includes crop and animal production, fishing and hunting, and food products manufacturing.
2. The employment figure for resources was based on estimates from Statistics Canada's SEPH survey and the Saskatchewan Mining Association. The Top 50 Companies was compiled by "Road to Prosperity", the Advertising Feature of the Leader Post, Saturday, December 30th, 2006.
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5. Dale Eisler, *False Expectations: Politics and Pursuit of the Saskatchewan Myth*, University of Regina, 2006.
6. Ibid.
7. Ron Petrie, "In Many Good Ways, Saskatchewan is Tops," The Regina Leader Post, March 17, 2008.
8. Statistics Canada, *Age of Public Infrastructure: A Provincial Perspective,* February 2008.
9. Ibid.
10. KPMG, *Competitive Alternatives Study, Comparing Business Costs in North America, Europe and Japan,* 2008
11. Jason Clemons, Niels Veldhuis, Keith Godin, Milagros Palacios, Martin Masse, *Canadian Provincial Investment Climate Report: 2007 Edition.*
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13. Canadian Federation of Independent Business (CFIB) "Help Wanted: Concern Over Shortage of Labour Continues to Grow; Saskatchewan's Long-term Vacancy Rates Highest in the Country", March 7, 2008 (www.cfib.ca).
14. Statistics Canada, *The Aboriginal Labour Force in Western Canada*, Catelogue no. 75-001-XIE, January 2007 Perspectives.
15. Ibid.
16. Yvan Guillemette and William Robson, *Realistic Expectations: Demographics and the Pursuit of Prosperity in Saskatchewan*, CD Howe Institute, No. 107., November 2007.
17. A special thanks to Professor John Richards of Simon Fraser University and Jane Badets of Social and Aboriginal Statistics Division, Statistics Canada for providing his calculations on aboriginal education outcomes from the 2006 Census.
18. The Learning Partnership, *Demographic Changes in Canada and Their Impact on Public Education,* November 2006.
19. Ibid.
20. Eric Howe, *Saskatchewan With An Aboriginal Majority: Education and Entrepreneurship,* the Saskatchewan Institute for Public Policy, 2006,
21. Ibid., Guillemette and Robson, *Realistic Expectations.*
22. Leslie Shiell and Colin Busby, *Greater Saving Required: How Alberta can Achieve Fiscal Sustainability from its Resource Revenues,* CD Howe Institute, No. 263, May 2008.