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GAS AND GEMS TAKING ECONOMY OF THE NORTHWEST TERRITORIES TO A NEW LEVEL, SAY TD ECONOMISTS

But booming growth will fizzle if barriers left standing

- NWT emerging as a growth dynamo, supported by its wealth of natural resources.
- Prospects for natural gas particularly bright, as plans for a pipeline to tap vast reserves forge ahead.
- Progress made in settling Aboriginal land claims and establishing self-government a key ingredient in territory's recent economic success.
- Challenges include the need to diversify beyond natural resources, strengthen the region's inadequate infrastructure, and increasing education rates among Aboriginals.

Yellowknife – Diamonds, natural gas, and the increased participation of Aboriginals in resource development have transformed Canada's Northwest Territories into Canada's fastest growing regional market, say economists at TD Bank Financial Group (TDBFG).

In a report entitled, **"Canada's Northwest Territories – Can Gems and Gas Bring Sustained Growth to the North?"** TD economists argue that a number of resource-development projects, both underway and in the works, have the potential to keep the region's economy growing at full tilt for many years. The results will be presented in Yellowknife today and are also available online at www.td.com/economics.

A positive turn in fortunes since early 1990s

"In addition to the discovery of diamonds at NWT's Point Lake in 1991, the gradual toppling of a number of barriers that had previously stood in the way of growth has been the key driver behind the NWT's recent strength," said Derek Burleton, Senior Economist of TDBFG. In particular, Burleton points to the major improvement in world commodity markets over the past ten years, especially in natural gas.

Aboriginals increasingly jump for a piece of the action

Another positive turn of events has been on the Aboriginal front, where First Nations – energized with a number of recently settled land claims – are increasingly seeking participation in resource development. "The Dene are no strangers to the boom and bust cycles of northern resources development. It is important for Dene governments to control and participate in these initiatives as well," said Noeline Villebrun, National Chief, Dene Nation.

Mackenzie Valley Pipeline taking centre stage

Among the projects currently on the table, none has captured as much attention as the proposed development of a \$4 billion pipeline that would move as much as 64 trillion cubic feet of natural gas, more than one-tenth of Canada's ultimate potential reserves, from NWT's Mackenzie Delta to hungry southern markets. "The direct boost to the territory's economy from construction of the pipeline would be substantial, but it is the indirect benefits that could ultimately offer the biggest payoff to the NWT. For example, in addition to laying the groundwork for long-term development of natural gas, it would

deliver a major shot to industries in the region such as hydro-electricity, telecommunication services and tourism,” noted Burleton.

Benefits of pipeline to flow south of 60

Burleton argues that the list of major beneficiaries from the Mackenzie Valley pipeline doesn't stop at the 60th parallel. “Significant rewards stemming from the pipeline's development would also flow to other parts of Canada in the form of higher economic activity and government revenues.” Alberta, Ontario, and British Columbia are three provinces particularly well-positioned to benefit. And, under current fiscal arrangements, all royalty and most tax revenue would flow to the federal government.

Challenges

While the NWT's medium-term outlook is indeed strong, the road is not free of potential potholes. The most pressing near-term challenge facing proponents of the pipeline is to deal with the concerns of the Deh Cho First Nations, whose traditional lands cover 40 per cent of the pipeline route. “Given that the involvement of the Deh Cho is critical, the federal and territorial governments will need to work with this group to address these concerns, some of which stem from possible impacts of the pipeline's development on the environment.”

Looking further down the road, the most daunting task confronting policymakers will be to transform what could be a one-time economic growth spurt lasting a decade or two into an expansion that can be enjoyed for decades. The need to diversify beyond natural resources, strengthen the region's inadequate physical and social infrastructure, and deal with the region's very high cost of living and complex regulatory environment are some of the key challenges that will need to be addressed in order to ensure that growth is sustained.

Perhaps most importantly, there is a severe lack of skilled labour in the NWT, which, along with the region's tiny population, results from low rates of education among Aboriginals. “The lack of skilled labour goes a long way in explaining why a meaningful share of economic benefits from large-scale projects leak out of the territory, as jobs and incomes flow to other regions.”

NWT government has little fiscal flexibility

Although the need to combat the challenges of an inadequate physical and social infrastructure will come with a price tag, the NWT government is in a weak position to rise to the challenge, as its revenues have not kept pace with the mounting growth-related spending pressures before it. “The federal government has recently stepped up with some additional funding to help the territory deal with these pressures, particularly in areas such as health, infrastructure and job training. But, the thrust of any longer-term solution needs to rest on providing the NWT with a fiscal and administrative flexibility to take control of its own destiny,” said Burleton.

Give NWT access to resource revenues

On a bright note, negotiations are already underway between the territorial government, the federal government, and the First Nations aimed at reaching a deal to devolve powers

– and notably, to give the NWT access to billions of dollars in potential resource royalties that will flow from large-scale development. Burleton cautions, however, that these complex negotiations could drag out for years.

One complicating factor is the need for the territory to receive a fair “net fiscal benefit” from resource revenues. This requirement is crucial, since under the current federal system, formulas are underpinned by the notion, and one that has credence, that federal assistance should be pared back as a region’s fiscal capacity increases.

“Clearly, time is of the essence, as the NWT government has explicitly stated that a new deal on devolution is a pre-condition to allowing the pipeline project to commence.” The government believes that without access to resource revenues, the fiscal costs associated with booming development will exceed the benefits.

Resource royalties no panacea

In any event, resource royalties will not flow in earnest for several years. And the federal government, faced with growing pressures of its own, can only be expected to foot so much of the bill. That means that in order for the territory to tackle its near-term goals, notably putting significant infrastructure in place soon, other options to enhance fiscal flexibility will need to be explored. For one, consideration should be given to raising the \$300-million federally-imposed borrowing limit on the NWT. “Although ongoing fiscal rectitude would remain a vital element in the territory’s ability to tap capital markets for financing, increased borrowing capacity would provide a powerful tool to address the territory’s infrastructure gap.”

The NWT could look at using tools currently available to it in order to create fiscal room, notably re-allocating spending or implementing revenue-raising measures. But Burleton concedes that the rapid spending pressures resulting from growth as well as the already-high cost of living in the territory are two impediments in the way of taking action on this front.

Private sector needs to be engaged

The private sector must also do its part as it will benefit from much of the upfront infrastructure spending. One good way to involve the private sector is to leverage its deep pockets and expertise through public-private partnerships. In fact, the government is already moving in this direction, with the public and private sectors joining forces to build a \$60 million bridge at Fort Providence. “The benefits that will likely flow from successful development of the north are likely to be shared across the public and private sectors. It only makes sense that all parties should share some of the up-front costs to turn this vision into reality.”

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This report, “**Canada’s Northwest Territories – Can Gems and Gas Bring Sustained Growth to the North?**” (including charts), is available in PDF format on TD Economics’ Home Page at www.td.com/economics.