CANADA’S NORTHWEST TERRITORIES
Can Gas and Gems Bring Sustained Growth to the North?

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The discovery of diamonds and a renewed interest in the territory’s sizeable wealth of natural gas has recently cast the spotlight on Canada’s Northwest Territories (NWT). With billions of dollars in private-sector investment having been injected into exploration and development of these two high-valued commodities, the NWT has been transformed into Canada’s fastest growing regional market. What’s more, there are further projects in the works that have the potential to keep the region’s economy running at full tilt for many years.

**Mackenzie Valley Pipeline takes centre stage**

Among the projects 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 the construction of the Mackenzie Valley Pipeline (MVPL) would be substantial. Yet, it is the pipeline’s indirect benefits that could ultimately offer the biggest payoff to the NWT. In addition to laying the groundwork for the long-term development of natural gas, the pipeline would deliver a big shot in the arm to a number of other major industries, including hydro-electricity, telecommunication services and tourism.

As importantly, substantial rewards would flow to other parts of Canada in the form of higher economic activity and government revenues. In particular, a recent study concluded that roughly two-thirds of the resulting employment gains from the project would accrue to regions in Canada outside the NWT, especially Alberta and Ontario. And, under current fiscal arrangements, all royalty and most tax revenue would flow into federal coffers.

**Policymakers face a big job**

Amid the recent buzz of the large-scale projects, policymakers in the NWT will be faced with some important questions. First and foremost, what is the likelihood that the economic boom underway will be sustained? And, how can they ensure that a good part of the gains will be enjoyed by the territory’s residents, rather than flow south of the 60th parallel?

**A positive turn in the 1990s**

The excitement that has been reverberating through NWT’s resource sector over the past few years stands in stark contrast to the sombre mood experienced during the mid-1980s to early 1990s, when a slump in world commodity prices and the removal of a number of oil and gas tax incentives by the Mulroney government weighed on exploration activity in the region. And, if that wasn’t enough, mining producers at the time were also faced with ongoing environmental concerns and outstanding Aboriginal land claims.

Since the early 1990s, however, a series of developments has breathed new life into resource development in the north – *momentum that we believe will have significant staying power*. Notably, price conditions have improved, especially in the natural gas industry, and the discovery of diamonds at Point Lake in 1991 kick-started what has been a whirlwind of diamond development. In fact, with two new mines already in operation, and one in the regulatory approval stage, the NWT will solidify its position as third largest diamond-producing region in the world, after Botswana and Russia.

Above all, the region’s Aboriginals – energized by a number of recently settled land claims – are increasingly seeking participation in resource development and the broader wage economy. Moreover, progress has been made in the area of self-government, with a big step forward taken in August 2003, when the Tlicho agreement was signed between the Dogrib people (now known as the Tlicho First Nation), the territorial government and the
federal government – the first deal in the NWT to combine Aboriginal land claims and self-government.

The boom could fizzle if roadblocks not cleared

With the barriers that had been traditionally holding back the region’s economic potential starting to topple, the outlook for the NWT economy has never been brighter. Economic growth is expected to remain at the top end of the provincial-territorial leaderboard through 2006. And, if the Mackenzie Valley pipeline project goes ahead – which we expect it will – the sizzling growth performance would likely extend into the next decade.

Still, the road ahead for the region is not free of potential potholes. The most pressing near-term challenge facing proponents of the MVPL is the need to deal with the concerns of the Deh Cho First Nations, whose traditional lands cover roughly 40 per cent of the 1,300 km pipeline route. The Deh Cho – one of the First Nations that has yet to sign a land-claims agreement – are particularly worried about the MVPL’s impact on the environment. Given that the involvement of the Deh Cho in the project will be critical, the federal and territorial governments will need to work with this group to address these concerns.

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 generations. Sustained long-term economic growth in the NWT – and an environment where future economic gains are widely shared among its residents – can only be a realistic goal if the following challenges are addressed:

Challenge 1: Diversifying beyond natural resources – Based on current trends, the resource sector will comprise nearly half of the territory’s GDP over the next decade, which would make the economy highly vulnerable to turbulent economic swings. Accordingly, it will be increasingly important to lay the foundation for other non-mining industries to thrive. In the report, we point to three strategically-important industries outside the mining sector that have particular potential to grow and prosper – hydroelectric power, telecommunications and tourism.

Challenge 2: Infrastructure – The region’s capacity to grow is being constrained by a substandard transportation and community infrastructure. Not only is there a sizeable existing physical and social infrastructure gap, but this shortfall is bound to increase further in light of the explosive economic growth taking place. In addition, communities in the NWT already must contend with considerably higher incidence of social problems – including violence, drug addiction and fetal alcohol syndrome – relative to that witnessed elsewhere in Canada, with inadequate infrastructure to aggressively tackle these issues.

Challenge 3: Labour shortages – The necessity of businesses to tap markets south of 60 for much of their man-power during the recent development of two NWT diamond mines highlights the problem of a severe lack of skilled workers in the region. Undeniably, shortages of skilled labour in the NWT are owing to a great extent to the territory’s tiny population base, harsh elements and high cost of living. But, the problem is exacerbated by low rates of education attainment among the Aboriginal population. Health and safety concerns among private-sector employers and stringent union requirements related to training and trade certification also threaten to disqualify a substantial share of Aboriginals from many of the new resource jobs. On a positive note, Impact Benefit Agreements developed with Industry have provided Aboriginal organizations in the NWT with increased opportunities for education and training.

Challenge 4: Impact on the environment uncertain – Compared with other ecosystems, the north is believed to be more sensitive to disturbances, and slower to recover. Little is understood about how a rapid acceleration in the pace of economic development will ultimately impact the north’s environment down the road.

Challenge 5: High costs of living/doing business and concerns about regulation – The higher costs of both living and luring skilled labour are not the only chilly headwinds blowing in the face of northern businesses. Uncertainty with respect to the future direction of NWT’s regulatory and tax regime is another. The current drive towards settling the remaining land claims and Aboriginal self-government is laudable, but raises worries about creating a more fragmented and complex regulatory environment.

Who should fund these costs?

The need to combat the challenges of inadequate physical and social infrastructure will come with a price tag. This, in turn, raises the question: who should ultimately
be on the hook for funding these costs, and in particular, the “big ticket: items on the infrastructure list. With the exception of new highways, which are under federal purview in Canada’s territories, most maintenance and expansion falls on the doorstep of the NWT government. However, the territorial government is in little position to rise to the challenge, as revenues have not kept pace with mounting growth-related spending pressures, leaving it in structural budget deficit position.

Worse still, the NWT government has little administrative flexibility to respond to changing fiscal circumstances. Given that the territory does not control the management and sale of public lands, government royalties from resource development remain the property of the federal government. And, with little revenue-raising capacity, the authority of the NWT government to borrow is limited to $300 million – a level that will be reached over the next few years under the current path of deficits.

**Federal government not turning a blind eye**

All of this is not to say that the federal government has ignored the plight of the territory – it is quite the contrary. Each year, significant funding is transferred to the NWT under the Territorial Formula Financing (TFF) – the largest source of revenue in the territory – with further amounts under the Canada Health and Social Transfer (CHST), and a number of other federal programs. Earlier this year, the federal government agreed to ante up further substantial funding to the NWT for work on the Dempster Highway and Highway 3, along with 10 permanent bridges, and announced plans to inject new monies into Aboriginal training.

**NWT needs to take command of its own destiny**

Still, the thrust of any longer-term solution needs to rest with providing the NWT with the fiscal and administrative flexibility to take control of its own destiny. Happily, this situation could change in the future, as negotiations are already underway between the territorial government, the federal government and First Nations aimed at reaching a deal to devolve powers – and notably, access of the NWT government to billions of dollars of potential resource royalties that will flow from large-scale development.

At the same time, however, the complexity of these negotiations suggests that they could drag out for a number of years. Clearly, time is of the essence. The NWT government has explicitly stated that a new deal on devolution is a pre-condition to allowing the MVPL to commence, since without access to resource revenues, the fiscal costs associated with booming development will exceed the benefits.

A key objective of devolution for the NWT government, and certainly a complicating factor in the current round of negotiations, is the need for the territory to receive a fair net fiscal benefit from resource revenues. This requirement is crucial, since under the current systems of Equalization and Territorial Formula Financing (TFF) in Canada, formulas are underpinned by the notion – and one that has credence – that federal assistance should be pared back as a region’s fiscal capacity rises in order to reduce long-term dependency. In negotiating a rate of grant reduction the federal government will need to be mindful of previous precedents pertaining to resource royalties, such as in Newfoundland & Labrador and Nova Scotia, where ongoing grant protection of 30 per cent is provided from revenues generated from offshore oil and gas.

**Resource royalties no panacea**

As noted, a deal on revenue arrangement and powers under devolution could take years to complete. And, the federal government, facing enormous pressures to fund a greater share of provincial-territorial health care and education, can only be expected to foot so much of the bill. This means that in order for the territory to tackle its near-term goals – notably putting significant new infrastructure in place before resource royalties begin to flow in earnest towards the end of the decade – other measures to enhance fiscal flexibility will be required.

**NWT government could look at existing tools**

The NWT could look at using tools currently available to it in order to create increased fiscal room, notably reallocating spending and/or raising tax revenues. However, finding significant savings out of the government’s existing $900 million annual budget would be a very difficult task, in view of growth-related pressures in the territory. That leaves higher taxes as a more viable alternative. But, even there, the government would quickly run up against a barrier. Most importantly, as indicated in Challenge 5, businesses and residents of the NWT are already faced with a high cost of living. And, while tax rates in the
NWT compare favourably against the national average, they are relatively high when stacked up against neighbouring Alberta. As a result, there are worries that a hike in taxes could create greater inducements for workers in the NWT to reside outside the territory (so-called fly-in-fly-out workers) and businesses to arrange their operations to take advantage of lower levies in other jurisdictions.

If the government chose to go the route of increasing taxes, the choice of which taxes to raise becomes extremely important. In our view, levying a consumption tax – notably the establishment of a territorial sales tax – would be a better route to go, given that they are less harmful on economic growth than taxes on income and savings. Put more simply, since the burden of a sales tax would be shared by temporary residents of the NWT and tourists, this type of levy would not trigger the same negative responses as an increase in income tax.

Look at raising the $300 million debt limit

The use of debt financing is another avenue that the NWT government could use to address some of the near-term challenges. However, as we pointed out earlier, the NWT government is currently constrained by a borrowing limit of $300 million. Even before an agreement is reached on devolution and resource royalties, consideration should be given to raising this limit. 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 huge infrastructure needs.

Private sector needs to be engaged

Above all, given the fact that much of the up-front infrastructure spending that will need to be put in place will ultimately benefit the private sector, it too must do its part. And, one good way to involve the private sector is to leverage its deep pockets and expertise through the use of public-private-partnerships (PPP). In fact, the NWT government is already moving in this direction. Currently, public and private sectors are joining forces to build a $60-million bridge – the Deh Cho Bridge – over the Mackenzie River at Fort Providence.

Harness the potential of the North

The benefits that will likely flow from successful development of the North are likely to be shared on both sides of the 60th parallel, and across the public and private sectors. It only makes sense then that all parties should share some of the up-front costs to turn this vision into reality.

TD Bank Financial Group has issued a number of reports over the past few years that have recommended ways to raise Canada’s standard of living – or real income per capita – above U.S. levels within 15 years. Success in harnessing the enormous potential of the north would help to move the nation closer to achieving that goal. And, raising incomes will better ensure that the social programs, and the overall quality of life that all Canadians enjoy, can be protected down the road.

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CANADA’S NORTHWEST TERRITORIES
Can Gas and Gems Bring Sustained Growth to the North?

With sunlight enjoyed around the clock during the summer and the northern lights brightening the sky in the winter, Canada’s Northwest Territories (NWT) has been known to shine. However, with the discovery of diamonds and, more recently, a rekindled interest in the territory’s sizeable wealth of natural gas, the spotlight on the NWT has never been brighter. In fact, the billions of dollars in private-sector investment that have been injected into exploration and development of these two high-valued commodities have transformed the NWT economy into Canada’s fastest growing regional market. What’s more, there are further projects in the works that have the potential to keep the territory’s economy expanding rapidly for many years.

Among the projects, none has captured as much attention as the proposed development of a $4 billion pipeline that would transport natural gas from the Mackenzie Valley in the NWT to southern markets by the end of the decade. The direct boost to the territory’s natural gas industry and economy from the pipeline development would indeed be substantial. Yet, it is the pipeline’s indirect or ancillary benefits that could ultimately offer the biggest payoff. In addition to laying the groundwork for the long-term development of natural gas, the project would deliver a big shot to a number of other industries – such as hydro-electricity and telecommunication services. As importantly, substantial rewards would flow to other parts of Canada in the form of higher economic activity and government revenues.

Amid the recent buzz of the large-scale projects, policymakers in the NWT will be faced with some important questions. First and foremost, what is the likelihood that a 10-20 year economic boom can be transformed into one that can be sustained into future generations? And, can diversification of the economy beyond these natural resources be achieved, and will the future economic gains be widely shared among the territories’ residents? Encouragingly, a number of barriers that have held back the region’s potential have begun to topple, most notably the settlement of some Aboriginal land claims. At the same
time, however, some serious impediments remain, including an inadequate infrastructure, severe shortages of skilled workers, high costs of development, and a regulatory environment that remains complex.

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The Northwest Territories — a regional snapshot

We begin by a brief portrait of the geography, people and economic make-up of the NWT. The territory covers a massive area, running from the borders of Saskatchewan, Alberta and British Columbia in the south to the Arctic Ocean in the north, and across to the Mackenzie Mountains in the west. In fact, its 1.2 million square kilometres would place it third in terms of land area among Canadian jurisdictions, behind Quebec and Nunavut. The NWT lays claim to the longest river in the country – the Mackenzie River – which extends 4,000 kilometres in the north-south direction, as well as two of the nation’s largest lakes, Great Slave and Great Bear Lake.

Although the NWT has a landmass that would rival that of many countries, its population of only 41,800 citizens at last count would not even give it city status. Still, the territory’s population count is larger than those of neighbouring Yukon (31,000) and Nunavut (29,000).
NWT’s capital city and business headquarters is Yellowknife, which is home to 17,900 residents or nearly 45 per cent of the territory’s total population. Moreover, there are five “regional centres” – Hay River, Inuvik, Fort Smith, Fort Simpson and Norman Wells – where populations range from 900-3,500 individuals. The remaining 26 communities generally have population tallies of less than 500 people. 

Aboriginals comprise half of NWT’s population

While the Aboriginal people make up only 3 per cent of Canada’s population, they comprise roughly half of the NWT’s population base. At 85 per cent, only Nunavut has a higher Aboriginal population share among Canada’s 13 jurisdictions, whereas the comparable figure is only 20 per cent in the Yukon. There are three recognized groups of Aboriginal peoples – the Dene (which includes the Gwich’in, Sahtu and Salt River Akaitcho, Deh Cho and Dorgib First Nations), the Inuvialuit, and the Metis. And, although both the Aboriginal and Non-aboriginal people are important to the population of larger centres such as Yellowknife, the small remote communities are primarily Aboriginal.

After advancing at a brisk clip in the first half of the 1990s, the population of the NWT actually shrank by 2 per cent during the 1996-2001 period, dampened by a combination of a lower natural increase (i.e., births less deaths) and higher net out-migration. In addition, the slippage occurred among both Aboriginals and Non-aboriginals, holding their respective shares of the territory’s population base relatively constant. On a brighter note, more recent quarterly population estimates show that both migration and overall population trends in the territory appear to have turned the corner since the end of 2000, bolstered by improved job prospects.

Interestingly, other demographic patterns that have been witnessed elsewhere in Canada – from an aging population to urbanization – are largely being mirrored in the NWT. Still, even with a rapidly growing share of residents in the 40-plus age group – the so-called “baby boomers” – the median age in the NWT (30 years) remains a sizeable 8 years younger than that of the Canadian average (38 years), reflecting in large part the relatively high fertility rates of women under 24 years.
The NWT economy heavily resource-based, but government main employer

Although it is undeniable that the traditional building blocks of the NWT economy – namely hunting, trapping and fur harvesting – remain important to maintaining Aboriginal lifestyles, the territory’s economic base has gravitated towards mining and mining-related activities in recent decades, especially as significant discoveries of mineral deposits and oil and gas reserves were discovered. By 2002, of the $2.8 billion in total economic activity in the NWT, direct mining activity accounts for slightly more than 30 per cent – a share roughly 10 times that of the Canadian average, and well above respective shares in the Yukon and Nunavut. At 20 per cent of GDP, the non-residential construction sector – which tends to move in lockstep with the timing of sizeable resource development projects – was the second largest industry in the NWT last year, followed by public administration, at 12 per cent. At the other end of the spectrum is manufacturing. More specifically, in light of the large distances from markets in the south and resulting high transportation costs, the NWT’s factory sector weighed in at a mere 0.3 per cent of GDP in 2002, a far cry from the 17-per-cent proportion posted in Canada as a whole.

While mining and construction stand out a neck above other industries in terms of economic value-added, this conceals the fact that the public sector remains the territory’s largest employer in spite of cutbacks in federal and territorial spending since the early 1990s. In 2002, about one-third of the NWT’s 21,000-odd employed either work directly for one of the levels of government in administration or for an organization funded by the government, most of whom reside in Yellowknife. In contrast, the highly-productive goods-producing industries, which make up about half of the NWT’s total income, account for only about one in seven jobs.1

Mineral development fuelling nation-leading growth

With the heavyweight mining and non-residential construction industries flexing their muscles in recent years, the NWT economy has been turning rates of economic growth that are the envy of the rest of Canada. In fact, while the division of the NWT and Nunavut into separate territories in 1999 left economic data in prior years not directly comparable, real GDP in the territory powered ahead by 13 per cent per year on average in the 2000-2002 period – a pace almost five times the national-average rate. And, the territory’s job market has gone along for the ride, as evidenced by the brisk increase in personal income and drop in the unemployment rate since 2000.

By 2002, virtually all job market indicators – from unemployment rates to labour market participation rates – stacked up favourably vis-à-vis the rest of Canada. Nonetheless, as the text box on page 5 shows, there is more to it than meets the eye – notably the sizeable gap that remains between Aboriginal and Non-Aboriginal populations in terms of labour-market participation, unemployment, and education attainment in the NWT.
A positive turn in fortunes in the early 1990s

Despite its ever-growing foothold in the economy, the NWT’s resource sector has not always enjoyed a smooth ride. In particular, between the mid-1980s and early 1990s, the fortunes of the sector’s leading industries – gold and base metals – soured, as production wound up at some large mines, and commodity prices began to follow a secular downtrend, rendering many projects in the higher-cost north unviable. Hence, additions to reserves began to dwindle. In the oil and gas sector, the picture was similar. Specifically, in the mid-1980s, producer cash flows slumped under the weight of weak oil prices. At the same time, the Mulroney government discontinued a number of generous tax incentives that had been provided by the previous Trudeau government under its 1980 National Energy Program to spur exploration activity in the North.² Add to the

How does the NWT compare to Canada?

The table below provides some important economic and labour market comparisons between the NWT and Canada. Some observers might find some of the statistics surprising. For instance, despite its relatively underdeveloped economy, NWT stands out ahead on both per capita GDP and real personal disposable income (PDI) – two commonly used measures of standard of living. This reflects the relatively high weighting of the highly-productive mining sector within the NWT’s economic landscape. And, employers tend to pay relatively high wages per worker in the north to help to attract and retain workers in view of the difficult weather conditions, considerably higher cost of living and greater scarcity of goods and services. The higher labour-market participation rates in

<table>
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<tr>
<th>ECONOMIC INDICATORS FOR CANADA AND NWT: 2002 (unless otherwise indicated*)</th>
<th>Canada</th>
<th>NWT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP per capita (chained 97$)</td>
<td>33,811</td>
<td>75,878</td>
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<tr>
<td>Real PDI per capita (chained 97$)</td>
<td>20,303</td>
<td>30,686</td>
</tr>
<tr>
<td>Participation Rate (%)</td>
<td>66.9</td>
<td>75.9</td>
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<tr>
<td>Employment Rate (%)</td>
<td>61.8</td>
<td>71.2</td>
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<tr>
<td>Unemployment Rate (%)</td>
<td>7.7</td>
<td>5.8</td>
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<tr>
<td>Median Age (years)</td>
<td>37.6</td>
<td>30.1</td>
</tr>
<tr>
<td>Life Expectancy (years)</td>
<td>79.0</td>
<td>76.2</td>
</tr>
<tr>
<td>% of Population 15+ with Post-Secondary Education**</td>
<td>43.8</td>
<td>43.9</td>
</tr>
</tbody>
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* Data are for 2002, with the exception of: life expect. (1999); population by educational attainment (2001)
Labour force statistics for NWT are from the annual labour force survey; ** includes university degrees, university and college certificates and diplomas, and trade certificates and diplomas
Source: NWT Bureau of Statistics, Statistics Canada, TD Economics

Labour force data are from the 2002 NWT Regional Employment & Harvesting Survey. The data are as at October 2002 and are not adjusted.
* includes university degrees, university and college certificates and diplomas, and trade certificates and diplomas

<table>
<thead>
<tr>
<th>ECONOMIC INDICATORS FOR ABORIGINAL AND NON-ABORIGINAL POPULATIONS</th>
<th>Aboriginal</th>
<th>Non-Aboriginal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Labour Force Statistics (%)</td>
<td></td>
<td></td>
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<tr>
<td>Participation Rate</td>
<td>66.1</td>
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<td>Employment Rate</td>
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<td>Population Shares (%)</td>
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<td>Annual Population Growth (%)</td>
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<td>1996-2002</td>
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<tr>
<td>Median Age (2001)</td>
<td>24.0</td>
<td>34.5</td>
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<tr>
<td>Highest level of Schooling (1999)</td>
<td>% of Population 15+ with Post-Secondary Education *</td>
<td>30.8</td>
</tr>
</tbody>
</table>

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the NWT vis-à-vis Canada is attributable, at least in part, to the larger share of younger workers, who tend to participate in greater numbers than older workers.

Still, the most striking data are those that show the stark contrast between Aboriginals and non-Aboriginals, notably in terms of rates of employment, unemploymen and level of schooling. On a happier note, these gaps have started to narrow in recent years, as rapid economic growth and the settlement of native land claims have opened the door to increased market opportunities for the NWT’s Aboriginal peoples.
broad list ongoing environmental concerns and outstanding Aboriginal land claims, and it is hardly surprising that the territory’s overall resource sector struggled over the period.

Since the early 1990s, however, a series of developments has breathed new life into resource development in the NWT—a momentum that we believe will have significant staying power. Notably, a host of land claims has been settled, Aboriginal participation in mineral development has picked up, diamonds were unveiled, and North America’s appetite for natural gas surged.

**Land claims have been settled**

In the NWT, there have been a number of important agreements signed since the mid-1980s that have turned over to Aboriginal groups ownership of land, cash compensation for infrastructure and training and a share of resource royalties. As of October 2003, about two-thirds of the aboriginal population of the NWT had settled their land claims, with negotiations continuing on the remaining one-third:

- *The Inuvialuit Final Agreement (1984)*. This agreement involved the Mackenzie Delta and Beaufort Communities of Aklavik, Sachs Harbour, Tuktoyaktuk, Paulatuk, and Holman. The Inuvialuit received surface title to 91,000 sq. km., subsurface title to 13,000 sq. km., cash compensation of $152 million over 14 years, one-time payments of $10 million for economic enhancements and $7.5 million for a social-development fund.

- *The Gwich’in Comprehensive Land Claim Agreement (1992)*. The communities of Aklavik, Inuvik, Fort McPherson, and Tsiigehtchic, received surface title to 22,329 sq. km., subsurface title to 6,158 km, and cash compensation of $141 million over 15 years. The Gwich’in were also given 7.5 per cent of the first $2 million of government royalties received from the Mackenzie Valley and 1.5 per cent on the balance.

- *The Sahtu Dene and Metis Comprehensive Land Claims Agreement (1994)*. Dene and Metis in the communities of Deline, Fort Good Hope, Norman Wells, Colville Lake and Tulita received surface title to 41,437 sq. km., subsurface title to 1,820 sq. km., cash compensation of $130 million over 15 years, as well as the identical royalty arrangement as that given to the communities under the Gwich’in Land Claims Agreement.

- In addition to the terms noted above, each of the Inuvialuit, Gwich’in, and Sahtu Dene and Metis Agreements established a number of co-management boards with guaranteed representation for the respective groups.

- In addition to these three negotiations that were conducted according to the comprehensive claims policy, the Smith Landing and Salt River First Nations settled their rights through the Treaty Land Entitlement Process in 2000 and 2001, respectively. As a result, cash compensation was provided and agreement was reached to establish two reserves near Fort Smith (one in the NWT for the Salt River First Nations and one in Alberta for the Smith Landing First Nations).

**Progress now being made on Aboriginal self-government**

While less progress has been achieved in Aboriginal self-government, momentum appears to be building on that front as well. In a policy paper released in August 1995, the federal government declared that self-government could be negotiated as part of comprehensive land claims agreements, setting the stage for self-government negotiations to begin. And, a big step forward was taken in August 22, 2003, when the Tlicho Agreement was signed by the Dogrib people (now known as the Tlicho First Nation), the territorial government, and the federal government. This was the first agreement in the NWT to combine Aboriginal land claims and self-government in the...
Aboriginal Businesses Poised to Benefit from NWT Development

Some notable Aboriginal businesses that stand to reap benefits include:

- Air Tindi
- First Air
- Nunasi Helicopters
- Canadian North
- Cooperative Stores
- NTCL Marine and Truck Freight
- Super 8 Hotel

NWT. The deal will hand over to the Tlicho First Nation 39,400 sq. km. of surface and subsurface lands, $152 million in cash compensation over 15 years, and a slice of royalties. But, as importantly, the Agreement established a regional Tlicho government as well as community governments in the four Tlicho communities. Notably, the regional Tlicho government was empowered with a broad range of law-making authorities in areas such as education, social services, child and family services, culture, language and wildlife management.

With the Tlicho Agreement, only the communities of the Deh Cho Dene and Metis, Akaitcho Dene and North-west Metis still have yet to settle their land claims. However, the three parties are all presently involved in combined land claims and self-government negotiations, and in most cases, progress has been made. Furthermore, other groups – including the Inuvialuit and the Gwich’in First Nations of the Beaufort-Delta Region, as well as two communities in the Sahtu region – are currently negotiating self-government.

Aboriginal groups are ready

At the heart of the recent land claims settlements has been the desire of the Aboriginal peoples to establish new institutions and programs that will allow them to benefit from economic development. This attitude represents a monumental shift from the past, when they for the most part resisted a move away from their traditional way of life. Aboriginal Development Corporations have been sprouting up across the NWT, as the push to form partnerships with government and the private sector increases, and larger numbers of aboriginals are entering the wage economy. According to the NWT and Nunavut Chamber of Mines, there are more than 200 aboriginal businesses currently in operation in the NWT, pulling in excess of $100 million in annual revenue. The accompanying text box lists some of Aboriginal businesses that are particularly well-positioned to take advantage of development opportunities.

It is not that their traditional sense of homeland and the importance of protecting the environment have been compromised. Rather, Aboriginal groups have become increasingly convinced that major developments and higher incomes can be pursued without inflicting environmental damage. It is important to note that a key concession in land-claims agreements has been the creation of a large network of interconnected protected areas where no development can occur.

Diamonds … right out of the blue

The developments on the Aboriginal front have raised the potential for mining development in the NWT. Without an abundant product, however, the territory’s mining machine would eventually come grinding to a halt. And, while the NWT still sits on large undeveloped deposits of tungsten and lead-zinc, the discovery of diamonds in the NWT in 1991 at Point Lake – an area about 300 km northeast of Yellowknife – gave a huge lift to an industry that started to show signs of fraying at the seams. Put simply, the timing of the diamond discovery could not have been any better.

![CANADIAN DIAMOND PRODUCTION](image-url)

F: forecast by TD Economics as at Nov. 2003; Source: NWT Resources, Wildlife and Economic Development, TD Economics
Over the past decade, the NWT has seen a flurry of activity in the diamond industry, culminating in the startup of North America’s first two mines in the Lac De Gras region. In 1998, BHP Billiton’s Ekati mine, which carried a $850-million price tag to develop, began production. And, earlier this year, following a $1.3 billion development phase, production at the Diavik Mine kicked off. Moreover, in October 2003, a proposed third mine at Snap Lake, with a $300 million capital cost, passed another major hurdle, when the federal minister of Indian Affairs accepted the assessment carried out by the Mackenzie Valley Environment Impact Review Board. That move paves the way for the project to receive final federal regulatory approvals, including land and water permits and an operating licence. Production at Snap Lake, which is owned by South African diamond giant De Beers, is expected to begin in 2005.

In addition to the vast magnitude of the diamond discoveries – Ekati is likely to run for another 11 years, Snap Lake for at least 20 years, and in the case of Diavik, between 15-21 years depending on the rate of production – the quality of the diamonds in the NWT is among the highest in the world. In fact, driven by both price and quantity, the value of diamond production at the three NWT diamond mines is expected to rise to $1.5 billion by 2006, or 12-15 per cent of the world total. That would vault the territory into third position among diamond-producing regions, ahead of South Africa (11 per cent). And, with exploration continuing to be ramped up in the NWT, and the race currently on to build Nunavut’s first diamond mine, Canada could narrow in on Botswana (29 per cent) and Russia (22 per cent) for top spot in terms of world production down the road.

The surge in diamond activity has given a major boost to the NWT economy and job market. Construction employment surged in the NWT in the mid-1990s, and once again in the early part of this decade, as the development phases of the Ekati and Diavik mines geared up, spurring a combined demand for roughly 1600 workers. About half of the positions went to individuals in the NWT. In addition, the ongoing mining activities at the Ekati and Diavik require a total workforce of some 2,200 strong, of which about 70 per cent are Northerners and roughly one-third are Aboriginal. At Snap Lake, about 450 people are likely to be employed during the development phase, which should run during the 2004-05 period, and a similar amount of manpower during the operations phase.

Other industries have been towed along by diamond development. On the service side, the spin-off benefits have rippled down to wholesale distributors, catering companies, housekeeping, food services, courier services, and sorting. But, above all, the NWT’s factory sector owes much of its recent strength to the expansion in its diamond-processing industry, which in turn has been underpinned by the willingness on the part of the diamond mining companies to support the Northern cutting and polishing industry through the supply of upwards of 10 per cent of the value of annual diamond production for these activities. The cutting and polishing facilities, which are located in Yellowknife, employ approximately 100 people, the majority of whom are from overseas. De Beers, the owner of Snap Lake, had agreed to return a similar amount of rough diamonds to the north, but now appears to be dragging its feet. Negotiations were continuing between the Government of the NWT and De Beers to address this issue at the time of writing.

**Oil and gas fever hits the north**

The oil and gas sector received a major boost in 1994, when the progress on the land-claims front resulted in new calls for exploration rights in the Mackenzie Valley. Since then, strong price conditions on the whole have rekindled considerable interest in oil and gas in Canada’s north.

Although crude oil continues to be extracted in the NWT community of Norman Wells, the focus for the most part in the territory’s oil patch has been on developing new...
supplies of natural gas, in light of mounting concerns about gas supply shortages in North America. With about one-half of the natural gas resources in the Western Canadian Sedimentary Basin already exploited, production has flattened in Canada, and productivity has slumped – a situation that is being mirrored in the United States. In other words, existing wells are getting smaller, and there is a need to drill a greater number of them. On the other side of the equation, North American demand for natural gas is expected to grow steadily in the years ahead, led by increased consumption of electric-power suppliers. These forces have driven up natural gas prices to above US$4 per MMBtu on average over the past three years – a price that natural gas producers have found highly profitable. Furthermore, with supply shortages unlikely to abate, the price is expected to hold up at an extremely high US$5 per MMBtu over the short-to-medium term.

Oil and gas companies operating in the NWT have responded by ramping up drilling activity at a hectic rate in both the southern and northern parts of the territory. In the south, five significant natural gas finds have been made in the Fort Liard area, with projected reserves of 4 trillion cubic feet (Tcf). Still, the potential of the south pales in comparison to that of the Mackenzie Delta and Beaufort Sea. At last tally, the Mackenzie Delta/Beaufort Sea had proven reserves of 9 Tcf, and potential recoverable reserves of 64 Tcf, the latter figure representing more than one-tenth of the Canadian total. And, given the exploration activity underway, that total is likely only going to climb further.

Momentum through 2006, and likely beyond

The completion of the relatively labour-intensive development stage of the Diavik diamond mine in 2002 is expected to constrain real GDP growth in the NWT to just under 3 per cent this year. Still, given that the series of tailwinds that have driven resource development over the past few years is expected to remain intact, look for real GDP in the NWT to grow by a still-heavy average annual rate of 7 per cent in the 2004-06 period – keeping it on the top of the provincial-territorial growth charts over the next few years. Employment, which has remained largely constant in 2003, is projected to rebound significantly in the 2004-05 period, as construction at Snap Lake is assumed to shift into overdrive. Accordingly, the unemployment rate in the NWT is expected to fall under further downward
pressure over the next few years.

And, the good news on the NWT’s longer-term outlook does not stop there. In particular, the pressing need to build a pipeline to move the large reserves of natural gas in the NWT has the potential to substantially lift the Territory’s economic growth outlook well beyond 2006. In the following section, we examine in some detail the proposed Mackenzie Valley Pipeline Project (MVPL).

**Interest builds in Mackenzie Valley Pipeline (MVPL)**

For many Canadians, the concept of building a pipeline from the NWT is not a new one – an attempt to build one in the 1970s fell victim to two major developments. First, the high cost of building a pipeline over permafrost created a monumental barrier for the consortium of Canadian and U.S. producers considering the project. And, second, a federal royal commission, led by Judge Thomas Berger, concluded in 1977 that although a pipeline from the Mackenzie Delta down the Mackenzie Valley to Alberta was feasible, it should proceed only after the settlement of land claims and following further study of the concerns raised by aboriginals and environmentalists. Berger’s recommendation of a 10-year moratorium against pipeline construction (or until land claims were settled and environmental concerns addressed) was adopted by the federal government.

Compared to the 1970s, conditions related to pipeline development have changed radically. For one, new technologies have been developed which have increased the project’s viability on the producer side. And, armed with their land-claim settlements, Aboriginal groups have looked at the project through a different set of eyes. Not only are most groups convinced that the pipeline can be built without harming the environment, an Aboriginal development corporation has signed on as a one-third stakeholder in the project.

**Three stages to pipeline development**

At an estimated cost of $5 billion, the project would involve three stages. First, the development of three anchor natural gas fields – Taglu, Parsons Lake, and Niglintgak – which would be developed by the respective operator of each field, in order to make them production ready. Second, the construction of a pipeline gathering system, at a cost of roughly $1 billion, to transport the natural gas to the northern end of the MVPL, near Inuvik. And,
third, the construction of the MVPL that will ship the gas from the Inuvik area to connect with the pipelines of Alberta. When completed, the pipeline, which would run approximately 1,300 kilometres, is expected to churn out natural gas at roughly 1.2 billion cubic feet per day (about 7 per cent of Canada’s current production rate). Moreover, the capacity could rise to 1.9 billion cubic feet per day through gas compression techniques.

**Barriers to the project are toppling one by one**

There have been a number of important developments over the past three years that are turning the development of the MVPL project from just a pipe dream into a reality. The key milestones to date include:

- **In February 2000**, four oil and gas companies – Imperial Oil, Gulf Canada, Shell Canada and Mobil Canada – formed the Mackenzie Delta Producers Group to study the feasibility of developing the Mackenzie Delta gas. Two of those companies have subsequently changed names as a result of the takeover frenzy in the oilpatch in the last few years. Mobil Canada is now represented in the group by ExxonMobil as a result of Exxon’s acquisition of Mobil Corporation in 1999. Gulf Canada is now known as ConocoPhillips as a result of its purchase in 2001 by Conoco, which later on merged with Phillips Petroleum.

- **In June 2000**, the Aboriginal Pipeline Group (APG) was formed to represent the business interests of the Aboriginal peoples of the Northwest Territories in the MVPL Project.

- **October 15, 2001**, the APG signed a memorandum of understanding (MOU) with the Mackenzie Delta Producers Group, which sets out the principles that will cover negotiation and benefit agreements, including education, training, employment and business opportunities. It allows for the APG to own up to one-third of the pipeline, and will allow it to exercise considerable influence over the construction and operation of the pipeline.

- **June 18, 2003** – TransCanada Pipelines (TCPL) formally came on board the pipeline project through the provision of a $80 million loan to the APG to cover the Aboriginal Group’s share of the project’s definition costs, including engineering studies, route studies, environmental studies, and community consultations. The agreement stated that the money would be repaid only if the pipeline is built and the one-third aboriginal ownership interest generates revenues. Furthermore, the deal gave the Delta Producers Group an option to sell five per cent of the line to TCPL, and gives the pipeline company the right to buy half of any further interests the producer group decides to sell, with the other half offered to the APG and other owners. The funds can also be used to leverage funding from lenders to pay for the aboriginal share of future pipeline construction costs. Lastly, TCPL agreed that it would write-off its $80 million loan if the project is not completed.

- **June 30, 2003** – two weeks after the proponents of the Mackenzie Gas Project submitted a Preliminary Information Package (PIP) to the federal regulatory authorities, the authorities declared that the information package was complete. The PIP signals the intent of the proponents to proceed with regulatory applications. Although the approval plan would normally take four years or more to complete, the Federal Indian Affairs Minister has predicted that the process can be accelerated to take only 24-30 months. The plethora of boards and panels with jurisdiction over the north including the National Energy Board and the Mackenzie Valley Environmental Impact Review Board have agreed to work together to review the project. Environment Canada, Fisheries and Oceans and Department of Indian Affairs and Northern Development (DIAND) along with several aboriginal land and water boards will also be involved in the environmental assessment.

Based on the federal predictions, if all regulatory hurdles are cleared, the development would begin in 2006 at the earliest, with production likely to start in 2008-2010.

**Not the only pipeline project on the table**

The MVPL has not been the only northern pipeline project to garner considerable attention over the past few years. Notably, a pipeline that would tap natural gas produced in Alaska, where recoverable reserves are four times those of the Mackenzie Delta, and send it down through Yukon, into northern B.C. and into the Alberta pipeline system, has also moved on to the radar screen. Still, the
hefty price tag of the project of roughly US$20 billion has been a major barrier to development (see topic boxes on pages 13 and 14). In any event, the Alaskan route option is no longer viewed as a competing project, as the majority of opinion now believes that the Mackenzie Valley pipeline project as well as the Alaska pipeline project are needed to meet the growing demand for natural gas in North America in the next decade.

Economic impacts of the MVPL

There have been some notable studies that have examined the economic benefits that would arise from the development of the MVPL project, namely those released by the Canadian Energy Research Institute (CERI) in 2000 and the Wright-Mansell (W-M) Research Limited in 2002. The reports differ in terms of scope, and not surprisingly then, churn out vastly different results (see accompanying table). Whereas the CERI study focused on the benefits of pipeline construction only, the W-M assessment took a broader approach, also building in to the benefits tally oil and gas development that would likely occur over the next three decades in order to ensure that the pipeline is filled to capacity. Moreover, the W-M report details how these benefits would likely be distributed across the various regions and levels of government.

Sifting through the results of these studies, the following conclusions can be drawn:

- The direct economic benefits flowing from the MVPL development phase would be substantial, with the bulk of investment expected to occur in the period of three years immediately prior to the commencement of gas moving in 2009-10.

- Still, as the W-M study shows, when the time horizon under study is extended further out, the indirect effects begin to soar. The pipeline’s development will lead to a higher annual profile of natural gas exploration and production activity than would otherwise materialize, while the “knock on” effects to goods- and service-producing industries become more pronounced over time.

- The NWT stands to be a major beneficiary in terms of increases in real output and income generated by the MVPL, although the CERI and W-M studies differ on the share of the total. In the CERI report, the NWT

![PROJECTED ECONOMIC BENEFITS OF THE MACKENZIE VALLEY PIPELINE (MVPL)]

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<td>CERI*</td>
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<td>Wright-Mansell Research Ltd. **</td>
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<td>Total</td>
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* Benefits to NWT including Nunavut
** Benefits that will accrue between 2002-2033
^ Two scenarios at gas price of US$3 & US$4 per thousand MCF
Source: Wright Mansell Research Ltd. Report (2003); CERI (2000); TD Economics

![EMPLOYMENT IMPACT BY PROVINCE OF THE MACKENZIE VALLEY PIPELINE IN 2002-33]

Source: Wright Mansell Study, TD Economics
Alaskan pipeline route – economics of project still up in the air

Similar to a MVPL, a pipeline for Alaskan natural gas has been discussed since the 1970s, but the project was shelved as a result of changes in the North American natural gas supply-demand balance. In recent years, shortages of natural gas in the United States, and Congressional efforts to boost the supply of energy Stateside, have re-invigorated talk of an Alaskan pipeline development. In particular, a proposed route – that would run south from Prudhoe Bay in Alaska, through Whitehorse in the Yukon, into northeastern B.C., and then connect with the Alberta pipeline system – has captured particular interest.

A feasibility study completed by the BP PLC, Exxon Mobil and Phillips Petroleum in May 2002 concluded that at US$20 billion, the project was not commercially viable. What’s more, the study indicated that the project’s cost could run as high as US$24 billion. The conclusion of the group was that the risks would outweigh the rewards – dealing a major setback to the Alaskan pipeline development.

Still, the proponents of the Alaskan Highway Route have not thrown in the towel, as they are exploring ways to make the project economically viable. For one, they are pushing for an up-front agreement on the royalty share of the Alaska government. But, even more importantly, their eyes have been fixed on the U.S. Congress, which is currently mulling over the notion of providing subsidies to the project as part of a comprehensive energy bill.

The Alaska pipeline proponents had been pressing for Congress to craft a bill that would include a tax credit to kick in if the price of natural gas falls below a certain level, effectively creating a floor price at say, US$3.25 per thousand cubic feet. However, in an attempt to reach a deal, Congressional leaders have instead shifted their support to the less-controversial provision of US$18 billion in loan guarantees for pipeline construction, accelerated depreciation, among other subsidies. Moreover, earlier plans by Republican leaders to allow drilling in the Arctic National Wildlife Refuge have been dropped from the latest version of the legislation.

As of late November 2003, the comprehensive energy bill had been passed in the House, but lost a narrow vote to end debate in the Senate. Hence, negotiations to generate the required 50 per cent support continue, and the bill will likely be revived next year. In any event, the absence of a floor price in the legislation represents a setback for the project’s partners.

The White House has indicated that it supports the Alaska pipeline, but it also believes that market forces should select the route. The Bush Administration also opposes any incentive that will give a competitive advantage to Alaska producers. In Canada, the federal government believes that the route should not be determined by legislation, and opposes any move by the U.S. Congress to implement a floor price. Not surprisingly, the Yukon government has been on record as supporting the construction of the Alaskan route, since the line would run through its territory and provide large economic benefits.

The Alaska Highway Route has not been the only pipeline proposal to move Alaska gas. In fact, the “over-the-top” route that would link the Alaskan gas reserves to the Mackenzie Delta gas reserves through an underground line in the Beaufort Sea has also received notable attention. However, with the Republican Congressional Leaders putting their support behind the Alaskan Highway Route, other proposals have been taken out of consideration. Moreover, while some Canadian aboriginal groups have supported the “over-the-top” proposal, as it would have provided them with 100 per cent ownership, the route has been prohibited by Alaska State legislation and it has also been opposed by environmental groups.

would enjoy about one-third of the overall increase in real GDP, while the W-M findings show that the bulk of output growth from the project would accrue to the territory. Indeed, W-M’s estimated potential jump in real GDP in the NWT of $33-$50 billion over the next 30 years is enormous, since it represents more than 10 times the present size of the territory’s economy.

- **Other Canadian jurisdictions will enjoy a big slice of the total pie for three reasons. First, the large requirements for goods, services and labour – especially during the construction phase – would undoubtedly lead to higher inter-regional exports to the NWT from other parts of Canada. Second, much of the income generated from the production and transportation of natural gas would accrue to companies based outside the territory. And, third, under current fiscal arrange-
Current Status Proponents are in the stage of regulatory The project secured government
Expected Start-up Between 2008-2010. Not yet determined
Pipeline capacity 1.9 billion cubic feet 5 billion cubic feet per day
Project Sponsors Imperial Oil Resources BP Plc.
Length of Route 1360 km from Mackenzie Delta to Alberta 2737 km from Prudhoe Bay to Alberta,
Natural Gas Reserves 9 Tcf, with an additional 55 Tcf expected to be 35 Tcf, with another 16 Tcf expected to
Areas of Natural Gas Presence Mackenzie Delta/Beaufort Sea North Slope
Total Project Cost US$3.8 bn (C$5 billion) US$20 billion

MACKENZIE VALLEY VERSUS ALASKA PIPELINE PROJECT

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<th>Mackenzie Valley Pipeline Project</th>
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<td>Project Sponsors</td>
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<td>with another 2800 km to Chicago</td>
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<td>Expected Start-up</td>
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<tr>
<td>Current Status</td>
<td>Proponents are in the stage of regulatory applications.</td>
<td>The project secured government approvals and certification from both sides of the border in the 1970s, which are reportedly still valid today. Proponents await passage of U.S. energy bill, which will include subsidies for pipeline development, to better gauge economic feasibility of project.</td>
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ments, all of the royalties and most tax revenue earned as a result of the project’s activities would flow to the federal government, which in turn, would be recycled throughout Canada.

• According to W-M, each province would share in the economic spoils of the MVPL project at least to a modest extent, led by Ontario — which will supply much of the manufactured goods for the development phase — and British Columbia.

• Nonetheless, the big winner among the provinces would be Alberta, whose current pipeline system will need to be expanded to accommodate the Mackenzie Valley route. More importantly, Alberta’s expertise in the oil and gas industry, highly skilled workforce, and close proximity to the NWT would stand it in particularly good stead. Above all, Mackenzie gas will provide new supplies of feedstock to Alberta’s oilsands and petrochemicals producers, who face declining natural gas reserves in their own province.
Would Mackenzie gas get absorbed by Alberta’s oilsands?

The last point deserves clarification, since there have been questions raised as to whether the new supplies of Mackenzie gas would ultimately be fully consumed by gas-hungry oilsands projects in northeastern Alberta. This view follows from industry estimates of gas demand from oilsands projects, which, at 1.2-1.5 billion cubic feet per day, roughly matches the capacity of the Mackenzie Delta pipeline. Furthermore, the three producers of the pipeline group – Imperial, Shell, and Conoco – each have bitumen projects that are either currently producing or will be brought on line over the next 10 years. For these producers, natural gas from the Mackenzie Delta could either be used as a hedge against higher gas prices or directly in their bitumen operations.

Still, it is a big leap to conclude that natural gas pumping from the Mackenzie Delta will necessarily be fully consumed by oilsands projects in the west. Undeniably, the natural gas from the Mackenzie Delta will serve to increase the amount of supply at the Alberta hub. However, because this increased supply will be available to all purchasers at the market price, it will not be dedicated to one market. All potential users in North America will, hence, compete for the northern natural gas.

Churning out more than just gems and gas

The numbers bandied about above on the economic impacts arising from the MVPL and oil and gas development are certainly impressive. But, even beyond the substantial dose of economic activity that is likely to arise in mining and related goods and services industries, for Northerners, the ultimate payoff could be much bigger – notably, the likelihood that the MPVL will act as a launching pad for the emergence of an array of strategically-important industries. Three examples of such industries include:

- **Hydroelectric power** – already, the prospects for pipeline development are creating considerable excitement in NWT’s electricity industry. More specifically, the need to power the pipeline’s compressor stations is encouraging NWT Power to explore the possibility of building a $500 million, 125-megawatt hydroelectric dam on the Great Bear River. In addition to powering the compressor stations required for the pipeline, the dam could provide communities with inexpensive, renewable power, at less than 20 cents per kilowatt-hour (kwh). The potential of NWT’s power industry is enormous, with preliminary studies showing that NWT has the potential to generate some 10,000 mega-watts of hydro-electric power – more than that of Churchill Falls. And, future projects along the Mackenzie River could use modern run-of-the-river technology that would result in less flooding.

- **Telecommunications services** – Inuvik-based Arctic
Digital Ltd has shown interest in developing a fibre-optic cable line that would be buried alongside the Mackenzie Delta pipeline and extend ultra-high bandwidth to the north. This line, which could be connected to almost a dozen communities in the Mackenzie Valley, would boost bandwidth to 10 gigabits per second, a 5000-fold increase from current capacity levels. The availability of fibre optics would enable northern companies better access to e-commerce and open possibilities for tele-health and distance education that are impossible with existing technology.

- **Tourism** – the increasing attention that is being placed on the NWT could be used as an opportunity to promote the territory’s tourism industry. Although the NWT’s tourism industry has had its success stories – namely attracting Japanese tourists to view the Aurora Borealis – the industry has remained small overall, with only just over 30,000 visitors on an annual basis. The tremendous allure of diamonds, the still-unfettered wilderness, and cultural diversity all offer considerable potential for tourism growth.

**KEY CHALLENGES AND RISKS**

If there is one theme that runs throughout this report, it is the huge potential of natural gas and diamonds to place the NWT on the track to healthy long-term growth. The forces – from favourable conditions in natural gas markets to increased aboriginal participation – all appear to be working in the same direction. Exploration spending in both the diamond and natural gas industries is yielding solid results, and reserve counts are rising.

Still, there are a number of potential impediments lurking on the near-term horizon that will need to be dealt with, especially to turn plans for the MVPL project into reality. The process remains early in the regulatory-approval stage, some concerns as to impact of the development on the environment and wildlife persist, and some land claims issues need to be addressed. Notably, the Deh Cho First Nations – whose traditional lands cover roughly 40 per cent of the pipeline route and who have yet to sign a land claims agreement – have particular concerns about the MVPL’s impact on the environment. And, given that the support of the Deh Cho remains a critical ingredient, the federal and territorial governments will need to work with this group to address these concerns. Even if these roadblocks are cleared, there is no guarantee that natural gas prices will remain high down the road. In fact, there is a good case to be made that as construction of the MVPL, and possibly an Alaskan route, move closer to completion, prices would fall back. And there is always the chance that some other competing sources of natural gas currently in their infancy – such as liquified natural gas and coalbed methane – will become increasingly important to satisfying U.S. energy demand in the future. Notwithstanding these uncertainties, the future appears very bright for conventional natural gas, and accordingly, the momentum appears to be on the side of the development of the MVPL.

Looking further down the road, the most daunting challenge facing policymakers in the region will be to transform what could be a one-time economic growth spurt enduring a decade or two into expansion that will be enjoyed for generations. That will be no easy feat. And, complicating this task will be the economy’s extremely high – and rising – reliance on its resource sector. In fact, based on current trends, output in the resource industries as a share of GDP will rise towards 50 per cent over the next few years. Not that an economy should not take advantage of its strengths – there is a lot to be said for “sticking with one’s knitting”. But, it will be increasingly important to lay the groundwork for other non-mining industries, such as hydroelectric power, telecommunications and tourism, to grow in lockstep in order to reduce the risk of turbulent economic swings that are often a by-product of a heavily resource-based economy. Alberta is a prime example of a jurisdiction that has used its wealth from oil

**RESOURCE-ORIENTATION OF NWT AND CANADA’S ECONOMY**

- **NWT**
- **Canada**

*Source: Statistics Canada, TD Economics*
and gas sector to create a healthy overall business climate. Today a myriad of non-energy industries, such as nanotechnology and biotechnology, flourish in the province.

Regardless, any strategy in the NWT that strives to achieve diversification and long-term economic sustainability will surely hit the wall if the region fails to address a number of more specific impediments. We begin with the territory’s inadequate infrastructure, which is being crushed under the weight of rapid industrial growth.

**Growth weighing on infrastructure**

Although the NWT can boast some areas of strength – it has built up a good network of air transport and marine facilities in place for example – most areas of its infrastructure are substandard. The existing highway network serving the region is greatly underdeveloped, with only one-third of the land area in NWT within 100 kilometres of an all-weather road. Winter roads, which are built annually on frozen terrain, have certainly helped to fill the gap in a cost-efficient way. But, they can result in considerable delays and bottlenecks in higher-activity areas during spring thaw and winter freeze. While there is a case to be made that additional year-round roads are required, it is the general state of the existing road and bridge system – which is battered each year by the elements – that is particularly worrisome. Specifically, many of the gravel roads across the NWT are not only in a state of disrepair, but can be dangerous to drive on.

Transportation infrastructure is not the only area in severe need in the NWT. Sizeable new investments are required in community infrastructure, particularly in areas where the strains from a rapid pace of development are becoming increasingly visible. Housing, education, nursing stations, electric generating capacity, and communications systems are all areas that require attention on the infrastructure front. Even without the pressures from growth, communities in the NWT already must contend with considerably higher incidence of social problems – including violence, drug addiction, and fetal-alcohol syndrome – relative to those witnessed elsewhere in Canada, with inadequate infrastructure in place to address these issues.

**Skilled labour in short supply**

The necessity for businesses to substantially tap markets south of 60 for manpower during the recent development of the two NWT diamond mines highlights a notable challenge that the NWT has faced for decades – a severe lack of skilled workers. An inadequate labour supply places clear limitations on business growth and retention, and goes a long way in explaining why the NWT will probably continue to see a meaningful share of economic benefits from large-scale projects “leak” out of the territory, as jobs, and hence, incomes flow to other regions. In fact, according to the NWT Bureau of Statistics, about 17.5 per cent of total labour income generated in the territory was attributed to non-residents in 2002, representing a loss of roughly $275 million to the NWT economy.10

Undeniably, shortages of skilled labour in the NWT are to a great extent owing to a combination of the territory’s tiny population base, the harsh elements and high cost of living in the north. But, as we pointed out in the text box on page 5, this problem is exacerbated by low rates of

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**ICE ROAD OPERATING SEASONS**

<table>
<thead>
<tr>
<th>Winter Road</th>
<th>Season Start</th>
<th>Season End</th>
<th>Operating Window</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mackenzie</td>
<td>19-Jan</td>
<td>16-Mar</td>
<td>8 weeks</td>
</tr>
<tr>
<td>Inuvik</td>
<td>15-Jan</td>
<td>10-Mar</td>
<td>16 weeks</td>
</tr>
<tr>
<td>Rae Lakes</td>
<td>10-Jan</td>
<td>21-Mar</td>
<td>10 weeks</td>
</tr>
<tr>
<td>Lupin Mine</td>
<td>10-Jan</td>
<td>21-Mar</td>
<td>10 weeks</td>
</tr>
</tbody>
</table>

education attainment among Aboriginals.

Happily, there has been some encouraging news on this front over the past several years. First Nations peoples have begun to turn to the education system in greater numbers – driven by their increasing desire to enter the market or wage economy – while Impact Benefit Agreements with Industry have set the stage for Aboriginal organizations to develop training plans and programs and provide assistance to their members attending post-secondary institutions. However, ongoing barriers will likely prevent a more rapid convergence between the NWT’s Aboriginal and Non-aboriginal populations:

• Despite recent efforts by some employers to offer up more flexible work arrangements, there is the ongoing desire for many Aboriginals to remain close to their communities/families and to carry on with their traditional – and often seasonal – “subsistence” lifestyle.

• Many of the job opportunities in the NWT are occurring in the highly-unionized resource sector, where the stringent requirements for training and certification disqualify a substantial share of Aboriginals. As a result, unions look to other parts of Canada to fill positions in the north.

• The fact that the NWT is virtually devoid of post-secondary institutions (PSE) puts the region at an even further disadvantage, although the only PSE of any note in the territory – Aurora College, with its three campuses in the NWT – provides a wide range of technical diplomas.

What’s more worrisome is that the gap between demand and supply of skilled workers in the north is on track to only get worse over the longer haul, as developments expected to take place over the next several years – including the MVPL and Snap Lake – require substantial numbers of workers with technical skills. And, the squeeze may be especially tight for labour in the oil and gas industry if the development of an Alaska pipeline goes ahead and coincides with that of the MVPL.

Even further out, demographic trends pose another challenge to narrowing the skills deficit. Although the population of the territory is significantly younger than that of Canada as a whole, it too is aging, and workers will be needed to fill the hole left by the region’s retiring baby boomers. Furthermore, as Canada’s population gains are
Devolution

In May 2001, leaders of the NWT Intergovernmental Forum endorsed a Memorandum of Intent (MOI) to begin negotiations on devolution of land and resource management responsibilities, including resource revenue sharing. The Memorandum of Intent sets out the initial objectives, principles, subject matters and process “to guide discussions to establish a formal process on devolution and resource revenue sharing.” The objectives set forth include:

- Obtaining the administration and control of public lands and water and the related jurisdictions and authorities normally held by a province, which are currently held by DIAND’s Development Northern Affairs Program and the National Energy Board.
- Creating an effective, efficient and coordinated resource management regime in the NWT that fosters sustainable development and provides certainty of process and outcome.
- Receiving an adequate net fiscal benefit from resource revenues to provide for the provision of necessary programs and services by the NWT governments and an incentive for continued development.
- Stimulating and advancing the future evolution of government in the NWT, by virtue of reaching and implementing the devolution agreement.

Formal negotiations for developing a devolution framework agreement began in September 2002. A deadline for this first major step of the framework was set for early 2004, with a final agreement being projected for the fall of 2005. The four parties involved in these negotiations are DIAND, the Federal Department of Finance, the Government of the Northwest Territories, and the Aboriginal Summit.

Uncertainty with respect to the future direction of the NWT’s regulatory and tax regime is another. More specifically, current negotiations between the Aboriginal Summit, the territorial government and the federal government aimed at achieving Aboriginal self-government are certainly laudable, but one possible negative implication of a creation of a new tier of government is that it could make the regulatory environment even more complex, at least in the short run. At the same time, business faces some questions marks regarding further land-claims agreements.

Fuelled increasingly by inflows of international migrants in the years ahead – individuals who have traditionally flocked to the five largest metropolitan areas in the nation – the NWT could face even greater downward pressure on its labour force.

Impact on the environment uncertain

Compared with other ecosystems in Canada, the north is believed to be more sensitive to disturbances, and slower to recover. And, while the possible environmental consequences of a project are taken heavily into account during the approval stage, policymakers will continue to grapple with the issue of how a rapid acceleration in the pace of economic development will ultimately impact the north’s environment down the road. Moreover, environmental concerns are broader than merely the effects of development on wildlife and climate. Notably, the longer-term socioeconomic effects in the NWT of rapid growth and increased immigration are also somewhat of a question mark.

Concerns about further red tape add to high cost of doing business

Higher costs of living, attracting skilled labour and acquiring other business inputs are not the only chilly headwinds blowing in the face of northern businesses.
and the outcome of discussions between the NWT and federal governments on devolve resource management authority and a resource revenue-sharing arrangement (see text box on page 19). Add to the list the fact that companies in the NWT – including Aboriginal Development Corporations – lack the experience and financial resources of their southern counterparts, and it is not hard to understand why taking advantage of business opportunities in the north is comparatively more difficult.

On the bright side, corporate and personal tax rates levied in the NWT are lower than in most Canadian jurisdictions, which provides some offset to higher costs experienced in other areas. At 42.0 per cent, the top personal marginal income tax rate in the NWT is roughly 3 percentage points lower than the national average, while there is no territorial sales tax in place. Furthermore, the Northern Residents Deductions provided by the federal government to residents of the north act to further reduce the effective personal tax rate in the territories. On the corporate side, both the general income-tax rate and that for small business are lower than the national average, and the NWT’s royalty regime put in place by the federal government is more favourable than in other Canadian regions.

**Who should fund these costs?**

No two ways about it – the need to combat the challenges of an inadequate physical and social infrastructure will come with a price tag. But, this raises the question: who should ultimately fund these costs, and in particular, the “big-ticket” items on the infrastructure list? Although spending on infrastructure is not the sole domain of the public sector in the NWT – for example, large-scale development projects normally involve private-sector outlays in order to ensure that mine sites are accessible – government is on the hook for a substantial share of the total infrastructure tab. And, with the exception of new highways, which are under federal purview in Canada’s territories, most maintenance and expansion of basic infrastructure currently falls right on the doorstep of the NWT government. At the moment, it remains unclear how the move toward aboriginal self-government in the NWT will play out in terms of future roles and responsibilities. But for now, the focus remains on the NWT government to put in place the capital spending required to support maintenance and expansion of infrastructure.
NWT government has little fiscal flexibility

In short, faced with a small tax base and mounting spending pressures, the NWT government is in a weak position to deal with the sizeable challenges on its plate. After fluctuating between modest surpluses and small deficits in the 1990s, the government has seen its budget balance slip into the red over the past few years. In fact, in fiscal 2003-04, a borrowing requirement of $77 million is projected on the heels of last year’s $37-million shortfall. Moreover, with the government anticipating further red ink through fiscal 2005-06, the territory’s total debt outstanding is expected to climb toward its federally-established debt limit of $300 million over the next few years.

A closer look at the NWT government’s books shows that the recent fiscal squeeze has occurred both on the revenue and spending sides of the ledger. Despite efforts to restrain spending in lower priority areas, high (and rapidly-rising) costs related to industrial growth and core service delivery have sent program expenditures up by roughly 5 per cent per year since fiscal 1999-2000. And, although own-source revenues have been following a healthy upward trend in tandem with the strong economy since the late 1990s, this has been partly offset by a concomitant decline in federal cash transfers, and more specifically, in advances made under the Territorial Formula Financing (TFF). The TFF is a federal program not unlike that of provincial Equalization, which aims to bridge the shortfall in spending needs and fiscal capacity (see page 22).

Own source revenues go up, TFF grants decline

As indicated in the text box, under the current systems of Equalization and TFF, formulas have been underpinned by the notion – and one that has credence – that federal assistance should be pared back as a region’s fiscal capacity increases in order to reduce long-term dependency. At the same time, however, the federal government has accepted the argument that if federal transfers are lowered one-to-one as a region’s own-source take rises, it would act as a disincentive to growth. The need to build in an “economic development incentive” into the TFF prompted the federal government to allow the territories to shelter 20 per cent of own-source revenues from grant reductions, or using a simple rule of thumb, to permit them to keep in the one in every five-cent increase in own-source revenues. Still, even with the positive change in the fiscal arrange-ment, the bottom line is that growth in NWT’s revenue base has been muted as TFF payments have correspondingly fallen.

Complicating matters is the fact that the NWT government has had little administrative flexibility to respond to changing fiscal circumstances. Given that the territory does not control the management of and sale of public lands – at least at the moment until a devolution agreement is reached – government royalties from resource development remain the property of the federal government. And, as was noted above, with little revenue-raising capacity, the authority of the NWT government to borrow is limited to $300 million.

With growth-related pressures only beginning to abound, the NWT government books will feel an even greater squeeze down the road. In fact, in an April 2003 study entitled Resource Development Impacts, the territorial government estimates that the service and infrastructure requirements of a growing economy and population base spurred by resource development could actually leave it $410 million worse off (i.e., after netting out the positive impact on revenues) over the next two decades. The NWT government has estimated that for every dollar of extra revenue earned from energy and mining projects, its costs will rise by $1.04 to meet the increasing demand for infrastructure and other services.

Feds are already major contributors to the north...

All of this is not to say that the federal government has failed to recognize the special needs of the territories – it is quite the contrary. While the TFF accounts for the bulk of federal transfers to the NWT, the territory is also a beneficiary of roughly $50 million per year in cash and tax
Territorial Formula Financing (TFF)

Since 1985-86, the Territories have received cash transfers from the federal government under a Territorial Formula Financing (TFF) arrangement. The principle behind the Formula Financing Arrangement is similar to that of the provincial equalization program – less well-off jurisdictions should receive funding to allow them to provide “reasonably comparable levels of public services at reasonably comparable levels of taxation.” But, the territories’ unique circumstances and expenditures requirements meant that equalization would not work for them.

Essentially, the formula measures the difference between the territory’s expenditure needs and its revenue-raising capacity, and provides a grant to fill the “fiscal gap”. The expenditure needs are based on a territory’s revenues in a base year. In addition, spending is adjusted for trend growth in provincial-local government spending, since the territories have similar responsibilities as the provinces. Beginning in fiscal 1990-91, a population adjustment was added to the calculation of spending needs.

On the other side, gross “eligible” revenues are estimated in the territories. The first step in computing “eligible” revenues is to calculate what the territories would have collected if their tax rates remained unchanged from levels set in 1992-93 (the current “base year”). Next, this “hypothetical” revenue tally is adjusted depending on the extent to which the territorial governments use the tax room or fiscal capacity available to them (i.e., tax effort). This tax-effort adjustment is the product of two special factors called “catch up” and “keep up”, which are calculated on the same base year (i.e., 1992-93). The “catch up” factor measures the extent to which actual revenues collected in the NWT varied from what would be have been collected if tax rates had been set at the all-province average. The “keep up” factor measures the cumulative change in the tax rates at the provincial-local level for Canada as a whole since 1992-93.

The federal government has made some concessions over the years in formula to compute “eligible” revenues. In 1990, the NWT government objected to the use of tax effort in the formula, in part because it was felt that many of the definitions used in calculating the national-average rates could not be validly applied to the territory given the differences between the NWT economy and its southern neighbours. As a result, the federal government agreed to apply a 15 per cent discount to the “catch-up” factor.

Moreover, given that, under previous Agreements, higher own-source revenues led to a matching drop in formula financing under the TFF, the territories complained that the arrangement acted as a disincentive to economic growth. As a result, in fiscal 1995-96, the federal government introduced a 20 per cent Economic Development Incentive (EDI), which meant that the roughly 20 per cent of own-source revenues in the territories was exempt from a reduction in transfers. This change was made revenue neutral in the first year, as the value of the additional revenues was subtracted from the territories’ expenditure bases.

The federal government pays the difference between expenditure needs, as measured by the formula, and “eligible” revenues. In recent years, this TFF grant to the NWT has amounted to $300-$500 million per year, or just under half of the government’s total budget.

The current TFF agreement comes up for renewal at the end of the current fiscal year. The territorial governments are arguing that the adequacy of the formula must be addressed. In particular, the Northern governments point to a number of federally-imposed budget restraint measures introduced by the federal government over the last decade that they believe have eroded the adequacy of the formula to meet territorial needs, notably a ceiling tied to nominal GDP growth – which has restricted growth in funding – and an arbitrary 5 per cent reduction in the territories’ expenditure bases in 1996. Lastly, the NWT government has argued that Census Canada has undercounted recent population statistics for the territory, dealing a blow to both the calculation of spending needs, and grants, under the TFF.

Source: GNWT, Federal government

capita basis – hardly a boon to a region like the NWT that faces poor economies of scale with a mere 41,800 residents. Still, in spite of this concern, and notwithstanding the drop in TFF transfers recorded over the past few years, the federal government spends substantially more in the NWT than what it receives from the region in terms of

Canada's Northwest Territories

December 3, 2003
up matching funds for the projects.

On the training front, the federal government announced this year its plans to spend $85 million over five years to boost job training for Aboriginals in Canada, with a goal to help 7,000 individuals across the country enter the workforce over the life of the program. This funding is consistent with both the September 2002 Federal Speech From the Throne and subsequent February 2003 budget, which placed high priority on addressing the still-sizeable gap in opportunities between Aboriginal and Non-Aboriginal peoples. In its 2003 budget, the federal government earmarked $80 million in funding over two years to strengthen Aboriginal communities, along with $20 million to support Aboriginal Business.

### Turning over resource royalties a solution

Although the recent federal announcements are certainly good news, the longer-term solution to placing the NWT on a more sustainable path should largely rest on providing the territorial government with access to the billions of dollars in potential resource royalties from resource development in the NWT. In contrast to the situation in the provinces, which lay claim to their resources, the federal government currently sets and retains the full amount of royalties collected from non-renewable sources and all of the fees collected from firms acquiring the right to explore in the NWT. And, while the federal and NWT governments, together with First Nations, have been negotiating a resource sharing formula as part of a broader effort to reach agreement to devolve powers (see text box on page 19), there is little indication that parties are close to resource royalties and corporate income taxes.

Recently, the federal government has further demonstrated that it remains sensitive to the plight of the NWT government in its quest to address urgent needs on the both its infrastructure and job-training fronts. In 2002, the NWT government requested federal financing under the $3 billion federal Strategic Infrastructure Fund over four years to construct Dempster Highway and Reconstruct Highway 3, and 10 permanent bridges. In response, the federal government agreed to ante up $20 million immediately and a further $45 million down the road as construction progresses. And, while this amount fell short of the $130 million initially asked for, the announcement was welcomed by the NWT government, which plans to put

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**Federer and NWT Net Royalty and Tax Projections Form Anticipated Resource Developments (Net Total Revenues After Offset)**

<table>
<thead>
<tr>
<th>Years</th>
<th>Net NWT</th>
<th>Federal FFA Offset</th>
<th>Federal CIT and PIT</th>
<th>Federal Royalties</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>1,000</td>
<td>1,400</td>
<td>1,600</td>
<td>1,800</td>
</tr>
<tr>
<td>2003</td>
<td>1,050</td>
<td>1,450</td>
<td>1,650</td>
<td>1,850</td>
</tr>
<tr>
<td>2004</td>
<td>1,100</td>
<td>1,500</td>
<td>1,700</td>
<td>1,900</td>
</tr>
<tr>
<td>2005</td>
<td>1,150</td>
<td>1,550</td>
<td>1,750</td>
<td>1,950</td>
</tr>
<tr>
<td>2006</td>
<td>1,200</td>
<td>1,600</td>
<td>1,800</td>
<td>2,000</td>
</tr>
<tr>
<td>2007</td>
<td>1,250</td>
<td>1,650</td>
<td>1,850</td>
<td>2,050</td>
</tr>
<tr>
<td>2008</td>
<td>1,300</td>
<td>1,700</td>
<td>1,900</td>
<td>2,100</td>
</tr>
<tr>
<td>2009</td>
<td>1,350</td>
<td>1,750</td>
<td>1,950</td>
<td>2,150</td>
</tr>
<tr>
<td>2010</td>
<td>1,400</td>
<td>1,800</td>
<td>2,000</td>
<td>2,200</td>
</tr>
</tbody>
</table>

Source: NWT government, TD Economics
an agreement. To be sure, these negotiations are complex – it took six years to reach an agreement in the Yukon. However, time is of the essence. The NWT government has explicitly stated that a new deal on revenue sharing and devolution is a pre-condition to allowing the MVPL to commence.

A key objective of devolution for the NWT government – and certainly a complicating factor in the current round of negotiations – is the need for the territory to receive of a fair net fiscal benefit from resource revenues to assist in the provision of necessary programs and services. But, the importance of handing over resource royalties and other powers is about much more than just dollars and cents. It is about giving the NWT the increased autonomy to take command of its own destiny.

The lack of progress to date in striking a deal with the NWT suggests that there is a lot at stake – namely, the massive resource potential of the territory and the related fiscal benefits. Federal royalties from resource development in the NWT are presently about $40 million per year, but they are expected to surge in the years ahead. Based on the current royalty regime, estimates of the combined royalties potentially flowing from the three diamond projects and oil and gas are as high as $6-$13 billion over the next 2-3 decades. In annual terms, that translates into an average of more than $200 million per year.

Not that the NWT and federal government are navigating through unchartered waters – agreements to allocate offshore oil and gas revenues (which fall under federal jurisdiction) have been signed with the energy-producing provinces in the Atlantic, and the Yukon territory and Ottawa reached a comprehensive deal on devolution and revenue sharing. As such, in negotiating a new fiscal arrangement on resources with the NWT, the federal government will need to be mindful of these previous deals pertaining to resource royalties.

The Newfoundland and Nova Scotia Offshore Accords, signed in 1985 and 1986 respectively, turned over the federal power to tax offshore oil and gas to these provinces. The federal government also granted transitional protection from declines in equalization payments, which has been gradually phased out over time. In 1994, the “generic solution” was introduced under the federal-provincial Equalization program. Under this provision – which was made available to Newfoundland and Nova Scotia as well as other provinces in special circumstances – ongoing grant protection of 30 per cent was provided, meaning that a dollar increase in offshore revenues would translate into a 70-cent decline in Equalization. It is important to note that the governments of Newfoundland & Labrador and Nova Scotia are pressing for better deal on sharing of offshore revenues just ahead of the expiry of the five-year Equalization agreement in 2004.

In 2001, the governments of Canada and the Yukon concluded a Devolution Transfer Agreement, which in addition to the transfer of other responsibilities, handed over to the territory access to revenues from the management of land and resources. In order to ensure a “net fiscal benefit” would be enjoyed by the Yukon, the federal government agreed to exempt the first $3 million of resource royalties generated in the territory on minerals, forestry and water from federal formula grant reductions, although revenues in excess of that level are subject to a one-to-one decline in grants. These revenues were in addition to the resource revenue-sharing arrangement that was agreed to under the 1998 Canada-Yukon Oil and Gas Accord. Under that agreement, the first $3 million in oil and gas revenues are exempt, and after that point, grants are cut back by an increasing scale of 60-80 per cent.

**NWT government shooting for more than 20-30%**

For the NWT government, the 30 per cent net fiscal benefit that is currently being guaranteed to Newfoundland & Labrador and Nova Scotia probably represents the floor of any new revenue-sharing deal that it would agree to. But, the territorial government’s wish list almost certainly extends to other areas. For example, the NWT would desire a commitment from the federal government that it cast aside the per-capita formula that is often the basis for determining allocation of federal funds, since much of the cost-pressures are stemming from industrial, rather than population, growth. Moreover, given the time frame to ratify such a deal, the territory could push for a transitional fiscal arrangement, whereby the federal government spend at least 20-30 per cent of the resource royalties on costs flowing from development activity immediately. These demands have all received the support of the NWT Chamber of Commerce.

**Resource royalties no panacea**

Regardless of any new revenue arrangement and pow-
ers under devolution, the bottom line is that the demand for government funds in the NWT will always be greater than the supply of funds available in the kitty. And, the federal government, facing enormous pressures to fund a greater share of provincial health care and education, can only be expected to foot so much of the bill. This means that in order for the territory to tackle its near-term goals – notably putting significant new infrastructure in place before resource royalties begin to flow in earnest at the end of the decade – other measures aimed at enhancing its fiscal flexibility might need to be considered.

**NWT government could look at existing tools**

The NWT could look at using tools currently available to it in order to create increased fiscal room, notably real-locating spending and/or raising tax revenues. However, finding significant savings out of the government’s existing $900 million annual budget would be a very difficult task, in view of growth-related pressures in the territory. That leaves higher taxes as a more viable alternative. But, even there, the government would quickly run up against a barrier. Most importantly, as indicated on page 19, businesses and residents of the NWT are already faced with a high cost of living. And, while tax rates in the NWT compare favourably against the national average, they are relatively high when stacked up against neighbouring Alberta. As a result, there are worries that a hike in taxes could create greater inducements for workers in the NWT to re-side outside the territory (so-called fly-in-fly-out” workers) and businesses to arrange their operations to take advantage of lower levies in other jurisdictions.

If the government chose to go the route of raising taxes, the choice of taxes to raise becomes extremely important. In our view, levying a consumption tax – notably the establishment of a territorial sales tax – would be a better route to go, given that they are less harmful on economic growth than taxes on income and savings. Put more simply, since the burden of a sales tax would be shared by temporary residents of the NWT and tourists, this type of levy would not trigger the same negative responses as an increase in income tax.

**Look at raising the $300 million debt limit**

The use of debt financing is another avenue that the NWT government could use to address some of the near-term challenges. However, as we pointed out earlier, the NWT government is currently constrained by a borrowing limit of $300 million. Even before an agreement is reached on devolution and resource royalties, consideration should be given to raising this limit. 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 huge infrastructure needs.

**Private-sector needs to be engaged**

Above all, given the fact that much of the up-front infrastructure spending that will need to be put in place will ultimately benefit the private sector, it too must do its part. And one good way to bring the private sector into the equation, both in terms of leveraging their deep pockets and

### TAX RATES NWT VERSUS CANADA

As of April 1, 2003

<table>
<thead>
<tr>
<th>Combination</th>
<th>Retail Sales Tax (%)</th>
<th>Fuel Tax</th>
<th>Tobacco Tax</th>
<th>Payroll Tax (%)</th>
<th>Corporate Income Tax</th>
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</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Gas (cents/litre)</td>
<td>Diesel (cents/litre)</td>
<td>Cigarettes ($/carton)</td>
<td>Small (%)</td>
</tr>
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<td>NWT</td>
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<td>10.7</td>
<td>9.1</td>
<td>42.0</td>
<td>1.0</td>
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<tr>
<td>National Average ^</td>
<td>45.75</td>
<td>14.2</td>
<td>14.3</td>
<td>22.4</td>
<td>1.9</td>
</tr>
</tbody>
</table>

* Average of all provincial and territorial rates, weighted by population. * PIT rates in effect for the 2003 taxation year.

** The NWT and Nunavut payroll taxes are levied on employees. For there are exemptions for small business and/or the rates vary all other provinces that levy payroll taxes, depending on size of the payroll.

Source: NWT government, TD Economics
expertise, is through the use of public-private-partnerships (PPP). In fact, the NWT government is already moving in this direction. Currently, public and private sectors are joining forces to build a $60-million bridge – the Deh Cho Bridge – over the Mackenzie River at Fort Providence. The kilometre-long bridge, which is expected to be completed by the summer of 2005, will increase accessibility to Yellowknife and areas north of the Great Slave Lake, which are areas that have been virtually cut off in the past for periods during the spring thaw and winter freeze. In order to compensate the private-sector partners in the project, a bridge toll will be collected, with ownership reverting back to the territorial government in 35 years.

**Conclusion: the time is now**

A combination of plentiful supplies of diamonds and natural gas, favourable market conditions, as well as easing concerns about Aboriginal land claims and the impact of industrial development on the environment has been raising the NWT economy to a new level, sending benefits to residents and southern markets. But, while there appears to be little stopping continued strong growth over the next few years, the territory’s machine will eventually sputter unless a number of barriers are addressed. In particular, an all-out effort is needed to improve the region’s fragile state of infrastructure, reduce the large skills deficit, address outstanding land-claims issues, and ensure that regulation across the levels of government is co-ordinated. A more sustainable fiscal arrangement, including access to resource royalties, more private sector participation in funding infrastructure projects, and a greater ability to borrow, represent three vital means to accomplishing these end goals.

The benefits that will likely flow from successful development of the North are likely to be shared on both sides of the 60th parallel, and across public and private sectors. It only makes sense then that all parties should share some in some of the up-front costs required to turn this vision into reality.

*Derek Burleton, Senior Economist*  
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ENDNOTES


2. The National Energy Program (NEP) was implemented by the Trudeau government in 1980 to encourage self-sufficiency in energy. Given that it viewed the far north as essential for asserting sovereignty, companies who explored there were entitled to write off more than 100 per cent of their exploration costs. While a positive development for activity in NWT’s Mackenzie-Beaufort region, these incentives actually dampened activity in the southern parts of the territory.


4. List provided by the department of Resources, Wildlife and Economic Development of the NWT government.

5. In fact, at current production rates, the NWT could surpass South Africa for third place in terms of production this year.


8. Ibid.

9. Ibid.


Additional References


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