



VIEWPOINT | RESEARCH

# **CANADA IN CRISIS:** **NEGLECT OF ESSENTIAL FUNDAMENTALS** **AND THE FAILURE OF GOVERNANCE**

***MAC VAN WIELINGEN***



*This following speech was delivered by Mac Van Wielingen as a Keynote address at the CAPP Investor Symposium on April 8, 2020.*

## INTRODUCTION

- The greatest opportunity Canada has in our current health and economic collapse is to grasp the necessity for a reset of our national priorities. Canada was already in a crisis prior to the current collapse. It is just that it was slow-moving, and the consequences were difficult to see at any point in time. *But the cumulative impact is now clear. When we look back to 2014, over the last approximately six years, the negative consequences of our national priorities, policies, and our politics are staggering.*
- The opportunity coming out of the pandemic and economic collapse is to place our country on a different trajectory. In recent years we have been particularly focused on environmental priorities, most notably to reduce emissions in line with our United Nations Paris Accord commitment. I want to say very clearly, in my opinion, our environmental aspirations and standards, and our environmental track record, is fundamentally not the problem.
- The problem is the rigidity of focus on this priority at the expense of other essential priorities. There has been a relative neglect – a lack of understanding – and a willingness to compromise other critical economic, social, and governance priorities in Canada. The problem has been the rigidity of focus on environmental goals, combined with the intense politicization of these goals, and political advantage seeking within regionalized electoral polarization. This explains a large part of recent years' underperformance and dysfunction.

## ECONOMIC FUNDAMENTALS

There is ample data from many reliable sources that portray a grim picture of Canada's investment performance, competitiveness, and productivity over recent years.

- Since 2014, growth in GDP per capita was the worst of all G7 countries and less than half that of the United States (US) (4% versus 8.7%).<sup>1</sup>
- Business investment is about 20% below peak levels of 2014. Although the resource extraction sector accounts for much of this, the majority of other sectors remain below 2014 levels.<sup>2</sup>
- The stock of inward foreign investment in Canada has grown at half the global rate since 2015 (10% versus 21% globally).<sup>3</sup>
- The World Bank places Canada 20<sup>th</sup> on the 2018 Logistics Performance Index, which ranks countries on certain key dimensions of trade, including transport infrastructure and logistics service. Germany ranks first and the US 14<sup>th</sup>.<sup>4</sup>
- 2019 per-worker investment ranks Canada 15<sup>th</sup> among the 17 OECD countries. In Switzerland, businesses invest twice as much per worker as Canadian businesses. This is critical to competitiveness and higher productivity.<sup>5</sup>
- Canada's productivity has significantly lagged that of the US, our main customer and competitor. In 2018, Canada generated US\$55.00 GDP per hour of labour compared to US\$76.50 in the US.<sup>6</sup>
- A 2017 survey of 60 of Canada's largest businesses foreshadowed our declining performance; "a third said the investment climate had deteriorated over the past five years, [and] only 2 percent said it had improved."<sup>7</sup>
- Returns on equities in Canada (including dividends) have been horribly inferior to global and US returns. Over the past 10 years, cumulative returns on global equities have been more than three times Canada's and returns on US equities have been almost six times greater than in Canada.
- The last five years have been worse. Total cumulative returns on Canadian companies in Canadian markets has been 4.5%. Global equities generated a total cumulative return over this time frame of 32.5%, over seven times that of Canada. So, this isn't just a Canada versus Trump story. *Canadian returns on Canadian companies in Canadian financial markets have not come close to global returns.*
- Compared to the US over the past five years, our equity market returns have been abysmal. Our cumulative 4.5% compares to 55% in the US, which is more than 12 times greater than Canada. *As a Canadian, if you were fortunate enough to accumulate savings, the last thing you should have done is to invest in Canadian companies on Canadian stock exchanges.*

- Underneath this data is another disturbing reality. We used to be a recognized global leader in responsible resource development. We are a small population, but we are highly educated. We have world-class technical skills and we have vast resources. The development of these resources under our environmental and governance oversight was our natural advantage. This advantage is now gone. Most of our leading resource companies in Canada are literally gone.
- We count 15 major companies that have shifted their focus to the US/elsewhere or have exited Canada since 2014. This is partly because of market reasons, but I know for a fact, that most left because of hostile policy ... and hostile politics. They did not feel welcome in Canada and they did not feel that they were stewarding their investor's capital well by investing in Canada.

**My general point is this.** We were in a slow-moving crisis of investment, competitiveness, and economic underperformance before the pandemic related collapse. *Now we have gone right over the edge.*

## SOCIAL FUNDAMENTALS

We have also been in a crisis of social distress over this same time period (since 2014). This distress was within Western Canada and particularly Alberta.

*But does it matter what part of the country job losses occur in? Do jobs in one part of the country have more value than in another part? If our energy producing region straddled Ontario and Quebec, would energy policy in Canada look different?*

I ask this question in Ottawa all the time. It is kind of superficial and it is confronting, but it gets the point across. Of course, energy policy would look vastly different. I have never met anybody who argues differently.

The data on social conditions in Alberta for the 2014 to 2019 period displays a disturbing picture. We all need to see this clearly. This is prior to the horrendous impact of the pandemic and oil price collapse.

- The number of unemployed not covered by employment insurance has risen 53 percent;
- Unemployment among young men is up 156%;
- Food bank usage is up 80 percent;
- Suicide hotline calls have increased by 85 percent;
- The number of individuals seeking counselling support in Calgary has increased 46 percent;
- Incidents of domestic violence in Calgary have increased by 150 percent;
- Non-violent crime is up 34 percent;
- Business insolvencies have increased by 58 percent; and
- Consumer bankruptcies are up 101 percent.<sup>8</sup>

There is no question market forces were a significant factor in the 2014 - 2019 downturn and stagnation. But, there is also no question that adverse energy and resource development policy was a significant part of the story. The current pandemic-caused devastation is now being layered on top of an already dire situation.

## GOVERNANCE FUNDAMENTALS

Underlying our economic underperformance and the distress in Western Canada is cumulative regulatory and governance dysfunction, with now highly visible adverse consequences.

Governance is about both effectiveness and fairness, or what I think of as effectiveness and integrity.

Regulatory burden is a problem in effectiveness and inhibits efficient functioning. This is a problem throughout all of Canada.

- According to the 2020 World Bank Ease of Doing Business Index, Canada ranks 30<sup>th</sup> out of 34 OECD countries in the time to get a permit for a construction project.<sup>9</sup>
- The Business Council of Canada, representing more than 150 major corporations, cites “inefficient regulation as the single greatest obstacle of competitiveness and economic growth.”<sup>10</sup>
- Regulatory burden and impediments include barriers to interprovincial trade. This is another factor that is constraining productivity.
- Regulatory effectiveness (or ineffectiveness) has played a significant role in the cancellation or withdrawal of over \$200 billion worth of major energy and resource development projects since 2014.<sup>11</sup> There is no question that market conditions were involved in many cases, but most companies also cited regulatory complexity, delay, inefficiency, and uncertainty, often compounded by obstructionism and intensely politicized in-fighting.
- In connection to Bill C-69 enacted in 2019, the opinion of virtually all expert witnesses in official Senate Committee hearings was that the problems of uncertainty, obstructionism, and politicized decision making were only going to get worse under this new legislation, not better.
- The extremism and lack of logic in Bill C-48, the tanker moratorium bill, was also an extraordinary affront to corporate and private investors. Northern Gateway had been approved by one government, but after a new government was elected, it rejected this approval, and slammed a tanker moratorium in its place. One major international investor said to me in response to the whipsaw of the Northern Gateway approval, “*Canada has become a sovereign risk.*”

The de facto rejection of Energy East was also a travesty. We would rather pay the full, world price for supplies from less reliable sources, than use our own supply, which is arguably the most reliable in the world.

These two pieces of legislation (Bill C-69 and C-48), and the Northern Gateway and Energy East decisions, demonstrated a lack of coherent strategic understanding. We were forcing ourselves to be more reliant on one customer and one part of the customer’s market (Midwest refineries).

These, and other related decisions, can be seen as strategic blunders in governance effectiveness (I certainly saw them this way!). ***They took investor confidence in Canada to a new low.***

But this is not just about investor confidence.

Canadians – the public – are losing confidence in our country’s ability to function. The recent rail blockades and lawlessness perpetrated by a small group of eco-activists was a wakeup call for many Canadians. This added to concerns about our functionality as a nation. In a recent DART & Maru/Blue poll, two-thirds agreed with the statement, “Canada is broken.”<sup>12</sup>

In considering governance integrity, most of us would appreciate that there is a governance problem when a governing body has the responsibility to oversee and attend to the interests of others, but then neglects these interests, or worse, acts with hostility towards those with these interests. Expressed from the perspective of investors, I have heard countless times some version of the following: “Western Canadian resource companies have a unique structural risk; they are not adequately represented in national policy and decision making.”

*Aside from our individual views of all these dynamics, I would contend that the most serious red flag of governance failure in Canada is the emergence of deep alienation within the West and what can reasonably be seen as a national unity crisis.*

A large proportion of the 7.5 million people in the energy producing region of the West no longer trust that their interests are fully considered as part of the national interest in Canada.

The opportunity – the necessity – is to reset our priorities, get really pragmatic and grounded, and make a significant course correction.

*We need to maintain our commitment to environmental priorities but in a more pragmatic and strategic context.*

## ENVIRONMENTAL FUNDAMENTALS

We are far from perfect on the environmental side, but our progress has gone largely unrecognized. Emissions on legacy oil sands production have declined significantly, and new projects are now being developed at lower emissions per barrel than the average in US and world markets.

- Emissions intensity of Canada’s oil sands is down 28% since 2000, and producers are committed to further reducing emissions by an additional 20% - 30% through to 2030.<sup>13</sup>
- Emission levels from new projects are close to, or below, the average level of refined US crude oil.
- A group of major companies representing about half of Canada’s oil production have committed to a long-term net zero carbon strategy.

## KEY POLICY QUESTIONS

If our focus is to reduce global emissions, and we can bring on new supply that has less emissions than the average in a particular market, ***how do we justify restricting our own volumes?***

It is the same argument for LNG. If we know that our LNG is probably the greenest in the world, and that our LNG would replace high emission intensity coal, ***how do we justify saying no to our own developers?***

***How do we justify giving up the investment activity, the jobs, and the tax base needed to fund our own social needs?***

***How do we justify ceding the market to other suppliers in jurisdictions that have far inferior environmental, social, and governance standards?***

Do we understand the dynamics in competitive markets?

If we phased out our oil sands and these volumes were replaced by other suppliers of heavy oil, by our calculations, the resulting reduction in emissions would be negligible.

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*Not only are we compromising our own economic, social, and governance standards, looked at from a global perspective, I believe we are also compromising the world's environmental aspirations.*

Japan, although the third largest economy in the world, is considered resource-poor, and in a shift away from nuclear energy, is in the process of building 22 new coal-fired power plants.<sup>14</sup> Why not develop and offer our LNG which would substantially reduce the emissions from those plants?

The only answer I have received to these questions relates to our United Nations Paris Accord commitment, which is currently seriously incomplete, as it fails to adequately deal with trade in energy products. This is incredibly limiting for Canada.

## CANADA'S ESG TRACK RECORD

In addition to improving GHG emission levels, there are numerous other achievements critical to Canada's ESG performance.

As I list these off, ask yourself why our national political leaders will not face outwards to all Canadians and the world and present these facts, extolling the excellence, accomplishments, and ESG performance of our industry.

- Our electricity sector is among the greenest in the world. **80% of our electricity is from non-GHG emitting sources**,<sup>15</sup> which is approximately **twice the 40% average for OECD countries**.<sup>16</sup>
- Canada is the **second largest producer of (non GHG emitting) hydro-electric power in the world** (after China).<sup>17</sup> This is a significant advantage in a world driving for reduced carbon.
- Canada was **the first country in the world to commit to national methane emission regulations**, and we are recognized as a **world leader in methane reductions from flaring and venting**.<sup>18</sup> Methane reduction regulations are a critical competitive differentiator for our natural gas sector and support the build-out of LNG.
- A 2018 independent scientific assessment by the Puget Sound Clean Air Agency recommended that a new Tacoma LNG facility in Washington State be supplied by Canadian natural gas. Based on a full life-cycle analysis, the agency concluded that US gas supply releases five to eight times more methane<sup>19</sup> than Alberta or BC gas, and as such, **the LNG facility should only be approved on the basis that its gas supply has to come exclusively from BC and Alberta**.<sup>20</sup>
- Canada is a **world leader in carbon capture and storage (CCS)**.<sup>21</sup>
- We have a **proven world-class pipeline transportation system** that is continuously getting safer.<sup>22</sup>
- Canada has proven world-class marine safety along the world's longest coastline. There are **20,000 tanker movements per year**,<sup>23</sup> and we have had no significant accidents or spills. The Trans Mountain terminal has loaded marine vessels since 1956 without a single spill from tanker operations.<sup>24</sup>
- Our **worker safety standards and outcomes are exemplary**.<sup>25</sup>
- Our industry is **the largest employer of Indigenous people**,<sup>26</sup> and new participation structures are evolving (or were evolving) that would allow these communities to participate as partners.
- We are among **the best in corporate governance in the world**. Virtually all global reports and independent rankings confirm this.



## CONCLUSION

We've now been through about six years of difficult markets and what at times, has seemed like interminable, sometimes hellish, hostility and resistance to our industry. ***It's one thing to make adjustments to bad markets or competition, lower prices etc., but it's another when hostility towards your interests comes from within your own country.***

What is different now amidst the global pandemic, is that Canadians are going to see and experience extremely difficult conditions in all respects within Canada, including sky-rocketing national and provincial deficits.

**It is going to force more realism, more pragmatism and a reordering of our essential priorities.**

While this moment is possibly the darkest ever for our energy sector, let's look out say, three years...

1. There will be a clean-up and consolidation.
2. The importance of our quality, long-life assets will become increasingly recognized. The de-facto absence of natural decline of our oil sands will become incredibly obvious in comparison with, for example, Permian production (which declines at approximately 30 - 40% per year).
3. The reliability and security of our supply will become increasingly valuable given the unpredictability of Saudi Arabia and Russia.
4. Pipeline egress will be sorted out and capacity problems will be largely behind us.
5. Costs will be lower, and we will be even more efficient and competitive.
6. We will continue with our exceptionally high commitment to environmental outcomes and emission reductions. This commitment is a critical, competitive point in capital markets.
7. We will slowly rebuild our contribution to the Canadian economy and the broader funding of social prosperity within Canada.

**The transformational opportunity is to encourage a contextual shift within Canada towards more realism and pragmatism, and a more holistic view of our priorities as a nation.** Our national priorities must be reformed and reshaped; energy policy can then be developed to serve these reformed priorities.

My final comment is that we must embrace a culture of advocacy. *This is not something that we turn on and off as needed.* We must hold the view that it is needed all the time.

The opportunity we have now is that Canadians will be much more receptive to the other essential priorities in Canada: to our economic conditions and issues of competitiveness; to our social needs and the risk of creating or amplifying distress relating to policy and politics; and to the representation of legitimate interests within all regions of Canada.

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