

Tea Leaf

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Northern Neighbor

Written by Jeff Thredgold, CSP, President, Thredgold Economic Associates

Canada has come a long way in terms of economic performance in recent years. It is the only member of the Group of Seven nations (Canada, France, Germany, Italy, Japan, the U.K., and the U.S.) to be running a budget surplus. It is also, by definition, the only Group of Seven member to actually be paying down some significant portion of its national debt.

In Balance

Canadian political leadership learned some valuable lessons in recent decades, with positive results now evident. When faced with budget deficits in, for example, the 1980s through the mid-1990s, the classic Canadian response was to raise taxes to cover the shortfall.

You can raise taxes “from Hell to breakfast”...with little likelihood of balancing a budget. The Canadians finally realized that the cure for budget deficits was to constrain the growth in spending.

The most recent Canadian forecast projects a balanced budget for the ninth consecutive year. The budget proposal also recommends modest reductions to various personal and corporate tax rates, a recognition that lower tax rates are a key to ongoing economic strength. A recommended cut in the Goods and Services Tax (akin to a national sales tax) is also planned.

Canadian economic growth in recent years has been nearly on par with that of the U.S. At the same time, the Canadian unemployment rate dropped to 6.1% in May...high by American standards...but the lowest Canadian unemployment rate in 31 years.

Rising Home Values

Strong U.S. economic performance during 2004-2006, combined with extremely low mortgage financing rates, led to some of the strongest U.S. home price appreciation on record. A similar result has occurred north of the border.

Solid Canadian economic growth has led to a sharp rise in Canadian housing prices. Home values have risen at low

double-digit rates, in line with similar U.S. home price appreciation. Home values have risen most noticeably in Western Canada, where growth has been particularly impressive as a result of high energy and commodity prices.



Headwinds

Solid Canadian growth is likely to continue, led by strength in consumer spending. However, the economy faces three powerful headwinds.

The first is a series of monetary tightening moves by the Bank of Canada, the Canadian equivalent of the Federal Reserve in the U.S. The Bank of Canada has raised its key rate seven times since September 2005, with the rate now at a five-year high of 4.25%. Additional tightening moves are likely in order to keep inflation pressures at bay.

The second headwind is high energy costs. While high energy prices have led to a surge in investment and employment in the natural resource sector so critical in Western Provinces, such higher prices are also paid by Canadian consumers.

The third headwind is a strong Canadian dollar, which has risen sharply versus the U.S. dollar in recent years. The Canadian dollar, or “loonie”, has appreciated more than 40% versus the U.S. dollar during the past three years and is at a 28-year high versus its American counterpart.

The result has been significant pain in the Canadian manufacturing sector. Canadian manufactured goods become more expensive in the U.S. and around the world when priced in other currencies. Nearly 200,000 manufacturing jobs have been lost in Canada since the end of 2002, including 120,000 last year alone (*USA TODAY*).

Powerful productivity gains in the sector will help minimize additional job losses in the future.

The strong “loonie” has also led to a sharp decline in the number of Americans vacationing and shopping in Canada over the past 36 months. Canadian resort communities and retailers dependent upon U.S. visitors are suffering.

At the same time, the crossover of Canadian visitors and shoppers to Northern U.S. communities has been robust. Canadian dollar strength now makes American products and services bargain-priced. At the same time, overall tax levies and gasoline prices are lower in the U.S.

Tradeoffs

As with most factors within economic study, there are winners and losers on both sides of most any issue. High energy prices, and the expectation of many that reasonably high prices are likely to continue, have led to an enormous surge in investment into developing the oil-rich tar sands so prevalent in Western Canada.

Good news finds Canada now sitting on what are generally agreed to be the second-largest oil reserves on the planet, exceeded only by those of Saudi Arabia. Good news includes the creation of thousands of high-paying jobs, with a severe shortage of skilled workers already a reality.

Good news also finds that oil production from the sponge-like sands, initially projected to reach one million barrels daily by 2020, has already reached that level. Oil company executives expect to double that output relatively soon, with a tripling of output within 10 years if prices stay high (*The Washington Post*). Such growth in output now finds Canada as the largest supplier of oil to the U.S.

Bad news finds a high environmental toll as a result, with enormous demand within the sector for water and natural gas. A sharp rise in greenhouse gas emissions is also a result. Each barrel of oil ultimately processed requires up to five barrels of water, carves up four tons of earth, and uses enough natural gas to heat a home for one to five days, according to the industry’s own calculations (*The Washington Post*).

I am one who is a strong believer in the power of technology to address problems. New technology to lessen the impact of energy production on the environment is both expected and welcome.

Universal Health Care Pain

All is not well in Canada, however. The much ballyhooed government-funded health care system is extremely expensive, largely broken, and in need of resuscitation.

The 38-year old system is a major frustration to Canadian citizens. Ordinary citizens are subjected to lengthy waiting lists for doctor visits, especially to see any type of specialist.

The Fraser Institute has found that it takes an average of 17.9 weeks between the time a patient makes an appointment to see a general practitioner and when they can then see a specialist (*The Wall Street Journal*). Wealthier citizens routinely cross the border into the U.S. to get more immediate, and in many cases, higher quality health care.

Canada’s Supreme Court threw a wrench into the health care debate in June 2005 when it struck down a Quebec law that banned private health insurance. “Access to a waiting list is not access to health care,” noted the court ruling. “Delays in the public health care system are widespread...in some serious cases, patients die as a result of waiting lists.” (*The Wall Street Journal*).

Desirable company? Canada is the only country in the world besides Cuba and North Korea to ban private sector health care (*Investor’s Business Daily*). Critics of the court decision fear a two-tier system will be created...a private sector system for people with money and the current system for the poor. Proponents of change argue it will improve care via competition and cut wait times for treatment (*The Associated Press*). Canadian doctors and nurses continue to flee the system in droves to practice in the U.S. or elsewhere in the world.

The costs of such a struggling program? The Manhattan Institute calculates that a Canadian earning \$35,000 annually pays a stunning \$7,350 in health care taxes. As satirist P.J. O’Rourke once noted, “If you think health care is expensive now, wait until you see what it costs when it’s free.”

“TEA”sers

The Way It Is...

- Refrigerated items, used daily, will gravitate toward the back of the refrigerator
- The chances of a piece of bread falling with the grape jelly side down is directly proportional to the cost of the carpet
- Leakproof thermoses...will



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