



January 11, 2008

L.R. Wilson, Chair
The Competition Policy Review Panel
280 Albert Street, 10th Floor
Ottawa, Ontario
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Dear Mr. Wilson,

The Atlantic Provinces Economic Council (APEC) is an independent policy research organization dedicated to the economic progress of Atlantic Canada. APEC is a trusted source of analysis and advice on current and emerging trends in Atlantic economy, and our programs reach a broadly-based membership in business and other sectors across the four Atlantic provinces.

Improving productivity performance and closing the prosperity gap with the US has been a focus of Canadian economic policy since at least the mid 1990's. While progress has been achieved in many areas, not all regions of Canada have shared in this success. Within Atlantic Canada, Newfoundland and Labrador has substantially improved its output performance over the past ten years largely based on the successful exploitation of its offshore oil reserves, with substantial investment by foreign multinational companies. The same trend has not been evident in the three Maritime provinces, all of which experienced deterioration in terms of output and labour productivity performance relative to Canada during this period. Although many factors have contributed to these variations in regional economic performance, our analysis suggests that Atlantic Canada may face an increasingly difficult task in attracting or retaining foreign direct investment, and that this could hurt the future economic prospects of the Atlantic region.

APEC is currently studying the role of foreign direct investment in Atlantic Canada, under the auspices of our newest initiative, the APEC Forum on Competitiveness and we released an earlier report on this topic in 2005. In this submission, I am profiling some of our new analysis, based on a survey of foreign firms which was undertaken in 2006. I anticipate this will be of interest to the Committee as it provides a unique source of analysis about Atlantic Canada. A full report is due to be released mid-2008.

Foreign Direct Investment in Atlantic Canada

Foreign firms account for a substantial portion of current economic activity in the Atlantic region in terms of output, employment and investment. An APEC study determined that in 2002, foreign firms in Atlantic Canada employed an estimated 53,700, equivalent to about 8.2% of all employees in the region's business sector.¹ Foreign firms are particularly important employers in the oil and gas sector, call centres and manufacturing.²

Over the past decade, foreign firms have been the key drivers behind investment and expansion in growth sectors such as offshore energy and call centres. Foreign firms in Atlantic Canada spent an estimated \$2.9 billion per year on capital investment during 2001-04, equivalent to about 35% of total business sector investment in the region.³ About 60% of this foreign investment was in the mining and offshore oil and gas industry, although this share rises to over 85% in Newfoundland and Labrador. There have been substantial benefits to the region from these investments: royalties alone from East Coast offshore energy projects are expected to total about \$2 billion in 2007/08.

Foreign capital investment has also been significant outside the offshore oil and gas sector. Foreign firms accounted for an estimated 47% of capital investment in Atlantic Canada's manufacturing sector between 2000 and 2004. These figures reflect the capital intensive nature of some of the larger foreign manufacturing operations in the region.

The number of foreign firms investing in the Atlantic region increased rapidly during the 1990s, peaking in 1999, but has since then declined.⁴ This pattern largely mirrors world trends in flows of foreign direct investment at least until 2003. Global flows of foreign direct investment have increased rapidly since 2003;⁵ but according to APEC's *Database of Foreign Firms* the number of foreign firms entering the Atlantic region has continued to decline.⁶ When combined with a number of disinvestments by foreign firms in Atlantic Canada since 2005 (notably plant closures in transportation and forestry), these indicate serious concerns about the continued attractiveness of the Atlantic region to foreign investors.

¹ APEC (2003). *A Profile of Foreign Firms in Atlantic Canada*. APEC: Halifax.

² Ibid. More recent analysis by APEC suggests that foreign firms account for 33% of the region's international exports of goods and services.

³ APEC (2005), *Attracting the Big Bucks: Foreign Investment in Atlantic Canada*. Halifax: APEC.

⁴ APEC (2003).

⁵ UNCTAD (2007). *World Investment Report 2007*. United Nations: New York.

⁶ The *Database* was last updated in the first quarter of 2006.

Factors Influencing the Investment Decisions of Foreign Firms

Foreign firms invest in the Atlantic region for different reasons depending upon the nature of their operations. According to the 2006 APEC survey of foreign firms, the two dominant factors that have drawn export-oriented foreign firms to the Atlantic region are the availability of a skilled labour force, and low wage and other operating costs. For manufacturers focused on international markets, transportation access is also a key consideration. Most export-oriented foreign firms place government incentives as a secondary consideration, with one important exception. Financial incentives are an important factor in attracting call centres to the region.

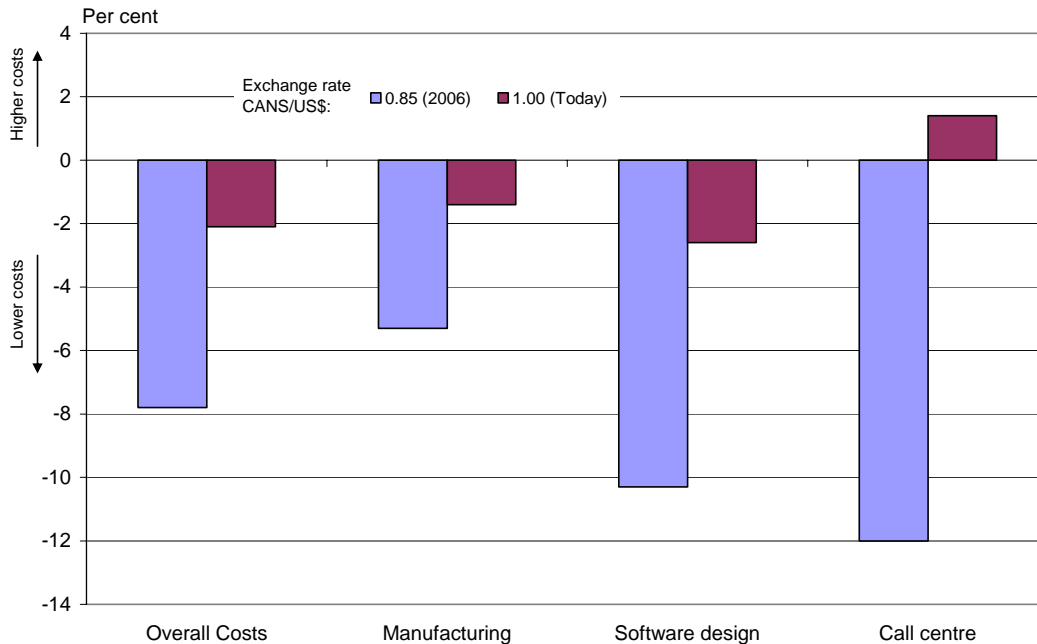
Can Atlantic Canada continue to offer the advantages which have attracted foreign firms in the past? An adequate supply of skilled labour is now a concern of both domestic and foreign firms.⁷ Unemployment rates have fallen across Atlantic Canada since the early 1990s and a shortage of workers is now evident in many areas. Demographic projections for the Atlantic region indicate that there will be little net population growth over the next decade while the aging of the workforce will lower the overall labour force participation rate. It is therefore highly likely that the aggregate size of the labour force in the Atlantic provinces will begin to decline during the next five years.

The Atlantic region's competitive edge in terms of low operating costs may also be difficult to maintain. Almost half of the world's greenfield investments are now in developing or transition economies. China, India, Vietnam, Indonesia, Romania, Bulgaria, and Ukraine have all seen significant increases in the number of these investments since 2002. These countries can typically offer much lower wage and operating costs than the Atlantic region.

The 56% appreciation of the Canadian dollar against the US dollar since 2003 has eroded the cost advantage of the Atlantic region, particularly for call centres, professional services and forestry firms exclusively focused on exporting to the U.S. market. As one call centre respondent noted in APEC's 2006 Survey of Foreign Firms: "the exchange rate has impacted our competitive advantage for U.S. business - it is no longer favourable." According to KPMG's bi-annual analysis of international business costs, the further 15% appreciation of the Canadian dollar since the 2006 study effectively wipes out the cost advantage of the Atlantic region relative to the United States (see chart).

⁷ APEC (2007), "Where Have All the New Workers Gone? Why Atlantic Canada's Labour Force Has Stopped Growing and What We Can Do About It" *Commentary*, 5 January.

Business Costs in Halifax Relative to the United States, Selected Industries



Source: KPMG *Competitive Alternatives* 2006.

In addition, the ‘thickening’ of the border due to tighter U.S. security requirements since 2001 may deter some manufacturers from using Canada as an export base for the United States.

Competitiveness of Atlantic Canada’s Business Climate

Foreign firms, whether they establish a new operation in the Atlantic provinces or acquire an existing operation, are uniquely positioned to assess the relative strengths and weaknesses of the business climate in Atlantic Canada because they operate in multiple jurisdictions across the globe. Their response to the APEC Survey of Foreign Firms reveals that on many indicators, Atlantic Canada’s business climate is not ranked significantly out of line with other locations. Between 50% and 75% of the respondents to our Survey indicated that Atlantic Canada was “average” on key components which determine the business climate such access to marine transportation, overall operating costs and labour force skills, and better than average on factors such as economic and political stability and unit labour costs.

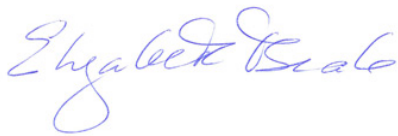
But on many other factors, Atlantic Canada’s business climate ranks poorly compared to other jurisdictions. For export-orientated businesses, the region is perceived to be much further away from major markets than comparable jurisdictions, implying higher transportation costs and longer delivery times. The region’s road and air transportation linkages are perceived to be significant weaknesses with poor road quality, border issues and lack of air access specific concerns. Foreign firms clearly view the regulatory environment in the Atlantic region as less favourable than comparable jurisdictions, citing concerns with regulatory overlap, duplication, lengthy time for approval and lack of transparency as key concerns. These are clearly issues which the

provinces and federal governments need to address, individually and collectively, if they want to improve the business climate to attract future foreign investment.

In closing, I hope that these observations will provide useful input to the Committee. I would like to add the comment that I am pleased to see a broad set of issues identified for review under the mandate of this committee. Canada's success as a destination for "talent, capital and innovation" will rest on our ability to maintain a dynamic economy, one that is committed to achieving social and economic wellbeing.

Further information on APEC's programs, including access to some of the research referenced in this submission, is available on our website at www.apec-econ.ca.

Yours sincerely,



Elizabeth Beale
President and CEO