

Atlantic Canada's Changing Competitiveness for International Investment

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About the Atlantic Provinces Economic Council

The Atlantic Provinces Economic Council (APEC) is an independent think-tank dedicated to economic progress in Atlantic Canada. Founded in 1954 as a partnership between the provincial governments and the private sector, its objective is to promote the economic development of the Atlantic region of Canada. It accomplishes this through analysing current and emerging economic trends and policies; by communicating the results of its analysis and consulting with a wide audience; and by advocating the appropriate public and private sector response.

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Mail: 5121 Sackville Street
Suite 500
Halifax, NS B3J 1K1

Telephone: (902) 422-6516

Fax: (902) 429-6803

E-mail: info@apececon.ca

Homepage: www.apececon.ca

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By David Chaundy

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Executive Summary

Foreign firms have played an important role in Atlantic Canada's economy for many years. There are more than 200 foreign firms currently operating in the Atlantic provinces. These firms can be found in most sectors of Atlantic Canada's economy, from manufacturing to retail and from transportation and wholesale distribution to business and professional services.

The evidence presented in this report indicates that foreign firms in Atlantic Canada provide a substantial net economic benefit to the region. There is therefore a strong economic motivation for continuing to welcome new foreign investors and encourage re-investment by existing foreign firms in the Atlantic region.

Foreign firms have boosted Atlantic Canada's short-term economic and employment growth through the entry of new firms and expansion of existing firms, most notably the growth of offshore oil and gas production and the expansion of call centre activity.

Foreign firms continue to make a sizeable contribution to output, investment, employment and income levels (including offshore royalties) in the Atlantic region, generating an estimated 33% of the region's international exports in 2005 and providing thousands of highly paid jobs.

Foreign firms in Atlantic Canada report positive impacts on the competitiveness of their local competitors and suppliers and, by training employees, on the region's stock of human capital. However, as most foreign firms in Atlantic Canada have not been heavily focused on R&D, and the region has few well-developed industry clusters, the scope for technology and knowledge spillovers to local firms has been limited.

The key message of this report is that the international competitiveness of Atlantic Canada is changing.

In the past, foreign firms have invested in the Atlantic region to access local markets, a skilled labour force, a low cost business environment and

the region's natural resources. But Atlantic Canada's overall relative attractiveness for *new* foreign investment is waning due to: its small and relatively slow-growing local market; its declining relative cost competitiveness reflecting factors such as the appreciation of the Canadian dollar and the emergence of other lower-cost jurisdictions; and its more subdued outlook for labour force growth.

In terms of *existing* foreign firms in the region, many foreign operators are facing significant pressures in terms of weak (or even declining) demand growth and poor cost competitiveness. The closure of several foreign-owned manufacturing plants and call centres in Atlantic Canada in the last few years highlights the huge competitive challenges and adjustments facing foreign (and Canadian) manufacturers and exporters in the region. These challenges partly reflect the region's prior focus on attracting foreign firms on the basis of the region's low costs. But the appreciation of the Canadian dollar and the widespread emergence of other low cost competitors have radically changed Atlantic Canada's relative cost advantages.

So how do governments need to respond to Atlantic Canada's changing competitiveness for international investment to best support the future prosperity of the region? This report does not identify any major issues that are unique to foreign firms. Both foreign and domestic firms would benefit from broad-based government policies to encourage innovation and productivity growth and improve the region's business climate.

Governments and investment agencies need to shift their focus from attraction efforts that emphasize a business case based largely on low costs to attraction and retention strategies that emphasise innovation and unique sources of regional competitive advantage within the global economy. This will likely mean emphasizing fewer job opportunities but jobs that are higher skill and higher paid.

Refocus investment attraction efforts

Attraction strategies need to refocus on the region's current strengths and best potential for future growth. This refocusing of investment attraction efforts may require adoption of sector specific strategies, rather than

broad-based recruitment efforts, so that industry specific location advantages can be identified that are not easily replicated elsewhere.

The region's best prospects for new foreign investment are in exportable services and in the resource (energy and mining) sector. In terms of services, however, the region's traditional focus on low cost labour as a prime advantage needs to shift to focus on higher value services where skill levels and other location factors are relatively more important than operating costs. There may be select opportunities to attract small manufacturing plants (where there is some unique competitive advantage the region can provide for a particular firm) but, in general, the evidence presented in this report indicates that the region has limited prospects to attract new greenfield manufacturing operations. This shift in favour of services, along with the growing importance of a skilled labour supply as a location factor, will require investment agencies to emphasize the stronger labour force potential in or near the region's larger cities. Whether the region can leverage its existing research capabilities to attract R&D intensive foreign operations to boost growth in niche industry clusters is an important opportunity that needs to be explored.

Develop progressive retention strategies

Governments need to investigate opportunities to encourage existing foreign firms, where possible, to redefine their role and develop strategic advantages within their multinational operations that will help ensure their long-term success within the region. This could involve investing in capital, new technology, training, or other productivity improvements to secure production for existing markets or to shift to new, faster growing product markets. These policies could form part of a systematic aftercare program to help secure the broader benefits of foreign investment (such as technology transfer) for the region and to prolong the life of such investment.

Refocus investment incentives

Governments should ensure that any assistance or incentives for either new or existing foreign firms helps to build sustainable competitive advantages rather than simply reduce business costs. This could include encouraging investment in new machinery or equipment, the adoption of

new technology, R&D and technology transfer, or other measures to boost productivity. With labour supply becoming an increasingly important issue for investment attraction, incentives that promote training will facilitate the transfer of knowledge from the foreign firm and enhance the stock of human capital in the region.

Policy priorities: Ensure an adequate labour supply

Securing an adequate supply of skilled labour will be a key challenge in the coming decades and was identified as the top concern by foreign firms in the region. There is no one single measure governments can take to improve the region's labour supply situation. Rather, governments need to take a comprehensive and integrated approach to labour supply development. However, two specific areas are particularly relevant in terms of the labour supply needs of foreign firms. First, young people need to leave school with adequate functional literacy levels. Second, Atlantic Canada must have an informed and responsive education and training system. Governments should ensure that tax-payer supported institutions receive regular input and validation from employers on the quality of their programs and graduates.

Policy priorities: Improve the business climate

While Atlantic Canada needs to shift to attracting higher value operations, which may be less sensitive to small differences in business operating costs, it is important that Atlantic Canada's overall business climate is reasonably competitive. This will make it easier to secure new investment and reduce the likelihood of losing existing investors. With many foreign firms operating in more than one province, governments should take further steps to cooperate on labour supply, tax, regulatory and transportation issues.

New Brunswick is reducing its general corporate income tax rate to 10%, but the other Atlantic provinces should give serious consideration, as their fiscal situation improves, to lowering their corporate income tax towards 10%, to ensure their tax environment remains reasonably competitive with other Canadian provinces.

Governments should continue with broad strategies to reduce the regulatory burden, such as those adopted by Nova Scotia and

Newfoundland and Labrador in recent years. In addition, in light of the competitive pressures discussed in this report, and with a large proportion of foreign firms operating in more than one province, the Atlantic provinces should look for further opportunities to harmonize regulatory regimes across the region. Governments also need to be aware of and responsive to regulatory issues that are unnecessarily hindering the performance of key sectors in the region. Governments could identify such regulatory (or other business climate) issues in follow-up interviews with foreign firms as part of an aftercare program or through other formal mechanisms.

Governments need to ensure the region's strategic highways are maintained at appropriate service levels to minimise delays and vehicle maintenance costs. However, with the service sector playing an increasingly important role in terms of foreign investment in the region, air access is also important. Governments should examine what steps they can take to help facilitate improved service levels between the larger Atlantic airports and major North American and European centres.

With continued potential for foreign investment to help develop Atlantic Canada's offshore, onshore and renewable energy resources, governments need to ensure that they establish and maintain regulatory frameworks that are expedient, upholding environmental and safety standards while minimizing regulatory uncertainty and inefficiency. Similarly, royalty regimes need to be internationally competitive.

While most of the business climate issues raised in this report are not new, the ongoing changes in the global economy, the lower rate of foreign investment observed in Atlantic Canada over the last few years, and the recent closure of foreign facilities in the region, should give added impetus to the importance of strengthening the region's business climate and ensuring that it remains competitive. Atlantic Canada's future prosperity depends upon it remaining open and fully engaged in the global economy.

INTRODUCTION

Foreign firms have played an important role in Atlantic Canada's economy for many years. There are more than 200 foreign firms currently operating in the Atlantic provinces. These firms can be found in most sectors of Atlantic Canada's economy, from manufacturing to retail and from transportation and wholesale distribution to business and professional services. Over the last decade international energy companies have been the key driver in developing offshore oil and gas projects, resulting in billions of dollars of royalties. Numerous foreign firms also set up call centres throughout the region providing thousands of jobs.

The direct employment benefits and tax revenue generated by foreign firms have been an important motivator for local, provincial and federal governments to attract foreign firms to the Atlantic region. Foreign firms can also provide financial resources and expertise not available in the local market, enabling the growth of both new and existing industries.

Furthermore, foreign investment can potentially stimulate productivity gains in the local economy through increased competition and technology transfer. For example, it is estimated that foreign firms directly accounted for about 70% of the productivity growth in Canadian manufacturing in recent decades while foreign firms have a positive spillover impact on the productivity of Canadian plants.¹ Research further indicates that foreign manufacturers make significant contributions to innovation in Canada: Foreign plants are more likely to innovate than their domestic counterparts, are more likely to introduce world-first rather than imitative innovations, and they rely heavily on collaboration both with related firms and non-related firms and local universities.² Foreign firms are also more likely to introduce advanced manufacturing techniques.³

¹ Baldwin, John R. and Gu, Wulong (2005). *Global Links: Multinationals, Foreign Ownership and Productivity growth in Canadian Manufacturing*. Ottawa: Statistics Canada.

² Baldwin, John R. and Hanel, Petr (2000). *Multinationals and the Canadian Innovation Process*. Ottawa: Statistics Canada.

³ Baldwin, John R., Rama, Ed and Sabourin, David (1999). *Growth of Advanced Technology Use in Canadian Manufacturing During the 1990's*. Ottawa: Statistics Canada.

Yet the environment for attracting and retaining foreign investment is changing. Multinational enterprises (MNEs) are reconfiguring their global operations as they develop sophisticated global value chains, relocating production to maximise efficiencies and seeking to exploit local advantages and expertise. Foreign investment is increasingly flowing into developing countries. The services and primary sectors are also capturing an increasing share of foreign investment. In addition, factors such as the substantial appreciation of the Canadian dollar since 2003, along with local issues such as concerns about the availability of skilled labour, raise important questions about the future role of foreign investment in the Atlantic region, and what this will mean for Atlantic Canada's economic performance.

Foreign Firms and Foreign Direct Investment

There are two main indicators used to measure the activity of multinational enterprises.

Foreign direct investment (FDI) refers to financial investment in a company such that the foreign owner has a significant voice in the management of the company, usually taken to mean ownership of at least 10% of the voting equity. FDI includes new flows of debt, equity and domestic profits that are not repatriated to foreign countries. In Canada, there are national data on the value of foreign direct investment (in terms of both annual flows and the total cumulative stock of FDI) but no provincial data are available.

Foreign-controlled firms (hereafter **foreign firms**) refer to firms where foreign investors control at least 50% of the voting equity. Measures of foreign control in an economy, such as statistics on employment in or capital investment by a foreign firm, refer to the whole corporation and not just the portion owned by the foreign investor.⁴ In Canada, there are annual national data on foreign control (in terms of assets and revenues) but no provincial data are provided on a regular basis.

This report focuses on the role and economic impact of foreign firms in Atlantic Canada, largely using primary data collected by APEC.

For further discussion of these definitions and the availability of data see APEC (2002a), *Foreign Investment in Atlantic Canada*. Halifax: APEC.

In recent years, the Atlantic provinces have experienced mixed fortunes in terms of foreign investment. A number of foreign firms in financial, business and professional services have chosen to establish an operation here. Foreign interest in the region's energy sector has grown and foreign investors continue to acquire Atlantic companies. However, several foreign firms have closed large manufacturing plants in the Atlantic

⁴ In practice there may be little difference between the two concepts as most foreign operations in the Atlantic region are 100% owned by the foreign investor.

region and more recently a number of foreign-owned call centres have closed. How can we make sense of these diverging trends? Are they an indicator of things to come? What will these developments mean for Atlantic Canada's economy?

APEC's *Database of Foreign Firms* and *Survey of Foreign Firms*

APEC has compiled a ***Database of Foreign Firms*** operating in Atlantic Canada. The *Database* includes information on all known foreign firms that have operations in the Atlantic provinces. The *Database* was first created in 2002 and was updated in 2006. There were a total of 236 foreign firms in the 2006 *Database*. APEC's *Database* includes information on the name and nationality of the foreign owner, employment in the Atlantic region, industry, and year and mode of entry.

APEC conducted a comprehensive web-based ***Survey of Foreign Firms*** between March and June 2006. Out of the 236 foreign firms in APEC's *Database*, a total of 138 firms completed the survey, representing a response rate of 58%. On all the key parameters the survey respondents are a statistically representative sample of the population *Database*. The survey included questions on the role of the Atlantic operation, sales and markets, degree of local decision-making, reasons for locating in Atlantic Canada, the current business climate in the region, corporate strategies, and constraints on output and investment.

This report provides answers to these questions by drawing upon a survey of foreign firms conducted by APEC. It presents new data on the role of foreign firms in Atlantic Canada's economy and their perceptions of the region's business climate. The report highlights the key challenges facing foreign firms in the Atlantic provinces and their priorities to improve the region's business climate. The report emphasizes Atlantic Canada's changing competitiveness for international investment and discusses how policies must respond to this new reality.

Chapter 1

A Profile of Foreign Firms in Atlantic Canada

Chapter Summary

- Based on data for 2006, call centres account for the largest number of employees among foreign firms in the Atlantic provinces followed by manufacturing and retail. About one in five foreign firms in the Atlantic region are involved in the offshore oil and gas industry.
- The Atlantic operations of foreign firms are generally bigger than local firms and are more likely to be located in the region's largest urban centres.
- The majority of the foreign firms in Atlantic Canada established their operations or acquired their current interests since 1990 with mergers and acquisitions an increasingly important mode of entry.
- The US is the most important foreign investor in the region.

This chapter presents a brief profile of foreign companies in Atlantic Canada as of 2006.

1.1 Industry Distribution

Manufacturers account for the largest number of foreign firms in Atlantic Canada: about 20% of all foreign firms in the region are in manufacturing. Wholesale is the second largest industry, with 17% of foreign firms, followed by professional services at 15% and call centres at 11%. The majority (67%) of the Atlantic operations of foreign firms are in services-producing industries.

About 8% of foreign firms are directly involved in the offshore oil and gas industry, as either major oil companies involved in exploration and production or as contract drilling and support service companies. However, a number of foreign firms in other industries are involved in the offshore oil and gas industry such as wholesalers providing business equipment or supplies and professional service firms providing engineering or geological services. APEC estimates that 20% of the

foreign firms in Atlantic Canada belong to the East Coast offshore energy cluster, defined to include all foreign firms in the oil and gas industry and those deriving 50% or more of their revenues from offshore energy activity.

Table 1.1 – Industry Distribution of Foreign Firms in Atlantic Canada, 2006

Industry	Number of firms	Number of firms (% of total)	Employment (% of total)
Agriculture, forestry, fishing & mining	8	3	4
Oil & gas (extraction & support activities)	18	8	5
Construction & utilities	4	2	1
Manufacturing	47	20	23
Retail trade	10	4	13
Wholesale trade	41	17	4
Transportation & warehousing	19	8	2
Finance, insurance, real estate & leasing	13	6	1
Professional, scientific & technical services	35	15	4
Call centres	27	11	37
Other business services	14	6	6
Goods-producing	77	33	33
Services-producing	159	67	67
All industries	236	100	100

Note: Other business services includes accommodation and food services.

Source: APEC Database of Foreign Firms.

In terms of direct employment, foreign-owned call centres are by far the largest employers with an estimated 37% of total employment by foreign firms in the Atlantic provinces. Manufacturers, led by Nova Scotia giant Michelin, account for 23% of employment in foreign firms. Retailers, led by Walmart, but including firms such as Staples, Home Depot and Future Shop which also have multiple stores across the region, account for an estimated 13% of employment. Firms in the offshore energy cluster account for just over 7% of total employment by foreign firms in Atlantic Canada.

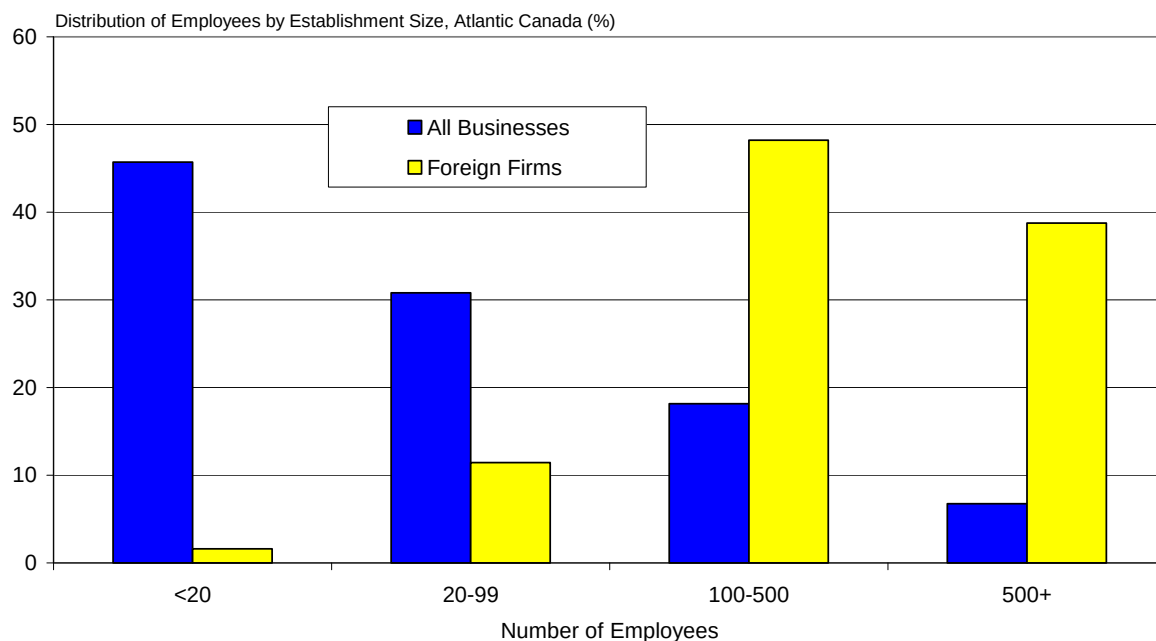
Walmart first established itself in Canada (and the Atlantic region) in 1994 with the acquisition of the 122-store Woolco division of Woolworth Canada. It now operates a network of 319 stores in Canada and employs more than 78,000 Canadians. As of December 2010, Walmart has 40 stores across Atlantic Canada.

1.2 Firm Size

The 236 foreign firms in Atlantic Canada in 2006 operated more than 800 establishments (e.g., plants, offices or outlets) in the region. More than half (53%) of these foreign firms operate only one facility but 8% operate in ten or more locations throughout the Atlantic provinces.

Foreign firms in Atlantic Canada are much larger than their domestic counterparts, with median employment of 60 people.⁵ Almost 40% of the foreign firms in the region employ 100 people or more. Total employment is heavily concentrated among the larger firms. The largest 30 foreign firms account for 71% of total employment among foreign firms.

Fig. 1.1 - Foreign Firms Are Much Larger Than Domestic Firms



Note: All businesses excludes establishments in public administration, health care and education.
Foreign firms include only those firms with one establishment.

Source: Statistics Canada *Labour Force Survey*, *APEC Database of Foreign Firms*.

⁵ Half the foreign firms employ less than the median, half employ more.

1.3 Location

Nova Scotia hosts the largest number of foreign firms in the Atlantic region. About 53% of the foreign firms in Atlantic Canada have their largest establishment (measured by employment) in Nova Scotia. About 24% have their largest Atlantic operation in New Brunswick and 21% in Newfoundland and Labrador. Only 2% of foreign firms have their largest facility in Prince Edward Island.

Table 1.2 – Provincial Distribution of Foreign Firms, 2006

Province	NS	NB	NL	PE
Distribution of foreign firms by location of largest operation	53%	24%	22%	2%
Proportion of foreign firms with at least one operation in the province	68%	43%	43%	9%

Note: Largest operation defined by employment. Totals may not sum due to rounding.
Source: APEC Database of Foreign Firms.

Many foreign firms have operations in more than one Atlantic province.⁶ In total, 68% of foreign firms in Atlantic Canada have at least one operation in Nova Scotia, 43% have at least one operation in New Brunswick or Newfoundland and Labrador, and 9% operate in Prince Edward Island.

Virtual-Agent Services, headquartered in Schaumburg, Illinois, operates customer care services from New Brunswick, Prince Edward Island and Ontario. It opened its first contact centre in Sussex, New Brunswick in 1999 and has since grown to almost 18 centres across the province, as well as 2 in Prince Edward Island. The company's networked facilities provide call centre solutions for industry such as travel and hospitality, telecommunications, retail sales and financial services. As of December 2010, the company employed 846 people in New Brunswick, and 96 in Prince Edward Island.

Urban locations are home to the vast majority of foreign firms with Halifax accounting for the largest share of both firms and employment. However, some of the larger foreign manufacturing plants are located

⁶ About 37% of foreign firms, representing more than half of total employment in foreign firms, have operations in more than one Atlantic province.

outside major urban centres and are often significant employers in these communities.

Table 1.3 – Urban Distribution of Foreign Firms in Atlantic Canada, 2006

Location	Number of Foreign Firms (%)	Foreign Firm Employment (%)	Atlantic Canada Employment (%)	Atlantic Canada Population (%)
Rural	27	43	53	59
Urban	73	57	47	41
<i>Of which:</i>				
Halifax	42	30	19	16
Other cities	31	27	28	25
All locations	100	100	100	100

Note: Urban is defined as Halifax, St. John's, Saint John, Moncton, Fredericton and Charlottetown.

Data on foreign firms based on location of largest operation only (in terms of employment).

Source: APEC Database of Foreign Firms.

1.4 Nationality of Investors

The United States is by far the biggest investor in the region, accounting for almost 60% of the foreign firms in Atlantic Canada. Other leading investors in the Atlantic region, in terms of the number of firms, include the United Kingdom (20 firms), France (14 firms) and Norway (12 firms).

Table 1.4 – Nationality of Foreign Firms in Atlantic Canada, 2006

	Number of foreign firms	Number of foreign firms (%)	Employment in foreign firms (%)
United States	138	59	74.5
European Union	64	27	21
Other Western Europe	22	9	1
Asia	7	3	3
Other	5	2	0.5
Total	236	100	100

Source: APEC Database of Foreign Firms.

The nationality of firms is heavily concentrated in terms of employment, with three countries accounting for almost 90% of Atlantic employment in foreign firms. The United States accounts for 74% of employment followed by France (8%) and the United Kingdom (7%). Atlantic

employment in French-owned companies is dominated by the presence of Michelin.

Regionally, Europe is the second largest source of investment in Atlantic Canada, with the European Union in particular, representing 27% of the firms and 21% of the employment in the region. Only 3% of the foreign firms in the region are from Asia.

1.5 Timing and Mode of Investment

In total, about 72% of the foreign firms present in Atlantic Canada made their initial investment or acquired their regional interests after 1990.⁷

Just over half (52%) of the foreign firms operating in Atlantic Canada established a new or greenfield operation and a further 4% set up a joint venture (see box for definitions and examples). The remaining firms acquired their current operations through a merger or acquisition.

Mode of Entry

There are three main modes of entry for foreign firms to establish operations in the Atlantic region.

A **greenfield** investment refers to a foreign firm building a new manufacturing plant or setting up a new office in the region. For example: Michelin set up two new tire manufacturing plants in Nova Scotia in 1971; Honeywell set up a repair and overhaul facility at Slemmon Park in Prince Edward Island in the early 1990s; and Xerox opened a new call centre in Saint John, New Brunswick in 1995.

In a **joint-venture** a foreign firm may set up a new company with either an existing Atlantic company or with other foreign firms. For example, EM&I Stantec is a joint-venture established in 2000 between Jacques Whitford (which was acquired by Stantec in January 2009) and UK-based EM&I to provide asset integrity management services for the offshore energy industry. The Hibernia, Terra Nova, White Rose and Sable offshore energy projects have been developed as joint ventures between several, generally foreign-owned, multinational energy companies.

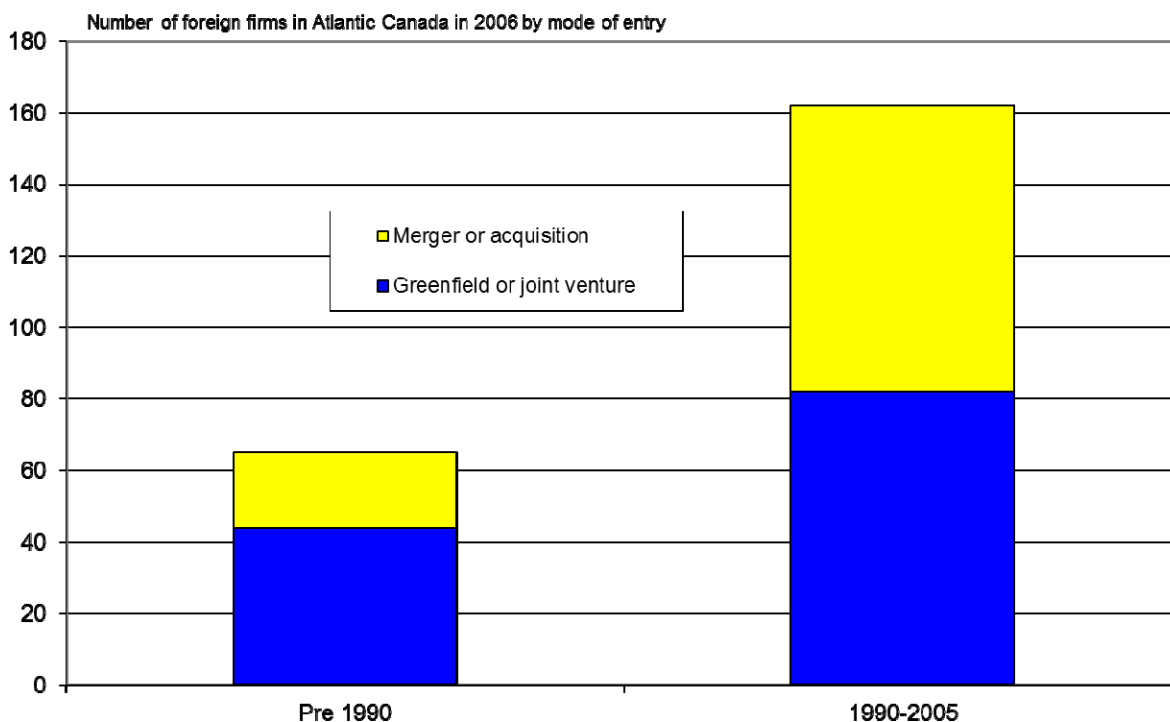
Under a **merger or acquisition**, a foreign firm may acquire either an Atlantic Canadian firm, or a Canadian or multinational firm with operations in Atlantic Canada. For example, in 2007, Houston-based McDermott International acquired Secunda International based in Dartmouth, Nova Scotia. Also in 2007, Brazil-based Vale acquired the Canadian mining company Inco, which operates the Voisey's Bay mine in Labrador.

In line with global trends, mergers and acquisitions have become much more important since 1990. For foreign firms entering the region before 1990, greenfield sites were the dominant mode, representing about 67%

⁷ Some of these firms may have been in operation long before they were taken over by a foreign investor.

of foreign firms. Since 1996, mergers and acquisitions have accounted for just over half (52%) of foreign firms entering the region.

Fig. 1.2 - Acquisitions An Increasingly Important Source of Foreign Investment



Source: APEC Database of Foreign Firms.

For new greenfield operations, there have been several waves of investment in the region's key sectors. The majority of foreign manufacturers established their operations in Atlantic Canada before the 1990s. Since 1990, 87% of the employment generated by foreign firms establishing new (greenfield) operations in the Atlantic region has been in the service sector, a notable shift from earlier patterns. According to APEC's *Database of Foreign Firms* only four foreign firms established new manufacturing operations in the region between 2000 and 2009. One of these is Repsol, which partnered with Irving Oil to construct a liquefied natural gas (LNG) terminal which began operating in 2009.

A large number of foreign firms in the offshore energy cluster set up operations in the Atlantic region in the second half of the 1990s but the number of new entrants has fallen considerably since 2002. There was a significant wave of new foreign firms establishing call centres in the region between 1998 and 2001, but the number of new entrants has

slowed noticeably since then (although some existing foreign firms have expanded into other locations in the region). Several foreign firms that provide professional services entered the region in the late 1990s and have continued to set up operations since 2003. In 2006-2007, there was an influx of new financial firms in Halifax providing administrative services for their hedge funds and other operations.

Chapter 2

The Economic Impact of Foreign Firms in Atlantic Canada

Chapter Summary

- Foreign firms generated almost 10% of the GDP of Atlantic Canada's business sector and about 33% of the region's international exports of goods and services in 2005.
- Foreign firms spent an estimated \$3.1 billion annually on capital investment in the Atlantic provinces during 2007-2009, much of this in the mining and oil and gas industry. Offshore royalties make significant contributions to provincial revenues, most notably in Newfoundland and Labrador.
- Foreign firms report positive impacts on the productivity of local firms but the nature of foreign investment in the region constrains the scope for substantial technology transfer.
- Outside of the energy sector, Atlantic Canada has a relatively small share of foreign capital investment in Canada.

This chapter presents new information on the contribution of foreign firms to Atlantic Canada's economy.

2.1 A Significant Contribution to Output and Exports

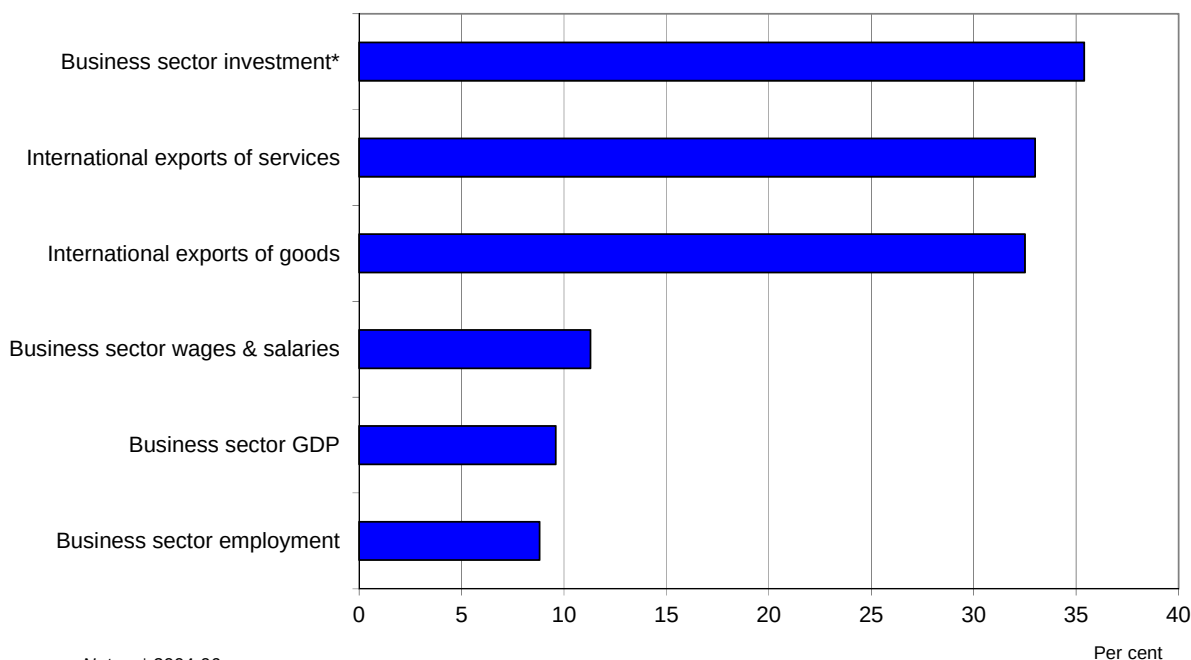
APEC estimates that foreign firms directly contributed over \$5.2 billion to Atlantic Canada's GDP in 2005, equivalent to 9.6% of GDP of the business sector (i.e. all industries excluding public administration, health care and education).⁸ By comparison, foreign firms accounted for about 21% of the assets and 30% of the revenues of corporations in Canada in 2006.⁹ APEC's numbers likely understate the contribution of foreign firms as they are based on the assumption that foreign firms have the same productivity as domestic firms. Foreign manufacturers typically

⁸ Business sector GDP also excludes the imputed rent on home ownership. Foreign firms were estimated to account for about 5.4% of total GDP in Atlantic Canada. The GDP estimates were derived by using foreign firms' share of industry employment as an estimate of their share of industry GDP.

⁹ Statistics Canada (2010). Foreign control in the Canadian economy. *The Daily*, March 8.

have higher productivity than Canadian firms or operate in higher productivity sub-sectors,¹⁰ a finding supported by wage data from APEC's *Survey of Foreign Firms*.

Fig. 2.1 - Foreign Firms' Share of Economic Activity in Atlantic Canada, 2005



Notes: * 2004-06.

Direct economic activity only. Does not include indirect or induced economic impacts.

The business sector is defined as all industries except public administration, health care and education.

Source: APEC.

The importance of foreign firms for Atlantic Canada's economic base is more clearly illustrated by examining their contribution to exports. APEC estimates that foreign firms in the Atlantic provinces derive almost half of their sales from outside the region. These revenues indirectly support local suppliers of transportation, wholesale and business services that are required to produce these exports. The resulting jobs and incomes help sustain local spending on retail sales, recreation and entertainment, housing renovations and motor vehicle maintenance.

Foreign firms account for an estimated 33% of Atlantic Canada's international exports of both goods and services. APEC estimates that foreign firms based in Atlantic Canada generated about \$7.8 billion in international merchandise exports in 2005, representing almost 24% of

¹⁰ Baldwin, John R. and Gellatly, Guy (2007). *Global Links: Multinationals in Canada: An Overview of Research at Statistics Canada*. Ottawa: Statistics Canada.

the region's non-energy merchandise exports and over 40% of its energy exports. By comparison, 45% of Canada's merchandise exports came from foreign-controlled firms in 2002.¹¹ APEC further estimates that foreign-owned call centres and other service firms (in IT and transportation) in the Atlantic region generated over \$800 million in international export revenues in 2005.

2.2 Highly Paid Jobs and Sizeable Offshore Royalties

Foreign firms in Atlantic Canada employ more than 58,000 people, equivalent to almost 9% of all employees in the region's business sector.¹² Several foreign firms are the major employer in their local, often rural, communities, providing significant local incomes. For example, the temporary shutdown of the Port Hawkesbury paper mill in Nova Scotia in 2006 (then owned by Stora Enso) contributed to a loss of more than \$250 million in export revenues, implying a substantial reduction in labour income and revenues for local employees and suppliers.

Economic Impact of Foreign Firms in Atlantic Canada, 2005

- Foreign firms generated almost 10% of Atlantic Canada's business sector GDP.
- Foreign firms in Atlantic Canada accounted for one-third of the region's international exports, with revenues of over \$8.5 billion.
- Foreign firms employed over 58,000 people in the four Atlantic provinces.
- Foreign firms in Atlantic Canada paid average annual wages of \$44,000, about 30% higher than the average for all employees in the region.
- Foreign firms spent \$3.3 billion annually on capital investment in Atlantic Canada between 2004 and 2006, equivalent to one-third of business sector investment.
- Royalties from offshore energy projects (which are majority owned by foreign firms) amounted to \$660 million in fiscal year 2005/2006 and \$2.7 billion in 2008/2009.

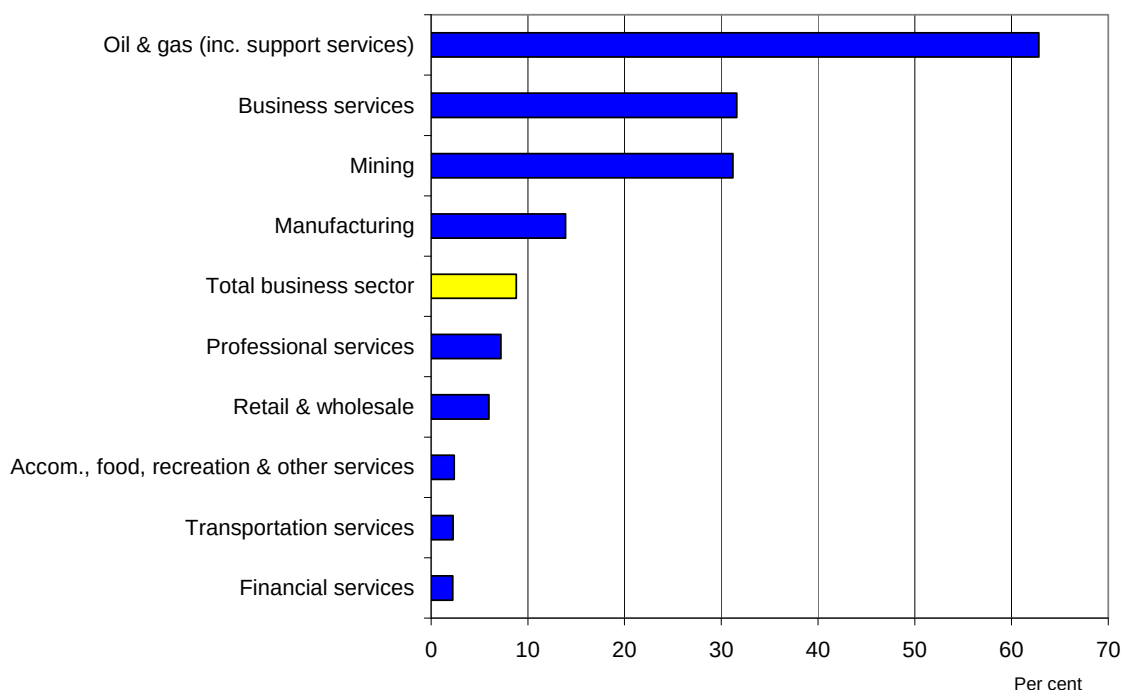
Foreign firms are particularly important employers in Atlantic Canada's mining, oil and gas industries and in business services (which includes call centres). In Canada, the industries with the highest share of assets

¹¹ Byrd, Craig (2005). *Foreign Control of Canada's Merchandise Exports*. Ottawa: Statistics Canada.

¹² Foreign firms account for 8.8% of all employees not working in public administration, health care or education and 5.4% of total employment (including the self-employed) in all industries in Atlantic Canada.

under foreign control are manufacturing, oil and gas, mining and wholesale trade.¹³ Foreign firms accounted for 32% of employment in Canadian manufacturing in 1999, much higher than the estimated 14% share of Atlantic manufacturing in 2005.

Fig. 2.2 - Foreign Firms' Share of Employment by Industry, Atlantic Canada, 2005



Note: Business services includes telephone call centres, telecommunications & information services.

Source: Statistics Canada Labour Force Survey, APEC Database of Foreign Firms.

Jobs with foreign firms in Atlantic Canada tend to be highly paid. In 2005, the average annual wage among foreign firms was \$44,300, compared with \$33,600 for all employees in the region.¹⁴ Data from APEC's *Survey of Foreign Firms* also suggests that, in general, foreign firms operate at the higher end of the value chain within each industry.

Among foreign firms, average wages were very high in professional services and support services for oil and gas while they were much lower in retail and call centres. Average annual wages of \$22,500 in foreign-owned call centres were well below the average wage for all industries in

¹³ Baldwin, John R. and Gellatly, Guy (2005). *Global Links: Long-Term Trends in Foreign Investment and Foreign Control in Canada, 1960 to 2000*. Ottawa: Statistics Canada.

¹⁴ Data on Canadian manufacturing plants indicate that in 1993, after controlling for plant size and age, plants operated by MNEs paid 12% higher wages than domestic plants. Baldwin, John R. and Wulong Gu (2005). Similarly, research from the UK finds that foreign firms pay on average more than domestic firms.

Atlantic Canada. However, some foreign call centres did pay average wages close to the all-industry average.

ExxonMobil headquartered in Irving, Texas, is the world's largest publicly traded international oil and gas company and the world's largest refiner and marketer of petroleum products. The company has a long history of involvement on the East Coast of Canada. ExxonMobil is heavily involved in Newfoundland and Labrador's offshore oil industry. It is the lead owner in the Hibernia field, which produced its first oil in 1997; and it is the second-largest stakeholder in the Terra Nova project, which began production in 2002. ExxonMobil is the lead developer for the Hebron oil field with construction expected to begin in 2012 to produce first oil by 2016 or 2017. The company holds several exploration licences in the Newfoundland and Labrador offshore. ExxonMobil is also the lead operator on the Sable Offshore Energy Project which began producing natural gas offshore Nova Scotia in 1999. In addition, ExxonMobil operates the Imperial Oil refinery in Dartmouth, Nova Scotia, which employs about 200 workers. The refinery began production in 1918 and supplies customers in Atlantic Canada and Eastern Quebec. The company also has a number of Esso gas stations in the region.

Foreign firms pay corporate taxes, pay wages that generate personal income taxes, and pay royalties on offshore oil and gas projects. These projects generated combined royalties for Newfoundland and Labrador and Nova Scotia of almost \$660 million in fiscal year 2005/2006. In 2008/2009 offshore royalties rose to \$450 million in Nova Scotia and \$2.2 billion in Newfoundland and Labrador. Since then offshore royalties in Nova Scotia have declined substantially but are forecast to be \$2.2 billion in Newfoundland and Labrador in 2010/2011.¹⁵

2.3 A Large Source of Capital Investment

Foreign firms in Atlantic Canada spent an estimated \$3.3 billion per year on capital investment during 2004-2006, equivalent to about 35% of total business sector investment in the region.¹⁶ About 45% of this foreign investment was in the mining and offshore oil and gas industry, although this share exceeded 80% in Newfoundland and Labrador.

¹⁵ Offshore royalties amounted to 27% of Newfoundland and Labrador's total revenues in 2008/2009 and a forecast 30% of total revenues in 2010/2011.

¹⁶ APEC calculations from Statistics Canada. *Foreign and Domestic Investment in Canada*. Ottawa: Statistics Canada. Various years.

Foreign capital investment has also been significant outside the offshore energy sector. APEC estimates that foreign firms accounted for 27% of Atlantic Canada's business sector investment outside of the mining, oil and gas industry in 2004-2006. In particular, foreign manufacturers invested about \$300 million annually in Atlantic Canada during 2004-06, about 24% of total capital investment in the region's manufacturing sector.

Nevertheless, outside of the mining, oil and gas industry, capital investment by foreign firms in Atlantic Canada amounted to 4.8% of the national total during 2004-2006, noticeably lower than the region's 5.9% share of capital investment by Canadian-controlled firms.

2.4 Recent Trends in Capital Investment by Foreign Firms

More recent data on capital spending by foreign firms in Atlantic Canada confirm that foreign investment continues to play an important role in Atlantic Canada's economy.¹⁷ Foreign firms spent an average of \$3.1 billion per year on capital investment in Atlantic Canada between 2007 and 2009, and were expected to invest a record \$3.7 billion in 2010, according to Statistics Canada's investment intentions survey. In 2009, foreign firms accounted for 46% of total non-residential investment in Newfoundland and Labrador and about 15% of non-residential capital spending in the three Maritime provinces.

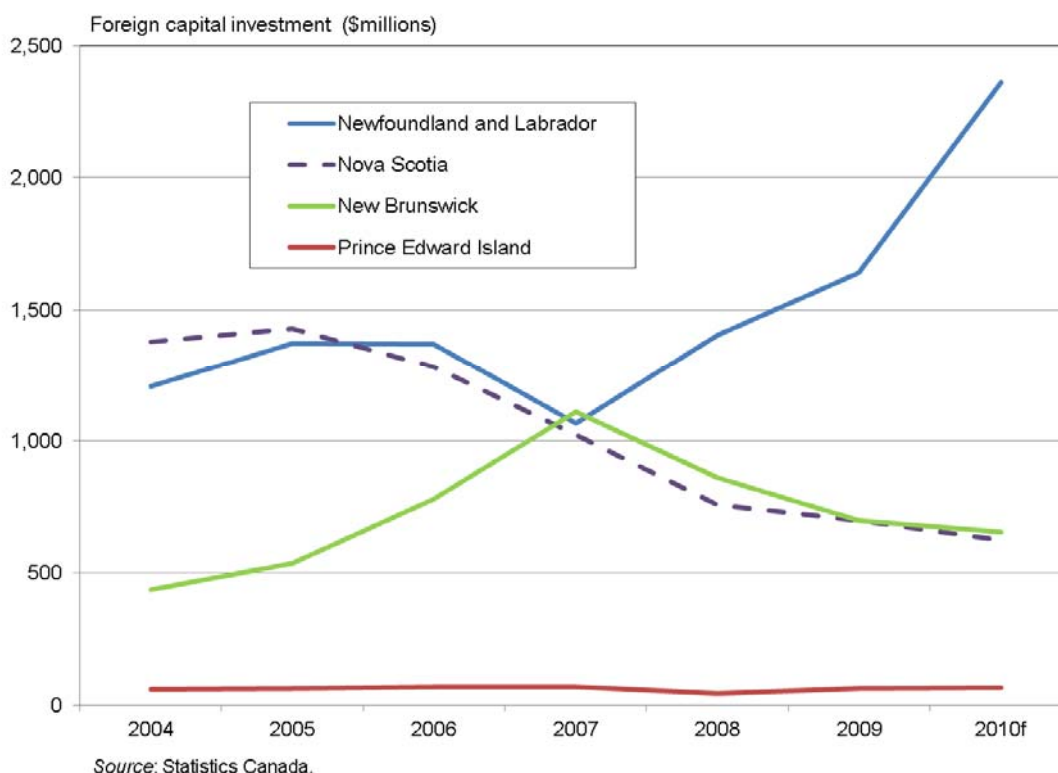
Newfoundland and Labrador is capturing a growing share of foreign investment in the Atlantic region due to the growth of its offshore oil and mining industries. Foreign capital investment in Newfoundland and Labrador has grown from about \$800 million in 2000 to a forecast \$2.4 billion in 2010. Its share of foreign capital investment in Atlantic Canada has similarly increased from an estimated 31% in 2000 to a projected 64% in 2010.

By contrast, foreign capital investment in Nova Scotia has been on a downward trend, declining from \$1.4 billion in 2005 to a forecast \$620

¹⁷ This section is based upon APEC (2011). Recent Trends and the Outlook for Foreign Investment in Atlantic Canada. *Report Card*. 2011 (February).

million in 2010, partly reflecting weakening foreign investment in its offshore energy and manufacturing industries. Foreign capital investment in New Brunswick peaked at more than \$1.1 billion in 2007 during the construction of the Canaport LNG terminal by Repsol and Irving Oil, but was expected to drop to \$660 million in 2010. Foreign capital investment in Prince Edward Island is much smaller, usually in the range of \$60 to \$70 million per year.

Fig. 2.3 - Diverging Trends in Foreign Investment in Atlantic Canada



This divergence in capital investment trends between Newfoundland and Labrador and the three Maritime provinces contributes to their differing performance in attracting foreign capital investment. The Maritime provinces account for a relatively small share of foreign capital investment in Canada, averaging 3.3% between 2007 and 2009, well below their 4.2% share of national GDP. By contrast, due to foreign investment in its offshore energy sector, Newfoundland and Labrador attracts a disproportionate share of foreign capital investment in Canada, averaging 2.7% between 2007 and 2009, well above its 1.8% share of national GDP.

The mining and oil industries accounted for 75% of total foreign capital investment in Newfoundland and Labrador between 2007 and 2009. In Nova Scotia, the offshore industry accounted for 41% of foreign capital investment in 2004, but this share has dwindled with the completion of the compression deck for the Sable platform in 2006, and the lack of any exploratory drilling since then.

Table 2.1 – Key Economic Contribution of Foreign Firms by Selected Industry

Industry	Employment	Investment/ construction	GDP/ Exports	Other Benefits
Oil and gas	+	✓	✓	✓ Royalties
Manufacturing	✓	+	✓	✓ Incomes in rural communities
Retail	✓	+		✓ Consumer choice/prices
Call centres	✓		+	
Wholesale	+			✓ Foreign equipment and services
Professional services	+		+	✓ Highly paid jobs

Source: APEC.

Foreign investment has been an important part of Nova Scotia's manufacturing sector with foreign firms spending about \$210 million annually on capital projects between 2007 and 2008, representing about 40% of total capital investment in that sector.¹⁸ However, capital investment by foreign manufacturers in Nova Scotia fell sharply in 2009 and 2010.

While foreign-owned call centres have been an important source of job growth in the Atlantic provinces in the past decade, capital investment by such firms is relatively modest. Foreign firms providing business services (including call centres) spent about \$18 million annually between 2007 and 2009, or about 17% of total capital investment in this sector in Atlantic Canada.

¹⁸ By contrast, foreign firms accounted for less than 10% of capital investment in New Brunswick's manufacturing industry in 2006 and 2007.

One area where foreign investment has been relatively steady is capital spending by foreign retailers which averaged about \$225 million annually in Atlantic Canada between 2007 and 2009, comprising about 30% of total retail investment in the region.

2.5 Positive Spillover Benefits But Limited Technology Transfer

The extent to which the indirect or spillover benefits of MNE activity manifest themselves at the regional level depends, in part, on the degree of local backward linkages (purchases from local suppliers) and forward linkages (sales to local customers). The degree of backward linkages depends upon many factors including the practices and motivations of the MNE and the capabilities of local suppliers. The degree of local sourcing has been a key concern in the region's offshore energy sector with increased benefits sought as key conditions for approving new developments.¹⁹ The large size and market power of a foreign firm may also create additional risks or costs for small local suppliers, and may unduly influence innovation, education and training programs in a region.²⁰

The degree of local sourcing – the proportion of inputs purchased within the Atlantic region – reported in APEC's *Survey of Foreign Firms* was more than double the 10-20% typically reported for manufacturers in developed countries.²¹ This may partly reflect the importance of Atlantic Canada's mineral, fish, forest and energy resources for foreign firms in the region and the fact that many foreign firms in the service sector will

¹⁹ Government of Newfoundland and Labrador (2007, August 22). *Equity, Improved Royalty Regime and Outstanding Local Benefits Highlights of Memorandum of Understanding for Hebron Development* [Press Release]. And Government of Newfoundland and Labrador (2007, December 17). *Formal Agreement on White Rose Expansion Includes Equity, Benefits and Super Royalty* [Press Release]. About 56% of the ongoing operational expenditures in Newfoundland and Labrador's offshore oil industry occur in the province and about 87-94% of employees were residents of Newfoundland and Labrador at the time of hire. Canada-Newfoundland Offshore Petroleum Board (2010). *Annual Report 2009/10*. St. John's: CNOLPB.

²⁰ UNCTAD (2001). *World Investment Report 2001: Promoting Linkages*. New York: United Nations. And Christopherson, Susan (2007). Power in Firm Networks: What is Means for Regional Innovation Systems. *Regional Studies*, 41(9), 1223-1236.

²¹ UNCTAD (2001). Local sourcing can be higher in particular industries and much higher levels of local sourcing have been reported for the transition economies of Eastern Europe and in some UK regions. A 2003 survey by Dr. David Stewart at Memorial University also reported relatively high levels of local sourcing by firms in Atlantic Canada. The degree of local sourcing reported in APEC's *Survey of Foreign Firms* may overstate the true proportion of inputs purchased within the Atlantic region as local wholesalers and retailers may purchase supplies produced outside the region.

have relatively limited non-labour inputs which may be more easily secured locally.

APEC did not quantitatively examine the size of local spillovers but respondents provided their own qualitative assessments. Based upon these responses, foreign firms have had a positive impact in improving the competitiveness of local suppliers, forcing local competitors to become more competitive and augmenting the region's stock of human capital by training local employees (see box for examples).²²

Examples of Positive Spillover Benefits

- A foreign wholesaler noted that its investment in local warehousing and service facilities had made its local (customer) companies more productive.
- An offshore energy operator stressed its contribution to improving local supplier capacity.
- One foreign firm emphasized its impact on more competitive pricing.
- A foreign firm providing business services reported that its local presence had 'raised the bar' with a resulting improvement in the quality of products and the degree of professionalism among local competitors.
- A foreign firm providing professional services described its impact in terms of boosting wage scales and the benchmark for skill sets.
- A foreign manufacturer highlighted its contribution to specialized training in areas such as lean manufacturing and Six Sigma.
- Another manufacturer reported that some local firms had been established by former engineering employees.

However, there seems to be a limited amount of technology transfer between foreign firms and Atlantic firms. Only 13% of foreign firms reported a large impact. This partly reflects the industry composition of the firms in the region, such as call centres, retailers and wholesalers which undertake relatively little R&D, and the fact that, according to APEC's *Survey of Foreign Firms*, few foreign firms have active research programs in the Atlantic region.²³

²² One foreign manufacturer emphasized their contribution to sponsorships and charitable initiatives in the region.

²³ Foreign firms have committed to spend money on R&D as part of offshore benefits agreements, such as a commitment to spend \$120 million on R&D during the life of the Hebron project.

Chapter 3

Corporate Perceptions of Atlantic Canada's Business Climate

Chapter Summary

- In general, a majority of foreign firms consider the business climate in the Atlantic region to be broadly comparable to other jurisdictions in which they operate.
- While Atlantic Canada was perceived to have some advantage in terms of low labour costs, its overall operating costs were rated only average due to higher energy and other costs.
- The region is seen as having a very small local market and is distant from major markets with weaknesses in its transportation system.
- Foreign firms describe the region as having relatively high corporate taxes and a less favourable regulatory environment than other jurisdictions.
- Foreign firms' priorities for improving the business climate focus on ensuring the availability of a skilled workforce, reducing corporate taxes, improving the regulatory environment and encouraging further offshore energy activity.

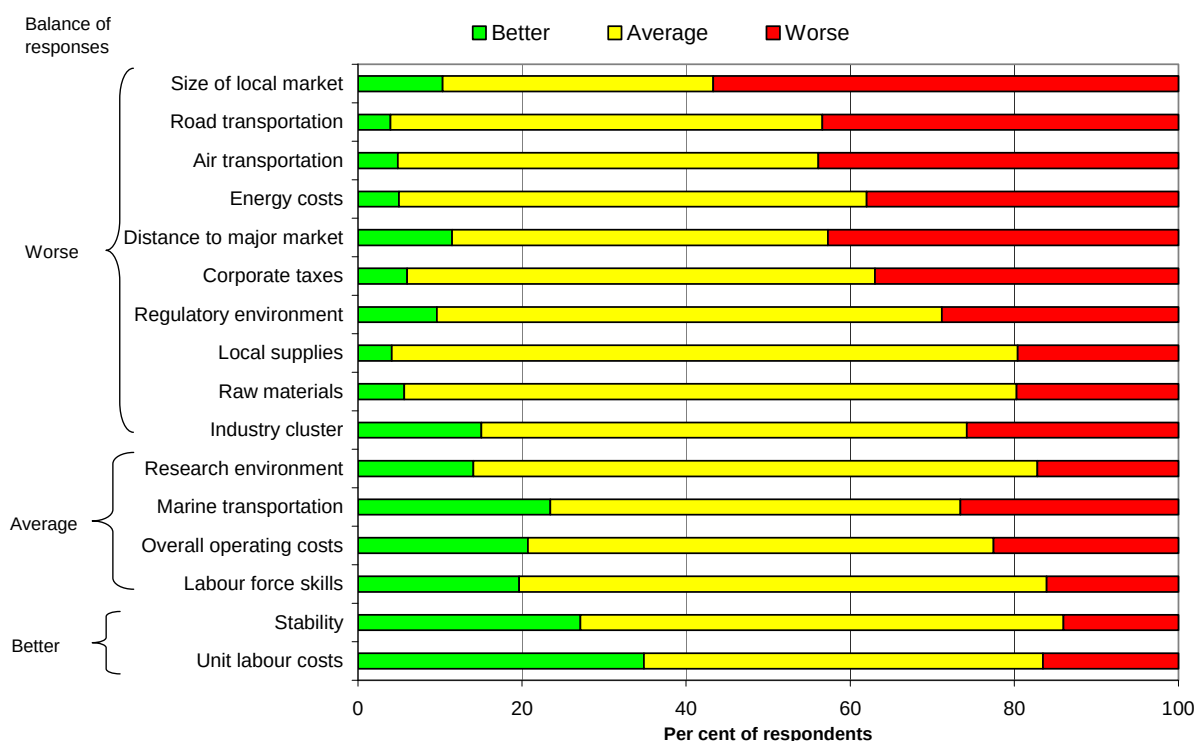
Foreign firms are uniquely positioned to assess the relative strengths and weaknesses of the business climate in Atlantic Canada because they operate in multiple jurisdictions throughout the world. This chapter presents their perceptions of Atlantic Canada's business climate and their priorities to improve it.

3.1 Assessing Atlantic Canada's Business Climate

Respondents to APEC's *Survey of Foreign Firms* were asked to compare the business climate in Atlantic Canada with the jurisdictions in which they have similar operations, based on an assessment of sixteen different factors.

In general, a majority of foreign firms consider the business climate in the Atlantic region to be comparable to other jurisdictions in which they operate. With the exception of the size of the local market, about 50-75% of firms rated Atlantic Canada as average on each business climate factor.²⁴

Fig. 3.1 - Relative Assessment of Atlantic Canada's Business Climate



However, the results also clearly reveal the perceived strengths and weaknesses of the Atlantic region, with more weaknesses noted than strengths. Using the balance of respondents as an indicator (i.e., the percentage of foreign firms rating Atlantic Canada as better than average less the percentage of firms rating the region as worse than average), there are only two components in which Atlantic Canada's business climate is better than average – economic/political stability and unit labour costs. There are four components in which Atlantic Canada is rated about average: labour force skills, overall operating costs, the local research environment and marine transportation. On the other ten factors, Atlantic Canada is rated worse than average.

²⁴ The Appendix provides details on the business climate ratings for select industries.

No real cost advantage except for labour intensive operations

On balance foreign firms in Atlantic Canada viewed unit labour costs in the region as better than other comparable jurisdictions. Atlantic wage rates are lower than in larger cities in Canada and the United States.

"The cost of employers' Workers Compensation Board premiums has to be addressed. Energy costs and transportation costs are also a disadvantage for us for bringing materials in and shipping products out." - Manufacturer

But payrolls are only part of overall operating costs. Foreign firms view energy costs as being relatively high in Atlantic Canada and transportation costs as being less favourable. These other factors appear to offset any advantage the region has on unit labour costs, other than for very labour intensive operations such as call centres or IT firms. Firms in the offshore energy cluster view the East Coast as being a high cost region in which to operate.

Labour force skills only average

A skilled labour force was one of the prime factors that attracted foreign firms to establish new operations in the Atlantic region. But by 2006 most (64%) foreign firms rated Atlantic Canada as only average in terms of labour force skills, with almost equal numbers viewing the region as better than average and worse than average. Only call centres gave the Atlantic provinces a clear positive rating.

"There is a shortage of workers that are fluent in written and spoken English as well as French or Spanish." - Call centre

Small local market with weak transportation linkages to distant major markets

The region's small local market – its total population is about 2.3 million – is a major constraint for firms focused on serving local customers and industries, such as those in professional services, or those that supply the offshore energy industry which currently has only three producing oil

projects off Newfoundland and Labrador and one producing gas project off Nova Scotia.²⁵

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 weaker than other jurisdictions with poor road quality, border issues and lack of air access identified as specific concerns. However, marine transportation was rated as average.

Corporate taxes and the regulatory environment are key concerns

Foreign firms view corporate taxes and the regulatory environment in the Atlantic region as less favourable than comparable jurisdictions. Call centres gave the region an overall positive rating on corporate taxes, likely due to the tax incentives made available to these firms.

"Reduce the red-tape associated with building and installation permits and related regulatory compliances." – Wholesaler

Concerns about the time and costs of the regulatory processes in the offshore energy sector along with related issues of regulatory overlap and complexity have been frequent irritants for oil and gas companies and suppliers to this industry.²⁶ In APEC's *Survey of Foreign Firms*, 67% of foreign firms in the oil and gas industry and 54% of firms in the offshore energy cluster stated that the region was worse than average in terms of its regulatory environment.

Even excluding firms in the offshore energy cluster, the balance of foreign firms indicated that the regulatory environment in the Atlantic region was worse than average. Several respondents pointed to a need to reduce overall regulatory red tape. One manufacturer referred to out-of-date labour regulations that limit its ability to adjust to changing global

²⁵ One of three satellite fields at the White Rose project is already in production. Nova Scotia's second offshore natural gas project, Deep Panuke, owned by Canadian headquartered Encana, is scheduled to begin production in 2011.

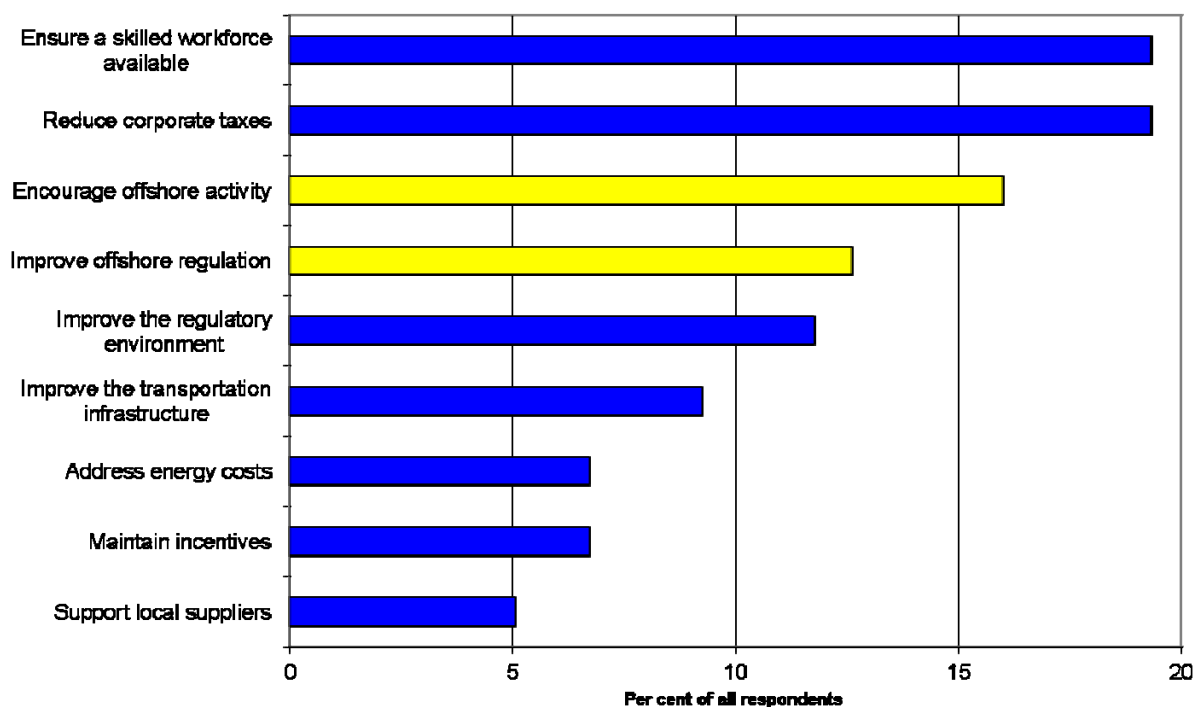
²⁶ APEC (2002b). How Do We Create the Best Environment for Maximizing the Benefits of Offshore Oil and Gas Developments?. *Atlantic Report*, 37(1&2), 5-7.

realities. Another manufacturer highlighted restrictive transportation regulations that impede the efficiency of moving manufactured goods. The additional costs associated with different regulations among the Atlantic provinces was also noted.

3.2 Corporate Priorities to Improve the Business Climate

Foreign firms identified several areas in which governments could take steps to help sustain or increase their output and investment in Atlantic Canada: ensure an adequate supply of skilled labour; reduce corporate taxes; improve the regulatory environment; and invest in transportation infrastructure. These priorities are consistent with a 2008 report by the national Competition Policy Review Panel which included recommendations to improve Canada's tax competitiveness and regulatory environment, to attract and develop talent, and to address the thickening of the Canada-US border.²⁷

Fig. 3.2 - Priorities for Government Action



²⁷ Competition Policy Review Panel (2008). *Compete to Win*. Ottawa: Government of Canada.

Ensure an adequate supply of skilled labour

Ensuring an adequate supply of skilled labour will be a key challenge in the coming decades and foreign firms identified this as their top concern. This issue was particularly important for large export-focused firms such as call centres and manufacturers, and reflect the region's perceived average scores on labour skills and Atlantic Canada's weak outlook for labour force growth.

"Personal income tax rates tend to scare away some applicants." - Wholesaler

Specific suggestions from foreign firms in the region included:

- Better training in educational institutions to ensure young graduates develop a greater "customer service" attitude
- Invest in language training to improve the supply of bilingual workers
- Strengthen the apprenticeship system – move away from traditional apprenticeships and provide programs that help young workers develop the skill sets needed to grow their employer's business
- Provide a training tax credit for firms upgrading the skills of their employees
- Reform the Employment Insurance program to reduce the incentive for workers to regularly use it when skilled job opportunities exist
- Reduce out-of-date, non-competitive and restrictive labour regulations
- Reduce personal income taxes
- Make it easier and more attractive for immigrants to settle in and stay in Atlantic Canada
- Allow easier access for temporary foreign workers (e.g., improve access for US technicians and contractors to service the area because of a shortage of local workers)

Improve the business climate: Lower corporate tax rates

An attractive business climate is critical to attracting new investment and encouraging re-investment in the region. A number of foreign firms, across a wide range of industries, indicated the need to reduce corporate taxes and to accelerate planned reductions in capital tax rates. Recent research indicates that corporate taxes are becoming a more important factor in location decisions.²⁸ In Nova Scotia, property taxes were also identified as a concern along with the level and procedures for setting Worker Compensation Board employer premiums.

Improve the business climate: Reduce regulatory impediments

Improving the regulatory environment was also an important priority for foreign firms. The need for better regulation, harmonization with other jurisdictions, and less red tape were emphasized by survey respondents. In fish processing, foreign firms advocated larger quotas for specific species and better regulation to encourage consolidation and ensure product quality.

Improve the business climate: Invest in transportation infrastructure

"Invest in infrastructure such as roads and bridges." – Manufacturer

Several firms, particularly manufacturers and transportation providers, emphasized the need to invest in the region's transportation infrastructure, particularly roads and bridges, as a means of improving road quality and thus lowering vehicle maintenance costs. Foreign firms pointed to the need to reduce inefficiencies in freight transportation due to restrictive or non-harmonized regulations and the need for progress in reducing delays and uncertainty at the US border. They also wanted to see improved air access between major North American centres and the region; this is particularly important given the current and future importance of services in foreign investment.

²⁸ Iqbal, Mahmood (2004). *Foreign Direct Investment: Decisions, Determinants, and the Role of Taxation – A Survey*. Ottawa: Conference Board of Canada.

Encourage offshore exploration and streamline regulation

For foreign firms that were part of the offshore energy cluster, their overwhelming priorities were to encourage more offshore exploration activity and to improve the regulatory environment. About 67% of the foreign firms in the offshore energy cluster stated that governments should do more to encourage exploration and more than half specifically identified the regulatory environment as being in need of improvement. This included providing greater clarity and certainty in the regulatory processes; reducing unnecessary requirements without compromising quality and safety; aligning regulatory standards within Canada and with international standards where possible; and ensuring that the overall regulatory environment is competitive with other jurisdictions.

"Governments can review and take an active role in the promoting of offshore drilling and exploration, by making it attractive to major operators to invest in the Eastern Canadian offshore" - Service provider, Nova Scotia

Chapter 4

Atlantic Canada's Attractiveness for New Foreign Investment

Chapter Summary

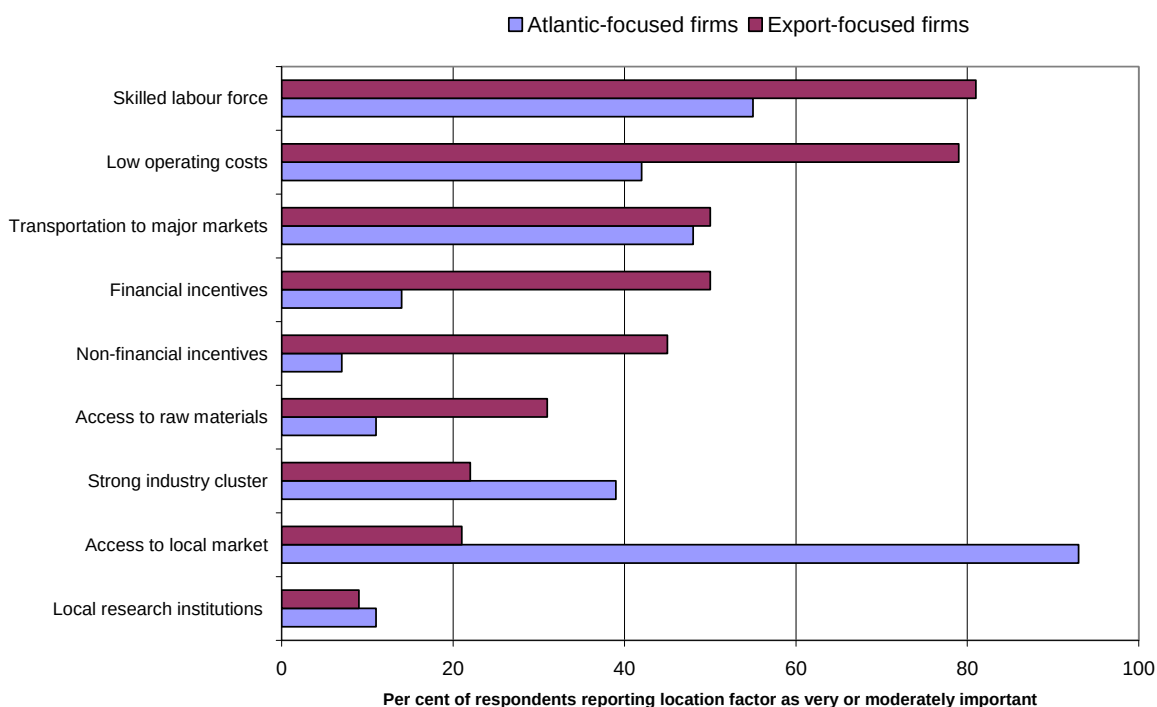
- Foreign firms have invested in Atlantic Canada for a number of reasons but primarily to access local markets, a skilled labour force, a low cost business environment and the region's natural resources.
- The annual number of foreign firms establishing new greenfield operations in Atlantic Canada has fallen since 2002.
- Atlantic Canada's competitiveness for international investment is changing due to global shifts in investment patterns, the higher value of the Canadian dollar and local demand and labour supply trends.
- These trends will make it harder to attract new manufactures and low-cost operations to the region. However, there remains potential for foreign investment in the energy sector and higher value exportable services.

This chapter explains why foreign firms have invested in Atlantic Canada, examines recent trends in the number of foreign firms coming to the region and discusses how the region's attractiveness for new foreign investment is changing.

4.1 The Available Labour Force and Low Costs Are Key Location Factors

Foreign firms have invested in the Atlantic region for different reasons depending upon the nature of their business. APEC's *Survey of Foreign Firms* asked firms making new greenfield investments to rate the importance of various location factors. The three primary motivations reflect market-seeking, resource-seeking (such as gaining access to natural resources) and efficiency considerations (e.g., low cost labour).²⁹

²⁹ These primary motivations are consistent with a survey of 50 MNEs in Canada. Verbeke, Alain, Huebner, Jefferson and Yuan, Wenlong (2006). *The NAFTA Effect: Multinational Enterprises in Canada*. Ottawa: Conference Board of Canada.

Fig. 4.1 - Importance of Selected Location Factors by Sales Focus

Source: APEC Survey of Foreign Firms.

For firms focused on serving markets in Atlantic Canada (such as firms in wholesale distribution, firms providing support services for the local oil and gas industry, and firms providing professional services), access to the local market was the dominant location factor. Labour supply and operating costs were secondary considerations and government incentives were not important.

The two dominant factors that have drawn export-orientated foreign firms to the Atlantic region are the availability of a skilled labour force and low wage and other operating costs. About 80% of such firms rated these factors as very or moderately important. These findings are not surprising given that the Atlantic region has traditionally had relatively high unemployment rates and relatively low wage costs.

Transportation access was also an essential consideration for manufacturers exporting to international markets. While low operating costs can offset higher transportation costs to more distant markets, the

availability, quality and reliability of such transportation linkages are critical.

Table 4.1: Top Location Factors by Selected Industry

Rank	Manufacturing	Professional Services	Call Centres
1	Low operating costs (83%)	Skilled labour force (85%)	Low operating costs (100%)
2	Transportation system (83%)	Local market (79%)	Skilled labour force (92%)
3	Skilled labour force (75%)	Low operating costs (62%)	Financial incentives (83%)

Note: Number in parentheses indicates percentage firms citing this factor as very or moderately important.
Source: APEC Survey of Foreign Firms.

Government incentives were a secondary consideration for most export-orientated firms, ranking behind economic fundamentals such as labour supply and operating costs. However, government financial incentives were clearly an important factor in attracting call centres to the region, emphasizing the potential importance of such incentives for cost-sensitive investments.

"Clearly the level of incentives received initially attracted investment by the company. Favourable future incentives could provide some acceleration in growth." - Call centre

Access to raw materials was the main reason firms in the primary sector (such as mining and oil and gas) established operations in the region. Access to raw materials was also a key factor for some manufacturers, such as those in the forest products industry.

The availability and quality of local research institutions was not an important location factor, a finding consistent with the lack of R&D activity undertaken by most foreign firms in the Atlantic region.

4.2 The Number of New Entrants to Atlantic Canada Subsidies

Global investment flows increased considerably in the second half of the 1990s but slowed substantially in 2001 with a global economic slowdown

and the impact of the 2001 terrorist attacks in the United States.³⁰ Foreign direct investment flows recovered sharply between 2003 and 2007, boosted by several years of strong economic growth, rising corporate profits of parent companies, and the increased number and value of cross-border mergers and acquisitions as companies continued to consolidate and strengthen their competitiveness.³¹ Global investment flows declined in 2008 and 2009 due to the global recession and financial crisis.

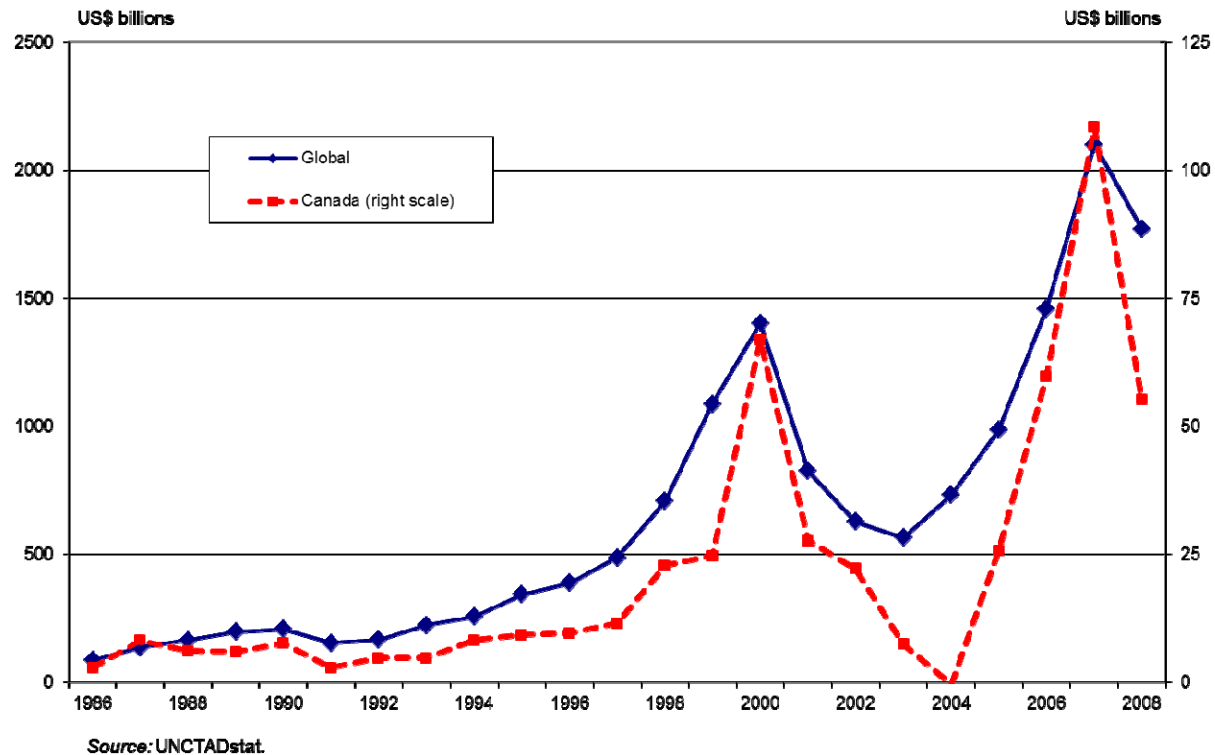
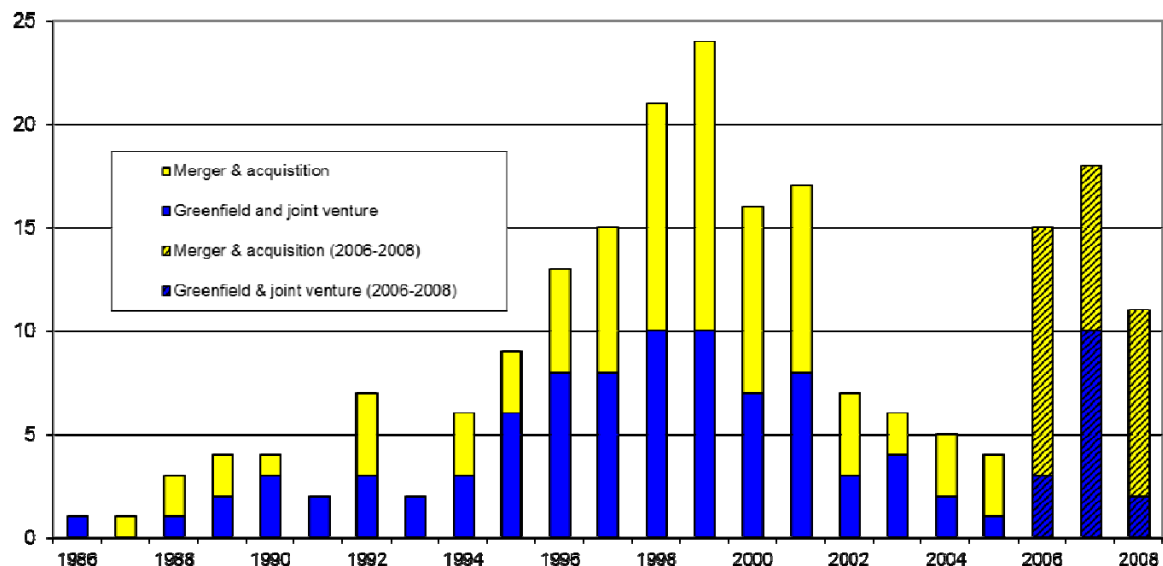
Flagstone Reinsurance Holdings Ltd is a global reinsurance and insurance company headquartered in Bermuda but with offices around the world. It was the first international financial services company to locate in Halifax in 2005 (then known as West End Capital Management). The company hires highly educated finance and IT professionals to provide back office technical support for its international operations. As of December 2010, the company has approximately 100 employees in Halifax. The Halifax offices are Flagstone's only operations in North America.

In line with these global trends, the total number of foreign firms investing in the Atlantic region increased rapidly during the second half of the 1990s and then declined. However, although there was a strong rebound in global investment flows between 2003 and 2007, the Atlantic provinces did not fully benefit. Nova Scotia was successful in attracting a number of new financial institutions to set up back office operations in Halifax in late 2006 and 2007. Aside from these firms, the total number of greenfield operations set up by new foreign firms in Atlantic Canada has fallen to an average of less than 3 per year since 2002; this is similar to the rate of foreign investment experienced in the late 1980s and early 1990s, but well below the 8-10 new greenfield operations being established annually in the region between 1996 and 2001.³² There have also been a number of disinvestments by foreign firms since 2005, with several manufacturers and some call centres closing their Atlantic operations. These trends point to concerns about the current attractiveness of the Atlantic region for foreign investment.

³⁰ UNCTAD (2002). *World Investment Report 2002*. New York: United Nations

³¹ UNCTAD (2008). *World Investment Report 2008*. New York: United Nations.

³² Even including these new financial service firms, the annual average number of new greenfield operations in the Atlantic provinces is well below the rates of foreign direct investment activity experienced between 1996 and 2001.

Fig. 4.2 - Global Inflows of FDI**Fig. 4.3 - Number of New Foreign Firms in Atlantic Canada by Year and Mode of Original Investment**

Note: For years 1986-2005, the chart shows the number of firms operating in the region as of March 2008 by the year and mode of their initial entry. Some of these firms have subsequently ceased operation. For years 2006-2008 the chart shows the number of new foreign firms (by year and mode of entry) that were operating as of March 2009.

Source: APEC Database of Foreign Firms.

Concerns about a declining attractiveness for foreign investment are not restricted to the Atlantic region. Canada's share of the global stock of inward foreign investment declined steadily from the early 1970s through the 1990s.³³ This does not simply reflect increasing competition from emerging markets as Canada's share of the stocks of inward investment in North America or among the G7 countries has also declined. However, since about 2000, Canada's global share of inward stocks of foreign investment have stabilized, and even increased relative to the US, largely due to increasing interest in Canada's resource sector.

4.3 Is Atlantic Canada's Investment Attractiveness Waning?

Global investment flows began to recover in the first half of 2010 and are expected to recover further in 2011 and 2012.³⁴ The global recession has not stopped the growing internationalization of production but there are some important changes occurring in the patterns of foreign investment:³⁵ First, developing and transition economies are expected to continue to grow in importance as both destinations and sources of foreign direct investment. Indeed, China, India, Brazil and Russia are among the top five most attractive economies for foreign investment.³⁶ Second, foreign investment in manufacturing is expected to continue to decline relative to the services and primary resource sectors.

"... an increasing number of companies now consider access to qualified and creative manpower as an important determinant of competitiveness. Consequently, a large share of FDI is influenced by (or even dedicated to) the search for qualified manpower." – UNCTAD (2007b)

What will be the key drivers behind foreign investment in the future? The three main motives for the internationalization of production remain market-seeking, resource-seeking and efficiency-seeking considerations. The most important location factor – mentioned by 43% of the largest

³³ Hejazi, Walid (2010). Dispelling Canadian Myths about Foreign Direct Investment. *IRPP Study*, No. 1. Montreal, Institute for Research on Public Policy.

³⁴ UNCTAD (2010), *World Investment Report 2010*. New York: United Nations.

³⁵ UNCTAD (2010).

³⁶ UNCTAD (2009). *World Investment Prospects Survey 2009-2011*. New York: United Nations.

multinational enterprises in the world in a recent survey – is access to large and growing local or regional markets.³⁷

The quest for resources has become an increasingly important motive for foreign investment (cited by 15% of respondents in the survey of multinational enterprises) with access to skilled labour the most important consideration. The search for low-cost labour remains an important location determinant, particularly for labour-intensive manufacturing and low-end service sectors where cost competitiveness is paramount.

Table 4.2: Likelihood of New Foreign Firm Entry in Atlantic Canada

Market Focus, Industry	Assessment	Note
Local market	Weak	Small, slow-growing local market limits incentive for market entry (other than specialist retailers in urban markets or suppliers to expanding local industries).
Export, manufacturing	Weak	In general, relative costs not favourable without other location-specific competitive advantage.
Export, services	Moderate/ Positive	Depends on labour supply and relative costs. Stronger potential for higher skill operations.
Export, mining/energy	Positive	High commodity prices provide potential for investment in mining, offshore and onshore energy projects and development of renewable energy resources (e.g., wind, tidal).

Source: APEC.

Aside from these three primary motives, companies consider the overall quality of the business environment (such as a stable investment environment and quality infrastructure) as a very important location determinant.³⁸ How well is Atlantic Canada likely to fare in terms of these dominant location factors?

³⁷ UNCTAD (2009).

³⁸ UNCTAD (2009).

Local Atlantic market: Small and slow-growing

The potential for further foreign investment focused on the local market is limited given the small size of the overall market in Atlantic Canada and the region's relatively modest growth prospects.³⁹ Little population growth is anticipated over the next ten years and one independent forecaster projects average annual real GDP growth for Atlantic Canada of only 1.7% over the next decade, well below the 2.4% national pace.⁴⁰

Any new foreign investment targeted at the local market may be at the expense of existing producers although gains in the market share of foreign firms would likely reflect lower prices, more choice or better products and services. The best prospect for foreign investment focused on the local market is likely to be in the region's largest cities where the population and consumer base is still growing at a reasonable pace.⁴¹ An expansion of the region's energy sector may also attract specialist service providers.

Larger North American market: Distance and weakness in transportation linkages constrain access

The Atlantic region is at a geographic disadvantage in that existing foreign firms view the region as being located further from major markets than comparable jurisdictions in which they operate. This suggests it will be difficult to convince firms that typically need to locate close to their major customers or markets to set up in the region, especially as Atlantic Canada's overall operating costs do not point to a significant offsetting cost advantage. Even for firms that do not need to locate close to their major markets or customers, perceived weaknesses in Atlantic Canada's transportation system, most notably air and road, are a serious challenge. The 'thickening' of the border due to tighter US security requirements

³⁹ Over half of the foreign firms in Atlantic Canada in 2006 depended upon sales in the Atlantic provinces for 50% or more of their revenues.

⁴⁰ Informetrica (2010).

⁴¹ Between Census 2001 and Census 2006, the population of Atlantic Canada's top six cities (Halifax, St. John's, Moncton, Saint John, Fredericton, Charlottetown) grew by 3.8% compared with a decline of 2.6% in the rest of Atlantic Canada and growth of 5.4% nationally.

since 2001 may further deter some manufacturers from using Canada as an export base for the larger US market.⁴²

"Transportation infrastructure is key to business development: as the local market is too small to sustain manufacturers, all goods must be transported to market. Efficient and effective transportation links are needed." - Manufacturer

The Atlantic region is trying to significantly enhance its role as an international gateway for container traffic, specifically for Asian goods destined for markets in Central Canada and the US Midwest.⁴³ In 2007, the Halterm container terminal in Halifax was purchased by Australian-based Macquarie and other foreign-owned transportation companies are active in the region.⁴⁴ It remains to be seen whether this potential can be realized. The global and US recession in 2008-2009 had a significant negative impact on the volume of container imports. Despite a recovery in 2010, container volumes are expected to take several years to regain their previous peaks.⁴⁵

The best prospects for new export-orientated businesses will likely rely on the Atlantic region's telecommunications infrastructure and availability of skilled labour, which are critical assets for call centres and firms providing professional services for foreign clients, although limited air access for managers and clients is an impediment.

Skilled labour: A key asset but the region's labour market is tightening

The availability of skilled labour is identified as an increasingly important location determinant globally and was the most important location factor for existing exporting-orientated business in the Atlantic provinces.

⁴² Goldfarb, Danielle (2007). *Reaching a Tipping Point? Effects of Post-9/11 Border Security on Canada's Trade and Investment*. Ottawa: Conference Board of Canada.

⁴³ APEC (2006c) *The Changing Global Economy: The Implications and Opportunities for Transportation in Atlantic Canada*. Halifax: APEC.

⁴⁴ The other Halifax container terminal at Fairview Cove is owned by Ceres Terminals, a subsidiary of the Japanese-based NYK Group. Various foreign partners are involved in a proposed container terminal at Melford in Nova Scotia.

⁴⁵ Mercator International (2010). *Port of Halifax Containerized Cargo Strategic Review Summary Report*. Halifax: Port of Halifax.

Ensuring an adequate supply of labour will be a bigger challenge going forward.⁴⁶

Unemployment rates have fallen across Atlantic Canada since the early 1990s. Unemployment rates in the region's six leading cities – Halifax, St. John's, Moncton, Saint John, Fredericton and Charlottetown – averaged 5.5% in 2007. Unemployment rates did edge up slightly during the recession, to average 6.7% in Atlantic Canada's top six cities in 2009, still well below the national unemployment rate of 8.3%. The region's unemployment data clearly indicate that there is now a very limited pool of "surplus" labour waiting to be tapped.

Keane, a IT services company with its headquarters in Boston, Massachusetts, operates in 11 countries with more than 12,500 employees worldwide. It was acquired by NTT DATA of Japan in January 2011. Keane established its office in Halifax in 1997 and employs about 500 people at its Advanced Development Centre.

While unemployment rates remain higher in rural areas, averaging 12.3% in 2007 and 14% in 2009, this partly reflects the seasonal nature of employment in these primary industry and resource-based regions.⁴⁷ Even when seasonal or displaced manufacturing workers are available, their education levels and skill sets will typically not match the requirements of foreign firms setting up service sector operations in the region's cities, aside from any geographic mobility constraints.

Demographic projections for the Atlantic region indicate that there will be minimal net population growth over the next decade while the aging of the workforce will lower the overall labour force participation rate. It is therefore likely that the aggregate size of the labour force in the Atlantic provinces will begin to decline during the next decade.

The outlook is better in urban labour markets with scope for continued migration to urban areas. The labour force in the region's six top cities has been growing at 1.6% annually between 2000 and 2008, only marginally slower than the 1.8% national pace. This is equivalent to a

⁴⁶ APEC (2007a). *Commentary: Where Have All the New Workers Gone? Why Atlantic Canada's Labour Force Has Stopped Growing and What We Can Do About It*. Halifax: APEC.

⁴⁷ APEC (2005). *Seasonality in Atlantic Canada: Trends, Challenges and Policy Issues*. Halifax: APEC.

combined total of about 9,000 potential new workers each year in these six cities. Relatively high wages will also help foreign firms attract workers from existing industries and employers in urban areas.

Perhaps the best labour supply opportunity is to reverse the pattern of outmigration of its young people, with the Atlantic provinces losing about 6,500 15-34 year olds annually to the rest of Canada during 2000 to 2007.⁴⁸ Many of these are highly skilled recent graduates and may be eager to stay in the region if they can find the right long-term career opportunities.

The Atlantic region needs to pay more careful attention to understanding and responding to the changing skill requirements of both established industries and potential new growth sectors.

The skills of the region's labour force, including its new graduates, will be a key determinant of Atlantic Canada's future competitiveness. The Atlantic provinces currently graduate about 30,000 students annually from its college and university programs pointing to a substantial flow of skilled workers available to enter the region's workforce. Yet when it comes to skill levels, existing foreign firms in the region only give Atlantic Canada an average rating compared with other jurisdictions in which they operate. This suggests that the Atlantic region needs to pay more careful attention to understanding and responding to the changing skill requirements of both established industries and potential new growth sectors.

Mineral and energy resources: Opportunities remain

Raw materials are critical for primary industries and resource-based manufacturing. The lack of growth in the fibre supply has been identified as a crucial factor in limiting the potential for new investment in New

⁴⁸ The net number of young people leaving the Atlantic provinces did fall by about half during the recession of 2008 and 2009 but is likely to increase again as the recovery takes hold.

Brunswick's forest industry.⁴⁹ Other regions, such as South America, can now provide faster growing fibre.

High commodity prices have stimulated an increase in exploration for metals and other minerals in the Atlantic provinces in recent years, particularly in Newfoundland and Labrador.⁵⁰ Exploration activity declined during the recent recession, but significant new finds, when combined with attractive long-term prices, could attract renewed foreign interest.

In terms of the offshore energy sector, exploration off Nova Scotia has weakened in recent years. The geology has proven to be more complex than initially anticipated and drilling rigs have been in short supply. With high costs and time-consuming regulatory processes, more lucrative plays elsewhere have been explored and developed.⁵¹ The development of large shale gas deposits in the United States has also contributed to lower natural gas prices. Newfoundland and Labrador's offshore oil industry, by contrast, is experiencing some growth with the development of satellite fields tied back to the existing infrastructure at the Hibernia and White Rose fields and the development of the Hebron oil field, which is expected to produce first oil in 2016 or 2017.

There has been increased interest in onshore exploration with one field near Sussex, New Brunswick, operated by a junior Canadian energy company, Corridor Resources, producing natural gas for export. Two US energy companies are now involved in onshore exploration in New Brunswick. Apache is involved in a joint venture exploration program with Corridor Resources while SouthWestern Energy has a three year exploration program underway.

European firms such as Enel (Italy), GDF Suez (France) and Acconia (Spain) have invested in wind farms in the region with further potential

⁴⁹ See Lord, Norm and Parsonson, Doug (2002). *New Brunswick Crown Forests: Assessment of Stewardship and Management*. New York: Jaakko Poyry Consulting and APEC (2008). *Building Competitiveness in Atlantic Canada's Forest Industries: A Strategy for Future Prosperity*. Halifax: APEC.

⁵⁰ APEC (2007b). *Commodity Boom Sparks Revival in Atlantic Canada's Mining Industry. Report Card*. 2007 (December).

⁵¹ Wood Mackenzie (2007). *An Assessment of Atlantic Canada's Offshore vis-à-vis Competing Jurisdictions*. Edinburgh: Wood Mackenzie.

for foreign investment as the region seeks to develop its renewable energy resources, including tidal power in the Bay of Fundy.

GDF Suez Energy North America, part of GDF Suez, headquartered in Paris, is a global energy company and the world's largest independent electricity power producer. It operates the two largest wind farms in Atlantic Canada. The company acquired Ventus Energy Inc. in late 2007 and operates both the 9MW Norway wind farm and the 99MW West Cape wind farm in Prince Edward Island. The West Cape facility became fully operational in 2009 and provides electricity to the City of Summerside as well as other local consumers. Suez completed the \$200 million 99MW wind farm at Caribou Mountain, near Bathurst, New Brunswick in late 2009. At peak operation, the project's 33 turbines will supply about two percent of New Brunswick's power.

With energy and mining projects continuing to dominate Atlantic Canada's investment potential, it is likely that foreign investors will find further opportunities to help develop Atlantic Canada's mineral resources.⁵²

R&D: An untapped resource?

Foreign firms have not generally established R&D units in the Atlantic region to tap into local research capabilities. This may reflect the lack of major research-based clusters in the region. Is there potential to attract new foreign investment focused on R&D?

In July 2006 **Novartis Animal Health** opened its Centre for Aqua Research and Development facility in Victoria, Prince Edward Island. The facility currently employs 28 people and is one of six global R&D sites operated by Novartis Animal Health (with two sites in the United States, two in Switzerland and one in Australia). The PEI centre focuses on developing new vaccines for the aquaculture industry. Novartis Animal Health also employs 43 people in its West Royalty Industrial Park manufacturing facility.

An increasing number of multinational firms are looking to locate R&D abroad although there is stiff competition from developed economies such as the United States, Japan and the UK as well as from developing

⁵² APEC (2010). Major Projects Inventory 2010: Looking Beyond the Public Stimulus. *Atlantic Report*, 45(1), 2-7.

countries such as China, India and Russia.⁵³ Low wages and large pools of skilled workers are attracting multinationals to expand R&D activities in developing countries and the Atlantic provinces will find it hard to compete on these two key drivers alone.

For the Atlantic region, potential targets would have to be niche opportunities related to existing world-class research capabilities (including both institutions and researchers in science and engineering) and corporate expertise. Nova Scotia and Newfoundland and Labrador have significant research capabilities relating to ocean technology while Prince Edward Island is enhancing its research infrastructure with a \$30 million investment to create an Island BioCommons Research Park.

Low costs: Traditional cost advantages at risk

Many foreign firms have established operations in the Atlantic region on the basis of perceived low costs. But, according to *APEC's Survey of Foreign Firms*, foreign firms now give the region an average rating. This indicates that the region will struggle to continue to attract firms on this basis alone.

Other lower cost locations are becoming formidable competitors. Half of the world's greenfield investments in 2009 were in developing or transition economies.⁵⁴ India, Vietnam, Thailand, Romania, Poland and Mexico have all seen significant increases in the number of greenfield investments between 2003 and 2008.⁵⁵ These countries offer much lower wage and operating costs than the Atlantic region. In Mexico, for example, business costs in manufacturing are estimated to be about 10% lower than in Atlantic Canada (Halifax), but with a 46% cost advantage in call centres.⁵⁶

The Canadian dollar appreciated by almost 40% between early 2002 and early 2006 to average about US\$0.88 at the time of *APEC's Survey of Foreign Firms*. This appreciation severely diminished the cost advantage

⁵³ UNCTAD (2005). *UNCTAD Survey on the Internationalization of R&D*. New York: UNCTAD.

⁵⁴ UNCTAD (2010).

⁵⁵ UNCTAD (2010).

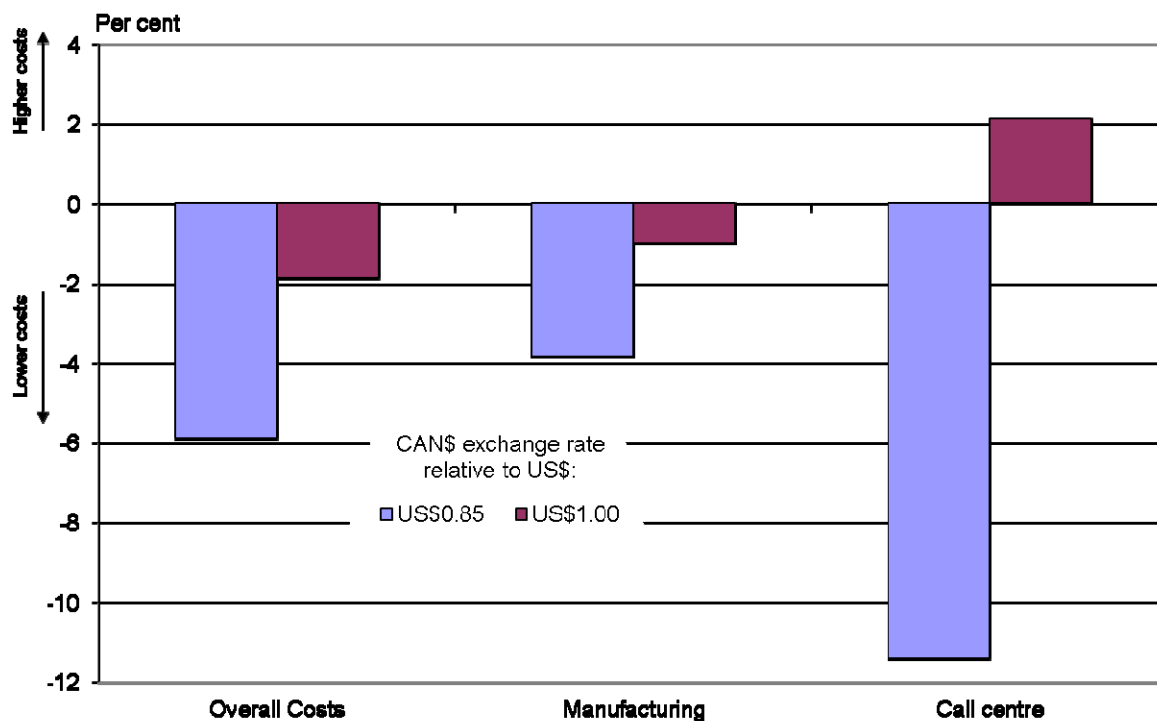
⁵⁶ KPMG (2010). *Competitive Alternatives 2010*. Retrieved January 7, 2010 from <http://www.competitivealternatives.com>.

of the Atlantic region relative to the United States and other countries with currencies that are pegged to the US dollar. This is a considerable concern as US investors account for 60-75% of existing investors in the Atlantic region. But it will also impact the decisions of European and Asian firms looking to establish a presence in North America.

"The exchange rate has impacted our competitive advantage for US business - it is no longer favourable." - Call centre

Exchange rate fluctuations can quickly change Atlantic Canada's cost advantage relative to the United States. Exchange rate sensitivity analysis using KPMG's biannual analysis of international business costs reveals that an appreciation of the Canadian dollar from US\$0.85 to parity with the US dollar wipes out the cost advantage of Halifax relative to similar sized cities in the United States, most notably for call centres.⁵⁷

Chart 4.4: Business Costs In Halifax Relative to Comparable Sized U.S. Cities



Source: APEC Calculations based on KPMG (2010), *Competitive Alternatives 2010*.

⁵⁷ The comparison used data on nine US cities with populations between 250,000 and 500,000. At parity with the US dollar, Halifax still has a small cost advantage compared with larger higher-cost US cities such as Boston and New York.

In manufacturing, existing foreign firms report that the region's overall operating costs are, on balance, higher than comparable jurisdictions. It will therefore be difficult to attract a new foreign manufacturer unless the Atlantic region can provide some other competitive advantage (or provide some financial offset). Natural resources such as forest and fishery are unlikely to provide such an advantage for new firms due to limited resource growth although there may be some potential for higher value processing of such resources within the bioscience field. However, growing energy demand in the US northeast, existing infrastructure and the relative ease of siting enabled Repsol to build a liquefied natural gas (LNG) terminal in Saint John, New Brunswick in partnership with Irving Oil. The facility began operation in 2009.

Repsol YPF is an international integrated oil and gas company based in Spain that operates in over 30 countries. The company is one of the ten largest private oil companies in the world and the third largest LNG company. It completed an LNG receiving and regasification terminal in Saint John, New Brunswick in 2009 in partnership with Irving Oil. The terminal is connected to the Maritimes and Northeast Pipeline via the Brunswick Pipeline with natural gas sold in Canadian and US markets. In addition, Repsol signed a deal in 2009 to purchase all the gas produced from the Deep Panuke natural gas project off Nova Scotia. In November 2008 Repsol also successfully bid for three exploration blocks off Newfoundland, in partnership with Husky Oil and Petro-Canada and performed seismic scans on the blocks in 2009.

At the time of APEC's *Survey of Foreign Firms*, international operators reported an overall cost advantage for labour-intensive service exports but this will likely have diminished with the further appreciation of the Canadian dollar since then. This suggests the need to focus on higher-end services where skill levels and other location factors are relatively more important than operating costs.

Chapter 5

The Outlook for Existing Foreign Production in Atlantic Canada

Chapter Summary

- The existing foreign firms in the region are facing a number of challenges with weak product demand and poor cost competitiveness the most prominent.
- Foreign firms are generally responding to these pressures by trying to squeeze maximum value out of their operations by improving operating efficiencies and finding new markets for existing products, rather than by adopting more innovation focused strategies.
- There remains potential for expansion of existing foreign-owned mining and offshore energy projects. However, there are limited prospects for expansion of foreign firms focused on serving the local market.
- Atlantic operations that play a unique role in their MNE have better retention prospects than those that must compete against multiple sister operations throughout North America.

The previous chapter concluded that it will be harder to attract new foreign firms to Atlantic Canada in the future. This chapter focuses on the foreign firms that are already here. Can we retain them and are they likely to expand their operations in the region? The chapter discusses the pressures facing these foreign firms and the strategies they are adopting to respond to these challenges.

5.1 Modest Projected Output Growth

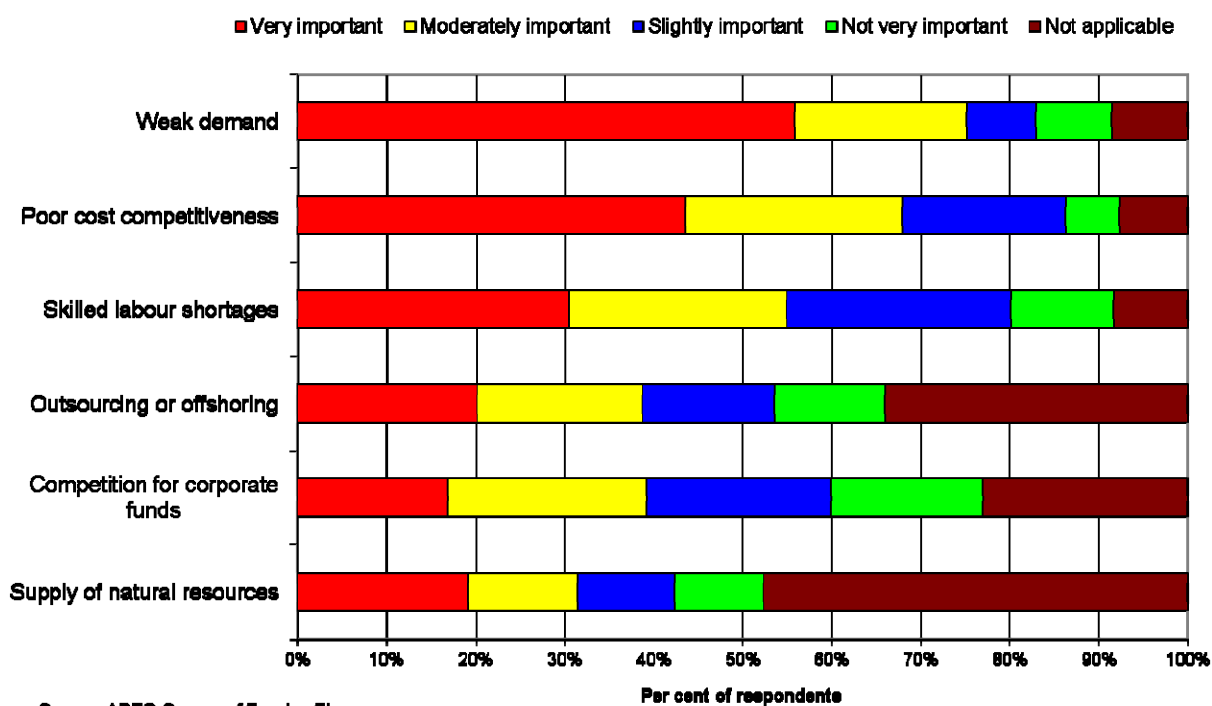
According to APEC's *Survey of Foreign Firms*, the overall output growth of foreign firms during the five year period 2006-2010 was expected to be more modest than the previous five year period (2001-2005). When weighted by employment, 80% of foreign firms said they expected to grow by less than 15% over the 2006-2010 period (equivalent to annual growth of less than 3%), double the proportion of firms that grew by less

than 15% in the previous five years. In particular, export-focused firms such as manufacturers, call centres and firms providing professional services that grew very rapidly in the previous five years expected to see much more moderate growth between 2006 and 2010.⁵⁸ Firms in the offshore energy cluster, particularly the oil and gas and drilling companies, were especially pessimistic.

5.2 Weak Demand and High Costs Limit Output Prospects

Declining or stagnant demand and poor cost competitiveness were identified as the two biggest constraints on future production and investment by existing foreign firms in Atlantic Canada.

Fig. 5.1 - Constraints on Future Production and Investment in Atlantic Canada



Weak demand is most acute for foreign companies serving clients in the Atlantic region where economic growth is likely to be modest. But export-focused manufacturers also reported significant concerns about demand. Even prior to the US and global recession of 2008-2009, demand for

⁵⁸ Survey respondents would not have anticipated the global recession of 2008-2009.

some of Atlantic Canada's key exports, including newsprint, lumber and potato products had begun to decline due to a variety of secular, cyclical and other factors.⁵⁹ These demand shifts are further compounded by mounting cost pressures.

Table 5.1: Constraints on Future Output and Investment, Selected Industries

Industry/Market Focus	Biggest Constraint	Second biggest constraint
Offshore energy cluster	Weak demand	Natural resources
Manufacturing	Weak demand	Cost competitiveness
Transportation & wholesale	Weak demand	Cost competitiveness
Professional services	Weak demand	Labour supply
Call centres	Labour supply	Cost competitiveness
Local market focus	Weak demand	Cost competitiveness
Export focus, one of many North American locations	Cost competitiveness	Weak demand
Export focus, only North American location	Labour supply	Weak demand

Source: APEC Survey of Foreign Firms.

Relative costs are a particular concern for firms with multiple operations in North America. Some Atlantic manufacturing plants have to compete against their sister plants within the MNE to win production contracts. As MNE's conduct strategic reviews of their global operations to improve their overall cost structure, or to reduce production capacity, each production site must justify its continued existence on the basis of cost and productivity advantages. Greenbriers, for example, closed its Trenton railcar plant in Nova Scotia in 2007 and shifted production to Mexico where costs are lower. The potential to relocate to lower cost jurisdictions presents real risks for the long-term viability of many existing operations in the Atlantic region if they do not have some other offsetting competitive advantage (e.g., local natural resources, geographic location or specialized machinery).

Foreign firms providing service exports to the United States, such as call centres, have also been impacted by reduced revenues in Canadian dollar terms due to the appreciation of the Canadian dollar since 2002. Beyond North America, the potential to shift production to lower cost developing or transition economies remains real. A majority of call centres and half

⁵⁹ APEC (2006a), *Competing in the Global Economy: Atlantic Canada's Recent Trade Performance and Policy Issues*. Halifax: APEC.

of the foreign manufacturers indicated that offshoring is an important constraint on future production in Atlantic Canada.

Other output constraints were important for particular types of firms. Skilled labour shortages are an acute issue for larger firms and labour-intensive operations such as call centres and professional service firms. The supply of natural resources were cited as a very important limitation on future output for firms in the offshore energy cluster, mining, fishing and resource-based processing. Firms providing wholesale, transportation or professional services to these industries were also concerned about the impact of natural resource availability on growth in these sectors.

Competition for corporate funds was not cited as a big constraint. This may reflect modest capital requirements expected by the operations in the Atlantic region. It may also imply that if the Atlantic operation can justify new investment then corporate funds are likely to be available, but weak demand or poor cost competitiveness will severely undermine the business case.

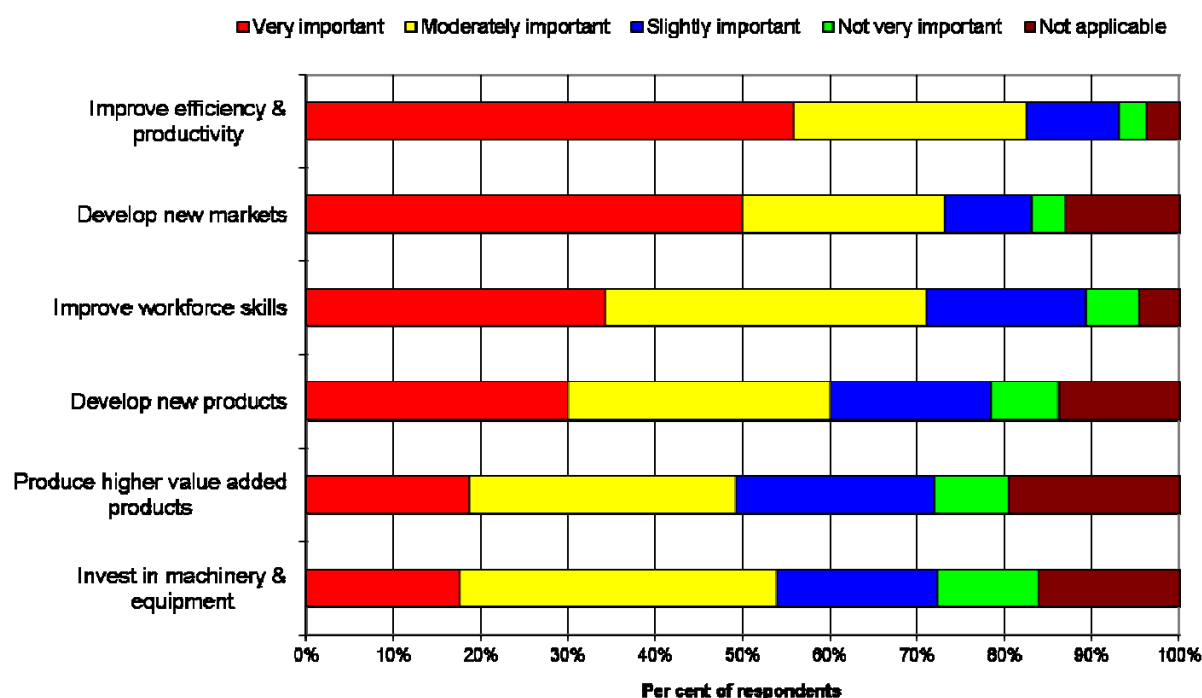
5.3 Corporate Strategies Focused on Squeezing Value Out of Existing Operations

In light of the constraints on their output foreign firms in the region are focusing on improving overall efficiency, reducing costs and developing new markets for their current products to squeeze maximum value out of their existing operation. Some manufacturers in the forest products industry, for example, have sought concessions from employees, power providers and governments to help improve their cost structure.

Innovation-related strategies such as developing new products or services, producing higher value products or services, or investing in new machinery and equipment are rated as least important. This may reflect the importance of choosing Atlantic Canada as a low-cost location in the initial investment decision. But it points to long-term risks if operations

in the Atlantic region cannot maintain their cost advantage or develop non-cost competitive advantages.⁶⁰

Fig. 5.2 - Strategies for Future Output and Growth in Atlantic Canada



5.4 Prospects for Retention and Expansion of Existing Foreign Firms

In order to evaluate the likelihood of the retention or expansion of existing foreign firms in the Atlantic region, it is important to consider the role their Atlantic operations play within the larger multinational enterprise. While decisions relating to day-to-day operations are generally made in Atlantic Canada, almost all decisions regarding major capital investments are made at or with approval from their Canadian or international head office.

About 56% of the foreign firms in Atlantic Canada are focused on serving clients in the Atlantic provinces. The size of the local market and the

⁶⁰ This finding is not limited to foreign firms. The largest firms headquartered in Atlantic Canada also reported a lower priority on innovation based strategies. See Chaundy, David (2006). Pressure at the top. *Progress Magazine*, 2006 (September), 128-146.

relative costs and benefits of serving these clients from the Atlantic region rather than from a regional or national head office are critical to their continued presence in the Atlantic region. For example, several firms in the offshore energy cluster have closed their offices or operations since 2002 because of a lack of new offshore developments and disappointing drilling results. Some retail firms may continue to add new stores throughout the region while others may expand in the larger urban centres.

Table 5.2: Likelihood of Foreign Firm Retention/Expansion in Atlantic Canada

Market Focus, Uniqueness	Assessment	Note
Local market	Limited prospects for expansion; Some risk of withdrawal.	Small, slow-growing local market limits potential for expansion outside main urban centres. Cost pressures or decline in local industry activity could lead to concentration in regional/national headquarters.
Export, multiple North American locations	Risk of further closures	Cost pressures will likely contribute to further closures. Steps to improve cost competitiveness, exploit unique strengths of the Atlantic operation, and secure production of new products will be critical to retention and for any prospects for expansion.
Export, only North American location	Some long-term retention risk	Need maintain unique strengths of existing operation in light of pressures to move to lower-cost locations.
Export, natural resources	Resource dependent	Expansion dependent on discovery of new commercial resources or improved viability of extracting undeveloped resources.

Source: APEC.

About 27% of the foreign firms in Atlantic Canada are export focused but with multiple sister locations throughout North America providing similar products or services. Cost competitiveness is a key challenge for these operations. These Atlantic operations will need to work hard to maintain or improve their competitive edge over their sister plants and offices by reducing costs and promoting the strengths of the Atlantic operation (e.g. superior marine access to new markets or the quality of the machinery and equipment at the plant). The pressures to reduce capacity are most intense in sectors where demand has been declining, such as newsprint. Securing production of new and fast-growing products

will be the key for expansion. Michelin recently invested in its operations in Nova Scotia, for example, with the production of its new extra-wide tire.

Michelin opened its first two plants in Nova Scotia in 1971 and a third in 1982. The three plants at Bridgewater, Waterville and Granton produce car, light truck, truck and bus tires and steel cord and employ about 3,500 workers. Exports from the Nova Scotia plants to the United States were valued at about \$750 million in 2009, the province's largest single export product. In 2006 the company announced a \$92 million investment in R&D and innovative new equipment to produce a new (X-One) wide-based truck tire at Waterville. The company also recently completed a two-year \$50 million investment to modernize and increase tire production capacity at its Bridgewater plant (which followed a \$36 million investment announced in 2006 to expand and modernize production of steel cord at the plant). Michelin operates 18 major manufacturing plants (employing 22,900 workers) in North America and has 72 plants worldwide.

About 17% of the foreign firms in Atlantic Canada are export focused but these operations are the only location in North America or the world for this particular product or service. While these Atlantic operations currently have a somewhat unique position within the multinational enterprise, some could face the risk of being moved to lower cost locations. More than half of these firms cited offshoring or outsourcing as a very or moderately important constraint on their future output. A decline in industry demand or a lack of skilled labour in the region could compromise the sustainability of these operations.

Concentra Solutions headquartered in Atlanta, Georgia, helps improve call centre performance. It operates one Quality Centre based in Hartland, New Brunswick, which provides performance-based compliance and customer service monitoring along with coaching and feedback for agents being monitored.

Expansion of foreign firms (including processors) reliant on natural resources is unlikely, except where new commercial mineral deposits are discovered or if known deposits become profitable to extract. For example, Husky is expanding its White Rose operation through the addition of three nearby satellite fields, while the various partners in the Hebron project are moving ahead with the development of that oil field. The Iron Ore Company of Canada (IOC), majority owned by Rio Tinto, is

proceeding with a \$539 million expansion at its iron ore operations in Labrador, part of a three-stage expansion programme. There is also potential for an expansion at the Voisey's Bay project, owned by Vale of Brazil, with the development of an underground mine. Meanwhile Xstrata is investigating reopening the Donkin coal mine in Nova Scotia.

Vale acquired the Voisey's Bay development in Newfoundland and Labrador in 2007 following the acquisition of Inco by CVRD (subsequently renamed Vale) of Brazil. The development involves the construction and operation of a mine and concentrator in Voisey's Bay, Labrador, and processing facilities in Long Harbour, Newfoundland. The mine started production in 2005 and construction of the hydrometallurgical nickel processing facility began in 2009 and will be completed in 2013. The company currently employs about 450 people in Labrador and will employ 400 at Long Harbour when the project begins operations. Subject to the completion of a successful underground exploration program, an underground mine development and expansion of the concentrator is expected to begin around 2018. An additional 350 people are expected to be employed at the mine and concentrator during the underground mining program. Vale is the largest mining company in the Americas and the world's second largest producer of nickel.

Chapter 6

Summary and Policy Directions

Chapter Summary

- There is a strong economic motivation for continuing to attract and retain foreign investment in the Atlantic region to support economic output and productivity.
- However, the international competitiveness of Atlantic Canada to both attract new foreign investment and to retain existing foreign firms is changing.
- In response to this changing environment, attraction efforts must refocus on new sources of competitive advantage while more attention is required to help ensure the sustainability of existing foreign operations in the region by helping them shift, where possible, from a low-cost focus to an innovation-focused operation.
- Continued efforts to ensure the availability of a skilled labour force and improve the business climate are also important.

This chapter summarizes the findings in this report relating to the contribution of foreign investment to Atlantic Canada's economy and the region's changing competitiveness for international investment. It outlines the key priorities for governments to best position the region to retain its existing foreign firms and to attract new foreign investment.

6.1 Summary of APEC's Findings: The Case for Foreign Investment in Atlantic Canada

The evidence presented in this report indicates that foreign firms in Atlantic Canada provide a substantial net economic benefit to the region. There is therefore a strong economic motivation for continuing to welcome both new foreign investors and encourage re-investment by existing foreign firms in the Atlantic region.

Foreign firms have boosted Atlantic Canada's short-term economic and employment growth through the entry of new firms and expansion of existing firms, most notably the growth of offshore oil and gas production and the expansion of call centre activity.⁶¹ Foreign investment in Newfoundland's offshore industry averages about \$1 billion annually.

Foreign firms continue to make a sizeable contribution to output, employment and income levels (including offshore royalties) in the Atlantic region, generating an estimated 33% of the region's international exports in 2005 and providing thousands of highly paid jobs.

In terms of dynamic spillover effects, the empirical evidence indicates that foreign firms boost the productivity of Canadian manufacturers. While APEC's *Survey of Foreign Firms* was not designed to directly verify such findings for Atlantic Canada, foreign firms in the region did report positive impacts on the competitiveness of their local competitors and suppliers and the region's stock of human capital. However, as most foreign firms in Atlantic Canada are not heavily focused on R&D, and the region has few well-developed industry clusters, the scope for technology and knowledge spillovers to local firms has been limited.⁶²

Several large foreign manufacturers in the Atlantic provinces are the economic cornerstone of the rural communities in which they are located. While these foreign firms have helped sustain these communities for many years, this high level of dependence also leaves these communities vulnerable to the loss of such operations.⁶³ As foreign firms tend to be larger than domestic firms the loss of several hundred high-paying jobs are not quickly or easily replaced. Northern New Brunswick, for example, is reeling from the effects of the closure of several foreign-owned manufacturing plants (forest products in particular) which have

⁶¹ Whether foreign firms have raised the underlying growth rate of the Atlantic region is an important question but beyond the scope of this report.

⁶² This assessment is similar to those for host regions in the UK which have found substantial direct employment effects of foreign investment but "a limited range of linkages and generally low levels of integration with host region economies." Phelps, N.A., MacKinnon, Danny, Stone, Ian and Braidford, Paul (2003). *Embedding the Multinationals? Institutions and the Development of Overseas Manufacturing Affiliates in Wales and North East England. Regional Studies*, 37(1), 27-40. In short, "the static effects of inward investment are positive, whereas the long-term, dynamic benefits are limited at best." Hood *et al* cited in Potter *et al* (2003, p. 43).

⁶³ This issue here is the dependence on one large employer, not foreign ownership per se.

displaced more than 2000 workers since 2004. While some workers may move elsewhere, older workers may find it particularly hard to adjust.⁶⁴

There are also potential negative economic impacts of foreign investment on a host community, although these reflect the impact of larger, more productive firms rather than foreign ownership per se. Foreign firms can boost wages making it difficult for some domestic firms to compete for labour. Some new foreign entrants may compete directly with local firms. And, as with any large employer in a small region, a foreign firm may have power to negotiate economic concessions from a particular community or to unduly influence educational programs in their favour.

Encouraging foreign investment does not mean that the governments should ignore domestic firms – there is scope and a need for both.⁶⁵ The offshore oil and gas industry would not have been developed without foreign multinationals – even these large MNEs structured these projects as joint ventures to manage their risk. Many innovative new companies are developed and built by Atlantic Canadian entrepreneurs. Some of these firms subsequently attract the interest of foreign investors that can provide further capital and specialized resources to fuel expansion, although foreign acquisition may risk the loss of some higher paid functions and local decision-making autonomy.⁶⁶

6.2 Summary of APEC's Findings: Atlantic Canada's Changing Competitiveness for Foreign Investment

The key message of this report is that the international competitiveness of Atlantic Canada is changing.

In the past, foreign firms have invested in the Atlantic region to access local markets, a skilled labour force, a low cost business environment and the region's natural resources. But Atlantic Canada's overall relative attractiveness for *new* foreign investment is waning due to: its small and relatively slow-growing local market; its declining relative cost

⁶⁴ APEC (2006d). The Growing Importance of Older Workers in Atlantic Canada. *Report Card*, 2006 (July).

⁶⁵ New Brunswick Business Council (2007). *Building Block for a Stronger New Brunswick: Statement on Self-Sufficiency*. Fredericton: New Brunswick Business Council.

⁶⁶ However, a summary of recent research on claims of “hollowing out” in Canada, finds that, at least for Canada as a whole, foreign acquisitions do not lead to a reduction in the number of head offices. See Hejazi (2010).

competitiveness reflecting factors such as the appreciation of the Canadian dollar and the emergence of other lower-cost jurisdictions; and its more subdued outlook for labour force growth.

Convergys, headquartered in Cincinnati, Ohio, operates 68 customer contact centres around the world, and employs about 65,000 people. It opened its first call centre in the Atlantic region in Dartmouth, Nova Scotia in 1998. The company's presence expanded over time and at one point Convergys employed over 4,000 people at five locations in Nova Scotia and about 1,800 people at two locations in St. John's, Newfoundland. Since early 2010, some of these locations have been closed, leaving the company with a reported 1,300 employees at two locations in Nova Scotia and less than 1000 employees in St. John's.

In terms of *existing* foreign firms in the region, many foreign operators are facing significant pressures in terms of weak (or even declining) demand growth and poor cost competitiveness. The closure of several foreign-owned manufacturing plants and call centres in Atlantic Canada in the last few years highlights the huge competitive challenges and adjustments facing foreign (and Canadian) manufacturers and exporters in the region. These challenges partly reflect the region's prior focus on attracting foreign firms on the basis of the region's low costs. But the appreciation of the Canadian dollar and the widespread emergence of other low cost competitors have radically changed Atlantic Canada's relative cost advantages.

So how do governments need to respond to Atlantic Canada's changing competitiveness for international investment to best support the future prosperity of the region? This report has not identified any major issues that are unique to foreign firms.⁶⁷ Both foreign and domestic firms would benefit from broad-based government policies to encourage innovation and productivity growth as both seem to place a relatively low priority on innovation-based strategies. Moreover, increased innovation and R&D in domestic firms would increase their capacity to absorb new technology from foreign firms. Foreign and domestic firms also have similar

⁶⁷ The Conference Board of Canada also concluded, in a recent study, that the main public policies identified as best practices to promote foreign investment and the benefits of such investment, are not unique to foreign investment, but are broadly appropriate for influencing real economic growth more generally. See Globerman, Steven and Chen, Victor Zittian (2010). *Best Policy Practices for Promoting Inward and Outward Foreign Direct Investment*. Ottawa: Conference Board of Canada.

priorities when it comes to improving the region's business climate and so both would benefit from any such improvements.⁶⁸

6.3 Policy Priorities: Refocus Investment Attraction and Retention Strategies

Governments and investment agencies need to shift their focus from attraction efforts that emphasize a business case based largely on low costs to attraction and retention strategies that emphasise innovation and unique sources of regional competitive advantage within the global economy. This will likely mean emphasizing fewer job opportunities but jobs that are higher skill and higher paid.

Refocus investment attraction efforts

Attraction strategies need to refocus on the region's current strengths and best potential for future growth. This refocusing of investment attraction efforts may require adoption of sector specific strategies, rather than broad-based recruitment efforts, so that industry specific location advantages can be identified that are not easily replicated elsewhere.⁶⁹ These regional assets could include local energy resources, a specialized labour force or specialized research facilities.

Consistent with global trends in foreign investment, the region's best prospects for new foreign investment are in exportable services and in the resource (energy and mining) sector. In terms of services, however, the region's traditional focus on low cost labour as a prime advantage needs to shift to focus on higher value services where skill levels and other location factors are relatively more important than operating costs. There may be select opportunities to attract small manufacturing plants (where there is some unique competitive advantage the region can provide for a particular firm) but, in general, the evidence presented in this report indicates that the region has limited prospects to attract new greenfield

⁶⁸ For priorities of Atlantic-headquartered firms see Chaundy (2006).

⁶⁹ Researchers have similarly concluded that Canada needs to focus on niche market opportunities. Sharpe, Andrew and Banerjee, Meghna (2008) *Assessing Canada's Ability to Compete for Foreign Direct Investment*. Ottawa: Centre for the Study of Living Standards. The federal government is focusing on a number of priority industry sectors as part of its FDI attraction strategy.

manufacturing operations.⁷⁰ This shift in favour of services, along with the growing importance of a skilled labour supply as a location factor, will require investment agencies to emphasize the stronger labour force potential in or near the region's larger cities. Whether the region can leverage its existing research capabilities to attract R&D intensive foreign operations to boost growth in niche industry clusters is an important opportunity that needs to be explored.

The Atlantic provinces show some signs of recognizing the need for change by shifting their attraction focus to higher value activities and new growth sectors. For example, the Nova Scotia government has recently acknowledged that the competitive environment for call centres in the province has changed substantially with the province no longer actively prospecting them.⁷¹ Its new economic growth strategy, released in November 2010, focuses on sustainable high value jobs that align with Nova Scotia's advantage. The prime focus of Nova Scotia Business Inc. (NSBI), Nova Scotia's business attraction agency, is the defence, security and aerospace sector, information technology and financial services.⁷² As part of its Island Prosperity Strategy, released in 2008, Prince Edward Island has narrowed its focus to four growth sectors – bioscience, aerospace, information technology (including video game development) and renewable energy.⁷³

Newfoundland and Labrador is focused on oil and gas, mining, information and communications technology, aerospace and defence, and ocean technology. Its Department of Business is currently developing an investment attraction strategy. Business New Brunswick has traditionally led New Brunswick's investment attraction with a focus on the development of three technology clusters – advanced learning (which includes e-learning and gaming/animation software), health, and

⁷⁰ Researchers have reached the same conclusion with regard to inward manufacturing investment in the UK's peripheral regions: "Inward investment policies that seek to replace 'ailing manufacturing industry' in the UK's peripheral regions with 'more manufacturing jobs' are, therefore, likely to fail." Fallon and Cook (2010), pp. 348-9.

⁷¹ Wood, Caroline (2010, December 16). NSBI Despondent About Future of Call Centre Sector. AllNovaScotia.com. Lund, Stephen (2010, December 17). Feedback: NSBI Despondent About Future of Call Centre Sector. AllNovaScotia.com. Flinn, Brian (2010, December 17). Paris Explains Decline of Call Centre Industry. AllNovaScotia.com. Jackson, David (2010, December 17). N.S. looks beyond call centres. Chronicle Herald, accessed online, December 21, 2010.

⁷² Nova Scotia Business Inc. (2010). *Business Plan 2010-2011*. Halifax: Government of Nova Scotia.

⁷³ Mayne, Michael (2008). *Island Prosperity: A Focus for Change*. Charlottetown: Government of Prince Edward Island. Investment attraction is now handled by Innovation PEI, a new Crown corporation which succeeded PEI Business Development Inc.

bioscience; and two industrial clusters – aerospace and defence, and energy.⁷⁴ However, the province is in the process of shifting to a new model of economic development with the creation of a new Crown corporation, Invest NB, that will include private sector input.⁷⁵ At the federal level, the government of Canada is committed to making Canada a magnet for global investment and innovation, and is expanding its efforts to promote Canada as a destination of global investment through a new Foreign Investment Promotion Strategy.⁷⁶

Develop progressive retention strategies

Governments need to investigate opportunities to encourage existing foreign firms, where possible, to redefine their role and develop strategic advantages within their multinational operations that will help ensure their long-term success within the region. This could involve investing in capital, new technology, training, or other productivity improvements to secure production for existing markets or to shift to new, faster growing product markets.

For example, one study of multinationals in Scotland found that the foreign subsidiary plays a key role as the ‘technological receiver’ of foreign know-how but these knowledge transfers and their impact are not automatic. The researchers advocated the need for “policies to encourage subsidiaries to develop technological capabilities of their own” such as linking local companies with local universities and research institutes and forming local networks of firms requiring complementary technologies.⁷⁷

A critical challenge is to ensure that the development of the foreign subsidiary benefits both the parent company and the region. Researchers have examined how local managers in the UK can attract sufficient resources and decision making power to positively influence the future of

⁷⁴ Business New Brunswick (2007). *Business New Brunswick Strategic Priorities 2007-2011*. Business New Brunswick (2010). Department of Business New Brunswick Annual Report 2009-2010. Fredericton: Business New Brunswick.

⁷⁵ Government of New Brunswick (2010). *Speech from the Throne*.

⁷⁶ Government of Canada (2008). *Seizing Global Advantage: A Global Commerce Strategy for Securing Canada's Growth and Prosperity*. Ottawa: Government of Canada. Further details on the various components of the Foreign Investment Promotion Strategy are available at <http://www.international.gc.ca/commerce/strategy-strategie/investment-investissement.aspx>.

⁷⁷ Siler, Pamela, Wang, Chengqi and Liu, Xiaming (2003). Technology Transfer Within Multinational Firms and Its Impact on the Productivity of Scottish Subsidiaries. *Regional Studies*, 37(1), 15-25.

the subsidiary.⁷⁸ Successful strategies include improving the subsidiary's track record to establish credibility with the parent company; taking the initiative to identify new market making opportunities; maintain exposure by showing that local initiatives can contribute to the MNE network; and being a good corporate citizen by demonstrating identification with the organization as a whole.

The Aditya Birla Group, India's first multinational corporation, is a large conglomerate operating in 25 countries around the world, with its headquarters in Mumbai, India. It operates two mills in New Brunswick. The first mill (AV Cell Inc.) was established in 1998 at Atholville (initially as a 75-25 joint venture with Canadian company Tembec Inc.) to produce dissolving rayon grade wood pulp. In 2006 the two companies purchased the St. Anne Nackawic wood pulp mill (AV Nackawic Inc.) and converted the mill to produce dissolving grade pulp; the conversion was completed in August 2008. The dissolving grade chemical pulp produced by the mills is the main raw material used in the manufacture of viscose staple fibre (rayon) at the Group's facilities in India, Thailand, Indonesia and China. In 2008, Aditya Birla increased its stake in both mills from 75% to 95% and is actively pursuing energy improvements at its plants. It is also investigating the potential for a new biorefinery. In addition, the Aditya Birla Group operates Aditya Birla Minacs call centres in the region. Its Moncton, New Brunswick location opened in 2000 with a smaller centre opening in Halifax in 2004. A third call centre was opened in Port Hawkesbury, Nova Scotia in 2007 but there were substantial layoffs at this location during 2010.

These policies could form part of a systematic aftercare program to help secure the broader benefits of foreign investment for the region (e.g., technology spillovers) and to prolong the life of such investment.⁷⁹ NSBI, for example, uses a "Team Nova Scotia" approach to ensure the continued growth of its target sectors, such as its emerging financial services industry, by bringing together industry, academia and government in a co-ordinated effort. The Greater Halifax Partnership adopted a business retention and expansion (BRE) program (SmartBusiness) in 2004 with SmartBusiness Action Teams responding to firm-specific or systemic challenges identified in interviews with businesses. In Nova Scotia, there is a BRE program operated by the 13 regional development agencies.

⁷⁸ Birkinshaw, Julian, Bouquet, Cyril and Chini, Tina (2006). *Attention HQ: Strategies for UK Subsidiary Companies*. London: Advanced Institute of Management Research.

⁷⁹ UNCTAD (2007a) *Aftercare: A Core Function in Investment Promotion*. New York: United Nations.

Several countries have also adopted explicit programs to improve local linkages and strengthen their local supplier community, for example, by improving awareness of local supply capabilities and by helping local firms upgrade their training or technology adoption.⁸⁰ There may be scope to adopt similar strategies in Atlantic Canada, particularly for the offshore energy industry and other larger foreign purchasers in the region, although such programs need careful design and evaluation.⁸¹ The federal government is introducing new aftercare services for foreign investors as part of its new foreign investment promotion strategy.

Refocus investment incentives

Provinces provide a variety of incentives to attract new businesses. Nova Scotia operates a performance-based payroll tax rebate with the rebate depending upon the number of jobs created or retained above a minimum salary level. Newfoundland and Labrador operates a Business Attraction Fund which can provide up to \$29 million annually to provide customized financial assistance for inward investors.⁸² New Brunswick also provides tailor-made incentives including loan guarantees and forgivable loans. Incentives available in Prince Edward Island include tax rebates for key sectors such as aerospace and bioscience as well as a variety of tax rebate programs for companies in strategic sectors.

Governments should ensure that any assistance or incentives for either new or existing foreign firms helps to build sustainable competitive advantages rather than simply reduce business costs. This could include encouraging investment in new machinery or equipment, the adoption of new technology, R&D and technology transfer, or other measures to boost productivity. With labour supply becoming an increasingly important issue for investment attraction, incentives that promote training will facilitate the transfer of knowledge from the foreign firm and enhance the stock of human capital in the region. Such spillovers benefit

⁸⁰ UNCTAD (2001).

⁸¹ For example, research from the UK found that a large proportion of suppliers did not experience any improvement in their competitiveness as a result of trading with foreign investors while many benefits arose from passive transmission processes rather than active networking activities. Attitudes of suppliers and foreign firms can limit the benefit of networking programs. Potter, Jonathan, Moore, Barry and Spires, Rod (2003). Foreign Manufacturing Investment in the United Kingdom and the Upgrading of Supplier Practices. *Regional Studies*, 37,(1), 41-60.

⁸² The fund is in addition to the long-established EDGE program which can provide a 10-15 year tax holiday from provincial income taxes.

the region and will be retained even if a foreign firm subsequently leaves the province.⁸³

For example, Nova Scotia's new Productivity Investment Program is designed to encourage businesses to become more productive, innovative and globally competitive.⁸⁴ The Capital Investment Incentive supports the purchase of technologically-advanced machinery, clean technology, equipment, software and hardware; the Workplace Innovation and Productivity Skills Incentive provides funding to companies to encourage investment in skills development and certification and help them adapt to the introduction of new technology and innovative processes, improve productivity, and strengthen international competitiveness. In Newfoundland and Labrador, the Research and Development Corporation has announced a call for proposals to support increased petroleum R&D in the province, with the intent that such expenditures will "act as a catalyst for growth that will maximize the potential for petroleum resource development".⁸⁵

Update and review Canada's investment regime

While Canada is in principle open to foreign investment, acquisitions of Canadian firms are subject to review if they exceed certain thresholds.⁸⁶ Such investments are reviewed to determine whether the acquisition is of "net benefit" to Canada. Canada also restricts foreign investment in certain sectors such as telecommunications and air transportation.⁸⁷

There have been calls for Canada to provide greater clarity of its investment policy.⁸⁸ The recent decision under the Investment Canada Act that BHP Billiton's takeover of PotashCorp did not provide a net

⁸³ Some employees may also develop the skills to start their own companies.

⁸⁴ Preference is given to exporters in five strategic sectors.

⁸⁵ Government of Newfoundland and Labrador (2010, June 10). *Research & Development Corporation Announces Call for Proposals for Directed Research Program – Petroleum R&D Accelerator* [Press Release].

⁸⁶ The threshold for the acquisition of a Canadian business by WTO members is an asset value exceeding \$299 million in 2010. This threshold is expected to increase to \$312 million in 2011. For cultural businesses or for non-WTO investors, the threshold for a direct investment is \$5 million. At present, foreign investments in transportation services, financial services and uranium production are also subject to the lower threshold. For a brief discussion of Canada's legislation and policy see APEC (2002a).

⁸⁷ For details and discussion see Mandel-Campbell, Andrea (2008). *Foreign Investment Review Regimes: How Canada Stacks Up*. Ottawa: Conference Board of Canada and Competition Policy Review Panel (2008).

⁸⁸ See, for example, Mandel-Campbell (2008) and MacKinnon, Janice (2010). The Potash Takeover Bid: The Deal That Wasn't. *Policy Options*, December 2010-January 2011, 49-52.

benefit to Canada has highlighted these concerns.⁸⁹ Others have gone further and argued in favour of a more open regime, for example, by substantially raising the threshold for review, reducing foreign investment restrictions in non-cultural sectors, by shifting the burden of proof away from foreign investors, or by limiting the review to national security only.⁹⁰

The Budget Implementation Act that received Royal Assent in March 2009, amended the Investment Canada Act so that only larger investments would be subject to review. Draft regulations to substantially increase the investment threshold were published in July 2009 but the regulations have to be finalized before these changes can come into force.⁹¹ The Standing Committee on Industry, Science and Technology agreed in March 2010 to “begin a review of the Investment Canada Act to ensure Canada's foreign investment legislation serves the best interests of Canadians” but did not specify any time frame.⁹² On February 1, 2011, the Committee agreed to a more limited review of the Investment Canada Act with regard to public disclosure of decisions under the Act and the effectiveness of the Act's enforcement mechanisms.⁹³

6.4 Policy Priorities: Ensure an Adequate Labour Supply

Ensuring an adequate supply of skilled labour will be a key challenge in the coming decades and was identified as the top concern in APEC's *Survey of Foreign Firms*. High paying jobs can only be created and retained in the region if the Atlantic provinces can attract, develop and retain a pool of highly skilled labour. However, as evidenced by the wide range of suggestions made by respondents to APEC's *Survey of Foreign Firms*, there is no one single measure governments can take to improve

⁸⁹ McKenna, Barrie (2010, November 28). Investment Canada Act is as clear as mud. Or potash. Globe and Mail. Retrieved January 18, 2010 from <http://www.theglobeandmail.com/report-on-business/commentary/barrie-mckenna/investment-canada-act-is-as-clear-as-mud-or-potash/article1816546/>.

⁹⁰ See, for example, Competition Policy Review Panel (2008) and Globerman (2008). An Evaluation of the Investment Canada Act and its Operations. Research Paper prepared for the Competition Policy Review Panel. preg and Mintz (2010) argue that foreign takeovers should only be blocked in exceptional circumstances relating to national security; acquisitions by foreign sovereign wealth funds or state-owned enterprises should be reviewed on a case-by-case basis to ensure they are pursuing commercial objectives and that there is a level playing field in terms of financial support.

⁹¹ The regulatory changes would also raise the threshold for investments in transportation services, financial services and uranium production. Amendments relating to a new national security review mechanism have already come into force.

⁹² Standing Committee on Industry, Science and Technology (2010, March 9). Minutes of Proceedings.

⁹³ Standing Committee on Industry, Science and Technology (2011, February 1). Minutes of Proceedings.

the region's labour supply situation. Rather, governments need to take a comprehensive and integrated approach to labour supply development, which must include dimensions such as the quality of primary and post-secondary education, literacy and training for existing workers, competitive tax policy and labour regulations, and a responsive immigration policy. However, two specific areas can be highlighted, that are particularly relevant in terms of the labour supply needs of foreign firms.

First, ensure young people leave school with adequate functional literacy levels. It was recently reported that between 25% and 35% of high school graduates fail basic literacy and math tests (geared to a Grade 8 level) that are administered by Michelin in hiring for its Nova Scotia plants.⁹⁴ Atlantic students also perform below the Canadian average on standardized reading, math and science tests.⁹⁵ With a majority of jobs in the future likely to require some post-secondary education, it is essential that young people have the required skills to complete employer-provided entry-level training programs or further education programs.⁹⁶

"Governments need to ensure the availability of a competent, sustainable workforce by working to keep our home grown ones here and by making it easier and more attractive for immigrants to settle and stay in Atlantic Canada. With a declining labour demographic looming and the draw of the West pulling, businesses will be competing more so than ever for a limited number of employees." - Call centre

Second, ensure Atlantic Canada has an informed and responsive education and training system. With the emergence of new growth sectors and the decline of some existing industries, young people need accurate and up-to-date information about future job opportunities and skill requirements, so they can make informed decisions regarding their education and training. Educational institutions also need to be responsive to the changing demand for graduates in particular fields and

⁹⁴ Ware, Beverley (2009, March 17). Many N.S. job applicants struggle with math, Michelin official says. The Chronicle Herald, pp. 1B.

⁹⁵ Knighton, Tamara, Brochu, Pierre and Gluszynski, Tomasz (2010). *Measuring Up: Canadian Results of the OECD PISA Study*. Ottawa: Human Resources and Skills Development Canada, Council of Ministers of Education and Statistics Canada.

⁹⁶ APEC (2006b). Literacy is Key to Improving Atlantic Economic Prospects. *Report Card*. 2006 (March). The Atlantic ministers of education and training released a 5-year regional literacy action plan in September 2009, which includes steps to improving literacy levels in Atlantic Canada's schools relative to the Canadian average.

the skill requirements of employers with these fields. For example, in 2007, Saint Mary's University developed a Certificate in Financial Instrumental Analysis in response to the labour market needs of Halifax's growing financial services sector. Governments should ensure that taxpayer supported institutions receive regular input and validation from employers on the quality of their programs and graduates.⁹⁷

The Atlantic provinces have recognized the labour force challenges they are facing. Newfoundland and Labrador officially launched its Youth Retention and Attraction Strategy in November 2009 to guide its investments in youth retention and attraction and to enable it to become a province of choice for young adults. The province reduced its personal income taxes in 2007 and has made further reductions since to fulfill its commitment to maintain the lowest tax rates in Atlantic Canada. Prince Edward Island acknowledged the primacy of labour force needs in its new prosperity strategy. It established Skills PEI, a division with its Department of Innovation and Advanced Learning to manage its labour market programs, including those previously provided by the federal government, but with the goal to focus these training investments in support of its four strategic growth sectors.⁹⁸

Nova Scotia is developing a new workforce strategy to help workers build new skills and learn new technologies; adapt its education and training programs to a changing labour market; improve employer investment and employee participation in workplace education and training; and launch a new Labour Market Information Program for career seekers, educational institutions, and employers. In its March 2009 budget New Brunswick announced reductions in personal income taxes over four years to help attract higher skilled workers to the province, although the new government has indicated that it will cancel future tax reductions for the highest income earners as it strives to reduce its large fiscal deficit.

⁹⁷ The Competition Policy Review Panel (2008) also recommended that "Governments should use all the mechanisms at their disposal to encourage post-secondary education institutions to collaborate more closely with the business community, cultivating partnerships and exchanges in order to enhance institutional governance, curriculum development and community engagement" (p. 68).

⁹⁸ Mayne (2008).

6.5 Policy Priorities: Improve the Business Climate

"Our parent company has world-wide operations with more than 50,000 employees. This is one of the most bureaucratically stifling and highly taxed operations in the group. The business environment does not make it easy to justify tying up capital to operate here." -
Transportation company

While Atlantic Canada needs to shift to attracting higher value operations, which may be less sensitive to small differences in business operating costs, it is important that Atlantic Canada ensures that its overall business climate is reasonably competitive. This will make it easier to secure new investment and reduce the likelihood of losing existing investors.

Lower corporate tax rates as finances permit

Nova Scotia and Prince Edward Island have the highest provincial general corporate income tax rates in the country at 16%, followed by Newfoundland and Labrador at 14%.⁹⁹ By contrast, New Brunswick has reduced its general corporate income tax from 13% at the beginning of 2009 to 11% by July 2010 with a further reduction to 10% by July 2011, saving businesses an estimated \$20 million in 2011-2012.¹⁰⁰ These reductions will give the province the lowest corporate tax rate in the country alongside Alberta and British Columbia.¹⁰¹ Manufacturers and resource companies may also be eligible for the 10% federal Atlantic Investment Tax Credit (AITC) which in some circumstances can substantially reduce the marginal effective tax rate (METR) on new investment.¹⁰²

Foreign firms identified a reduction in corporate income taxes as a high priority to help improve the region's business climate. An up-to-date review of empirical studies concludes that foreign direct investment

⁹⁹ For the manufacturing sector, a provincial tax credit gives Newfoundland and Labrador the lowest corporate rate in the country at 5%.

¹⁰⁰ New Brunswick Department of Finance (2009). *Delivering Lower Taxes for New Brunswickers*. Fredericton: New Brunswick.

¹⁰¹ Ontario is planning to reduce its general corporate income tax rate to from 12% to 10% by 2013. Manitoba has deferred a reduction from 12% to 11%.

¹⁰² New Brunswick Department of Finance (2008). *A Discussion Paper on New Brunswick's Tax System*. Fredericton: Government of New Brunswick.

decisions are sensitive to both marginal and average corporate tax rates.¹⁰³ Both the statutory rate and the METR matter.¹⁰⁴

Nationally, Canada has improved its business tax competitiveness relative to other countries.¹⁰⁵ The federal government reduced its corporate income tax from 18% to 16.5% on January 1, 2011 with a further reduction to 15% by January 2012. It has called on the provinces to reduce their statutory corporate income tax rates to 10%. The Competition Policy Review Panel also urged federal and provincial governments to continue to reduce corporate income tax rates; called on the provinces to expedite the phase out of provincial capital taxes;¹⁰⁶ and recommended that Prince Edward Island (along with Ontario and three Western provinces) harmonize their provincial sales tax with the federal goods and services tax.¹⁰⁷

"Help make doing business in Atlantic Canada competitive by improving the business climate. Eliminate/reduce taxes as soon as possible rather than phasing in changes: Businesses need relief now not years down the road." - Manufacturer

In light of the fiscal deficits currently facing Nova Scotia and Prince Edward Island, a reduction in the general rate of corporate income tax is unlikely during the next couple of years.¹⁰⁸ However, as their financial circumstances improve, these provinces should give serious consideration to lowering their corporate income tax towards 10%, to ensure their tax environment remains reasonably competitive with other Canadian provinces.¹⁰⁹ Growth in offshore energy revenues may give

¹⁰³ Do Mooij, Ruud A. and Ederveen, Sjeff (2008). Corporate Tax Elasticities: A Reader's Guide to Empirical Findings. *Oxford Review of Economic Policy*, 24(4), 680-697.

¹⁰⁴ Department of Finance Canada (2008). Considerations in Setting Canada's Corporate Income Tax Rate. *Tax Expenditures and Evaluations 2008*, 38-53. Government of Canada: Ottawa.

¹⁰⁵ Chen, Duanjie and Mintz, Jack (2010). Canada's Tax Competitiveness After a Decade of Reforms: Still An Unfinished Plan. SPP Research Papers, 3(5). Calgary: University of Calgary School of Public Policy.

¹⁰⁶ Nova Scotia is the only Atlantic province with a capital tax on non-financial corporations although this will be phased out by July 2012; however, the four Atlantic provinces retain the highest capital taxes in the country on financial institutions.

¹⁰⁷ Ontario and British Columbia moved to a harmonized sales tax in 2010. Shifting to a value-added tax rather than a sales tax reduces the tax on business inputs such as machinery and equipment.

¹⁰⁸ Corporate tax revenues in Nova Scotia have averaged about \$350 million over the last three fiscal years, or about 4.3% of total revenues; in Prince Edward Island, corporate tax revenues have averaged \$32 million or 2.3% of total revenue; and in Newfoundland and Labrador corporate tax revenues have averaged \$533 million or 7.2% of total revenues.

¹⁰⁹ With labour intensive services and higher paid service jobs likely to play an increasingly important role in foreign investment in the region, it is important to maintain a balance between corporate taxes and personal income taxes, as

Newfoundland and Labrador more scope to make such a reduction. But provinces must be careful not to compromise the quality of their education systems and transportation infrastructure which are also important to foreign investors.¹¹⁰

Identify and reduce regulatory impediments

Improving the regulatory environment is also important for foreign firms. Taking steps to speed up approval processes, reduce compliance costs, revise outdated regulations, and harmonize regulations within the Atlantic region would help reduce business operating costs without harming safety, environmental or other standards.

In recent years, governments have been pursuing broad strategies to reduce the regulatory burden. For example, Newfoundland and Labrador's Red Tape Reduction Initiative reduced the paperwork and regulatory burden on business by 27% between 2006 and 2009 with a commitment to ensure no net increase in regulatory requirements going forward and to continuously improve how the government interacts with business and the public.¹¹¹ Nova Scotia achieved a 20% reduction in the paperwork burden as part of its five-year Better Regulation Initiative.¹¹² As part of this initiative the government established a 10-day service standard to issue business licenses and permits and introduced a new Regulatory Management Policy across all departments. At the municipal level, a new downtown plan for Halifax was approved in 2009 to streamline and provide greater certainty to the development approval process.¹¹³

In terms of interprovincial barriers, the governments of New Brunswick and Nova Scotia signed a Partnership Agreement on Regulation and the Economy (PARE) in February 2008 to help standardize and harmonize

relatively high rates of either tax could discourage the growth of such businesses in the region. APEC is currently completing a detailed assessment of tax policy in the Atlantic region.

¹¹⁰ Gliberman and Chen (2010). A US study also found that high state expenditures relative to corporate taxes, and other pro-business policies, were a positive influence on investment. See Fox, S.E. and Lee, J. H. (1996). Determinants of Foreign Firm Location Decisions in the United States, 1985-1990 – Implications for State Economic Development Policies. *American Politics Quarterly*, 24(1), 81-104.

¹¹¹ Government of Newfoundland and Labrador (2009, May 7). *Twenty-Seven Per Cent Less Red Tape as Government Streamlines Processes and Improves Service* [Press Release].

¹¹² Government of Nova Scotia (2011, January 10). *Province Making it Easier To Do Business in Nova Scotia* [Press Release].

¹¹³ Halifax Regional Municipality (2009, June 16). *Regional Council Approves HRMbyDesign* [Press Release].

regulations between the provinces and to ensure mutual recognition of professional and trade credentials. During its first year the provinces reported progress in several areas including taking steps towards harmonizing trucking permits, regulation of the onshore petroleum industry, and the regulation of compulsory certification trades.¹¹⁴ In light of the competitive pressures discussed in this report, and with a large proportion of foreign firms operating in more than one province, the Atlantic provinces should look for further opportunities to harmonize regulatory regimes across the region.¹¹⁵

"Harmonize interprovincial regulations in Atlantic region." - Insurance company

Governments should also be aware of and responsive to regulatory issues that are unnecessarily hindering the performance of key sectors in the region. APEC's *Survey of Foreign Firms* was not designed to identify detailed industry-specific regulatory barriers, but these could be identified in follow-up interviews with foreign firms as part of an aftercare program (discussed above) or through other formal mechanisms.¹¹⁶

Identify and improve key transportation deficiencies

Foreign manufacturers and transportation providers emphasized the need to invest in the region's transportation infrastructure as well as to reduce inefficiencies due to restrictive regulations. As part of initiatives to provide an economic stimulus to their economies, the four Atlantic provinces did boost transportation spending in the region in 2009 and 2010, with most of this new spending directed to roads and bridges.¹¹⁷ However, as the provinces try to eliminate their fiscal deficits, capital spending is expected to return to more normal levels.

Recognizing that each province is heavily dependent on each other's transportation network, the four Atlantic provinces released a regional

¹¹⁴ Partnership Agreement on Regulation and the Economy (2010). Annual Report 2009/2010.

¹¹⁵ As noted earlier, about 37% of the firms in APEC's *Database of Foreign Firms*, representing more than half of total employment in foreign firms, have operations in more than one Atlantic province.

¹¹⁶ Such interviews or other mechanisms could also be used to identify transportation, labour supply and other business climate issues.

¹¹⁷ APEC (2010).

transportation strategy in 2008, that calls on all three levels of government and the private sector to work together to provide sufficient, sustainable long-term funding, to update policies and regulations, and to enhance service levels.¹¹⁸ The most pressing need identified in the strategy was to rehabilitate the region's strategic highways to restore them to their design service levels.

"Getting to Atlantic Canada is really costly and difficult. It is a real problem for prospects coming to visit." - Call centre

While ensuring sufficient long-term funding to maintain the region's highway network is important, with the service sector playing an increasingly important role in terms of foreign investment in the region, air access is also an important issue. While low business density in the region has traditionally been an impediment, the Atlantic governments should examine what steps they can take to help facilitate improved service levels between the larger Atlantic airports and major North American and European centres. For example, the government of Newfoundland and Labrador recently launched a 5-year strategy to improve air access in the province.¹¹⁹

Evaluate further options to encourage exploration and new energy developments

The Atlantic offshore energy sector has been a significant source of growth in terms of investment, output and royalties and it has stimulated the development of a cluster of domestic and foreign-owned suppliers and service providers. However, exploration activity, particularly in Nova Scotia, has slowed considerably in recent years as energy companies have pursued more attractive plays elsewhere in the world. Low natural gas prices will further hinder offshore exploration activity. Satellite fields are being developed off Newfoundland and Labrador along with progress

¹¹⁸ New Brunswick Department of Transportation (2008). *Charting the Course: The Atlantic Canada Transportation Strategy 2008-2018*. Fredericton: Province of New Brunswick.

¹¹⁹ Government of Newfoundland and Labrador (2010, October 13). *New Long-Term Strategy Aims for Greater Air Access in Province* [Press Release].
launched a 5-year air access strategy in October 2010.

toward the new Hebron project but overall exploration activity remains modest.

Provincial governments have taken initiatives to improve access to geological data and provide more flexible terms and conditions for new exploration licences to help encourage exploration.¹²⁰ Nova Scotia launched its offshore renewal plan in October 2008.¹²¹ As part of its new energy strategy, released in January 2009, the province committed to modernize offshore exploration and development legislation and regulations (in collaboration with the federal government) and is investing \$19 million to support geoscience research.¹²²

"Provide certainty to the regulatory processes and local benefits and fiscal conditions." - Energy company, Newfoundland & Labrador

As part of its energy plan, released in September 2007, the government of Newfoundland and Labrador committed to establish a working group to develop regulatory and fiscal measures to promote targeted exploration activity and to facilitate the development of satellite fields including reduced cycle time approvals.¹²³ It also noted that it "is time for the provincial and federal governments to conduct a joint comprehensive review and update the [regulatory] regime", committing to work with the federal government and stakeholders to improve the efficiency and effectiveness of the offshore regulatory structure. The Canadian Association of Petroleum Producers has advocated for fiscal measures "to restore the economics and enhance the competitiveness of the region", such as restoring the Atlantic Investment Tax Credit to 15%, accelerated capital cost allowances and other exploration incentives.¹²⁴

With increased interest in onshore developments, such as shale gas exploration in New Brunswick, governments need to continue to ensure

¹²⁰ Canada-Nova Scotia Offshore Petroleum Board (2007, April 19). Regulator Announces Changes for the Offshore of Nova Scotia [Press Release].

¹²¹ Nova Scotia Department of Energy (2008). *Nova Scotia Offshore Renewal Plan*. Halifax: Nova Scotia Department of Energy.

¹²² Nova Scotia Department of Energy (2009). *Toward a Greener Future: Nova Scotia's 2009 Energy Strategy*. Halifax: Province of Nova Scotia.

¹²³ Newfoundland and Labrador Department of Natural Resources (2007). *Focusing our Energy: Newfoundland and Labrador Energy Plan*. St. John's: Government of Newfoundland and Labrador.

¹²⁴ Canadian Association of Petroleum Producers (2006). *Response to the Newfoundland and Labrador Energy Plan Discussion Paper*. St. John's: Canadian Association of Petroleum Producers.

that they establish and maintain regulatory frameworks that are expedient, upholding environmental and safety standards while minimizing regulatory uncertainty and inefficiency.¹²⁵ There is scope here for the provinces to work together to establish a common regulatory regime for future shale gas developments. Both New Brunswick and Nova Scotia committed, as part of their Partnership Agreement on Regulation and the Economy (PARE), to work towards harmonization of their onshore legislation and examine the potential for a common Onshore Petroleum Operational Regulatory Authority.

"Ensure the regulatory and fiscal environment is competitive with other jurisdictions seeking investment to develop oil and gas reserves." - Energy company, Nova Scotia

6.6 Concluding Comments

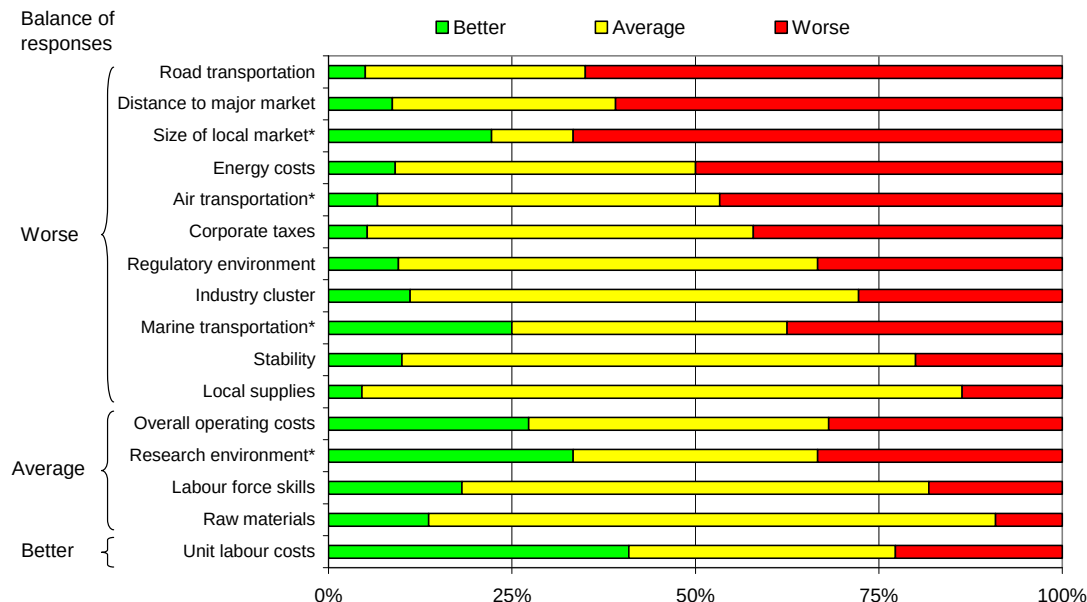
Foreign investment has played an important role in Atlantic Canada's economy and will continue to do so. However, foreign investment, whether by new foreign firms or reinvestment by existing firms, will be increasingly difficult to secure. Governments need to focus their efforts on the types of activity where the region can make a competitive and sustainable business case. And with many foreign firms operating in more than one province, governments should take further steps to cooperate on labour supply, tax, regulatory and transportation issues.

Foreign firms operating in Atlantic Canada (and Atlantic firms with global operations) have a keen sense of the region's strengths and weaknesses. While most of the business climate issues raised in this report are not new, the ongoing changes in the global economy, the lower rate of foreign investment observed in Atlantic Canada over the last few years, and the recent closure of foreign facilities in the region, should give added impetus to the importance of strengthening the region's business climate and ensuring that it remains competitive. Atlantic Canada's future prosperity depends upon it remaining open and fully engaged in the global economy.

¹²⁵ Similarly, royalty regimes need to be internationally competitive.

Appendix: Assessment of Atlantic Canada's Business Climate by Industry

Fig. A.1 - Assessment of Atlantic Canada's Business Climate: Manufacturers

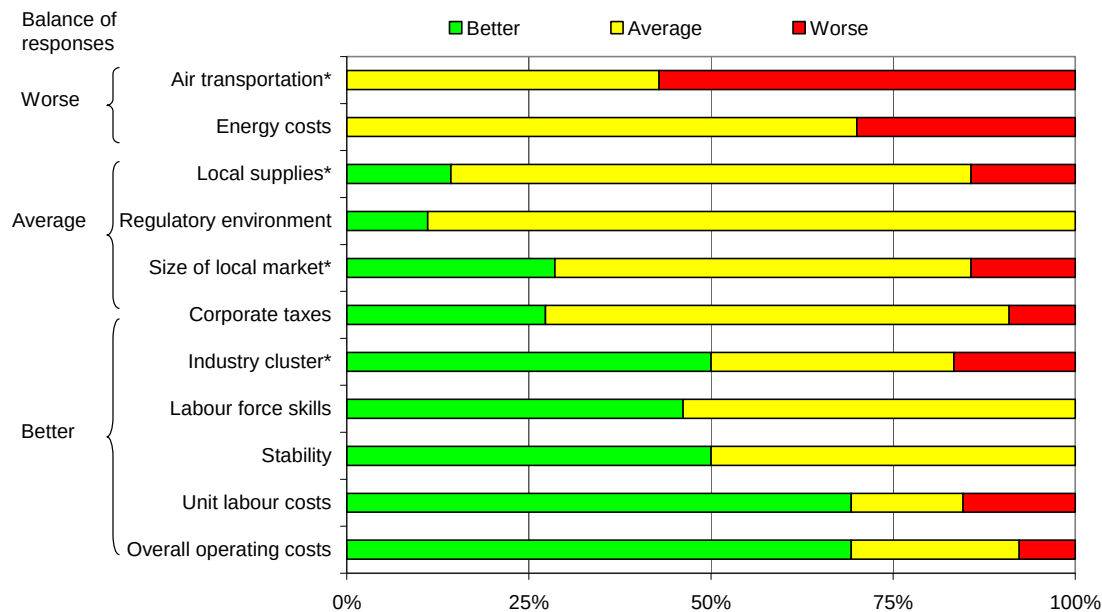


Note: Based on responses from 22 manufacturers. Ranked by balance of respondents, from worst to best ranking.

* Several firms indicated not applicable.

Source: APEC Survey of Foreign Firms.

Fig A.2 - Assessment of Atlantic Canada's Business Climate: Call Centres

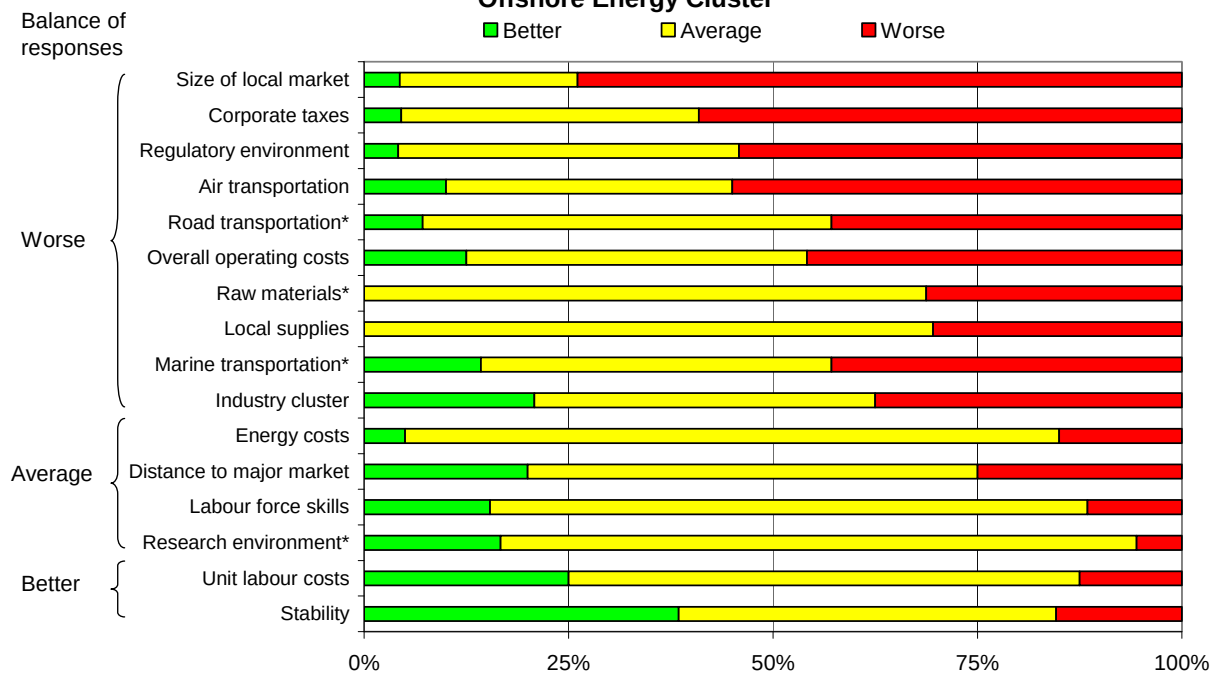


Note: Based on responses from 13 call centres. Ranked by balance of respondents, from worst to best ranking.

* Several firms indicated not applicable.

Source: APEC Survey of Foreign Firms.

**Fig. A.3 - Assessment of Atlantic Canada's Business Climate:
Offshore Energy Cluster**

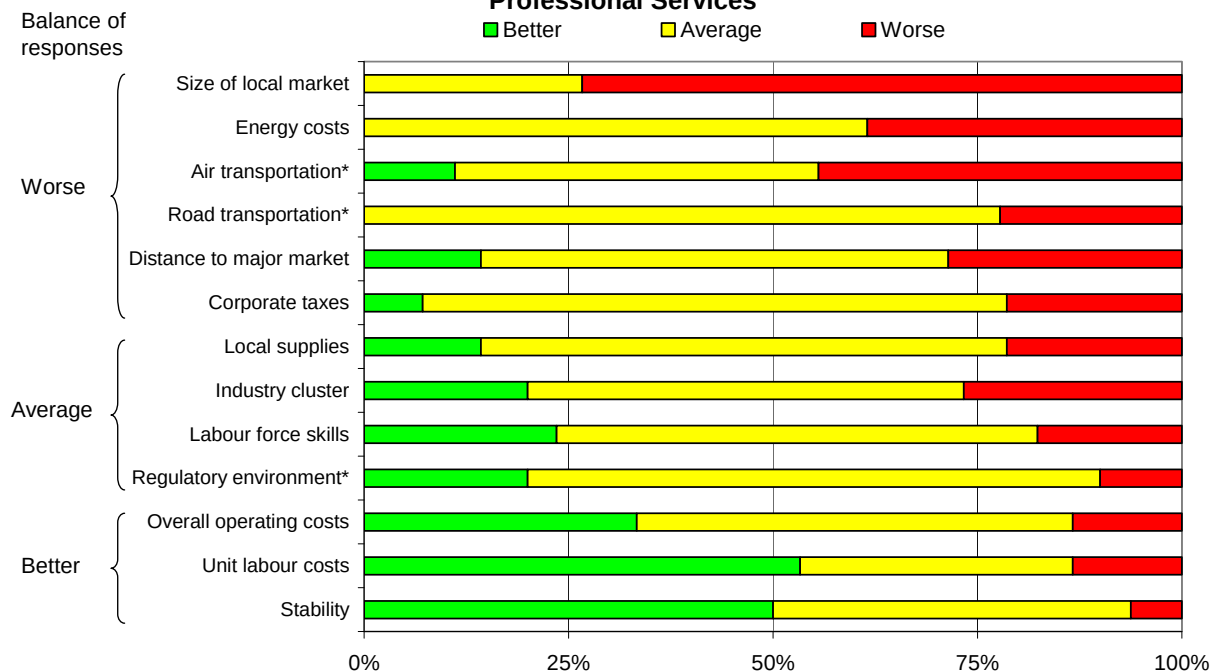


Note: Based on responses from 24 firms in the offshore energy cluster. Ranked by balance of respondents, from worst to best ranking.

* Several firms indicated not applicable.

Source: APEC Survey of Foreign Firms.

**Fig. A.4 - Assessment of Atlantic Canada's Business Climate:
Professional Services**



Note: Based on responses from 15 professional service firms. Ranked by balance of respondents, from worst to best ranking.

* Several firms indicated not applicable.

Source: APEC Survey of Foreign Firms.

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