



NOVA SCOTIA

**Economic Development
Office of the Minister**

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January 14, 2008

Mr. L. R. Wilson
Competition Policy Review Panel
280 Albert Street, 10th Floor
Ottawa, ON
K1A 0H5

RE: Competition Policy Review Panel

Dear Mr. Wilson:

I am writing to share the Government of Nova Scotia's views for the Competition Policy Review Panel.

Nova Scotia's economic growth strategy, "Opportunities for Sustainable Prosperity" (OfSP) (2006) makes many of the same observations concerning the changes in the world economy that have prompted the creation of the Competition Policy Review Panel. In order for an economy such as ours to be prosperous, we identified three fundamental elements:

- A better business climate, which includes appropriate taxation policies and investment incentives;
- Increased productivity through innovation; and
- Increased competitiveness, primarily through trade (which includes the export of goods and services, and both inward and outward investment).

We would suggest that whatever recommendations the Panel puts forward be aimed at these three objectives.

As we note in OfSP, Nova Scotia is a small province with an aging and shrinking population. Our domestic market is insufficient to give our companies much of an avenue for growth; therefore, they need to search for new markets outside the province and Canada in order to thrive. As the Panel has noted, the ways in which our companies engage these new markets is evolving and presents new challenges. For example, many of our businesses are turning to outward investment as a means of entering markets and are becoming integrated into global value chains – for government, the question then becomes how best to assist with these activities when, clearly, traditional export-oriented programs are not entirely appropriate.

Mr. L. R. Wilson
Page 2

It is clear that Canada's competition and investment policies are inextricably linked to the current and future prosperity of the Province, and we welcome the opportunity to assist in the work of the Panel.

There are a few major themes we would like to touch on in more detail, including: the value of foreign investment and the manner in which it is assessed; sectoral restrictions on FDI; the importance of company headquarters and their relation to R&D and innovation; the impact of changing trade patterns; and the role of the Canadian dollar vis-à-vis Canada's competitiveness as a destination for investment.

I have attached an Appendix which illustrates our views on these issues. We look forward to further expanding our views directly to the Panel on its visit to Halifax in March.

Yours sincerely,

Angus MacIsaac
Minister

cc. Hon. James M. Flaherty, Minister of Finance
Hon. Jim Prentice, Minister of Industry

APPENDIX

Value of foreign investment

Foreign direct investment has been a critical bedrock of the provincial economy for decades. Its importance is hard to overstate. In fact, relative to its share of the Canadian population, Nova Scotia has the highest levels of inward investment of any province in the country.

New inflows of foreign capital, whether via the creation of new company locations or the expansion of existing facilities, is always welcome. It is certainly not vital that Canadian business activities are domestically controlled and owned – as mentioned, Nova Scotia has a number of large, foreign-owned companies (e.g., Michelin, Stora Enso) that have made substantial contributions to the provincial economy over many years.

On the other hand, one of Nova Scotia's largest companies, Maritime Life, was lost to the Province as a result of a foreign takeover (by John Hancock). Any concerns we would have over foreign ownership would center around outcomes, not takeovers per se, and they have to be evaluated on a case-by-case basis. In some instances, foreign takeovers can be an excellent source of new ideas, productivity and capital inflows. At the same time, they can also be a source of major job losses and the loss of tax revenue.

Sectoral restrictions

Canada has historically restricted investment in key sectors such as telecommunications for sound reasons. In both telecommunications and transportation, there is a long-standing tradition in Canada that "the last mile will get serviced". That will not and should not change. Both these sectors are absolutely vital to the entire Canadian economy.

Nevertheless, studies by the OECD and others have shown that restrictions on FDI into Canada are higher than in the majority of OECD countries. While a number of these restrictions are in certain sectors, given the overall positive impact FDI has on the national economy, there is a strong argument that our policies are too constraining.

Any policies we adopt need to reflect all the regions of the country. On balance, the positive benefits to be gained from FDI far outweigh the negatives. But it is important that inward investment be spread across the country, in so far as it is possible – otherwise it is likely to exacerbate regional disparities that already exist. A completely unrestricted investment environment may concentrate investment flows in certain parts of the country, at the expense of domestic competition elsewhere.

This is of prime importance for Nova Scotia, given that we have one of the larger rural populations in Canada – one facing the twin challenges of demographics and competition for skilled labour from faster-growing areas elsewhere in Canada. Creating the enabling infrastructure that allows businesses to flourish in such an environment is not simple. As an example, the Province is currently in the middle of a project that will see broadband rolled out to the entire population of Nova Scotia by 2009, even in rather remote areas. That we are able to achieve such a goal is due largely to a highly

competitive telecommunications marketplace that is characterized by two large domestic players, and a number of smaller competitors. A similar situation exists with two major food retailers which, at the moment, provides for good competition but would quickly deteriorate were one of them to exit the Nova Scotia market.

Any loss of domestic competition is likely to show up in places like Nova Scotia and we would urge the Panel to pay close attention to this issue.

The regulations in the financial services sector have long been a source of discussion. A highly competitive financial services sector is of vital interest to Nova Scotia, as it is to the rest of the country. While we view a specific regime in financial services as important, we would question how well the current one is working. For example, the venture capital environment in Canada is far less effective and pervasive than the equivalent one in the United States, and lending to all sectors could be improved.

It is our view that the restrictions in the other three sectors are far less vital and could arguably be removed altogether.

Company headquarters and R&D

Canada's economy has historically had significant "branch plant" aspects – with both positive and negative effects. One key aspect here is that company headquarters tend to be the primary location of R&D, and so as headquarters disappear R&D numbers are likely to fall as well. Given Canada's relatively low level of private sector R&D, this is a potential concern, and may explain the poor numbers in the first place.

The other issue is that, faced with economic difficulties, companies tend to retrench to their base location. Head offices tend to be the last ones closed. All things being equal, a domestic company is likely to provide more stability to our economy than a similar-sized foreign-owned one. At the same time, the importance of head offices is not sufficient justification to overly restrict foreign ownership given the numerous benefits FDI brings. What is needed is a blend of the two.

Arguably the biggest impact we can have in this area is to provide the support to mid-sized Canadian-based companies (e.g., Research in Motion) that enable them to become large multinationals. In the absence of mergers or takeovers, such companies are highly likely to remain based in Canada, conduct R&D here and so on. Realistically, companies do not move head offices that frequently. We may spend too much time worrying about the large companies in Canada at the expense of our SMEs.

Changing trade patterns

As noted earlier, global trade patterns are moving toward what is known as integrative trade – encompassing exports, imports, and investment (both inward and outward).

Traditional export sales into foreign markets are still very important but other aspects are becoming increasingly important. Also, the rising Canadian dollar is having a large impact on trade patterns. As our goods become more expensive relative to our competitors, setting up operations directly in foreign markets makes economic sense as does entering new markets through strategic alliances, etc. As noted by the Panel, Canadian companies are specializing in various parts of global value chains.

However, exactly how the operations of Canadian companies are changing is not well understood at present, beyond a great deal of anecdotal evidence. It is our understanding that a Statistics Canada study is in the works that may help answer some of these questions, but preliminary data is unlikely to be available until 2009. More research is desperately needed, and this is a key priority of our own trade development work.

Most of the firms in Nova Scotia fall into the small- and medium-sized enterprise category. Government support for export, import and investment expansion is very important to these firms, and there are a number of programs, both federal and provincial, designed to aid in the process but they need to be more targeted to the changing trade environment, hence the need for a better understanding of precisely what that entails.

Promotion of direct investment abroad

It is our view that more work could be done “branding” Canada. There are a number of federal programs but their effectiveness is questionable. This is particularly true when it comes to investment attraction. We are pleased to see greater emphasis being placed on investment in DFAIT offices abroad but, in our experience at least, there is very little interaction with provincial investment expertise.

More trade and investment agreements, bilaterally if necessary, are critical. In particular, as the United States moves ahead with bilateral trade agreements, we are seeing evidence that some large Atlantic Canadian companies are transferring parts of their operations to American affiliates so as to gain preferential access to markets.

Impact of the C\$ on investment

There are good reasons why Canadian companies engage in outward investment in the first place, including: access to new markets, lowering costs, acquiring new technology and other productivity improvements and so on. Sales in foreign markets are often much easier through foreign affiliates than via direct export sales from Canada.

There are also documented spin-off benefits to CDIA including higher levels of R&D, as well as higher levels of exports and trade more generally. A higher Canadian dollar does not remove any of these benefits – it simply weights the equation even further in favour of CDIA.

Paradoxically, the rise in the C\$ is likely to increase our competitiveness for foreign investment – up to a point. The example of the United States in the past decade shows that a relatively high exchange rate is not necessarily the barrier to investment one might expect. In particular, to the extent that an appreciating Canadian dollar is due to the underlying fundamentals of the economy vis-à-vis our competitors, it might lead to improved business confidence in Canada and actually promote investment.

On the other hand, Canadian assets are made more expensive in foreign terms and this may dissuade potential investors, all other things being equal. It may prevent the acquisition of assets “on the cheap” – which is probably a positive benefit. In any event, even if the quantity of investment drops slightly, it is likely the quality will improve. Firms making investments in Canada under these conditions are likely to be large players with the intention of making a long-term commitment to the country.