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NEWFOUNDLAND

ECONOMIC DEVELOPMENT PERSPECTIVE

1986

**Federal Economic Development Coordinator
St. John's, Newfoundland**

(All statistics and conclusions are contingent upon data available as
of February 26, 1986)

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1. SUMMARY

During the past five years Newfoundland's economy has passed through a difficult period of recession and rationalization. That process, for the most part, is complete and while the province's resource-oriented industrial base has undergone substantial downsizing, the basis appears to be emerging for a period of sustained, moderate growth.

Newfoundland's economy can be considered to have two main elements in terms of growth potential: the traditional resource industries which make up most of the goods-producing sector and dominate the rural economy, and the service sector which provides over 70 percent of the province's employment and is largely urban-based.

The potential of the existing resource industries to create new employment is quite limited, although productivity improvements and, to a lesser degree, increases in output can be expected. Service-sector expansion has slowed with the general move toward restraint in government, but the prospect of offshore petroleum development has provided a stimulus to investment and business expansion, particularly in the St. John's area.

The most intractable economic issue in Newfoundland remains unemployment, as is reflected in Table I (Page 4). The provincial unemployment rate rose dramatically during the 1982-84 recession, from 13.9 percent in 1981 to 20.5 percent in 1984, and there is little evidence to suggest that it will soon subside.

Employment losses experienced during the recession, particularly in resource industries, have not been made up during recovery -- indeed, for Newfoundland's labour market there has not been any widespread recovery. Meanwhile, return migration of Newfoundlanders who lost jobs elsewhere in Canada during the recession has supplemented the already-rapid growth of the labour force. The result is a large pool of unemployed in the province's labour market which will not quickly be absorbed.

Newfoundland remains heavily dependent upon federal transfers and this dependency has increased with the recent rise in unemployment. Thirty percent of personal income is derived from transfers as opposed to 15 percent nationally, while 48 percent of the province's revenues are fiscal transfers. Because of this dependence, the provincial government is extremely sensitive to any federal measures which would limit or reduce transfer programs, either to government or to individuals.

From a developmental perspective, the principal issues of concern in Newfoundland relate to energy prospects in hydro-electricity and offshore petroleum, and to the advancement of technological developments in the marine field.

The province's substantial hydro-electric generation potential in Labrador could provide both short-term activity and long-term industrial advantages to Newfoundland, but development remains blocked in the absence of bilateral agreement with Quebec. The provincial government's attempts to force agreement through court action have failed, and Newfoundland now may be expected to attempt again to address the issue through negotiation.

Offshore oil development has reached the point where a development decision is imminent, with most administrative and basic technical questions now resolved. Recent declines in oil prices have raised some uncertainty about Mobil's decision to move ahead with Hibernia, but in any case the outcome could be announced by June.

Recent changes in federal exploration incentives policy have yet to be fully reflected in drilling activity, but with the present price environment it is clear that exploration will decline.

Diversification and expansion in Newfoundland's economy, apart from direct energy development, will stem mainly from service and general business expansion stimulated by oil industry development.

Present levels of construction investment, particularly in the St. John's area, indicate that such an expansion is under way. The marine technology sector also continues to expand with the recent commissioning of two major research and training facilities: the National Research Council's Arctic Vessel and Marine Research Institute and the Newfoundland Institute of Fisheries and Marine Technology.

The province appears set for a period of renewed growth, at least in the eastern urban region, and 1986 will be a critical year in determining how these prospects will develop.

2. ECONOMIC OVERVIEW

Newfoundland's economic structure is characterized by a dependence on resource commodity production and an otherwise narrow industrial base. The fishery, pulp and paper and mining industries, along with construction and manufacturing, contribute only 26 percent of the province's total output. The service industries and government are the largest contributors to the gross domestic product as is shown in Table II (Page 6). The dependence of the resource sectors upon export markets makes the economy extremely sensitive to changing international economic circumstances.

Since Confederation, Newfoundland has suffered a significant trade deficit with the rest of Canada and while much of what the province consumes both in terms of both consumer and industrial goods comes from other parts of Canada, few Newfoundland goods are purchased by other provinces.

The province's employment structure is dominated by the service-producing sectors which account for over 70 percent of all employment. Of the goods-producing sectors, employment in fishing and fish processing remains the most important. Geographically, employment in the service sectors is concentrated in St. John's, with employment in the resource sectors dispersed throughout the rural areas of the province and in a number of regional centres.

Newfoundland suffers from a number of disadvantages with respect to the expansion of its economic base.

Its remote location in relation to the Canadian and American markets means Newfoundland goods incur high transportation costs if marketed on the mainland. Products exported to other countries face tariff structures which, as in the important case of fish products, increase with the degree of processing.

Production for the local market is constrained by various factors, limiting the number of products which can be economically produced for a market of less than 600 000 people.

The prominence of such industries as the fishery in Newfoundland's industrial base results in a highly seasonal pattern of industrial output and employment, as each year much of the province's fish processing capacity is closed for the winter months. Other industries such as construction and, to a lesser extent, forestry also contribute to seasonality.

Newfoundland's commodity exports are also extremely vulnerable to cyclical fluctuations in world economic circumstances and the local effects of such fluctuations are often magnified because of the large number of one-industry towns.

Existing industries within the province have few linkages with one another and produce a small proportion of the goods consumed. As a result, revenue generated by these industries quickly leaks out of the economy, providing little additional income or employment.

Newfoundland industries have tended to lag behind those in other parts of Canada with respect to the adoption of new technologies. This has been recognized and, particularly during recent years, measures to upgrade technology and improve productivity have begun to be implemented. This has led to major investment programs in the pulp and paper and fishing industries. Nevertheless, overall productivity levels remain below national levels.

Since Confederation in 1949, Newfoundland has struggled to catch up to the other provinces in social and economic terms.

While there can be no doubt that economic conditions in Newfoundland have greatly improved, the province still lags behind the rest of Canada with respect to most economic indicators. Indeed, disparities in Newfoundland are stark even in comparison to neighbouring provinces in the Atlantic region.

During the 1970s, a large entry of young people, an increased participation rate and reduced outmigration resulted in a rapid increase in the labour force. Despite above-average performance with respect to job creation, the unemployment rate increased substantially and remains at approximately twice the national average.

Personal income also increased. However, much of the gain was the result of increased transfers, with earned income remaining significantly below the Canadian average.

TABLE I

1985 Economic Indicators

	<u>Nfld.</u>	<u>Atlantic Provinces</u>	<u>Canada</u>	<u>Nfld. as a % of</u>	
				<u>Atlantic</u>	<u>Canada</u>
Population (thousands)	580	2 307	25 359	25.1	2.3
GDP (millions/current \$)	5 558	24 489	420 671	22.7	1.3
Labour Force (thousands)	224	978	12 639	22.9	1.8
Employment (thousands)	176	822	11 311	21.4	1.6
Unemployment Rate	21.3%	15.9%	10.5%	134.0	202.8
Participation Rate	53.0%	56.9%	65.2%	93.1	81.3
Earned Income					
per Capita (\$)	6 750	8 322	12 268	81.1	55.0
Personal Income					
per Capita (\$)	9 703	10 815	14 412	89.7	67.3

Source: Statistics Canada and Conference Board of Canada

The provincial government is extremely dependent upon federal transfers, which account for nearly 50 percent of the province's total revenues. In addition, federal transfers to individuals have grown rapidly in recent years, largely as a result of increased expenditures related to unemployment insurance and job-creation programs.

Unemployment insurance payments totaled nearly \$500 million in 1984 and an estimated \$555 million in 1985. An additional \$45 million to \$55 million has been spent annually on job-creation programs, with the primary objective of allowing individuals to requalify for unemployment insurance.

The magnitude of these unemployment insurance and job creation expenditures, particularly in rural areas of the province, raises concerns with respect to possible adverse impacts on mobility, educational attainment and work attitudes.

Unfortunately, the composition of federal government transfers to the province has shown a trend in recent years away from longer-term economic development expenditures toward short-term job creation and income support. Economic development expenditures under the General Development Agreement (GDA) and the more recent Economic and Regional Development Agreement (ERDA) up to March 31, 1985, totaled over \$500 million while over the same period \$2 billion was spent on unemployment insurance and more than \$300 million was spent on job creation.

The imbalance of transfer payments and regional development expenditures was exacerbated by the recent recession and the consequent rise in unemployment. Nevertheless, the post-recession performance of the provincial economy illustrates the continued need for developmental programs.

Newfoundland's economic performance since 1980 has been characterized by halting growth, particularly in the resource-based export industries. Prices and output levels in these industries have fluctuated and remained weak as international markets passed through a protracted recession.

In the ensuing period since 1983, Newfoundland's principal resource industries have undergone a series of structural adjustments. Negative growth was recorded in two of the past five years and over that period real growth in Gross Domestic Product (GDP) averaged only 0.5 percent annually. The province, in fact, only regained its pre-recession peak level of GDP during 1985.

During the past five years, a substantial rationalization has taken place in certain sectors of Newfoundland's economy. This is illustrated by a decline in the contribution of the goods-producing sectors to GDP which accounted for 40 percent of total output in 1980, but by 1984 had fallen to 32 percent. Since the total real level of GDP was virtually the same in both years, this implies a significant decline in absolute terms for these sectors.

Among the resource industries, mining was responsible for most of the decline as the production capacity for iron ore and other minerals was permanently cut back. Forest products and fisheries output also shared in the resource industry contraction.

TABLE II
Newfoundland Output and Employment by Sector

	<u>1984 GDP</u> <u>(million \$)</u>	<u>% of</u> <u>GDP</u>	<u>1984</u> <u>Employment</u>	<u>% of Total</u> <u>Employment</u>
Agriculture	22	.4	1 500	0.8
Forestry	55	1.1	1 800	1.0
Fishing	105	2.1	11 000	6.2
Mining	345	7.0	3 700	2.1
Manufacturing	440	8.9	15 000	8.5
Construction	370	7.5	11 000	6.2
Utilities	252	5.1	(1)	
Total Goods-Producing	<u>1 589</u>	<u>32.1</u>	<u>44 000</u>	<u>25.0</u>
Transportation and Communication	510	10.3	18 000	10.2
Trade	510	10.3	30 000	17.0
Finance, Insurance and Real Estate	440	8.9	6 000	3.4
Services	1 195	24.1	56 000	31.8
Pub. Admin.	705	14.2	19 000	10.8
Total Service-Producing	<u>3 360</u>	<u>67.9</u>	<u>129 000</u>	<u>73.3</u>
Other	_____	_____	<u>3 000</u>	<u>1.7</u>
Total	4 949	100.0	176 000	100.0

Source: Statistics Canada and Newfoundland Statistics Agency
(1) Included with Transportation and Communications

The structural adjustments undergone by Newfoundland's resource industries affected employment directly, as permanent downsizing of workforces has taken place. The desirable impacts of this are improved productivity and improved cost structures in industry. The unfortunate consequence, however, has been an increase in the already large pool of unemployed.

A lack of sufficient, productive employment opportunities is the crux of Newfoundland's economic and social problems. By way of illustration, the proportion of Newfoundland's potential labour force which is employed -- the employment ratio as computed by Statistics Canada -- is 41.7 percent. The comparable figure for Canada is 58.4 percent.

Based on this Canadian standard, Newfoundland has an employment shortfall of over 70 000. It can readily be appreciated that this level of underemployment, when translated into income terms, is sufficient to explain most of the disparities between Newfoundland and other provinces.

Aside from the longstanding structural issue of underemployment, employment in Newfoundland has not yet regained its pre-recession level. From a level of 179 000 in 1981, total employment fell to a low of 174 000 in 1982-83 and has recovered only partially to 176 000 in 1985. Consequently, unemployment rates have risen from 13.9 percent in 1981 to 20.5 percent in 1985.

The increase in Newfoundland's unemployment rate cannot be wholly attributed to job losses within the province. Migration in search of employment has long been a characteristic of the Newfoundland labour force.

Historically, there has been a continuous outflow of migrants which has varied in response to the severity of unemployment within the province and the perceived opportunities elsewhere. In the early 1970s, net outmigration fell dramatically during a period of industrial growth and construction activity, only to resume in the late 1970s as employment prospects in Newfoundland slowed.

People moved to other parts of Canada, particularly to Alberta, resulting in average annual outflows of nearly 6000 people from 1976 to 1981.

During the 1980s, deteriorating economic circumstances elsewhere -- and especially in Alberta -- resulted in a large-scale return of previous outmigrants, increasing the growth of the population significantly during 1982 and 1983. This was to some extent responsible for the increase in the province's unemployment rate at that time. The normal pattern of outmigration has since re-established itself, although this has not been sufficient to diminish the unemployment burden.

Over the past two years, and doubtless because of the slackness of the labour market, a number of new trends have become evident. Employment of union members, particularly in the construction industry, has fallen dramatically, to the point of reversing the previous dominance of unionized labour in the province's construction sector. Wage rates have fallen for several occupational groups and increases for many other occupations have slowed well below the rate of general inflation. In 1984 and the first three quarters of 1985, wage settlements averaged 2.3 percent and 2.7 percent respectively.

High wage rates in relation to levels of productivity and rigidities in the province's labour market have in the past been identified as contributing to unemployment in Newfoundland. While the changes noted above are recent and not firmly established, they may indicate that necessary adjustments are now under way, leading to improved prospects for future employment growth.

3. RESOURCE SECTORS

i) Fishery

It was hoped that 1985 would be a year of upturn in the Newfoundland fishing industry.

After a period of dislocation brought on in 1983 by the financial troubles of its largest fish companies and their subsequent restructuring by the federal and provincial governments and the Bank of Nova Scotia, activity in the fishing industry was expected to normalize. Evidence of improving fortune would have helped to restore public confidence in the troubled industry.

By mid-summer, however, it became apparent that this was not to be. While the offshore trawler fleet performed strongly, catches by the small-boat inshore fishery fell well below the previous year's level. Appeals to both levels of government for help resulted in the institution of a Special Response Program to provide the affected fisheries employees with sufficient work to qualify for unemployment insurance benefits over the winter season.

Despite this setback, there are encouraging signs of stabilization in the industry. The Fishery Products International (FPI) organization has been put in place and its restructuring completed by an injection of \$234 million of equity by the federal and provincial governments. The company's five-year business plan sets out a strategy to achieve profitability by 1986, with emphasis on increased efficiency, improved quality and a rationalization of the company's operations by divesting fifteen fish processing plants.

It is encouraging that there has been a ready private sector response to the sale of processing facilities surplus to FPI's needs. Nine of the fifteen plants offered for sale were purchased within a few weeks of the divestiture announcement. Four were purchased by an existing fishing company which wished to expand. The other five were sold to a group of investors with expertise in the fishery. Evidently these plants are seen as potentially viable by investors who have both experience in the industry and the financial resources to take advantage of the opportunity.

The recent upheaval in the fishery has resulted in a greater concentration of investment in quality-improvement measures. Steps are being taken to improve the quality of fish at all stages of catching, landing and processing. A program of dockside grading is to be implemented to provide compensation commensurate with quality of the fish when landed.

A potentially significant trend in Newfoundland fish processing is a recent shift toward higher-value-added products. This has coincided with a trend in North America toward increased per capita consumption of fish, possibly linked with a preference for seafood based on perceived health benefits. These developments have contributed to a current strong price and market outlook.

Present exchange rates also are contributing significantly to the sales revenues of Canadian fish exporters as fish prices are set in the U.S. (Boston) market.

A disquieting development during the past year has arisen from growing protectionism in the U.S. towards imports from Canada.

After complaints from New England that Canadian fish products are unfairly subsidized, an investigation has resulted in a preliminary decision to impose a 6.8 percent ad valorem tariff on Canadian fresh fish exported to that country. While only a small portion of Newfoundland's fish exports are sold fresh, there is concern that this tariff will spill over into the frozen fish sector.

Similarly, an anti-dumping decision resulted in a 26 percent duty on Canadian salt-fish exports into the Puerto Rico market earlier in the year. The industry has organized itself to fight such protectionist measures and is aggressively pursuing its interests through the U.S. countervail process.

ii) Mining

The number of mining operations in Newfoundland has diminished over recent years. There are currently three metal mining operations active in the province as well as five non-metallic mineral mines and a number of quarry operations.

The major minerals produced include iron ore, zinc, asbestos, gypsum and cement, while a number of others are produced in smaller quantities at commercial levels or as adjuncts to manufacturing operations.

In contrast to the low incomes and seasonal employment experienced by the majority of Newfoundland communities which have relied upon the fishery, mining communities have existed as centres of highly paid stable employment. On the other hand, communities where mines have been closed have become pockets of intractable unemployment and, because of their generally isolated locations, they have limited access to alternative employment opportunities.

The mining sector is one of the largest contributors to Newfoundland's Gross Domestic Product, representing seven percent of the total in 1984. Because of the capital-intensive nature of the industry, the employment generated accounts for only 2.1 percent of the province's total. The

sector's share of total output and employment have fallen dramatically during the past five years due to production and staffing cutbacks. As recently as 1979, mining represented double its present proportion of GDP and employment.

The iron ore industry dominates Newfoundland's mining sector, with two large mines located in western Labrador producing 86 percent of the province's total mineral output. This represents over 50 percent of Canada's total production of iron ore and is the only mineral in which Newfoundland accounts for a significant proportion of national production.

The recent recession, combined with a number of structural and technical changes within the world steel industry, has reduced the demand for iron ore, resulting in a severe contraction of both output and employment in the Labrador iron industry.

Newfoundland's traditional iron ore markets are not likely to recover fully. The European Economic Community has imposed import restrictions, Japan and North America have reduced capacity, and competition has intensified with increased low-cost supplies from developing nations.

Within the Labrador industry, the focus has shifted to improving productivity and efficiency in order to retain the present level of international competitiveness, and thus the current share of the North American market.

Newfoundland's non-ferrous mining industry has moved into a period of contraction. Over the past few years, two major metal mines have closed as a result of reserve depletion and another is approaching the limit of the known deposit. One of the non-metallic operations, an asbestos mine, has changed ownership and has had difficulty in finding markets for its product.

Generally, the existing industry is at a "mature" stage and while most companies will continue to operate, they will not generate growth.

One new mine is in the development stage at present. This is a fluorspar mine owned by Minworth Ltd. which is being developed with federal and provincial financial assistance, at a total cost of \$14 million. The operation will employ approximately 100 people when it comes into full operation in early 1987.

Mineral exploration stands in marked contrast to Newfoundland's mature existing industry. Exploration activity has risen dramatically and nearly 20 000 active claims were under exploration at the end of 1985. The main focus of attention is on gold and precious metals, a focus which was intensified by a promising gold find by B.P.-Selco on the southwest coast of the island which is now being evaluated for commercial development. Reserves found to date are believed to contain 1.5 million ounces of recoverable gold in relatively high-concentration ore.

Other precious-metals finds have been reported, and occurrences of rare earths, strategic metals and base metals are undergoing exploration or evaluation.

While the only immediate prospect for development is the above-noted gold discovery, the high level of exploration activity offers some prospect of renewed mining industry growth in the medium-to-long term.

iii) Forestry

Three newsprint mills, located at Stephenville and Corner Brook on the west coast and Grand Falls in central Newfoundland, dominate the forest industry in the province.

These mills control the majority of the forestry resource on the island and, therefore, have a major influence on lumber production, employment in the logging industry, and overall utilization of the resource. Total newsprint production in Newfoundland for 1984 was 650 000 tonnes with a value of \$315 million.

The bulk of Newfoundland's newsprint is shipped to markets outside Canada. As these shipments made up 7.5 percent of Canada's total newsprint exports in 1984, Newfoundland's mills are particularly sensitive to world trends in supply and demand, currency exchange rates, quotas, and tariff and non-tariff barriers.

There is currently a world oversupply of newsprint and Canada's relative currency strength, except with respect to the U.S. dollar, makes it difficult for Newfoundland mills to sell overseas at competitive prices. Recent changes in quota and tariff policies are also restricting export sales.

The European Economic Community has acted to reduce the amount of foreign newsprint imported, and countries in Latin America which have new production capacity coming onstream have indicated they may increase trade barriers to protect domestic producers.

Mill modernization has become necessary to reduce costs and improve product quality so as to remain competitive and improvements are in progress in all three mills in the province.

A \$30 million modernization project ongoing at Abitibi-Price's Grand Falls mill is designed to improve the efficiency of the mill and thus reduce costs. The project was approximately 60 percent completed by December 31, 1985. The second Abitibi-Price mill, located at Stephenville, is relatively new and is the most efficient on the island. It has also received investment during 1985.

The province's third newsprint mill, at Corner Brook, was recently purchased by Kruger International Ltd. The mill, previously owned by Bowater, was built in 1925 and is now undergoing a complete modernization. This program will cost \$221 million and is expected to be completed by 1988.

Both the Grand Falls and Corner Brook modernization programs are being assisted by the federal government through an ERDA subsidiary agreement.

Opportunities for the expansion of the pulp and paper industry beyond the existing three mills are constrained by the available pulpwood resource. In fact, the wood requirement of the existing industry is projected to exceed the desirable maximum harvesting level later in this century. This resource shortfall is the result of an imbalance in the age classes of the forests and is compounded by losses due to fire and insect infestations.

The projected timber shortage will be minimized through expanded silviculture, increased protective measures against fire and insect damage, and the implementation of paper mill technology designed to make more efficient use of wood fibre. These measures are being assisted through ERDA sub-agreements on Forestry and Pulp and Paper Mill Modernization.

iv) Agriculture

The agriculture sector in Newfoundland is relatively small, representing only 0.4 percent of the GDP. However, the industry has made steady growth in the recent past and its contribution to the economy is increasing. Gross farm income increased by 47 percent between 1980 and 1984, reaching a level of \$40.7 million. Employment in the sector in 1980 totalled 1500 person years and in 1984 registered 1800 - an increase of 20 percent.

Though agriculture is not a large sector on a provincial scale, its importance in the rural economy is significant. Primary agriculture provides a viable economic base for a small number of communities and in aggregate the sector supports some 1800 people. Agriculture is the only primary activity, aside from minerals, which has the potential to create increased productive employment in rural Newfoundland and its expansion is, therefore, a significant economic development goal.

It is estimated that only 40 percent of the food which can be competitively produced in Newfoundland is now supplied locally. Serious constraints to the further development of the sector include an underdeveloped land base, low financial capacity, slow rate of technology adoption, and inefficient marketing systems.

Nevertheless, opportunities exist for expanding and diversifying output of certain agricultural commodities. Soil surveys and land-use plans show approximately 100 000 ha of land is suitable for agriculture on the island, adequate to produce all the crops which could be marketed competitively. Of this total, only some 7000 ha are currently in agricultural use. Most of the remainder remains forested.

While potential exists to further develop the sector, several issues will have to be addressed. Farmers need improved access to capital to facilitate farm expansion and improvements. Measures are required to ensure that producers quickly adopt new farm management practices appropriate to Newfoundland conditions and means need to be found to help producers identify, evaluate and respond to market opportunities.

4. TRANSPORTATION

Newfoundland's dispersed population, geographic location, rugged terrain, often adverse weather conditions and the physical separation of the island portion of the province from Labrador and the remainder of Canada are factors which contribute to the importance of transportation as a major influence on economic development.

The current transportation system in Newfoundland has evolved from a combination of physical, constitutional, political and economic factors to become a complex, heavily-subsidized, multi-modal system.

The system is less modern than that in other areas of Canada and is generally characterized by higher costs and lower efficiency and quality of service, primary considerations when deciding whether or not to locate a business in Newfoundland, especially given the distance to major North American markets and sources of supply.

Largely due to the island's geographic location and its small manufacturing base, inbound general freight movements far exceed outward volumes. This imbalance creates significant problems for carriers in balancing front-haul and back-haul volumes and associated rate structures.

The bulk of Newfoundland's freight services are currently provided by three modes: rail, truck, and direct water. Though some freight is shipped by air, this mode is used primarily for passenger transport.

In 1984, the total general freight shipped to Newfoundland via the three major modes amounted to 918 396 tonnes. The modal share distribution of these shipments was 37.8 percent rail, 29.6 percent direct water, and 32.6 percent truck.

TABLE III

Historical Review of Inbound General Freight
Modal Distribution

Year	Rail		Direct Water		Truck		Total Volume (thousands of tonnes)
	Volume (thousands of tonnes)	% of Total	Volume (thousands of tonnes)	% of Total	Volume (thousands of tonnes)	% of Total	
1970	398	66.9	197	32.2	16	2.7	611
1975	482	52.5	253	27.6	183	19.9	918
1980	243	26.1	400	43.0	287	30.9	930
1984	347	37.8	272	29.6	299	32.6	918

* Source: Water Transportation Assistance Directorate,
Transport Canada

Several changes to the freight system to and from Newfoundland have been experienced over the last two to three decades. However, in the past decade total freight volume has been relatively static.

Table III indicates that in 1970 the rail mode dominated the movement of general freight into the province. However, as a result of deterioration in the quality of rail service, a simultaneous increase in the extent and quality of truck service and a revolutionary change in the direct water mode due to containerization, the situation had changed dramatically by 1980. Rail's share of freight declined to 26 percent while trucking and direct water transport together captured 74 percent of the freight market.

In 1980, a federally sponsored five-year plan to revitalize the railway service through containerization was initiated. The impact of this plan was apparent by 1984 with rail occupying 38 percent of the market, largely at the expense of the marine mode. However, the success of this program has not appreciably reduced the large losses of the railway system, which at this point, continue to be financed by the federal government.

5. BUSINESS OUTLOOK

During 1986 and into 1987, the Newfoundland business community will continue to recover from the still evident effects of the North American and world recession. Growth will be greater than in 1985 but, as in the past, will run at less than the national pace. Against this backdrop, the attitude of the business community will be one of seeking to consolidate and cautiously consider possibilities for expansion.

For the most part, activity in the fishery, forestry and mining sectors is dominated by a few large companies. While these and other smaller companies plan some new capital investment in 1986 and 1987, the activity is not expansionary in nature. It is largely dedicated to modernization and technology upgrading to enable the companies to become more competitive in the international marketplace.

The major medium-term prospect for business expansion and growth rests with the offshore oil sector and, specifically, in the development and production of the oil deposits in the Hibernia field off Newfoundland.

While Newfoundland firms will be assessing opportunities and planning means whereby they can become involved, no significant business expansion or investment can be expected until late 1986 at the earliest. If the Hibernia project proceeds as scheduled, local firms will need to have plans finalized by then, otherwise the opportunities, at least for Hibernia, will have passed.

The somewhat slow pace of business expansion to take advantage of Hibernia can be attributed to the existing narrow industrial and manufacturing base, the small size of most firms, restricted access to financing, and the relatively low level of technological and managerial sophistication as compared to foreign and mainland firms which have greater experience in this and associated industries.

A further reason for the caution of some local firms is that when the Hibernia discovery was first announced, a number of local businesses expanded to take advantage of anticipated new activity. When this did not materialize, local businesses and individuals suffered considerable losses. This has injected a high level of caution into current planning.

Nevertheless, some of the larger consulting/engineering and construction firms do recognize the opportunities that exist. These firms have arranged joint ventures and other forms of consortia with Canadian, U.S., and European firms and are aggressively pursuing and planning for these opportunities.

In Newfoundland, the service sector dominates activity, at least in terms of employment. This sector has, in the past, demonstrated its ability to keep pace with expansion in the primary and secondary sectors.

This service sector, which to a large extent is based in St. John's, has traditionally been the strongest sector in the province, with a sound financial base. This is evident in the current aggressive construction program for office buildings and a new hotel and convention centre currently under way in the St. John's area. It is expected that the service sector will maintain its relative share of economic activity.

6. PROSPECTS FOR GROWTH

The potential for dramatic acceleration in Newfoundland's economic growth over the next decade depends upon two energy developments.

Both oil and gas and hydro-electricity developments have been touted for years as imminent prospects, yet the timing of projects has been repeatedly pushed back. Expectations may have cooled somewhat, but the current view of these developments appears to be optimistic.

The stimulus that these major energy projects can provide to the Newfoundland economy will be crucial in assisting the province to escape its current malaise and break the cycle of unemployment insurance, make-work and federal government transfers.

The associated employment opportunities have the potential to greatly improve the current unemployment situation and will facilitate the process of labour adjustment in the primary resource sectors. At the same time, the stimulus of these developments may provide the basis for expansion and diversification of the provincial industrial base.

1) Oil and Gas

Events related to the Newfoundland offshore in 1985 have contributed significantly to progress in the province's search for economic development opportunities.

While government/industry agreement has yet to be reached on several strategic issues, planning -- both at the industry and regulatory level -- has advanced sufficiently to allow much better project definition and hence realization of what can be expected from oil and gas development.

Overall, 1985 marked a major turning point with the signing of the Atlantic Accord and the transition of industry and government focus from exploration to the project development phase.

The Atlantic Accord, signed February 11, 1985, resolved the outstanding federal-provincial jurisdictional dispute and resulted in a number of specific activities related to the approval process for offshore developments, including the establishment of a Canada-Newfoundland Offshore Petroleum Board.

In addition, a \$300 million Offshore Development Fund was created to defray social and economic infrastructure costs in advance of production, and a federal-provincial administrative network has been created. While no funds have yet been disbursed from the Offshore Development Fund, a first round of funding proposals has recently been approved.

Fiscal negotiations, which will establish the revenue-sharing between the Hibernia partners and governments, have begun and are expected to be completed during the first half of 1986. The completion of these negotiations will be extremely significant in mapping how any economic rent will be shared over time. Concurrently, an industrial benefits agreement is being negotiated between government and industry.

Exploration for new reserves reached a high level during 1985, prior to the expiry of the Petroleum Incentives Program. However, Hibernia development continued to be the centrepiece of offshore activity.

In September Mobil Oil announced that it would develop Hibernia with a gravity-based production system, satisfying one of the provincial government's major requirements. Development based on this system is estimated to cost \$4.2 billion (1984 \$C) and will provide a total of 21 500 person-years of direct employment, of which 67 percent will be Canada-based.

Newfoundland is expected to benefit from 9500 person-years or 44 percent of the total project employment.

Through its Environmental Impact Statement, Canada-Newfoundland Benefits Plan and its Development Plan, Mobil Oil has indicated that it will begin producing Hibernia oil by 1992.

Currently it is in the process of selecting a project services and topside engineering contractor to design and manage construction of the project. Come-By-Chance has been selected as the location for construction, expected to begin in 1987. Other sites to be used as fabrication and assembly locations have yet to be announced.

To date, the concentration of attention has been on the Hibernia field, which is currently estimated to contain between 500 million and 800 million barrels of oil, although significant discoveries have also been made in smaller fields ranging from 100 million to 300 million barrels.

The Terra Nova and North Ben Nevis fields, owned by Petro Canada and Husky/Bow Valley respectively, could be combined with other smaller fields and developed by means of floating production systems. Further delineation drilling is necessary to establish better reserve estimates, but development of these fields could actually occur before Hibernia starts producing in 1992.

Beyond its value as an energy source, oil and gas development has been pursued for its potential contribution to job creation and industrial benefits. The degree to which local industry is positioned to capture benefits will be partly determined by the strategic decisions and policy options taken by government.

Both levels of government have undertaken studies to determine supply-side requirements for industrial capability and competitiveness in relation to Hibernia development. The province has established its benefits priorities and is placing major emphasis on construction, fabrication and assembly, and engineering.

The nature and extent of benefits should be more clearly defined once the fiscal negotiations are concluded and the company's Development Plan and the Canada-Newfoundland Benefits Plan are approved by the Canada-Newfoundland Offshore Petroleum Board.

ii) Hydro-Electricity

The provision of adequate and competitively priced electrical energy is an important ingredient in the maintenance and growth of economic development in the province. Currently, it is projected that Newfoundland will require a new generation-source for domestic supply by 1992.

With virtually all of the island hydro sites now developed, the immediate alternatives for the province are installation of additional oil-fired thermal generators at a cost of \$170 million, which would supply projected needs to 1996, or access to hydro-electric power from Labrador.

If Labrador power is not available in the longer term, the province may have to consider coal- or natural-gas-fired thermal generation in an attempt to provide a source of power at predictable prices.

In the short term it is increasingly likely that the province will be forced to install additional thermal-generating capacity.

Transmission of power from Labrador would require a 1125-km transmission line to be built over three years at a cost of \$1.4 billion. Additionally, Labrador power to meet on-island requirements in 1992 could only be made available from recall of power from the Churchill Falls power development which is currently committed to Hydro-Québec.

It is unlikely that a resolution of the issues associated with access to Labrador power can be resolved in time to meet that schedule.

The provincial government's first objective concerning Labrador power appears to be to achieve a resolution of the dispute over access to power from the Churchill Falls development.

The province has petitioned the courts unsuccessfully to obtain access to this power via a clause in the contract with Hydro-Québec. Since this has failed, a political solution appears to be the only option available.

Talks were undertaken at various times with the Lévesque government but were not successful. It remains to be seen whether discussions with the Bourassa government will prove more productive.

Until an agreement can be reached with Quebec, power from any source in Labrador will likely be unavailable to the island.

Any deal with Quebec would likely involve the development of one or both of two hydro sites on the Lower Churchill River. The Gull Island site has a generation potential of 1600 megawatts and a cost of \$2.87 billion, while the Muskrat Falls site would produce 600 megawatts at a cost of \$1.98 billion.

The larger site, having a lower per-unit cost, would be among the most cost-effective developments in Eastern Canada. It has been projected that construction of this project would create 10 000 person years of employment and, over a six-to-seven-year construction period, inject in the range of \$700 million to \$800 million into the economy. Development is not feasible, however, unless an agreement can be reached with Quebec to transmit the power that is surplus to Newfoundland's needs to Eastern Canadian and U.S. markets.

Unless and until an agreement can be reached with Quebec, construction of such projects as a transmission line to the island and the Gull Island development will not proceed. Accurate projections, therefore, as to when these major developments could begin to act as engines of growth are impractical.

Unless Labrador power can be sourced at reasonable prices by the early 1990s, the limitation of available energy and its increasing costs will inhibit economic expansion in Newfoundland and Labrador.

The federal/provincial Lower Churchill Development Corporation (LCDC) was set up some years ago to plan and promote the Gull Island project. Given the apparent benefit to Newfoundland and the Canadian economy generally, this may well be an appropriate time for a pro-active approach by the federal government to assist in removing the obstacles to such developments.

7. DEVELOPMENT ISSUES

Newfoundland's economic development over the medium term will take place in the context of two divergent sets of circumstances.

On the one hand, the province's existing resource sectors -- fishing, forestry, and mining -- from which most employment opportunities have traditionally been drawn, have reached a state of maturity where little additional employment will be created.

On the other hand, new prospects related to the development of offshore oil and gas reserves have the potential to stimulate a significant expansion in certain areas of the province.

The effects on offshore prospects of falling international oil prices and the new Frontier Energy Policy announced in October 1985, remain to be seen.

The replacement of the Petroleum Incentives Program (PIP) by the new Frontier Energy Policy is expected to tend to reduce exploration since PIP, which provided a grant covering 80 percent of exploration costs, has been replaced by the Exploration Tax Credit, a tax-based incentive.

Recent reductions in oil prices are now being assessed. Clearly it is the oil prices of the 1990s, not those of today, which will impact upon Newfoundland's offshore development, and current expectations are for some price recovery in the medium term. However, the present risk in the price outlook could force companies to delay making a final decision on whether to initiate development.

The issues affecting the three traditional resource industries center on rationalizing the existing industries and resolving particular obstacles facing them in terms of productivity, market access and technological advancement.

In forestry, modernization programs are under way and it is expected that the resulting improvements in cost and quality will ensure product marketability.

The mining industry, for the most part, has been rationalized, and the exploration programs which will form the basis for future mine development are being carried out.

The fishery remains the sector which will require the most attention.

The corporate restructuring of the Newfoundland fishery is now well in motion. However, a major issue for the industry is the recent set of countervail actions put forward in the United States against Canadian fish imports.

The preliminary findings issued to date indicate that subsidy and assistance programs to the fishery will have to be reviewed and perhaps significantly revised.

At the same time the industry is in need of a broad upgrading of technology in its harvesting and processing operations. This may be made more difficult if the financial programs which exist to assist such investment in the industry are threatened by protectionist measures on the trade front.

Quite a different set of issues exists in relation to new development prospects outside the traditional resource sectors.

Declining prospects for future employment growth associated with Newfoundland's existing industries point to the need for further expansion and diversification of the provincial economy.

Opportunities have been identified with respect to spin-offs from offshore oil and gas development, ocean industries based on the demands of the offshore, expertise currently being developed in the field of cold ocean research and technological developments in the fishery, energy-intensive industries based on Labrador hydro, the further processing of natural resources, and local manufacture of more of the industrial and consumer goods currently imported to the province.

Significant progress has already been made in establishing the province as a world leader in the field of ocean science and technology.

The province's reputation in this field has been derived from the activities of institutions such as NORDCO, C-CORE, the Fisheries College, Memorial University, North West Atlantic Fisheries Centre and a growing number of private sector firms.

This body of expertise has been enhanced recently with the completion of the NRC's Arctic Vessel Research Institute and the opening of the Newfoundland Institute of Fisheries and Marine Technology, which will shortly include North America's first flume tank for conducting training and research and development related to the development and use of fishing gear.

A successful resolution of the current dispute between Newfoundland and Quebec with respect to Labrador hydro could create a positive environment for the attraction of energy-intensive industries to a Newfoundland location.

Opportunities exist, for example, for the production of ferro-silicon in Labrador. If the province is successful in its efforts to identify a company interested in pursuing these opportunities, the federal government undoubtedly will be approached with respect to the provision of both capital incentives and financial support for the construction of required industrial infrastructure.

It has long been recognized that a number of opportunities exist related to import substitution and the further processing of natural resources which can provide the basis for expansion of the local industrial base, particularly within the rural areas of the province.

Past attempts to promote the exploitation of such opportunities have met with limited success for a number of reasons.

This is not to say that the objectives of value-added expansion should not be pursued, but progress can be expected to hinge on the speed with which basic requirements can be provided.

Emphasis on technology development, training and research has been increasingly evident in provincial and federal development programming. A sustained and increasing emphasis on these areas will be required if the strategy of increasing value-added and expanding industrial linkages is to succeed.

