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ECONOMIC DEVELOPMENT PERSPECTIVE FOR QUEBEC

1987-1988

Office of the Federal Economic
Development Coordinator for Quebec

September 15, 1987

Office of the Federal Economic Development Coordinator
Bureau du coordinateur fédéral du développement économique

1980-81
1981-82
1982-83

This analysis focuses on structural changes in Quebec's economy and attempts to identify the major issues in its development.

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Ce document est aussi disponible en français.

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1. SUMMARY

The Quebec economy continued to expand in 1986, showing a 3.1 percent gain in gross domestic product. Although lower than in the previous two years, the province's moderate economic growth, slightly under the national average, remained above rates in the United States and other major industrialized countries. Economic growth in Quebec is expected to accelerate this year, but slow down next year.

With production growth performing well, the Quebec share of national economic activity stabilized at 22.7 percent. The rate had been declining gradually after peaking at 25.5 percent in 1967. This downward trend in Quebec's economic weight within Canada has paralleled the relative decline in its population, which went gradually from 28.9 percent of Canada's population in 1966 to 25.8 percent in 1986.

The province's economic structure has changed markedly in the past 10 years. The primary and secondary sectors have contracted, while the tertiary sector now accounts for over 70 percent of employment. At the same time, particularly following the 1981-82 recession, Quebec embarked on profound changes in its industrial base. The economy of the province, traditionally an exporter of resources, is turning toward finished products for export with greater value added.

Located mainly in remote regions, the resource sector must deal with problems of competitiveness, world oversupply, protectionism and resource management. This type of activity is affected by strong cyclical variations because of its dependence on international markets.

Meanwhile, manufacturing is still suffering from profound weaknesses caused by the loss of comparative advantages, especially in the non-competitive traditional industries. These industries are concentrated in the Montreal, Eastern Townships and Mauricie/Bois Francs regions. The seeds of change have been planted, however, and industries have begun to modernize, increase productivity, and gear themselves to export markets, particularly since the recession.

The tertiary industries, some of which are highly regulated, have traditionally been oriented toward the local market. These industries, and production services in particular, are gradually becoming more open to international competition. For the past ten years, this sector has been by far the largest source of new jobs, with consumer services, albeit often not highly productive, leading the way. Public administration, long a major employer in the

Québec City and Outaouais regions, has continued to grow since the late seventies, levelling off in the past few years because of government spending restraint programs.

To overcome its structural weaknesses and cope with changes in its environment, Quebec will have to meet a number of important challenges. Five of them are among the major issues in Quebec's economic development. These are the strengthening of Montreal's role as a national development pole, the acceleration of industrial restructuring, innovation and R&D, local entrepreneurship, initiatives for policy reforms and their impact on the socio-economic climate.

Strengthening Montreal's role in the Canadian economy is undeniably one of the main issues in Quebec's economic development. The recent recovery has slowed the erosion of Montreal's relative position in the Canadian economy and created a general climate of optimism. This is an excellent time to set the Montreal economy on more solid foundations by calling on the many strengths of this important metropolitan area.

As international competition and technological development intensify and restrictions on trade with the US and other countries are relaxed, the Quebec economy must accelerate industrial restructuring. Greater efforts and efficiency in innovation, R&D and technology transfer are highly desirable. Local entrepreneurship is an essential ingredient in the development of remote regions. Each region should direct its own development according to its own potential. If this goal is to be achieved, the obstacles facing small and medium-sized businesses must be reduced. Both in Ottawa and Québec City, several plans for policy reform are being examined in various areas critical to economic development. Indications are that these reforms will have a positive impact on the economic climate of Quebec, which is particularly favourable at present.

2. ECONOMIC CONDITIONS AND OUTLOOK

2.1 Overview

The Quebec economy continued to grow for the fourth consecutive year in 1986, but at a slower rate. Its gross domestic product increased 3.1 percent in 1986, as compared with 4.1 percent the previous year. This growth rate is slightly lower than that of the Canadian economy as a whole.

Residential construction turned out to be the most dynamic component of the Quebec economy in 1986. Stimulated by low mortgage rates, a moderate employment increase and the capital gains exemption, housing starts broke the 60,000 mark for the first time since 1976. Strong consumer spending spurred by lower interest rates, employment and personal income growth, and lower savings rates also contributed much to Quebec's economic growth in 1986.

For the third time since the start of the recovery, Quebec's capital expenditures grew at a faster rate in 1986 than in Canada as a whole. During the past few years, Quebec has once again progressively achieved the share of Canadian capital expenditures it held in the late seventies, over 20 percent. Private investment, particularly in manufacturing, was chiefly responsible for this good performance; its share of total capital expenditures went from 62.9 percent in 1976 to 76.2 percent last year.

As far as international exports are concerned, they contributed little to the growth of the Quebec economy in 1986. Because of the slowing US economy, they grew by only 7.1 percent. International exports accounted for 19.4 percent of the GDP in 1986; this share has varied from 19 to 20 percent since 1981. Another 20 percent of Quebec's gross domestic product is exported to other provinces. About 75 percent of international exports went to the US, compared with 65 percent in 1981. Printing paper, automobiles, aluminum and alloys, lumber, aircrafts, aircraft motors and parts, semiconductors, railway rolling stock, and various ore concentrates were Quebec's main exports in 1986. These products represented over 50 percent of the province's exports.

For the first time since the beginning of the recovery, employment in Quebec grew more slowly than in Canada as a whole. The number of employed persons in Quebec grew by 62,000 in 1986, up 2.2 percent from the previous year, compared with a 2.9 percent increase for all of Canada. In 1986, it was the secondary sector that contributed the most to employment creation in Quebec -- an unusual occurrence. Accounting for a little less than one-quarter

of total employment, this sector was responsible for over 52 percent of new jobs in Quebec last year. However, the tertiary sector has created the most jobs since the recession. Of a net 282,000 jobs created in Quebec between 1982 and 1986, 222,000, nearly 80 percent, were in the tertiary sector.

Throughout the recovery period, the unemployment rate has declined, hitting 11.0 percent in 1986, although this is still higher than it was at the beginning of the decade. The rate is 2.9 percentage points lower than its peak in 1983, but is still above the national average. The gap between the Quebec and Canadian rate has narrowed slightly in the past few years, while the gap between the Ontario and Quebec rates has widened.

2.2 Regions

The participation of Quebec's regions in its economic growth varied widely in 1986.

While, on the whole, the resource regions (Gaspé/Lower St Lawrence, Saguenay/Lac St Jean, Abitibi/Temiskaming and North Shore/New Quebec) dominated employment growth with a 3.7 percent increase, the central regions (Québec City, Mauricie/Bois Francs, Eastern Townships and Outaouais) had an overall employment growth rate of only 2.2 percent, equalling the provincial rate. In the Montreal region, the employment growth rate was 1.9 percent, falling below the Quebec average for the second consecutive year. The most dramatic growth spurt was posted in the Abitibi/Temiskaming, where employment grew 9.4 percent. The Outaouais and Gaspé/Lower St Lawrence regions, on the other hand, saw respective declines of 1.7 and 1.2 percent.

The unemployment situation improved everywhere except in the Gaspé/Lower St Lawrence (where the rate rose from 17.1 percent to 19.3 percent), the North Shore/New Quebec (from 13.6 percent to 14.9 percent) and the Outaouais (from 10.9 percent to 12.3 percent). The Québec City region had the lowest rate (9.1 percent), while the Gaspé/Lower St Lawrence had by far the highest rate.

2.3 Forecast

Quebec's economic growth should accelerate in 1987 and slow down considerably next year. According to the Conference Board of Canada, Quebec's economic activity should grow by 4.2 and 2.3 percent respectively in 1987 and 1988. Quebec's economy is expected to grow faster than that of Canada as a whole (3.3 percent) this year, but at a rate closer to the national average next year.

Stimulated by the current residential construction boom, consumer spending will grow as quickly this year than in 1986 and will therefore continue to spur economic growth.

The investment outlook is very good. With an exceptional growth in housing starts and several major industrial projects continuing in the manufacturing sector, including Hyundai, Domtar, QIT Fer et Titane, and Norsk Hydro, Quebec investment should grow by approximately 15 percent in 1987. Firms are expected to continue investing massive amounts in machinery and equipment to modernize their plant and increase productivity.

The export outlook is hardly promising, mainly because of the low economic growth forecast in the US.

Because of the austerity programs prompted by budget deficits, government spending will also have little effect on economic growth this year.

3. STRUCTURAL CHANGE

The Quebec economy has been through considerable changes in the last 10 years. Its economic structure has altered profoundly, with the tertiary sector increasing its dominance over the rest of the economy.

Less obvious is the fact that Quebec is creating a more modern, productive, diversified and open industrial base. Traditionally an exporter of natural resources, Quebec resolutely turned, in the mid 1970s, to exporting finished products with greater value added. Its entire economy became more open to outside markets, especially with the impetus of a new generation of dynamic local entrepreneurs.

These structural changes took place in a context of a moderate average annual growth rate of 2.1 percent during the years 1976-1986. This was, however, a period marked by many major changes in the world economic environment which influenced the scope and type of structural changes that occurred in Quebec's economy. The Tokyo Round reduced tariffs, there were oil shocks in 1973, 1979 and 1985-86, raw material prices dropped everywhere, technological progress accelerated and newly industrialized countries began to play more important roles. The recession of 1981-82, which hit Quebec harder than other places, seems to have been the most important single cause of the industrial change, now gathering speed in Quebec and becoming increasingly noticeable.

But Quebec has not succeeded in reversing the trend that is decreasing its economic weight in Canada. It has managed to stabilize its share of national production since 1981 at 22.7 percent; last year it increased slightly. From 1967, when Quebec reached a peak of 25.5 percent of Canadian production, its share slowly declined to 22.4 percent in 1983-84.

The relative decline of the Quebec economy is apparent in most of the indicators. Quebec saw its share of employment decline from 28.0 percent of Canadian employment in 1967 to 24.6 percent last year. The same is true for personal income; Quebec's share went from 26.2 percent in 1967 to 24.4 percent in 1986. The decline was offset by a rise in transfer payments to Quebec during the period. With respect to capital expenditures, Quebec may have done some catching up in recent years, but its share of Canadian capital expenditures has fallen from its 1964 peak of 25.9 percent. Quebec accounted for only 21.8 percent of Canadian capital expenditures in 1986. In the past 10 years, Quebec has improved its productivity in relation to the Canadian economy as a whole, as its share of national production stabilized while its share of employment

continued to decline. Quebec productivity equalled 90.6 percent of Canadian productivity in 1986, in relation to 88.3 percent ten years earlier.

The erosion of Quebec's position in the Canadian economy in the past twenty years has paralleled its relative demographic decline. While Quebec accounted for 28.9 percent of Canada's population in 1966, it gradually dropped and reached 25.8 percent in 1986. However, net migration became positive in 1986 (+4,420), ending the negative trend that began 15 years ago. The vitality of international immigration combined with a sharp reduction in Quebec's interprovincial migration deficit accounts for the turnaround.

3.1 Tertiary sector

During the past 10 years, the tertiary sector has continued to improve its position in the Quebec economy. The tertiary sector now accounts for nearly 69 percent of the gross domestic product (GDP) and 71 percent of employment. This change has taken place mainly at the expense of the manufacturing sector, but construction and the primary sector have also suffered a relative decline.

The shift of employment toward the tertiary sector, which occurs in all developed economies, was also more marked in Quebec than in the rest of Canada. The tertiary sector accounted for 90 percent of job creation in Quebec between 1972 and 1981, compared with 76 percent in the rest of the country. Since 1981, the tertiary sector has been the only one of the three main economic sectors to show increased employment levels in Quebec.

a) Predominance of consumer services

Consumer services, in the past ten years, contributed the most to the growth of the tertiary sector at its employment increased by 180,000. These services, which include trade, amusement and recreation, personal services, accommodation, restaurants and other services, constitute the largest share of the tertiary industries, accounting for nearly 40 percent of employment in the sector. Government services, the second largest component of the tertiary sector, with 35.7 percent of employment, have also grown considerably, adding another 166,000 jobs since 1976; most of this growth took place in the late 1970s.

Production services did not grow as quickly; nonetheless, these services, which include transportation, communications and other public utilities, finance, insurance, real estate and business services, have created an additional 83,000 jobs since 1976. Slower growth in this area no doubt stems from the sector's difficulties in the late 1970s in Montreal, where most are

located. Because they are critical to economic development, these industries are known as the "dynamic" tertiary activities. Often traditionally regulated, they are becoming more open to international competition, particularly in finance. They have also become an important issue in the present trade talks with the United States and within the GATT.

The shift in employment toward the service sector is reflected in the growing number of part-time jobs. From 1980 to 1986, 130,000 part-time jobs and 41,000 full-time jobs were created in Quebec. This trend slowed sharply in 1986, however, with 48,000 of the 62,000 new full-time jobs.

The trend toward part-time work is particularly evident among young people and women. It is assumed that these are mostly jobs with low value added involving little attachment to the labour market. Thus, since the beginning of the recovery, Quebec recovered the jobs lost during the recession in quantity but not in quality.

In the next few years, the tertiarization process is expected to continue because of plans to modernize the manufacturing sector, on the one hand, and the declining relative position of the resource sector, on the other hand.

In response to the recession and proposed deregulation, the transportation industry has had to rationalize production, regardless of the mode of transportation involved. Users, especially freight users, could benefit from the regulatory reform, with prices for transportation in the order of 5 percent to 10 percent lower than they would be under existing regulations. Some transportation jobs will be lost through increased productivity; job creation among shippers and in the rest of the economy should more than compensate for these losses. In the longer term, however, employment in the sector is expected to grow.

In adapting to this shift in economic activity toward the tertiary sector, Quebec has advantages that will work to increase the productivity as well as the relatively low value added of this sector. These include, inter alia, its scientific, technological, university and production services infrastructures.

b) Tourism

In Quebec, the tourism industry plays a leading role in economic expansion and regional growth; some 85,000 direct jobs depend on the industry. Given the value of the US dollar and the preferences of American tourists, we can expect the tourist industry to continue to play a predominant role.

Apart from its unique cultural character, Quebec has several advantages which could be better exploited, including its proximity to the Canadian and US markets and its excellent transportation system. Major cultural events such as the Leonardo da Vinci exhibition and the International Jazz Festival, as well as cultural centres in the Montreal region, are important to the revitalization of the Quebec tourist industry.

However, the industry has serious problems in Quebec. Its lack of competitiveness stems largely from a failure to adjust to new conditions in the market place. Under-investment in the accommodation sector, especially in moderately priced accommodation, the state of certain recreational facilities, insufficient large cultural facilities, dispersion of tourist attractions and strong competition from other provinces and countries have all had a negative effect on Quebec's tourist industry.

c) Cultural industries

The cultural industries are mainly tertiary activities. They are wide-ranging and overlap with the communications sector. They include broadcasting, cable, publishing, sound recording, the audio-visual industries (film, video, television), the performing arts, radio, print media, visual arts and architectural heritage. Quebec's cultural industries account for more than 25 percent of the sector in Canada and are concentrated in the Montreal region.

In its report, the Consultative Committee on the Development of the Montreal Region identified audio-visual, sound recording and performing arts as sectors with the strongest international cultural potential.

In Montreal, there is also a close relationship between cultural activities (artistic events lasting for a limited time) and cultural industries themselves. Stage presentations from several festivals (Jazz, Just for Laughs, etc.) are recorded and sold by the private sector to broadcasters and distributors in the international market. French-language Quebec programs for broadcast were exported to France for the first time in 1987.

The feature film industry, subject to severe fluctuations, is doing well at the moment. Montreal is at present the Canadian feature film and co-production capital. In the last two years, production of American feature films there has doubled. Film crews are completely booked. However, the federal government's plans to cut tax deductions for investments in Canadian feature films from 100 percent to 30 percent may have a negative impact on the dynamism of the industry.

Despite the strong presence of the public sector in Montreal (Telefilm, National Film Board, etc), the region, like the rest of Canada, is not sufficiently experienced in new image technologies because of lack of appropriate research and development.

d) Regional impact

The Outaouais and Québec City regions are naturally the most dependent on the tertiary sector, because they are important government centres.

The tertiary sector is also strongly represented in the Montreal region. The sector's contribution to the economy of the region and that of Quebec as a whole also stems from the large size of the tertiary industries in Montreal and their diversification. In particular, the main "dynamic" tertiary industries in the province are located there. Montreal serves as Quebec's main production services centre (financial and consulting services, research centres and head offices) and has a highly developed post-secondary education network, with four universities, and highly diversified health care services. The weakening of some of its "dynamic" services during the last decade contributed to the marked slowdown in the Montreal economy, particularly between 1976 and 1985. The dependency of its manufacturing sector on non-competitive traditional industries is also one of the causes of Montreal's relative decline. Montreal's problems and the need to revitalize its economy are a major issue in Quebec's economic development at present.

The Québec City region depends largely on the tertiary sector, which provides more than three-quarters of employment. Personnel cutbacks in the provincial government have had a major impact and have added to the problems of the primary sector, particularly in asbestos mining. In the coming years, the main sources of employment should involve R&D activities, high technology and tourism.

The Outaouais grew at an above-average rate throughout the period, although the rate fluctuated widely from year to year. More than anywhere else, the economy of the Outaouais depends increasingly on the tertiary sector.

3.2 Secondary sector

The secondary sector, which consists of manufacturing and construction, now accounts for only 27.8 percent of Quebec's gross domestic product and 24.6 percent of total employment. Its share of employment declined the most, indicating, inter alia, a relative rise in productivity in relation to the rest of the economy. This phenomenon is especially evident in the manufacturing industries.

a) Manufacturing

Manufacturing GDP has dropped from 22.5 percent to 21.0 percent of the Quebec GDP in the past 10 years. Manufacturing now accounts for only 19.7 percent of employment, compared with 24.0 percent ten years ago.

This contraction of the manufacturing sector is due to the loss of traditional comparative advantages, especially concerning salary costs. The wage gap that once existed between Quebec and Ontario, which would have helped attract labour-intensive industries to this province, gave way to wage parity in the late 1970s. In addition, the rise of newly industrialized countries because of lower labour costs and the growing application of advanced technology, as well as the reduction of trade barriers made it increasingly difficult to compete in a once sheltered domestic market. To increase their productivity, financially weak Quebec manufacturers have had mainly to reduce labour costs. With the shock of the recession, they cut back employment and slowed salary increases.

The increase in productivity achieved through lower labour costs was reflected in a low level of investment. Quebec's share in Canadian manufacturing investment remained about 20 percent from 1976 to 1982, dipping as low as 17.8 percent in the depths of the recession. However, during the last three years, manufacturing investment has recovered and now represents about 29 percent of Canadian investment in manufacturing. In 1987, Quebec should once again invest in proportion to its demographic weight.

An important share of manufacturing employment in Quebec is concentrated in the traditional industries, which are often not very competitive. These include food and beverages, tobacco, clothing, textiles, leather and furniture. Because of fierce foreign competition and efforts to restructure and modernize, the traditional manufacturing industries lost 34,000 jobs between 1976 and 1986. These industries still account for 35 percent of manufacturing employment; ten years ago, they represented close to 40 percent. During this time, the modern sectors, defined as rubber and plastics, printing, machinery, transportation equipment, electrical products, chemicals and miscellaneous manufacturing industries, gained 30,000 jobs and are now the largest major manufacturing group, accounting for 37 percent of total manufacturing employment. Resource processing industries lost 25,000 jobs. These include wood, paper, primary metals, metal fabricating, non-metallic mineral products, petroleum and coal. Thus, manufacturing in Quebec has begun to move toward a more modern and competitive industrial structure.

The survival of the traditional sectors is due in no small part to customs tariffs and import quotas. Although the production cost gap between Quebec and Third World firms remains too wide in some sub-sectors, there is still a future for firms that can adjust to foreign competition. There is room for competitive firms in declining sectors, firms that discover and effectively exploit special niches, stressing design, products with greater value added, and the latest technologies. However, gains in employment may not be sufficient to compensate for the expected losses of non-competitive firms.

Certain modern industries such as petrochemicals and shipbuilding are also faced with important structural problems. As far as the petrochemical industry is concerned, worth noting, among others, are gas liquids supply problems, a world oversupply situation and a move toward rationalization by European and Japanese firms; such a trend toward rationalization is now taking place in East End Montreal as well. Shipbuilding is facing both declining demand and poor international competitiveness. The recent grouping of Quebec's shipyards under a single banner may help to offset these problems. The automobile industry is faced with excess production capacity problems in North America and these will be exacerbated in the medium term.

In the pulp and paper industry, the modernization plan launched a few years ago has spurred considerable investment. The pulp and paper and primary metals sectors are largely behind a remarkable growth in capital expenditures in the past three years. On the other hand, the modernization effort has resulted in a smaller demand for manpower. Should trade barriers between Canada and the US be relaxed, certain firms may be expected to continue their efforts to modernize, which will lead to major job losses in these industries by the end of the decade.

In this redeployment over the last 10 years, many older workers have lost their jobs and have been unable to find others. They have joined the ranks of the long-term unemployed or simply withdrawn from the labour force. The proportion of long-term unemployed nearly doubled in Quebec during the recession and was still extremely high in 1986, nearing 30 percent (the pre-recession rate was 18 percent). At the same time, the participation rate of 55-64 year-olds dropped sharply to only 42.5 percent in 1986. This alarming situation, which is worse in Quebec than anywhere else in Canada, affects male workers most severely.

Quebec does, however, have a number of assets on which to base expansion of its manufacturing sector. The abundance of hydro-electric resources, for example, and cheap rates, have encouraged the establishment and modernization of energy-intensive industries. This policy has borne particular fruit in the case of

aluminum ingot-making and pulp and paper, and has also produced similar results in electrochemistry and electrometallurgy. In the next few years, the US market could help to bring about new hydro-electric projects in Quebec if the province succeeds in increasing electricity exports to the northeastern States.

Other opportunities are expected to materialize in the aerospace industry. The federal government has signed major investment agreements with Pratt & Whitney, Canadair and Spar to promote Quebec's aerospace industry. The granting of the CF-18 maintenance contract to a consortium led by Canadair in 1986 was another step in this direction. In addition, the purchase of this Crown corporation by Bombardier could help to ensure its recovery.

The manufacture of urban transportation, telecommunications and data processing equipment is well established in Quebec, which has a number of dynamic companies turning out the highly specialized products on which the future of these sectors depends. Leading-edge information technologies will make all sectors of the economy more productive and more competitive. The establishment of closer ties between Quebec and the rest of Canada, on the one hand, and the Francophone countries on the other, could open up new markets and speed up the growth of telecommunications and cultural industries related to high technology. The second Summit of Francophone Countries, which was held in Québec City in early September 1987, has helped to further several co-operative projects in these areas, including the project to establish an international Francophone centre for distance education. Also, the development of expertise and research capability in biotechnology, as indicated by the opening of the Biotechnology Research Institute in Montreal this year, could attract bio-industries to the province and contribute significantly to strengthening the industrial base. Other areas, such as composite materials, will become increasingly important. The presence of the National Research Council's Industrial Materials Research Institute in Boucherville, near Montreal, may prove to be a major strength for Quebec in this sector.

b) Regional impact

The Eastern Townships depend more heavily than any other region on manufacturing, which accounts for 27.4 percent of total employment there. Manufacturing accounts for 25.1 percent of employment in the Mauricie/Bois Francs region, and 21.8 percent in the Montreal region.

The restructuring of Quebec's industrial base, with uncompetitive traditional industries gradually modernizing and giving way to more technologically advanced sectors, is having an effect throughout the province, of course, but the main impact is being felt in these three more industrialized regions.

All three regions are facing major structural problems because of the importance of traditional manufacturing industries. However, some restructuring has taken place both through rationalization and contraction of traditional industries and the emergence of new ones. This is particularly true in the Eastern Townships and Mauricie/Bois-Francs regions. The Eastern Townships have shown new dynamism in recent years, focussing on high-technology sectors, especially in the Sherbrooke area. As for the Mauricie/Bois-Francs, electrometallurgy and electrochemicals have made important inroads, thanks to the development of the Bécancour industrial park; the Drummondville region has made good progress in metal products and printing. Restructuring in the Montreal region seems to be slower, but its large size and diversified base mask its achievements to some degree.

3.3 Primary sector

Over the last ten years, production in the primary sector decreased relative to the Quebec economy as a whole, but also in absolute terms. Mining was especially responsible for this situation. Forestry and fishing grew considerably, increasing their share in the economy. As for agriculture, it grew at a lower rate than the economy as a whole.

a) Review by industry

Agriculture, on which important manufacturing industries, mainly in the food and beverages sector, depend, is geared mainly to the domestic market. The overall constraint on production and processing of agricultural products stems from relatively high operating costs which limit competitiveness, while necessitating considerable government support, which is more and more difficult to maintain in the current context of government spending restraint. Growth in agriculture will depend on higher productivity and greater diversification and processing of agricultural products. Early in 1987, the governments of Canada and Quebec signed an agreement to develop the agri-food sector, improve its competitiveness and encourage private-sector innovation.

Forestry is still a major contributor to the economy in eight of Quebec's ten economic regions. Like agriculture, its importance is reflected by the impact it has on manufacturing. Manufactured forest products account for 14 percent of manufacturing employment and 22.5 percent of Quebec's total exports.

The industry in Quebec is currently faced with structural problems, in spite of excellent market prospects in the longer term; when cost competitive supplies are expected to pose a problem because of a history of inadequate reforestation and the spruce

budworm epidemic. This industry will have to intensify its efforts to modernize and streamline processing operations and adopt an intensive action plan for the protection and management of Quebec's forests.

Mining has been in a slump since 1976, but particularly since 1980. There are many reasons for the decline: the industry, and iron, asbestos and copper in particular, has felt the prolonged effects of the last recession and long-term structural changes. Stabilization of production since 1984, combined with a steep drop in employment, has led to a marked increase in productivity.

The mining industry has already adjusted fairly well in the eighties; asbestos and iron might once again suffer major losses in output and employment. Gold is now the leading metal in the province and accounts for almost all mineral exploration in Quebec. The industry has been faced with a saturated market and excessive competition from many developing countries. Its survival depends both on ongoing efforts to improve productivity and the discovery of new deposits.

Fisheries play a secondary role in the Quebec economy. Even so, the industry is of paramount economic importance in certain regions, especially the Gaspé, the Magdalen Islands and the North Shore, where few alternative sources of income exist. Quebec fisheries are in difficulty. Problems include highly limited species and products diversification, major seasonal problems, major discrepancies in income depending on species fished and type of vessel (inshore or offshore), an inadequate distribution system, remoteness and size of territory, obsolescence of some equipment and inadequate service infrastructures. The Canadian and Quebec governments have just signed a subsidiary agreement on fisheries development. It is aimed mainly at modernizing and constructing port infrastructures, promoting marketing and processing, and increasing the level of services. Another objective of the agreement is to encourage consultation and coordination between the two governments which have also signed a memorandum of understanding on the development of commercial aquaculture.

b) Regional impact

Quebec has about a hundred single-industry towns, half of them wholly dependent on the forestry sector. Slowdown in primary activities has already led to the shutdown of some of them, and others have gone into a slump.

The communities affected by declining primary activities are mostly in Quebec's resource regions, namely the Lower St Lawrence/Gaspé, the North Shore/New Quebec, Saguenay/Lac St Jean, and Abitibi-Temiskaming. The population of all these regions has declined since 1981.

The Lower St Lawrence/Gaspé still has the highest unemployment rate in the province and by far the lowest personal disposable income. Its economy is heavily dependent on the primary sector. Substantial amounts have been invested in a number of areas under the Eastern Quebec Development Plan, and close to \$190 million has been committed by the federal government to marine, air and rail transport infrastructure, fishing equipment, forestry, mining, agriculture, tourism, industrial expansion and human resource development.

The relative importance of the secondary sector in the Saguenay/Lac St Jean region, which accounts for one-quarter of all employment there, sets it apart from the other resource regions. There is little diversification in manufacturing: primary metals, consisting almost entirely of aluminum, provide 40 percent of jobs. The other industries are paper, wood, and food and beverages. Consolidation and modernization in industries such as pulp and paper and aluminum point to job losses.

The primary sector - mining, forestry and agriculture - is strongly represented in the Abitibi-Temiskaming region. This region is experiencing a boom because of the good performance of the mining and paper industries.

With a 10.1 percent decrease, the North Shore is the region that has experienced the largest decline in population since 1981. In addition to the shutdown of Gagnon, this trend, resulting from the decline of the iron industry, has particularly affected the towns of Sept Îles, Port Cartier and Fermont. Schefferville, in New Quebec, which is linked economically to the North Shore, has virtually shut down. The Baie Comeau area, with a more diversified economy and more solid industrial base, suffered little in the last recession because of the \$750 million expansion work at the Reynolds aluminum smelter. Baie Comeau has become the largest urban area on the North Shore in terms of population in the past few years, outstripping Sept Îles. The region's economic future still depends largely on its forest and mineral resources.

4. ISSUES IN QUEBEC'S ECONOMIC DEVELOPMENT

4.1 Strengthening Montreal's role

Despite the upheaval of the past few decades, Montreal remains a strategic region in the Canadian economy and, of course, in Quebec.

The Consultative Committee on the Development of the Montreal Region recognized this situation in its report published in November 1986. The committee recommended that the main parties involved adopt a development plan directed at a lasting recovery for the region. The plan would aim to take advantage of Montreal's many strengths and would include seven priority axes of development: international activities, high technology (telecommunications, space technologies, aerospace, microelectronics, informatics and biotechnology), international trade and finance, design, tourism, cultural industries and transportation. According to the Committee, the private sector must lead the way in regional development in the context of more concerted government action.

Although it still suffers from the structural weaknesses that accelerated the decline of its relative position in the Canadian economy, the Montreal region seems to have gotten its second wind with the economic recovery.

Of particular note among the main weaknesses in the Montreal economy is the fact that traditional industries provide over 37 percent of manufacturing employment. There are also certain problems with the "dynamic" tertiary sector, especially production services; despite their growth in the last 15 years, these services have grown more slowly than in other major Canadian metropolitan areas and have had their share of problems, with the departure of certain head offices and the weakening of Montreal's role in transportation and financial services.

However, the region does have many strengths: a diversified economic infrastructure, a critical mass in many areas of research and development, four large universities, a considerable number of medical institutions, modern transportation and communications networks, a new class of dynamic entrepreneurs and a large pool of highly specialized labour.

Given its many strengths, Montreal definitely has the potential to play a leading role in the Canadian economy. The present climate of optimism provides an ideal opportunity for establishing concerted action to achieve long-term remedies for continuing structural weaknesses and prepare the region to face the challenges of technological change, growing international competition, freer trade and market deregulation.

4.2 Industrial restructuring

Although the Quebec economy has performed well since the beginning of the recovery, particularly in areas such as private investment and productivity, it continues to lag behind its competitors in terms of productivity and international competitiveness. The gap is due to a higher rate of under-utilization of human resources, which is reflected in a lower participation rate and relatively high unemployment rate, and to poorer returns on resources used.

To cope with increasing international competition and accelerating technological change, industrial redeployment will require more flexible and skilled labour, at a time when Quebec workers are not as well trained as others and its universities are going through a financial crisis. A trade liberalization agreement with the United States, and in the longer term under the GATT, would lead to a profound adjustment in firms now protected by tariff and non-tariff barriers. In the context of an agreement with the United States, the federal and Quebec governments agree inter alia that transition periods and appropriate provisional measures for firms and workers in vulnerable sectors would have to be introduced in order to encourage them to adjust to the new competitive context as well as a mechanism for settling differences in order to limit the impact of American protectionist measures on the Canadian economy and regions.

If past experience, such as the Tokyo Round agreement, which resulted in significantly lower tariffs, particularly for manufactured products, is any indication, increased trade liberalization could bring about an inter and intra-sectoral redeployment of human resources and capital toward more productive activities, a considerable increase in the size and production runs of firms, and greater specialization in competitive niches. The less competitive industries could experience a slowdown in both activity and the creation of new firms. On the whole, net gains in employment could be very positive.

The fact remains that technological change can disproportionately exacerbate the situation of certain groups already disadvantaged in the work force (young people, women, older workers, native people and the disabled). The more dynamic the economy and the more equitably the fruits of economic growth are distributed, the easier the adjustment will be.

A study by the Quebec government identifies the industries that would benefit from a trade liberalization agreement with the United States and those that would be made more vulnerable by such an agreement. Among the sectors that would benefit from such an

agreement and therefore from increased access to the large American market are metals, forestry, furs, aeronautics, urban transportation equipment, rubber, informatics products and services, and certain printing and publishing industries. These industries are generally modern and competitive. Vulnerable firms are in agriculture and agri-food, fisheries, clothing, textiles, leather, metal products, chemicals, household appliances, rolled and extruded products (aluminum and copper), trucking and cultural industries.

Although the past will not necessarily be repeated, experience shows that an economy with qualified, flexible labour and innovative firms is better able to adjust and develop when faced with profound economic changes than a protected economy.

Despite fears in some circles regarding a trade liberalization agreement and regardless of whether such an agreement is signed with the United States, the challenge of industrial restructuring must be met by the private sector and the community, with the assistance of government. Whatever changes are made to current adjustment programs, these measures must take into account sectoral, regional and local factors.

4.3 Accelerating innovation

The use of science and technology is a significant lever in Quebec's economic development. However, Quebec is still lagging behind in its R&D efforts. It spent only 1.15 percent of its 1984 gross domestic product on research and development, compared with 1.34 percent in Canada, which in turn lags behind other major industrialized countries (the figure for the United States was 2.7 percent).

Technological sectors with strong potential for growth in Quebec include informatics, biotechnologies, electronics, manufacturing techniques, electrochemicals, electrotechnologies, space technologies and aeronautics. In order to build on these strengths, there are several ways to increase sector contributions, including increased transfer and dissemination of technology to small and medium-sized businesses; the use of government supply contracts to support the development of high-technology firms; the establishment of stronger links regarding innovation and R&D among universities, research institutes, and venture capitalists; greater focussing of government and university research on market requirements; more effective management of technological change in firms; greater co-operation and flexibility in work methods and labour relations; and, finally, directing university graduates toward innovative firms and promising sectors, and on-going training of workers.

However, the cost of realizing these opportunities could be high. Budget restrictions in universities and public institutions, which serve as driving forces in the sector, are major constraints. There is also an insufficient supply of start-up capital, especially for small and medium-sized businesses. Inadequate knowledge of high-technology markets is another barrier to ensuring that R&D and innovation have a greater impact on Quebec's economic development.

The federal and Quebec governments have an important rôle to play in the development of the sector. Subsidiary agreements between Canada and Quebec on industrial, scientific and technological development, and on communications firms, have already contributed to the launching of many projects in this area in cooperation mainly with the private sector, and could stimulate others. In addition, the federal, provincial and territorial governments signed, in March 1987, the first national science and technology policy. The governments of Canada and Quebec and the private sector have invested considerable sums in the high-technology sector in recent years. There is a definite need to consolidate gains and focus on strengths by ensuring that existing R&D investment is used efficiently. The initiatives recommended by the Picard report for the Montreal region could be used as a frame of reference by both governments, but also by the private sector as a means of increasing the efficiency and impact of scientific and technological activities. In the same vein, the proposed federal tax reform does not suggest any changes to the R&D tax credit, and Quebec's last budget included improved measures to spur research and development, particularly with respect to industrial research conducted for companies by universities.

4.4 Local entrepreneurship

Growing attention to entrepreneurship stems from the importance of small and medium-sized businesses in job creation and the key role of the entrepreneur in the innovation process, particularly through the establishment of dynamic new firms.

Entrepreneurship is recognized as an increasingly strategic ingredient in local economic development. Communities could aim for greater self-reliance by exploiting their economic potential themselves rather than relying on governments and the establishment of large companies from the outside.

Now, when government intervention in the economy is being challenged and large firms have exhausted their potential for job creation, there is an opportunity, and a need, to promote local

entrepreneurship, particularly in resource regions. The success of small and medium-sized firms in certain areas of Quebec, such as the Beauce, Abitibi and Eastern Townships, shows how pertinent this focus is. The spectacular rise of a new class of dynamic Quebec entrepreneurs is also helping to create an extremely favourable climate for entrepreneurship by providing models with which aspiring entrepreneurs can more easily identify. At the same time, the establishment of the Quebec Stock Savings Plan (QSSP) has helped to significantly increase the proportion of the population that is prepared to take risks. While 4.4 percent of Quebecers owned stock in 1977, that proportion jumped to 14 percent in 1987, compared with 15 percent in Canada as a whole.

The obstacles facing the entrepreneur include lack of financing, especially start-up capital, lack of management skills, government red tape and complicated government regulations. The birth of the entrepreneurial spirit, however, depends much on local economic potential and regional conditions, which are more favourable in some areas than in others. The overwhelming presence in certain regions of non-innovative large manufacturers controlled from the outside has probably created a climate of dependence and dulled entrepreneurship. However, the presence and emergence of large and dynamic local firms may encourage the development of intrapreneurship and sub-contracting by local small businesses.

The establishment of the QSSP, which has provided Quebec firms with more than \$5 billion in investment from the public since 1979, and the more recent establishment of the Quebec program for investment corporations in Quebec's firms (SPEQ) have certainly helped small and medium-sized Quebec firms to lessen the crucial problem of finding risk capital to finance expansion. The same is true of the venture capital firms, which have increased markedly in Canada in the last ten years. The supply of start-up capital continues to be insufficient, however. There have been some experiments with incubators and seed money, such as Soccrent in the Saguenay/Lac St Jean and TIEM, in Québec City. These organizations provide new entrepreneurs with common administrative and technical services, and often with consulting in various areas such as management.

The federal and provincial ministers responsible for small business agreed at their meeting in June 1987 to join forces to promote entrepreneurship, especially among young people and women. The federal government tabled, in May 1987, an action plan to lighten the burden of red tape on small business. In addition, the report of the Quebec Minister for Small Business, "Les PME au Québec - Etat de la situation", released in late 1986, also highlighted this problem as well as that of the impact of regulations on this type of firm.

4.5 Policy reforms and climate

With a view to reducing government intervention in the economy and increasing international competitiveness, several major plans for economic and social policy reforms both in Ottawa and Québec City are being examined.

Federally, the first phase discussed in the white paper on tax reform, tabled in June 1987, aims to establish more equitable distribution of the tax burden and increased competitiveness, especially with the United States. The second phase will be devoted to reform of the sales tax system. The Meech Lake Accord, signed by the First Ministers in June 1987, will bring Quebec into the Constitution and will also implement a more co-operative form of federalism. Quebec was the first province to ratify the accord at the end of June 1987.

Meanwhile, negotiations are continuing with the United States to arrive at a draft free trade agreement by October 4, 1987. The federal government tabled its new policy advocating reform of the Canadian financial sector on December 18, 1986. The restructuring of financial markets, which began to take effect on June 30, 1987, is intended to make the system more flexible by promoting the integration of financial services (banks, stock brokers, trust and insurance companies), while reinforcing supervisory measures to avoid conflicts of interest. The federal government also tabled a policy to deregulate the transportation industry in a paper entitled "Freedom to Move". Crown corporations such as Teleglobe Canada, Canadair, Canadian Arsenals and Pêcheries Cartier have also been privatized. In the context of the establishment of the Atlantic Canada Opportunities Agency, the Western Diversification Office and the special federal program for Northern Ontario, decisions will be made on the federal approach to regional development in Quebec. In the area of social reform, a national childcare policy is expected to be tabled in the fall.

The Quebec government has already begun to improve the state of its own finances, and is expected to adjust to the federal tax reform. Quebec will soon be following up on its policy to decompartmentalize the financial sector, a process which began a few years ago. Quebec has also just completed a first wave of privatization. A second may take place later. A new family policy is being drafted to enable Quebec to meet the demographic challenge posed by its low birth rate and aging population. The government is expected to publish a policy document shortly on income security integrating welfare and taking federal tax reform into account.

These new policies, which have come at a time of economic growth in Quebec and Canada as a whole, should help to consolidate the presently favourable socio-economic climate.

Labour relations have improved considerably in recent years. The Quebec government, in the Spring of 1987, succeeded in signing collective agreements in the public and parapublic sectors without too many problems. Although some aspects of labour legislations are still deemed negative, the business community is happy about the present climate in Quebec. This new relative social peace has been reflected, inter alia, in the role played by the Fonds de solidarité de la Fédération des travailleurs du Québec. Not only has the fund provided capital for firms in difficulty, but it has also led to interesting experiments in participative management.

STATISTICAL ANNEX

TABLE 1

MAIN ECONOMIC INDICATORS

	<u>1981-1985</u> <u>(%)*</u>	<u>1986</u> <u>(%)</u>
Gross domestic product		
. rate of growth (constant \$)	2.0	3.1
. Quebec/Canada (current \$)	22.7	22.9
. Quebec/Ontario (current \$)	61.6	58.8
Population (in thousands)	6,438**	6,540
. Quebec/Canada	26.5**	25.8
. Quebec/Ontario	74.7**	71.8
Productivity***		
. Quebec/Canada	90.8	90.6
. Quebec/Ontario	92.8	90.5
Net migration	-7,555	+4,420
Employment (in thousands)	2,696	2,866
. rate of growth	0.8	2.2
. Quebec/Canada	24.6	24.6
. Quebec/Ontario	64.3	62.9
Participation rate****	61.2	62.4
. Quebec/Canada	94.7	95.0
. Quebec/Ontario	90.7	91.1
Unemployment rate	12.5	11.0
. Quebec/Canada	119.0	114.6
. Quebec/Ontario	142.0	157.1
Earned income per capita		
. Quebec/Canada	91.0	91.8
. Quebec/Ontario	81.5	80.1
Personal income per capita		
. Quebec/Canada	94.5	93.5
. Quebec/Ontario	87.1	84.7

* Average of annual values unless otherwise indicated.

** Data for 1981

*** GDP in 1981 dollars, divided by employment .

**** Labour force as a percentage of the civilian population 15 years and over

Sources: Statistics Canada and Conference Board of Canada

TABLE 2
BREAKDOWN OF EMPLOYMENT IN QUEBEC BY SECTOR

	<u>1976 AND 1986</u>			
	<u>1976*</u>	<u>%</u>	<u>1986*</u>	<u>%</u>
Total primary 1)	119	4.8	127	4.4
Manufacturing	589	24.0	565	19.7
. Traditional sectors 2)	232	9.5	198	6.9
. Modern sectors 3)	179	7.3	209	7.3
. Resource processing 4)	177	7.2	152	5.3
Construction	145	5.9	141	4.9
Total Secondary	<u>734</u>	<u>30.0</u>	<u>706</u>	<u>24.6</u>
Tertiary				
. Consumer services 5)	636	25.9	816	28.5
. Production services 6)	408	16.6	491	17.1
. Government and other services	557	22.7	725	25.3
Total tertiary	<u>1,601</u>	<u>65.2</u>	<u>2,032</u>	<u>70.9</u>
TOTAL **	<u>2,456</u>	<u>100.0</u>	<u>2,866</u>	<u>100.0</u>

* For 1976, the 1970 classification was used, and for 1986, the 1980 classification.

** Addition of components will not equal total because of rounding.

- 1) Agriculture, forestry, hunting and fishing, mining;
- 2) Food and beverages, tobacco, leather, textile, knitting mills, clothing, furniture;
- 3) Rubber and plastics, printing, machinery, transportation equipment, electrical products, chemicals and miscellaneous manufacturing industries;
- 4) Wood, paper, primary metals, metal fabricating, non-metallic mineral products, petroleum and coal;
- 5) Trade, amusement and recreation, personal services, accommodation and restaurants, other services;
- 6) Transportation, communications and other utilities, finance, insurance, real estate and business services.

Source: Statistics Canada, Labour Force Survey

TABLE 3

BREAKDOWN OF GROSS DOMESTIC PRODUCT BY SECTOR IN QUEBEC

1976 AND 1986

	<u>1976 - %</u>	<u>1986 - %</u>
Agriculture	2.1	2.0
Forestry	0.5	0.5
Fisheries and trapping	0.0	0.0
Mining	2.1	0.9
Total primary	<u>4.7</u>	<u>3.5</u>
Manufacturing	22.5	21.0
Construction	8.2	6.8
Total secondary	<u>30.7</u>	<u>27.8</u>
Transportation, communication and other utilities	9.7	11.0
Trade	12.4	12.2
Finance, insurance and real estate	12.8	15.2
Community, business and personal services	23.4	24.0
Public administration and defence	6.3	6.3
Total tertiary	<u>64.6</u>	<u>68.7</u>
TOTAL	<u>100.0</u>	<u>100.0</u>

Source: Conference Board of Canada

TABLE 4.1

POPULATION AND ADMINISTRATIVE REGIONS OF QUEBEC

	<u>Population</u> <u>June 1, 1986</u>	<u>Share (%)</u>	<u>1981-1986</u> <u>(%)</u>
RESOURCE REGIONS			
. Gaspé/Lower St Lawrence*	231,638	3.5	- 1.0
. Saguenay/Lac St Jean	299,864	4.6	- 0.3
. Abitibi/Temiskaming	154,737	2.4	- 0.4
. North Shore	103,527	1.6	-10.1
. New Quebec	14,247	0.2	- 7.4
TOTAL	<u>804,013</u>	<u>12.3</u>	<u>- 2.0</u>
CENTRAL REGIONS			
. Québec City	1,047,397	16.0	1.5
. Mauricie/Bois Francs	446,728	6.8	1.2
. Eastern Townships	241,017	3.7	0.8
. Outaouais	287,221	4.4	4.9
TOTAL	<u>2,022,363</u>	<u>30.9</u>	<u>1.8</u>
MONTREAL REGION	3,713,900	56.8	2.3
PROVINCE TOTAL	6,540,276	100	1.6

* The territory of the Eastern Quebec Development Plan extends beyond the boundaries of the Gaspé/Lower St Lawrence administrative region. That entire region, with the exception of the Magdalen Islands is included but on the southwest, the limits of the Plan's territory extends considerably beyond the border of the administrative region. The population in the Eastern Quebec Development Plan area stood at 308,762 inhabitants in 1986.

Sources: Statistics Canada (1986 Census) and Bureau de la Statistique du Québec, special tabulation.

TABLE 4.2

OVERVIEW OF QUEBEC REGIONS
LABOUR MARKET

	Unemployment Rate		Participation Rate		Employment
	1985	1986	1985	1986	1986/1985
	%	%	%	%	%
RESOURCE REGIONS					
. Gaspé/Lower St Lawrence	17.1	19.3	55.1	54.5	-1.2
. Saguenay/Lac St Jean	14.8	13.3	56.6	58.7	7.3
. Abitibi/Temiskaming	14.1	11.8	57.4	60.3	9.4
. North Shore/New Quebec	13.6	14.9	62.2	64.4	0.7
CENTRAL REGIONS					
. Québec City	9.1	9.1	60.6	61.1	1.6
. Mauricie/Bois Francs	13.6	12.4	58.5	60.6	6.6
. Eastern Townships	10.8	9.5	62.1	61.3	1.2
. Outaouais	10.9	12.3	67.3	66.4	-1.7
MONTREAL REGION	11.7	10.5	63.9	63.8	1.9
PROVINCE TOTAL	11.8	11.0	62.2	62.4	2.2

Sources: Statistics Canada, Labour Force Survey, and Bureau de la statistique du Québec.

TABLE 4.3

OVERVIEW OF QUEBEC REGIONS

ECONOMIC STRUCTURE

	<u>Employed persons 1986</u>		
	<u>Primary</u> %	<u>Secondary</u> %	<u>Tertiary</u> %
RESOURCES REGIONS			
. Gaspé/Lower St Lawrence	12.2	18.4	69.4
. Saguenay/Lac St Jean	10.5	20.8	68.7
. Abitibi/Temiskaming	19.0	12.8	68.2
. North Shore/New Quebec	16.9	17.3	65.8
CENTRAL REGIONS			
. Québec City	5.2	18.8	76.0
. Mauricie/Bois-Francs	9.2	29.7	61.1
. Eastern Townships	7.8	31.0	61.2
. Outaouais	4.0	18.8	77.2
MONTREAL REGION	1.9	26.7	71.4
PROVINCE OF QUEBEC	4.4	24.6	71.0

Sources: Statistics Canada, Labour Force Survey, special tabulation.

EIC, Economic Services Branch - Quebec Region.

