



# NAFTA Renegotiation

Principal Issues for the ICT Industry

June 2017

# Context and objectives

- ▶ On May 18, 2017, the United States officially announced its intention to renegotiate the North American Free Trade Agreement (NAFTA), opening a 90-day consultation period before the start of formal discussions with Canada and Mexico.
- ▶ In light of this, the Quebec government entrusted Raymond Bachand with the mandate to act as Special Advisor, whose role is to identify priority issues for the province and gather the concerns and expectations of the main economic players whose interests would be affected by such a renegotiation.
- ▶ Given the key role that information and communications technologies (ICT) companies play in Quebec's economy and in its relations with the United States, TechnoMontréal was solicited by the Minister of Economy, Science and Innovation to report on the potential impact on the industry.
- ▶ To this end, the present document proposes a methodological approach and analytical framework to **measure the impact of the NAFTA renegotiation on the ICT industry** and to summarize the priority issues, the concerns of companies within the sector, as well as the possibilities for improving NAFTA.

# Highlights

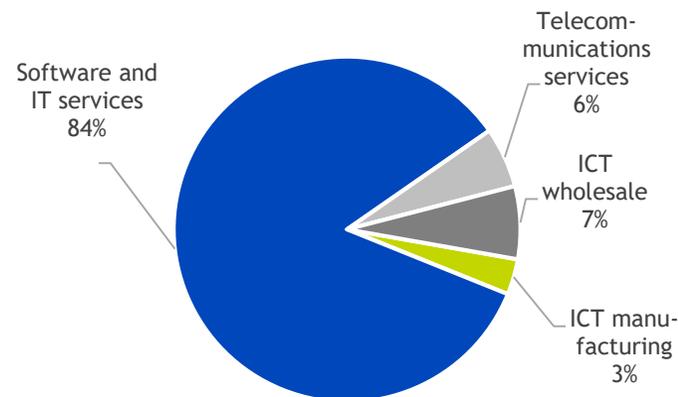
- ▶ 7,540 ICT companies in Quebec, 78% of which have less than 10 employees.
- ▶ 117,110 employees and 20,500 independent workers.
- ▶ GDP growth of the ICT industry is twice as fast as the overall Quebec economy.
- ▶ 64% of the Quebec production of ICT goods is exported to the United States (principal commercial partner).
- ▶ 93% of companies surveyed have a presence in the United States and 33% in Mexico.
- ▶ 58% of companies specify that they are major suppliers of ICT products or services for clients situated in the United States (compared with 15% in Mexico).
- ▶ 73% of respondents believe that the NAFTA renegotiation will have an impact on their activities: relocation of activities, loss of competitiveness, hindering to workers mobility, etc.
- ▶ 65% of companies state, however, that they do not have a contingency plan in place to minimize the negative effects of a NAFTA renegotiation.

# Quebec's ICT Industry Overview

# A sector composed mainly of small companies

- ▶ In 2016, the ICT industry counted more than 7,540 companies in Quebec (Canada: 41,880), 84% of which belong to the software and IT services subsector.
- ▶ Although the Quebec ICT industry is dominated by very small firms (less than 10 employees) with approximately 5,910 companies in total, their proportion is 6 percentage points lower than in Canada (78% vs. 84%).
- ▶ Large companies (500+ employees) are very few: there are 25, including subsidiaries of foreign multinationals. Bell and CGI are notable among the giants of the ICT industry.

Quebec companies by subsector in 2016

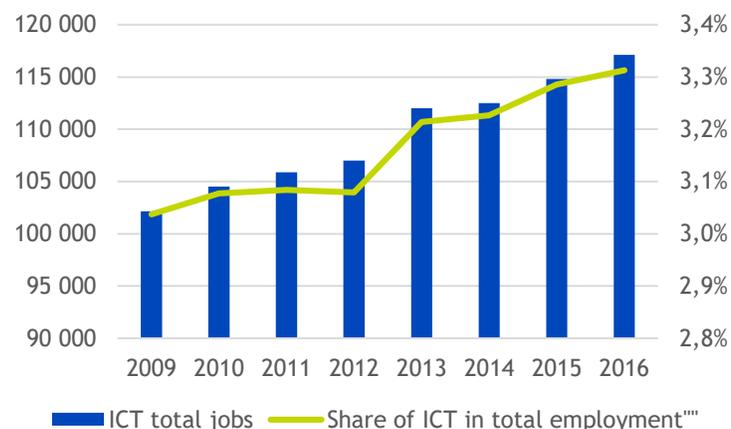


Source: Statistics Canada, Table 552-0005, Business Register.

# A dynamic industry: Quebec's job creation engine

- ▶ In Quebec, between 2009 and 2016, the average annual job growth in the ICT industry was three times faster than in the overall economy (+2% vs. +0.7%).
- ▶ This progression is mainly due to the rise in employment in the software and IT services subsector, which now includes 6 out of 10 employees in the industry.
- ▶ In 2016, Quebec ICT jobs (117,110) represented 24% of all ICT industry jobs in Canada (490,090). The province thus ranks 2<sup>nd</sup> nationally, behind Ontario (203,890) and ahead of British Columbia (57,360).
- ▶ Furthermore, the number of independent ICT consultants is estimated at 20,500 in Quebec.<sup>1</sup>

ICT jobs in Quebec  
between 2009 and 2016

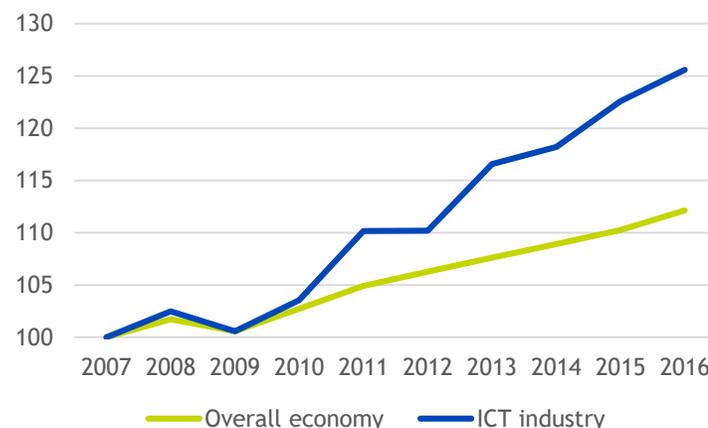


Source: Statistics Canada, Table 281-0024, SEPH.

# A major contribution to Quebec's economic growth

- ▶ In 2016, the gross domestic product (GDP) of the ICT industry reached nearly **\$16.1B**, representing 5% of Quebec's GDP.
- ▶ Since 2007, the average annual GDP growth in this industry has been twice as fast as that of the overall Quebec economy (+2.6% vs. +1.3%).
- ▶ The vitality of the ICT industry, particularly its Montreal ecosystem, is also an attraction for foreign direct investment in the province.
  - In fact, 52% of foreign investments made in 2016 in Greater Montreal involved ICTs (total: \$1.3B).<sup>2</sup>

GDP growth in Quebec between 2007 and 2016



Source: Statistics Canada, Table 379-0030, GDP at basic prices, base 100 = 2007.

# The United States: main trading partner of ICT companies

- ▶ Exports of ICT-related products are dependant on the U.S. market, despite a downward trend in recent years. More than **64% of the Quebec production of ICT goods was exported to the United States in 2016** (\$1.6B).
  - Vermont ranks first among the states in terms of exports from Quebec (\$772M), followed by New York (\$241M) and California (\$98M).
- **Mexico accounts for 3% of Quebec's exports of ICT products.**
  - Since the enactment of NAFTA, there has been a marked increase in trade between Quebec and Mexico.
  - Whereas in 1994, Mexico was the 15<sup>th</sup> largest export partner for Quebec, it rose to 4<sup>th</sup> place in 2016.

Country	1994	Rank	2016	Rank	AAGR
United States	3532.0	1	1600.2	1	-3.5%
United Kingdom	16.6	7	82.5	2	7.6%
China	52.1	3	73.1	3	1.6%
Mexico	7.8	15	70.5	4	10.5%
Germany	23.3	5	52.1	5	3.7%
Hong Kong	8.7	13	51.9	6	8.5%
Japan	43.6	4	49.2	7	0.6%
France	15.7	8	44.3	8	4.8%
United Arab Emirates	0.7	48	44.2	9	21.0%
Singapore	4.4	19	41.4	10	10.7%

Source: Statistics Canada, Trade Data Online, in \$M.  
AAGR = average annual growth rate

# Issues Related to NAFTA Renegotiation

# Companies focused on foreign markets

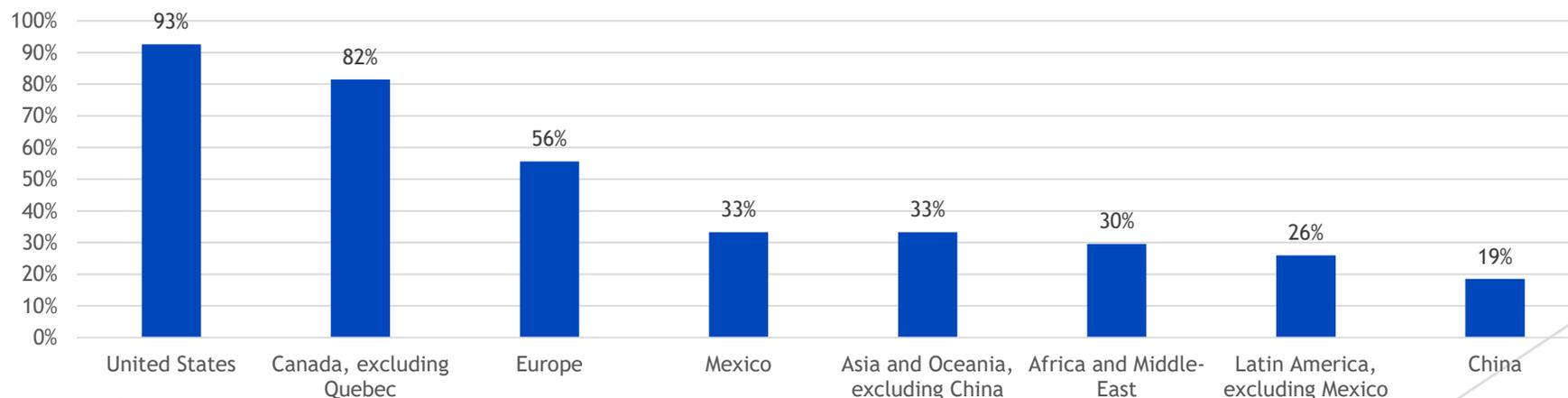
- ▶ TechnoMontréal conducted a survey with 42 companies within the ICT industry from May 15 to 29, 2017.
- ▶ Among the respondents, **79% declare that they export ICT-related products or services** (compared to 21% of Quebec SMEs, all sectors combined<sup>3</sup>).
  - These companies have experience with markets outside of Quebec as 74% have been exporting for more than 5 years, and only 4% of them have been exporting for less than 2 years.
  - They are very predominantly Quebec companies (79%), meaning that they were either founded in Quebec, or their head office is located here.
- For the companies surveyed, the share of their revenue for export is averaged at 40%, compared to 34% for other SMEs within Quebec's ICT industry.<sup>4</sup>

# The U.S. market: main target for companies in the ICT industry

- ▶ The companies surveyed primarily serve U.S. and Canadian (excluding Quebec) export markets.
  - **93% of respondents surveyed are present in the United States, 82% in the rest of Canada, 56% in Europe and 33% in Mexico.**
  - The states most frequently cited by respondents are Massachusetts, New York, California, Florida and Ohio.

## Main markets where ICT companies export

2017, N = 27, % of respondents, several possible choices



# Supply chains strongly integrated with the United States

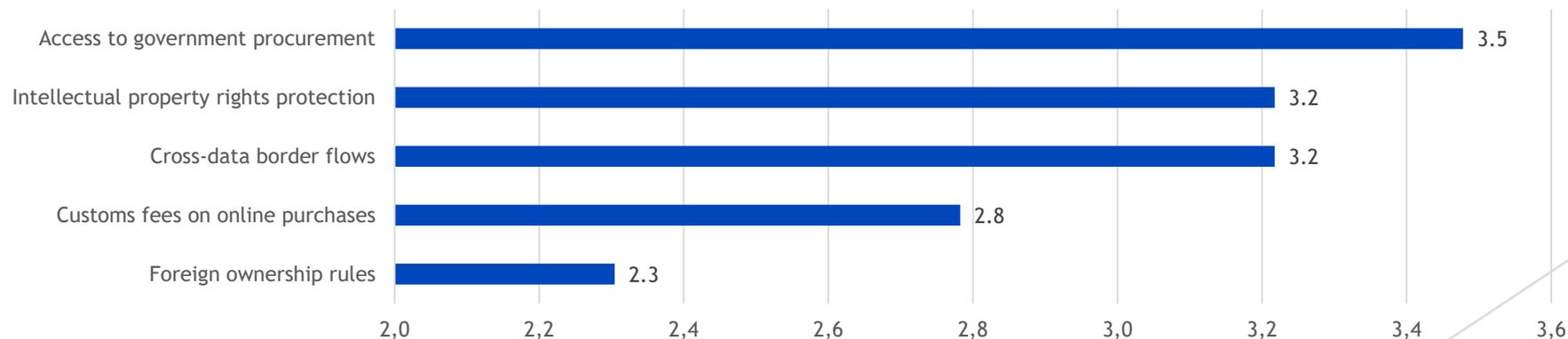
- ▶ 58% of companies surveyed say they are major suppliers of ICT-related products or services for clients in the United States.
  - Software and IT services: Google, Microsoft
  - Semi-conductors : MegaChips, Texas Instruments
  - Telecommunications: Mercury Systems
- ▶ 65% of companies also indicate that they have suppliers based in several U.S. states, including California, Massachusetts and New York.
- ▶ On the other hand, Quebec companies that participated in the survey seem to have established fewer trade partnerships with their Mexican counterparts.
  - Respectively 15% and 12% of respondents declare that they are neither a major supplier nor a client of ICT-related products or services for Mexico.
- ▶ In addition, among the other suppliers of Quebec ICT companies are countries in Europe (France, United Kingdom) and Asia-Oceania (Australia, Japan).

# The NAFTA renegotiation raises key issues for the ICT industry

- ▶ This survey highlights the issues identified by companies as priorities in relation to the sectoral markets in which they operate.
  - The main sectoral markets served by companies within the ICT industry include the public sector, commerce, health, aerospace and transportation & logistics.
  - The priority issues include access to **government procurement**, protection of **intellectual property rights**, **cross-border data flows**, customs fees on **online purchases** and **foreign ownership rules**. It should be noted that numerous respondents also pointed to the **mobility of workers** as another important issue.

## Priority issues concerning the NAFTA renegotiation

2017, N = 23, score according to rank



Source: TechnoMontréal.

# Main concerns for companies

- ▶ **Access to government procurement**
  - Provisions related to U.S. content in ICT supply and service contracts for U.S. federal and state governments
- ▶ **Protection of intellectual property rights**
  - Extension of the protection period from 50 to 70 years, as provided for in the latest bilateral trade agreements
- ▶ **Cross-border data flows**
  - Opening of procurement process to update the transnational data infrastructure for U.S. -based cloud computing companies
- ▶ **Customs duties for online purchases**
  - Harmonization of customs duty exemptions for online purchases (\$20 in Canada vs. \$800 in the United States).
- ▶ **Foreign ownership**
  - Lowering the foreign ownership limit of major telecommunications providers (threshold currently set at 46.7%).
- ▶ **Mobility of workers**
  - Concerns about the maintaining TN visas for temporary workers in the category of Computer Systems Analyst.

# Potential impact on company activities within the ICT industry

- ▶ 73% of respondents believe that the NAFTA renegotiation will have an impact on their activities.
- ▶ Despite the fact that respondents are aware of the impact that could result from a renegotiated NAFTA, they do not appear to have a contingency plan in place.
- ▶ Thus, 65% of companies indicate that they do not have a strategy to minimize the negative effects of a renegotiation.
- ▶ Among those who do have such a plan, the strategies mainly target the growth of U.S. content in their ICT products or services (e.g. incorporation or buyout of a U.S. entity).
- ▶ However, this approach could ultimately lead to job losses in Quebec's ICT industry.

Type of impact	% of companies <sup>5</sup>
Relocation of activities due to local content requirements	83%
Loss of competitiveness and of market share	83%
Tightening of certification conditions and product approvals	68%
Decrease in border fluidity for merchandise	67%
Hindering to workers mobility	64%

Source: TechnoMontréal.

<sup>5</sup> Percentage of companies for which a renegotiated NAFTA would have a significant or very significant impact on the cited terms (N = 23).

# Recommendations from the ICT Industry

# NAFTA for the digital age

- ▶ **Recommendation 1: Encourage fair and equitable access to government procurement for ICT supplies and services**
- ▶ **Recommendation 2: Define a legal framework for the governance of data (security, protection and control)**
- ▶ **Recommendation 3: Preserve tariff exemptions for ICT products and services**
- ▶ **Recommendation 4: Consider ICTs in both the global supply chain and emerging markets**
- ▶ **Recommendation 5: Promote the mobility of ICT workers**

# Detailed Survey Results

# Profile of respondents

To what subsector of the ICT industry does your company belong? (N = 28)

Subsector	% respondents
Manufacturing	25%
Software and IT services	64%
Telecommunications services	7%
Wholesale and repair	0%
Other	4%

What is the ownership of your company? (N = 28)

Origin	% respondents
Quebec company (i.e. the company was founded in Quebec and/or the head office is in Quebec)	79%
Canadian company (i.e. the company was founded in Canada and/or the head office is in Canada)	11%
Subsidiary of a foreign company	11%
Don't know	0%

How many permanent employees (salaried) does your company have in total? (N = 28)

Size	% respondents
Less than 10	11%
From 10 to 49	61%
From 50 to 99	14%
From 100 to 249	4%
From 250 to 499	4%
More than 500	7%

# Market sectors served

Which market sector do your ICT-related products and/or services serve? (N = 23)

Market sector	% respondents
Public	30%
Retail	22%
Health	22%
Aerospace	17%
Energy	17%
Transportation & logistics	17%
Construction	13%
Financial / insurance services	13%
Manufacturing	13%
Environment	9%
Security / defense	9%
Automobile	4%
Video games and multimedia	4%
Other*	26%

\* The “Other” category includes:

- Management
- Real estate
- Media
- ICT

# Main impacts of a NAFTA renegotiation

In your opinion, what would be the main impacts of a NAFTA renegotiation for your company?  
(N = 23)

Type of impact	Very significant impact	Significant impact	Little impact	No impact	Does not apply	Total
Decrease in border fluidity for merchandise	43%	24%	10%	5%	19%	100%
Hindering to workers mobility	45%	18%	18%	9%	9%	100%
Loss of competitiveness and of market share	26%	57%	13%	4%	0%	100%
Relocation of activities due to local content requirements	39%	43%	9%	4%	4%	100%
Tightening of certification conditions and product approvals	27%	41%	14%	5%	14%	100%