



Issues for Industry in Québec

The Canadian Club of Montreal

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Salutations.

I want to thank the Canadian Club of Montreal for inviting me. For more than a century, this has been a forum for discussing major economic and social questions, and I am pleased to be here among friends and many of our customers.

It's a real pleasure for me to share a few thoughts with you.

I will be leaving behind my duties as President and Chief Executive Officer next week, after ten years at the head of a company that is deeply woven into the social and economic fabric of Québec and that is at the heart of the major energy issues.

There are few companies, big or small, businesses or institutions, that are not our customers. Almost 90% of our deliveries are to these sectors, where we serve about 45,000 customers.

And so it's obvious that we share our future with our customers.

Our economies have performed very well in general in the last 10 years and have proven to be resilient in a changing environment. Both in Québec and in Canada, 2006 concluded a 14th consecutive year of sustained growth.

That's a first.

Last year, the unemployment rate hit its lowest level in 33 years. Consumers were able to benefit from strong purchasing power, the value of domestic production continued to grow, and inflation remained stable.

This outwardly calm sea hides deep currents that are about to considerably change our new economic and social structures.

We are moving from a comfortable chartered course into uncharted waters.

The head of a corporation today has to be vigilant, has to think fast and work hard – very hard.

The past is no guarantee of the future. Old maps are no longer useful. Groundswells come quickly, are often surprising, and, unfortunately, elements sometimes combine to create the perfect storm. We only have to think about the pulp and paper sector to be convinced of that.

A CEO today needs to make sure that his boat is shipshape and that he has a dynamic and competent crew; otherwise, it is at risk of being shipwrecked.

I'd therefore like to focus on a few examples of these major undercurrents. These currents call for prudence. How we navigate them may take Québec into rather rough seas, or lead to a safe harbour, if we do what needs to be done.

Let me now look at some of the major constraints faced by Quebec companies.

Some time ago, in 2002, I participated in a meeting between business leaders and the President of the Bank of Canada. At that time, we were concerned about the negative effects of a Canadian dollar pegged at 63 cents, which made it expensive to purchase technologies and equipment in U.S. dollars.

During that meeting, I remember David Dodge saying that the only strong correlation that bears out between Canadian and American currencies is the price of oil and of natural resources. When those prices are high, the Canadian dollar is on the increase. This assertion has turned out to be true, even more so since U.S. deficits have done nothing to correct this tendency.

Five years later, the problem has totally changed. The Canadian dollar has appreciated by 25% against the U.S. dollar. This is a sea change for an economy that sends more than 85% of its exports to the U.S.

For this reason alone, many companies have come to grief. It is nevertheless reassuring to state that this has not been a disaster and that the great majority have adapted.

Through resilience and business savvy, our business leaders have grown from this challenging situation.

The manufacturing sector is at a crucial point and large and small companies are trying to secure their future.

Besides the level of the Canadian dollar, they also have to face increases in the costs of their energy and raw material supplies. As well, they are confronted by the arrival en masse in their market niches of products manufactured at low cost in emerging economies.

To be here tomorrow, businesses have to reinvent themselves today.

This reorientation is unavoidable, because emerging economies will be unbeatable when it comes to manufacturing products that are labour-intensive, especially since these economies now have access to advanced tools and technologies.

If ever “think global” had meaning, it is now!

In our flat world, competition is borderless, knows no time zone, and is always on the job, 24/7, somewhere in the world.

Another troublesome factor is that Québec is going to experience a demographic shock whose effects we are just beginning to feel and which will have significant impacts on our productive capacity.

In 2006, the first baby-boomers hit 60 and, like me, they dream of retiring. In 2030, almost one-quarter of the Québec population will be over 65. In the years to come, our society is going to be one of those most affected by massive retirements.

This can already be felt in several job categories and this phenomenon of shortage is going to become more and more acute. We are going to have to learn to produce our goods and dispense our services with fewer employees. That is inevitable.

In the past, we had people looking for jobs. Today, we have jobs looking for people.

This demographic trend is going to put pressure on the management of our most talented resources. The challenge is even greater because young talent is now more flexible and more mobile. It does not respond to traditional hiring incentives and is not only more difficult to recruit, but also to retain.

The responsibility is on us, as employers, to create the right conditions in order to attract and retain not only graduates, but also skilled workers.

We have all the elements of a crisis in the making.

But any crisis, if we seize the opportunities it brings, may be the time to make considerable progress. Necessity is the mother of invention – and there is a necessity! As an American economist once said, “A crisis is a terrible thing to waste.”

Again, we have to analyze the situation lucidly – a word, by the way, that should not make us blush. The facts won’t go away and, in the long term, they end up making sense. However, myths are tenacious and it takes a lot of persuasion and a consistent message to change perceptions that have been deeply anchored for several generations.

One of these myths is quasi-free schooling. Here in Québec we have an education system that is among the most generous in the world. Unfortunately, the State has less and less funding capacity. But still we refuse to adjust the level of tuition fees. The result is that university budgets no longer allow them to keep pace with what our neighbours are doing.

Our universities are chronically under-funded. Estimates put the shortfall for Québec university budgets at \$450 million a year.¹ That is \$450 million which, every year, creates a wider gap between our universities and their peers in the rest of Canada. Our universities have been in debt for a number of years, which limits their prospects for future growth.

¹ Lacroix, R., *Le sous financement des universités québécoises*, November 30, 2006.

Progressively, imperceptibly, a sector that is vital for the future, not only for industry and trade, but also for science, arts and letters, is floundering.

Today's lack of financing will end up costing more to society as a whole while jeopardizing our capacity to innovate.

We are quietly throwing away the key to our future.

If the price to be paid for this practice was at least offset by a higher graduation rate than that of our neighbours, we'd have to think twice. But such is not the case.

In 2003-2004, the average tuition fees for post-secondary education was \$1,862 in Québec, well below the \$5,557 in Nova Scotia, the \$4,923 in Ontario, or the Canadian average of \$4,025.²

Now, in 2001, only 20% of Quebecers between 20 and 21 attended university, versus 33% in Nova Scotia and 26% in Ontario.

As I said earlier, whether we like it or not, facts are facts. And, for the time being, we are obviously paying a high price for poor enrolment results.

² *La hausse des droits de scolarité réduirait-elle l'accessibilité aux études universitaires*, Montreal Economic Institute, February 2004

Our standing on the world stage is directly related to the ability of our education system to produce the engineers, scientists, managers and artists that will enable us to continue to grow and do what we do best.

Our cutting-edge industries, those of today and those of tomorrow, are going to need to develop in synergy with colleges, universities, and research centres.

We therefore have to give them the financial ability to hire the best professors and acquire the means and equipment that will ensure an optimal quality of research and teaching.

Top minds will only come if we offer top level research infrastructures and funding.

A progressive alignment of tuition fees with those of other provinces is urgently needed. On the other hand, so as not to close the door on gifted students, we need to adjust the loans and bursaries programs accordingly.

As well – and this is an idea that is circulating more and more under different guises – taxation could be reviewed in order to give our graduates a 3-5 year tax break, up to the amount of tuition fees paid.

That would have the advantage of helping keep here in Québec people trained with public funds and encourage the retention of our

best brains. Who knows, it could also attract and retain foreign students and thus help reduce the expected demographic deficit.

I'd now like to change course and look at energy from a sustainable development angle.

The peculiar winter we are having has had a profound effect on raising awareness of the phenomenon of climatic warming. When it is green instead of white in mid-January, we all say something is not right. Even skeptics are starting to be confused.

Opinion polls and weather forecasts make for shifting politics, it seems.

Caution is called for, given the accumulation of scientific observations. A prerequisite to reducing greenhouse gases must be the more intelligent consumption of fossil fuels.

Even those who don't buy into the climate change creed must change their energy consumption pattern.

At the current rate of consumption, oil reserves will be exhausted in 30 or 40 years, natural gas supplies in 70 years, according to the latest statistics from the International Energy Agency.

Energy conservation is thus doubly needed, both from an environmental and an economic viewpoint. The too-rapid attrition of

fossil resources would doubtless have very negative impacts on the development of our societies – all around the world.

As well, pressure on these resources is going to increase due to the rapid progress of emerging economies. In 2005, for the first time in history, Asian consumption of oil surpassed that of North America. That is reflected in the price.

With Asia stepping into the pole position of oil-consuming regions, we can only expect this kind of pressure on resources to grow in the future.

In 2002, a barrel of oil cost about \$25 U.S. Five years later, it is trading at more than \$70 U.S. The price of natural gas in North America more than doubled in 2001 and since then has remained very volatile.

As Yogi Berra would have said, while I hate making forecasts, especially for the future, looking into my crystal ball, I can say that the future will be: more of the same; relatively high and volatile prices.

Gaz Métro's experience teaches us that the combination of the cost of energy and environmental concerns leads to very different consumption behaviour. Our companies have been investing for years in high-performance technologies to reduce their atmospheric emissions and their energy costs.

For some sectors of our industry, energy costs account for up to 25% of their total operating costs and thus are a significant factor in their competitiveness.

To stay competitive, energy savings are now a must.

That is why, and we are helping in this regard, our industrial customers have made considerable efforts that are, however, difficult for us to measure. Their consumption is, of course, greatly influenced by their level of production. But figures from Statistics Canada indicate that, between 1990 and 2003, Québec industry as a whole reduced its emissions by 6.8%.

For its part, Gaz Métro has done its homework in this area by taking steps to control methane emissions into the atmosphere well before the Kyoto Protocol was signed. By reviewing our way of doing things and investing, by 2006, we had reduced our annual greenhouse gas emissions by 24% compared with 1990. We are well ahead of the Kyoto target.

Also, starting in 1999, we developed a program to analyze the behaviour of a cohort of 126,000 of our residential and commercial customers. Eliminating the effect of temperature variations, between 1999 and 2005, we found that those who participated in our energy-efficiency programs reduced their consumption by an average of 23%! What is even more surprising is that others also reduced theirs by almost 16%!

We have the proof that significant energy savings are possible.

Now let's look at why.

One of the things that has contributed to this success is the introduction of new technologies. For example, new boilers operate at 95% efficiency, while old models hardly reached 70%. Natural gas heating with this type of modern equipment releases very little emissions into the atmosphere, and we promote their installation through our financial assistance programs.

But the most determining factor is without doubt the increase in prices that has bolstered the environmental motivation of our customers, who have adjusted their natural gas consumption habits downward and insulated their buildings better.

This leads me to the subject of electricity rates. Quebecers are champions in all categories of electricity consumption. Their per capita consumption is twice that of the U.S.

That is why the proportion of electricity in our energy portfolio is two times higher than in Ontario, while that of natural gas is two times lower. In Ontario, natural gas is used for heating.

Once again, Quebec is a distinct society. It is the only place in North America, and probably in the world, where electricity is used for space and water heating.

Using electricity for heating is an economic and environmental aberration. It is one of Québec's greatest strategic errors. It would have been better to use electricity where it is essential, such as for lighting, machinery, telecommunications, information technology, etc., etc. Surplus electricity could then have been used to develop industries or been exported.

There is a gold mine right next door to us. Both Ontario and the Northeastern U.S. have a huge demand for electricity and the price is right.

Québec has storage capacity (in its reservoirs) and hydroelectric generating stations that enable it to buy electricity when the price is low and re-sell it when prices are high. That explains why, in 2005, almost 24% of the revenues of Hydro-Québec Production, that is, \$1.5 billion, came from only 8% of its total deliveries through sales on external markets.

When Québec sells its clean energy elsewhere, it replaces thermal production and contributes to reducing greenhouse gases.

If Québec had the same electricity consumption profile as Ontario and used natural gas for heating, the result would be significant excess capacity. Exported to our neighbours at market prices, this would represent, in terms of income to the Québec government, more than \$5 billion a year.

I am sure that we could find a way to invest that kind of money in health, education, and in our failing infrastructures.

If we want Quebecers to gradually consume less electricity and use the right energy in the right place, a good price signal has to be given. Small steps are being taken in the right direction, but there is still a long way to go before electricity is sold at its real value in Québec.

In conclusion, I believe it is our duty as citizens and business leaders to explain, and constantly re-explain, some principles of our economic reality.

All of us in this room, in one way or another, have the occasion to communicate our vision. As I said earlier, facts are facts – still, they have to be known.

Let's face it, it's time for a reality check!

Each and every one of us has to make sure that hard facts prevail over false perceptions and wishful thinking.

We have to work tirelessly to inform our citizens about the winning conditions for the sustainable development of our society.

Adequate funding for universities and research, and the adjustment of electricity rates are, I believe, part of those conditions.

Thank you.