CANADA 2020.CA

Progressive policy for a modern Canada

The Canada We Want in 2020

Competition Matters

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January 30, 2013

About Canada 2020

- Canada 2020 is a leading, independent, progressive think-tank
- Canada 2020's objective is to inform and influence debate, to identify progressive policy solutions and to help redefine federal government for a modern
- Our primary focus is on the role of the federal government

The Canada We Want in 2020

- Launches a debate about the role of the federal government in Canada

- Forward-looking project focused on five key challenges
  - Increasing innovation and productivity
  - Rising to meet the Asia challenge
  - Squaring the carbon circle
  - Reducing income disparities and polarization
  - Securing our health system for the future

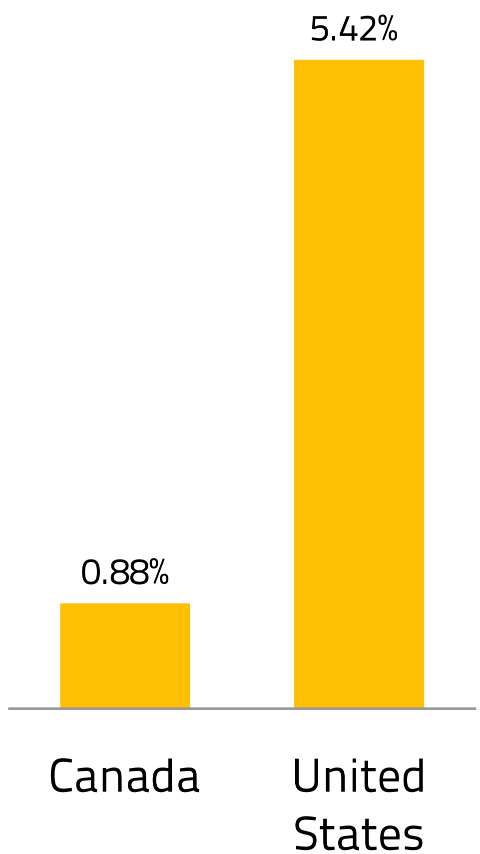
- Oriented towards policy influence
  - Opening book launch: November 2011
  - First series of panels: January – May 2012
  - Second series of panels: January – May 2013

The productivity problem

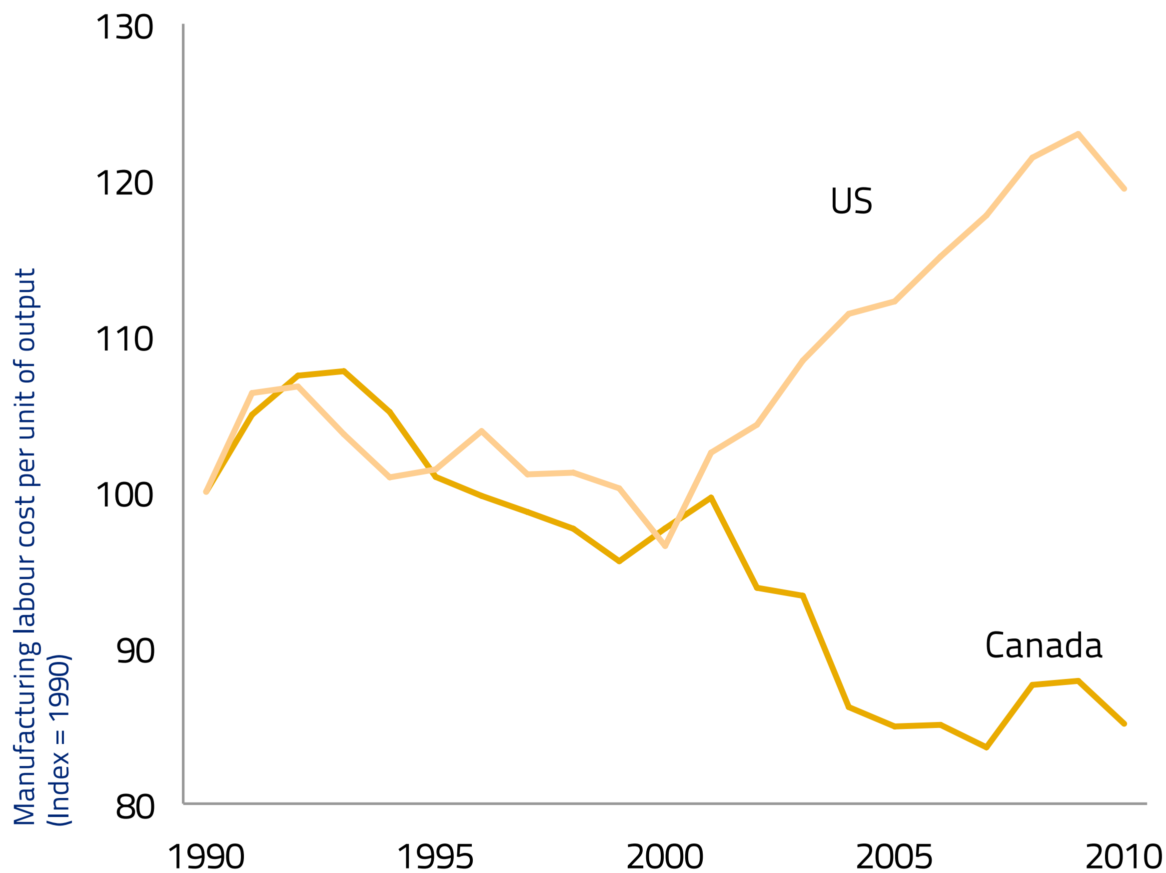
- Productivity – the average output produced with a given input – measures a nation's economic performance
- Productivity is closely linked, through wages, to the economic well-being of citizens
- Between 1984 – 2011 relative Canadian business productivity fell from 90% of the U.S. level to 71%
  - Since 2000 Canada has seen less than 1% average annual growth in business sector productivity
  - Canada is losing ground compared to most major competitors

Canada lags the U.S. by an increasing margin

Manufacturing productivity,
CAGR 2000 - 2008

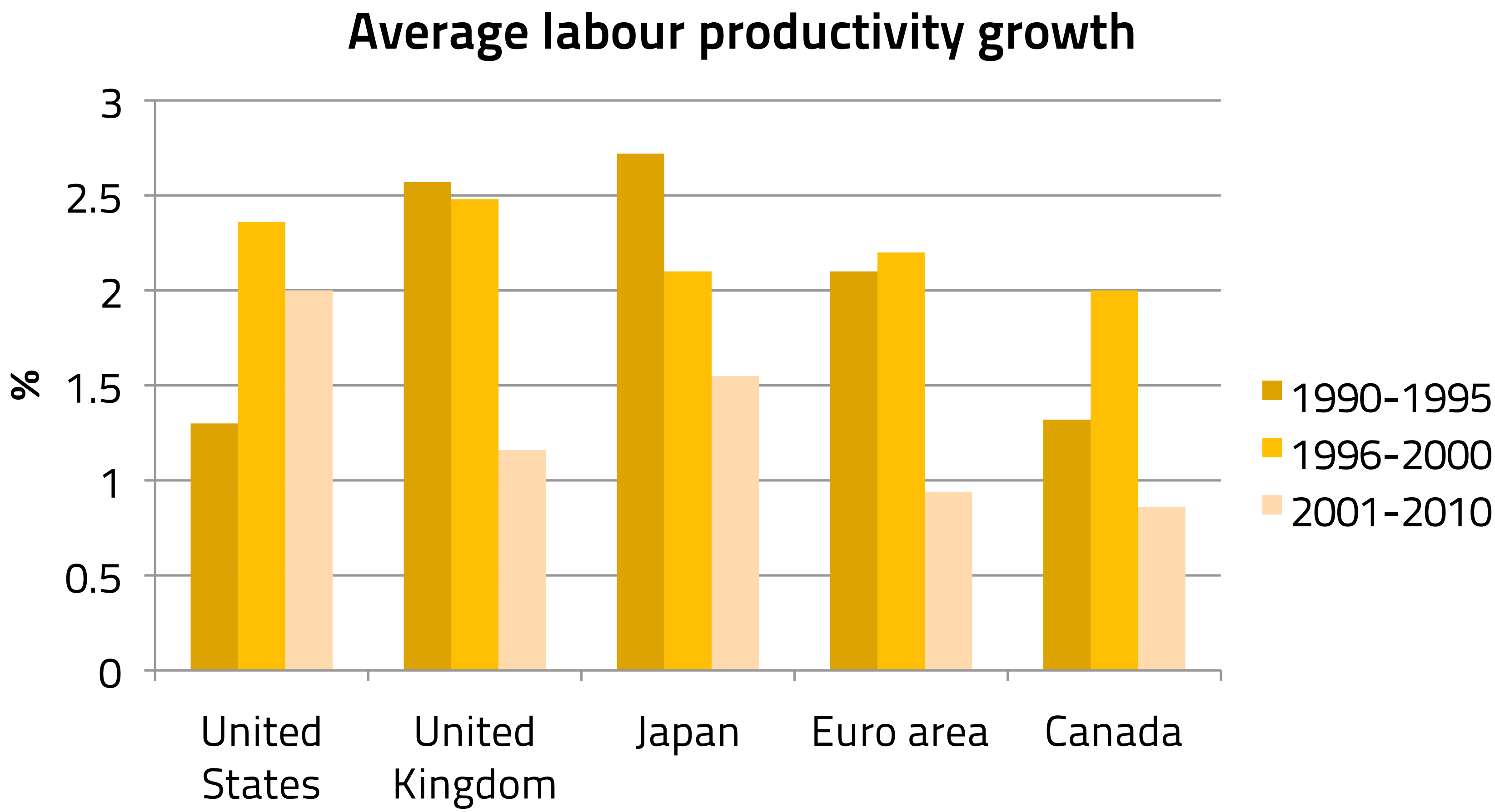


Manufacturing labour cost per unit of output,
1990 - 2010



Source: Deloitte, citing Centre for the Study of Living Standards, OECD

We are also underperforming relative to other competitors



Source: OECD productivity database. Includes EU 10/11 to 2001 and EU15 after 2001.

What is holding Canada back?

- Relative to the U.S. business productivity growth in Canada has fallen almost every year, since 1997
- During this time many of the factors that should underpin increased productivity have been in place
  - Macro-level stability
  - Increased public support for university research
  - Increased public – through not private – R&D spending

Could it be – at least in part – the relative lack of competition in Canada?

- Increased competition is generally understood to spur investment and innovation and to increase both firm-level and overall sectoral productivity
  - **Market selection effect**
    - reduces the market share of less productive firms
  - **Restructuring effect**
    - increases firm-level incentives to reduce costs
  - **Entry effect**
    - stimulates incentives for low-cost firms to enter markets

The evidence

- Studies show:
  - Increased labour productivity in sectors that are opened to foreign competition (through lowering of tariffs)
  - Better overall productivity performance amongst Canadian firms that export
    - Around 30% difference in productivity between forms that export and those that do not, according to Deloitte
    - Firms benefit from increased competition and increased exposure to best practices
  - Amongst non-exporters, better productivity for those that enter new domestic markets
  - A strong correlation between productivity and the effectiveness of competition policy enforcement
  - A correlation between competition and firm growth, and between high-growth firms and job, revenue and productivity growth

Deloitte analysis of why Canadian firms cannot sustain growth

Lack of competitive intensity	Low risk tolerance	Poor trade activity	Weak investment
• High competitive intensity drives higher levels of growth, innovation and investment • Canada's focus on preserving the status quo has caused businesses to shy away from competition	• Canadian business leaders are substantially more risk averse than U.S. leaders • As Canadian companies mature, they become less likely to engage in activities that contribute to rapid growth	• Openness to trade has a tangible positive effect on GDP and income growth • Canadian firms have very poor export intensity compared to counterparts in advanced economies	• Investment in R&D and ICT improves productivity growth • Canadian investment in R&D and ICT lags other OECD countries

Growth and productivity

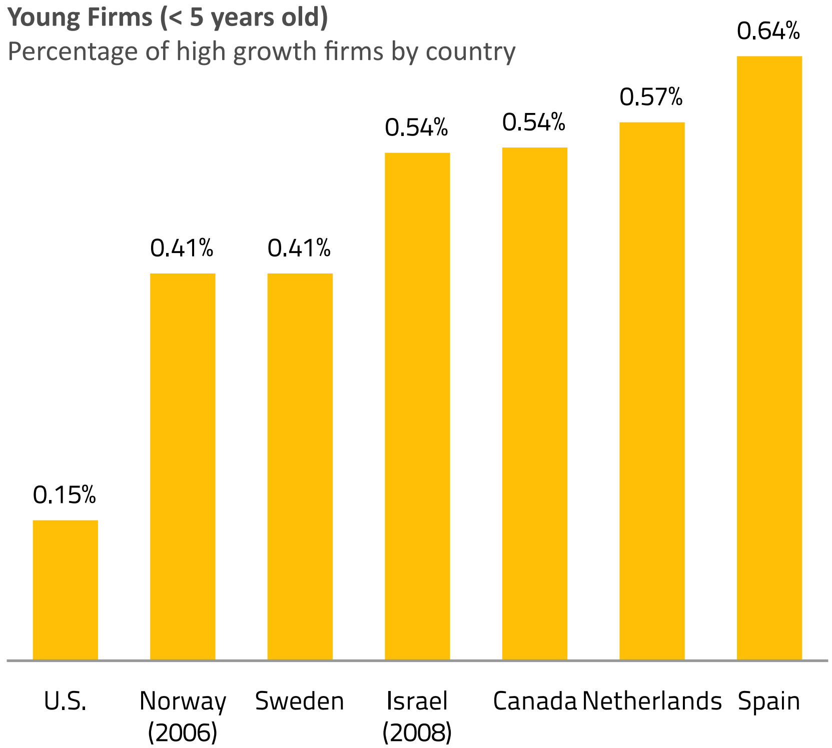
Growth is a strong driver of improvements in firm level productivity for all but the smallest firms

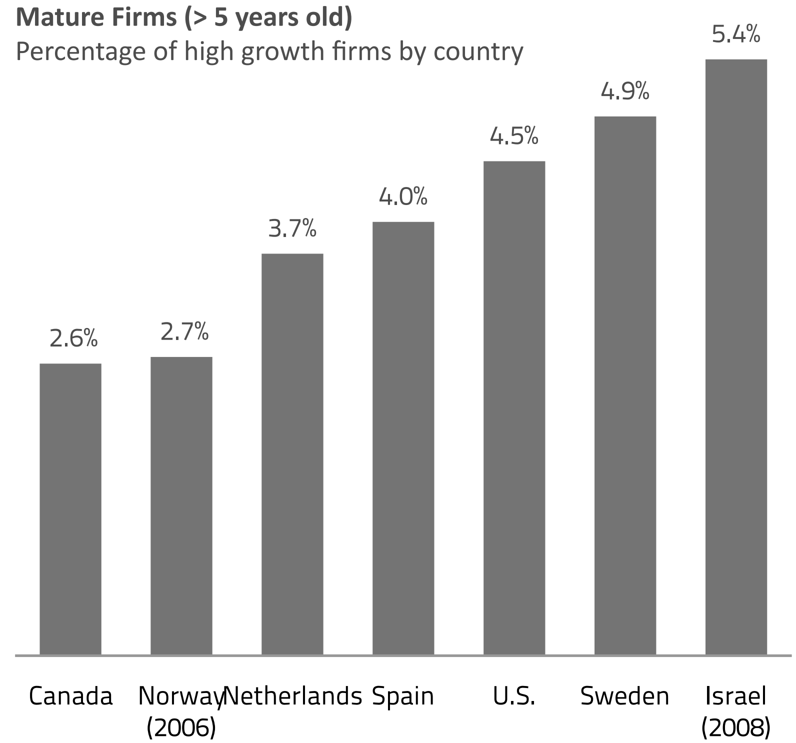
U.S. productivity by firm size and growth rate: 2002-2006

Source: *Deloitte Canada, The Future of Productivity, U.S. Small Business Administration*

Yet, according to Deloitte, Canadian firms have a hard time sustaining growth

Growth in services firms, 2005 - 2007





Note: High growth firms are defined as firms with 20%+ annualized employment growth over a 3 year period. Scope of firms is limited to those with 10-250 employees with $30K-$50M revenues in the first year of the period. Similar trend is observed in manufacturing firms.

The protected sectors in Canada

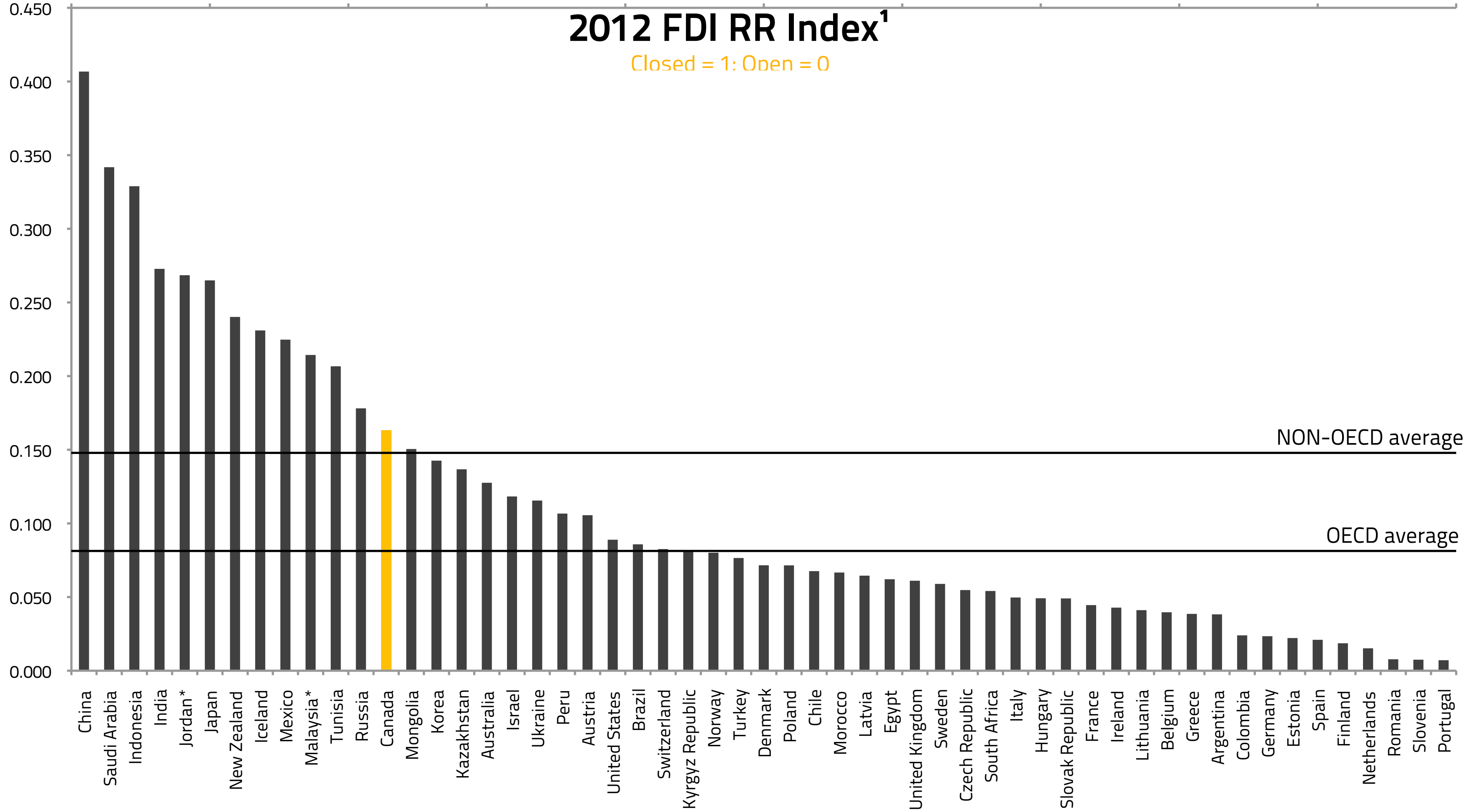
- Regulated sectors in Canada account for approximately one quarter of GDP (15% if healthcare is excluded)

- Importantly, many areas that are heavily regulated are 'network sectors' which strongly impact the rest of the economy, for example:
  - Telecommunications
  - Financial services
  - Airlines
  - Electricity generation and transmission

Various types of regulation exist

- Sectoral restrictions on foreign ownership
  - e.g. telecommunications, banking, airlines
- Restrictions on foreign trade and investment
  - continuing import quotas/tariff barriers and "net benefit" test under Investment Canada Act
- Inter-provincial barriers to trade
  - especially in electricity and professional services

Canada is well above the OECD average for restrictiveness of foreign direct investment



Notes: [1] Incorporates restrictions up to September 2012. *Preliminary scores.

Though competition in Canada is intensifying

- Inter-provincial Agreement on Internal Trade (AIT) signed in 1995
  - Limited success, initially, but amended and strengthened in 2009
- A number of bilateral trade agreements have been agreed between provinces over the past decade
  - 2006 Trade, Investment and Labour Mobility Agreement between B.C. and Alberta, extended to Saskatchewan as New West Partnership for Trade in 2010
  - 2009 Ontario-Quebec Trade and Economic Agreement
- 2009 Amendments to the Competition Act give Canada a world-leading framework for combating anti-competitive conduct
  - Though a 'regulated conduct doctrine' insulates regulated sectors from full application of competition law
- Greater emphasis on free trade agreements
  - Still over-reliance on NAFTA (less than 10% of Canada's trade with emerging markets)

Key questions

- To what extent is lack of competition responsible for poor productivity growth in Canada?
  - N.B. some argue the contrary: that it is deregulation, free trade and the move away from a managed economy that has been problematic for Canada (Jim Stanford)

- Which types of regulation are most detrimental to productivity growth?
  - How are 'natural monopolies' best regulated?

- Are there reasons why current regulations make sense, even if they have negative effects on productivity?
  - For example, did our banking system prosper amid global turbulence because of greater regulation?
  - Is there a strong case for 'infant industry' protection or protection in the cultural industries?

- Is the current 'net benefit' test under the Investment Canada Act sufficiently clear and welcoming to foreign investors?

The federal role

- Only some restrictions on competition fall within the ambit of the federal government
  - While it does have overall power to oversee 'trade and commerce' there are political constraints on the exercise of this power
- Is there a will to see change at the federal level?
  - What can we learn from recent decisions under the Investment Canada Act, from trade policy and from changes to the Competition Act and its enforcement?
- What is the scope for further loosening of restrictions in the near future, given vested interests?

What you can do

- Our goal in this project is to increase debate
- We actively encourage feedback on our work
  - Submit comments or opinion pieces through our website www.canada2020.ca
  - Contact us directly info@canada2020.ca
- Provide feedback on our January 30, 2013 event through our post-event survey
- Use our materials to host your own events and discussions

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THANK YOU FOR YOUR INTEREST