"The Hollowing Out of Corporate Canada?"

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I was struck by the manner in which the balanced theme for this Conference – "Mergers & Acquisitions: New Threats and Opportunities" – morphed into the more provocative title assigned to me for my remarks today. And, just in case anyone missed the point, there will be a sequel tomorrow! (You may actually discover that this is a topic on which John Manley and I agree more than we disagree.)

Everyone seems to have seen the 12 page Globe and Mail special late last year entitled "For Sale: Corporate Canada." Many, however, may have missed the sub-title "Hollow Fear?," hence the question mark that I added to the title for my remarks.

Not long after agreeing to speak on this topic, I became, as a Director of Shell Canada, and the announcement by Royal Dutch Shell of its proposal to buyout the minority, more personally involved in the "hollowing out" trend. So I speak today at least with the benefit of some experience, if not conviction, about the topic.

Just before Christmas, TransCanada Pipelines – another company I am involved with – announced its acquisition of American Natural Resources (ANR) – a major U.S. pipeline and gas storage company. So, there is a lot of action on the topic. At least pipelines are actually hollow on occasion! But this "takeover" does fly in the face of some of the hand-wringing.

Unquestionably, foreign takeovers of Canadian crown jewels like DOFASCO, Falconbridge and INCO have spawned a new surge of angst that our business icons are disappearing in "a paroxysm of global consolidation."

There are, of course, reasons to be concerned when Canada loses head offices through consolidations or takeovers. It is not just bad news for lawyers and bankers by the way. It means the loss of senior corporate jobs and because, in the private sector, likes tend to attract likes it also means that fewer Canadians may have the opportunity for senior executive positions. After all, patronage is by no means exclusive to government! It may well also mean the loss of some R&D and a decline in the impetus for made in Canada technological innovation.

The headlines are certainly catchy and in some cases, troubling. But they highlight one part of a larger story. Statistics, those dreaded things that dull the senses, suggest that Canadians are actively investing in and acquiring companies outside Canada and that volume exceeds what is happening in Canada. Not global icons perhaps and not resource-based companies by and large – except of course Glamis Gold - but high-tech, software and life-science firms. What some see as the future economy. Statistics also show that both the number of head offices in Canada and employment levels in head offices increased strongly from 1999-2005. Again, according to Stats Canada, "much of the dynamism in Canada's head office sector actually comes from foreign-controlled firms", a trend confirmed by reports a few weeks ago. So, we must be doing some things right.

Clearly, the "sky is falling" label will always stir more interest than a simple declaration that the sky has some clouds but who would turn up to hear the latter proposition? (Even before my association with CanWest, I knew what headlines grab attention and what sell. Good news rarely generates twelve page specials.)

I have often heard non-Canadian senior executives say that, when you look around the world, there are few more stable or attractive places to invest than Canada.

The good news, too, is that the Canadian economy is breaking out of the small domestic market and following the path of other mature industrial economies in seeking out foreign investment opportunities.

Witness, for example, not only Goldcorp's $8.7B acquisition of Glamis but also Power Corp's $3.9B acquisition of Putnam.

A separate issue is whether Canada is losing its share of global foreign investment. On that point, the statistics are less precise, as is the conjecture underpinning statistical analysis.

Some bemoan what they perceive as the timidity or risk-averse propensity of Canadian corporate managers and directors and the obsession with short-tem profits over bold global strategies. But are any of these unique to Canada?

Until Halloween, we seemed headed towards an Income Trust economy (perhaps for similar, risk-averse or tax-averse reasons.) Almost everyone understood by then that it would not make sense to transfer our national economy into an Income Trust economy. Something had to give and it did. Far be it for me to say whether the actual prescription is the right one but the decision itself seemed necessary. It may well signal the prospect of some similarly audacious, policy initiatives ahead.

What is happening in Canada on acquisitions and mergers is, of course, part of a global dynamic in which Brazilian, Chinese and Indian firms are now joining the ranks of companies acquiring or trying to acquire North American and European icons. In fact, 2006 was a record year in terms of the number and size of transactions. More than $4 trillion in total.

If you assume that globalization is the root of all evil, that ends the debate. But if, instead, you believe that the important issue is whether our economy is best able to adapt to the current dynamic, that at least provides a basis for further discussion.

And to me that is the critical issue.

It depends fundamentally on the kind of economy we want to have and whether we see our future increasingly as part of a global economy or one we can or should shield from a trend towards greater integration and freer movements of capital, goods and services.

In my view, if Canada seeks to improve its policy environment for investment and innovation, if we choose to bolster our educational and research facilities in a pragmatic manner emphasizing excellence and merit, we can generate new opportunities for our people and new avenues of growth for our economy that will more than allay spasmodic fears about being "hollowed out."

If, however, we respond to the siren song of nationalistic impulses and place blunt, new restrictions on foreign investment and additional tax and regulatory burdens on doing business in Canada, the economic price and, I suspect, the social cost would be very high.

This is not theory. We have tried that kind of prescription before. The preservationist spirit is always alluring for some politicians but it has proven to be patently unsuccessful. (Think NEP!)

A few other lessons from history tend to reinforce the fact that nationalist policies per se can have a perverse effect.

In 1945, Argentina's economy was in many ways on a par with Canada's - a roughly equivalent GDP based primarily on similarly abundant natural resources. But, over the past 60 years, a combination of populism, statist or interventionist government policies and fiscal mis-management shielded much of Argentina's economy from competitive stimuli and investment to the point where its per capita income is today one-seventh (15%) of Canada's.

Venezuela is another case in point. As big and, in some respects, as rich as Texas, Venezuela has seen the purchasing power of its citizens decline steadily since 1970. Despite the highest prices ever for oil – Venezuela's principal resource – it today has the highest rate of poverty in Latin America; along with a growing fiscal deficit.

Mexico, like Canada, has the potential to be an energy powerhouse but exploration and production of oil and gas have been hamstrung by history and what might best be characterized as inefficient, nationalistic, "hollowed in" policies. In the name of "patrimony", Pemex, a state-owned entity was excluded from NAFTA. Private investment is not allowed in it and the federal government now takes more than 50% of Pemex's revenues. Despite record prices for oil, Pemex has run up a massive debt and recently posted a net loss of $7 billion. A shortfall of funds for investment means oil production is falling and refining capacity is stalled. Mexico has become a net importer of both natural gas and refined petroleum products, notably gasoline.

As someone who was directly involved with the Free Trade negotiations and more broadly with managing relations with the U.S., I am no stranger to the nationalist/protectionist passions so easily aroused in Canada (and especially here in Toronto.)

These emotions fly in the face of credible analysis including the most recent one by the Royal Bank of Canada underscoring not only the success of the FTA and NAFTA for Canada but also the plain fact that none of the predicted "fears" – 'production moving south, exports shrinking along with investment and jobs' – materialized. Instead, those agreements, which some argued at the time would "hollow" us out, helped make our economy more competitive and better able to cope with the real, as opposed to the emotional challenge of globalization. The authors of this study stressed, however that, in today's environment, we should not be complacent, assuming that what was done more than a decade ago is all that is needed. Significantly, the fact that not much has happened since in terms of trade liberalization is part of today's challenge.

In the '80s and early '90s, the buzz word for business was diversification. Today the talk is more about consolidation or, if you are in communications, convergence. Whatever it may be called, there is a sense that Canada may be missing out or failing to adjust. Some of the strongest critics are executives of our most successful global champions.

We do seem to have difficulty supporting or celebrating the few global champions that remain in Canada. There is almost something un-Canadian about being "big" or "global". More often than not, we even seem uncomfortable with business success.

The real questions we need to ask, however, are whether we are equipping ourselves to continue to prosper in a more competitive global economy, whether we have government policies, educational facilities and, dare I paraphrase Lucien Bouchard, a work ethic in Canada that will enable us to be successful in attracting investments – internal and external – and that will strengthen our relative position in a more dynamic global economy.

The Conference Board of Canada's report "Mission Possible", published this month, offered several practical suggestions to address the underlying questions; some are not new but many have been ignored for too long.

The analysis underpinning this assessment is compelling. Canada has been slow in adapting to changes in the global economy. Our per capita GDP slipped from fifth to tenth in the past fifteen years. We have been indulging our abundance of natural resources to the point where the flab is eating away at the muscle. This may work when times are good but simply retards investment and policy changes that would better secure our future.

Easy proximity to the world's largest market right on our doorstep has also enabled us to coast while others work more diligently to penetrate the fast-growing emerging markets like China, India and Brazil. Feel good trade junkets are no substitute for focussed negotiations.

The Conference Board's report tries to shake us out of the false comfort of complacency but their prescriptions – increased productivity, improved competitiveness, smarter regulations, lower taxes, etc. - are likely to be more appealing to economists than to politicians or, frankly, the electorate. Just try getting elected on any of these proposals.

In terms of competitiveness, the World Economic Forum placed Canada twelfth, just below Taiwan and Israel, and just ahead of France and Australia – up from sixteenth a year ago. Not bad perhaps and part of the reason for our complacency. But, we could easily do better and we need to do better for a time when our natural resources will no longer provide a crutch of convenience.

When you examine our performance in trade negotiations of late, there is little room for satisfaction. Canada is not, of course, responsible for the collapse of the Doha Round but, while the Australians, the Mexicans and yes, even the Americans have been concluding regional and bilateral trade agreements where they can, our track record stands close to zero. Without the will, there simply is no way and yet few in our business community seem concerned. Complacency again?

So, in order to stimulate more investment and innovation in Canada, we need a more attractive tax and investment policy framework, complemented by a more robust trade policy agenda. Mostly, we need to look beyond the "I'm alright Jack" sentiment of today and consider what will be needed for tomorrow.

Because our fiscal situation is remarkably solid – the "fundamentals" as our Finance department is apt to say – the government actually has scope for sensible changes to our tax system and tax structure that would boost investment and innovation. Meanwhile, our provincial governments should follow the excellent example of Alberta and British Columbia and move tangibly to dismantle internal barriers to trade and impediments to the mobility of labour as well as obsolete or over-lapping regulations. Just imagine what Free Trade in Canada might do for our economy. Before contemplating a deepening of NAFTA or a broader, more assertive, external trade agenda, we need first to get our act together right here at home.

A separate question is what, if anything, governments should do to check the pace of foreign takeovers.

In his November statement, Minister Flaherty hinted at the need to review foreign takeovers of companies where the "national interest" merited such attention. I endorse this approach and would welcome more discussion.

Oh, I know economists cringe at the notion of fetters of any kind on investment – because they undermine basic economic growth principles. But economists do not have to get elected. Politicians do and electoral passions are easier to arouse in the name of nationalism or national interest than in defence of economic theory. Not surprisingly, Minister Flaherty described his initiative as part of an "Advantage Canada" agenda.

But, let's be realistic. Virtually every country in the world, including the bastion of free enterprise on our southern border, has the means to review and block transactions in the name of national security or national interest.

The Europeans have their own distinct approach. Despite the strong process of economic integration within the EU, France and Italy, among others, have difficulty reconciling that basic commitment with the nationalist desire to maintain domestic champions in the energy and transportation sectors.

China is reluctant to allow more than 49% ownership of virtually any significant enterprise while Chinese companies seek full entry elsewhere. The Chinese are concentrating heavily in Africa to secure the supply of needed resources precisely because they sense growing reservations from the industrialized world about their acquisition objectives.

When there was a prospect of a state-owned Chinese company bidding for NORANDA, the then government introduced, but did not implement, legislation that would have added a "national security" provision for specific sectors. I personally would endorse serious examination of new legislation with that objective in mind.

Russia is a special case in many ways with explicit new restrictions in several sectors and a penchant to "restructure" previously approved investments. If you think that Shell, Mitsui and Mitsubishi reduced their stake in the Sakhalin project because they needed money, think again. Russia's action in this instance was described by the Economist as "assertiveness bordering on gangsterism."

At a minimum, I believe that Canada should have the capacity to restrict state-controlled entities from any country from indulging the openness of our market economy for acquisitions and takeovers. After all, these entities are shielded from those some market forces in their own markets.

At the same time, we should establish new criteria in the name of national security that would enable us to safeguard sectors deemed to be vital to our national interest. This would help not only to nurture nascent technologies, e.g. in defence or sensitive resource sectors, but also to bolster global champions.

We could start by examining how the Exon-Florio review process has worked in the United States and determine whether any of its elements would be helpful in preserving sensitive technologies and operations in Canada.

By way of example, the United States government attached a very heavy security over-ride to Alcatel's purchase of Lucent with an explicit provision potentially to unwind that transaction.

Exon-Florio was, by the way, the basis for the "national security" exemptions that the United States has insisted on adding to all of its trade agreements, including NAFTA.

When I was with CAE, some of you may recall, I had difficulty understanding why our government, at that time, decided not to invoke the national security exemption provided in NAFTA that would have allowed support for indigenous Canadian technology but chose instead to buy simulators for our Airforce from our major United States competitor. The United States had insisted on including this national security exemption in NAFTA precisely for government procurement of this kind and, unlike Canada, is rarely reluctant to use it to serve its national interest.

While we are at it - and in the interest of balance - we should take a very hard look at existing restrictions on foreign investment to see whether, or to what extent, they continue to serve any useful objective. Minister Flaherty noted in his November statement that "policy restrictions on foreign investment in Canada have contributed to our economy's relative decline in foreign direct investment flows." He added that "according to the OECD, Canada has the highest level of explicit restrictions on foreign equity ownership in the G7 (<u>not</u> including Russia) – primarily in the transportation and telecommunication sectors."

So, having defined the problem, the government should begin to address a solution, one that will acknowledge the dramatic changes that have occurred in the world economy since our investment legislation was last revised more than twenty years ago.

We should strive for more transparency generally on investments and explicit provisions for arbitration or dispute settlement, all with a view to creating greater fairness, more certainty and stability for capital markets.

Negotiating more Foreign Investment Protection Agreements (FIPAs) is a popular but only partial prescription. After all, these essentially grandfather existing rules and existing inequities and, at best, restrict further back-sliding.

Above all, we need a clear indication of what the policy environment for investment will be, which foreign ownership restrictions will be preserved and how terms like "net benefit" and "national security" can best be defined and implemented.

Investment policy per se is not the only issue requiring greater clarity. Our vaunted strength as an "energy super power" for instance is hobbled more these days by a degree of policy paralysis and a labyrinth of overlapping regulations and jurisdictions spawning contradictory policy priorities and seemingly endless consultative and regulatory processes among various levels of government in Canada, not to mention lengthy Court deliberations as well. And all this is before we decide how to do more about the environmental challenge.

We need some bold decisions on major power or energy projects that will be fundamental to our future growth. Decisions that would stimulate, not retard, investment and secure, not obscure, our natural resource potential.

In Toronto, you know that the provincial government had to do some back flips on policy to ensure that the lights stay on next summer … before the election. What you may not know is that the heartland of our energy resource – Alberta – faces a similar dilemma. Demand is already very close to available supply in what everyone knows is a boom economy. But there are few if any authorized plans for expansion and new power generation cannot be turned on overnight.

Don't get me wrong. There is a legitimate role for regulation in energy, as in other sectors, but legitimacy is not simply a matter of process or a function of numbers in the process. Let's ensure that the purpose being served equates with a rational definition of the national interest and allows for timely decisions.

Reasonable, stable and predictable regulatory and investment regimes are what will stimulate the funds and the technologies needed to develop additional energy resources. If we continue to procrastinate, we will undermine what should be one of our most powerful levers for economic growth.

Ultimately it is a matter of political will. I happen to believe that a few key decisions on power generation and transmission – whether on Lower Churchill or Mackenzie or on nuclear plants – would do more to serve a tangible commitment to national unity than any semantically-enhanced resolution adopted by Parliament.

Conclusion

So, on balance, I understand the concern in some quarters about the loss of major Canadian crown jewels. I am less convinced that what has happened is either unique to Canada or a cause for alarm. It is part of a global dynamic, one in which Canada has much to contribute and much to gain.

We cannot be complacent but, instead, we need to resist the tired, nationalist nostrums that, as history demonstrates, do not work. We should ensure that our tax and regulatory environment for business continues to improve, that our trade and investment policies support growth objectives in line with the 21st century global economy and that our educational facilities keep pace with the demands of our young new century.

Our governments should adopt policies attuned to the needs of the future not the fads of the day. We could use more clarity on investment policy and should not shy away from explicit review provisions that serve defined objectives. But we also need bold policy decisions more generally and more cohesion among the various levels of government in Canada that would enable us to chart a robust growth plan for the future.

We should also try to nurture a healthier culture of entrepreneurship in Canada, stimulating and nurturing home-grown champions and replacing the timidity and caution in Bay Street Boardrooms with some of the competitive zeal we see, on occasion, on the ice in the Air Canada Centre – especially when the Senators are in town!