

Paul Deegan  
Vice-President  
Government & Public Relations  
BMO Financial Group  
11th Floor, 302 Bay Street  
Toronto, Ontario M5X 1A1  
416-867-4770  
416-867-5460 (fax)

Mr. L. R. Wilson  
Chair, Competition Policy Review Panel  
280 Albert St., 10<sup>th</sup> Floor  
Ottawa, Ontario K1A 0H5

Dear Mr. Wilson,

On behalf of BMO Financial Group, thank you very much for your kind invitation to respond to the October 30, 2007 consultation paper issued by the Competition Policy Review Panel. We commend the Government of Canada for its leadership in seeking input into one of the most important issues facing our country. We also commend your efforts, along with those of Mr. Edwards, Ms. Hudon, Mr. Jenkins, Mr. Levitt and the others involved in your deliberations, to sharpen our nation's competitive edge by examining Canada's competition and foreign investment policies.

The panel has raised a number of critical issues and our responses are provided in the attached document. We hope that our input will be helpful as you prepare your recommendations on how best to create an environment that will enhance Canada's attractiveness as a destination for investment and economic activity and, more importantly, create the conditions to allow Canadian firms to capture global opportunities.

BMO Financial Group has been helping Canadians capture global opportunities since 1817. It provided Canada's first sound and plentiful currency, and played a major and continuing role in the development of the country. It contributed to the realization of Confederation in 1867, took part in the financing of the first transcontinental railway in the 1880s, and provided many of the functions of Canada's central bank until 1935.

In order to sharpen Canada's competitive edge, we believe it is imperative that government sharpen Canada's regulatory regime, continue the substantial progress it is already made to reduce business taxes and make further investments in education, training and skills development.

As an institution and as a nation, we favour principles-based solutions over rules-based solutions. In our view, policy should be guided by the following principles:

- Regulation should encourage innovation and foster competition;
- Regulation affecting the national economy should be administered with a national perspective;
- Regulatory frameworks should be balanced and transparent;
- Regulatory regimes themselves must be competitive on a global scale;

- Policy should reduce uncertainty for all stakeholders;
- Policy should encourage strong, efficient, Canadian-headquartered companies;
- Policy should allow Canadian companies to become more competitive more quickly and effectively;
- Policy should encourage Canadian companies to extend their market reach and strengthen their market position – in effect, increasing competitiveness;
- Policy should encourage Canadian businesses to export and operate abroad, allowing them to grow faster than the domestic market alone permits;
- Policy and regulations should provide greater flexibility for Canadian businesses, allowing them to adapt quickly to the changing landscape and better compete with foreign firms;
- Policy should remove impediments to competition, rather than prescribe competitive outcomes;
- Policy, while allowing business to succeed, should also allow consumers to reap benefits through lower prices, greater access, and choice;
- Policy should not advantage foreign firms over Canadian firms;
- Business taxes should be competitive on a global basis in order to attract foreign companies to Canada and to increase the competitiveness of Canadian firms;
- Policy should encourage the development, attraction and retention of skilled workers; and
- Above all, policy must serve the public interest.

We believe the application of these principles will have the following positive outcomes:

- Aggregate income will expand at a faster pace;
- The productivity gap with our major competitors will be eliminated.;
- Canadians will benefit from increasing employment opportunities across a wider range of industries;
- Owners and shareholders of companies, including pensioners, will achieve competitive returns, which in turn provide greater access to capital to finance growth; and
- Tax revenues will rise, providing government with greater ability to deal with economic and social issues such as education, training and infrastructure;
- Above all, Canada will be more prosperous and successful on the world stage.

We thank you for considering our attached responses. Should you have any questions, feel free to contact us. We believe your review should be conducted as expeditiously as possible, and that government should consider your recommendations in the context of the principles enumerated above. Given that many of these issues come under provincial and territorial jurisdiction, we believe all levels of government should strive to work together to ensure that Canadians enjoy even greater prosperity in the future and Canada becomes the destination of choice for the best, brightest and most ambitious from around the world.

Sincerely,

Douglas Porter

Earl Sweet

Deputy Chief Economist

Senior Economist

## CANADA IN A GLOBAL CONTEXT

*1. Should Canadians be concerned about foreign takeovers of Canadian firms? How important is domestic control and ownership of Canadian business activities to Canada's economic prospects and ability to create jobs and opportunity for Canadians?*

Foreign direct investment generally benefits the Canadian economy, although there can be situations where it is not in the best interest of Canadians. Ownership should not be a concern, as long as objectives and decisions are based upon economic/financial considerations. While the 'net benefits' test should remain the primary tool, other criteria such as national security are becoming important issues, particularly with the rapid growth of capital in sovereign wealth funds.

*2. How important are company headquarters to Canada's economic prospects and ability to create jobs and opportunity for Canadians? How important are global divisional head offices? What factors influence their location?*

BMO believes it is critically important to the Canadian economy, and indeed to the country, to have world-class Canadian-headquartered companies, which repatriate export earnings. Competitive Canadian-headquartered companies, with the high-level support functions associated with them, offer value-added economic activity, higher tax revenues and higher-quality jobs that can retain our best and brightest of young Canadians.

This can only be achieved if Canadian businesses remain internationally competitive, which implies not only being able to compete with foreign competitors in Canada, but also in markets outside the country. Head offices foster the development of management and R&D skills among the domestic population. Furthermore, they provide relatively high-value jobs and support professional and business services, and increase the likelihood that they will be contracted from local providers.

Global divisional offices are also important to Canada. Factors that influence their location include competitive tax regimes, a conducive business environment, access to a financial services hub, proximity to key markets and potential for growth.

*3. How do Canada's policies impacting direct investment, both inward and outward, affect Canada's competitiveness as a destination for FDI and as a platform for global growth?*

Canada's approach to policy has provided mixed results, in terms of the country's attractiveness to FDI. Sound macroeconomic policy yielding low and stable inflation and interest rates and a solid fiscal position are clear positives.

However, there are also FDI-inhibiting elements to Canada's approach to policy:

- Surprise policy announcements that seem to lack policy logic catch foreign investors off-guard
- Lack of clarity concerning rules and standards that govern the marketplace are negative for FDI

- Despite having a fiscal competitive edge, policymakers have been timid in seizing this advantage by lowering business taxation to best-in-class rates
- Slow progress in removing inter-provincial barriers to economic activity is a disincentive to FDI
- The multiplicity of regulatory regimes for the foreign investor who wants to operate on a national scale is a disincentive to FDI
- More needs to be done to improve the competitiveness of the country's regulatory system, including eliminating duplicative structures such as securities regulation and also shifting the context to principles-based from its current prescriptive-based nature

*4. Do Canada's economic policies appropriately reflect our increased integration with the North American and global economy? How might these policies be changed to better reflect this new competitive environment?*

Canada's policies do reflect, to some extent, its increased integration within the North American and global economy. As far as trade is concerned, Canada has generally eliminated and reduced barriers to trade in goods and services as a participant in NAFTA. Canada is also committed to reducing barriers to trade within the context of the World Trade Organization.

However, there are still some areas where policies are not consistent with a move toward freer trade and ownership (e.g., agricultural support measures, restrictions to foreign ownership in some sectors). Changes in policy that generally reduce barriers to trade and investment, subject to considerations relating to the 'security of the national economy', would make for a more competitive and flexible economy. Specifically, such an environment is likely to be conducive to an improved allocation of resources and enhanced productivity performance.

## INVESTMENT POLICIES

*1. What impact has the ICA had on the Canadian economy and Canadian competitiveness, and specifically on our ability to attract FDI?*

ICA has generally been positive for the Canadian economy by lowering the benefit test and facilitating the inflow of FDI.

*2. What changes to the ICA and Canada's investment review regime would help Canada address the challenges and complexities of the modern global economy, within the constraints of Canada's international obligations?*

- *What, if any, changes to the investment review process would enhance Canada's competitiveness and improve Canadians' understanding of the benefits of FDI?*

Reduce the number of reservations concerning free trade in investment (relative to WTO and NAFTA), where reasonable; increase transparency as to what constitutes the net benefit test; and, ensure the decision-making process is grounded in sound public policy.

- *Should the net benefit test be adapted to reflect the new competitive environment? If so, how?*

The new competitive reality is that opportunities for growth and profits are related to a significant extent in emerging countries – as they adopt market-friendlier policies, become part of trade agreements, and generate very strong growth. Thus, the old way of looking at the benefits of foreign investment – i.e., does it create jobs? – may no longer be appropriate. Therefore, investment policy and the net benefit test should de-emphasize benefits purely in terms of labour headcounts and put more emphasis on things such as the transfer of technology and management skills and increased access to foreign markets.

## SECTORAL INVESTMENT REGIMES

***Canada maintains specific regimes to govern, review or restrict investment in six sectors: telecommunications, cultural industries, broadcasting, transportation services, uranium production and financial services.***

*1. What changes, if any, are required to Canada's sectoral investment regimes to minimize or eliminate negative impacts on Canada's competitiveness?*

Policy should not determine investment flows and output or restrain strategic initiatives.

*2. What have been the impacts of these investment regimes on productivity and competitiveness in the specific sectors?*

By protecting domestic industries and restricting access to capital and technology transfer, sectoral investment regimes have, in some cases, impaired productivity and overall efficiency, raised prices, and reduced choices for consumers.

*3. Are there alternative mechanisms that would achieve the non-economic policy objectives of the sector while also ensuring maximum competitiveness of firms operating in the sector?*

Objectives such as national security, the encouragement of Canadian culture and values, safety and soundness of the financial system can be achieved through appropriate existing regulatory structures, such as OSFI and the CRTC.

## COMPETITION LAW

*1. How does Canada's competition policy affect Canadian competitiveness in an environment of globalization and free trade?*

Canada's competition policy has yielded mixed results in terms of fostering competitiveness of industry. For example, the ability of the banks to make acquisitions and compete in foreign markets has been diminished by the implicit ban on mergers.

*2. What changes to Canada's competition regime would enhance the competitiveness of Canadian firms in the global economy? What international best practices, if any, would strengthen Canadian competitiveness as a destination for foreign investment if we were to adopt them?*

Canada's competition policy should focus on two elements: first, ensuring that Canadians benefit from competition and have access to a range of suppliers at competitive prices; second, promoting an environment where firms can compete effectively and succeed. Thus, discrimination amongst industries should be eliminated.

For instance, competition policies and processes should be applied equally and fairly to all industries. This has not always been the case in Canada; eg. an implicit ban on bank mergers whereas life insurance companies have been allowed to combine.

Careful consideration should be given to legislative or interpretative initiatives that would shift the focus of the 'efficiency defence' from 'total surplus' to one which focuses on the redistribution of wealth from consumers to producers. The 'total surplus' approach treats the wealth transfer as neutral, as it is very difficult to assess the appropriateness of shifting wealth from 'consumers', who could be other companies, to 'producers', who could be shareholders or pensioners. The focus of policies concerning mergers should be to ensure the most efficient allocation of resources to achieve maximum competitiveness and overall economic welfare. There are better policy tools to achieve redistributive policy goals, including taxation, regulatory structures, and transfer payments.

We would not support interventionist approaches such as the undertaking of proactive 'market studies' by competition authorities. Maximum competitiveness and wealth generation is best achieved through the allocation of resources by market forces. Investigations should be initiated only when there is a clear reason to do so.

*3. Does Canada's approach to mergers strike the right balance between consumers' interest in vigorous competition and the creation of an environment from which Canadian firms can grow to become global competitors?*

Given the increasingly integrated nature of the global economy, size (scale economies) is often required to be internationally competitive. In a small economy such as Canada's, the achievement of sufficient scale may mean that there are only a few competitors. To this end, competition policy should shift its focus of the impact of business initiatives from only local markets to global markets, recognizing the substantially increased contestability of the markets for many goods and services.

## PROMOTING CANADIAN DIRECT INVESTMENT ABROAD

*1. What barriers, either formal or informal, do Canadian firms face when seeking to make investments and acquisitions abroad?*

The barriers are either those imposed by foreign governments attempting to maintain national control over domestic industries and resources or tax policies which put Canada-based firms at a competitive disadvantage in global markets, such as the deductibility of interest paid on foreign acquisitions..

*2. How should the government adapt its policies to promote increased Canadian direct investment and acquisitions abroad? What measures have been adopted by other countries that are relevant to Canada?*

The only policy change required to facilitate outbound investment is improving clarity, certainty, and competitiveness of business taxation. The recent initiative to change the treatment of interest payments on debt financing foreign activity is a negative to foreign acquisitions. Other than providing a competitive business tax structure and negotiating with foreign governments for increased access, the primary government policy towards outbound investment should be that market forces be the driver.

*3. Are there policies or approaches that would be useful in addressing the particular challenges faced by small and medium-sized enterprises as they seek to become global competitors and participants in global value chains?*

A competitive business tax structure and streamlined regulatory structure are the primary facilitators in this area. As governments cannot, and should not, pick winners and losers, market forces should be the predominant factors.

*4. What impact does a higher-value Canadian dollar have on CDIA?*

An appropriately priced Canadian dollar, relative to one which is undervalued, improves the ability of Canadian firms to make foreign acquisitions by raising purchasing power. A Canadian dollar which rises materially above its fundamental level may increase CDIA as firms restructure global operations in response to reduced competitiveness of Canada-based operations. However, by adversely impacting revenues and profitability for significant parts of the economy, it may ultimately reduce the ability of firms to implement global strategies.

## **BECOMING A DESTINATION FOR TALENT, CAPITAL AND INNOVATION**

*1. How can Canada better promote inward FDI? What policy change could contribute to the achievement of this objective?*

- Implementation of much more competitive business and personal tax regimes.
- Modernization of infrastructure.
- Improving physical access to the U.S. market.
- Investing in education and training.
- Increased focus on attracting skilled immigrants.
- Streamlining approval and accreditation of foreign credentials.
- Increasing the skill level of Canadians:
  - encourage apprenticeship programs
  - more partnerships between business, academic institutions and government
  - the addition of graduate schools in science, engineering and medicine to attract and retain the very best talent, to foster the development of research and development hubs around universities and to increase the transfer and application of technology for commercial purposes

*2. In particular, what mix of policy changes would be required to make Canada the preferred point of entry to, and location in, the North American market for the high-value activities of non-North American business entities?*

Focusing on the above suggestions, avoiding interventionism, and ensuring clarity and certainty in the policy environment would achieve this objective.

*3. Is the modernization of Canada's competition and investment laws sufficient for successfully attracting foreign direct investment in Canada? What other priorities and policy issues should governments address?*

Yes, reliance on market forces, in the context of improved competition and investment policy structures, would make Canada more attractive to foreign direct investment.

*4. What impact does a higher-value Canadian dollar have on Canada's competitiveness as a destination for investment?*

A Canadian dollar which is materially above its fundamental level is a negative for FDI, as it reduces the competitiveness of Canada-based operations and also raises concerns that the value of investments would be reduced when the dollar reverts towards its fundamental value (and possibly overshoots).

*5. What further could be done in Canada to promote an ongoing review of Canadian competition, investment and productivity performance aimed at Canada's sustained competitiveness?*

There should be an ongoing review to ensure that regulations are sensible, principles-based and allow the marketplace to work.