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Competition Policy Review Panel
Research Paper Summary

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Title: The Role of Sectoral Ownership Restrictions

Subjects Addressed:

- Sectoral Ownership Restrictions
- Air Passenger Transport
- Telecommunications
- Broadcasting
- Cultural Industries
- Uranium Mining

Alternatives to Ownership restrictions:

There are two prominent alternatives to the sectoral ownership regimes in Canada: foreign investment review and participation limitations; both are already used in some policy fields (namely the ICA and in the financial services sector). Research has revealed a strong body of opinion concluding that foreign investment review is problematic because it begins with a negative presumption about foreign investment that diverges from the historical record in Canada. As well research indicates that the undertakings imposed by a review process have little value-add because they either are not enforced or take the form of already planned activities. In addition to these intangible criticisms, the research has found that the ICA and CRTC investment review regimes act as a toll on ownership changes and lower the sale-price of acquired companies.

Participation restrictions are a less applied measure of public policy in Canada – only the financial services sector has them, but they are a feature of the corporate charters of some prominent Canadian companies (for instance PetroCanada and CN Rail). Research has shown that there is firm body of opinion that only the financial services sector has a compelling prudential justification for widely-held rules. As well, research demonstrates concern that participation restrictions would unduly limit corporate governance options by precluding a publicly-held company from becoming privately-held. The research indicates that while all three approaches (sectoral ownership restrictions, investment review and participation restrictions) suffer from difficulties in both principle and administration, the effects of participation restrictions are most ambiguous while the costs of investment review and sectoral ownership restrictions are tangible and aggravate a considerable body of opinion against them.

The Ownership Restrictions in Air Passenger Transport:

Research has indicated that the sectoral ownership restrictions in Air Passenger Transport in Canada are based on a tenuous assumption that Canadian

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shareholders will be willing to sacrifice profitability to satisfy public policy goals not finance from the public accounts. As well the leading case study, Air Canada Enterprises, shows that this policy has been extremely difficult to implement while assuring ACE the requisite finance to maintain operations, resulting in an imbalance between voting stock and risk capital, which exposes those with premium (voting-shares) to a situation of moral hazard. Research reveals a concern about the state of competition in the market for Air Passenger Transportation in Canada. There are two prominent proposals for alleviating these concerns: eliminating the ownership restriction for domestic carriers, and raising the restriction from the current 25% to 49% - noting that any increase beyond this is not possible due to landing rights agreements with other jurisdictions.

Comparing the situation in Canada to that of other jurisdictions, the research found that most jurisdictions in the European Union have already increased their permissible foreign ownership of airlines to 49%; Australia when faced with several similar concerns to that of Canada about foreign control, competition and service to remote locations instituted a right of establishment policy that allowed wholly foreign owned airlines to service domestic routes and this resulted in a number of new entries into the Australian air passenger transport market. Research indicated that the Cabinet has the power to take either or both of these steps without changes to the existing legislation. The research report further noted that the two measures were not incompatible. The research suggests that in maintaining comparability with foreign regulations in this sector, raising additional foreign capital and increasing competition Canada would be well served to raise the foreign-ownership limit to 49%.

The Ownership Restrictions in Telecommunications:

The current ownership restrictions in Telecommunications limit ownership to 46.6% of any common carrier – which is further subdivided into direct and indirect holdings of voting shares. The research report indicates that the primary effect of these restrictions has been to prevent the foreign acquisition of Canadian telecommunications common carriers – but that this has come at the cost of greater facilities-based competition in the Canadian market as sought by Industry Canada. The ownership restrictions do not apply to foreign-controlled resellers of telecommunications services and the research reveals that this has necessitated a continual dispute-resolution function by the CRTC. The report cites previous research by the House of Commons standing committee on Industry, Science and Technology that the limited facilities-based competition in the Canadian market has cost telephone subscribers \$1.06 per subscriber per month in additional charges, and the comparable figure for cable-television services is \$2.61. As with air passenger transport the research shows asymmetries between risk capital and voting stock under this sectoral regime.

The research has also indicated that in addition to these pernicious effects, the ownership restrictions alone have been insufficient to ensure that

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telecommunications services remain owned by Canadian nationals, and must be accompanied by regulations mandating that these corporations be controlled 'in-fact' by Canadians. The paper notes that the Telecommunications Policy Review Panel had previously concluded that the concerns about foreign ownership of telecommunications service providers were more appropriately dealt with through amendments to the Criminal Code. The research does not support the argument that the insulation of incumbent firms from competition is necessary to protect jobs in the industry, including those at the highest corporate level. Furthermore, comparisons with foreign jurisdictions revealed that many, if not most in the OECD, had already lessened or lifted restrictions in this sector. Given the documented concerns and recommendations of previous investigations, the research indicates that Canada has no further need of the ownership restrictions in telecommunications. Indeed, the most compelling argument for the ownership restrictions was the suggestion that Canadian-owned firms would be more amenable to participating in cross-market subsidization arrangements in pursuit of public policy goals – arrangements that the research suggests have long been out of favour with the Canadian government as a policy tool.

The Ownership Restrictions in Broadcasting:

The present ownership restrictions in broadcasting are very similar to those for the telecommunications sector, but are more deliberate in their emphasis of Canadian control 'in-fact' of Broadcast Distributors. Many of the arguments pertaining to the pros and cons of the ownership regime in telecommunications are identical for the broadcasting sector, noting that their close similarity often leads to effectively identical regulation. Nevertheless, broadcasting is perceived to be much more sensitive than telecommunications services in Canada because of the amalgamation of broadcasting services and content production in many firms. Research suggests that liberalization of the telecommunications sector has been delayed by these concerns in broadcasting coupled with equity considerations between the two sectors. However, the paper notes that previous study by the Telecommunications Policy Review Panel and the House of Commons standing committee on Industry, Science and Technology had determined that the broadcast and content production functions could be separated in both firm operations and government policy; the research has found that there is no strong body of opinion on the specific benefits to be realized by the liberalization of broadcasting, allowing concerns about cultural protection to dominate the policy discussion. Research suggests that, as with telecommunications, the policy and analytical separation of broadcast content from transmission eliminates the compelling justification for the sectoral regime.

Ownership Regimes in Cultural Industries:

There are at present a variety of ownership regimes administered by Heritage Canada for cultural businesses; a review of each in turn was beyond the scope of the research. Nevertheless, each regime also features a number of policy levers (direct subsidies, tax incentives, and licensing arrangements) that are used to promote the production of Canadian cultural products. The research suggests

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that these alternative levers may be more practical for increasing the total output and consumption of Canadian cultural products. A case study of the Chapters and Indigo merger reveals that despite the concern of the Competition Bureau that this would create a *de facto* monopoly on bookselling in Canada, the undertakings imposed by the Bureau (esp. the sale of certain smaller chains now owned by Chapters-Indigo) has not been realized, and research suggests that the ownership restrictions in bookselling have hindered the sale of these assets and resulted in higher book prices in Canada. The research casts doubt on the viability of higher prices for cultural products as a way to encourage increased consumption of them by Canadians.

Ownership Restrictions on Uranium Production:

The research has shown that the ownership restrictions placed on Uranium production are motivated by a strong body of concern with the role of potentially dubious state-owned enterprises and nuclear non-proliferation goals – however the research also suggest that a more refined screening technique is both possible and desirable in this sector given that the area of concern is quite specific.

Conclusions:

In addition to the specific conclusions drawn above, the research has indicated that where still needed investment-screening mechanisms should be narrowly focussed; the purpose of this residual screening should be to prevent identifiable harm to Canada or danger to pressing policy objectives (such nuclear non-proliferation). Research also suggests that regulations mandating 'control in-fact' of companies by Canadians should be reduced in partially liberalized sectors as there is no compelling evidence to suggest that Canadian owners and directors of firms behave any differently in their operating decisions than would foreign owners and directors. Indeed, the research has indicated that the most tangible effect of the sectoral ownership regimes has been to insulate incumbent firms from competition, leading to higher consumer prices and less incentive to innovate in the market.