

Cell phone carriers and competition



The failed potash takeover

by Christine Van Geyn

Confessions of a closet tree hugger

by Mark Milke

Can money buy you happiness?

by Tim Mak

Keep securities regulation decentralized

by Hugh MacIntyre

ECONOMIC COMIC CONTEST



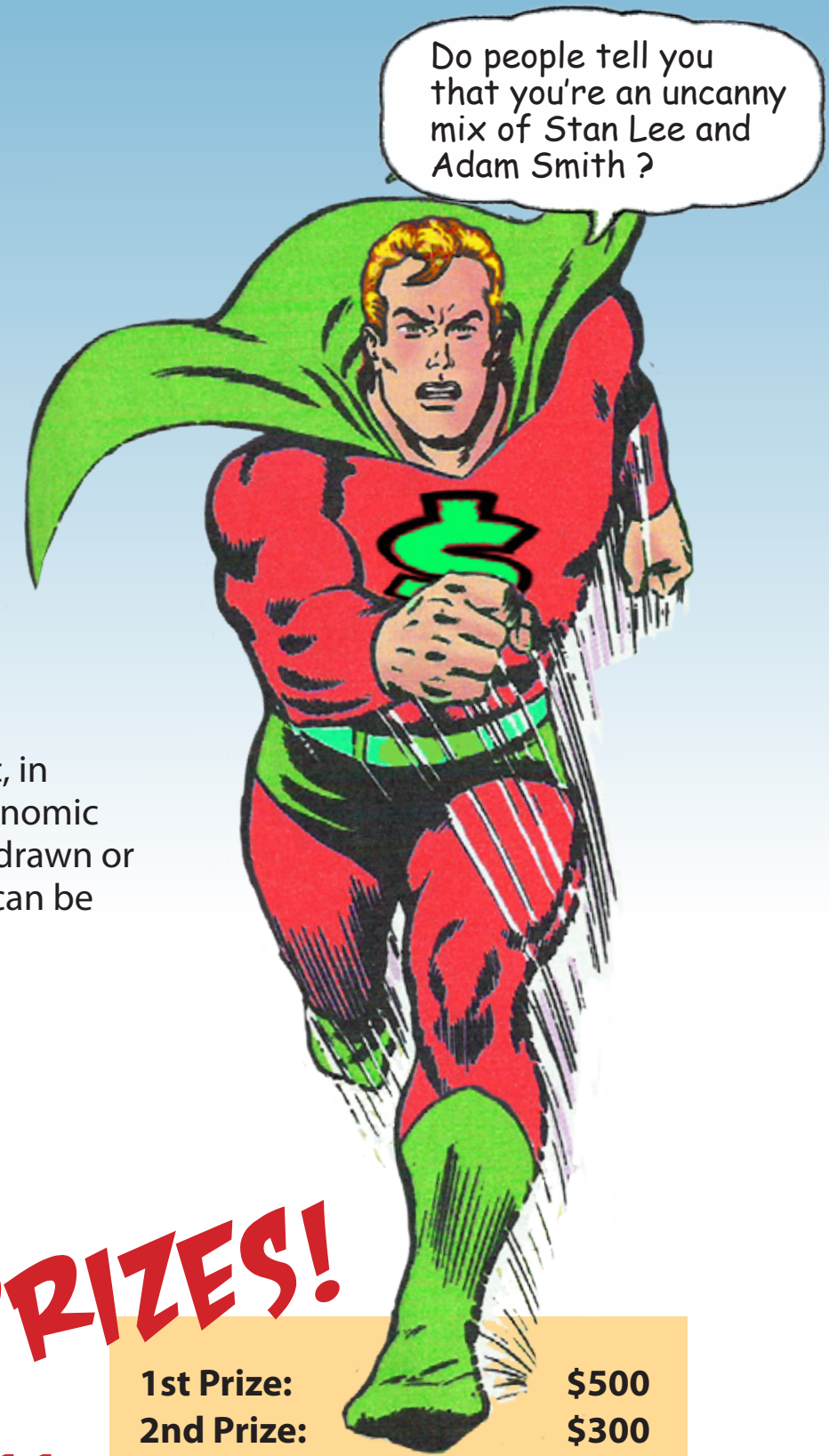
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Concepts to consider:

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- Supply and demand
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- Competition
- Unintended consequences

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Canadian student review

Welcome!

Dear readers,

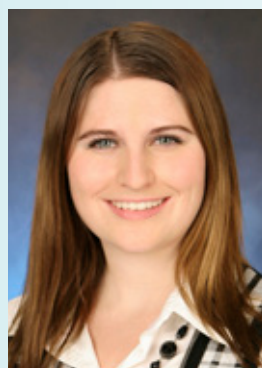
While compiling the Spring
2011 issue of *Canadian Stu-
dent Review*, I began to see
an emerging trend with the
students' articles—every-
thing led back to competition. What role does
economic freedom—hence, fewer regulations
— have in your happiness? Are you frustrated
with your cell phone bill? Why can Bell, Telus,
and Rogers charge Canadians such expensive
wireless rates? From export cartels hindering
the world-wide Potash market—which in turn
contributes to the third-world food crisis—to
provincial securities regulators constraining
government power, the importance of
competition is everywhere.

I encourage you to read all of the compelling
articles in this issue, and check out our contests.
The deadline for the comic contest and essay
contest are coming up in June—good luck!

Best wishes,


Lindsay Mitchell

Editor, *Canadian Student Review*



Contents

- 4** **The failed potash takeover**
by Christine Van Geyn
Government protection of export cartels hinders markets
- 10** **Confessions of a closet tree hugger**
by Mark Milke
Helping the environment through individual responsibility
- 14** **Can money buy you happiness?**
An examination of happiness economics
by Tim Mak
Total income vs. relative income: what makes us happier?
- 20** **Keep securities regulation decentralized**
by Hugh MacIntyre
Provincial securities regulation constrains government power
- 25** **Breaking the shackles on Canada's
telecommunication industry**
by Mark McGinley
Canadian cell phone carriers and the trouble
with the lack of competition
- 32** **Hot topics**
What's new from the Institute



The failed potash takeover

by **Christine Van Geyn**

In August 2010, Australian mining giant BHP Billiton made a \$38.6 billion, hostile take-over bid for PotashCorp., a Saskatoon-based Potash mining firm (Dvorak and Kilman, 2010). PotashCorp markets its products through an export cartel called Canpotex. Export cartels are agreements between firms either to set prices for exports or to divide the export market (Khemani and Shapiro, 1993). Canpotex is an export cartel because Saskatchewan's three major potash producers use it to set prices for foreign potash buyers and to control supply.

This conduct is typically illegal if aimed at domestic markets. However, there is a long-

Potash plant in Saskatchewan

standing international practice of exempting export cartels from domestic competition law (Sokol, 2008). Canada has an explicit exemption for export cartels in section 45(5) of the *Competition Act* (1985). When BHP made its initial hostile take-over bid, its CEO Marius Kloppers stated that the new firm would market outside of the cartel, which would effectively break it up. Both the Saskatchewan provincial government and the Government of Canada were concerned about the end of the tax revenues they received from the artificially high world prices of potash made possible by the cartel (Rocha and Jordan, 2010). The deal finally failed because, on November 4th, 2010, Minister of Industry Tony Clement used his power under the *Investment Canada Act* to block the takeover.

Explanations for export cartel exemptions

The transaction, and the Government of Canada's response to protect the potash export cartel, raises the issue of the treatment of export cartels in both Canada and internationally. Although their proponents claim that export cartels exemptions enhance efficiency, this justification is insufficient. According to this incorrect theory, by centralizing common sales activities, cartels allow members to avoid costly duplication of services. In a competitive market, these lower costs are passed on to buyers in the form of lower prices. If this efficiency explanation is correct, cartel operation should be associated with both an increase in the rate of export and

a fall in the price of those exports (Dick, 1990). However, this does not occur in practice. The political process interferes, and efficiency ends up being determined by the political process, rather than by economics.

This was the experience with Canpotex. During the potash price squeeze in 2007; Canpotex restricted supply and pushed through higher and higher prices on its contracts (Waldie, 2010). This behaviour can be explained partly by strategic trade theory, which suggests that a government creates export cartel immunity in order to improve its terms of trade (Sokol, 2008). According to this theory, cartels are associated with a reduced export volume and a higher export price, which is exactly the result we see with Canpotex. Government policies exempting export cartels shift rent from a foreign firm to a domestic one. Collectively, competitive firms will export more than a monopolist would, leading to less favourable external terms of trade, and a lower industry rate of return (Dick, 1990).

Export cartels are also justified as a way for exporting firms to overcome market barriers in the importing state. Exporting companies tend to lack knowledge of the market they are targeting, which causes competitive disadvantages relative to the competitors within the importing state (Becker, 2007). However, Canpotex was not formed to facilitate market entry. It was formed in the 1970s in order to restrict the supply of potash and stabilize the price because new Saskatch-

The political process interferes...



Potash ore

...and efficiency is no longer determined by economics

ewan mines were flooding the market. Moreover, Canpotex controls a substantial part of the world's supply of potash and supplies mostly into markets that have no domestic production (Waldie, 2010).

Public choice theory suggests yet another explanation for the existence of export cartel exemptions: the consumers harmed by export cartels are foreign. Foreign consumers are a large and diffuse group, and therefore less effective than the participants of export cartels at mobilizing politically to protect their interests (Sokol, 2010).

Harm caused by export cartels

One of the most obvious objections to export cartel exemptions is that they allow the firms in exporter states to pursue monopolies and cartel profits at the expense of the importing

state (Becker, 2007). This is described by Fox as a “beggar-thy-neighbour” approach to international trade. The events surrounding PotashCorp “exposes a very soft underbelly of anti-trust—exemptions and non-coverage. Nations like Canada, which publically deplore cartels, allow them when they hurt only foreigners” (*Cartelization*, 2010: 340).

Export cartel exemptions can also harm trade by leading to retaliatory measures between states. It is sometimes the case that firms in target states organize market power in response to the conduct of an export cartel (Immensa, 1995). Professor Rahl describes this as the tendency of “cartels [to] beget other cartels” (1989:9). This harms total, overall welfare. On a global basis, the anticompetitive effects of export cartels can be no better than a zero-sum game, as one country's exports' gains from monopoly rents are another country's consumers' losses (ABA, 1991).

There is also the possibility of purely domestic harm resulting from export cartels. Unless there is no consumption whatsoever of the exported goods in question in the home mar-

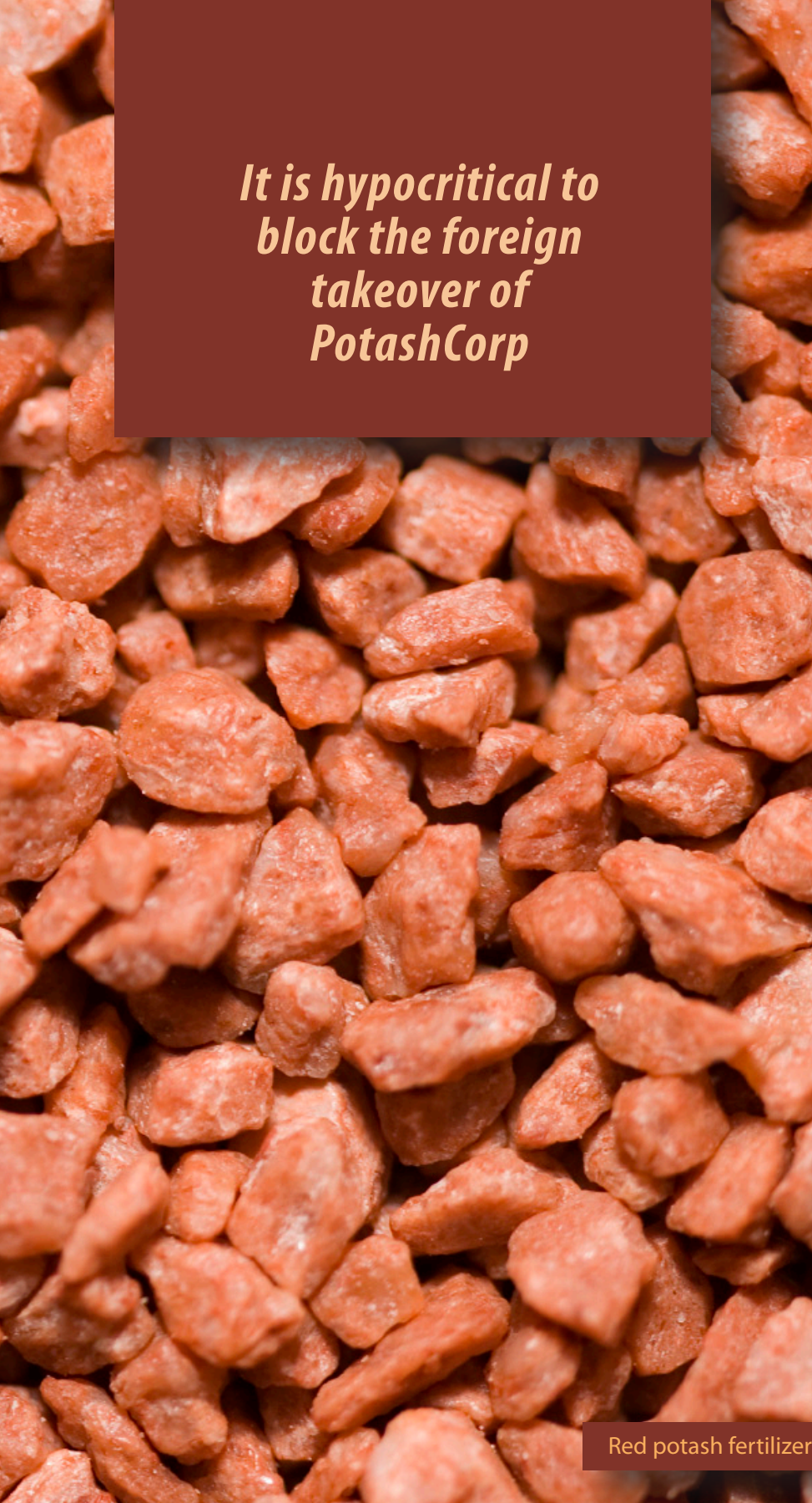
ket, export cartels are likely to influence the amount of production as well as prices on the home markets (ABA, 1991). Even if firms are able to resist the temptation to collude domestically, the fact that sensitive pricing information is shared in order to set foreign prices may lead to “conscious parallelism” (Immenga, 1995:125). While Canada exports 95% of the potash produced, it still consumes 5% within Canada (Stone, 2009).

Eliminating export cartels

The Organisation for Economic Co-operation and Development (OECD) has called for “the worldwide repeal of cartel exemption coupled with an efficiency defense” (OECD, 1993). Likewise, the American Bar Association proposed repealing export cartel exemptions, but only after subject to a “rule of reason” analysis (ABA, 1991:85). This is



Cartels beget other cartels



*It is hypocritical to
block the foreign
takeover of
PotashCorp*

Red potash fertilizer

a sensible solution. The instances in which cartels facilitate the entry of exporters into new markets, and help exporters to overcome market distortions in foreign markets would need assessment.

Canada has also become a prominent proponent for the end of export cartel exemptions. In recent deliberations in the OECD and the World Trade Organization (WTO), the Canadian government has endorsed the view that existing immunities for export cartels in various countries' laws (including Canada's) should be repealed or substantially abridged (Trebilcock, 2010). It is therefore quite hypocritical that the Government of Canada blocked the foreign takeover of PotashCorp in order to protect a domestic export cartel.

***How can a prohibition on
export cartels be achieved?***

The effects doctrine: a unilateral solution

The unilateral application of antitrust law by the importing state against export cartels hosted by foreign states could be a partial solution to the problem. The United States has successfully used the "effects" to prosecute international cartels that harm US consumers (Hauser and Schone, 1994). This doctrine allows one country to enforce its competition laws against conduct that occurs primarily or exclusively in the territory of another country, when it is intended to have some injurious

effect in the territory of the enforcing country, and has that very effect (*US v Aluminum Co. of America*, 1945).

Most parts of the world have accepted some form of the effects doctrine (Fox, 2002). Both Canadian and European competition authorities have taken tentative steps towards the assertion of extraterritorial jurisdiction of their own. The limit of the effects doctrine is the ability of foreign countries to access the information needed to prosecute cartels that have anticompetitive effects within their borders. This is particularly problematic in countries like Canada, which have no requirement that export cartels report their activity. A possible solution could be that states could reform their laws to require notification of export cartel activity, and transparency. Under this proposed regime, immunity would be given to export associations that will not be anticompetitive. It would then be up to the antitrust agency of the importing country to take steps against any potential anticompetitive behaviour by export cartels (Sokol, 2010).

The Irish Competition Authority (ICA) has used this kind of approach. When seeking to determine what foreign firms might be engaging in anticompetitive conduct in Ireland, the ICA made use of the filings of US export cartel associations. This is unilateral

enforcement, but made possible at a low cost through transparency (Sokol, 2010).

International solutions

One of the most promising avenues for an international solution to export cartels is the WTO. A formal effort to address competition issues within the WTO began when members agreed to launch the Working Group on the Interaction Between Trade and Competition Policy (WGTCP) at the WTO Ministerial Conference in Singapore in 1996 (Hafbauer and Kim, 2008).

The European Union, Canada, and Korea are advocates of a WTO Competition Policy Committee, which would monitor

PotashCorp Tower in Saskatoon



all notifications and transactions between separate member states (Clarke and Evenett, 2003).

According to World Trade Organization reports:

Canada takes the view that a WTO Competition Policy Committee should be established. Such a committee could play a significant role in enhancing exchanges between Members and serve as a forum for Members to learn about each other's practices and policies. This type of dialogue would be distinct from the case-specific cooperation, such as exchange of notifications or coordination of investigations that occurs under bilateral arrangements (World Trade Organization, 2003).

However, despite these statements of support, WTO members failed to reach a consensus on the content of possible international competition rules. After the September 2003 Cancun Ministerial Conference ended in deadlock, the General Council of the WTO dropped competition policy from the Doha agenda in 2004 (Hufbauer and Kim, 2008).

Since the WGTCP has failed to achieve a consensus on new international competition rules in the WTO, it is worth considering how the existing WTO framework could be used to prohibit export cartels. The most promising WTO provision is Article 11.3 of the *Agreement on Safeguards*, produced in the

Uruguay round, which states that "members shall not encourage or support the adoption or maintenance by...private enterprises." A footnote to the agreement then reads that, "of similar measures include export moderation, export-price...monitoring systems, export...surveillance" (Becker, 2007:124). This approach has not yet been used against export cartels, but has some potential.

There are, however, some problems with using the WTO. For example, the current WTO remedies are not suitable for competition law objectives because they are limited to trade retaliation. This measure runs counter to the objective of competition law: competitive markets (Canadian Comp. Bureau Draft Paper, 1999).

Conclusion

Export cartels like Canpotex reduce global welfare and harm foreign consumers. Canpotex is particularly damaging, because potash is used as a fertilizer by the developing world. The Canadian cartel, combined with the cartel activity in other potash-producing countries like Belarus and Russia, contribute to the artificially high global price of fertilizer and the food crisis.

Governments do not deny the harmful effects of domestic cartels, yet export cartels continue to operate under exemptions. Through

unilateral application of the effects doctrine, and through increased transparency, states can take some steps to protect themselves. However, what is really required to end export cartels is coordinated action, and coordination will require political will. Until there is more political will for a coordinated effort to end export cartels, situations like the blocked takeover of PotashCorp by BHP will continue to reduce global welfare.

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A photograph of a person's arms and hands hugging a tree trunk. The person's hands are pressed against the rough, reddish-brown bark of the tree. The background is a soft-focus green forest. A green horizontal bar is overlaid on the top left of the image, containing the title text in white.

Confessions of a closet tree hugger

by **Mark Milke**

Several years ago, after a day-long hike in Kananaskis country (a magnificent wilderness that touches Banff National Park), I drove by two vehicles stopped by the side of the mountain highway.

The passengers were busily feeding potato chips to a small herd of mountain sheep.

I could have kept driving and cursed the central Canadian tourists under my breath (sorry, but the SUVs had Ontario plates), or I could have grabbed my cell phone and passed on their licence plate numbers to park wardens, who might have levied a fine.

Instead, I pulled over and gently asked the visitors to stop feeding the sheep the “treats.” The chips, I explained, would only encourage the animals to trot by the road more often, which could have tragic consequences if a car came around a nearby corner too quickly. The tourists mumbled an embarrassed acknowledgment; I wished them a wonderful stay in the mountains.

I’m aware that for some, the notion that a Fraser Institute director might care about nature goes against type. The conventional narrative is that concern for continued prosperity is necessarily anti-environment



Buying into easy stereotypes misreads reality

(the opposite narrative also exists, where self-identified greens want the human race to live in medieval hovels).

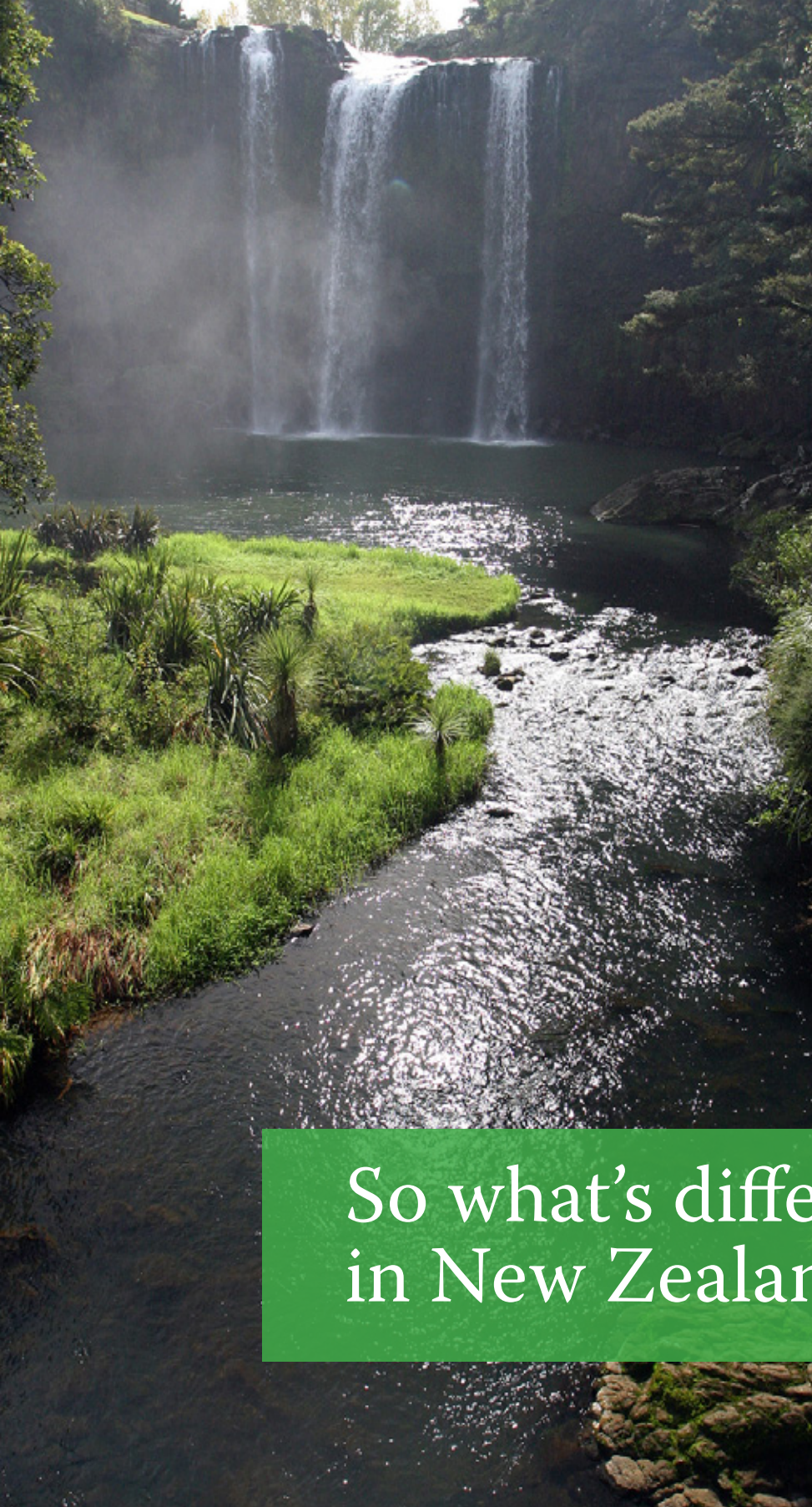
However, the real debates on the environment, and our responsibility for it, are far more nuanced. They involve useful deliberation about the role of more or less regulation, “carrots” and “sticks” in environmental governance, the role of entrepreneurs and

technology in solving problems, and what it takes to make countries prosper so they have the extra wealth to properly care for the natural world. (Dirt-poor Haiti, for example, won’t get serious about green issues until it conquers rampant poverty first.)

So, full confession: I’m a closet tree-hugger. As an undergraduate, I spent three summers tree planting because I preferred the outdoors to an

office. Give me a choice now between a glitzy Las Vegas vacation or a hike in the Rockies, and it’s no contest. And on occasion, that requires personal action. When I spot beer cans in the woods, I’ll haul them out and fume at the irresponsible miscreants who brought and tossed them.

Anyone who buys into the easy stereotypes misreads the reality that plenty of



So what's different in New Zealand?

“conservative” people are also conservationists. Southern Alberta ranchers, some of the most hard-core, fiscal conservatives in the country, are also the most protective of the natural environment. Polluting the land and water is not good for their business. Just as importantly, despoiling nature offends their sense of personal responsibility for the land under their care.

Such ranchers live by their convictions, leaving a far smaller environmental footprint than the Ted Turners and Al Gores of the world, who own multiple mansions and jet-set about while preaching “sustainability.” Instead, the ranchers’ desire to both make a decent living and respect nature is an obvious rebuke to would-be green messiahs and a positive example for the rest of us.

These days, it’s all too easy to cut a cheque to a green lobby group or blithely assume governments can organize, regulate and direct all matters concerning the environment.

The result is that “teaching moments”—such as my encounter with the sheep-feeding tourists—are often lost. So too is a positive personal impact on the preservation of the wild.

The reality of a Canadian preference for rules over responsibility hit home when a friend from New Zealand commented on the plethora of signs posted in our national parks. They listed a slew of prohibited activities, including blasting one’s stereo, feeding animals, and littering. “So what’s different in New Zealand?” I inquired. To paraphrase his reply, such behaviour was understood to be unacceptable and dumb. In Kiwi country, signs are fewer and lists shorter because anyone engaged in the above activities would be swiftly reminded by locals to stop. In contrast, we Canadians make a religion out of being “polite”—and shove off responsibility to government.

I don’t claim that individual responsibility can solve every environmental problem, or always bridge the divide in policy disputes. But taking greater personal care of Canada’s flora, fauna, forests, meadows, rivers, lakes, and oceans certainly couldn’t hurt.



Mark Milke is the director of Alberta Policy Studies at the Fraser Institute. He also manages the Fraser Institute’s Centre for the Study of Property Rights.



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Can money buy happiness?

An examination of happiness economics

by **Tim Mak**

Does more money make one happier? A whole field of economics, known as “happiness economics” exists to answer this very question, both on the international level (are richer countries happier than poorer countries?) and the intra-national level (are richer individuals happier than poorer individuals within a given country?).

The answer to this question has serious implications for policy makers. If higher standards of living—often measured by average income (GDP)—increases happiness, then any government concerned with the happiness of its citizens should focus on policies that boost the growth of the economy as whole.

If, as some happiness economists argue, the crucial determinant to happiness is not our

absolute income per se, but our income *relative* to others around us, then this suggests the focus should be on redistributing wealth and making society more equitable.

The academic literature is—like many topics in the social sciences—contentious, but growing evidence supports the GDP notion. Although earlier research suggested that average income had no substantial effect on happiness, more recent research seems to indicate that increasing



absolute income does, in fact, buy greater happiness. Such studies also show that there is a strong—perhaps direct—relationship between economic policies and institutions (e.g., economic freedom), that increase average income as well as happiness.

The Easterlin Paradox

Arguably, happiness economics as a field began with the 1974 publication of University of Southern California professor Richard Easterlin's seminal paper, *Does Economic Growth Improve the Human Lot? Some Empirical Evidence*. Easterlin's paper reaches some fascinating conclusions that prompt inquiries in happiness economics to this day. Within each of the 19 countries examined, Easterlin finds that individuals with higher incomes report being more happy than those with lower incomes (1974). This makes intuitive sense: the richer individuals are, the more they can fulfill their desires, and thus the happier they are.

Paradoxically, however, Easterlin finds also that, as a whole, richer countries do not appear to be happier than poorer countries. In particular, he points out that despite the growth of the American economy between 1946 and 1970, overall happiness had not increased during that period.

What does this mean? Easterlin interprets his results to indicate that it is not absolute income

that makes one happy, but one's income in relation to those around him/her (1974).

In other words, if everyone in society made \$1,000 more this year than they did last year. Under these findings, happiness would not increase because everyone's relative position would remain the same. Individuals would be happier, though, if their income rose while the income of their neighbours did not, thus putting them in a better position in comparison. Although less intuitive, this could make sense: if our expectations depend on the expectations of those around us, then absolute increases in income do not increase our happiness unless our relative income increases as well.

So what are the policy implications of Easterlin's conclusions? Economists who favour this view suggest that if the absolute income of a country is not what makes people happy—and relative income is—then it is incumbent upon the government to promote a more equitable income distribution, and to implement a more European-style, socially democratic state (Wilkinson, 2007).

Indeed, this view has traditionally been widely accepted among happiness economists. For instance, *Economist* writer Will Wilkinson noted "that happiness research [which] supports the policies of a more thoroughgoing egalitarian welfare state...appears to have become a sort of conventional wisdom among those who study



Does more wealth relative to our neighbours really make us happier?



GDP growth seems to increase happiness

happiness” in a Cato Institute paper examining the issue (2007:2). However, more recent research with broader data sets now question Easterlin’s findings.

Money does buy happiness

In the 1990s, economists started to revisit and reassess the claims made in Easterlin’s paper. Economist Ruut Veenhoven, a professor emeritus at Erasmus University in the Netherlands, wrote papers in 1989 and 1991 concluding that increased GDP per capita correlates with greater levels of happiness.

By the time Veenhoven revisited the issue again in a paper with Dr. Michael Hagerty of the University of California Davis in 2003, a whole host of literature had asserted a relationship between happiness and the absolute income per capita for 40 countries, in direct refutation of Easterlin’s original study exploring 19 countries. It found also that, contrary to Easterlin’s original findings, happiness in the United States had risen with per capita GDP from 1972 to 1994 (Veenhoven and Hagerty, 2003). The pair do not explain why their results are different from Easterlin’s, but their differing methodologies and the different time periods studied probably played a part in their various outcomes.

“The results show that increasing national income [GDP per capita] does go with increasing national happiness...contrary to strict relative utility models,” write Veenhoven and Hagerty (2003:2) Among other criticisms, Veenhoven and Hagerty claim that Easterlin made the mistake of only examining middle- and high-income countries, and that including poor countries showed positive correlations between GDP and happiness. It is in poor countries where increasing the average income had the greatest positive effect on happiness.

This an important revelation, that although absolute GDP growth seems to increase happiness, there is a diminishing marginal return. In other words, increasing GDP among higher-income countries boosted happiness less than increasing the GDP of lower-income countries by the same amount.


The concept of a diminishing marginal return can be illustrated as follows: the more money one has, the less happiness one additional dollar—the marginal dollar—will provide. A destitute man would clamor for a dropped dollar, while a billionaire might not think twice about it. In the same way, an increase of \$10 billion for a rich country (assuming same population) may lead to paltry increases of happiness compared to that same increase for an extremely poor country.

Perhaps the most ambitious study on the relationship between average income and happiness, and the most compelling rebuke of Easterlin's claims, comes from a 131-country examination of life satisfaction and GDP per capita, written by Betsey Stevenson and Justin Wolfers of the University of Pennsylvania.

According to the authors:

Using recent data on a broader array of countries, we establish a clear positive link between average levels of subjective well-being [a measure of happiness] and GDP per capita across countries, and find no evidence of a satiation point beyond which wealthier countries have no further increases in subjective well being (2008:1).

These new and improved works have their own implications: if a growth in the average income increases happiness, then any government hoping to maximize well-being and life satisfaction should promote policies which drive economic growth, rather than focusing merely on the pursuit of income redistribution measures and welfare state programs—in fact income redistribution measures have been shown to have little effect on happiness (Ouweneel, 2002).



Economic freedom brings happiness through choice and opportunity


Since increasing per capita income increases happiness, then it follows that employing policies and institutions which promote per capita income growth will increase happiness.

Economic freedom makes us happier!

There is evidence to show that greater levels of economic freedom—a smaller government, fewer regulations, and lower taxes—result in more robust economic growth (Gwartney et al., 2010). This would suggest, based on the case outlined above for GDP growth as a driver of happiness, which freedom would indirectly lead to greater personal satisfaction.

Recent studies suggest that economic freedom may also have a direct and positive effect on happiness. In fact, studies have shown that economic freedom correlates with happiness almost as much as any other factor (Veenvhoven, 2005). In fact, the broadest study of the relationship between the two factors show that economic freedom was four times more important than GDP per capita in directly determining happiness (Ovaska and Takashima, 2006).

According to the economists who wrote the study, the positive relationship between economic freedom and happiness may be due to the satisfaction we derive from being able to



Policymakers should focus on increasing average income

make our own choices and embrace the opportunities that we desire:

The results suggest that people unmistakably care about the degree to which the society in which they live provides them opportunities and the freedom to undertake new projects, and make choices based on one's personal preferences (Ovaska and Takashima, 2006: 210).

Conclusion

Although older studies have suggested that relative, rather than absolute, income in a society is the key driver of happiness, more recent work has disputed this by suggesting that absolute growth in income boosts happiness. This, along with increasing evidence that greater economic freedom increases the

contentment of individuals, suggests that policymakers who wish to increase overall happiness should focus on economic policies and institutions that boost increases in average income, rather than wealth redistribution.

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Keep securities regulation decentralized



by **Hugh MacIntyre**

Canada is unusual among developed nations in that it does not have a national securities regulator. Instead, each of Canada's thirteen jurisdictions has its own regulatory body. Each province and territory has its own provincial securities legislation and regulatory bodies in each jurisdiction have prescribed powers to create rules and adopt policies. This has created concern in some quarters that a patchwork of different regulations will disadvantage Canada. For instance, a report produced for the Minister of Finance by the Expert Panel on Securities Regulation (EPSR) called *Creating an Advantage in Global Capital Markets: Final Report and Recommendations* recommends creating a national securities commission. The EPSR claims that the current decentralized system is too

burdensome for both investors and governments alike.

There are, however, some advantages to having a decentralized policy process that are overlooked by the EPSR. Also, the disadvantages outlined in the report are greatly exaggerated and in some cases are not really disadvantages at all. Though it is important for the various regulatory bodies to coordinate on some issues, Canada is better served by keeping the current decentralized system.

Benefits of decentralization

One of the advantages inherent in a federal state is that it allows citizens greater choice in which policy environment in which they will work and live (Tullock, 1994). A provincial government that offers superior policy at a lower cost is more likely to attract the most capable immigrants and the most investment. In the case of security regulations, companies can choose into which provinces they will raise capital. This is commonly referred to as “voting with your feet,” and, in a limited way, it creates competition between governments that is similar to the competition in a market place. This competition adds a constraint on government power that is complimentary to the democratic system and, “the addition of voting with your feet to voting with a ballot is a significant improvement” (Tullock, 1994: 34).



A second advantage to a decentralized system is that it allows greater policy experimentation and thus more policy learning. Policy making is almost always experimental (Freeman, 2006). Academics and policy makers have theories on what the effect of a policy will be, but the only way to know definitively is to first implement that policy. The obvious danger of such experimentation can be mitigated by learning from other jurisdictions (Freeman, 2006). For example, if Quebec is considering a reform, they can learn from what has or has not worked in Ontario. If the federal government dictated policy for both provinces, there would be no way to learn from differences that could improve government policies.

The third way that a decentralized system is advantageous is that it allows for a greater voice of regional differences and interests. Canada is

not a homogeneous country and the economies of the provinces vary greatly. This is reflected in the differences in approach to regulating securities (Mohindra, 2002). The EPSR recognizes the importance of a regional voice and recommends that a “Council of Ministers” be included in the structure to represent each province’s interests (EPSR, 2009: 53). The flaw with this solution is that for the national securities regulator to have any coherence or meaning, it will have to produce a single set of policies for all provinces. Therefore, some provinces are bound to have their interests better served than other provinces. The only way to ensure that provincial interests are all protected is by allowing provinces to create their own policy (Mohindra, 2002).

EPSR concerns with decentralization

Despite the advantages outlined above, the EPSR presents three points—which can be better divided into five arguments—against the current decentralized regulatory system. The first is that it is difficult for securities regulators to act quickly in a coordinated manner. The second is that it is difficult to fit the different regulatory bodies into a “national systemic risk management team” (EPSR, 2009: 40). The third is that there is a duplication of effort across the provinces. The fourth is that there is variation in the levels of protection enjoyed by investors.

The fifth and final point is that having to comply potentially with thirteen separate regulations leads to a high compliance cost (EPSR, 2009).

The EPSR refers to Canada's delay in restricting short-selling in September 2008 as an example of a case in which Canada acted too slowly (EPSR, 2009). The underlining assumption is that this interference in the market was beneficial and needed to occur quickly. Without making a judgment in this particular case, swift action on the part of a regulator is not necessarily positive. Public policy is difficult to get right, and hasty actions are often damaging. This is especially true when dealing with issues of property rights—an integral part of most securities regulation. Any decentralized system



is valuable if it slows down public policy, makes arbitrary rule making more difficult, and allows for greater debate. In this way the very disadvantage presented by the EPSR is in fact actually an advantage.

The second point that the EPSR makes also puts too much importance on the swiftness of response. It is a dubious claim that a coordinated "management team" would be able to produce an instant regulation that would have a positive impact on the economy and securities markets. Especially considering that much of the delay is due to the consultation process of some provinces, not coordination problems (for example, see Part V of the *Ontario Securities Act*). If a proposed regulation has merit and requires coordination, then the regulatory bodies should be able to negotiate with each other. Negotiations between government agencies are common in any governing structure (Tullock, 1995) and it is certainly common among Canada's securities regulators (Mohindra, 2002). Furthermore, coordination is simplified through the Canadian Standards Association by developing universal standards. The merit of speeding up that process is not outweighed by the risks involved in creating hasty and harmful regulations.

The complaint that there is a duplication of effort is common in any federal system. The assumption is that economies of scale in a combined system would save on



costs, but the reality is that inefficiencies created by consolidating into large monolithic organizations often outweigh the efficiencies of economy of scale (Tullock, 1995). At the same time, the inefficiencies of duplication have been partially alleviated by cross-jurisdictional agreements. Combining organizations would lead to difficult political decisions such as where should jobs be cut and which organizational model should be used. The path of least resistance would be to retain redundant jobs, and to latch together a mismatch of organizations. In fact, the Canadian Securities Transition Office has already committed itself to offering a position to all staff in participating regulators (CSTO, 2010), which makes it highly probable that there will be redundancies and thus inefficiencies.



Variation in levels of investor protection is not inherently a negative trait and it is only one of several factors that must be balanced when creating securities regulation; compliance cost, for example, is another important factor. The importance given to certain factors differs among Canada's securities regulators depending on circumstances and philosophy (Mohindra, 2002). There is no guarantee that a single monolithic body would be more able to handle the complexity of securities regulation (Tullock, 1995). In fact, a monolithic regulator would be at a disadvantage because it would not allow policy experimentation to discover the best balance of the various factors.

Cost of compliance would not necessarily decline with a single securities regulator. Harmonization so far has only led to the increase

in the complexity of securities regulations and thus has made it more difficult for firms to comply (Mohindra, 2002). This is partly because a single regulator or more harmonized regulatory system faces less competitive pressure to keep compliance costs low. The EPSR is simply assuming that a monolithic regulator would keep costs low, but experience has demonstrated that the opposite is more probable.

Conclusion

There is no overwhelming advantage to a centralized securities regulator, but there are several advantages to keeping it decentralized. A decentralized system forces regulators to compete to create better regulation, it allows for more policy experimentation, and it is more able to incorporate regional diversity. The EPSR exaggerates the importance of quick policy making and it makes flawed assumptions about the greater efficiencies and lower compliance costs of a monolithic system. Finally, it ignores the disadvantage of harmonizing investor protection, and it does not consider that a decentralized system would be better able to handle complex policy problems.

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ASK THE EXPERT

Breaking the shackles on Canada's telecommunication industry

by **Mark McGinley**

The antiquated methods of the Canadian Radio-television Telecommunications Commission (CRTC) and the *Telecommunications Act* are constraining competition in Canada's telecommunications industry. Through the CRTC's increasingly archaic and inappropriate responses to the rapidly changing technological environment, and the *Telecommunication Act's* severe restrictions on foreign control in domestic telecommunication providers, Canada's telecommunication industry is losing its competitive edge (Sinclair et al., 2006). This is especially true in the two most important and fastest growing sectors of the telecommunications industry: wireless and broadband services. In order to reverse this trend and reaffirm Canada's position



as a world leader in telecommunications, it is crucial that Canada significantly curtails the scope and authority of the CRTC. Further, the *Telecommunications Act* needs to be amended through substantial liberalization of the restrictions on foreign control of telecommunication providers. The time has come for Canada to demand an end to the excessive and unnecessary regulations and legislative restrictions that have been crippling competition in one of Canada's most important industries.

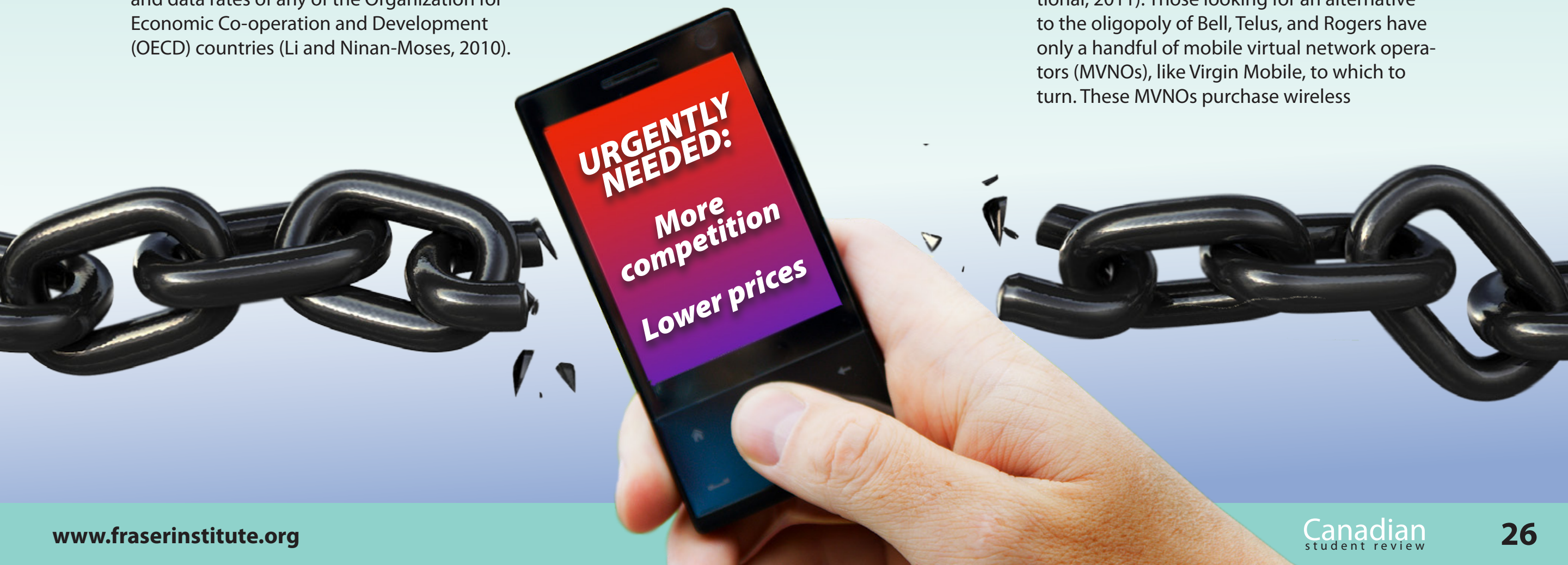
The need for change

Canada has the most expensive wireless voice and data rates of any of the Organization for Economic Co-operation and Development (OECD) countries (Li and Ninan-Moses, 2010).

At the obscene cost of \$67.50, Canada boasts the highest minimum monthly cost of a complete cell phone package, including voice, data, and text, of any of the OECD countries (Li and Ninan-Moses, 2010). Further, Canada ranks second only to Mexico in OECD countries with the lowest number of wireless subscribers per 100 inhabitants (Sinclair et al., 2006). Unfortunately, this trend is not confined to the wireless sector. In 2003, Canada ranked second among OECD countries in the number of broadband subscribers per 100 inhabitants; two years later Canada dropped four spots to sixth position (Sinclair et al., 2006). We are lagging behind

Japan, South Korea, and the United States in rolling out fiber optic cable and in the development of next-generation networks (Sinclair et al., 2006).

High prices for wireless services and the lagging development of our broadband and next-generation wireless networks are but a symptom of a larger and more systemic issue—a lack of healthy competition in the telecommunications industry. In the early 1990s, there were fifteen wireless competitors in Canada, but now there are only three major network providers who control over 90% of the wireless market by revenue (Business Monitor International, 2011). Those looking for an alternative to the oligopoly of Bell, Telus, and Rogers have only a handful of mobile virtual network operators (MVNOs), like Virgin Mobile, to which to turn. These MVNOs purchase wireless



Turn regulation over to the Competition Bureau



spectrum at wholesale prices, plus a CRTC approved markup, from the major three network operators (Pach, 2006), effectively ensuring the propagation of the oligopoly. Presumably, the network operators would never sell enough of their excess spectrum for these MVNOs to ever pose a serious threat.

Clearly, something is very wrong with the Canadian telecommunications industry, and substantive reform of the telecommunications policy framework is urgently needed if we are to reverse these trends.

Reform of the CRTC

The CRTC, a regulatory body that, without a hint of irony, advertises itself as a public interest-oriented agency, began regulating telecommunications in 1976 when it assumed authority from the Canadian Transport Commission (Doern, 1997). At this time, the telecommunications industry was radically different from the industry of today; natural monopolies were commonplace, derived from former crown corporations now privatized as a result of recent deregulation. In this market the CRTC's price regulation and market interference made sense and appropriately prevented the abuse of market power. However, the market has changed and the same policies that once protected consumers are now punishing them. The CRTC needs to be reformed and its role reduced to ensure that competition issues

are heard by an administrative body with the institutional expertise to properly adjudicate them: the Competition Bureau.

The telecommunication industry does not require regulation that is *sui generis*, that is, regulation unique to the sector (Lacobucci and Trebilcock, 2007). Accordingly, regulation of the telecommunication industry should be transitioned to Canada's general competition regulator, the Competition Bureau. This would solve a number of problems inherent in the overlapping authorities conferred by legislation on the CRTC and the Competition Bureau, bringing Canada in-line with the best practice models identified by the Telecommunications Policy Review Panel (TPRP) (Sinclair et al., 2006).

Unlike the CRTC, the Competition Bureau has the authority under the *Competition Act* to make *ex-post* regulations, regulations that respond to a problem as opposed to *ex-ante* regulations designed to prevent a problem (Department of Justice Canada, 1985). This power would allow the Competition Bureau to step in and apply *sui generis* regulations only in the event of a market failure, thereby increasing market freedom.

Shifting regulatory responsibility for telecommunications from the CRTC to the Competition Bureau better aligns these government agencies with their core competencies, promoting more informed decision-making. Such a shift

could relieve the government from having to correct ill-conceived decisions in the realm of telecommunications; the Conservative government has overruled CRTC decisions four times in the last five years, evidencing the CRTC's inability to properly regulate on competition issues (Cowan, 2011).

The shift of authority from the CRTC to the Competition Bureau would ensure that the telecommunications industry would be regulated to the minimum extent necessary as ordered by the Governor-in-Council in 2006 (Government of Canada, 2006). Under s. 34 of the *Telecommunications Act*, the CRTC has the power to hold back from regulating a service where competition is sufficient to protect users from abuse of market power (Department of Justice Canada, 1993). However, it is rarely the case that a bureaucracy voluntarily refrains from exercising its power (Lacobucci and Trebilcock, 2007), and indeed the CRTC has demonstrated an intention to consolidate rather than relinquish its regulatory authority. In 2008, a document released by the CRTC entitled *A Competitive Balance For The Communications Industry* recommended that Canada's broadcasting, telecommunications, and radio-communication industries be governed by a single enactment over which it would preside as the ultimate authority (CRTC, 2008). This recommendation is in direct opposition to the recommendations advanced in the TPRP final report, heralded as the most comprehensive overview



There are numerous benefits to foreign, direct investment

of Canada's telecommunication sector in over 30 years (Business Monitor International, 2010). Since the CRTC appears unwilling to voluntarily cede its authority to preside over competition issues, external action is required to vest the authority with the agency that is the most competent to wield it.

Liberalization of foreign direct control restrictions

Canada is one of a small number of OECD countries that explicitly restrict foreign control

of telecommunication providers, boasting one of most restrictive and inflexible set of rules regarding foreign investment in the telecommunications sector (Sinclair et al., 2006). Foreign control of domestic telecommunication providers is restricted though the combination of two separate pieces of legislation—the *Telecommunications Act*, which prevents foreign ownership of more than 20% of a telecommunication provider's voting shares, and the *Canadian Telecommunications Common Carrier Ownership and Control Regulations*, which prevent foreign control of more than one-third of a holding

company with a stake in a telecommunications provider. To foster a healthy, competitive environment, these restrictions need to be significantly reduced, if not removed entirely.

There are numerous benefits to foreign direct investment (FDI), including increased access to capital, the transfer of knowledge and expertise, and the development of new, value-added offerings (Business Monitor International, 2011). Moreover, FDI generally reduces the cost of capital in an industry, and the Canadian telecommunications industry is no exception. A 2003 study by Network Research Inc. estimated that foreign ownership restrictions increase the cost of capital by \$1.06/month per subscriber for established telephone companies, and \$2.61/month per subscriber for Canadian cable companies (Network Research, 2003). Liberalizing these restrictions would infuse liquidity into the market, and allow new entrants access to cheaper capital.

In addition to the financial benefits, there are several other benefits accompanying liberalization of foreign control restrictions:

[the] liberalization of the restrictions on foreign investment in Canadian telecommunication carriers would increase the competitiveness of the telecommunication industry, improve the productivity of Canadian tele-



**Liberalization
will spur
competition**

communication markets, and generally be more consistent with Canada's open trade and investment priorities (Sinclair et al., 2006: 14).

The TPRP is not the only advisory board to come out against foreign control restrictions; the Standing Committee on Industry, Science, and Technology (INDU) advocated not just for the liberalization, but the outright removal, of all Canadian ownership restrictions in the telecommunications industry (INDU, 2003). Liberalization of these restrictions is a more realistic goal than outright removal given the political opposition likely to rise against such a proposal. Such liberalization will spur competition in telecommunications industry, and allow Canada to excel in the global economy alongside the vast majority of the OECD countries.

Conclusion

Increasingly out-dated and inappropriate regulations have shielded the Canadian telecommunication industry from vigorous competition for too long. The CRTC, in its desire to protect competition, has failed to discern the fairly straightforward distinction between protecting competition and protecting competitors. By inexplicably favouring the latter at the expense of the former, the CRTC has failed, and it is the Canadian consumer who must bear the weight of that failure—a failure kept fresh through a monthly reminder found in the mailboxes of

those lucky enough to afford cell phones.

Despite the laudable efforts of the Conservative government in overturning some of the more egregious offenses of the CRTC, the legislature is not without blame in the creation of Canada's telecommunication oligopoly. The *Telecommunications Act* has insulated the telecommunication industry from competition, allowing the three major providers to grow fat from the proceeds of a decade long gouging of the Canadian consumer. The telecommunications industry is extremely capital-intensive, and liberalization of foreign control restrictions would inject the financing needed to build the network infrastructure and acquire the wireless spectrum rights that would allow legitimate competition with Canada's telecommunication oligopoly. Let us cast off the legislative and regulatory restrictions shackling competition in the telecommunications industry and allow Canada's telecommunication industry to grow stronger and more vibrant in the face of vigorous competition.

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Ottawa facing significant financial risk if Canada suffers a major earthquake

by **Niel Mohindra**

Unlike individuals or companies, governments in Canada and elsewhere commonly self-insure against risk. This means that rather than purchase insurance externally, most governments accept the risks and associated costs. While this can be the most effective way for government to manage day-to-day risk, as we have seen from recent earthquakes in Japan and New Zealand, catastrophic events are another matter altogether.

Canada faces a very real risk of a major earthquake. A recent paper by the Toronto-based Institute for Catastrophic Loss Reduction estimates a 30% chance that an earthquake strong enough to cause significant damage will strike southwestern British Columbia in the next 50 years, a region that includes Vancouver and Victoria. There is also a 5 to 15% chance that a damaging earthquake will strike southern Quebec or eastern Ontario in the same time



Earthquake damage in Japan.

Wikimedia Commons

frame, a region that includes Montreal, Ottawa, and Quebec City.

If we assume that a major earthquake is likely in Canada, then it logically follows that the federal government needs to take a more proactive approach to managing the financial risks associated with having a major earthquake occur in a densely populated area.

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Ignatieff's Liberals just don't get it

by **Charles Lammam, Milagros Palacios, and Niels Veldhuis**

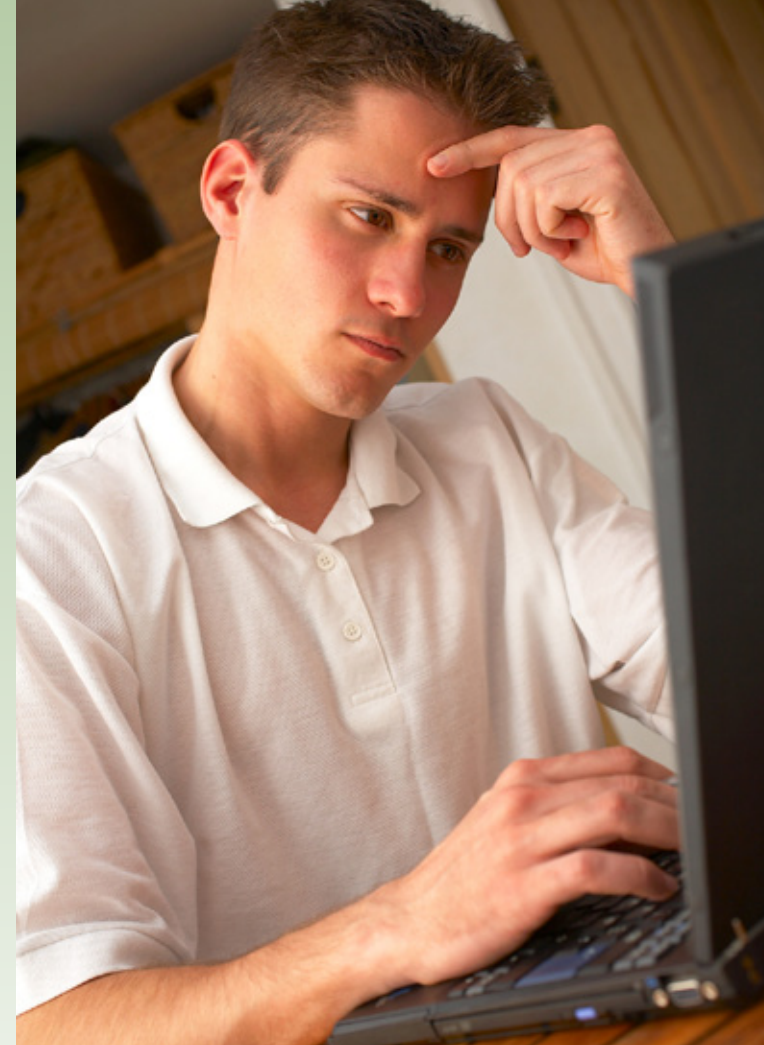
In January 2011, federal opposition parties joined forces to demand that the Conservative government reverse its corporate tax rate reductions. "[This] will send a very clear message that this government ought to change course," warned former Liberal leader Michael Ignatieff (Fitzpatrick, 2011). But if increasing corporate tax rates is good policy, why have governments of all ideological stripes across Canada done the opposite by slashing them? It is because they understand the economics. Business tax reductions yield significant benefits to all Canadians by way of making the economic landscape more attractive for investment. Jurisdictions that lower business taxes increase the after-tax rate of return on investment. Increased returns, then, provide the incentives for investment and leave firms with more money to reinvest.

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