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ROUNDTABLE ON EXIT STRATEGIES

-- Note by the Delegation of Canada --

This note is submitted by the delegation of Canada to the Competition Committee FOR DISCUSSION at its forthcoming meeting to be held on 16 - 17 June 2010.

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ROUNDTABLE ON EXIT STRATEGIES

-- Note by Canada --

1. Introduction

1. The purpose of this note is to provide Canadian insights and perspectives on the questions posed in the OECD "Call for Country Contributions" document that identifies questions, challenges and suggested sources relevant to pro-competitive exit strategies for national and global financial sectors and systems.

2. Canada fully agrees with the many OECD documents distributed for this Roundtable that emergency measures to assist financial and non-financial companies and industries, and the fiscal stimulus packages of some national governments over the past three years may have distorted competition in national and global financial and non-financial markets and may have distorted as well international trade and investment flows. These documents note in particular that in some jurisdictions, during the crisis, emergency measures took precedence over competition rules, and that government guarantees and other bail-out operations for banks that are firm specific can have long-term adverse effects on the competitive environment.[1] It is essential that the exit strategies of all countries should be designed to remove and not add distortions to national and global competition and international trade associated with these emergency measures.

3. This note will pay greater attention to non-financial firms, sectors, and markets, and focus on the more general principles that are relevant to pro-competitive exit strategies for both financial and non-financial sectors.

2. Canada's Response to the Global Recession

4. Canada's emergency measures for firm restructuring and fiscal stimulus programme were smaller in both absolute terms and relative to GDP than those of most other OECD countries. As one indicator, the Canadian government's fiscal deficit as a proportion of GDP is estimated to be 4.6% in 2010, compared with 12.8% in the UK, 11% in the U.S., about 8% in France and Japan, and an average of 7.1% in the Euro area.[2]

5. Direct financial assistance to business was limited to Canada's partnership with the United States to assist the North American motor vehicle sector.[3] The Canadian financial sector continued to operate in the usual manner and to be profitable throughout most of the recession period. Moreover, Canada did not adopt "Buy Canadian" or other domestic preference policies, and in fact had to absorb a major appreciation of the Canadian dollar relative to the American dollar, which greatly increased import competition in our domestic market and provided important export market opportunities for producers in the United States and other countries.

1 See in particular OECD (2009b) and OECD (2009c).

2 The Economist (2010b).

3 Waddell (2010).

6. The Government's actions in support of Canada's automotive sector were based on sound principles. These principles include: looking beyond immediate challenges to factors for long-term success; protecting taxpayers; ensuring support is based on strong business cases; making support available to the range of automotive firms; recognising that Canada is part of a highly integrated and increasingly global market; and ensuring that all stakeholders are involved.

7. It has been demonstrated that the effects of a failure of one or more large automotive companies in Canada would not be localised to one province or area of Canada solely. Rather, the supply chain that produces automotive parts, as well as the suppliers of steel, textiles and plastics essential to automobile manufacturing are widespread across Canada. Moreover, the extent of integration in the auto sector is pervasive, and any failure in one firm would have direct effects not only on their suppliers but on competitors as well since the major suppliers sell to all of the assemblers. An immediate shock to the automotive supplier base would pose a risk to the manufacturing operations of the rest of the North American assemblers.[4] As a result, the Government has taken significant steps to support the automotive sector to help it adjust to a rapidly changing global environment.[5]

8. Canada's fiscal stimulus programme largely focused on infrastructure and the provision of other public works and public goods which helped to lay the foundation for greater competition, innovation and national competitiveness in the years ahead. The application of Canada's competition policies, competition laws and other laws and regulations were not softened and made more permissive over this period. Instead, the recession period was business as usual for Canadian governments in their continuing efforts to foster greater competition and competitiveness in Canadian industries and markets.

9. In this regard, during this period in March 2009, the Government of Canada introduced and the Canadian Parliament passed substantive amendments to the core conspiracy, abuse of dominance and merger provisions of the *Competition Act* in order to make competition law enforcement in Canada more effective, and more consistent with the competition regimes of our major trading partners. Over the same period, the Government of Canada made significant amendments to the *Investment Canada Act* that lowered obstacles to foreign investment to ensure that reviews of transactions of net benefit to Canada are focused on larger transactions.

10. In Budget 2010, the Government subsequently announced changes to satellite and uranium foreign ownership rules; and as well announced public consultations on telecommunications for ownership rules which are forthcoming. These changes were designed to increase competition, consumer choice and domestic and foreign entry into these sectors. In short, despite the global economic crisis, the Government of Canada has continued to implement competition policy and related reforms in order to make our markets even more competitive and open to foreign direct investment and global competition. This is one

4 The "too big, important and/or inter-connected to be allowed to fail" externality argument emerged in the financial sector but it also applied to non-financial markets and industries starting of course with the North American and European motor vehicle industries. See Waddell (2010), Beck (2008 and 2010).

5 In 2008–09, the Government of Canada and the province of Ontario provided significant support to Chrysler and General Motors (GM) to help them restructure, through short term loans, debtor-in-possession financing and exit financing. The federal government and the Ontario government made $3.8 billion available to Chrysler. In return, the governments received a 2.5-per-cent equity stake in the restructured firm. Moreover, all of the US$9.5 billion committed to GM has been disbursed. Canada and Ontario received a combined 11.7-per-cent ownership stake in a restructured GM, as well as US$403 million in preferred shares.

reason why outside experts believe the economic recession was shorter and less severe in Canada than in many other OECD and other major economies.[6]

11. Recent progress has been made under the Agreement on Internal Trade (AIT) by the federal, provincial and territorial Committee on Internal Trade (CIT). In October 2009, the CIT approved amendments to the AIT which revised the Agriculture and Food Goods Chapter, extending coverage of the Chapter to all technical measures related to agricultural products. This will further facilitate inter-provincial trade for the benefit of all Canadians, including producers and processors. The Chapter will come into force once all Parties sign the Chapter.

12. In addition, on October 7, 2009, the new Dispute Resolution Chapter came into force. The Chapter will significantly strengthen the enforcement measures for government to government disputes, including monetary penalties for non-compliance with panel recommendations. As well, in August 2009, the revised labour mobility chapter came into force so as to achieve full labour mobility. These revisions will enable any worker certified for an occupation by a regulatory authority of one Party to be recognised as qualified for that occupation by all other Parties.

13. Finally, in order to address concerns expressed by Canadian business with respect to obstacles they face, a work plan on business regulations and standards was approved in July 2009 by the Committee. The primary objective of the work plan is to identify those business impediments (i.e. regulatory discrepancies, overlapping and duplicative regulations) that raise business compliance costs. The work plan targets three areas, namely; reconciling corporate registration and reporting requirements, identifying priority business sectors where licensing requirements impose a burden on business and where greater reconciliation would be beneficial, and strengthening obligations under the AIT as they relate to regulations and standards.

14. Finally, the Government of Canada's March 2010 budget, as well as the budgets of other Canadian governments at the provincial and municipal levels, have laid out programmes to reduce government spending, deficits and debt in the coming years – and thereby promote market competitiveness, economic efficiency and private investment, and business expansion in the future.

3. Exit Strategy Themes That are Important to Canada

15. Canadian financial assistance and other interventions during the global financial crisis and economic recession were designed and implemented in a manner that ensured minimum adverse impacts on competition in Canada, and on the access of our trading partners to Canadian markets. Furthermore, while the exit strategies now being implemented by the Government of Canada and other Canadian governments will be challenging for Canadian citizens, businesses, and industries, these strategies will have positive implications for competition in Canadian and global markets, through further reductions in the burdens and distortions that government deficits and debt place on businesses, consumers, and the operation of markets.

16. The remainder of this note presents a Canadian perspective on how this can be achieved. Particular attention is given to competition policy and law, and the key interactions between competition and other policies and regulatory regimes that are important to achieving this objective. Canada believes that the following principles are of paramount importance.

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6 See The Economist (2010a).

3.1 Build Exit Strategies into Emergency Measures from the Outset

17. Exit strategies and measures to minimise harm to competition, consumers and economic efficiency and to achieve other long-term economic objectives should be built into and made an integral part of the design and implementation of emergency measures and fiscal stimulus programmes from the very beginning.[7]

18. This is done in Canada by designing our financial assistance agreements with industry to minimise negative impacts on competition, competitors, consumers and economic efficiency, meet other public policy objectives as needed, and provide strong incentives to business recipients to repay their loans and to use the government aid to solve their financial and competitiveness problems.[8]

19. Canada has implemented a number of policy approaches to foster adjustment and productivity in the economy, generally including policies affecting the intensity of competition and market access. The implementation of such instruments was guided by the following three principles:

- **Do no harm** through ensuring that: government intervention does not impede competition or the proper functioning of the market or does so to the minimum extent possible; the measures taken do not have any unintended adverse effects on the firm and its suppliers, customers and competitors; and government action would neither precipitate a failure nor impede necessary adjustments; and through considering whether a lack of intervention might lead to a disorderly restructuring that would result in a loss of efficiency in the economy.

- **Determine the systemic effect of business failure** through: identifying the scope of failure and to what extent it is restricted to the firm or alternatively will have a system-wide effect along or across value chains; determining the extent to which the firm is integrated vertically and horizontally into value chains and whether a failure would threaten other parts of the value chain, competitors and/or sectors which rely on the same, interwoven supply chains.

- **Ensure a viable business emerges following a government intervention** by ensuring that: all stakeholders (e.g., shareholders, employees, suppliers) participate in and contribute to the restructuring; and the intervention would potentially result in a net positive return to the firm, the government and the overall economy.

20. In short, any intervention made by the Government of Canada to facilitate company restructuring has to be principled based, conducted on a case-by-case basis, and requires significant review, oversight, due diligence and adherence to strict covenants. In addition, similar to the proposals by the OECD, the Canadian government tightens the terms of financial assistance agreements and imposes other pressures and penalties on beneficiary companies that are: slow to respond to market opportunities; improve their financial and competitive performance; and repay their government loans, repayable contributions and other financial obligations to the government.[9]

21. As noted, the Government of Canada's stimulus programme for FY 2009 and 2010, called Canada's Economic Action Plan, emphasised public infrastructure and other public goods as well as related public policy objectives such as: tax reductions; actions to stimulate housing construction and renovation and skills development; and support to businesses and communities in difficulty (e.g. the auto

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7 See OECD (2008).

8 See Waddell (2010).

9 OECD (2009b).

sector). These measures included increased investments in Export Development Canada and the Business Development Bank of Canada to improve liquidity in the marketplace and to help these two financial institutions to provide further assistance to exporters and small and medium-sized businesses that were in difficulty during the global financial crisis.

3.2 Ensure Effective Competition Policy and Competition Law Enforcement

22. To the extent that some OECD members softened their competition policies and competition law rules during the crisis, a clear statement should be made that from this point on, national competition laws are now being applied in a vigorous and highly co-ordinated manner among all OECD member states and throughout the global economy through, e.g. the work of the OECD Competition Committee and International Competition Network.

23. The emergency measures and fiscal stimulus programmes over the past two years were intended to provide companies in financial distress with *temporary* assistance during a difficult period in order to improve their financial and competitive performance. It was recognised by OECD member governments that some financial and non-financial companies would use this grace period to get back on their feet, while for other companies, the emergency measures may have simply delayed their inevitable exit from the market.

24. As emphasised earlier, a clear signal should be sent to national and international businesses and their stakeholders by Governments and competition authorities in OECD member countries that competition policy and law will not be used and misused in the future to allow anticompetitive mergers, cartels, abuses of dominance and other anticompetitive arrangements and conduct that: (i) would give companies in distress more time to get their affairs in order; but (ii) would cause serious harm to competition and consumers; and (iii) would slow down the processes of stabilisation and reform in national and global financial markets, and of reform and structural adjustment in national and global economies, that are essential to sustainable economic growth and prevention of similar crises in the future.[10]

25. Mergers and acquisitions can play an important role in restructuring and enhancing the strength and stability of the financial sector. In some jurisdictions, these proposals continue to be assessed for the most part from a financial stability perspective. As the economic recovery builds momentum, each proposed merger and acquisition will also need to be assessed by the appropriate competition law jurisdiction or jurisdictions in terms of the competition law standards of the merger's effects on markets. These merger reviews would need to take full account of the important differences between jurisdictions with respect to the extent of competition in their current financial industries and markets, the quality of their financial regulatory regimes, and other considerations that are addressed in a typical merger analysis.

3.3 Apply the Competition Lens to Policies and Regulatory Regimes

26. Exit strategies that remove distortions caused by emergency measures and promote national and global competition, market access and international trade in the future need to go beyond appropriate competition policies and competition law enforcement. The work of the OECD over the past two decades on the interactions between competition law and policy and other policies and regulatory regimes – such as trade, industrial, innovation, and science and technology policies, intellectual property rights, sectoral regulations and regulatory reform, corporate governance and bankruptcy laws, and consumer policy and protection laws – point out that all of these policy and regulatory regimes need to work together to generate the competitive, innovative and dynamic national and global economies that are required to support sustainable economic growth and a better quality of life in the future.

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[10] Beck (2010).

27. This requires that the competition toolkit as well as the consumer impact and other tests and toolkits developed by the OECD and its member states over the past number of years could and should be applied in a consistent pro-competitive manner in removing the global crisis emergency measures and implementing the national and global exit strategies in the coming years.[11] Related policy issues where the competition lens can be applied during the exit strategy period can be especially important in this regard. They include:

- Any "temporary" trade protection measures that impede market access and protect inefficient domestic businesses should be phased out as part of any exit strategies. Their elimination is needed in order to support national and global competition, help to reduce government spending and deficits, and bring government rules into line with WTO and other international trade obligations.

- As noted above, some of the companies that were protected by special measures during the crisis will not have the ability to survive when protections and emergency measures are removed. Governments have a responsibility to ensure that the required bankruptcy, corporate reorganisation and restructuring laws and social safety net programmes are in place so that these failing firms can exit the market in an orderly manner with minimum harm to competition and to the welfare of workers, communities and other stakeholders. Exit strategies to promote competition and sustainable economic growth in the future require competition, bankruptcy, securities, corporate governance and other policies, laws and regulatory regimes that allow the orderly exit of inefficient companies, and the easy entry and expansion of more efficient and dynamic competitors in both financial and non-financial markets.[12]

- National and global policy and regulatory regimes should promote not only static competition in the near term but as well dynamic competition, innovation, technological change and entrepreneurial start-ups in the long run. Despite the economic crisis, the Government of Canada did not intervene in several high profile insolvencies and restructurings, but rather allowed the insolvency processes of Canada and the United States to facilitate the orderly exit or restructuring of Canadian firms. It is likely that some of the companies that received significant financial assistance from governments during the crisis will exit the market as the economic recovery continues. Additional government assistance to these failing firms could simply further distort business incentives and competition and slow down the improvements in private and government "balance sheets" that are so important to sustainable economic growth.

4. Concluding Comments

28. To summarise, the major themes from a Canadian perspective are as follows:

- Financial sector exit strategies and regulatory reform are clearly very important and the emphasis given by the OECD and others to the implications of pro-competitive exit strategies for national and global financial sectors and systems is fully understandable.

- We should go beyond financial sector reform to address how national and global exit strategies and their implications for competition affect the interactions between the financial and non-financial sectors**,** as well as competition, economic efficiency, welfare and related socio-economic outcomes and objectives in non-financial industries and markets.

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11 See in particular OECD (2007) and OECD (2010).

12 OECD (2009b).

- National and global exit strategies of government must send a clear signal to business which changes their strategies and incentives from seeking financial support and protection from governments to taking measures to address their own financial, corporate governance and competitiveness situation.

29. One implication is that more research should be conducted on exit strategies, competition, the interactions between financial and non-financial sectors, and the implications for competition, efficiency, innovation, competitiveness and stability in non-financial markets and industries. For example, the research by Beck[13] and his colleagues on the interactions and tradeoffs between competition and stability could be extended to some non-financial industries, markets and supply chains that have similar characteristics in such areas as network, domino and contagion effects that can make them fragile and subject to collective financial distress that affects all major players in a market, industry and/or supply chain.[14]

30. Without a doubt, financial companies, industries and markets are very different from non-financial companies, industries and markets and therefore the interactions between competition, financial stability and other public policy issues are also very different and complex.[15] However, the lessons we are now learning in assessing the interrelationships between competition, exit strategies and regulatory reform for financial industries could also be helpful in increasing our understanding of similar issues in many non-financial industries with similar characteristics. For example, future research on competition and stability could focus on the implications of different competition/stability relationships in the financial sector on the non-financial sectors, and on the ability of global and national financial sectors to meet the needs of financial consumers and business customers, large and small.[16]

31. Further theoretical, empirical and policy analysis is needed to provide guidance to decision makers in the future on the weight to be given to the "too big to fail" argument and the conditions that either strengthen or weaken this argument that would be relevant to a specific financial or non-financial industry, company or set of companies that are in distress.

32. The analysis as well should address situations when financial assistance to industries and companies is unavoidable, by providing guidance to decision-makers on how the assistance should be designed to minimise the cost to taxpayers; the distortions to competition, the quality of service to customers, consumer welfare and aggregate efficiency; as well as the moral hazard, opportunism and related strategic behaviour problems which delay exit strategy implementation and increase the risks of future business requests for bailout assistance because of high growth/high risk products and strategies, which presume that governments and taxpayers will pay for the downside risks through future bailouts.[17]

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13 Beck (2008, 2009 and 2010) and Beck et al. (2010).

14 See e.g. Cseres K. J. (2008).

15 OECD (2009).

16 See Stiglitz (2010).

17 See Beck (2009).

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