



January 11, 2008

Mr. Lynton Ronald Wilson  
Chair  
Competition Policy Review Panel  
280 Albert Street, 10th Floor  
Ottawa, Ontario  
K1A 0H5

**Denis E. Henry**  
Vice-President,  
Regulatory Affairs

Dear Mr. Wilson:

I am pleased to provide you with Bell Aliant's submission to the *Competition Policy Review Panel*. Bell Aliant believes the work of the Panel is vitally important to the competitiveness and productivity of the Canadian economy. We appreciate the opportunity to provide our views on the challenges Canada's economy faces, and advance some ideas on how these challenges can be tackled successfully.

Sincerely,

A handwritten signature in black ink, appearing to be "D. Henry", written in a cursive style.

Attachment

**Bell Aliant Regional Communications**  
110 O'Connor Street, Floor 14  
Ottawa, Ontario  
Canada K1P 1H1  
Bus: (613) 785-6361  
Fax: (613) 594-9539  
E-mail: [denis.henry@bell.ca](mailto:denis.henry@bell.ca)

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**Bell Aliant Submission to the  
Competition Policy Review Panel**

In Response to ***Sharpening Canada's Competitive Edge***  
A Consultation Paper Issued by the Competition Policy Review Panel

## Introduction

### **Bell Aliant**

Bell Aliant, a widely held, publicly traded income trust, is one of North America's largest regional communications providers, serving Canadians in six provinces—Newfoundland and Labrador, New Brunswick, Nova Scotia, Prince Edward Island, and large parts of Ontario and Quebec. We are the third largest incumbent local exchange carrier in Canada, serving 5.3 million Canadians and employing over 10,000 people. Bell Aliant offers information, communication and technology services that include voice, data, Internet, video and value-added business solutions.

As a leading telecommunications company specializing in regional and rural markets, Bell Aliant has an interest in the Government of Canada's actions respecting business regulation, tax policy and other policies that affect the competitiveness of the Canadian economy. For this reason we make this submission to the Competition Policy Review Panel.

### **The Importance of the Competition Review**

Bell Aliant commends the Government for launching the Competition Policy Review. This Review comes at a critical time for the Canadian economy. Export oriented industries are adjusting to the competitive pressures associated with exchange rate parity with the United States. The economic slowdown in the United States, and the resulting reduced demand for Canadian goods and services, is a serious concern. The manufacturing sector, in particular, is restructuring and downsizing to reflect these new competitive realities and will face relentless pressure to make productivity enhancing investments to remain competitive in this economic environment.

Economists generally agree that the biggest challenge facing the Canadian economy is our productivity performance, and in particular, Canada's widening productivity gap with the United States. With nearly 40% of Canada's GDP derived from exports, and over 80% of Canadian exports destined for the United States, Canada's productivity relative to the US is critical to our competitiveness and standard of living. Yet by recognized measures Canada's productivity is significantly below US levels. Moreover, across the OECD Canada is doing poorly, ranking a mediocre 13<sup>th</sup> among 30 OECD countries between 1995-2000, and alarmingly 20<sup>th</sup> between 2000-05.<sup>1</sup> This poor performance adversely affects competitiveness. The World Economic Forum report ranked Canada 16<sup>th</sup> in global competitiveness in 2006, down from 8<sup>th</sup> place in 2002. The consequences of Canada's poor productivity performance for competitiveness and our standard

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<sup>1</sup> Conference Board of Canada, *Mission Possible: Stellar Canadian Performance in the Global Economy, The Canada Project Final Report Volume 1, 2007*, Chapter 2, p. 1

of living puts increasing pressure on governments to act quickly and in a strategic and aggressive manner.

## The Causes

According to most studies, Canada's weak productivity performance is attributable to a number of factors, including private sector under-investment in research and development and machinery and equipment--in particular information and communications technology (ICT). One recent OECD study found that Canada's productivity growth since 2000 has lagged the US because "Canada failed to benefit from the same wave of technology adoption that was driving productivity growth up in the United States and other high-growth OECD countries".<sup>2</sup>

Recent studies have also shown a skills mismatch in the Canadian economy, with a particularly worrying shortage of ICT professionals. A forthcoming Conference Board of Canada report predicts that demand for information technology workers will out-strip supply in the next few years. Computer science undergraduate enrolment in Canada has declined by 46% during 2002-06.<sup>3</sup> There are not enough Canadian students studying computer sciences, but also math, engineering and natural sciences--disciplines that are all crucial to innovation and hence productivity. This is puzzling because there is no lack of demand in Canada or globally for these skill sets—quite the contrary in fact.

No less a factor in productivity growth performance is the extent to which companies face burdens and costs associated with unnecessary and outdated regulation. The government's actions to date in reducing regulation and commitments to reduce regulation further, articulated in its science and technology strategy and other documents, have been very positive developments.

Investment in ICT and the associated infrastructure, such as broadband, is also increasingly important to the sustainability of many rural and remote communities in Canada, where economic opportunities are typically more limited and where disparities in economic growth and income persist. ICT investment and diffusion will enhance the economic prospects and social benefits for people and businesses in these communities.

With this as backdrop, Bell Aliant recommends the government of Canada pursue a strategy aimed at major improvement in Canadian productivity growth performance, especially relative to the United States. Any such strategy needs to

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<sup>2</sup> Cited in Barrie McKenna, "IMF, OECD urge Canada do drop foreign ownership caps", *Globe and Mail*, December 20, 2007

<sup>3</sup> Conference Board of Canada, "Securing our Future: Components of a Comprehensive IT Workforce Development Strategy", forthcoming in January 2008

put an emphasis on policies that stimulate business investment, in particular in ICT.

### **Time for a Productivity Strategy**

The federal government is to be commended for three recent initiatives that will have a positive impact on Canada's productivity growth performance and the competitiveness of the Canadian economy:

- The elimination of the corporate surtax in 2008 and reduction of the federal corporate income tax rate that will bring the tax rate down to 15 percent by 2012, from more than 22 per cent today (which will free up capital for productivity enhancing investments);
- The Government's Science and technology strategy, *Mobilizing Science and Technology to Canada's Advantage*, which should lead to more innovation in the economy, spurring productivity growth;
- Regulatory reform, notably with respect to the telecommunications industry via, among other things, the Cabinet's Policy Directive to the CRTC in December 2006 ("Implementing the Canadian Telecommunications Policy Objectives"), which directed the CRTC to "*rely on market forces to the maximum extent feasible as the means of achieving the telecommunications policy objectives, and when relying on regulation, use measures that are efficient and proportionate to their purpose and that interfere with the operation of competitive market forces to the minimum extent necessary to meet the policy objectives.*"<sup>4</sup> This Direction represents a philosophical sea change in the federal government's approach to regulation. It recognizes the productivity, efficiency and competitiveness advantages to Canadian businesses and consumers from a greater reliance on market forces and a lesser resort to intrusive regulation.

These three initiatives are major steps in the right direction and Bell Aliant urges the government to remain on the course of corporate tax reductions, de-regulation and incenting investment in science, technology, innovation and human capital.

Solving the productivity dilemma will take time, patience and focussed action in a select number of policy areas. Now is the time to act, especially given Canada's reasonably strong fiscal position in a time of worsening productivity performance and declining global competitiveness.

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<sup>4</sup> Government of Canada, "Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunications Policy Objectives", 2006-12-27, *Canada Gazette Part II, Volume 140, No. 26*

A productivity strategy could be underpinned by explicit and ambitious “stretch targets”, such as the goal of closing the Canada-US productivity gap within 7-10 years. An explicit target could focus government decision-making on this strategic priority and become an organizing principle for all federal economic policy going forward.

### **Where to Act?**

The Competition Policy Review panel consultation paper stated: “*one contributing factor [to slow productivity growth] is an apparent underinvestment in machinery, equipment and technology, which are all important drivers in boosting productivity*” (p. 7). Bell Aliant sees this underinvestment as a major contributing factor to Canada’s poor productivity performance, particularly with respect to investments in Information and Communications Technology (ICT).

It has been estimated that, during the period 1997-2001, the ICT sector was responsible for over 40% of productivity growth in Canada.<sup>5</sup> One study has estimated that 70% of the productivity gains in Canada over 1995-2000 were attributable to the ICT industry.<sup>6</sup>

The real economic gains associated with the transformative power of ICTs and networks, however, result from the diffusion of the technology and its widespread adoption by businesses and workers economy-wide, as well as its use by consumers. Unfortunately, ICT diffusion in Canada, particularly its adoption by business, is not impressive by international standards. Fuss and Waverman have calculated that 56% of Canada’s productivity gap with the US is attributable to insufficient ICT diffusion throughout the Canadian economy.<sup>7</sup> Other estimates conclude that Canada invests 30% less in ICT than the US. Only 50% of Canadian small and medium sized businesses are using or implementing Internet business solutions versus 61% in the US. And Canada ranks 17<sup>th</sup> in *The Economist*, Information and Communication Technology Index-- a measure of ICT usage, which includes per capita measures of telephone lines, internet usage, personal computers and mobile phone users.<sup>8</sup>

This underinvestment is partly the result of high marginal effective tax rates (METR) on ICT assets in Canada. According to the Telecommunications Policy Review Panel, Canada’s METR on ICTs is about 47%, as compared to 32% for

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<sup>5</sup> Statistics Canada study cited by Richard Simpson in “From Electronic Commerce to e-Economy: Strategies for a Digital World”. Presentation in Mexico City, September 4, 2004, p. 5

<sup>6</sup> Bart van Ark, Robert Inklaar and Robert H. McGuckin, “The Contribution of ICT-Producing and ICT-Using Industries to Productivity Growth: A Comparison of Canada, Europe and the United States, *The International Productivity Monitor*, Spring 2003, p. 59

<sup>7</sup> Melvyn Fuss and Leonard Waverman, “Canada’s Productivity Dilemma: The Role of Computers and Telecom”, Bell Canada’s submission to the Telecommunications Policy Review Panel, August 2005, p. 5

<sup>8</sup> *The Economist*, Pocket World in Figures, 2008 edition, p. 62

machinery and equipment excluding ICTs. More generally, Canada's effective tax rates on capital investment are the 8<sup>th</sup> highest of 81 industrial and developing countries.<sup>9</sup> These tax rates are clear impediments to productivity growth.

## Policy Recommendations

Bell Aliant recommends the following initiatives as part of a productivity growth strategy:

1. **Establish a temporary ICT Investment Tax Credit (for five years) to reverse the underinvestment of ICT.** The Telecommunications Policy Review Panel concluded that an Investment Tax Credit would be the most effective way to reduce the METR on ICT investment. ICT tax credits already exist in Japan, South Korea, Spain and various US states. The tax credit should be for incremental investments in computers, communications equipment, software, computerized manufacturing equipment, training and other expenses related to ICT investments. The tax credit should be refundable to small and medium sized businesses to incent firms that do not pay tax to make needed productivity enhancing investments;
2. **Increase significantly federal ICT research funding.** ICT is a strategically important sector for Canada. The Council of Canadian Academies report "*The State of Science and Technology in Canada*" identified ICTs as one of four principal clusters of technology strength in Canada. Yet this cluster has not been treated as strategically important from the standpoint of federal research and development funding. A more co-ordinated and strategic funding of ICT research would have positive effects on productivity growth in the longer term by increasing Canada's strength in the transformative technologies that flow out of ICT research, producing economy wide spill-over effects;
3. **Increase the talent pool of ICT professionals through a variety of means,** including immigration system and credential recognition reforms. As the government noted in its science and technology strategy, such an effort will require co-operation with other levels of government, universities, colleges, the private sector and not-for-profit stakeholders. Consideration should be given to establishing a specific target increase in ICT professionals, as Germany and Ireland have done;
4. **Continue to reduce taxes and reform tax systems that impede capital formation and business investment in productivity enhancing technologies, with a particular emphasis on sales tax harmonization.** The federal government's recent initiatives to significantly reduce statutory

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<sup>9</sup> Conference Board of Canada, *Mission Possible*, p. 60

corporate tax rates and eliminate capital taxes will make Canada more attractive to foreign investors and free up resources for Canadian based firms to invest in physical and human capital, which should improve productivity performance. We encourage the Government to continue to seek the collaboration of provinces and territories to reach a lower, combined federal-provincial-territorial statutory corporate tax rate. Another piece of unfinished tax reform business is harmonizing provincial sales tax regimes with the GST, which Atlantic Provinces did a decade ago to the benefit of their economies<sup>10</sup>. Provincial retail sales taxes are particularly high on business inputs, including purchases of capital goods such as ICT. This distorts economic decisions and discourages productivity enhancing business investment. Bell Aliant commends the federal government for its commitment to tax harmonization, articulated in Budget 2007 and the 2007 Fall Economic Statement. We urge that this agenda be pursued with the provinces with renewed vigour.

## **Conclusion**

Bell Aliant would like to thank the Competition Policy Review Panel for seeking input to their process. We believe the work of the Panel is critical to Canada's competitiveness and economic performance. We urge the panel to be bold and strategic in its recommendations to the government. The competitiveness of the Canadian economy, and the living standards of Canadians, depend on it.

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<sup>10</sup> See Michael Smart, "Lessons in Harmony: What Experience in Atlantic Provinces Shows About the Benefits of a Harmonized Sales Tax", C.D. Howe Institute, 2007