

The Joy Of Productivity

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In today's Internet world, communication is faster than ever before. More information is available at the touch of a finger than could have been imagined just ten years ago. The pace of change is accelerating and competition knows no boundaries. In order to prosper, you have to be proficient and innovative, or you will never make the grade. It is no easy task becoming a world leader in business or politics. Governments must aid and abet productivity and research, striving to improve the lot of the public at large.

CHEQUES AND BALANCES

Anyone who has been an investor will understand why the shares of conglomerates sell at a discount to what the various and sundry divisions might fetch if well-managed and traded on their own. As difficult as it is to find one top-flight CEO, it is virtually impossible to hire competent people to guide each of the components. Proof is the case of ACE Aviation Holdings Inc., its main subsidiaries being Air Canada, regional carrier Jazz, the Aeroplan loyalty programme, and the aircraft maintenance, repair and overhaul division. The recent Air Canada IPO, priced at \$21, soon crashed down to \$15.65 a share. No one would take the blame – not the underwriters, management or the hedge funds. All suggested “market conditions” were at fault, despite the S&P/TSX composite going nowhere but up. Instead, it was likely the result of the greed of the underwriters claiming an overabundance of orders, and the company's senior executives agreeing to increase the size of the offering from \$400 to \$525 million. Or might it be because of Air Canada's long history of being poorly run, or all of the above?

Apply this train of thought to governments, and you can easily understand why politicians often fail to deliver on what they vowed to do. Both the Liberals and the Conservatives have, at times, expressed a sleight-of-hand vision for improving Canada's economic performance. Rather than a radical agenda, there is nothing in the prime minister's recent economic and fiscal update so provocative to the Opposition as to force an election. It is sketchy and disposable at best. Those who had their fingers crossed hoping the combined federal and provincial spending might eventually be cut back and limited to one-third of GDP, down from its present level of 41 percent, are disappointed. As they are with the goal to limit the increase in programme expenditures to an average of one percent less than the growth in GDP when, in fact, the Tories plan to bump up spending by \$13.2 billion, or 7.1 percent, on top of the mind-blowing 47 percent increase over the previous six years approved

by the Grits. Put another way, whereas Paul Martin pledged to hold the line at 3 percent per year, only to average 8.2 percent, Stephen Harper proposes an increase that is well above the projected nominal GDP growth rate of 4.6 percent in 2007. Certainly not as expected, nor will it help to improve economic competitiveness, or raise the level of prosperity. Meanwhile, Canadians will have to take a back seat and wait for comprehensive tax relief.

As to paying off the \$481.5-billion national debt which costs taxpayers \$34 billion per year in interest payments, the finance minister targets to eliminate the “net debt,” being the combined federal, provincial and municipal ownings, less the accumulated assets of the Quebec and Canada pension plans. Hardly a challenging objective, less than the repayment rate in recent years, and certainly not a great leap forward as claimed.

Deep within the endless acronyms and ponderous prose, the auditor general’s latest report delivers a message of concern about the freewheeling spending habits of the federal government. New programmes are simply piled on top of old ones. There is no systematic evaluation of the effectiveness or relevance of any particular initiative. Departments and agencies do not have to submit performance data to show that the money was wisely spent. Given as the Treasury Board has been allowed to cloak its doings in secrecy, the Conservatives are going to have a difficult time fulfilling their promise of accountability.

Though the wise are delighted there will not be a further reduction in the GST, as it was a dumb policy to begin with, lowering taxes on savings income and considering opportunities to decrease distortions is not enough. Neither is the notion the federal government will dedicate the reduction in annual interest payments arising from debt repayment to tax cuts, as such will never amount to much. Removing interprovincial trade barriers, and the implementation of a national securities commission, aiming to reduce red tape by 20 percent might. If the Conservatives fail to leave more of each dollar earned in people’s pockets, there is no chance whatsoever of improving the country’s overall level of productivity. With real estate developers scrambling about trying to accommodate the rapid increase in the size of the bureaucracy, even though functions are being transferred to the provinces, how can those in Ottawa have the gaul to suggest they are acting in the best interests of the average Canadian? By its very nature, Parliament cannot provide people with energy, initiative or happiness. Those things they must do for themselves. If it tries to make provision for everyone’s welfare, it will only succeed in having those who shirk the responsibility for their own well-being become dependent, petulant children. It would be better if the swivel servants buzzed off, and Ottawa stopped writing cheques.

FOREIGN INVESTMENT POLICY

The governor of the Bank of Canada seems to be constantly wringing his hands trying to reduce the rate of inflation and, thereby, enhance our economic freedom, lower interest rates, stimulate investment and other long-term economic projects. Minimizing this hidden tax will also help to raise the price-to-earnings ratio investors are prepared to pay in buying stocks, and consequently decrease the cost of equity capital. Though bond yields have subsided in recent years, and the price of shares which pay a generous dividend boosted, there remains the risk of deflation.

This brings back to mind the question as to whether or not we should be concerned about takeovers by foreigners. Did those of Inco, Falconbridge, the Hudson’s Bay, Dofasco, Intrawest and Vincer have a positive or negative impact? There is no doubt the shareholders made out like bandits. The mines, stores, mills, ski slopes, and vineyards

never moved away, and additional capital investment made each more productive. Left to their own devices that might not have happened, at least not as quickly. The minister of finance is now toying with the idea that if “a large state-owned enterprise with non-commercial objectives and unclear corporate governance and reporting” was to take a run at a substantial Canadian company, it should not be allowed to proceed, “as it may be a threat to our long-term interests.” Notwithstanding these concerns, the government must not get in the way, given as foreign investment has been falling, no other G7 or OECD country’s decline as great as Canada’s, policy restrictions and screening procedures the main cause. Furthermore, these sort of constraints limit the ability of Canadian firms competing in the global economy to attract expertise, strengthen their customer base, pursue new opportunities, and improve productivity. The quest should be to maximize the benefits of foreign investment. Inventing obstacles is a bad idea.

Instead of burying our heads in the sand and worrying about Canada being hollowed out by foreign takeovers of household names, we should celebrate the fact that there are more world-class Canadian companies these days than ever before. In 1985, thirty-three were ranked among the top five in their particular business. According to the University of Toronto’s Institute for Competitiveness and Prosperity, we now have seventy with a dominant position in their respective niche market. Our next target should be one hundred. Rather than trying to dissuade foreign investors, politicians must encourage competition, lower taxes on investment, and eliminate barriers to free trade.

LAGGING BEHIND

Canadian labour productivity continues to lose ground. The sluggish performance is the downside to the upbeat story that the jobless rate is at a three-decade low. Historically and sensibly, the trend in competency has correlated with movements in corporate profitability. Unfortunately, many Canadian firms have bucked that relationship, the advances due more to stronger prices, not because of having done a better job. The risk is that when profits eventually take a tumble, it will reveal the general lack of underlying gains in efficiency. According to the Centre for the Study of Living Standards, Canada’s relative level of proficiency among industrialized countries has slipped from fifth to seventeenth place since 1973, to only 73.7 percent of that of the United States, its lowest level since the 1950s, down from 91.4 percent in 1984. The good news is that our slowing economy may get a boost from the marked increase in the rate of capital expenditures, which should start to pay off in higher profits over the next several years. The total growth in capex for the third quarter of 2006 was 27.3 percent, the fifteenth consecutive double-digit quarterly advance, the thirteenth above the long-term average of 17.9 percent. Notwithstanding, domestic productivity could still erode if capacity utilization rates fall, which seems likely if the economy weakens.

Despite rapid global economic growth, and the dazzling opportunities technology affords, new plant and equipment outlays by the bigger companies have been anything but impressive. Their ratio of capital expenditures to net free cash flow is at a forty-year low and stock buybacks at an all-time record level. So far, it is only the little guys who are investing in the future. For all its talk about entrepreneurial capitalism and risk taking, the investment community’s shortsighted concerns about the near-term impact on profit margins and per share earnings, outweigh the prospects for improved productivity and greater returns longer-term. Instead, the investment bankers and institutional investors are

promoting mergers and acquisitions, believing they are less disruptive. Though some may seek shelter in the more liquid large-caps, there is sound reason why the performance of the more venturesome small-cap stocks continues to lead the way, and by a wide margin.

While those in Ottawa stood by, China supplanted Canada as the US's biggest supplier. It also accounts for 9 percent of Canadian imports, triple the tally in 2000. Not only does it have a vast pool of cheap labour and the most modern of production facilities anywhere in the world, it is being helped along by an undervalued currency. Tied to the greenback for most of the past decade, the 43-percent gain in the purchasing power of the loonie has also meant roughly the same vis-à-vis the renminbi. However, despite the hue and cry about the loss of something like 210,000 jobs in manufacturing, primarily in Quebec and Ontario, our unemployment rate continues to decline. Which means, in effect, that there is a shortage of skilled labour, and explains why Canadian business leaders and exporters are lobbying for faster write-offs for new investment, improved research and development credits, and additional allowances for training among other measures. The US whipped itself into shape a decade ago by shedding jobs and boosting productivity. Employment has stabilized, and output is up 6 percent over the past year, compared to a 2 percent drop in Canada. It is high time we got in step. Without reinvestment in growth – the key ingredient for improving productivity and sustaining stock-market values – we do not stand a chance of keeping up with our neighbours, or the Chinese.

DEPRECIATION VERSUS CORPORATE TAX CUTS

Some argue that corporate income taxes are destructive, that they reduce investment and economic growth, jobs and wages, and are hidden in the price of the necessities of life. But, must they be lowered or eliminated for Canada to be competitive on the world stage, or would accelerated depreciation allowances trigger a further increase in capital investment, and a greater rate of gain in productivity? US companies pay income, federal and state taxes equal to 1.8 percent of GDP; Canadian businesses pay the equivalent of 3.4 percent. (Personal income taxes currently account for 7.8 percent.) Their marginal effective rate for equity-financed investment in machinery is 23.6 percent, our's is 24.8 percent. The real tax rate when debt-financing is used, is negative 45.9 percent there, negative 37.9 percent here. Most of our significant enterprises are flush with cash. Unless CEOs are willing to pay the excess funds out to the shareholders, or invest in the future, or both, there is little reason to believe tax reductions will result in productivity improvements. Quite the contrary. Corporate welfare is just for bums.

ENVIRONMENTAL CONCERNS

Complicating matters is a new poll which found that, with the exception of health care, the environment topped the list of national issues for the first time since 1990. It is considered to be a real concern, not just one of the faux subjects people tend to tell the pollsters they care about because they think it is what they should be saying. It also played a key role in the stunning shift that saw Republican control of the United States Senate and House of Representatives handed over to the Democrats. Stephen Harper has obviously got the message, and is unlikely to allow such an opportunity to score points go by before the next election. He will undoubtedly introduce stricter measures aiming to reduce air pollution and contain so-called greenhouse gas emissions, before Stéphane Dion tries to steal his political thunder. There is absolutely nothing either can do to change the weather!

However, before the voters go off half-cocked, they must come to realize that these issues are not interrelated. The first has to do with the quality of the air we breath, the second is about global warming, and the third concerns the forces of nature which continue to be unpredictable. Great strides have been made in Europe and North America in reducing air pollution, not so the case in India and China. Though there is no doubt that temperatures about the globe are rising and the trend seems to be accelerating, the cause – and what if anything can be done about it – remains in question.

When politicians respond quickly to headlines, as they all too often do, they cause more damage than good. Al Gore's documentary, *An Inconvenient Truth*, is a perfect such example. At no point in his claim that carbon dioxide emissions are the cause of global warming does he discuss the natural evolution of the planet. Nor does he seem to understand that, were it not for the strata of remains of many millions of extinct animal and plant species, there would be no reserves of crude oil and natural gas. Neither is mention made of the effect of the ongoing deterioration of the physical condition of the glaciers and snowcaps. Yet we all know that ice cubes in our freezers, though kept at a constant sub-zero temperature, turn frosty within days, soon stick together, shrink in size and will melt away in a glass of cold water in no time at all. Just imagine what would happen if they were exposed to nature for zillions of years?

Ever since the time of the ice age the depth and size of the glaciers and snowcaps have progressively diminished. As a consequence of pitting, coning, and calving, the relative extent of the surface area has increased measurably, thereby accelerating the process. So too has the rate of vaporization, and such will continue to be the case ad infinitum. Which explains why there are likely to be more thunderstorms and tornadoes as time goes on. If you think that the recent increase in carbon dioxide emissions is to blame, you had better brush up on your knowledge of physics, as in its solid or liquid state it acts as a refrigerant, as a gas it is used as a fire retardant!

Rather than have the parliamentarians question the press coverage of advocacy groups with error-proned studies based on inconclusive data, it is far easier for them to blame the private sector and force it to pay for their folly. As the Europeans have discovered to their horror, if Canada was to meet its Kyoto Accord commitments it would undermine the economy, the impact on global climate would be minimal. The protocol is but a mindless step towards a much more Draconian future. In the face of an alleged tsunami of public concern, matched only by the voters ignorance, it is not surprising the Conservatives have "gone green" for fear of the ballot count come the next election. If the unusual winter weather in Canada and the hypocritical howls of the Opposition members were to cause the government to fall over this issue, it would be a travesty. As a matter of cynicism, there is no point in doing anything until the true facts are known and every major or developing industrial power signs on and, more importantly, keeps to its commitment, which the Liberals failed to do on all accounts. In fact, emissions are worse today than ever before, and more overseeing by dead weight bureaucrats is not the answer to the claims by either the brainless parrots, or those whose real interest lies in their very own near-term political future. Climate change is an inevitable reality. It has been so since long before the dawn of man. Human ingenuity rather than grand top-down political schemes is the better way to solve any and all of the world's problems. Drastic action at a national level is sheer insanity.

At the risk of committing heresy, the debate in the House of Commons and the media ought also to include a fair assessment of the benefits alongside the declamation of harm,

though such is unlikely to occur in the heat of the political battle. Nonetheless it should be noted that, thanks to conservation, cross-border cooperation, warmer weather and thus easier access to food, the worldwide count of the majestic polar bear has increased from 5,000 to 10,000 in the 1950s and 1960s, to between 20,000 and 25,000 today. Like the federal government's proposal to limit pollution and greenhouse gases, the future of the Earth's largest carnivore had best be debated in the open. The fright about its prospects would appear to be a triumph of politics over reality. They are certainly not drowning as a few alarmist claim. The very notion of an international "cap-and-trade" emission scheme is another questionable thought, as it will do nothing to reduce carbon dioxide levels on a universal basis. It would only benefit the brokers who make the market.

Like the more renowned economists, who usually get the magnitude of deviation right but seldom the direction, the many concerned about the threat of anthropogenic climate change are grasping at straws. The boondoggle that ethanol in gasoline will reduce overall carbon dioxide emissions is but a reflection of the corniness of crowds, in that more will be the result not less. Instead, the politicians would be well advised to start asking about what we might learn from nature to improve commerce. There are many investors who have seen the light. It is time the business and government leaders did likewise, if for no other reason than to cover their own backsides. If the Conservatives have their political wits about them, they will do all they possibly can to promote investment in more fuel-efficient plants, machinery, automobiles, buses and trucks. Make every effort to balance the sources of energy by encouraging the private sector to expand the supply of solar, thermal, tidal, wind, hydro and nuclear power, none of which emit gases of any kind; and pray for great weather and an impressive turnout on election day. Providing they stick to the party's basic principles, there is a better than even chance the Tories will defeat the Grits and gain a majority. Canada's productivity statistics will improve, wages and benefits increase, common stock prices rise, our position on the international stage come back to the fore. There is little anyone can do to stop the glaciers and ice caps from melting. Such has been the case ever since time began. The good news is that Canada stands to succeed despite the foolishness of its misinformed citizens, the politicians and their carrot-and-stick policies. Not because of them!

THE ADVANTAGES OF ONE CANADA

In 1839, Lord Durham, Governor General of British North America, commonly referred to as Radical Jack for his controversial philosophies, called for the union of Lower and Upper Canada, and the assimilation of *les Canadiens*. As a result of his blatant insensitivity and fundamental miscalculation, we have been skating on thin ice ever since. Nothing does more to lessen the chances of improving our standard of living than the seemingly endless debate about Quebec's future within Canada. To most Canadians the resolution calling the Québécois a nation within a united Canada is a meaningless exercise. It is but gamesmanship begun by a mistake-prone candidate for the Liberal leadership, picked up on by a mischievous separatist leader, and played to the hilt by the prime minister and, I must add, the new leader of the Opposition. To expect politicians to put their conscience ahead of the party line, is to be naive. Certainly, the two Steves have not done so!

Politics is a rough business. It can be ferocious and often treats with great harshness or irony those who are drawn to it. The recent convention in Montreal was a golden opportunity to recast the Liberal Party's image of scandal and cronyism, modernize its

message, and take hold of the future. Instead the delegates dwelled on the Canada of old. Opposed to everything the Tories stand for, they failed to offer alternatives. Despite the power and population shift to the west, finding a person with courage and wisdom to guide them through the next unity challenge, and capable of rebuilding their presence and support in Quebec, became the ultimate focus. Whether Stéphane Dion is up to the task of gaining a majority in the next federal election remains a mystery. Perhaps he and his kingmaker, Gerald Kennedy, have what it takes. But, I have my doubts.

Meanwhile, if Canada is ever to get ahead in the world, we need to speak about a common identity, and move beyond emphasizing our differences. One Canada is still the choice of most Canadians, including a large minority in Quebec. So why all the fuss, when the time wasted could be better spent improving the country's well-being and competitiveness. There is nothing quite like the joy of productivity!