

## From the Hollowing Out of Corporate Canada, to the Productivity Challenge

*Gordon Nixon is president and CEO of RBC Financial Group, Canada's largest bank and financial services institution. In Toronto recently, he met in his office at RBC headquarters with Policy Options editor L. Ian MacDonald for a discussion of economic public policy issues, notably the "hollowing out" of corporate Canada, productivity challenges facing the country, the exchange rate and the question of a common currency in an integrated North American market. Nixon also argues that bank mergers and resulting economies of scale and critical mass represent an important growth opportunity for Canadian banking in an increasingly globalized industry.*

*Gordon Nixon est président et chef de la direction de RBC Financial Group, première société canadienne de services financiers et bancaires. Au siège social torontois de son entreprise, il s'est récemment entretenu avec le rédacteur en chef d'Options politiques, L. Ian MacDonald, d'une variété de questions et de politiques économiques, y compris le « creux de vague » que traversent les grandes entreprises du pays, les défis liés à notre productivité, le taux de change et l'éventualité d'une monnaie unique en Amérique du Nord. M. Nixon y parle aussi des économies d'échelle et de la masse critique résultant des fusions bancaires, lesquelles constituent à ses yeux une excellente occasion de croissance pour les banques canadiennes à l'heure de la mondialisation accélérée du secteur.*

**Options:** You've spoken of the hollowing out of corporate Canada. What did you mean by that?

**Gordon Nixon:** I spoke of the hollowing out of corporate Canada as a symptom of the fact that Canadian industry has lost some of its competitiveness relative to other countries. And as a result of that, we've had a number of our leading companies in our critical industries that have been taken over, in many cases by foreign entities, and particularly American companies. And as a result, we've had a significant loss of head offices and industry leaders, which has an important impact on our cities and on our economy and the overall stature of our business community.

**Options:** You referred, as an example, to the oil and gas sector, where there had been 58 companies on the index and now there are only 11 from that original group. What are the implications of that in the oil patch to the head office situation in Calgary?

**Gordon Nixon:** I think it's had a very dramatic impact on Calgary. A lot of the mid-size companies in Alberta have disappeared as a result of takeovers, and I say particularly foreign takeovers. And there is no question that it's had an impact on the scale of the industry and the activity level of that marketplace.

**Options:** You referred in one speech to declining Canadian competitiveness and a benchmarking report by Roger Martin of University of Toronto and Michael Porter of Harvard, that Canada has slipped from third to fifth place. What would be the role of the exchange rate in that? Of the weak dollar?

**Gordon Nixon:** My own view on the exchange rate is that it is in some cases a bit of a crutch, if you will, for a lack of competitiveness. It acts almost as a buffer to protect us to some degree from issues of competitiveness in areas like productivity and innovation. I would argue that the economic performance of Canada and the strength of our econ-

omy is partially a result of our currency offsetting some of the slippage that we have had in keeping up with the United States, in areas like productivity, innovation and competitiveness.

**Options:** You pointed out that, in terms of technological upgrades for Canadian industry though, all of these things are denominated in US dollars.

**Gordon Nixon:** Absolutely. It's a circular argument, because what it does is it acts as a buffer against productivity improvements by essentially making our industries compete on the cost of labour, etc.—costs of production. But the cost of investing in our industries, which are primarily denominated in US dollars, becomes more expensive. If we want to invest in technology, if we want to invest in innovation, the weaker currency hurts that. So it becomes circular. We do more to compete, on the basis of a low cost currency, as opposed to on the basis of investing in technology and innovation.

**Options:** Is the 63-cent dollar in itself a comment by the world markets on Canadian productivity? Mr. Chrétien likes to say it's just kids in red suspenders in Chicago and New York.

**Gordon Nixon:** Well, it's combination of the two. And it's primarily the former as opposed to the latter. The US dollar clearly has a premium because the US is viewed as the most powerful reserve currency in the world, and the US is viewed as a very attractive place for foreign investment. So, as a result, I believe there is a bit of an artificial premium to the US dollar relative to fundamentals, whether it's trade balances, whether it's purchasing power, or whatever. But there is no question that it's a reflection of the fact that Canada's productivity rates and ability to compete are reflected in a weaker currency relative to the United States. And if Canada had higher productivity rates than the United States, then clearly we would either have a stronger currency, or we would have an even stronger competitive position relative to the US industry.

**Options:** In the integrated North American economy, the NAFTA area, we have some Canadian companies such as Alcan and Nortel, as you know, that now denominate all their sales in US dollars. Do you think we are, or should be, moving towards a common currency in North America?

**Gordon Nixon:** I don't believe there is any such thing as a common currency in North America. We either convert to the US dollar or maintain

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our own currency. I don't believe that the US is going to share governance around things like monetary policy. So it's a question of whether we migrate towards the US currency. And I don't think that that is appropriate at this juncture, for two rea-



Photo Jean-Marc Carisse

RBC President Gordon Nixon testifies before the Senate Banking Committee hearings on bank mergers. "Consolidation of financial services would be good for the long term in our industry," he tells *Policy Options*.

sons. The first reason is I don't believe the Canadian public is ready for it. It's a political reason, but I think that's the reality of our country. But, secondly and very importantly, I think our dollar provides a buffer against economic shocks that result from lower productivity or lower competitiveness and that is something that you want to maintain with respect to flexibility in your currency. If you look at countries in the world that have fixed exchange rates with the US dollar, when they run into economic challenges, or have

economic problems, they don't have the buffer of currency to protect themselves against economic shocks. And I think that's very important.

**Options:** So that in the event that we were to move towards the US dollar, the governor of the Bank of

Canada would be one of 13 members of the Federal Reserve and that's it. That would be the extent of our control over monetary policy?

**Gordon Nixon:** Clearly the ability of the governor of the Bank of Canada to influence our economic situation would be reduced. And I think that's a very powerful tool.

**Options:** Do you think that control of monetary policy is an essential attribute of national sovereignty?

**Gordon Nixon:** I think it's pretty important. I would at this juncture be uncomfortable about not retaining control of our monetary policy. Maybe at some point, we'll evolve, as a North American economy, to the point where it becomes less of an issue, but we're not there. Remember we do not have an open market with the United States currently. We don't have free flow of labour. We don't have totally open transportation and open borders. There is not even total free trade with the United States. Look at softwood lumber. Look at steel. So I very much agree with David Dodge's viewpoint that we've got to be tackling a lot of fundamental issues that relate to an open econ-

omy before you get into discussion about transparent currency.

*Options:* In recent speeches, you focused on Canadian competitiveness and productivity. How do you see the major issues?

*Gordon Nixon:* We laid out a number of areas of focus to improve Canada's competitiveness and productivity. And I think one of the challenges around the issue of productivity is that you have to take an incrementalist approach to improve your productivity rate, and it takes a very long period of time and it takes the buy-in from a lot of different constituents. It's not like fighting deficits, where you can set a financial budgetary target and you can essentially run your books to achieve that target. When you get into issues around productivity, you're talking about things like research and development, investment and education, training of the workforce, economic clusters, all of those issues. And I think the key challenge for us as a country is how we establish what the five or six real priorities are that we're going to work on, and actually start talking about implementation and execution. They also involve things, of course, like tax rates, regulatory inefficiencies. One of the issues that we face is everyone talks about regulatory inefficiencies, everyone recognizes that we've got huge regulatory inefficiencies in this country. At some point we've got to start talking about fixing them. And that's the challenge. We as a country are good at identifying some of the inhibitors to enhanced productivity. It's a question of how you actually mobilize public policy, labour, business, politicians, and so on, to implement some of those solutions around it.

*Options:* There was a time when eliminating and reducing the deficit was the major economic issue in the public policy agenda. Is productivity the next big idea?

*Gordon Nixon:* It's certainly "a" next big idea, and I think it's currently an issue which is going to set the stage for strengthening of our economy as you look out over the long term. But it's

a very tough one to communicate to the general public, because it's not like deficits where people can understand the fact that we borrow more money than we have, and at some point we have to repay that money. When you start talking about productivity, everybody agrees that if we can enhance productivity, if we can enhance innovation, we would be better off for it. There is no disagreement in any constituent body around that issue. The problem is how you actually execute a strategy to get there. It revolves around issues like funding of education, cutting taxes, regulatory barriers between provinces, health care, all of those issues come into play. As soon as you start talking about the individual issues, then you get huge divergence between various constituents in the community. So how you actually mobilize solutions to some of the issues around higher education, around cluster development, around tax reductions, and so forth, is much tougher.

It's great for people to stand up and say "Canada should have a goal of becoming fifth in the world in research and development spending by 2010." Having goals gives you targets to shoot for, there is nothing wrong with that. But at the end of the day, at some point, you've got to talk about how you get there. Execution is the order of the day and that's where there are challenges. We can't mobilize any kind of consensus in this country around something as simple as national securities regulations. We can live with the existing system (of regulators in every province). But to me, it's sort of symptomatic of a number of regulatory inefficiencies that we live with in this country.

So I think the challenge with productivity as an issue is there is a whole bunch of incremental things that we have to keep working on, to make ourselves a more competitive country. It's a very tough issue to mobilize a sort of political consensus around.

*Options:* In terms of communicating the importance of this issue, when you mention the word "productivity"

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to, say, an auto worker in Oshawa, he thinks you're talking about his job. How do you communicate to him that our standard of living is actually declining?

*Gordon Nixon:* I think Canadians are starting to understand because so many people, whether in the business community or politicians or academia, are talking about it. It took a long time to mobilize consensus that reducing deficits was an important issue for the country. But when the public was on board, they became very supportive. At the end of the day, we mobilized the Canadian public around the importance of getting our books in order. And I think one of the reasons we're enjoying very strong economic strength today is because we have done a very good job in fiscal policy in this country over the last number of years. If you look at Canada, which is fiscally in reasonable shape, it is a competitive advantage. But I think what we've got to do is when we talk about productivity, innovation, competitiveness, we should be talking around building future industries, investing in research and technology, investing in science, investing in each of our individuals and trying to dissipate this fear that productivity gain means job reductions. The US has one of the highest productivity rates in the world, and they have one of the lowest unemployment rates in the world.

*Options:* The Canadian economy had a pretty good year in 2002. What is your forecast for 2003?

*Gordon Nixon:* I think the US is going to have a hard time breaking out of its current malaise very quickly. But I think that the US economy will continue to perform in a positive fashion. I don't believe we're necessarily going

to do a double-dip recession, but I do think that we're going to have very slow growth of the US economy over the next 12 months. I think that Canada will continue to outperform the US. The big question mark is, if the US economy is growing at a very slow rate, whether we can maintain 3 1/2 percent to 4 percent growth rate in this country in the face of a slow US economy. I think we will outperform the US, so I think the story in Canada is still a very positive one. It's just a question of degree.

*Options:* Why do you think that Canada outperformed the US in 2002? John Manley talks about the "Northern Tiger." Do you buy in on that?

*Gordon Nixon:* I buy into some of it. If you look at the mix of the businesses in the two countries, Canada has a much greater weighting for small and medium business, and less of a weighting for large business. And what you have is a major restructuring in the upper end of the corporate marketplace as a result of what's occurred in stock markets. Canada has been far less influenced by that. If you look at the mix of the economy, it's not just small business and large business, a lot of the industries in Canada have been performing reasonably well. The energy industry has been doing reasonably well, some of our commodity-based sectors have been performing reasonably well. In the US economy, a lot of the industries which have really suffered have been sectors like telecommunications and high technology. That has less of an impact on the Canadian economy. We have Nortel as our fallen angel in the telecommunications sector, but we have a few of them, while the US economy has many more. A lot of those industries which drove productivity in the United States have sort of fallen as a result of the burst of the bubble. And the question is whether that changes the trend line. I don't think it does. I think the US will continue to invest very heavily

in research and development in technologies. You also have much greater loss of wealth in the United States than in Canada. They're much more heavily invested in stock markets. So I think it's the combination, a mix of small business, big business, the industries, the wealth effect of the United States, and the fact that the industries where the bubble really burst are much heavily weighted in their economy.

*Options:* Is it fair to say that Canada's growth in the 90s was driven primarily by exports, which created four new jobs in five, while the present positive cycle seems to be more retail-driven in Canada? By consumption? Is that a factor of low interest rates?

*Gordon Nixon:* There is no question that the strength of the retail component of the economy is resulting in our performance being much stronger. Our interest rates policy has a lot to do with that. If you look at the Canadian economy today, one of the reasons why I do think it will continue to outperform is you have very low interest rates in this country. You've got very low historical unemployment rates in this country. You haven't had the same degree of dislocation, or even wealth effect, if you will, in this country. So you've got the vast majority in this country employed, you've got low

our export driven industries continue to perform very well, like our commodity-based sector.

*Options:* If you were advising John Manley on the budget, would you be planning on using the surplus, or fiscal dividend as John McCallum once famously called it, to continue to pay down debt? Or would you be reinvesting in health care and some other things?

*Gordon Nixon:* I think it's a combination of the two. One of the things that makes Canada strong as a country is there the balance in terms of our approaches. Without sounding wishy-washy—trying to draw the line down the middle—I think that's something that is a strength of Canada. There is no question that we need greater investment in health care and education. I think what the Canadian public is demanding is, let's not waste it, and let's not waste money in other areas as well. I think that's where the debate around health care and education should occur. But at the same time we should clearly not lose focus on the fact that we should continue to keep our books in order, and we should continue to look for ways to take inefficiencies out of our taxes. And that doesn't mean tax cuts, but it means inefficiencies out of our taxes. We have to find that correct balance. And what politicians, the government should be focused on, is finding that right balance.

When we talk about productivity, innovation, and competitiveness, we should be talking around building future industries, investing in research and technology, investing in science, investing in each of our individuals and trying to dissipate this fear that productivity gain means job reductions.

interest rates which gives them greater buying power—particularly in the real estate sector—with less of an impact from the decline in the equity markets. And that combination results in the consumer side of our economy being that much stronger. We have had some impact on those industries which are particularly sensitive to a downturn in the US economy. But again some of

*Options:* Finally, you recently appeared before the Senate Banking Committee, Senator Kolber's committee, which is charged with the question of defining the public interest in bank mergers. Does RBC have a view on that, in terms of whether bank mergers are in the interest of Canada going forward?

*Gordon Nixon:* Absolutely. We

There is no question that we need greater investment in health care and education, and that we should be using funds processed in the fiscal surplus, if you want to describe it like that, to improve in areas such as education and health care. I think what the Canadian public is demanding is, let's not waste it...we have to find that correct balance.

think that the consolidation of financial services, which people like to say are the bank mergers, would be good for the long term in our industry. And as a result of that, they are in the public interest. I think that the key is the definition of how transactions can and should be done to ensure that public interest issues are looked after. If we come to the conclusion that consolidation is in the public interest, the most important issue is how do you define the rules, the criteria, the parameters around enabling consoli-

dation to occur in a way which is positive to the industry and the various constituents of that industry. But in terms of the issue around consolidation, if we don't allow our financial services industry to take advantage of consolidation in the future, then we are going to be more and more marginalized relative to financial services companies that are growing in other parts of the world, and particularly the United States.

Canadian banks are among the best banks in the world in terms of things like productivity and competitiveness, innovation. What we really lack is scale and opportunity to grow outside. If we create the scale and the opportunity to grow and expand beyond our borders, then we will generate incremental benefits to the country. Are we currently living up to the potential that we have, given the restrictions that were placed on us as a result of the mergers?

*Options:* As you know, one of the big issues, particularly in the Ontario Liberal caucus when Royal Bank and Bank of Montreal were talking about merging in 1998, was the alleged closure of retail branches in small towns in Ontario. But if 95 percent of bank transactions are done at the ATMs and

on line, what is the importance of the retail bank branch network?

*Gordon Nixon:* What is still important is that 70 percent of our customers are in a branch once every couple of months. They don't necessarily go in for loans, but they go in for more complex transactions, of which loans can be one. They go in for advice, for planning, they go in if they have issues or problems, so the branch system, the branch network, is still exceedingly important.

But I think the bigger issue is you've had significant rationalization of branch networks since 1998 across all financial institutions. If mergers were to occur today, I don't think you would have the same degree of sensitivity around branches. First, because we already have had a high degree of consolidation, and second because there are a lot of institutions out there that would love to grow and to acquire redundant branch systems. There would be foreign institutions, there would be domestic institutions that would love to have the opportunity to take advantage of consolidation and to expand their distribution channels. The key issue with respect to branches is to ensure that there is lots of competition in most of these marketplaces in Canada.

## Books received—Livres reçus

Sylvia BASHEVKIN. *Welfare Hot Buttons: Women, Work, and Social Policy Reform* (University of Toronto Press, 2002).

Christian DEBLOCK (dir.). *L'Organisation mondiale du commerce. Où s'en va la mondialisation?* (Éditions Fides, 2002).

Patrick JAMES, Donald E. ABELSON, Michael LUSZTIG (eds.). *The Myth of the Sacred: The Charter, the Courts, and the Politics of the Constitution in Canada* (McGill-Queen's University Press, 2002).

Marie MCANDREW. *Immigration et diversité à l'école : Le débat québécois dans une perspective comparative* (Les Presses de l'Université de Montréal, 2001).

Richard W. POUND. *Stikeman Elliott: The First Fifty Years* (McGill-Queen's University Press, 2002).

Maeve QUAID. *Workfare: Why Good Social Policy Ideas Go Bad* (University of Toronto Press, 2002).

Michel SEYMOUR (dir.). *États-Nations, multinationales et organisations supranationales* (Liber, 2002).

Hamish TELFORD and Harvey LAZAR (eds.). *Canada: The State of the Federation 2001. Canadian Political Culture(s) in Transition* (Institute for Intergovernmental Relations, 2002).

Bruno THÉRET. *Protection sociale et fédéralisme : L'Europe dans le miroir de l'Amérique du Nord* (Presses de l'Université de Montréal, 2002).