FP COMMENT

PHILIP CROSS

History loves fiscal irony

Clearly, history has an enormous appetite for irony. British prime minister Neville Chamberlain went from saying the Munich Agreement secured "peace for our time" to declaring war on Germany less than a year later. Strident anti-Communist Richard Nixon opened up relations between the U.S. and China.

Nowhere are policy reversals more ironic than in budget-making. French Socialist President François Hollande was elected on the promise of breaking with the fiscal austerity allegedly suffocating much of Europe. However, following a second downgrade of France's credit rating in less than two years, he introduced $72-billion of spending cuts and tax hikes over the next three years. Last month he fired his cabinet to quell an incipient revolt in the Socialist Party against his conversion to the merits of austerity and structural reform. Hollande's main contribution to stimulating growth are the brisk sales of the tell-all book of former first lady Valerie Trierweiler, in which she reveals his contempt for the poor as "sans dent" or toothless. So much for Solidarity with the masses.

These actions establish Hollande as a worthy successor to François Mitterand, the first Socialist president of France. Elected in 1981, he invited the Communist Party into his cabinet and pursued a radical economic plan of wealth taxes and nationalizations. Two years later, faced with the inevitable economic crisis, he made his famous "tournant de la rigeur" and adopted austerity, in the process driving the communists out of his government and starting them down the road to oblivion (they won 1.7% of the vote in the 2012 election).

There has been a long litany of radical leftist governments who, faced with a burgeoning economic crisis, an empty fiscal cupboard and credit downgrades, have made death bed conversions to austerity. Most famously in Canada, Bob Rae's NDP government won the Ontario election in 1990 on the promise to "proudly fight the recession and not the deficit" in the words of finance minister 'Pink' Floyd Laugren. They proceeded to jack up the deficit to a record $9.1-billion with profligate spending on social programs. Two years later, with the economy in tatters and the deficit spinning out of control, the government reversed

Funny how big-spending politicians end up on the other side of the great debate

course, enraging its union base by introducing the Social Contract that imposed a wage freeze and unpaid leave on public sector employees to save $2-billion.

Similar examples litter Canada's history books. Following the crippling 1981-1982 recession, Quebec Premier René Lévesque abandoned the Parti Québécois' trade-union roots and imposed a steep wage cut of 25% for six months on public sector workers. Jean Chrétien was elected in 1993 on Red Book promises of cutting the GST and adding $6-billion to infrastructure spending, while warning that eliminating the deficit too quickly would boost the unemployment rate to 25%. Two years later, after a debt rating downgrade and the *Wall Street Journal* calling Canada an honourary member of the Third World, he embraced fiscal austerity in the 1995 budget. Unemployment stayed stubbornly below 10%, proving Chrétien wasn't much better at forecasting than keeping promises.

It is not just in Canada that political promises to spend more and inflate budget deficits inevitably must confront reality. Bill Clinton was going to spend his way out of the lingering 1991 recession, but was convinced by his Wall Street-trained treasury secretary that adopting austerity would do a better job of bringing down interest rates and stimulating growth, igniting a boom that carried him to re-election. Barack Obama inflated the U.S. government deficit to record levels for two years before reversing course under pressure from a Republican Congress, resulting in a near-record shrinkage of the U.S. deficit over the last two years. It will be interesting to see when and how Ontario Premier Kathleen Wynne breaks her commitment to more government spending; history suggests two years, after a downgrade of Ontario's debt.

History's love of irony is so complete, I openly expect Gabrielle Nadeau Dubois, the militant leader of Quebec's student revolt in 2012 against a trivial hike in tuition fees, will someday be the one to explain the need for students to face the reality of Quebec's fiscal straightjacket and accept markedly higher tuition fees. Fscal reality trumps utopian ideology every time.

Finncial Post

Philip Cross is the fomer chief economic analyst at Statstics Canada.

Too many Canadian companies remain unprepared to deal with the next wave of activism from the U.S.

The shareholder activism threat

WES HALL

Public companies have long eyed the continued upward trend in shareholder activism and wondered if they will be the next target. Looking at the results of the 2014 proxy season and ahead to next year, the message is clear: Get ready. U.S. activists have you in their sights.

Our 2014 Proxy Season Review saw the number of proxy contests in Canada remain at the elevated level first seen in 2009, with 26 fights this year. While the resource sector was most active, in part due to the continued weakness of the commodities market, no free passes were issued by activist funds, with 20% of the fights launched by American firms.

The outcome for Canadian companies hasn't been good. Management only won 12 engagements, with activists claiming five victories outright — notably at Hanfeng Evergreen — and on another eight occasions reaching a settlement after extracting concessions from management in cases like Orange Capital's run at InnVest REIT and Smoothwater Capital's settlement with Equity Financial, both resulting in activist nominees being placed on the boards. That's not a good ratio if you're supposed to know these fights are coming.

What these numbers don't show is what's happening behind the scenes. Companies are more willing to settle before anything becomes public because activists have become more sophisticated and put management on their heels from the outset. They're arriving at boardroom doors armed with independent analysis, alternative corporate strategies that actually enhance shareholder value and quality director nominees.

Coupled with their skill in leveraging media attention and willingness to escalate to an expensive proxy war, more companies may be judging that standing up to an activist just isn't worth the cost and headache.

The problem for Canadian companies is not just increased activist sophistication but that the ranks of the activist investor are set to swell. A report from Preqin says that ahead of the 2014 proxy season, 28 activist hedge funds were launched — more than double the year before.

With successful players like Carl Ichan and Bill Ackman inspiring a new generation south of the border, you can expect more activists to come to Canada in 2015. Orange Capital was new on the scene in 2014 and launched two proxy fights and is active in several other situations.

Canada has a welcoming regulatory regime with a more lax warning threshold

Here's why: First, Canada has a welcoming regulatory regime with a more lax warning threshold — 10% vs. 5% share ownership — and majority voting policies now mandated by the TSX, making it easier to advance change.

Second, with the U.S. market getting crowded, many players will get elbowed out as the low hanging fruit is picked off and head north in search of spoils.

These investors, especially the smaller ones, will be able to take up larger stakes in a Canadian company than they might otherwise be able to in the U.S. thanks to the weaker Canadian dollar, relatively smaller size of Canadian companies, and the increased willingness of institutional investors to work with activists.

But perhaps the most responsibility for attracting the eye of southern activists lies with the Canadian boards themselves, whose passive approach leaves them vulnerable. Hoping it won't happen to you isn't a viable defensive strategy.

Too many companies are out of touch with their shareholders — both in terms of who they are and how they think or actually vote — confusing an investor's fondness of an asset with fondness of that asset's management.

As a result, they fail to close off avenues for activist attack by taking a good hard look at their board, management and performance, adopting best practices in governance like Say on Pay, "refreshing" the board and the executive team when necessary, and instituting an advance notice by-law to avoid any ambushes.

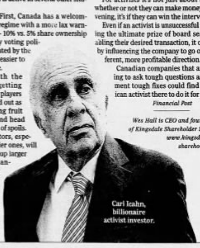
For activists it's not just about assessing whether or not they can make money by intervening, it's if they can win the intervention.

Even if an activist is unsuccessful in achieving the ultimate prize of board seats or enabling their desired transaction, it often wins by influencing the company to go off in a different, more profitable direction.

Canadian companies that aren't willing to ask tough questions and implement tough fixes could find an American activist there to do it for them.

Financial Post

Wes Hall is CEO and founder of Kingsdale Shareholder Services. www.kingsdaleshareholder.com



Carl Icahn, billionaire activist investor.

Crippling medical research

LAWRENCE SOLOMON

Over the last 30 years, spending on medical research and development soared more than five fold, but it didn't produce five times as many research geniuses whose insights brought us five times the life-saving discoveries, not by a long shot. Instead of the extra billions finding their way to a new generation of ever better funded, ever more empowered intellects, the money went mostly to medical mediocrities spawned by the expanding government bureaucracies that sucked up the monies, and that, too often, helped squelch rather than advance knowledge.

Before the rise of major health bureaucracies such as the Centers for Disease Control and the National Institutes of Health, science gave us the breathtaking breakthroughs that medicine still relies on today — penicillin and antibiotics, vitamins and insulin, vaccines for typhus and polio, devices like x-rays, electrocardiographs, contact lenses, kidney dialysis machines, CT scanners, MRIs and pacemakers and procedures like blood transfusions, laser treatments, open-heart surgery and organ transplants.

Medical breakthroughs haven't stopped under the bureaucratic weight but they've slowed to a crawl. CNN's "10 medical advances of the last 10 years," published last year, mostly listed improvements on earlier discoveries such as refinements for laparoscopic surgery, invented a century ago. CNN's list includes items to make bureaucrats proud, such as expansions in smoke free laws.

While the amount spent developing new drugs has soared — U.S. companies spent $49-billion in 2010 compared to $15-billion in 1995 — the number of new drugs entering the market has plunged. Worse, most of them are deemed "me-too" drugs because they aren't much different from existing drugs. According to the World Health Organization, a dollar invested in R&D between 2005 and 2010 was 70% less productive in terms of producing a profitable drug than a dollar spent in the previous decade.

What hasn't declined in the medical field is dogma, as best illustrated by the 2005 Nobel Prize for Medicine, awarded to Barry Marshall for an outside-the-box discovery more than two decades earlier. Marshall, a trainee in internal medicine in Australia, realized that ulcers — then a very serious ailment — were caused by an easily treated bacterial infection rather than by stress, as commonly believed. Marshall was ridiculed, called a quack, dismissed when he presented his findings to an annual meeting of the Royal Australasian College of Physicians, dismissed by the pharmaceutical companies, dismissed by funding bodies that held the purse strings to research grants, dismissed by important medical journals. Although he soon successfully cured his own patients without subjecting them to conventional treatments — like antidepressants to allay the patients' presumed stress-induced gastric acids or surgical

Before the rise of major health bureaucracies such as the Centers for Disease Control, science gave us the breakthroughs

removal of their ulcerated stomachs — the medical world treated him as a fraud, asserting his results couldn't be replicated and in any case couldn't be true. Even after Marshall, in desperation, decided to prove that infections caused ulcers by infecting himself and then curing the resulting ulcer with an antibiotic, he remained a charlatan to most for another decade.

A breakthrough came when Marshall's story was published — not in an august scientific journal but in Star, a supermarket tabloid that ran stories about Nancy Reagan adopting alien babies, and then in Reader's Digest and National Enquirer. To the establishment's chagrin, these periodicals' readers increasingly demanded his cure for their ulcers, and physicians, after seeing the results, slowly were won over. Eventually, the scientific research establishment was forced by popular opinion to investigate the science and Marshall's nightmare — and that of millions of needless sufferers — was over.

Today, not only have ulcers disappeared as a major debilitating disease, stomach cancers have too — the same bacterium had been responsible for them both. Why the dogma and the personal attacks on Marshall? How could so many for so long ignore the evidence that was so obvious and so easy to verify? An answer lies in the willful blindness of the vested interests that dominate the medical field.

Money provides one vested interest. Anti-ulcer medicines represented the largest therapeutic drug market worldwide, with sales in the 1990s growing to almost $20-billion. Big pharma had no interest in gutting this moneymaker and neither did individual practitioners. "Every gastroenterologist was doing 20 or 30 patients a week who might have ulcers, and 25% of them would," Marshall later explained. "Because it was a recurring disease that you could never cure, the patients kept coming back." Surgeons whose bread and butter was removing stomachs also weren't interested in hearing their particular specialty wasn't needed; neither were the numerous scientists grinding out me-too papers by the hundreds on topics such as how to better manage ulcers by tweaking the dose of this or that antidepressant.

Money aside, personal egos and professional reputations were at stake. And cementing these powerful incentives together to form a near-impenetrable groupthink were government agencies that amplified the conventional wisdom and increasingly influenced what research should and shouldn't be done, what papers should and shouldn't be published, what drugs should and shouldn't be licensed. In this medical-industrial-governmental complex, there was and is little appetite for out-of-the-box thinkers who challenge the status quo; there was and is an insatiable need to squelch dissent.

Does more government money in the hands of this already bloated complex save lives, or destroy them? That will be the subject of a future column in this series.

Financial Post

Lawrence Solomon is executive director of Consumer Policy Institute. LawrenceSolomon@nextcity.com