

**Submission to the Competition Policy Review Panel**

**on the topic**

**Canada's Foreign Investment Policy – *the Investment Canada Act***

**By**

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**House of Commons, Ottawa**

**December 2007**

## **CONTENTS**

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**RECOMMENDATION**

**RATIONALE**

**BACKGROUND & CONTEXT**

**DEBUNKING MYTHS**

**CONCLUSION**

**RECOMMENDATION:**

Foreign takeovers of Canadian companies should be allowed if they are in Canada's national interest. The *Investment Canada Act* should be amended to change the approval criteria from net (economic) benefit to the test of whether or not the proposed transaction is in Canada's national interest. Canada's national interest criteria would be defined and articulated by the Governor-in-Council (Cabinet) through regulation, guidelines and convention, and would focus on strategically important national assets.

**RATIONALE:**

Since its enactment in 1985, the application of the *Investment Canada Act* by Industry Canada has become a redundant 'rubber-stamp' process. Not one takeover has been rejected since Investment Canada's inception. Incorporating the 'national interest' test would align Canada with countries like the United Kingdom, Germany, Australia and Japan – all of whom review foreign takeovers in the context of the 'national interest' or 'public interest'. A review by the federal Cabinet of all major foreign acquisitions would ensure that major Canadian corporate icons that are key strategic assets would remain in the hands of Canadians and used to advance our national objectives. Limiting the review to acquisitions proposed by state-owned enterprises and/or those transactions that run counter to our national security interests is not sufficient. A broader criterion is required.

## **BACKGROUND & CONTEXT:**

Foreign Direct Investment (FDI) is an important tool for the creation of wealth and economic prosperity. It can take many forms – from Greenfield investment creating new production or service capacity – to minority equity investments – to debt financing, sale and leaseback, etc. FDI often creates jobs in the host country; it can facilitate economic expansion; it can help to create a more competitive business environment; and contribute to productivity-enhancing investment in machinery and equipment. For these and other reasons, most countries are eager to attract foreign direct investment from around the world.

At the same time, however, there are concerns raised about foreign direct investment – especially foreign takeovers which often are no more than ‘paper transactions’ offering limited synergies but resulting in the loss of Canadian control. While it is true that many foreign takeovers result in increased investment in the entity by the acquirer, this is not always the case, and many feel uncomfortable with the idea of foreign ownership of a significant share of domestic economic activity. They argue that foreign-controlled enterprises may not always act in the national, or local, interest; that profits can be redirected out of the country; and that foreign ownership could have national security implications in cases where products or industries are of strategic importance. These concerns tend to be most pronounced in the energy and natural resources sectors.

For the reasons mentioned above, many countries, including Canada, do not offer foreign investors unlimited access to domestic assets; many limit or restrict investment in sectors deemed to be of strategic (or cultural) importance. In Canada we have such restrictions in the banking, transportation, telecommunications and cultural sectors. In addition, numerous countries have mechanisms in place that review major proposed foreign investments to ensure that they are in the national interest. The recent sell-off of some of Canada's most important companies should raise alarm bells. Industry Canada, charged with determining whether these transactions are good or not for Canada has approved each and every foreign takeover since 1985. Equally silent has been the governments of the day in this country - both Liberal and Conservative - that have thus far chosen to

'stand on the sidelines' while company after company is swallowed-by foreign interests. Since 1985, more than 12,100 Canadian firms have been taken over by foreign interests. That includes major companies like Molson's, Dofasco, Labatt's, Inco, Van Houtte, Alcan, Falconbridge, the Hudson's Bay Company, The Four Seasons Hotels - and even - the Montreal Canadiens. In the first eight months of 2007, foreigners snapped up more than 90 billion dollars of Canadian corporate assets. This prompted *The Economist* to observe recently,

*"When corporate icons first began falling into foreign hands Canadians were largely sanguine. But buyouts have continued at a record pace and the ownership of some prized companies has moved offshore. These include the mining giants Inco and Falconbridge, the luxury hotelier Four Seasons and the aluminum giant Alcan. The bidding war for BCE began just as a number of business leaders were calling on the government to prevent what they claimed was the 'hollowing out' of corporate Canada."*

Recent public opinion polls have shown that Canadians are concerned about this trend. In fact, it is not only ordinary Canadians who are worried. Many of Canada's CEOs are concerned as well. According to a recent survey conducted by the Canadian Council of Chief Executives, four out of five of Canada's leading CEO's think Ottawa should impose new restrictions on takeovers by foreign state-owned firms and seven out of 10 favour reviewing acquisitions by outsiders for national security concerns. Most telling perhaps is the fact that of all the G8 nations, Canada remains the only jurisdiction without any additional 'national interest' or 'national security' provisions for foreign takeovers. The current government's more recent decisions to tax income trusts and make changes in the non-deductibility of interest expense has actually encouraged a recent spate of takeovers in the oil patch, while at the same time hindered the ability of our domestic companies to invest outside of Canada. Perhaps in response to criticism and the damaging results of their actions, the current government moved on December 7<sup>th</sup>, 2007 to 'clarify' rules on foreign investment for state-owned enterprises. The impacts of this clarification are yet to be seen, but their intent is to place some restrictions on State Owned Enterprises (SOE's) acquiring Canadian companies.

I believe there should be a more conscious and thoughtful process in Canada about foreign direct investment in Canada. This debate should be encouraged by the government through consultations like this one, and also when major takeovers are proposed. Such a debate will contrast the views of those who believe that the takeover of Canadian icon companies is not a problem because FDI outbound exceeds FDI inbound, and those who believe that more careful attention needs to be paid to the data, and Canadians should be concerned with these takeovers. There are those individuals who believe that restricting foreign acquisitions will negatively impact inbound FDI, and those who believe otherwise. Some argue that all foreign acquisitions are good for the Canadian economy while others will dispute this. I will attempt now to address these points, and show that there is legitimate cause for concern around these issues.

#### **DEBUNKING MYTHS:**

***Myth Number 1 - "Foreign takeovers of Canadian icon companies is not a problem because FDI Outbound exceeds FDI Inbound."***

Inevitably, when foreign takeovers are debated in Canada the argument is made that as long as Canadian companies are investing abroad, there should not be a concern about inbound FDI. The question may be asked, what has one to do with the other? Further, if inbound FDI exceeded FDI outbound, a situation we may well experience for the year ending in 2007, would we then have a problem? The appropriate question to be considered in the context of the debate is - should Canada allow its corporate sector to be 'hollowed out' as long as we are investing abroad?

Canada has had a positive balance in FDI since 1997 but Canadians are buying smaller, less prominent enterprises from others, while non-Canadians are focused on our national champions.

Barbados, Bermuda, and the Cayman Islands are among Canada's top destinations for direct investment. The total investment in these 3 countries reached \$62.8 billion in 2006, and has grown 90.4% since 2000. In other words while our corporate giants and national icons are being 'snapped up', Canadians are investing in off-shore tax havens!

Canada also has the nebulous distinction of leading, since the beginning of last year, the value of public targets as a percentage of market capitalization – exceeding the U.K., the U.S.A., the Nordic countries and France. Moreover, from 2003 to 2006 Canada lost fourteen corporate global leaders. Glen Hodgson, Chief Economist of the Conference Board of Canada, notes that Canada's trade and investment market share has been falling, year-after-year, since the end of the 1970's.

***Myth Number 2- "Restricting foreign acquisitions will negatively impact Inbound FDI."***

Economists, business leaders and free marketeers commonly argue that the restriction of foreign acquisitions will negatively impact the flow of inbound Foreign Direct Investments. In the strictest sense this is true. Unreasonable barriers, and burdensome regulations and red-tape can act as a disincentive to companies looking for markets in which to invest. Reasonable safeguards, however, such as a national or strategic interest test, which are already in place in many other G8 countries, have clearly proven not to be an obstacle to investment.

The experience in Australia is a good example to illustrate this point. Australia's investment policy is set by the national Treasurer and administered by the Foreign Investment Review Board (FIRB). Australia encourages foreign direct investment as a way to build its domestic economy. As stated in the government's summary of its FDI policy, "In recognition of the contribution that foreign direct investment has made and continues to make to the development of Australia, the general stance of policy is to welcome foreign investment."

Furthermore Australia places relatively few conditions on foreign direct investment. Similar to the provisions of the *Investment Canada Act*, most relatively small purchases of land or business interests by foreigners are exempt from any prior notification to the Australian government. If a foreign interest, however, wishes to make a purchase of land or an Australian company over a certain value threshold, then it must report its intention to do so to the Australian government, triggering a government review.

This review process, which elicits comments from relevant parties, is intended to ensure that any larger foreign investment in Australia is not contrary to the *national interest*. Any proposal deemed not to be in the national interest can be blocked.

The thresholds that trigger such a review in most industries are as follows:

- greater than \$50 million for acquisitions of substantial interests in all existing businesses;
- over \$10 million for the establishment of new businesses; and
- greater than \$50 million for offshore takeovers.

According to paragraph 3 of the Australian government's *Summary of Australia's Foreign Investment Policy* document:

*"The Government has the power under the Foreign Acquisitions and Takeovers Act 1975 (the FATA) to block those proposals subject to the FATA which would result in a foreign person acquiring control of an Australian corporation or business or an interest in real estate where this is determined to be contrary to the national interest."*

Paragraph 5 of the same document elaborates on the notion of investments "contrary to the national interest":

*"The Government determines what is "contrary to the national interest" by having regard to the widely held community concerns of Australians. Reflecting community concerns, specific restrictions on foreign investment are in force in more sensitive sectors such as the media and developed residential real estate. The screening process provides a clear and simple mechanism for reviewing the operations of foreign investors in Australia whenever they seek to establish or acquire new business interests or purchase real estate. In this way the Government is able to encourage foreign investors to operate in Australia as good corporate citizens if they wish to extend their activities in Australia."*

Australia has had this legislation on its books since 1975 and it has not affected their inbound FDI in any significant way. Business has not been 'scared off' by this legislation mainly because Australia has been very cautious in their application of these powers. In fact Australia has rarely used this power at all. One high profile case deserves mention - the proposed takeover in 2001 by Royal Dutch Shell of an Australian energy company – Woodside Petroleum. The AUS \$10 billion bid was rejected on the grounds that Shell would operate the company as part of its global portfolio and not in the best interests of Australia. At the time, the decision to block this investment was met with concern by the business community. It was suggested that the investment was blocked on political grounds - Woodside was Australia's second largest oil and gas company. The claim of political interference was vehemently denied by the Australian government which maintained that the investment was rejected on purely economic grounds. Specifically, the Australian government argued that there were insufficient safeguards to ensure that Shell would not favour its own competing oil and gas projects over a development in the Australian offshore. The initial reaction to the rejected investment proposal was immediate. The day the rejection was announced, the Australian dollar lost about one cent against the U.S. dollar and share prices in Woodside plunged. There was also an outcry in the investment community over the message that this rejection sent regarding Australia's openness to FDI. This impact was short-lived, however. The Australian dollar recovered its lost value soon after, and there was no long-term effect on Woodside share prices. There was also no discernible impact on future investment in Australia. FDI inbound flows following 2001 were strong, suggesting that there were no lingering effects from the attempted takeover of Woodside by Shell. In 2001 FDI inbound into Australia was AUS. \$9 billion - by 2004 it had climbed to Aus \$58 billion. While the threshold amounts used by Australia may be low by Canadian standards, and the inclusion of Greenfield investments perhaps not required in this country, the foreign investment policy in Australia appears to be sound.

Countries like Japan, Australia and the United Kingdom have tougher hurdles than Canada - either national interest or public interest tests. Even the United States has implemented a 'national security' test. Many other countries have similar criteria. The Russian government is currently considering limits on foreign ownership in 39 'strategic'

areas, including natural resource deposits and biotechnology. In China new regulations allow officials to block foreign acquisitions of Chinese companies if the deal is deemed a danger to 'economic security'. Many U.S. states have laws that restrict hostile takeovers. Given these facts, is it reasonable to expect retaliation from these same countries if Canada were to implement a similar test for foreign acquisitions?

***Myth Number 3: "All Foreign acquisitions are good for the Canadian economy."***

If we were to limit the discussion to economics and finance, then the statement, "all foreign acquisitions are good for the Canadian economy," might have some validity. Even on that point, however, some economists argue that we should question the value of FDI inbound given Canada's current account surplus. They argue also that foreign takeovers increase the value of the Canadian dollar, reduce competition, and increase market power for some. Policy makers and Parliaments, however, must concern themselves also with political decisions around public policy, national interests, and national identity.

Corporate entities concern themselves primarily with shareholder value and directors are duty bound to maximize this shareholder value. A by-product of this is that corporate executives also do very well when foreign takeovers are consummated. Recent examples of multi-million and even billion dollar executive bonuses have flooded the media lately. Are the private interests of corporate directors, executives, and shareholders always aligned with Canada's national interests? I think that this is not always the case.

Governments must concern themselves with broader issues. For example, when considering a takeover, policy makers must assess not only short term impacts, but also mid to long term impacts. They must take into account the possibility of the stripping of corporate assets, plant closures, downsizing workforces, and flipping companies for quick profits. Today, investment bankers & private equity players exist with the primary goal of purchasing undervalued companies and maximizing profits. More often than not, their methods include those just mentioned above.

The primary tool to ensure the protection of Canadian companies, work-forces, and communities today in Canada is the 1985 *Investment Canada Act*. The purpose of the

*Investment Canada Act (ICA)* is to “encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada”.

Under the ICA, a prospective investor has an obligation to demonstrate that the proposed transaction is of net benefit to Canada. The ICA provides a list of factors considered by the Minister of Industry in determining whether a transaction is of net benefit. The factors assessed are:

- the effect of the investment on the level and nature of economic activity in Canada;
- the degree and participation by Canadians;
- the factors of productivity, efficiency, technological development, product innovation and variety;
- competition in Canada;
- the compatibility with national industrial, economic and cultural policies; and,
- Canada’s ability to compete in world markets.

The ICA provides no specific weighting to the factors, nor is any single factor determinative. On balance, the positives must outweigh the negatives for an investment to be approved.

As mentioned earlier, since the ICA came into effect, more than 12,100 Canadian companies have been taken over by non-Canadian interests. Under the watch of the ICA Canada’s corporate sector is being ‘hollowed out’. The retention of head offices in Canada is not significant, when assets are stripped and workers laid-off. Strategic corporate decisions are not being made in Canada when the beneficial ownership is outside of Canada. While the ICA purports to extract concessions from foreign acquirers, more often than not these concessions serve simply as ‘window dressing’ and of limited value in the medium to long term. It is not evident that any longitudinal studies have

been performed in Canada to determine whether or not the 12,100 foreign takeovers in Canada since 1985 have delivered the net (economic) benefits to Canada that were promised.

## CONCLUSION:

While it is true that the OECD has highlighted Canada's high level of formal restrictions to inward FDI, it is nonetheless ironic that many OECD countries have hurdles for foreign takeovers that exceed those in Canada. Some have questioned the OECD methodology; and, interestingly the OECD measure does not include energy and mining. What differentiates Canada, however, are the sectoral restrictions in telecommunications, transportation, banking and culture that are in place largely because of our close proximity to the United States, and our desire to retain our national identity and remain independent from the strongest economy in the world. This should be a concern that would be understood by those in Europe and elsewhere.

We need to raise the threshold for determining whether or not a foreign takeover is in Canada's national interest or not – and bring Canada into closer conformity with other G-8 countries. This can be affected through amendments to the *Investment Canada Act*. A Private Members Bill, C-386, *An Act to amend the Investment Canada Act (foreign investments)*, which is in the name of Roy Cullen, M.P., and currently before the House of Commons, will accomplish this, but it will take some time. The Bill will die on the order paper when Parliament is dissolved for a general election. The Conservative government can act decisively now.