



Volume 3 • Issue 4 • October 2010

## **CANADA'S FOREIGN DIRECT INVESTMENT CHALLENGE: Reducing Barriers and Ensuring a Level Playing Field in Face of Sovereign Wealth Funds and State-Owned Enterprises**

by Matt Krzepkowski and Jack Mintz\*

### **SUMMARY**

Recent takeovers – and attempted takeovers – of strategic resource companies have renewed concerns that some of Canada's prized corporate players are falling into foreign hands. However, data shows that Canada has not been a significant attractor of multinational investment, lagging behind a number of developed and developing nations. Indeed, since the mid-1990s, Canada has been a net exporter of capital in world markets, as foreign direct investment by Canadian companies far outpaced the inflow of foreign capital. Rather than being hollowed out, we are hollowing out other countries.

As a general policy, Canada should reduce barriers to foreign direct investment and welcome our growing role in international markets. As many studies have shown, foreign direct investment brings significant net benefits to the Canadian economy, including knowledge transfers, new management, better wages and productivity.

Only in limited circumstances, such as in the case of protecting Canada's national security, should Canada block foreign takeovers of Canadian companies.

In the interest of neutrality and minimizing economic distortions, takeovers of Canadian companies by foreign sovereign wealth funds or state-owned enterprises should be reviewed on a case-by-case basis. When state-owned enterprises have similar commercial objectives and operate on a level-playing field without financial support by state owners, they could also provide net benefits to the Canadian economy.

One important area that requires further consideration is with respect to the tax-exempt status of sovereign wealth funds and state-owned companies. Canadian tax treaties should be reviewed to ensure that Canadian withholding taxes maintain an even playing field among private and state-owned businesses operating in Canada.

---

\* Doctoral Student in Economics and Palmer Chair of Public Policy, School of Public Policy. We wish to thank David Bercuson, Jason Langrish and Colin Robertson for helpful comments.

## INTRODUCTION

A sharp increase in foreign investment in Canada in 2007 revived historic concerns that foreign corporations are increasing their influence in, and taking advantage of, our domestic markets. These fears were also prevalent during the technology boom at the tail end of 2000 that resulted in a few significant takeovers of Canadian companies, a trend that proved to be short lived.

Now, several years later, we are seeing a similar influx of foreign investment in Canada focused on natural resources. However, even in these brief periods of inflows of capital, Canada has not been a significant attractor of multinational investment, lagging behind a number of developed and developing nations — a point we raised two years ago.<sup>1</sup>

At the same time, Canada continues to gain strength as a capital exporter, with outbound investment flows surpassing inbound foreign direct investment. Several Canadian companies are international players, including Agrium Inc., Barrick Gold Corp., Brookfield Asset Management Inc., Power Corp., Manulife Financial Corp., Nexen Inc., Research in Motion Ltd., Suncor Energy Inc. and Thomson Reuters Corp., to name a few. Another significant Canadian multinational, Potash Corp., is now the target of a hostile takeover attempt by BHP Billiton PLC, one of the largest mining companies in the world. As part of the drama, a ‘white knight’ could appear, and the speculation is that it is likely to be a Chinese state-owned enterprise.

Canada is in a quandary. Our lacklustre record in attracting foreign direct investment reduces competition in Canadian markets for investment and talent that comes along with new management. Meanwhile, Canadians are reaping economic benefits from involvement in international markets. All this suggests that Canada should look at its policies to deepen our global attractiveness and make sure that we are open to inbound and outbound capital flows. Recent tax changes that have reduced Canada’s corporate income tax rate and withholding tax on interest paid to non-residents help attract investment as well as grow Canadian multinationals.

With emerging markets becoming an increasing source of international investment, many state owned enterprises and sovereign wealth funds are buying assets in Canada, a phenomenon that is not new but becoming more important than in the recent past. In some cases, state-owned enterprises have played an important role in growing Canada’s industrial base, including several in the resource sector such as Statoil ASA (majority-owned by the Norwegian government), Abu Dhabi National Energy Co. (also known as TAQA), Korea National Oil Corp., PetroChina Investment Co. and some previously state-owned enterprises like BP PLC, Total SA and Canada’s own Petro-Canada.

In some cases, the government has already taken action to protect Canada’s interest. When MacDonald-Dettwiler and Associates Ltd. was involved in a takeover, Canada blocked the sale for national security reasons. The company did have technology, Radarsat 2 satellite, that could serve an important role in national defence and Canada was reluctant to let a United States company control it.

---

<sup>1</sup> Matt Krzepkowski and Jack M. Mintz (2008), *Squeaky Hinges: Widening the Door to Canadian Cross-border Investment*, No. 69, E-brief, C.D. Howe Institute.

A key issue addressed in this paper is whether some state-owned enterprises might have non-commercial objectives or financial advantages in acquisition markets due to subsidies or tax benefits that provide a competitive advantage or an ability to outbid taxable commercially oriented entities. In our view, Canada should make sure a level playing field exists among companies in takeover markets so that Canadian companies are operated by the most able as determined by market decisions, not simply those with an advantage due to government support. This is especially important in Canada's resource sector, so Canadians, as owners, benefit from bringing in the best private producers to maximize rents.

As a general rule, Canada should welcome foreign takeovers and take advantage of our growing role in international capital markets. However, there are some instances when Canada should review, on a case-by-case basis, takeovers when they compromise national security or operate at an unfair advantage as state-owned enterprises. Some review of our tax laws may be needed to ensure that companies operate at a level-playing field.

## **CANADA'S MADIOCRE RECORD OF FOREIGN DIRECT INVESTMENT INFLOWS**

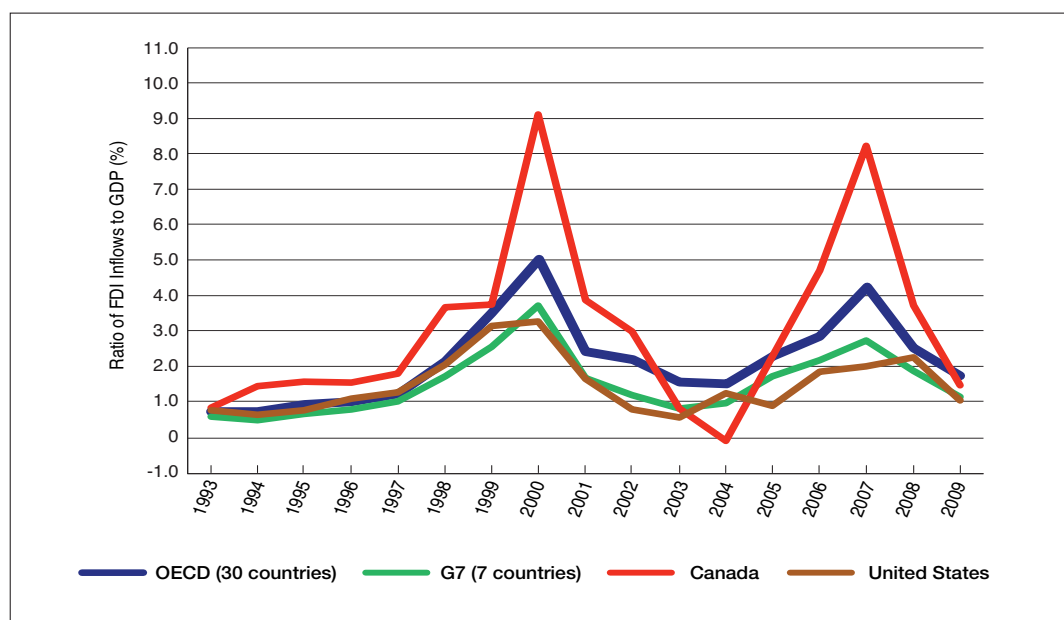
About a fifth of business assets in Canada are controlled by foreigners, with roughly 60 percent of foreign control emanating from the United States.<sup>2</sup> Measuring inflows of foreign direct investment (FDI) as a percentage of GDP, Canada ranked 26th out of 92 countries during the recent boom in 2007.<sup>3</sup> More crucially, this temporary boom of inflows has since waned and inflows have declined back down to normal levels (Figure 1) due to falling commodity prices, a stronger Canadian dollar and a recessionary global economy. Our rank has also declined. Using five-year averages of investment flows, a more indicative measure of overall standing due to the large year-to-year fluctuations in investment flows, Canada ranked 46th for the period 2004-2008, dropping from a rank of 33rd during the 1999-2003 period (see Table 1), or about the same rank as a decade ago. This is not just about Canada lagging behind developing nations that may have positioned themselves to attract investment due to a lack of sufficient human and capital resources to develop their own industrial sectors. Canada ranks 14th out of 30 OECD countries in our sample from 2004-2008, although second in the G7.

---

<sup>2</sup> Statistics Canada, *Business Performance and Ownership*, (Ottawa, 2007), [http://www41.statcan.gc.ca/2007/2239/ceb2239\\_000\\_e.htm](http://www41.statcan.gc.ca/2007/2239/ceb2239_000_e.htm).

<sup>3</sup> Direct investment abroad (net outflows) and foreign direct investment (net inflows) in the reporting economy represent the change in the assets owned by investors in a country for cross-border investments. Direct investment includes equity capital, reinvested earnings, other capital and financial derivatives associated with various inter-company transactions between affiliated enterprises that are at least 10 percent owned by the parent. Excluded are flows of direct investment capital for exceptional financing such as debt-for-equity swaps. See International Monetary Fund's *Balance of Payments and International Investment Position Manual* (Sixth edition, 2009).

**FIGURE 1: Ratio of FDI Inflows to GDP for Selected Countries and Country Groups, (Based on Groups' Total Inflows and GDP)**



SOURCES: FDI flows: International Monetary Fund, International Financial Statistics, September, 2010; GDP: World Bank, World Development Indicators, July 2010.

**TABLE 1: Country Ranking by the Ratio of Foreign Direct Investment Net Inflows and Net Outflows as a Percentage of GDP (Averaged over 2004-2008 for 92 Countries)**

Rank by FDI Sum	Country or Area Name	FDI Inflows (% of GDP)	Rank By Inflows	FDI Outflows (% of GDP)	Rank By Outflows	Sum of Inflows and Outflows (% of GDP)	Change in Rank <sup>(1)</sup>
1	Luxembourg <sup>(2)</sup>	282.67	1	322.16	1	604.83	0
2	Hong Kong <sup>(3)</sup>	23.42	3	23.91	3	47.32	0
3	Hungary	24.38	2	21.61	4	45.99	27
4	Iceland	9.70	16	24.78	2	34.48	30
5	Belgium <sup>(2)</sup>	16.56	7	15.77	5	32.33	2
6	Singapore	16.29	8	12.30	7	28.59	-1
7	Bulgaria	20.90	4	0.62	54	21.51	18
8	Austria	9.82	15	11.65	8	21.47	31
9	Seychelles	17.31	5	1.56	34	18.87	10
10	Bahrain	10.31	13	8.05	9	18.37	16
11	Estonia	12.02	12	5.36	18	17.39	9
12	Switzerland	4.46	44	12.84	6	17.30	-2
13	Cyprus	10.05	14	6.74	12	16.78	0
14	Jordan	15.31	10	0.17	68	15.48	23
15	Macao <sup>(4)</sup>	17.13	6	0.90	46	18.03	13
16	Azerbaijan	7.31	22	5.71	17	13.01	-13
17	Netherlands	4.88	39	8.03	10	12.92	-11
18	Malta	15.36	9	0.12	74	15.48	-7

cont'd

TABLE 1: cont'd

Rank by FDI Sum	Country or Area Name	FDI Inflows (% of GDP)	Rank By Inflows	FDI Outflows (% of GDP)	Rank By Outflows	Sum of Inflows and Outflows (% of GDP)	Change in Rank <sup>(1)</sup>
19	Georgia	12.23	11	-0.07	89	12.16	19
20	Sweden	5.15	37	6.61	14	11.76	-12
21	United Kingdom	5.45	32	5.83	16	11.28	-9
22	Israel	5.34	35	5.02	20	10.36	18
23	Spain	3.27	51	6.47	15	9.74	-8
24	Chile	7.00	24	2.33	30	9.32	-7
25	Fiji	9.23	17	0.01	83	9.24	51
26	Solomon Islands	8.04	20	0.85	48	8.89	65
27	Kazakhstan	8.65	18	0.01	82	8.66	-9
28	Republic of Moldova	8.11	19	0.15	69	8.26	7
29	France	2.95	54	5.04	19	8.00	-13
30	Jamaica	7.20	23	0.72	49	7.92	-3
31	Malaysia	3.66	47	4.10	22	7.76	13
32	Canada	3.78	46	3.98	23	7.75	-9
33	Romania	7.44	21	0.14	70	7.58	29
34	Croatia	6.18	28	0.89	47	7.07	-5
35	Kuwait	0.12	91	6.69	13	6.81	57
36	Latvia	5.90	30	0.91	45	6.81	14
37	Egypt	6.33	27	0.43	59	6.76	50
38	Cambodia	6.62	25	0.12	72	6.74	8
39	Honduras	6.58	26	-0.01	84	6.57	3
40	Czech Republic	5.37	34	0.98	44	6.36	-19
41	Ukraine	5.98	29	0.25	65	6.22	26
42	Costa Rica	5.83	31	0.31	61	6.14	15
43	Norway	1.06	85	4.94	21	6.00	-11
44	Russian Federation	3.21	52	2.64	26	5.85	20
45	Poland	4.52	41	1.22	38	5.74	11
46	Lithuania	4.49	43	1.17	39	5.65	5
47	Colombia	4.51	42	1.08	41	5.59	16
48	Uruguay	5.41	33	0.14	71	5.55	20
49	Tunisia	5.25	36	0.09	77	5.34	12
50	Portugal	2.40	64	2.52	27	4.92	-26
51	Macedonia (FYR)	4.93	38	-0.02	85	4.92	-18
52	Slovenia	2.48	63	2.43	28	4.91	8
53	Slovakia	4.53	40	0.30	62	4.83	-17
54	Thailand	4.10	45	0.58	55	4.68	-5
55	Denmark	1.40	79	3.21	25	4.61	-46
56	Barbados	2.94	55	1.66	33	4.60	27
57	Germany	1.25	82	3.25	24	4.51	-26
58	Finland	2.33	65	1.94	32	4.27	-44
59	Australia	2.84	57	1.26	36	4.10	-16
60	China	3.37	50	0.63	53	3.99	-6
61	El Salvador	3.51	48	0.26	63	3.77	8
62	United States	1.66	75	2.08	31	3.74	-10

cont'd

TABLE 1: cont'd

Rank by FDI Sum	Country or Area Name	FDI Inflows (% of GDP)	Rank By Inflows	FDI Outflows (% of GDP)	Rank By Outflows	Sum of Inflows and Outflows (% of GDP)	Change in Rank <sup>(1)</sup>
63	Italy	1.35	80	2.38	29	3.73	2
64	Brazil	2.32	66	1.23	37	3.55	-17
65	Ireland	-3.88	92	7.29	11	3.42	-61
66	Argentina	2.72	59	0.66	52	3.38	-11
67	Botswana	3.42	49	-0.05	88	3.37	-26
68	New Zealand	2.96	53	0.24	66	3.20	-10
69	Morocco	2.84	56	0.43	60	3.27	11
70	Mexico	2.53	61	0.57	56	3.11	-22
71	India	1.93	71	1.06	42	2.99	11
72	Pakistan	2.74	58	0.06	79	2.80	16
73	Mauritius	2.22	67	0.55	57	2.77	-2
74	Turkey	2.50	62	0.25	64	2.75	12
75	South Africa	1.69	73	0.71	50	2.40	-2
76	Philippines	1.62	76	0.71	51	2.33	-2
77	Benin	2.14	68	-0.05	87	2.09	-5
78	Greece	1.06	84	1.02	43	2.08	1
79	Togo	2.56	60	-0.51	92	2.05	-20
80	Belarus	2.04	69	0.01	81	2.05	-3
81	Niger	1.66	74	0.22	67	1.89	9
82	Namibia	1.96	70	-0.11	90	1.84	-1
83	Swaziland	1.76	72	-0.04	86	1.72	-38
84	Senegal	1.61	77	0.10	75	1.71	-9
85	Republic of Korea	0.59	88	1.11	40	1.69	-15
86	Sri Lanka	1.53	78	0.12	73	1.65	-8
87	Japan	0.22	90	1.43	35	1.65	-2
88	Bolivia	1.31	81	0.03	80	1.34	-66
89	Paraguay	1.19	83	0.07	78	1.26	-5
90	Venezuela	0.68	87	0.52	58	1.20	-37
91	Kenya	0.73	86	0.09	76	0.82	-2
92	Cameroon	0.54	89	-0.11	91	0.43	-26

## NOTES:

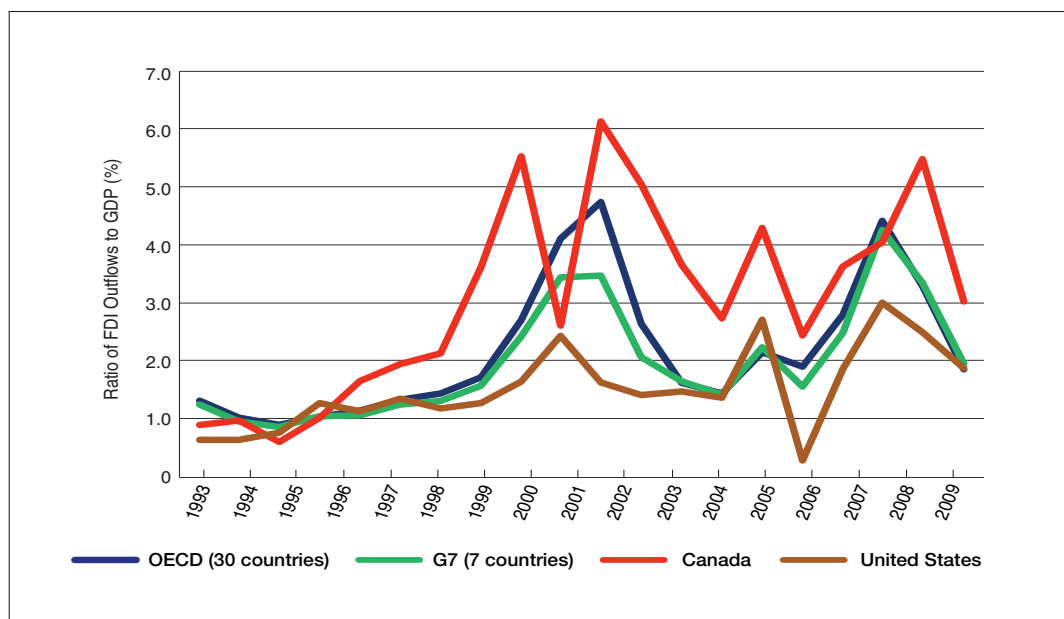
1. Change in rank is from the average values over the period 1999-2003.
2. The averages used for change in rank for Luxembourg and Belgium are over the period of 2002-2003. Prior to 2002, the combined FDI inflows and outflows were reported for these countries. The Belgium-Luxembourg combined averages over 1999-2003 for FDI inflows, outflows, and sum of inflows and outflows are equal to 50.6%, 54.6%, and 105.2% of GDP, respectively.
3. Hong Kong is China's Special Administrative Region.
4. Macao is China's Special Administrative Region.

SOURCES OF DATA: FDI flows: International Monetary Fund, International Financial Statistics, September, 2010;  
GDP: World Bank, World Development Indicators, July 2010.

The decline in investment in 2008 can be seen prominently in recent mergers and acquisitions (M&As) involving Canadian interests. Activity started to decline in the final quarter of 2007 and continued throughout much of 2008. Total M&As in Canada, which totalled \$370 billion in 2007, fell to \$115 billion in 2008.<sup>4</sup> The average number of transactions per quarter and the total value of these transactions began increasing again during 2009. They are finally trending around what we were experiencing prior to 2006.

Canada has always been a larger player in investment outflows. The only two periods in the last 15 years in which it has been net importer of capital have been the two most recent economic booms. Canada has remained above the OECD average in terms of outflows as percentage of GDP almost entirely throughout the last 15 years and maintained sizeable outflows going into 2008, before 2009 finally brought an expected decline in investment abroad from Canadian firms (Figure 2). Unfortunately, Canada's world ranking has still been falling over the last 15 years. When taking the average net outflows for the periods 1999-2003 and 2004-2008, Canada's rank has fallen from 16th to 23rd.

**FIGURE 2: Ratio of FDI Outflows to GDP for Selected Countries and Country Groups, (Based on Groups' Total Outflows and GDP)**



SOURCES: FDI flows: International Monetary Fund, International Financial Statistics, September, 2010; GDP: World Bank, World Development Indicators, July 2010.

To construct a measure of openness to investment we combine these two measures, providing the sum of inflows and outflows as a percentage of GDP. Under this classification, Canada ranks only 32nd out of 92 countries, behind countries such as the United Kingdom, Sweden, Spain, and France.

<sup>4</sup> All merger and acquisition statistics from Crosbie & Company Inc., various years.



While sitting at an average level in the world FDI/GDP rankings, Canada's rank in potential FDI, as measured by the United Nations Conference on Trade and Development (UNCTAD), is a lofty 11th in the world (of 141 countries), making Canada one of largest underperformers in FDI inflows. This indicates either that Canadian flows are subject to different criteria than that measured by the UN, or we are not living up to our potential.

This is not to say that Canada should become a conduit to attract as much FDI as possible. Indeed, a number of the major nations rank somewhat low in our ratio of FDI/GDP despite being pegged as attractive locations to FDI, including most of the G7. However, there are additional benefits that a resource rich country like Canada may have from added international capital and we should position ourselves to take advantage of these benefits without having to run the risk of being 'hollowed out' by multinational corporations. As Canada is no longer as reliant on manufacturing as has been in the past, having developed instead a reliance on natural resources, we must be careful to ensure that the wealth from these resources is kept within our borders, rather than allowing the exportation of rents.

The growth of a number of developing nations that have become important players in international trade and financial markets has altered the composition of countries investing in Canada, which presents new challenges. Though the United States remains Canada's largest trade partner as well as source of FDI, these shares have been falling over time. Whereas 69 percent of our stock of foreign investment originated from the United States in 1987, this stock has fallen to 52 percent in 2009, with Europe taking most of this slack, growing from 22 percent to 35 percent, and Asian markets increasing their share more slowly, from 5 percent to 9 percent.

## WHY CANADA SHOULD BE OPEN TO FDI

The most common arguments against increased foreign investment have centred on the potential of foreign investment 'crowding out' domestic investment. There are also concerns FDI has a negative effect on a nation's balance of payments due to an increase in demand of capital and intermediate goods. The research on crowding effects of foreign investment has yielded mixed results, with some supporting crowding in<sup>5</sup> and some crowding out,<sup>6</sup> though none of these correlations come close to providing proof of causation. Similarly, dissecting a causal relationship between FDI and the balance of payments is difficult<sup>7</sup> and Canada's generally strong current account balance suggests this is not a compelling case.

---

<sup>5</sup> Barry Bosworth and Susan Collins (1999), *Capital Flows to Developing Economies: Implications for Saving and Investment*, in *Brookings Papers on Economic Activity*, 30(1), 143-180.

<sup>6</sup> Bruce A. Blonigan and Miao G. Wang (Washington, D.C., 2005), *Inappropriate Pooling of Wealthy and Poor Countries in Empirical FDI Studies*, in T. Moran, E. Graham, E., M. Blomstrom (Eds.), *Does Foreign Direct Investment Promote Development?* Institute for International Economics, 221-243.

<sup>7</sup> Gary, Hufbauer, Darius Lakdawalla and Anup Malani (New York and Geneva, 1994), *Determinants of Direct Foreign Investment and Its Connection To Trade*, in UNCTAD Review.



Further objections to increased foreign control have focused on differences in the strength of corporate governance in foreign countries and on concerns that while domestic firms operate in the domestic interest, foreign companies do not. Corporations newly formed via mergers and acquisitions may be subject to host country governance laws, something that has been largely seen as a potential benefit to developing nations, but could hurt the makeup of corporations in developed nations that are acquired by firms subject to weaker corporate laws. These fears have few legs to stand on, with little evidence that increased globalization has had an effect on corporate governance, due to the strength of local interests of host countries.<sup>8</sup> There is also no basis to claims that firms from nations with less stable institutions gain, or attempt to gain, an advantage from investing in countries with better corporate standards.

Other popular criticisms of foreign direct investment include that it leads to a lack of research and development, low productivity, few linkages to the rest of the economy and to a transfer of headquarter functions abroad, resulting in a reduced stake in the community through charitable contributions. Little evidence has been provided to buttress these arguments. One important study<sup>9</sup> found that foreign-controlled companies created more head offices in Canada than Canadian-controlled companies, undertook more research and development in Canada, had higher productivity rates and paid higher wages. Their knowledge-based activities also contributed to better performance by Canadian-controlled companies linked to them.

Thus, there are significant potential benefits realized by allowing investment into Canada as recognized by the Competition Policy Review Panel.<sup>10</sup> If a foreign corporation chooses to invest in a market, as opposed to export or arrange license agreements, it is generally assumed they exhibit at least one of the oft-cited 'OLI' advantages (Ownership, Location, Internalization) over domestic firms.<sup>11</sup> These advantages manifest themselves in foreign multinational firms continually showing to be more productive than their competition, in both labour and total factor productivity due to technological advantages, returns to scale, or higher capital intensities.<sup>12</sup> This does not result in more efficient foreign firms forcing out domestic firms, as the technological advantages of large multinationals have spillover impacts on domestic firms,<sup>13</sup> which lead to increased labour productivity and higher wages for workers.<sup>14</sup>

---

<sup>8</sup> Tarun Khanna, Joe Kogan and Krishna Palepu (2006), *Globalization and Similarities in Corporate Governance: A Cross-Country Analysis*, in *The Review of Economics and Statistics*, 88(1), 69-90.

<sup>9</sup> John Baldwin and Guy Gellatly (Ottawa, 2007), *Global Links: Multinationals in Canada: An Overview of Research at Statistics Canada*, in *Canadian Economy in Transition Series*, Statistics Canada.

<sup>10</sup> Competition Review Panel, Industry Canada (Ottawa, 2008), *Compete to Win*.

<sup>11</sup> John H. Dunning, *American Investment in British Manufacturing Industry*, (London: Allen & Unwin, 1958).

<sup>12</sup> Robert E. Lipsey, *Home and Host Country Effects of FDI*, No 9293, in *NBER Working Papers, National Bureau of Economic Research* (2002).

<sup>13</sup> Mangus Blomstrom and Ari Kokko (1998), *Multinational Corporations and Spillovers*, in *Journal of Economic Surveys*, 12(3), 247-277.

<sup>14</sup> Zadia Feliciano and Robert E. Lipsey, *Foreign Ownership and Wages in the United States, 1987 - 1992*, No 6923, *NBER Working Papers, National Bureau of Economic Research*, (1999). See also David Figlio and Bruce A. Blonigen (2000), *The Effects of Foreign Direct Investment on Local Communities*, in *Journal of Urban Economics*, 48(2), 338-363.

These benefits are not restricted to firms investing and transferring technology to less developed countries. In fact, technological spillover effects may be greater for industries that require more skilled labour and where the technological differences between domestic firms and foreign firms are smaller, indicating FDI inflows may be more beneficial for developed countries such as Canada.<sup>15</sup>

Overall, there is much to gain from foreign direct investment. Given Canada has been a net capital exporter since the mid-1990s, it would be odd for Canada to shut its doors to foreign investors while our own companies are successfully competing abroad.

## IMPORTANCE OF STATE-OWNED ENTERPRISE AND SOVEREIGN WEALTH FUNDS IN FDI: IS THE PLAYING FIELD EVEN?

With many emerging countries experiencing strong growth, resulting in substantial capital funds that could be deployed anywhere in the world, state-owned enterprises are playing a prominent role in foreign acquisition markets. A number of important mergers have taken place involving state-owned enterprises, including companies from advanced G-20 countries like France and Korea and emerging economies such as China and the Middle East. As we illustrate in Table 2, many global acquisitions of over \$1 billion have involved resource companies in 2009.

**TABLE 2: Cross-border M&A deals worth over \$1 billion completed in 2009 involving wholly or partly-owned State-Owned Enterprises**

Value (\$B)	Acquired company	Acquiring company	State
16.9	British Energy Group PLC	Electricité de France International SA (EDF)	France
9.6	Volkswagen AG	Qatar Investment Authority	Qatar
7.2	Addax Petroleum Corp	Sinopec International	China
6.1	Nuon NV	Vattenfall AB	Sweden
4.5	Constellation Energy Nuclear Group LLC	Electricité de France International SA (EDF)	France
4.4	Cia Espanola de Petroleos SA	International Petroleum Investment Co	UAE
3.9	Harvest Energy Trust	Korea National Oil Corp (KNOC)	South Korea
3.9	Chartered Semiconductor Manufacturing Ltd	Advanced Technology Investment Co LLC	UAE
2.9	Advanced Micro Devices Inc	Advanced Technology Investment Co LLC	UAE
2.8	Felix Resources Ltd	Yanzhou Coal Mining Co Ltd	China
2.0	Ternium Sidor	Corporacion Venezolana de Guayana	Venezuela
1.6	OOO SeverEnergia	OAO "Gazprom"	Russia
1.4	OZ Minerals Ltd	China Minmetals Nonferrous Metals Co Ltd	China
1.3	ProLogis (China Operations)	GIC Real Estate Pte Ltd	Singapore
1.2	Singapore Petroleum Co Ltd	PetroChina International (Singapore)Pte Ltd	China
1.2	Romp petrol Group NV	AO Natsionalnaya Kompaniya	Kazakhstan
1.1	Oil Search Ltd	International Petroleum Investment Co	UAE
1.1	Banco de Venezuela SAICA	Republic of Venezuela	Venezuela
1.0	Singapore Petroleum Co Ltd	PetroChina International (Singapore)Pte Ltd	China
1.0	Sibir Energy PLC	OAO Gazprom Neft	Russia

SOURCE: UNCTAD, *World Investment Report (2010)*

<sup>15</sup> Magnus Blomstrom, Ari Kokko and Steven Globerman (Basingstoke: Palgrave, 2001), *The Determinants of Host Country Spillovers From Foreign Direct Investment: A Review and Synthesis of the Literature*, in N. Pain (Ed.), *Inward Investment, Technological Change and Growth*, 34–65.

Acquisitions made by state-owned enterprises are not a new trend – there have been many instances in the past whereby sovereign wealth funds or, more typically, state-owned enterprises have bought up foreign companies when operating at a global scale. Some well-known energy companies that were once owned by governments include BP (privatized in 1987), France’s Elf Aquitaine (privatized in 1994), Petro-Canada (privatization completed in 2004), and Norway’s Statoil (still state-controlled). Many participated in developing Canada’s natural resource economy.

When state-owned enterprises operate on the same basis as privately owned companies, decisions are based on commercial criteria. To acquire foreign companies or invest in greenfield projects, a state-owned enterprise would have no distinctive non-economic advantage compared to other companies, thereby raising little concern for policy. However, state-controlled companies might benefit from government subsidies, low-cost loans and/or tax-exempt status that provides them a competitive edge in markets. State-owned enterprises might be in position to acquire companies not because of superior management skills but because they rely on government support.

Governments could block outright foreign takeovers by state-owned enterprises over fears that state-owned companies have public-supported advantages. Canada recently blocked the takeover of MacDonald Dettwiler on the grounds that the current Investment Canada Act requires takeovers to be evaluated in terms of their net benefit. Presumably, a takeover by a foreign state-owned enterprise that provides no economic benefits but leads to poor financial performance and tax avoidance might be viewed as failing the ‘net benefit’ test. Takeovers could be blocked on these grounds.

Yet, it is not clear that the best policy is to simply block state-owned enterprises from takeovers given that new foreign companies operating in Canada could eventually improve industrial performance through competition that is nearly impossible to predict accurately. Policies should aim to ensure that a level playing-field is achieved instead.

For example, the tax-exempt status of foreign sovereign wealth funds and state-owned enterprises can provide them an advantage that enables these entities to outbid Canadian companies on the presumption that most Canadian corporate tax can be avoided. This can be achieved by restructuring Canadian businesses so that most payments made to the state-owned entity are exempt from tax in the non-resident country but are deductible expenses in Canada. Under treaty arrangements, the income paid to the parent may bear some but little Canadian withholding tax. Canadian policy could be revised to ensure that favourable withholding tax rates are not negotiated in these instances when related-party transactions are involved. Alternatively, certain types of deductions taken in Canada could be disallowed to ensure corporate tax is paid. While this would put foreign state-owned companies on a level playing field with taxable Canadian companies, it might also be necessary to adjust tax policies with respect to other tax-exempt entities operating in Canada as well as foreign investors who employ tax-efficient structures to avoid Canadian tax.

## THE CASE OF RESOURCE INDUSTRIES

One special consideration is with respect to non-renewable extractive industries. In Canada, resources are owned by the state, so effectively a private company invited to extract resources serves as a partner with the state. Representing its citizens, governments have a responsibility to make sure that resource rents, which are collected from the royalties and taxes paid by producers, are maximised.

In principle, provincial governments, as owners of the non-renewable resources, might wish to have some say in determining partners to extract resources. Presumably, the province would like to maximize economic rents and therefore welcome foreign takeovers if they improve management and profitability. As long as bidders have no special subsidy or tax advantages, then the takeover market helps ensure that governments get the most able producers as partners in resource development.

The recent case of BHP Billiton's proposed hostile takeover of Potash Corp. is a good illustration of this principle. Without doubt, BHP is a successful corporation and its willingness to offer a higher price for Potash's shares, compared to the market prices that existed prior to the takeover announcement, implies that the existing owners would be able to share in profits that would be generated by better operational efficiency after the takeover. However, if BHP were able to acquire the company only because it had government financial support, then the Saskatchewan government could be concerned that it might lose economic benefits that would be generated by Potash Corp.'s activities in the province.

Our interest is not to judge whether the BHP price is appropriate or not – markets will eventually make that determination. However, given Canada's mediocre FDI performance, there seems little case for the government, as opposed to the shareholders, to block BHP Billiton's acquisition of Potash Corp. Should such a move result in a state-owned enterprise buying up Potash Corp. for an even higher price, the Government of Saskatchewan might be concerned about whether it derives top economic rents from production taking place in the province. This outcome could also undermine investment performance in Canada as well potentially hurt relations with other countries where our own companies are investing.

## CONCLUSIONS

Canada is far from being hollowed out as often claimed when foreign investors acquire Canadian companies. The evidence does not support that foreign direct investment in Canada is large. If anything, Canada is an underperformer.

Instead, Canada is a net capital exporter with our own successful domestic companies operating at a global scale. Rather than being hollowed out, we are hollowing out other countries.

In our view, foreign direct investment provides positive benefits to the Canadian economy and should therefore be encouraged rather than blocked, except in special circumstances. In particular, takeovers of Canadian companies by foreign state-owned enterprises might raise some concern if foreign governments provide special support to the state-owned enterprise that puts it in an advantageous market position. The aim of Canadian policy is to try to make sure that all companies, regardless of ownership, operate under a level playing field rather than simply blocking foreign companies operating in Canada.

## About the Authors

### **Dr. Jack Mintz**

#### **The James S. & Barbara A. Palmer Chair in Public Policy**

Dr. Jack M. Mintz was appointed the Palmer Chair in Public Policy at the University of Calgary in January 2008.

Widely published in the field of public economics, he was touted in a 2004 UK magazine publication as one of the world's most influential tax experts. He serves as an Associate Editor of *International Tax and Public Finance* and the *Canadian Tax Journal*, and is a research fellow of CESifo, Munich, Germany, and the Centre for Business Taxation Institute, Oxford University. He is a regular contributor to *Canadian Business* and the *National Post*, and has frequently published articles in other print media.

Dr. Mintz presently serves on several boards including Brookfield Asset Management, Imperial Oil Limited, Royal Ontario Museum and the Board of Management, and the Board of Morneau Sobeco. He was also appointed by the Federal Minister of Finance to the Economic Advisory Council to advise on economic planning and served as research director for the Federal-Provincial Minister's Working Group on Retirement Income Research.

Dr. Mintz held the position of Professor of Business Economics at the Rotman School of Business from 1989-2007 and Department of Economics at Queen's University, Kingston, 1978-1989. He was a Visiting Professor, New York University Law School, 2007; President and CEO of the C.D. Howe Institute from 1999-2006; Clifford Clark Visiting Economist at the Department of Finance, Ottawa; Chair of the federal government's Technical Committee on Business Taxation in 1996 and 1997; and Associate Dean (Academic) of the Faculty of Management, University of Toronto, 1993-1995. He was founding Editor-in-Chief of *International Tax and Public Finance*, published by Kluwer Academic Publishers from 1994-2001, and recently chaired the Alberta Financial and Investment Policy Advisory Commission reporting to the Alberta Minister of Finance.

In 2002, Dr. Mintz's book, *Most Favored Nation: A Framework for Smart Economic Policy*, was winner of the Purvis Prize for best book in economic policy and runner-up for Donner Prize for best book in public policy.

Dr. Mintz has consulted widely with the World Bank, the International Monetary Fund, the Organization for Economic Co-operation and Development, the governments of Canada, Alberta, New Brunswick, Ontario, and Saskatchewan, and various businesses and nonprofit organizations.

**Matt Krzepkowski** completed his M.A. in economics from the University of Calgary in 2009. He is currently working on finishing his Ph.D. in economics at the University of Calgary, specializing in Public Economics and Finance.

## ABOUT THIS PUBLICATION

The School of Public Policy Research Papers provide in-depth, evidence-based assessments and recommendations on a range of public policy issues. Research Papers are put through a stringent peer review process prior to being made available to academics, policy makers, the media and the public at large. Views expressed in The School of Public Policy Research Papers are the opinions of the author(s) and do not necessarily represent the view of *The School of Public Policy*.

## OUR MANDATE

The University of Calgary is home to scholars in 16 faculties (offering more than 80 academic programs) and 36 Research Institutes and Centres including *The School of Public Policy*. Under the direction of Jack Mintz, Palmer Chair in Public Policy, and supported by more than 100 academics and researchers, the work of The School of Public Policy and its students contributes to a more meaningful and informed public debate on fiscal, social, energy, environmental and international issues to improve Canada's and Alberta's economic and social performance.

*The School of Public Policy* achieves its objectives through fostering ongoing partnerships with federal, provincial, state and municipal governments, industry associations, NGOs, and leading academic institutions internationally. Foreign Investment Advisory Committee of the World Bank, International Monetary Fund, Finance Canada, Department of Foreign Affairs and International Trade Canada, and Government of Alberta, are just some of the partners already engaged with the School's activities.

For those in government, *The School of Public Policy* helps to build capacity and assists in the training of public servants through degree and non-degree programs that are critical for an effective public service in Canada. For those outside of the public sector, its programs enhance the effectiveness of public policy, providing a better understanding of the objectives and limitations faced by governments in the application of legislation.

---

### DISTRIBUTION

Our publications are available online at [www.policyschool.ca](http://www.policyschool.ca).

### DISCLAIMER

The opinions expressed in these publications are the authors' alone and therefore do not necessarily reflect the opinions of the supporters, staff, or boards of The School of Public Policy.

### COPYRIGHT

Copyright © 2010 by The School of Public Policy.

All rights reserved. No part of this publication may be reproduced in any manner whatsoever without written permission except in the case of brief passages quoted in critical articles and reviews.

### ISSN

1919-112x SPP Research Papers (Print)  
1919-1138 SPP Research Papers (Online)

### DATE OF ISSUE

October 2010

### MEDIA INQUIRIES AND INFORMATION

For media inquiries, please contact Morten Paulsen at 403-453-0062.

Our web site, [www.policyschool.ca](http://www.policyschool.ca), contains more information about The School's events, publications, and staff.

### DEVELOPMENT

For information about contributing to The School of Public Policy, please contact Cheryl Hamelin, Director of Development, by telephone at 403-210-6622 or on e-mail at [c.hamelin@ucalgary.ca](mailto:c.hamelin@ucalgary.ca).

### EDITOR

Claudia Cattaneo



This paper was released at *The Energy Roundtable, 2010*  
sponsored by The Canada Europe Roundtable for Business.