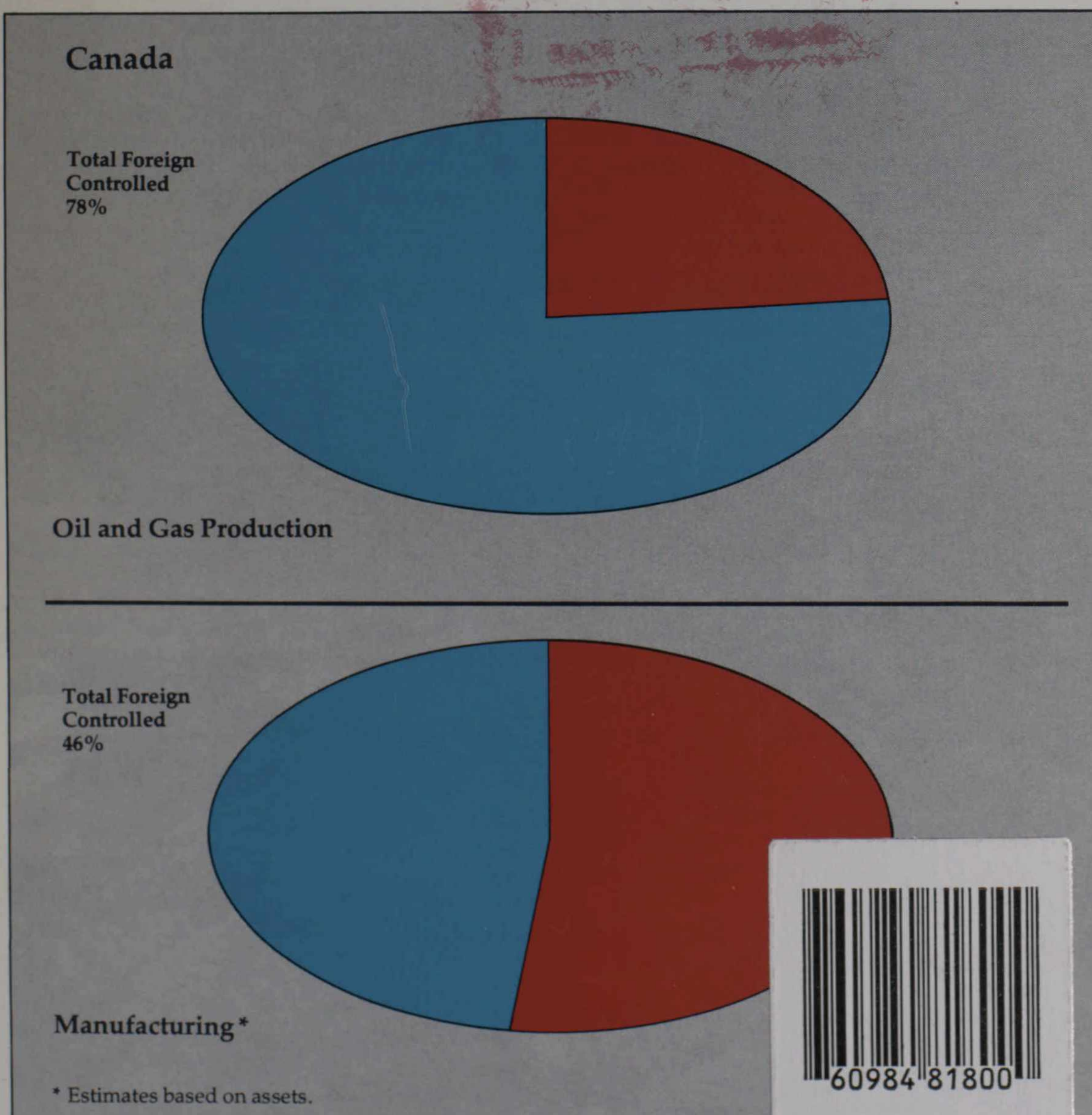
# CANADA
## TODAY / D'AUJOURD'HUI



**Foreign Control of Key Sectors – as of December 31, 1980**




**Source** – Combined Data from Statistics Canada; Energy, Mines and Resources Canada

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# Investments

Bankers and industrialists believe that Canada's greatest period of growth is just ahead. The pie will grow (particularly the energy pie) and foreign companies and investors will share it.

There are, however, problems. Britons may not realize that nineteen of the fifty largest firms in Canada are owned or controlled by foreign companies. Canadians do.

American firms dominate the production, refining and marketing of Canada's oil and natural gas. They also dominate chemicals, the auto industry, the manufacture of electrical products and a great deal more.

The most striking fact about U.S. direct investment is its size—over $38 billion, or 80 per cent of all foreign direct investment in Canada. U.K. direct investment in Canada is $4.4 billion, or 9 per cent of the total. U.K.-controlled investment is $7.4 billion, or 11 per cent of the total.

Young nations with resources attract capital. In the nineteenth century, when the United States was as young as Canada is now, British investors controlled many of its enterprises. This worried Americans. A decision in the city of London could cause a panic on Wall Street and an unemployment crisis in Illinois. Today, however, only two of the fifty largest firms in the United States are foreign-owned.

Canada is willing to share its growth, but it does not wish to have foreign companies control three-quarters of production revenues in such an essential sector as the oil and gas industry. Fifty-fifty ownership is closer to what Canada has in mind there.

In this issue of CANADA TODAY/D'AUJOURD'HUI we consider Canada's efforts to strike an appropriate balance between investments from home and those from abroad.

# The Evolution of Foreign Investment Policy

Canada has always attracted large amounts of foreign capital. British investors dominated at first, but by the mid-1920s Americans had become the chief owners of Canada's developed and developing natural resources.

The change, in the words of economist and historian Harold Innis, was "accompanied by friction and a vast realignment of the Canadian system."

In the 1950s Walter Gordon, Chairman of the Royal Commission on Canada's Economic Prospects, said that "if we do not take steps to regain control of the Canadian economy—and this will not be easy—I do not believe Canada will be able to retain her independence indefinitely in any real sense of the term . . . ."

But Gordon also said, "Canadians must fully realize that we share this continent with [the United States] and this must be forever; there is no provision for divorce in the intimate relationship between our two countries."

Gordon went on to become a controversial Finance Minister under Prime Minister Lester Pearson. In 1966 the Pearson government asked Canadian-based foreign corporations to make a conscious effort to foster the growth of Canadian technology and trade, and in 1975 the Trudeau Government issued guidelines for foreign companies, entitled "New Principles of International Business Conduct."

During the seventies the government created two instruments which would ensure Canadians a greater involvement in their own economy.

Petro-Canada Ltd. was chartered in 1975. Its primary purpose was to ensure Canadians a greater involvement in the development of their own petroleum resources and to make sure that Canada has a secure supply of oil and gas. It is an integrated producer and refiner of oil and gas, which is intended to serve as a vehicle for government policy. It can acquire open Federal or Crown Reserves. Industry was against the crea-

**Cover Illustration:**

*The figures for foreign control of oil and gas production in Canada do not take into account the major takeovers by Canadian companies in 1981, which have significantly reduced foreign control.*

*Canadian statistics on foreign control of manufacturing tend to understate the extent of foreign control because:*

- *Determination on the basis of assets ignores the fact that foreign controlled companies have a greater than proportional control of the market.*
- *In Canada, foreign ownership of 10% or more does not necessarily establish foreign control.*

tion of Petro-Canada initially, but the opposition has softened.

The evolution of the Foreign Investment Review Agency began in 1971 when Herb Gray, then Minister of National Revenue, suggested that a specific agency be created to screen foreign investments. After thorough debate, a bill to do so was passed by the Canadian Parliament in 1973.

It provides for the review of two types of foreign investments: taking control of an existing Canadian business and establishing a new business in Canada.

## Canada's Energy Policy

Canada's energy policy, announced in October, 1980, has three general goals: to achieve energy self-sufficiency, to provide Canadians with the opportunity to participate in the growth of the energy industry, and to ensure an equitable distribution of energy revenues among all Canadians.

Although Canada is a net exporter of energy, primarily natural gas and electricity, it is still a net importer of oil. Imports are approximately 430,000 barrels a day or 25 per cent of crude oil requirements. The new energy policy contains measures to achieve energy independence, including a conservation program, a fuel substitution program and an incentive program for exploration and development in the provinces and the Arctic and off Canadian shores.

At the end of 1980, according to the latest Energy, Mines and Resources data, 72 per cent of the Canadian petroleum industry (in terms of upstream revenues) was foreign-owned, and 78 per cent was foreign-controlled. Before the policy was introduced, seventeen of the twenty-five largest oil and gas companies in Canada were foreign-owned and controlled, and these companies accounted for three-quarters of all production. The government's target is 50 per cent Canadian ownership of oil and gas production by 1990.

Legislation now in the House of Commons offers particular exploration and development incentives to Canadian firms. It also provides that:

- Holders of rights in northern and off-shore lands must maintain active exploration programs.
- Canadian investors, government and private, will have at least a 50 percent interest in production from such lands.
- As part of this ownership requirement, Petro-Canada (or some other designated Crown Corporation) will have a 25 per cent working interest in these producing wells.


*The wildcat wells shown on the map constitute Dome Canada's 3-year Arctic Islands exploration program.*

• A Petroleum Incentives Program provides escalating grants for exploration in the North and in offshore regions. Under this program, the after-tax (after incentive) cost of $1 spent on exploration in these areas will range over the next few years from 28 to 40 cents for foreign-owned firms. This compares to an after-tax cost of about 63 cents for exploration in the U.S.

Only Canadian-controlled companies will receive incentive payments for exploration or development on provincial lands. For exploration on federally owned lands (in the North and offshore) foreign-controlled companies will receive a 25 per cent incentive payment. Canadian-controlled companies will receive incentives ranging from 50 to 80 per cent for exploration and 10 to 20 per cent for development on federal lands, depending on the degree of Canadian ownership.

In order to give the industry a period of adjustment, a sliding scale of Canadian ownership targets has been established, making companies with Canadian control and at least 65 per cent Canadian ownership in 1981 eligible for the maximum incentive grants. The minimum ownership requirement will rise by two percentage points annually, to reach 75 per cent by 1986.

## The Dome Case

Dome Petroleum is the striking example of a company that found it practical and profitable to take advantage of Canada's energy policy and Canadianize a part of itself.

Dome, which has enormous holdings in Canada, has been the most aggressive explorer in that country in recent years.

On January 29, 1981, Dome announced the reorganization of its subsidiary, Dome Canada Ltd., to form a new company that would finance exploration projects in western Canada, the Beaufort Sea, the Arctic Islands and off Canadian shores. In return the new company would acquire a 50 per cent interest in the Dome lands explored.

Canadians would own at least 75 per cent of Dome Canada, which would, in consequence, receive the maximum incentive grants for exploration.

This is how the ownership ratios were achieved: Dome Petroleum, the principal, bought 45 per cent of the stock in the new company. The rest, 55 per cent or $420 million worth, was offered exclusively to the Canadian public. The stock offering was immediately taken up. Since some 39 per cent of the parent company is owned by Canadians, this means that Canadians own about 75 per cent of the new company.

Dome Canada's 1981 exploration programs in the Beaufort Sea, western Canada, the off-shore East Coast and the Arctic Islands totaled $400 million. In the second quarter of the year it was engaged in the drilling of forty wells in the West. Of the first eight completed, six indicated gas discoveries. For its services Dome Canada earned a 50 per cent interest in approximately 110,000 acres surrounding the forty wells.

## The View from FIRA

"Make no mistake about it, most Canadians recognize and acknowledge the signal contribution that foreign investment, including U.S. investment, has made to Canada . . . . But we are also aware of the costs associated with at least some of that investment . . . . I am, of course, referring to situations where a substantial proportion of foreign-controlled Canadian businesses are in effect restricted to servicing the Canadian market, are not permitted to take advantage of export opportunities, do not have any research and development program nor any reasonable measure of autonomy in decision-making and technological innovation . . . . Canadians are understandably quite sensitive to the behaviour of foreign-controlled corporations whenever it affects their chances of getting high-skilled employment, their ability to participate directly in the development and benefits of industry and, especially, their ability to determine their own economic destiny. Public opinion polls over the last 10 years have consistently shown strong popular support for measures designed to remedy problems of this sort . . . ."

*Gorse Howarth, Commissioner of the Foreign Investment Review Agency, speaking at Harvard Law School, June 1981.*

## FIRA: The Rules of the Game

A foreign firm planning to acquire an existing Canadian firm or start a new one submits an application to the Foreign Investment Review Agency.

FIRA's basic role is to decide if the proposed investment is likely to be of significant benefit to Canada. The assessment is based on performance-oriented criteria specified in the Act. These cover economic activity (including resource processing); sourcing and exports; Canadian participation in management and ownership; industrial efficiency (including productivity, technological development and innovation); competition; and compatability with government policy.

FIRA works with applicants who do not meet the "significant benefit" requirements and who are willing to upgrade their submissions. After consulting with officials in the provinces that might be affected and with other federal departments, it makes a recommendation to the Minister of Industry, Trade and Commerce. The Minister in turn makes a recommendation to the Cabinet, which makes the final decision, on a case by case basis.

More than 90 per cent of all proposals considered by FIRA since it began its screening operation in 1974 have been approved.

## Interdependence

*Former U.S. Ambassador to Canada Thomas Enders spoke on FIRA in a speech at Stanford University, May 3, 1979.*

"Canada/U.S. relations will not work well if we feel that we are prisoners of our interdependence, not its masters.

"How can we retain control? There are a variety of means. One is to recognize the need for such national safeguards as Canada's Foreign Investment Review Act (FIRA) and the U.S.'s countervailing duty authorities. It was feared that FIRA might act as a barrier to new incoming investment in Canada. But rather it has applied its mandate—to assure benefit to Canada in investment proposals. Its current approval rate of 90 per cent is an indication of the quality of proposals it receives. I can understand how Canada, relying as heavily as it does on outside investment, feels the need for having such a mechanism to insure that its interests are identified and met."

## Price Waterhouse Report

The investment firm of Price Waterhouse recently surveyed the non-tax restrictions on direct foreign investment in seventy-three countries.

It had this to say about Canada:

" . . . traditionally foreign investment has been welcomed in Canada. The development of Canadian natural resources has required substantial injections of foreign capital, both debt and equity, and foreign investors have played a very significant role in the growth of the Canadian economy since the Second World War. However, as the Canadian economy matures, there has been an increasing tendency for the National and provincial governments to impose some restrictions on new foreign investments, particularly in certain sensitive sectors of the economy. In spite of this, there are still relatively few restrictions in Canada if the country is compared to other industrial countries."

## A Word About Product Mandating

A foreign firm wishing to do business in Canada is likely to be judged favourably if its Canadian plant will produce products which will be sold on the world market.

Most often this means that the parent company gives the subsidiary a "world product mandate," that is, the exclusive franchise to produce a particular thing. A mandate may have little significance—one to produce nuts, bolts, nails or paper clips would not involve the development of research facilities or the employment of highly skilled and highly paid workers—but many American parents have found it profitable to make their Canadian subsidiaries respectable partners in international enterprises. Two examples are given below.

### Signal Companies and Garret Manufacturing Ltd.

Signal Companies is a $4.2 billion-a-year conglomerate with interests in petrochemicals, trucks, television, avionics and aerospace. Garrett Corporation of Los Angeles is a division of Signal, and Garrett Manufacturing Ltd. of Toronto, a subsidiary of Garrett. GML has a hustling, enterprising research and development section and a contract to design and produce the first airborne digital temperature control systems ever built, for the Boeing 756 and 767.

When GML was awarded a contract to produce air data computers for the CF-104 fighter, Garrett Corporation invested $15 million in the Toronto plant, upgrading the facilities from a warehouse and assembling operation to a full manufacturing plant. It promoted GML to an active manufacturing division, one of eight in North America and eleven in Brazil, Great Britain, Ireland, France and West Germany.

The cooperative operation has proved notably successful. In 1960 GML imported 90 per cent of the materials it assembled and exported nothing. Today it exports about 75 per cent of its aerospace products. From the start it has been given mandates to produce sophisticated systems, and the profits have been reinvested in the plant. The company employs 1,000 people in four plants and earmarks 12 per cent of its sales revenues for research and development.

Its exports include a miniature emergency locator beacon for the Swedish Air Force, which broadcasts the location of a ditched plane and permits the crew to send and receive voice messages, and a VHF/AM transmitter-receiver, which is used by air traffic controllers around the world.

GML has proved profitable for both its parent corporations and for Canada.

### A Joint Venture in Quebec

A Canadian firm, Haley Industries, and an American one, the Bendix Corporation of Southfield, Michigan, have joined in a venture to produce ductile iron castings in Farnham, Quebec.

Haley was already producing high quality magnesium and aluminum alloy castings for the aircraft industry in its plant at Orillia, Ontario.

The Bendix Corporation is one of the world's largest independent suppliers of automotive products and, unlike many similar U.S. firms, it did not have a foundry of its own.

Haley saw Bendix as a partner-customer in a new venture. After extensive studies to analyse its potential, the two firms financed Métallurgie Farnham, Inc. jointly. They share control.

The plant was constructed at Farnham, about thirty miles from Montreal, with access to its market and close to supplies of pig iron and scrap. A significant factor in the site choice was the availability of power from Hydro-Québec, whose rates are among the lowest in North America. The foundry is expected to produce 20,000 tons of caliper brake castings by 1983, a large part of which will be used by Bendix in its operations. Other likely buyers have been found in the automotive, construction and farm machinery industries.

FIRA, in approving the undertaking, noted that it placed a modern, efficient plant in an area of high unemployment.

## The Banker's View

W.D. Mulholland is the Chairman and Chief Executive Officer of the Bank of Montreal. He is also an American citizen. The Bank, the third largest in Canada, has been a major source of financing for energy development projects. In an interview with CANADA TODAY/D'AUJOURD'HUI Mr. Mulholland made the following points.

**Q.** What would you see as the need for capital investment in Canada in the next decade, especially in the field of energy?

**A.** The Canadian economy will probably require the equivalent of $700-750 billion—in constant 1980 U.S. dollars—in new investment during the remainder of this decade. This is large by historical standards. It reflects the expected boom in energy development, as well as projections by the Economic Council of Canada that the growth rate of real GNP will average 2.5 per cent during the next ten years and that the capital requirements to finance this growth will rise to 25 per cent of GNP.

Of this sum, I would guess that about $240 billion (in 1980 U.S. dollars), or nearly one-third of all investment, will be required over the decade for energy-related investment. The most significant increases within the energy sector will relate to oil and gas investment activity.

**Q.** Do you see there being competition between Canadian and foreign investors as to who will have an opportunity to invest in developments in Canada?

**A.** Canada has traditionally had to import capital to finance her investment needs. Since investment as a proportion of total output is expected to increase in this decade, there should be ample investment opportunities for both Canadian and foreign investors.

**Q.** Do you have any comments on the degree to which foreign investors are allowed to invest in Canada?

**A.** The degree to which foreign investors will be allowed to invest in Canada is clearly a political policy decision. The National Energy Program has spelled out the conditions for the energy sector. The Honourable Marc Lalonde, Minister for Energy, Mines and Resources, has explicitly stated that the government had no intentions of extending the types of restrictions embodied in the National Energy Program to other industries or other sectors of the economy. In these other industries and sectors, the Deputy Prime Minister and Minister of Finance, Mr. Allan MacEachen, has indicated that the only requirements for foreign investors will be to satisfy the more general objectives of the Foreign Investment Review Agency.

## U.S. Investment in Canada

"Canada is the chief locus of U.S. external investment, accounting for 25 percent. Canada's share of U.S. external funds during this century has stayed consistently in the 25 percent range. The present size of U.S. investment in Canada is due, therefore, not to any increase in concentration in Canada, though that was a factor in the 1950's and 1960's, but to the remarkable growth of U.S. investment worldwide and Canada's consistent share of that investment.

"A second and long-standing characteristic of U.S. investment is the high proportion represented by direct investment, involving ownership or control of Canadian industry. Between 1900 and 1913, for example, about 55 percent of U.S. investment was direct investment, compared with only 11 percent of British investment. After 1914, the proportion fell below 50 percent but resumed its predominance after 1945. Between 1946 and 1974 the book value of U.S. investment increased by nearly $44 billion, of which nearly $27 billion or 62 percent was due to increased direct investment. Although portfolio investment was again relatively stronger in 1975 and 1976, the proportion of direct investment in the total stock was still 58 percent at the end of 1976. By comparison, only 40 percent of other foreign investment was direct investment. One consequence of the size and age of U.S. direct investment is its ability to grow from earnings generated in Canada. In recent years retained earnings of subsidiaries have been the principal source of additions to foreign direct investment . . . ."

*Joan Gherson, an economist with the Research and Analysis Branch of FIRA.*

## Economic Strategy and Foreign Investment

The economic development plan for the 1980s tabled by the Deputy Prime Minister and Minister of Finance Allan MacEachen in the House of Commons on November 12 included the statement that "The special measures being employed to achieve more Canadian ownership and control of the oil and gas industry are not, in the Government of Canada's view, appropriate for other sectors."

On the subject of FIRA it stated that:

" . . . the Agency has enabled the government to ensure that Canadians as a whole are in a position to benefit from the new foreign direct investment that continues to be welcomed here. At the same time, the review process has provided a fair and impartial treatment of all foreign investors regardless of nationality. The government wishes to ensure that the administration of the Act is timely and efficient. A review of administrative procedures is now underway to establish what changes in these procedures are warranted on the basis of the first seven years' experience.

"In the Speech from the Throne in the spring of 1980, reference was made to three specific measures, two of which involved changes to the Foreign Investment Review Act. For the time being, no legislative action is intended on these measures until progress on the major initiatives already undertaken by the government has been assessed.

"The government's objective is to ensure that foreign-controlled corporations and their Canadian counterparts alike contribute fully to the development of an innovative and internationally competitive industrial structure, pursuing Canadian objectives in areas such as research and development and international marketing with equal vigour. The guiding principle of FIRA is that foreign investment must be of significant benefit to Canada. It is a principle that should be easily adhered to by good corporate citizens."

## A Matter of National Interest

*Excerpts from a speech given last September by Secretary of State for External Affairs Mark MacGuigan to the Center for Inter-American Relations in New York.*

"Canadian governments have historically felt the need to intervene in national life to knit together and develop a huge, under-populated and in some cases forbidding land. Among the results are national television and radio networks, national airlines, the Canadian National Railway family of companies and a host of other government undertakings . . . . The need for . . . government intervention in the Canadian economy remains to this day.

"Government involvement represents a pragmatic . . . response to particular circumstances. The private sector has been and will remain the driving force behind Canada's economic development. We share with you the perception that one of the best guarantors of a free society is a free economy. But Canadian governments, at the provincial as well as federal levels, are at ease with . . . judicious intervention.

"Canada's economy is a tenth the size of yours, and is more heavily dependent on primary resource industries. The manufacturing base in Canada is narrower and is significantly foreign-controlled. In the past twenty years, the public debate . . . has centred on the question of foreign ownership.

"While Canadians acknowledge the benefits, it became clear after a decade of study . . . that there were very significant *costs* involved as well.

"In 1974 the Government established a foreign investment review process, to screen foreign investment . . . .

"Canada chose to deal with the problem totally in accordance with our international undertakings. There has been no question of nationalization, confiscation or forced sale. Foreign investors have simply been told the conditions under which they would be welcome.

"And I should emphasize the notion of welcome. Canada needs and wants foreign investment which will benefit all parties concerned. Foreign companies and individuals will continue to do business profitably in Canada. I don't believe that those who are complaining about our policies are in fact arguing that they have lost money on their investments. Certainly *not*. And by comparison with other countries, there are very few more secure places to invest money than Canada."

## British Direct Investment in Canada (1978)*

($ Millions)

| | |
|---|---|
| Chemicals | 359 |
| Vegetable Products | 234 |
| Wood and Paper Products | 272 |
| Iron and Products | 219 |
| Mining and Smelting | 460 |
| Oil and Gas | 858 |
| Merchandising | 405 |
| Financial | 1,141 |
| **Total (All Enterprises)** | **4,476** |

* Source: Statistics Canada

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