

## Foreign Investment in Australia and Canada

Is foreign ownership the price of a high standard of living in Canada and Australia? If not, why do we have so much foreign control? If it is, then what would alternative courses cost, and what would they involve? Questions like these have been raised in Canadian discussion of foreign investment for the last twenty years, without any final answers. The questions go right to the heart of Canadian policy in many areas, however, since they pose choices for the quality of life as well as for living standards, for economic freedoms, and for national identity. Despite foreign investment controls in both countries the degree of foreign ownership has been growing, - financed in many cases by income generated inside the recipient country itself. At the same time the proportion of finished manufactures in the exports of both countries has fallen, as we both have become more dependent upon resource exports and upon outside technology. Is this because no country in the modern world can both grow and control its own resources? Before drawing this conclusion, let's look carefully at the Canadian case.

Foreign controlled (principally U.S.-controlled) enterprises accounted for more than 50% of Canada's manufacturing industry assets in 1976, over 95% of the petroleum and gas industry assets, and over 60% of assets in the mining industry. There was very substantial American participation in the financial sector, and in other portions of the service sector. The picture in Australia is not dissimilar - the ABS lists foreigners as controlling 49% of large manufacturing enterprise assets in 1975/76, and 59% of mining enterprises (by value added), and (within that) 84% of petroleum and brown coal output. The degree of Canadian dependence is higher than these figures might indicate, however, since the statistical authorities in Canada count an enterprise as foreign-controlled only when foreign shareholdings exceed 50% of the total, whereas Australia will count it as foreign

controlled if a single foreign holder has <sup>15</sup> 25% or more of shares and there is no larger single Australian holding.

American participation in the Canadian economy has been growing steadily since 1945, without any apparent slackening following the control measures introduced in that period. During the 1940's Canada greatly reduced its portfolio indebtedness (bonds and stocks) to Great Britain, while increasing its direct investment debts to the United States (i.e. through branch plants and foreign subsidiaries).

This set the stage for the Canadian resources boom of the '50s and '60s, much of it carried out by American multinationals. Certain sectors and projects were reserved for Canadian enterprises (banking and broadcasting, for example) but the general approach was 'open slather' - it was assumed that Canadian enterprises competing on even terms with Americans should, on balance, hold their own.

Well, they didn't. Canada remains a net importer of capital throughout the 1950s, and foreign-owned firms, on average, grew faster than Canadian firms of the same size. The mushrooming of Canada's foreign-owned sector reflected both greater economic integration on a North American basis, and the rise of 'multinational corporations' dealing in many countries. As part of this process Canada too has exported capital (about 50% of it to the U.S.A.) and has seen some of its own companies expand into multinational concerns (Alcan, Inco, Noranda, Massey-Fergusson). Despite the two-way nature of the flow, however, there was no wave of Canadian takeovers in the U.S.A. to balance events in Canada, since the Canadian outflow was smaller (\$15.9 billion of Canadian investments abroad in 1973, as against \$54.6 foreign investments . . . /3

in Canada), and has less frequently formed part of a controlling interest in an enterprise. As a rule foreign investments in Canada have occurred in the faster-growing sectors, particularly resource-based ones, and have frequently involved large shipments of raw or semi-processed commodities to foreign processors. Where they have occurred in manufacturing it has often involved the assembly of a single produce or component (e.g. IBM typewriters) using parent-company technology. Some of the earliest Canadian subsidiaries were formed under the incentive provided by tariff protection. In more recent years the Canada-USA auto-pact (which provides for modified free trade in vehicles and components) has had a strong influence in trade and investment in that sector.

One of the first people to become alarmed by the developing situation was James Coyne, Governor of the Bank of Canada, who in 1960-62 made a series of speeches stressing that Canada was "living beyond its means" - i.e. it was covering the cost of its excessive imports by selling off its businesses to Americans. The remittance obligations incurred by this process made a vicious circle - the country would have to sell off more and more businesses to pay the increasing interest and dividends due. Economists disagreeing with Mr. Coyne pointed to the increase in the country's productive capacity which had come from the foreign investment, and argued that the openness of the economy made Canada more competitive. Furthermore, they argued, repayment burdens for direct investment tended to be highest when the economy could most easily afford it. In due course Mr. Coyne resigned following a bitter clash with the government over monetary policy.

The next Canadian economic nationalist to attempt to stem foreign investment (and thus American ownership) was Walter Gordon, who as Finance Minister levied a takeover tax as part of his 1964 budget shortly after taking office. The proposal set off a collapse on Canadian stock and bond markets as U.S. money pulled out in massive amounts, and <sup>it</sup> was shortly withdrawn. Mr. Gordon resigned several years later. Subsequently Eric Keirens, as Minister of Energy Mines and Resources, opposed the development of a Canadian pipeline to Arctic gas supplies, on the basis that its capital requirements would inevitably draw in vast sums of American money, and result in further loss of Canadian control in the economy. Keirans resigned from the Cabinet shortly thereafter. These gentlemen had, however, left their mark on the public <sup>consciousness</sup> ~~conscience~~, and government studies of the questions - the 1968 Watkins Report and the 1972 Gray Report - eventually led to the passage of the Foreign Investment Review Act in 1973. This Act came into operation in two stages: the first providing for a review procedure for foreign takeovers, and the second stage (in 1974) providing for a review of new businesses started by foreigners, and expansion of foreign-controlled businesses into new (or "unrelated") fields.

The basic criteria for approval under the Act is that an applicant demonstrate, on balance, a "significant benefit" to Canada from the transaction. The final decision rests with Cabinet. An applicant must be given a reply within 90 days, although provision exists for longer consideration. In advising the Minister of Industry Trade and Commerce (who makes the recommendation to Cabinet), FIRA gives an assessment of such factors as the expected employment effects of the proposal, the use of Canadian inputs, management and technology, and the consequences of a refusal in terms of business failures, etc. Through liaison

with the Restrictive Trade Practices Commission it is ascertained that the proposal will conform with Canada's anti-combines laws. It is not unusual for an initial application to be withdrawn following advice to the applicant from the Agency, and for it to be resubmitted including features on e.g. employment and management that make it more acceptable. The Agency also informs the governments of the provinces involved of the proposal details, and these provincial governments have often already negotiated with the applicant over such matters as royalties, plant siting incentives and tax concessions. Consequently, provincial concerns to obtain foreign investment have often been put directly to federal Cabinet, as well as to the Agency.

Australian screening procedures are not greatly dissimilar to Canada's, although they do involve private businessmen sitting on the Foreign Investment Review Board that advises the Treasurer. Australian rulings are made by the Treasurer alone, not by Cabinet. Broadly speaking, the Australian regulations governing foreign investment are somewhat wider than the Canadian ones (involving, for instance, specific bans on real estate purchases and investment in financial intermediaries) and have more specific bench-marks for Australian equity participation - i.e. the requirement that Australians own (or be in process of acquiring) at least 50% of the common shares in the enterprise, and have at least 50% of the seats on the board of directors. Canada has not yet laid down percentage requirements of this sort. The Australian Treasurer is also responsible for administering Australia's exchange controls (which Canada does not have) and these are used as one avenue of control and enforcement for FIRB decisions. Australian export controls were another powerful enforcer under Mr. Whitlam's government, and they are still present, although I believe are not used for this purpose, today.

It is very hard to appraise whether the FIRA foreign investment control regime has had a significant effect on the degree of foreign ownership in Canada, although it is quite probable that its very existence has improved the Canadian benefit from particular transactions. The aggregate problems is like trying to build a dam over a sponge - what used to be done directly may now be done indirectly, - where an American firm may once have bought up a weak Canadian firm at an early stage, it may now acquire the same market position by expansion or by tailoring the transaction to FIRA's requirements and modifying them in practice. A further consideration in recent years has been the incentives offered by all levels of government to attract new businesses - the particular benefit of investment to a town or region is very specific and immediate, whereas the cumulative cost to the country as a whole is much more difficult to assess.

What are these costs? Specialists are not agreed on their extent, but are more agreed on their nature. First, there is the loss of sovereignty - of the ability of the national government to set the rules for business behaviour. Particularly irritating instances of this for Canada arose when U.S.A. Trading with the Enemy regulations prevented sales by Canadian subsidiaries parents to Cuba or China, or U.S.A. anti-trust laws prevented Canadian-based firms from pooling patents to meet U.S.A. competition. In balancing the different governmental requirements of the various countries where they do operate, MNE decision makers must consider not only overt legal requirements, but also their day-to-day relations with regulators in all jurisdictions, and on this basis it is hard to escape the suspicion that, to borrow a famous <sup>football</sup> ~~hockey~~ phrase "nice guys finish last". Another cost of foreign ownership arises from the dependence on foreign research and development that it induces. This has been a matter of much concern to science officials in Ottawa, and the Canadian Government introduced incentives in recent

years designed to encourage firms in Canada to develop their capacity to innovate and develop new products. These capabilities allow the country be identified by the quality and imagination of its products, and offer a degree of security against obsolescence. Foreign-owned firms also offer this security, but on terms that are dictated from outside. Another cost stems from the international use of data banks - there are probably more complete financial records of many Canadians kept in Texas or California (where credit card companies centralize data) than can be found in Canada. Canadian laws against misuse of this data may not be enforceable there. Finally, there is the question of effective economic control. Tax incentives don't work as well with large multinational enterprises as they do with domestic ones, and the policy change necessary to get a desired response from them may have to be very large indeed.

On the other side of the coin, multinational enterprises have a unique ability to organize technology and resources across boundaries, with potential benefits for all parties involved. It has never been part of Canadian policy to seek the kind of autarchy prevailing in Albania, for example, and even the People's Republic of China is exploring the advantages of making deals with large international firms. The fact that the MNE has survived and flourished as the world's main means of transferring technology, despite strenuous efforts by many governments and organizations to displace it, is in itself testimony to its effectiveness. There is little reason to believe that MNEs are bad employers - on the contrary most studies seem to show that they pay higher wages than average, furnish good working conditions, and pay some attention to their community setting. Indeed, some concern of governments may derive from the sometimes supra-national loyalty of employees to their global corporation employer.

It is largely accepted that in the present era multinational regulation is necessary if MNEs are to be effectively controlled, and both Canada and Australia have participated in U.N. and OECD deliberations to this end. The problems are formidable, however, since each country wishes to see its own regulatory priorities applied internationally, and but is not always willing to accept those of others. 'Headquarters countries', such as the U.S.A., have pressed for the acceptance of the principle of 'national treatment', whereby countries would undertake to treat foreign-owned firms in the same manner as they did domestically-owned ones in regard to taxes, trade practices and similar matters. While Canada in general does accord such national treatment (once FIRA clearance has been given), it is likely to stand by its right to place limitations on foreign firms that individually transgress some aspect of national policy.

Multinational firms often have very complex international operations which make it difficult to assess tax liabilities, and Canada like Australia, faces a major hurdle in securing sufficient data on 'transfer prices' (the prices at which branches of a firm in different countries buy goods and services from each other) to assess profits and taxes equitably. Most well-established MNEs avoid blatantly devious transactions, but the complexity of their accounts is such that even experienced Revenue Canada assessors can never be entirely sure that profits accruing from Canadian operations have not been transferred abroad in one form or another.

The enterprise which engages in responsibilities of a multinational nature ought to face some form of multinational accountability. It was with this in mind that Canada proposed in the U.N. Sixth Committee in 1971 that a code of ethics be developed for MNEs. A particular object at that time was to develop



an accountability framework for dealing with marine pollution - but principles are also needed to cover other 'international' responsibilities of MNEs, and discussion of MNE regulation is now underway in many places.

Canada differs somewhat from Australia in the intensity with which the American presence pervades every aspect of Canadian life. However ubiquitous American influence may sometimes seem in Australia, there is in Australia no confusion of identities. With 90% of Canada's population living within 100 miles (150 km?) of the U.S.A. border, watching American TV, surrounded by American products and American advertizing, frequently visiting American cities, and adopting American goals and standards, the question of national identity is inescapable for Canada. It also demonstrates another aspect of the Canadian character - that Canadians often tend to get on very well with Americans as individuals while expressing reservations about them as a class. In the foreign investment field it sometimes appears that this behaviour is also reflected - Canadians oppose foreign control of businesses in general, but in any particular case manage to live quite happily with it. The whole may turn out to be more menacing than the sum of its parts, however. Once Canadian streets are practically identical to American main streets, communications are dominated by American entertainment and businesses are almost entirely American branch plants, then the Canadians who care to be something different will have nothing left to preserve.

The openness which has allowed foreign enterprises to enter and grow in Canada is a by-product of one of the best features of Canadian small-l liberalism. We have been committed as much as Australians to letting everyone have a 'fair go' - including the foreign businessman. The fact that we have built internationally

competitive businesses in fields like heavy mining machinery and space electronics may demonstrate the bracing effects of a foreign presence just as much as it demonstrates that Canadians can operate advanced industries on a world scale.

The battle to preserve (or restore) the country's identity is not one limited to foreign investment alone, and not one in which negative and ideologically-motivated anti-Americanism has a proper place. Unless Canada can build competitive industries on the basis of its own technologies and human resources, then it will risk seeing its best talent move to where the action is. Thus it has been Canadian Government policy through instrumentalities such as the Canada Development Corporation and Petro Canada to encourage Canadian entrepreneurship in large as well as small units. A number of organizations, such as the Federal Business Development Bank, are helping to prod private sources of finance into giving greater support and venture capital to innovative Canadian enterprises. Canada simply cannot afford to offer its citizens a very low standard of living, both because of the 'brain drain', and because minute comparisons of daily 'living' conditions with the country to the south is a fact of life.

Australia's problems in this field appear remarkably similar to Canada's although Australia is further back on the road and its dilemma is not as intense. The percentages of foreign control in Australia are somewhat lower, allowing for the different definitions employed. The sources of Australian investment are much more dispersed (with Japan and Britain balancing the U.S.A.), thus lessening any tendency for a single foreign power to dominate the scene. Australia's island position is reflected in its ability to apply certain types of controls - exchange controls and export controls - which help put teeth into its more comprehensive foreign investment legislation. Even allowing for these differences, however,

the same organic process seems to be in train. Familiar old local brands are disappearing from the shelves, new resources enterprises under foreign direction have become the main growth sector, and the screening process does not seem to have affected the aggregate growth of the foreign-owned sector. The present recession has caused both countries to seek to attract 'appropriate' foreign investment to help restore employment. Indeed, given the need to pay for money already borrowed, both countries depend on foreign investment inflows to maintain their international payments position.

The road that Canada has followed on foreign investment might be called the path of least resistance, or the primrose path, depending on your viewpoint. Worthy adherence to the concept of an open economy has left us with what is, in effect, an economy very closely linked to that of our large neighbour. Decisions to become more self-sufficient at this late stage are bound to be painful, but some people believe there is now simply no alternative, if any Canadian identity is to be preserved. Looking over our shoulder, as it were, and seeing Australia headed in the same direction farther back on the same path leads one to wonder whether ~~on the one hand the forces at work are so strong that even a country as far from business headquarters as Australia lacks alternative models for development, and on the other, whether there is much~~ scope for cooperation in seeking a solution.