



Submission to the Competition Review Panel

January 2008

The Asia Pacific Foundation of Canada is pleased to respond to the Competition Review Panel's call for submissions. Established by an Act of Parliament in 1984, the Foundation is an independent, not-for-profit think-tank on Canada's relations with Asia. The Foundation functions as a knowledge broker, bringing together people and knowledge to provide current and comprehensive research, analysis and information on Canada's transpacific relations. It promotes dialogue on economic, security, political and social issues, fostering informed decision-making in the Canadian public, private and non-governmental sectors.

This submission pertains to Sections 3 and 5 of the consultation document, on "Investment Policies" and "Promoting Canadian Direct Investment Abroad" respectively.

Investment Policies

Canada has one of the most open regimes for inward foreign investment and Canadians generally support foreign investment¹. While the Investment Canada Act (ICA) exists as a mechanism to review certain large-scale foreign investments in Canada, the Act has not in general been seen as an obstacle to foreign investment, except in the case of designated sectors which have specific limits on foreign participation.

Part of the original impetus for reviewing the ICA appears to be a concern that the Act is not equipped to reject investment from undesirable foreign sources. This concern has two dimensions: i) investment from foreign state-owned enterprises, and ii) foreign investment that may jeopardize the national security of

¹ A national opinion poll conducted by the Asia Pacific Foundation of Canada in 2006 found that 64 percent of Canadians agreed (with 19 percent strongly agreeing) with the statement "Canada would benefit from more Asian investment to Canada, including in the energy sector." *Canada's Views on Asia*, pages 10 & 12. Web: http://www.asiapacific.ca/analysis/pubs/pdfs/surveys/opinion_poll2006.pdf

Canadians. While these two issues have been removed from the revised mandate of the Panel, it is important for panel members to note that overly restrictive or unclear measures directed at state-owned enterprises and any sweeping prohibition of foreign investment on security grounds could have a chilling effect on foreign investment of all kinds. These two issues are in fact central to the panel's mandate to address transparency and efficacy considerations of the ICA.

Singling out state-owned enterprises for special review under the ICA is problematic because of the great diversity in state-owned businesses. Several Asian countries have state participation in "flagship" industries such as natural resources, utilities, telecommunications, transport, and infrastructure. A number of Asian governments have also set up investment holding companies that are funded by pension contributions, official reserves, distributions from state-owned companies, and other assets connected with the state. These so-called "sovereign wealth funds" have been in the limelight because their recent investments in a number of high-profile Western financial institutions. Examples include a US\$5B investment by China Investment Corp in Morgan Stanley; the Abu Dhabi Investment Authority's injection of US\$7.5B into Citigroup; and the Government of Singapore Investment Corporation's acquisition of a nine percent stake in UBS as a result of its US\$11B investment in the Swiss bank.

In the case of transition economies such as China, an ongoing process of privatization is transferring a significant share of productive assets into the hands of the private sector. Nevertheless, the nature of political control in China has meant that the state continues to retain some degree of ownership and control over many "privatized" entities, directly or indirectly. The line between state and non-state is therefore unclear, and any investment review mechanism that attempts to flag state ownership as a special case will face this definitional problem. In the case of China, which is an increasingly important source of outward investment, a restriction on state-owned investment could be interpreted in such a way as to effectively block most if not all investment from the People's Republic. The Foundation's 2006 Survey of Chinese Outward Investment http://www.asiapacific.ca/analysis/pubs/listing.cfm?ID_Publication=573 shows strong interest on the part of Chinese enterprises in Canadian investments, especially from state-owned enterprises. Forty-six percent of the state-owned enterprises in the sample expressed an interest in investing in Canada, substantially higher than the level of interest from private, publicly owned, and foreign joint venture firms in China.

The definitional challenge cuts both ways. If the Canadian government adopts a vague definition of state ownership to assess inward investment, other governments could use the same ambiguity to potentially block investments from Canadian-based pension plans such as the CPP or resource revenue funds such as the Alberta Heritage Savings Trust Fund.

It has been suggested that one way of distinguishing between acceptable and unacceptable state-owned investment is to determine if the investing entity has “non-commercial” objectives. However, there is a wide range of corporate behavior that is influenced by considerations other than short-term profit maximization, and which might be deemed as “non-commercial”. Is corporate social responsibility “non-commercial”? What about “ethical sourcing”? The temptation will be to consider state-ownership as a principal indicator of an entity with non-commercial objectives. But this would amount to a tautological argument that is predisposed against state ownership.

A better way to distinguish between desirable and undesirable investments is to focus on the behavior and practices of the firm. The “net benefit” test could be strengthened, for example, by including assessments of corporate governance and disclosure practices. However, these requirements should apply equally to state-owned and non-state owned companies. To single out state-owned companies, therefore, is unnecessary and confusing.

The same applies to the inclusion of a national security provision in the ICA. It may well be appropriate to have such a provision, following the practice of other industrialized countries, but any prohibition on investment in Canada on security grounds would presumably apply to both state-owned and non-state owned foreign companies. Singling out state ownership is not only superfluous, it could have the effect of signaling to transition economies such as China that their investment is not welcome. Chinese direct investment overseas has risen from US\$3B in 2003 to US\$18B in 2006, and is likely to continue growing at a rapid rate. While every proposed investment from a foreign source should be considered on its merits, the Government of Canada should send a strong signal that it welcomes Chinese investment in Canada and that the ICA does not discriminate against state-owned enterprises.

Promoting Canadian Direct Investment Abroad

A Canadian Development Finance Institution?

The Foundation is a strong advocate of Canadian direct investment abroad. In 2001, the Foundation published a report entitled “The Case for a Canadian Development Finance Institution”

http://www.asiapacific.ca/analysis/pubs/listing.cfm?ID_Publication=161 .

focusing on the role of Canadian investment in developing countries. While the material in the 2001 publication needs updating, the suggested principal considerations in establishing a CDFI are worth revisiting. These include

- *The need to address both development assistance priorities and domestic industry needs.*
- *Independence from government and politics.*
- *Funding for the DFI should not be taken from the ODA budget.*
- *Project selection should be based on commercial viability, risk diversification, and delivery of both host- and home-country benefits.*
- *A limited number of countries, including lower-income developing economies, should be targeted.*

Since the publication of the 2001 report, Export Development Canada has played a bigger role in facilitating Canadian direct investment abroad, including the development of a number of innovative funding instruments to support Canadian companies looking to expand abroad. In many ways, the new EDC programs have been playing the role of a CDFI for projects in middle-income countries. The Government of Canada should strongly support EDC's new emphasis on Canadian outward investment. At the same time, there may be a niche for a new mechanism that facilitates private investment in more risky markets, and which is tied to Canada's international development objectives, including private sector development programs at CIDA.

Tracking Canadian Direct Investment Abroad

The Foundation maintains a database of Canadian companies with a physical presence in Asian countries, and publishes a monthly "Investment Monitor", which tracks new Canadian investments in Asia (http://www.asiapacific.ca/analysis/pubs/pdfs/im/2007/im_dec2007.pdf). Since 2001, we have conducted an annual survey of Canadian investment intentions in Asia. Some of the key findings over the past seven years include:

- Since 2003, the percentage of companies planning to invest in Asia over the next 12 months has risen from just under 50 percent to about 70 percent in 2007. In the last four years, not a single respondent has indicated that the company in question is planning to decrease its investment in Asia in the next 12 months.
- The medium-term interest of companies looking to invest in Asia is even stronger. From a low of 62 percent in 2001, the percentage of companies with plans to invest in Asia over a 2-5 year period reached a high of 85 percent in 2007.
- In 2007, the type of planned investment was more or less evenly-split among the three categories of new direct investment, expansion or

upgrading of existing facilities, and mergers/acquisitions. There has been a sharp increase in planned mergers and acquisitions in Asia since 2005, from 16 percent of respondents in 2005 to nearly 35 percent in 2007.

- China (not including HK, SAR) is consistently ranked as the most likely target for planned investment, accounting for between 17 and 26 percent of respondents, followed by Southeast Asian economies. Planned investment in India has risen sharply in recent years, from four percent in 2003 to more than 10 percent in 2007. Among our respondent set, planned investment in the United States has been consistently around 10 percent.
- The most important reason for planned investment in target markets is the expected economic growth in those markets. This is a reflection of the economic rise of Asian economies, especially China and India. The strong growth prospects of Asian economies is also reflected in the finding that the majority of planned investment is for the purpose of selling into Asian markets, rather than as an export platform for Canadian or global markets. Of the reasons cited for investing in Asia, only 20 percent of responses were related to “outsourcing to remain competitive”.

This year’s investment intentions survey will be carried out in mid-January, with results expected by early February. The Foundation will be pleased to provide the panel with this year’s findings, which will include responses to a number of the specific questions posed in the consultation document.

In 2005, the Foundation published a report on Canadian investment and services exports in India

http://www.asiapacific.ca/analysis/pubs/listing.cfm?ID_Publication=356 .

Using Indian data, financial industry reports, as well as media sources, the Foundation estimates that the stock of Canadian investment in India is twice as large as the official numbers from Statistics Canada. The report points to a number of reasons why Canadian investment abroad is understated in the official statistics. One of the first priorities in developing public policy for Canadian investment abroad, therefore, should be an improved data collection system. The government should assign resources to improve data collection and to support research and analysis on the costs and benefits of Canadian investment abroad. Priority should be given to research on Canadian investment in large emerging markets such as China, India, Korea, and ASEAN.

The benefits of Canadian direct investment abroad are generally understood by policy and business elites. Even among the general public, there is more support for outward investment than is usually assumed². Nevertheless, an explicit policy

² 75 percent of respondents to the 2006 APF national opinion poll agreed (26% strongly agreed) with the statement “The Government of Canada should promote greater Canadian investment in Asia.” Canada’s Views on Asia, pages 10-13.

of promoting Canadian investment abroad remains politically sensitive and there is a need for greater public awareness of the benefits of outward investment for Canada. The government can play a role by strengthening the outward investment mandates of departments and agencies such as DFAIT, Industry Canada, and EDC. Other groups such as think tanks and research organizations can also provide leadership in this area, drawing on sound research and case studies.

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