

POSITIONING CANADA FOR CONTINUED COMPETITIVENESS IN THE MINING, MINERALS AND METALS INDUSTRY

A Submission to the Competition Policy Review Panel from the Mining Association of Canada, January 2008

1.0 INTRODUCTION

On July 12th, the federal Ministers of Industry and Finance announced the creation of a Competition Policy Review Panel and tasked this panel with a mandate to “review key elements of Canada’s competition and investment policies to ensure that they are working effectively and that Canada is positioned for continued economic competitiveness”.

More specifically, as noted in its discussion paper *Sharpening Canada’s Competitive Edge*, the panel seeks input and aims to reach conclusions regarding, among other issues, how Canada can assure its position as an attractive destination for investment, whether the government needs to change its investment review policies, whether Canada should be concerned about foreign takeovers, how Canada should promote outward investment, and whether Canada’s competition policy requires changes. The Panel’s ultimate objective is to provide recommendations to the federal government in the aim of enhancing Canada’s ability to attract talent, capital and innovation.

This submission, prepared by the Mining Association of Canada (MAC), provides the views of the Canadian mining, minerals and metals industry (generally known as the “mining industry”) on the theme of investment competitiveness and foreign direct investment. The Canadian industry is enjoying a prosperous period driven by robust economic activity in emerging economies such as China. Canada is well-positioned as a mining country to continue capitalizing on these global opportunities, although there are many challenges ahead. As emphasized in this paper, there are a number of activities and priorities that the federal government could pursue to further enhance Canada’s investment attractiveness and to support the mining industry.

2.0 BRIEF OVERVIEW OF CANADA’S MINING INDUSTRY

As one of the world’s leading mining countries, Canada was the top destination for global mineral exploration in 2006 - receiving 19 percent of world spending, followed by Australia at 11 percent and the United States at 8 percent. Canada ranks first globally in the production of potash and uranium; second in nickel and cobalt; third in titanium, aluminum and platinum metals; fourth in cadmium; and fifth in zinc and molybdenum.

The mining industry contributes \$40 billion to Canada’s annual GDP and employs 368,000 workers in mineral extraction, smelting, fabrication and metals manufacturing. Average wages are considerably higher (by 15-24 percent) than those in the finance, forestry, manufacturing and construction sectors. The industry accounts for approximately 17 percent of Canadian goods exports. Exports of aluminum, gold, nickel, and copper each exceeded \$5 billion in 2006 and exports of steel-making coal amounted to \$4 billion, while exports of zinc, iron ore, uranium, potash and diamonds were each around \$2 billion.

While the industry is important in local, remote and northern communities, it also contributes to the economy of Canada’s larger cities. Toronto is a world leader in mining finance, while Montreal houses important aluminum and iron ore companies, Saskatoon houses the world’s largest producers of potash and uranium, and Edmonton has become a global centre for oil sands expertise. Vancouver is home to the world’s leading cluster of mineral exploration companies. Several thousand supplier companies add to this overall impact – Canada’s major

railroads, ports and engineering firms draw significant benefit from the industry. Canadian mining companies are also active in research and development - investing a sum comparable to that of the oil and gas, automotive, or aerospace sectors.

It is important to note as well that the industry is the largest private sector employer of Aboriginal Canadians, and a number of progressive socio-economic agreements have been implemented, providing literacy, training, employment and financial-sharing benefits to signatory Aboriginal groups. There remains potential to broaden this level of activity.

Beyond these bilateral financial agreements with Aboriginal groups, the industry is also an important macro-economic contributor to government coffers. According to a recent study for the Mining Association of Canada, the industry paid around \$4.7 billion to federal and provincial/territorial governments in 2005. Including payments by the fabricated metal products and oil sands mining firms would add a further \$4.6 billion – generating total payments approaching \$10 billion per year. Payments have undoubtedly grown in 2006 and 2007 in line with increased mineral prices.

The mining industry is enjoying a prosperous period. Robust economic growth in emerging economies, particularly China, is driving global demand for minerals and metals. In 2006, China bought 25 percent of the world's base metals, versus a 5 percent share in the 1980s. In the coming decades, China will face an increasing gap between supply of and demand for minerals and metals. Among the 45 minerals with proven reserves in China, only 21 will meet domestic demand by 2010, reducing to six by 2020. This consideration, along with growth in India and the still relatively low metals intensity of these economies, suggests that global demand will remain strong. This trend is affecting the Canadian industry in two ways – first as a supplier of product to these specific markets and second as a price-taker benefiting from overall price increases stimulated by this global demand.

3.0 KEY DRIVERS OF INVESTMENT IN THE CANADIAN MINING INDUSTRY

While times are good in the Canadian mining industry, and while the present global mineral price situation is a primary driver of investment, it is important to note that the industry does face a number of challenges. For example:

- There is a present and projected shortage of labour – skilled and unskilled – as the baby-boom generation moves through the workforce and as the sector deals with some industry-specific realities.
- Project approval times and costs are increasing and the industry faces cumbersome consultation and regulatory processes. Parallel issues, such as unresolved land claims, can add to these costs and delays.
- These obstacles and delays impair the ability of industry to address a further challenge - namely the declining levels of domestic reserves of key minerals. Canada's copper, zinc, silver and lead reserves have all declined by some 80 percent over the past quarter-century – this has implications for the long-term viability of value-added facilities.
- The sustained growth of the value of the Canadian currency can serve to reduce the profitability/feasibility of mining and metals operations that receive revenues in U.S. dollars yet pay expenses in Canadian dollars.

While several other variables affect the competitiveness of an investment regime, the members of the Mining Association of Canada have identified three as being particularly important.

1. Tax Policies

Government tax policy should support a competitive and internationally-active industry. The Canadian corporate tax regime is reasonably competitive internationally – and significant revenue

flows from the petroleum and mining industries have contributed to the government recently announcing corporate tax reductions that will enhance this competitiveness. However, there are additional tax improvements relating to accelerated capital cost allowance, exploration in proximity of existing mine workings, applicability of flow-through share revenues toward environmental improvements, and simplification of royalty regulations, among others, that should be considered in the future. Given the challenge that faces the industry in recruiting workers, it would also be appropriate for the government to consider whether the withholding tax presently imposed on foreign contractors is necessary or whether it is counter-productive.

2. Investment in Infrastructure, including Geoscience

As noted earlier, the mining industry accounts for 17 percent of Canadian goods exports and several products have annual export values exceeding \$2 billion. The industry relies upon Canadian infrastructure – ports, railroads, highways, international bridges - in order to reach global markets with competitively-priced products.

In rail services, for example, the industry contributes a significant percentage of the freight revenues of CN and CP each year. These two railroads enjoy a monopoly position in many regions and it is therefore very important that rail services be efficient and fairly priced. The in-progress changes to the Canadian Transportation Act will help in this regard although more improvements through other processes, such as the government's promised Level-of-Service Review, are also needed.

Canadian ports also draw considerable revenue from the mining industry. Investment in port infrastructure is required, as is investment in road and rail linkages to the ports. As well, close attention must be paid to quickly resolving any future labour disputes and other disruptions at our ports, particularly in Vancouver.

In northern Canada, there is also a need for increased investment in transportation infrastructure to support economic development in the three territories. There is considerable mining potential in northern Canada, where the interest of analysts and investors can be affected by the efficiency with which products can be moved in and out of prospective mine sites.

A less-visible type of infrastructure – the geological mapping and e-database of important mineral-related information – is also critical to a mining nation such as Canada. In this regard, the federal government's investment in geological mapping has declined by 50 percent since 1988, a decline which is even steeper at the provincial and territorial level. The result of these cuts is that some Canadian regions, particularly the north, are poorly mapped. Being able to spend high-risk exploration dollars in areas where good geoscience information is available improves the likelihood of finding commercial-scale mineral resources. Increased and sustained government investment in geoscience is needed – this is an important component in addressing Canada's mineral reserves crisis and in enhancing the investment attractiveness of the country.

3. Efficiency and Effectiveness of Canadian Regulations

In proposing projects, Canadian mining companies and domestic and foreign investors depend on governments for a clear understanding of information requirements, approval processes, timetables and responsibilities. There have been problems with Canadian project review processes for many years, although the mining industry is pleased with the recent creation of a major projects management office and the objective of cutting average review times in half, from four years to two. This effort, though, remains in its infancy and requires sustained priority attention from the government. The government should also seek comparable improvements through the ongoing Northern Regulatory Improvement Initiative.

While the major projects review office represents a step forward, it is evident that many regulatory and process challenges remain. Recent reports by the Auditor General and the Conference

Board of Canada highlight regulatory and authorization processes as being costly, cumbersome, inconsistent and unfair. These obstacles are relevant to major and minor projects; they exist at multiple levels of government; they are problematic in many regions, especially the north; and they intersect with questions of Aboriginal consultation, land use planning, and government sharing of resource revenues. The efficiency, cost-effectiveness and clarity of these processes must be improved.

4.0 INDUSTRY VIEWS REGARDING FOREIGN DIRECT INVESTMENT

There are few industry sectors in Canada as internationally active as the mining industry. Canadian companies are global leaders; there are almost one thousand Canadian exploration companies active in other countries. The Toronto Stock Exchange provided 38 percent of the world's mining equity in 2006 and, reflecting an expertise with smaller companies, handled some 84 percent of the world's mining financings in that year. TSX-listed firms have around 4200 mineral projects in different stages of development outside Canada.

Canada has been a strong mining country since before Confederation – the Geological Survey of Canada, for example, was established 25 years before the country was formed. As a “home grown” sector with a long history, the Canadian minerals and metals sector has traditionally invested more abroad than it has received in Canada – in approximate terms, levels of Canadian direct investment abroad (CDIA) have for many years been roughly double the value of the stock of foreign direct investment in Canada (FDIC). In 1995, Canada had \$25 billion invested abroad in mining, versus foreign firms having \$10 billion invested in Canada. As of end-2006, according to Statistics Canada, Canadian mining companies had \$62 billion in direct investment abroad, while foreign firms had \$38 billion invested in Canada.

This level of mining industry CDIA represents 12 percent of Canada's total CDIA stock – a level which is comparable to that of the energy sector and, among specific sectors, trails only the financial services sector in this measure. This CDIA in mining is aimed primarily toward the United States and Latin America, although Canadian mining firms have investment interests in around 100 countries.

The level of FDIC in Canadian mining represented almost 9 percent of total foreign direct investment stocks in Canada in 2006, up from a 6 percent share the previous year. This significant increase reflects the foreign acquisitions that occurred in the minerals and metals sector in 2006.

The international bids for control of the prominent Canadian mining companies Inco and Falconbridge in 2006 served to highlight a number of strategic and policy issues for observers of the global mining industry – as did the acquisition of business icon Alcan by Rio Tinto in 2007. At its core, as a business strategy issue, a handful of large companies are attempting to acquire scale across a number of commodities and to emerge as diversified “super-majors” in a process comparable to the consolidation that occurred in the oil and gas industry a decade ago. These global players include BHP Billiton, Rio Tinto, Anglo American, Vale (formerly known as CVRD), and Xstrata. These firms are operating under the premise that constrained production capacity combined with strong global economic growth and infrastructure development in China and India will combine to leave commodity prices “stronger for longer”.

Having reached this supply/demand/price conclusion, the objective of the global companies has become one of acquiring reserves and landholdings and broadening their technical skills and ability to find more deposits. Canadian firms and their assets have become prime targets in this respect.

As a general principle, members of the Mining Association of Canada support a free and open flow of direct investment – where the government's main role is to ensure the fairness and

openness of two-way flows. Foreign investment flows – inward and outward – enhance the access of Canadian businesses to new technologies, to fresh ideas and concepts, and to larger markets and production chains.

This principle is illustrated through the example of Xstrata's investment in Canada in 2006 when it acquired Falconbridge. Following from the acquisition, the company's huge global nickel operations have been headquartered in Canada while the Canadian copper and zinc operations have been integrated within a global network.

It should also be noted that it would be delicate, if not hypocritical, to call for restrictions limiting foreign investment in Canada when Canadian companies such as Barrick, Goldcorp, Teck Cominco, Cameco, Kinross and many others are actively investing and acquiring assets in foreign countries. Ironically, one of the factors that made Alcan such an attractive target in 2007 was the foreign acquisition of France's Pechiney that it itself undertook in 2003. The potential hypocrisy of tighter Canadian controls would also become evident in examining junior "mineral exploration" type investments in this sector. An estimated 62 percent of the world's exploration companies are Canadian – these companies explore and appraise minerals in countries throughout the world.

While the broad liberalization that can accompany WTO agreements is desirable, it is important to note that lower-profile tools such as Foreign Investment Protection Agreements (FIPAs) can also be useful – this is doubly true in an age when WTO progress seems unlikely for the foreseeable future. FIPAs, and the investment provisions of potential free-trade agreements, can provide some assurance to Canadian firms investing abroad – through imposing discipline on foreign governments and through providing access to independent rules and arbitrators in the case of dispute. It is important that the Canadian government negotiators, where possible, strive to have this discipline and fairness also apply to existing CDIA, rather than simply to future investments.

There are unsettling actions being seen or contemplated in various countries (Venezuela, Bolivia, Argentina, Mongolia, Chile, Russia and others) where the existence of strong and effective FIPAs would serve to provide some comfort to Canadian investors. Beyond pursuing these protection agreements, the Canadian government should apply particular diligence in those instances where investments/acquisitions of Canadian firms may be originating from countries such as these – countries which may not exhibit the same openness and transparency as Canada.

As a final point, members of the Mining Association of Canada believe that the federal government should proceed very carefully on the subject of reviewing potential FDIC by state-controlled entities or on the related subject of national security. Rather than developing a one-size-fits-all blanket policy in this respect, it may be preferable to examine such FDIC issues on a case-by-case basis as they arise. In making case-by-case decisions, the federal government must be careful to not move toward a slippery slope and to not invite retaliatory measures from other countries.

5.0 SUMMARY

As one of the world's leading mining countries, Canada was the top destination for global mineral exploration in 2006 and ranks first globally in the production of several minerals. There are few industry sectors in Canada as internationally active as the mining industry - the industry accounts for approximately 17 percent of Canadian goods exports and has a stock of \$62 billion in direct investment abroad. The industry employs approximately 368,000 Canadians and pays several billion dollars annually to Canadian governments in the form of income taxes and royalties.

MAC underlines the following areas as critically important contributors to future competitiveness and prosperity. These areas are key drivers of investment and should be priorities for the Competition Policy Review Panel and for the federal government.

1. Government tax policy should support a competitive and internationally-active industry. While Canada offers a reasonably competitive business tax regime, there are a number of tax improvements noted in this submission that should be considered in the future.
2. The industry relies upon Canadian infrastructure in order to reach global markets with competitively-priced products. There is a need for increased investment in transportation infrastructure to support economic development in northern Canada and to facilitate the cost-efficient movement of products by railroads, ports, highways and international crossings.
3. A less-visible type of infrastructure – the geological mapping and e-database of important mineral-related information – is critical to a mining nation such as Canada. Increased and sustained government investment in this area is needed to help address Canada's mineral reserves crisis and to enhance our investment attractiveness.
4. MAC notes the federal government's commitment to improve the regulatory process through the establishment of a Major Projects Management Office, with the goal of halving permitting/review times from four years to two. This effort, though, requires sustained priority attention from the government. Comparable attention and results need to be delivered from the Northern Regulatory Improvement Initiative.
5. MAC supports a free and open flow of direct investment – where government's main role is to ensure the openness of two-way flows. Foreign investment flows – inward and outward – enhance the access of Canadian businesses to new technologies, to fresh ideas and concepts, and to larger markets and production chains.
6. Foreign Investment Protection Agreements, and the investment provisions of potential free-trade agreements, can impose discipline and transparency on foreign governments and hence provide assurance to Canadian firms investing abroad. It is important that government negotiators, where possible, strive to have this discipline and fairness also apply to existing direct investment abroad, rather than simply to future investments.
7. Beyond pursuing these protection agreements, the Canadian government should apply particular diligence in those instances where investments/acquisitions of Canadian firms are originating from countries which may not exhibit the same openness and transparency as Canada.
8. The federal government should proceed with caution on the subject of reviewing potential foreign direct investment in Canada by state-controlled entities. Such issues should be considered on a case-by-case basis as they arise and, in so doing, the federal government must be careful to not provoke retaliatory measures from other countries.