Tradescapes: Foreign investment in Canada and Canadian investment abroad

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ABSTRACT: Over the past few years, much has been made among public policy opinion leaders of "the hollowing out" of Canada's industry by way of foreign investment, especially from the United States. But Canadian investment abroad is very strong, including in the United States. This discussion paper will look at foreign investment in Canada and Canadian investment abroad and consider its relationship to international trade

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INTRODUCTION

When Canada Really was "a backwater"

When Alexander Baring of England's great investment banking house visited Upper Canada – today's Ontario – in 1797, he adjudged it as:

> "beyond the reach of any export market and must like Switzerland subsist from its own resources." Both it and Lower Canada (today's Quebec) were "a perfect deadweight to Great Britain." The settlers were without any kind of patriotism and as soon as self-interest dictated a change of policy, "the same scene will be played which we witnessed in these States (he wrote from Philadelphia) with the only difference that the Contest will be much shorter." The only reason for occupying the Canadas had been to secure the northern frontier of what was now the United states, "but since the loss of the latter they are of no service but to the empty vanity of large territorial possessions and to increase Ministerial patronage at the expense of the (British) Nation."[1]

Alexander Baring, however, was far more bullish on Upper and Lower Canadas' southern neighbour, the United States, as early as 1801. Barings was also far more bullish on Argentina with its superior climate, superior lands and proven natural resources, and its greater accessibility via the shipping lanes by sail.

[1] Philip Ziegler, *The Sixth Great Power: A history of one of the greatest of all banking families, the House of Barings, 1762-1929*. New York: Alfred A. Knopf, 1988, p. 66.

From Backwater to Potential Powerhouse

However, by the middle of the 19th century, Barings' attitudes toward Canada and Argentina had reversed. A Barings business partner observed that "'They appear to be thriving in Canada,' he told Bates in 1841, 'and to be a prudent, frugal and good sort of people'" (Ziegler, 157). By 1848, the development of Canada was far behind that of the United States, primarily for lack of access to capital and investors. It was to the investment bankers Barings and Glyns in London that the Canadians turned. When the CPR was to be built and the new Dominion of Canada agreed to loan $20 million of the $35 million that the CPR was authorized to raise, George Stephen turned in 1884-1885 to Barings to underwrite an issue of $3 million of stock (Ziegler, 227-228). But Barings confidence in Argentina was undermined in spite of its natural attributes as shown in Thomas Baring's judgment that "'this so-called Republic is possibly under a more despotic rule than any other country on the face of the earth'" (Ziegler, 231).

Throughout much of the 20th century and on into the present century, Canada has continued to be a desirable destination for foreign investment. What was decisive in Barings' preferring Canada over Argentina, despite Argentina's natural assets, was Canada's government and its other cultural attributes.

Where Do Investors Invest?

Investment is not uni-directional. Canadians are investing abroad, around the world. But like the 19th-century investment bankers of Barings, Canadians tend to invest in countries whose government and other cultural attributes mirror the historical Canadian commitments to the rule of law, the sanctity of contracts, honesty, thrift, prudence, and work ethic.

When investors make investment decisions, they look for countries like this – like Canada. Their decisions to invest are in effect affirmations of their confidence in a country, including its business climate and commercial culture. Decisions against proceeding with investment may well be an expression of misgivings about a country's government and its commitments to the rule of law and other key principles. When investors clamor to invest in a country, they are often giving that country an 'A' grade.

Investment as Trade

Further, when investors allocate capital from their own political jurisdiction to another, they are engaging in a form of trade – they are expressing what Adam Smith called "the division of labour." In his *Wealth of Nations*, Smith opposed the notion that every political jurisdiction must "do" or produce everything. Smith argued that because of advantages of resources, labour supply, geography, or climate, that some jurisdictions can more efficiently produce certain things. That it is to the advantage of people in other jurisdictions to buy this produce instead of trying to produce it themselves. When investors move capital, they are usually seeking a greater return on investment elsewhere than they can obtain at home. Or, they're seeking to protect their capital from a jurisdiction whose government or economic conditions endanger it. The recipients of the investment are given access to capital that is necessary to further develop their production and business. Both the investor and the invested potentially see a net benefit from the movement of this capital – the investment.

Foreign Investment and the Government of Canada

Recently, however, foreign direct investment in Canada has been politically – and very publicly – repudiated. Earlier this year (2008), Canada's Minister of Industry Jim Prentice refused to approve the sale of *MDA*'s *Space Division* to the U.S.-based *ATK* – a non-state-owned, public company – for $1.3 billion cash. As Christopher Sands argues, this move of the Government of Canada could scare off U.S. investors.[2] Sands gives a helpful resume of the shift in Canada's willingness to entertain foreign investment with the establishment of the *Foreign Investment Review Agency (FIRA)* in 1974 by the Trudeau Government,

[2] Christopher Sands, "Northern Exposure." *The American* (17 June 08). Found at: http://www.american.com/archive/2008/june-06-08/northern-exposure, June 2008.

and of the exclusions Canada required in order to sign the Canada-U.S. Free Trade Agreement.

Now, FIRA powers are held by the federal *Investment Canada*, albeit less far-reaching as reformed by the Mulroney Government, but nonetheless effective as seen in the recent rebuff of *ATK*'s proposed purchase of *MDA*'s *Space Division*. But the power to refuse a significant investment or sale was not exercised in respect of China's *MinMetals*' attempted takeover of *Noranda* in 2004. *Noranda* avoided the takeover by engineering a merger in June 2005 with *Falconbridge* of which *Noranda* already owned nearly 60%. The new *Falconbridge* was later taken over by the Switzerland-based *Xstrata*. The Government of Canada did not move to stop this, either.

Nor did the Government of Canada repudiate the investment of $150 million in the Athabasca oil sands in 2005 by the *China Offshore Oil Corporation* by way of its purchase of shares in the *MEG Energy Corporation*. Nor did the Government refuse the deal between *Enbridge Inc*. and the PRC's *PetroChina* for half the supply of the proposed "Gateway pipeline." The Chinese companies are state-owned. Nor did the Canadian Government turn away investments in the oil sands by Abu Dhabi's *Taqa* or Norway's *Statoil*.

On what basis does the Government of Canada reject significant foreign investment?

What I Intend to Argue

In what follows, I intend to survey recent foreign investment in Canada, Canadian investment abroad, and compare the two. I will argue that foreign investment in Canada and Canadian investment abroad are good things generally, that Canadians should take foreigners' willingness to invest as something of a report card on Canada's economy and commercial culture, and that Canadians should concentrate their investment abroad in countries that uphold the rule of law, the sanctity of contracts, and the commercial virtues. Finally, I will argue that the Government of Canada should only disallow foreign investment when there is a demonstrable threat to Canada's economic well-being or its national security.

FOREIGN INVESTMENT IN CANADA

Canada is in a very strong position as a destination for foreign investment. Foreign investor demand for Canadian shares continues to grow. Off-shore investors purchased an additional $2.5 billion of Canadian shares in May, for a fourth consecutive month of increasing equity investment. Nearly two-thirds of this activity was in secondary markets, with shares of technology, mining and energy firms drawing most of the foreign investment. The *Standard and Poor's / Toronto Stock Exchange* composite index has been the only major world stock market in 2008 to post a year-to-date gain, driven by high commodity and energy prices.

In the longer term, Canada saw a 98% jump in foreign direct investment (FDI) from $252.563 billion in 1999 to $500.851 billion (B) in 2007.[3] In what follows, we look at the longer term trends in FDI since 1999 up through the first quarter of 2008.

FDI by Geography

Over half of this jump in FDI came from European Union (EU) countries[4] excluding the United Kingdom (UK). EU countries other than the UK nearly doubled their FDI in Canada with investment up 98% in 2000 ($72.008B) over 1999 ($36.341B). But the UK's FDI in Canada was also up by 50% in the same period.

FDI from the United States (US) was up about 10% in 2000 ($193.651B) over 1999 ($176.045B). In 1999, US FDI represented nearly 70% of world FDI in Canada. In 2000, US FDI fell to just over 60% of world FDI in Canada. In 2001, US FDI bounced back to about 64% of world FDI, holding steady through 2003

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[3] All amounts are given in Canadian dollars unless otherwise specified.

[4] Austria (1995), Belgium, Bulgaria (2007), Cyprus (2004), Czech Republic (2004), Denmark (1973), Estonia (2004), Finland (1995), France, Germany, Greece (1981), Hungary (2004), Ireland (1973), Italy, Latvia (2004, Lithuania (2004, Luxembourg, Malta (2004, Netherlands, Poland (2004, Portugal (1986), Romania (2007), Slovakia (2004, Slovenia (2004, Spain (1986), Sweden (1995), and the United Kingdom (1973). Countries without bracketed dates were members at the founding of the *European Union (EU)*, May 9th 1950.

and 2004, falling slightly to 63% of world FDI in 2005, falling to just over 61% of world FDI even though US FDI was up about 7.5%. And in 2007, US FDI was about 58% of world FDI in Canada.

Meanwhile, world FDI in Canada rose 98% from 1999 ($252.563 B) to 2007 ($500.851B). Roughly 20% of the increase in world FDI came from EU countries excluding the UK. The UK's FDI in Canada accounted for 16% of the increase – meaning that of the increase in world FDI, about 36% came from the EU altogether. About 45% of the increase in world FDI in Canada from 1999 to 2007 came from the US. That means approximately 81% of the ramp-up in world FDI came from Canada's trading partners in the EU and from the US, its largest international trading partner.[5] The remainder of the increase in world FDI came from Japan (about 2%), from other OECD countries (about 5%),[6] and all other countries (about 12%).

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[5] All calculations in this section are based on data collected by *Statistics Canada* that appear in Table 10, "Foreign direct investment in Canada, by geographical area," *Canada's International Investment Position*, First quarter 2008. Ottawa: Department of Industry, 2008, p. 27.

[6] Australia (7th June 1971), Austria, Belgium, Canada, Denmark, Finland (28th January 1969), France, Germany, Greece, Hungary (7th May 1996), Iceland, Ireland, Italy, Japan (8th April 1994), Korea (12th December 1996), Luxembourg, Mexico (18th May 1994), Netherlands, New Zealand (29th May 1973), Norway, Poland (22nd November 1996), Portugal, Spain, Sweden, Switzerland, The Czech Republic (21st December 1995), The Slovak Republic (14th December 2000), Turkey, United Kingdom, and the United States. Those appearing without bracketed dates are founding members of the *OECD*, organized December 14th 1960 and ratified by the founding countries in 1961. The bracketed dates signify when that country was admitted to the *OECD*.

FDI by Industry

Statistics Canada groups the data they collect into five broad, industry categories: wood and paper, energy and metallic minerals, machinery and transportation equipment, finance and insurance, and services and retailing. A sixth category is designated for "all other industries."[7]

In 2007, some $151.776B of FDI in Canada was concentrated in energy and metallic minerals – about 30% of FDI in Canada. Finance and insurance saw $103.228B in FDI or 20% of all FDI. Machinery and transportation industry ($51.937B) and services and retailing ($51.483B) each claim about 10% of FDI, while wood and paper ($17.309B) saw just 3.5% of FDI in Canada. The remaining 25% of FDI is spread across all other industries.

The big story since 2000 is the huge growth of FDI in Canada's energy and metallic minerals industry – and most of that in energy. From 2000, FDI in this sector grew by 170% from $56.306B to $151.776B in 2007. Even so, FDI in Canadian finance and insurance grew from 53.965B in 2000 to 103.228B in 2007 or 91%. The growth in energy and metallic minerals FDI since 2000 represents 38% of the growth of FDI in Canada from 2000 through 2007. The growth in finance and insurance FDI claims 20% of overall FDI growth from 2000 through 2007.

[7] Drawn from Table 11, "Foreign direct investment in Canada, by industry," *Canada's International Investment Position*, First quarter 2008. Ottawa: Department of Industry, 2008, p. 27.

FDI in services and retailing grew from $25.367B in 2000 to $51.483B in 2007 – it more than doubled, and represents about 11% of the total increase in the same period. Machinery and transportation equipment FDI grew from $43.647B in 2000 to $51.937B in 2007 – up 17% over the period. But FDI in the sector actually fell slightly below 2000 levels in 2005, and it has risen 17% from 2005 to 2007. FDI in this sector has recently recovered.

There's a similar story in the wood and paper industry over the same period where FDI fell off about 20% from 2000 ($16.384B) to 2004 ($13.095B). However, wood and paper FDI bounced back to $17.309B in 2007.

Profits on FDI

FDI of $319.116B in 2000 realized profits of $22.531B or 7% of total FDI. Profits fell off to about 5.8% in 2001 and about 5.4% of total FDI in 2002. Overall FDI profitability rose to 8.3% in 2005 and was 7.2% or $35.960B on total FDI of $500.851B in 2007.

Foreign Portfolio Investment by Instrument

Comparing the last quarter of 2000 with the first quarter of 2008, foreign portfolio investment (FPI) in Canadian bonds has fallen from $427.228B to $404.109B.[8] US FPI in bonds rose slightly from $194.720B in 4th Q 2000 to

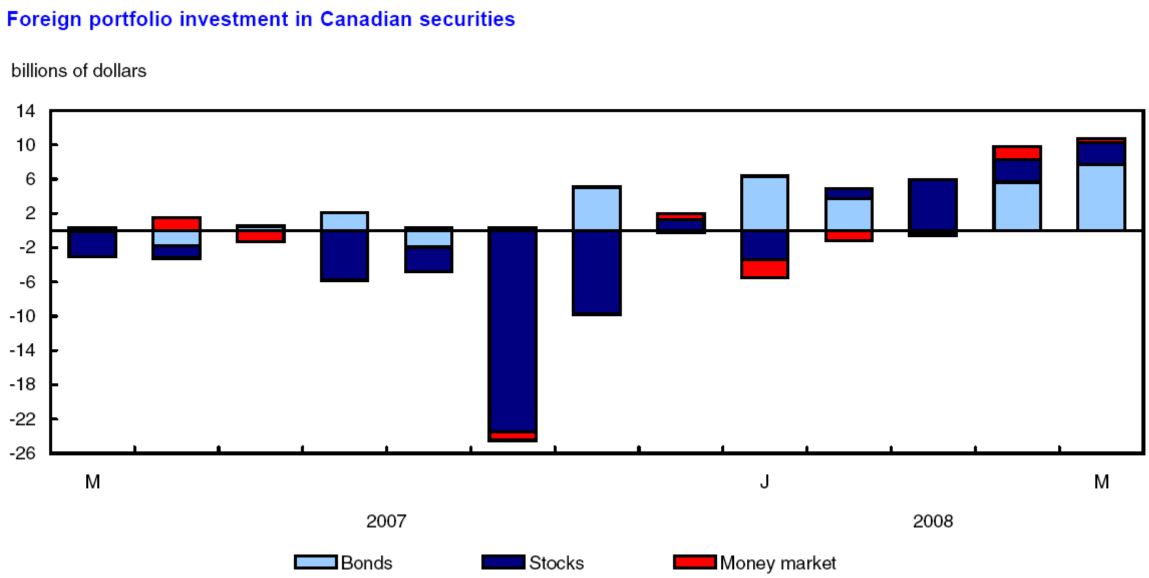
[8] Table 13, "Portfolio investment in Canadian bonds, by geographical area," *Canada's International Investment Position*, First quarter 2008. Ottawa: Department of Industry, 2008, p. 30.

$208.720B in 1st Q 2008, but fell from a high of $264.933B in 4th Q 2002. UK FPI in bonds has risen from $39.033B in 4th Q 2000 to $71.034B in 1st Q 2008 – up 82%. FPI from OECD countries excluding the US, the UK, the EU, and Japan fell from $26.782B in 4th Q 2000 to $13.108B in the 1st Q of 2008. FPI in bonds is down just under 10% from the EU (excluding the UK), and Japanese FPI in Canadian bonds is down slightly.

FPI in Canadian stocks[9] reached a high-water mark in 2004, topping out at $100.042B from all countries, and falling to $82.658B in 2007. The high-water mark for US FPI in stocks was also in 2004, reaching $90.957B in that year, falling to $74.006B in 2007. UK FPI was $2.237B in 2004 – down from a high of $2.433 in 2002 – and fell to $1.706B in 2007. Other EU countries increased their positions from $444 million in 2000 to $1.925B in 2007. Japanese FPI topped out at $186 million in 2004 and fell to $19 million in 2007. It's also down in the other OECD countries – from $2.246B in 2000, falling to $1.467B in 2007. In all other countries, however, FPI in Canadian stocks rose from $2.123B in 2000 to $4.214B in 2006, falling to $3.534B in 2007. FPI in money market instruments of all kinds – government, non-financial corporations, and financial corporations – is down

[9] Table 15, "Portfolio investment in Canadian stocks, by geographical area," *Canada's International Investment Position*, First quarter 2008. Ottawa: Department of Industry, 2008, p. 34.

from $27.961B in 2000 to $21.999B in 2007.[10]



Source: *Statistics Canada*[11]

CANADIAN INVESTMENT ABROAD

Recent Canadian Investor Activity

Canadian investor demand for foreign stocks held in May, with Canadians investing $5.1B abroad. Canadian foreign equity purchases total $15.8B since February 2008. In May, Canadians preferred non-US stocks ($4.4B), focusing their investment on banking and energy shares.

In general, Canadians returned in strength to foreign money markets and "passed" on foreign bonds. Investors from Canada made purchases of foreign money market paper in May, 2008, amounting to $1.2B. Half of this flowed to US

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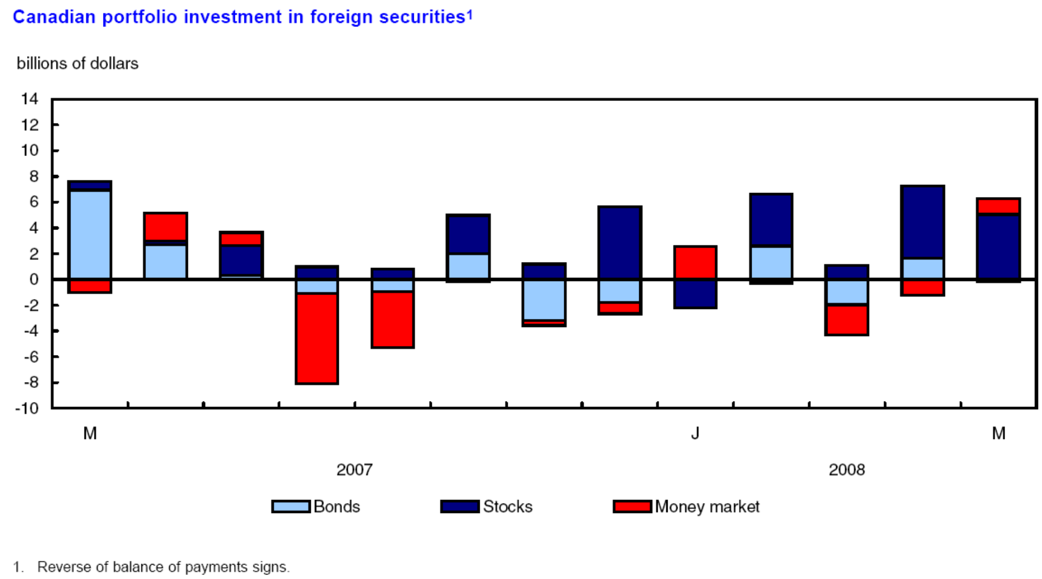
[10] Table 16, "Portfolio investment in Canadian money market instruments, by geographical area," *Canada's International Investment Position*, First quarter 2008. Ottawa: Department of Industry, 2008, p. 35.
[11] Chart 1, Statistics Canada, *Canada's International Transactions in Securities*, May 2008. Ottawa: Department of Industry, 2008, p. 11.

Treasury bills as short-term interest rates in the United States rose forty-four basis points, and has continued to ramp up since the collapse of the US real estate market in August, 2007.[12]

Longer Trendlines

On the longer term, Canadian direct investment abroad (CDIA),[13] in the US, rose from $151.775B in the last quarter of 1999 to $242.523B in the first quarter of 2008 – up 60%. Canadian holdings of (US) foreign bonds rose from $17.702B in 4th Q 1999 to $78.386B in 1st Q 2008 – up 342%. Canadian holdings of (US) foreign stocks rose from $71.355B in 4th Q 1999 to $103.281B in 1st Q 2008 – up 45% for the period, after peaking at $118.008B in 4th Q 2002. All forms of Canadian portfolio investment abroad (CPIA) in the US are up from $89.056B in 4th Q 1999 to $187.287B in 1st Q 2008, down from a peak of $203.490B in 1st Q 2007 (up 128% over 4th Q 1999).

[12] Statistics Canada, *Canada's International Transactions in Securities*, May 2008. Ottawa: Department of Industry, 2008, p. 11.
[13] Data analyzed in this section is drawn from *Canada's International Investment Position*, First quarter 2008. Ottawa: Department of Industry, 2008, pp. 53, 55, & 57.



Source: *Statistics Canada*[14]

CDIA in all other countries (excluding the US) rose from \$138.956B in 4th Q 1999 to \$308.894B in 1st Q 2008 – up 122%. CPIA rose from \$90.718B in 4th Q 1999 to \$192.263B in 1st Q 2008 – up 112% over the period. CDIA in all countries – including the US – was up 90% and CPIA was up in all countries by 111%.

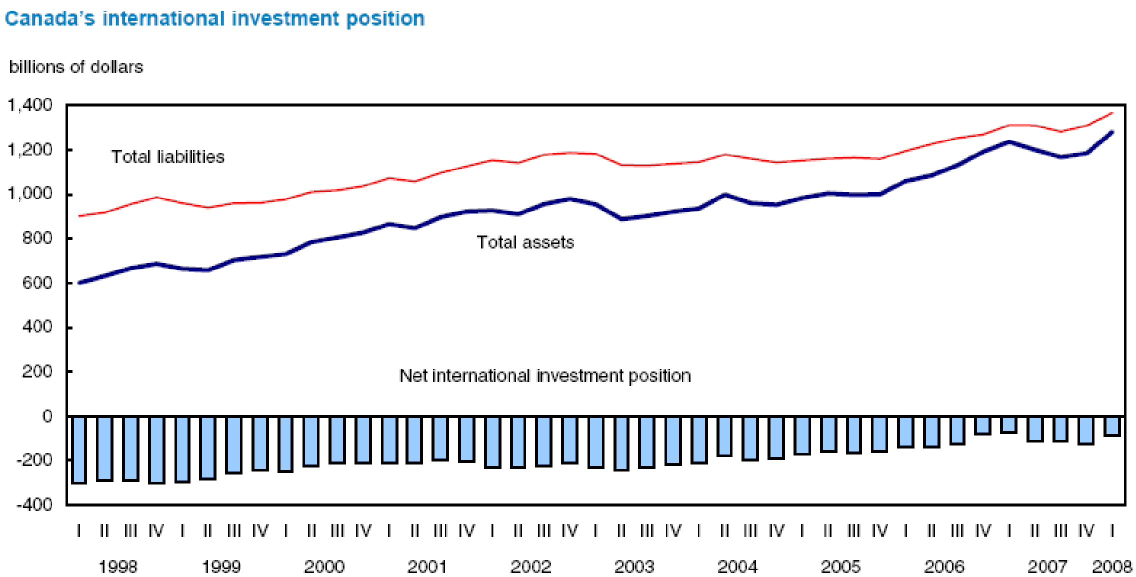
FOREIGN INVESTMENT IN CANADA AND CANADIAN INVESTMENT ABROAD: A COMPARATIVE ANALYSIS

Foreign investment and Canadian investment

Taking the aggregate of FDI, FPI in Canada, and all other forms of foreign investment in Canada, and the aggregate of CDIA, CPIA, and all other forms of Canadian investment abroad, from the standpoint of assets (Canadian investment abroad) to liabilities (foreign investment) the Canadian position stands up very well. Canadian investment abroad has more than kept pace with

[14] Chart 2, Statistics Canada, *Canada's International Transactions in Securities*, May 2008. Ottawa: Department of Industry, 2008, p. 12.

foreign investment in Canada. If the trend were to continue, the value of all forms of Canadian investment abroad would soon overtake the value of all forms of foreign investment. The same is true of a comparison of FDI and CDIA (see below).



Source: *Statistics Canada*[15]

In any case, the value of Canadian investment abroad and foreign investment is each 80% to 90% of the value of Canada's GDP. The total value of Canadian investment abroad and foreign investment in Canada is about $2.7 trillion in the aggregate – exceeding by 80% the value of Canada's GDP.[16]

Why is this important? In what follows, I attempt to unpack some insights from foreign investment in Canada and Canadian investment abroad.

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[15] Chart 1, *Canada's International Investment Position*, First quarter 2008. Ottawa: Department of Industry, 2008, p. 11.

[16] Projected by *Statistics Canada* to be $1.5 trillion for 2008.

DISCUSSION POINT: ***Given that the value of Canadian investment abroad has kept pace and could exceed the value of foreign investment in Canada, should Canadians be concerned about foreign investment?***

Investment as an Economic Indicator

First, foreign investment overall and its growth track with the strength of Canada's largest export sectors.[17] The tremendous growth of FDI in energy and metallic minerals tracks with the ramp-up in Canada's exports of mineral energy. The growth in FDI in machinery and transportation equipment investment approximates the recovery in the machinery and equipment sector exports over the past two or three years. In the same way, the decline in the early 2000s and only marginal, recent growth in FDI in the wood and paper industry tracks with the decline of exports from this sector. By the same token, the more recent, increased investment in wood and paper in 2006 and 2007 and 1st Q 2008 may point to good things to come in this industry, despite the present pain felt by workers, management, and longer-term investors.

DISCUSSION POINT: ***That is, an increase in investment in a sector could suggest an upcoming increase in production, and a subsequent increase in exports from that sector in Canada.***

[17] For a description of Canada's six largest export sectors, see *Greenlighting Trade: A Trade Corridors Atlas*. Hamilton, Ont.: Work Research Foundation, 2006.

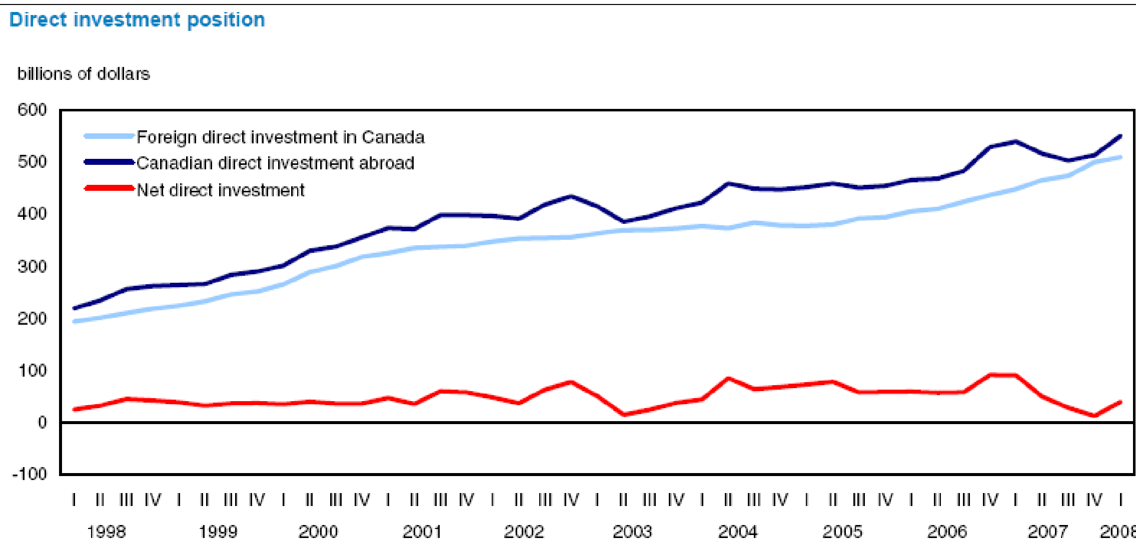
Investment as Trade: "Division of Labour"

The facts of both foreign investment in Canada and Canadian investment abroad provide an apt illustration of Adam Smith's *Wealth of Nations* argument for trade as "division of labour." That this division of labour is to the advantage of all for those who enjoy certain geographic and climatic, transportation, work force, expertise, and other advantages to make some products for trade, and others who enjoy other similar advantages to make other products. According to Smith, the result is a product of higher quality at lower cost for all.

For example, some climates are suited to coffee plantations while others are suited to growing high-quality, Durum wheat. Some economies have a large supply of labour that is advantageous to the production of labour-intensive goods, such as clothing. Other economies boast a highly-educated labour force better suited to the providing knowledge-intensive services, such as systems analysis. Each can serve and produce goods for the other.

Investment can work in a similar way. Those with a certain expertise, a certain quantity of capital, with a need to diversify their investments, access to the production advantages of another jurisdiction, et al., will invest in one jurisdiction or region of the world to the advantage of all. Others will pursue different investment objects. But both can serve to the advantage and the good of the other. For example, foreign investors may want to diversify their holdings into energy commodities, channeling their investment into Alberta's capital intensive oil sands extraction. Canadian investors may opt to build an auto parts plant abroad in order to achieve access to other markets for their products.

DISCUSSION POINT: ***Again, investment – foreign investment in Canada and Canadian investment abroad – suggests a "division of labour" and a kind of trade between countries whose investors place a stake in Canada and countries in which Canadian investors make an investment stake.***



Source: *Statistics Canada*[18]

Investment as a cultural-intellectual activity

The latter example of an auto parts manufacturer underlines the notion of trade as a cultural-intellectual activity. The parts manufacturer is taking its

[18] Chart 2, *Canada's International Investment Position*, First quarter 2008. Ottawa: Department of Industry, 2008, p. 11.

capital abroad, but not only that. It is taking its expertise to build and operate a plant to another jurisdiction.

Likewise, when Canadian oil and mining industries invest in projects abroad, these sectors take their knowledge base as well as their capital base. They take their intellectual capital as well as their monetary capital. Even further, they take their culture of business practices as well as commitments to the integrity of one's "word" and the sanctity of contracts . . . or "not."

DISCUSSION POINT: ***Investors may take their intellectual and cultural capital when they invest monetary capital in another country – they engage in an intellectual-cultural trade.***

Investment as "Confidence"

When foreign investment comes to Canada, it is suggestive of a certain confidence in Canada's economic culture – its ethos and practices in respect of management and labour relations, labour's commitment to quality production, to honesty and the sanctity of contracts, as well as the quality of physical infrastructure. There are, still, places in Canada where billion-dollar deals are done on the strength of a handshake.

Foreign investors count on Canada's reputation for an amenable and reliable economic culture that is safe for capital investment. Their investing is a real, if intangible, expression of confidence in Canada. Canadian government regulatory powers can enhance investor confidence by maintaining the integrity of Canadian securities exchanges, banking, insurance, and accounting practices. Investor confidence is also enhanced by Canadian regulatory powers as applied to manufacturing quality and safety.

Conversely, there may be legitimate questions about the quality of workmanship and production in certain Canadian industries. Once lost, it is difficult to recover investor confidence, and Canadians risk that industry's moving operations abroad. And for government to use its coercive powers to prevent capital's moving from Canada is just to further diminish foreign investor confidence in Canada's economic culture.

FDI and FPI in Canada are roughly at parity, with FDI in 1st Q 2008 at $510.581B and FPI in 1st Q 2008 at $506.896B.[19] FDI suggests confidence on the part of entrepreneurial and corporate investors seeking access to the Canadian markets, production cost advantages, or other advantages. FPI suggests confidence on the part of these investors in Canadian companies, their corporate culture, their management, their workers, productiveness, and quality of output.

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[19] Table 1-1, "International investment position with all countries — 2007 to 2008." *Canada's International Investment Position*, First quarter 2008. Ottawa: Department of Industry, 2008, p. 19.

DISCUSSION POINT: ***Foreign investment in Canada – and Canadian investment abroad – constitutes an expression of confidence in the commercial and political culture, as well as the prospects for ROI.***

Investment as an Enhancer of Freedom and Quality of Life

Foreign investment or investment abroad may give the investor the freedom to live in another jurisdiction or region of the world. By virtue of her investment, the investor may be permitted to live in another jurisdiction, and enjoy its advantages – whether climatic, cultural, physical safety, the security of wealth, or otherwise. Politically oppressed ethnic, cultural, or religious groups have used their ability to invest as a means of escaping oppression for thousands of years.

Conversely, if one were quite happy living where he was for the reasons given above or for reasons of family or affinity, investing abroad affords the investor the ability to participate in economic activities not available to him at home. This was true of the great Venetian trading empire, the Dutch and British commercial empires, and it is true of investors who are citizens of Europe as well as Canada and the United States, today.

Further, foreign investment or investment abroad can go far to improving the lots of peoples with little opportunity, economically, educationally, or otherwise. Remember Canada and the U.S. in 1848 – Canada was a backwater for lack of access to capital investment, while next door the United States was thriving because of a steady stream of capital investment. The importance of access to capital holds, today. A development agency operating among the Hill Peoples of Laos, Burma, and Thailand, engages in leading Hill Peoples to discontinue the cultivation of labour-intensive opium poppies in favour of coffee plantations. However, what made this crop substitution viable was a German investor's agreeing to buy all product from the coffee plantations, and to invest his capital in the plantations on terms very favourable to the Hill People coffee planters. As a result, the Hill Peoples who switch from opium to coffee acquire the wherewithal to build villages with proper public hygiene, better houses, dispensaries, and schools. Because they are not using up the land with opium cultivation requiring frequent moves to new sites, the Hill People villages acquire permanence, and the Hill Peoples acquire property rights recognized by, for now, the Government of Thailand. And their children are given opportunities for higher education. German capital investment from Europe is leading to human flourishing among the Hill Peoples of Asia's Golden Triangle.

DISCUSSION POINT: ***Foreign investment in Canada and Canadian investment abroad can enhance freedom and quality of life, and may well constitute a humanitarian activity that improves the lives and circumstances of those receiving the investment.***

SOME GUIDING PRINCIPLES FOR FOREIGN INVESTMENT AND INVESTMENT ABROAD

As suggested above, Canada is a preferred destination for foreign investment for a reason – or several reasons. Likewise, Canadians are careful about where they invest abroad. Following is a list of some principles or characteristics that make for a desirable destination for investment. Canada and other jurisdictions desiring investment should maintain commitments to:

1. ***Limited states*** that nonetheless hold a monopoly on the use of force to enforce the rule of law, including regulatory authority, within their respective, defined, geographic territories;
2. **The principle of the plurality of authority and power**. This entails recognizing that states' (governments') monopolies on the use of force should not translate into monopolies on authority and power. Other institutions, organizations, and associations – including economic, financial, and trading institutions – should exercise forms of authority and power which may even

be coercive. A healthy society – and a desirable destination for investment – disperses power and recognizes the plural nature of authority;

3. **The "pluriformity" of society – that there is a plurality of institutions, organizations, and associations** with distinctive functions and objects. The state is not the only institution of society. Business, unions, religious institutions, and other non-governmental organizations also compose society. They should be encouraged to fully assume their respective responsibilities and roles in it;
4. "**Sphere sovereignty" and "subsidiarity" – related ideas – that each institution, organization, and association is sovereign within its sphere of authority and power, with some overlap among the spheres**. Sphere sovereignty and subsidiarity should inform each state's exercise of force, guide its function as arbiter of justice and adjudicator of society's pluriformity, and frame a state's relations to other states and international institutions, organizations, and associations. It should also inform international trade;
5. **"Democracy" explicitly understood as constitutional, representative government**. Each state is itself subject to the rule of law, as is democratic will;

6. **An adherence to a culture of honesty and equity, to thrift and a work ethic, to the sanctity of contracts and property rights,** supported by the force of law and regulation; and
7. **Investing, trading countries keep in view the pursuit of justice** with a view to human flourishing as a general, guiding principle.[20]

DISCUSSION POINT: ***The principles above make Canada a desirable destination for investment. But they also tend to give Canadians the wherewithal to generate wealth, develop productive capacity and expertise, and build a network of relationships globally as foreign investors come to our shores. This, in turn, affords Canadians the ability to invest abroad – calculating likely destinations for their investment according to these principles, and potentially carrying these principles where they invest. The principles could serve as a useful screen in determining the desirability or security of a destination for Canadian investment abroad.***

HOW SHOULD CANADA REGULATE FOREIGN INVESTMENT?

Investment Canada and *MDA*

Last spring, the Hon. Jim Prentice, Canada's Minister of Industry, used the powers of the Government of Canada under the *Investment Canada Act* to

[20] These also appeared in *Greenlighting Trade: A Trade Corridors Atlas* in slightly different form.

disallow the US-based *ATK*'s proposed purchase, for US$1.3 billion cash, of the *Space Division* of Canada's *MDA Corporation* headquartered in British Columbia with operations in Quebec, Ontario, Alberta, as well as B.C. The proposed sale had gotten a lot of attention from media, a few employees, certain labour unions, and from elected officials.

The Minister of Industry suggested that he disallowed the sale for reasons of Canadian security connected to the *RADARSAT II*. However, one might be forgiven for drawing the conclusion that politics had more to do with the outcome than substantive policy reasons or considerations of national security.

"Branch Plant" or Nation of Investor-Entrepreneurs?

Among the arguments put forward in media was that the proposed US-based corporate purchase of the *MDA Space Division* was an example of "the hollowing out" of Canadian industry. Or, that the purchase was yet one more indication of Canada's status as a branch-plant economy, a backwater to the huge US economy.

However, on the latter concerns, the research described above suggests something quite different. Canadian investment abroad may soon outstrip foreign investment in Canada – even as both increase at very healthy rates of growth. Further, while still significant, U.S.-based foreign investment is diminishing as a share of overall foreign investment in Canada. Meanwhile, the

EU has increased its share of overall foreign investment in Canada. Should Canada fear takeover by EU investors?

Far from Canada's persisting as a branch-plant economy, Canadians are using their participation in Canada's economic, trading, and investment culture to invest abroad around the world, taking with them their intellectual, cultural, and social capital as well as their monetary capital. They are employing this to greatest advantage for themselves, their customers, AND for people of the jurisdictions in which they invest.

"Politics," Investment Policy, and National Security

Without going too far into the details of one instance of foreign investment in Canada, we can agree that foreign investment in Canada should not be over-ruled for reasons of domestic politics. As Christopher Sands argues in his piece cited above, when the Government of Canada's decisions about foreign investment are, or are seen to be, decided by domestic, political considerations, this does little for investor confidence in Canada's investment culture. And it's not only US investors who may pause before investing in Canada.

I hope we can agree also that reasons of national security can legitimately guide the Canadian Government's refusal to approve certain foreign investment.

Sovereign wealth funds have raised national security concerns with certain governments and publics.

Sovereign Wealth Funds

Sovereign wealth funds (SWF) are pools of capital accumulated and controlled by governments.[21] The Government of Canada's *Canada Pension Plan* (*CPP Fund*) may well qualify as a sovereign wealth fund, along with the Government of Alberta's somewhat diminished *Heritage Trust Fund*, among others. [22]

These pools invest in all kinds of interests, but the investments that have drawn the most attention are China's SWF investments in energy and mining off-shore, and SWFs based in the Arabian peninsula that have taken large positions in major, US financial institutions including *Citigroup*.[23] *JP Morgan Chase*, the new owner of *Bear Stearns*, appointed John Moore, formerly of *Bear Stearns*, to oversee

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[21] See Adrian Blundell-Wignall, Yu-Wei Hu, and Juan Yermo, "Sovereign Wealth and Pension Fund Issues." OECD, *Financial Market Trends* (2008):117. Found at: http://www.oecd.org/dataoecd/27/49/40196131.pdf, June 2008.

[22] The *CPP Fund* invests assets belonging to the *Canada Pension Plan* and is managed by the *CPP Investment Board*. The Fund is valued at $122.7B and invests 62.7% of its funds -- $77.1B – in equities (Found at: http://www.cppib.ca/Investments/, July 08). The *Alberta Heritage Savings Trust Fund* stood at ca. $17B as at March 2008, about half of which is invested in equities (Found at: http://www.finance.alberta.ca/business/ahstf/annrep08/report.pdf, July 08). The federal *Public Sector Pension Investment Board* manages a $35B fund, about half of which is invested in equities (Found at: http://www.investpsp.ca/en/investment-highlights.asp, July 08).

[23] Prince Al-Walid bin Talal bin Abdul Aziz Al Saud holds a ca. 4.4% position in *Citigroup* through his *Kingdom Holding Company*, a public company listed on the Dubai exchange. Although the company is ostensibly public, the prince holds 95% of all shares. Although the prince is generally considered outside the hub of political power in Saudi Arabia, he is nonetheless a member of the Saudi Royal Family which holds and exercises that power.

the investment bank's relations with SWFs globally.[24] This follows the example of *Lehman Brothers* in April, 2008, and *Merrill Lynch* was expected to follow suit. Investment bankers around the world find doing business with SWFs to be potentially very lucrative.

The Government of Australia announced earlier this year that it shall review all proposed foreign investment from SWFs in respect of national security. If the Government of Australia deems any investment by a sovereign wealth fund may adversely affect the national security of the Australian state and people, the investment is not permitted to proceed. Australia is not alone in its concern.[25]

Perhaps in part as a response to concerns in Australia, Europe, and elsewhere, the *International Monetary Fund (IMF)* called a meeting of twenty-five member states with SWFs, May 1st 2008, in Washington, D.C. The states organized the *International Working Group of Sovereign Wealth Funds (IWG)* co-chaired by the *IMF* and the *Abu Dhabi Investment Authority (ADIA)*.[26] The *IWG* convened in Singapore on July 8th 2008, *in camera*, and it is scheduled to report by

[24] Sundeep Tucker, "JPMorgan names head of sovereign funds." *FT.com* (27 June '08). Found at: http://www.ft.com/cms/s/0/ad18ddd2-446b-11dd-b151-0000779fd2ac,dwp_uuid=b03d580a-4ff0-11dc-a6b0-0000779fd2ac.html, July 2008.

[25] Cf. Jonathan Wellum, "Short-Termism II: From Flash Wealth to Better Values." Hamilton, Ont.: Work Research Foundation, 2008. Found at: http://www.wrf.ca/pdfs/08.wellum.st2.pdf, July 2008.

[26] "International Working Group of Sovereign Wealth Funds is Established to Facilitate Work on Voluntary Principles." IMF press release, April 30th 2008. Found at: http://www.imf.org/external/np/sec/pr/2008/pr0897.htm, May 2008.

October 2008 "a set of SWF principles that properly reflects their investment practices and objectives."[27]

"The Red Wilson Report"

On June 27th 2008, Red Wilson, the chairman of the *Competition Policy Review Panel*, presented their findings in a report, "Compete to Win."[28] Among others, the report recommends that the Government of Canada set a $1 billion threshold before a review is triggered. It proposes to shift the onus to the federal Minister of Industry to show how an investment is not in Canada's "national interest." However, if implemented as proposed, this may require the Minister to give closer review and examination to all foreign investment in respect of national security – not just those exceeding the $1 billion threshold. In general, however, the report appears to call on the Government of Canada to exercise caution against political assessments in favour of principle-based assessments of foreign investment.[29]

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[27] IWG member countries are: Australia, Azerbaijan, Bahrain, Botswana, Canada, Chile, China, Equatorial Guinea, Iran, Ireland, South Korea, Kuwait, Libya, Mexico, New Zealand, Norway, Qatar, Russia, Singapore, Timor-Leste, Trinidad & Tobago, the United Arab Emirates, and the United States. Vietnam. Saudi Arabia, the *OECD*, and the *World Bank* will participate as permanent observers.

[28] L. R. Wilson, "Hollowing out? The answer is more foreign investment, not less." *The Globe and Mail* (27 June 08). Found at: http://www.theglobeandmail.com/servlet/story/LAC.20080626.COMPETE26/TPStory/?query=wilson, June 2008. For a summary and to download the report, *Compete to Win*, go to: http://www.ic.gc.ca/epic/site/cprp-gepmc.nsf/en/Home (Found: June, 2008).

[29] *Policy Options* will publish my forthcoming review and analysis of the Red Wilson report in its September 2008 issue.

TEN QUESTIONS: CANADA'S INVESTMENT PRACTICES AND POLICIES

1. **Given that the value of Canadian investment abroad has kept pace and could exceed the value of foreign investment in Canada, should Canadians be concerned about foreign investment?**
    a. Is Canada a branch-plant economy?
    b. Or, is Canada a nation of investor-entrepreneurs?
2. **Does an increase in investment in a sector could suggest an upcoming increase in production in that sector, and a subsequent – consequent? – increase in exports from that sector in Canada?**
3. **Does investment – foreign investment in Canada and Canadian investment abroad – suggests a "division of labour" and a kind of trade between countries whose investors place a stake in Canada and countries in which Canadian investors make an investment stake?**
4. **When investors take their intellectual and cultural capital when they invest monetary capital in another country –do they engage in an intellectual-cultural trade?**
5. **Does foreign investment in Canada and Canadian investment abroad constitute an expression of confidence in the commercial and political culture, as well as the prospects for ROI?**
6. **Is there such a thing as principle-based investment – beyond ROI?**

a. **Do the principles above make Canada a desirable destination for investment?** Do they also tend to give Canadians the wherewithal to generate wealth, develop productive capacity and expertise, and build a network of relationships globally as foreign investors come to our shores?

b. **Do these – should these – principles guide Canadians' investment decisions abroad?** Should the principles serve as a useful screen in determining the desirability or security of a destination for Canadian investment abroad? For example, among the much-touted growth markets of "BRIC" – Brazil, Russia, India, and China – should Canadians prefer India over the rest because of its British institutions, including common law, and English, over the rest? Should Canadian investors prefer Brazil over Russia and China for its stronger commitment to constitutional democracy?

c. **Should Canadian investors take these principles with them when they invest abroad?**

7. **Can foreign investment in Canada and Canadian investment abroad enhance freedom and quality of life?** Does it – Can it? Should it? – constitute a humanitarian activity that improves the lives and circumstances of those receiving the investment?

8. **Should Canada regulate foreign investment in Canada? If so, on what basis?** (See my article in the September 2008 edition of *Policy Options* (http://www.irpp.org/po/) on "Compete to Win" the report of the *Competition Policy Review Panel*)
    a. National interest?
    b. Competitiveness?
    c. National security?
    d. On a principled basis – furthering democracy, the rule of law, political and economic freedom?
9. **How should the Government of Canada regulate foreign investment?**
    a. On what basis does the Government of Canada apply the Investment Canada Act?
    b. What amendments should be made to the act, and what changes should be implemented to policy in this area?
10. **Should Canada be concerned about the growth of Sovereign Wealth Funds and their investing in Canada? Should other countries be concerned about Canada's Sovereign Wealth Funds investing in their economies?**