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Date Sept. 2 1992
Abstract

The process of globalization has, since World War II, transformed relations between states, and between states and multinational enterprises (MNEs). Canada was one of the first countries to be transformed by this process - a trail-blazer particularly with respect to foreign direct investment (FDI). This thesis argues that Canada consciously took a globalist approach in its economic development via its openness toward, and active encouragement of, FDI. Canada's approach was facilitated by many factors, notably its cultural and historical ties to the U.K. and the U.S., its immigrant citizenry, and its muted nationalism. This approach, while novel at the time of its institution, has been replicated by states around the world in the last twenty-five years as globalization of the world market has accelerated.

The Canadian case is of interest, however, because just at the time when other countries were shifting towards the more liberal and globalist approach to FDI that Canada had championed, Canada changed course and implemented stringent restrictions on FDI. Then, hardly a decade later, Canada returned to a more liberal and open approach to FDI regulation. This thesis argues that Canada turned away from the globalizing trend because foreign penetration of the Canadian economy had become, by far, the highest in the world. This fact, united with anti-American sentiments and a Trudeau-inspired rise in nationalism, set the stage for a dramatic increase in protectionist restrictions, in particular the creation of the Foreign Investment Review Agency (FIRA) in 1974. The election victory of the Conservatives in 1984 and the subsequent abolishment of FIRA symbolizes Canada's return to a globalist approach to its economic well-being. This thesis will argue that Canada's lapse into protectionism collapsed because Canada was out of step with liberalizing global trends and the costs of this, in terms of general welfare, were too high to be borne by a small country, particularly one whose economy had historically relied so heavily on foreign investment.
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1.1. Introduction

International investment has become a very important facet of the world economy. The flow of international investment has grown particularly rapidly in the last two decades to the point where it has overtaken international trade flows as the engine of growth in the world economy. Economic integration among the economies of the world began in earnest at the end of the Second World War. The rapid growth of world trade and the recent explosion of direct investment and the establishment of various co-operative arrangements among MNEs are both the cause and effect of increased economic interdependence among firms and states. Along with global integration and the changing role of multinational enterprises (MNEs), there has been a significant increase in intra-regional trade and direct investment flows in the Triad countries (i.e., North America, EU, Japan). The increased trade and investment linkages complement one another and create a cycle of increased economic interdependence among trading partners. MNEs are the main actors carrying out this trade and investment.

MNEs are increasingly dependent for their success on infrastructure facilities and the knowledge base of national economies which are at least partly shaped by government technological, industrial, educational and other policies. Governments, on the other hand, are competing more and more for the resources and capabilities of MNEs, and in the process they have lost the power to pursue isolationist economic policies which try to limit MNEs' influence.

A central characteristic of interdependence is the intermeshing of domestic and foreign economic policies.¹ MNE-related public policy extends from 'foreign' policy issues of trade, direct investment flows, technology and skill transfers, the repatriation of profits and the like, all the way to 'domestic', economy-wide issues of

the development of infrastructures, privatizations, public procurement, standard-setting, antitrust, subsidies and regional development. Another facet of interdependence is what Razeen Sally calls an "institutional competition of systems", which can be defined as competition of immobile factors (i.e., states' legal and public policy packages) for mobile capital. Mobile capital includes the financial, production and human capital of MNEs.

Canada is perceived globally as a country of moderation, compromise and sensibility, in all aspects of its internal and external relations. However, there is one area where Canada has not displayed its usual moderateness and where it stands out as a leader among advanced industrial states. Canada has encouraged the flow of FDI into its economy to such an extent that by the 1970s it had the highest proportion of foreign ownership of any developed market economy. Although the extent of foreign ownership declined over the 1980s, it remained substantial. This situation has stimulated endless debate among Canadians as they try to understand this uncharacteristic "extremism".

One of the major reasons that Canada has a special history of foreign investment is because of its colonial past. At the time of Confederation in 1867, most foreign investment in Canada came from the United Kingdom in the form of portfolio investment. By 1900, however, FDI had risen to where it accounted for one-quarter of total foreign investment in Canada. Increasingly, after 1900, more and more of gross capital imports came from the U.S., almost exclusively in the form of FDI. Following World War II, U.S. direct investment in Canada increased dramatically again. The stock of FDI then accounted for one-half the level of foreign investment in Canada. The level of foreign ownership and control in Canada's economy became the highest in the industrialized world.

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Not surprisingly, therefore, Canadian attitudes toward foreign investment have had to reconcile two realities. On the one hand, there is a high degree of foreign ownership and control of Canadian industry. On the other, there is a continuing need for foreign direct investment to bring technology and management expertise into the economy. Generally, FDI promotes efficiency and competition in Canada's small and open market. Government policy on foreign investment in Canada has aimed to balance these two conflicting realities.4

In terms of its approach to the world economy, Canada has not behaved like a model 'small state'. Peter Katzenstein argues that because of their small domestic markets and their dependence on world trade, small European states such as Sweden, Belgium, and the Netherlands are generally free traders that avoid measures such as tariffs and import quotas. Instead, while adopting liberal policies internationally, they employ domestic social and economic policies that compensate their citizens for the harsh changes that international markets thrust upon them. In Katzenstein's words they "live with change by compensating for it."5 In many small European countries, these compensatory policies are the result of corporatist political arrangements based on an ideology of social partnership and the existence of highly centralized producer groups that voluntarily coordinate conflicting goals.6

Although Canada fits part of this description, the differences outweigh the similarities. In terms of similarities, as in other small states, Canadian federal and provincial governments have attempted to reduce external dependence through the ownership of public enterprises or Crown corporations. Canada's staples-led growth pattern necessitated more interventionist state policies than those in the U.S. or Britain. Heavy reliance on natural resources exposed the Canadian economy to fluctuations in world commodity markets, tying the country's fate to swings in the

6Katzenstein, ch. 3.
prices of natural resources. Domestic economic crises frequently resulted, striking various regions within the country disproportionately. To maintain national unity, the federal government was forced to intervene with adjustment efforts. Consequently, the state gained a prominent role in organizing the economy, as it underwrote the huge infrastructure investment in transportation necessary to get resources to market, and as it compensated for the economic havoc created by fluctuations in international markets.

But the comparison with small European states cannot be pushed further. While the Canadian state may be more interventionist than its laissez-faire neighbor to the south, its involvement in the economy does not compare to that of other small states. Canada cannot engage in corporatist policies because it lacks the coherent and centralized producer groups necessary to produce compromises at the bargaining table. Furthermore, it is questionable whether its weak and continuously reorganizing state agencies have the capacity to implement many policies derived from such compromises. As a result, Canada does not have many of the compensatory policies evident in other small states. Interestingly, these groups are usually the ones that would lobby for protectionism and argue in favor of a restrictive policy toward foreign investment. The weakness of these groups in Canada might be a reason for Canada's openness toward FDI throughout most of this century.

Interestingly, despite its general history of openness to FDI, Canada has often not been a free trader. Instead, it has relied extensively on tariffs as a tool in the industrialization process. Indeed, the first major flow of FDI into Canadian manufacturing was in part a response to the tariffs imposed under the National Policy of 1879. This policy enabled American firms to jump tariff barriers through subsidiaries designed to service the Canadian market.

8Jenkins, 111-112.
Canada's open and welcoming approach to FDI has become the trend in the globalizing economy. Canada chose consciously to give up some autonomy in exchange for economic gains and more rapid development. National autonomy in foreign economic policy began to shrink significantly in the 1970s and 1980s when deregulation of financial markets and the rise of new information technology spurred an enormous increase in financial linkages. Ironically, when the rest of the industrialized world began to liberalize and make adjustments to function more efficiently in the global market-place, Canada went against the tide by choosing to increase regulation and control of FDI. But after only a decade, Canada returned to its original FDI-friendly outlook. This shift in policy was solidified with the demise of the Foreign Investment Review Agency (FIRA), the Free Trade Agreement (FTA) with the U.S. and then again when the FTA was expanded to include Mexico in the North American Free Trade Agreement (NAFTA).

There are three main reasons why Canada had a very liberal attitude toward foreign investors so early in its history and why it was willing to cede significant influence over its economy to foreign companies. First, as a result of its colonial history and cultural ties to the U.K. and the U.S., Canadians possessed the necessary trust to form successful investment relationships with foreign companies. Canadians did not feel that their national security, autonomy or sovereignty was threatened by the high level of foreign control because the control was in the hands of people of the same Anglo-Saxon background. The investors, on the other hand, could lower their transaction costs because of these ties. A common language, culture, history, and legal system worked to create a fertile ground for investment. This trust was further strengthened by their alliance through the World Wars and the Cold War.

The second reason why it was easier for the Canadian government to leave realist security-maximizing thinking behind and open up its economy to foreign investors before most other countries was because Canadians, by having an
immigrant background, at some point had represented foreign human capital themselves. Being a state created by immigrants for immigrants, the mental framework of globalization was in place long before it was in the rest of the world. Foreign capital, goods, services, ideas and people were needed to develop the country, and Canada had more trust in the foreign investors and their intentions than did other countries in the same period. At least they were willing to gamble on them. The belief that mutual dependence would be beneficial for both investors and Canadians reigned. The high level of foreign control in the Canadian economy was not regarded as a problem until the late 1960s.

The third reason for Canada's early openness to foreign investment is due to its muted nationalism, which is a direct consequence of the country's diverse immigrant history. Canada chose a model of nation-building where the nurturing of diverse ethnic backgrounds and tolerance was emphasized. The often intense nationalism of many European states acted to prevent openness to foreign investment within Europe until the creation of the European Communities (EC). However, that depth of nationalist sentiment has never been present in Canada, and for this reason, Canada was able to take advantage of foreign investment dollars much earlier. Nationalism in Canada remained muted until the Trudeau government managed to whip up some nationalist sentiments in the 1970s and early 1980s, when concern about foreign control of the economy increased sharply and came to be regarded as a serious problem requiring remedy.

Some analysts, however, do not acknowledge that Canada ever made the conscious decision to pursue a liberal, continentalist foreign investment policy. Rather, they focus on Canada's inability to resist American manipulation of Canada's economy and politics due to the proximity of the two countries, the cultural similarities, and the massive size of the United States compared to Canada. According to this perspective, Canada was being quietly taken over by U.S. companies, who were acting as agents of an imperial American government. In
light of these "facts", Canada was more or less destined to be trapped and eventually engulfed by the U.S., unless the Canadian government were to radically change course by halting FDI from the U.S. entirely, enduring economic hardship to restore autonomy in its economic and political affairs. To summarize, these analysts saw Canada's foreign investment policy not as consciously and enthusiastically continentalist and global, but rather as a policy born out of virtually insurmountable structural constraints.⁹

This thesis, however, argues not only that Canada was one of the first countries to "globalize" its investment policy, but that Canadian policies since Confederation have consciously taken a global approach for many reasons beyond the obvious structural ones. Mutual trust, muted nationalism, the lowering of transaction costs, and the shift from confrontation to cooperation for mutual benefit are some of the characteristics of recent globalization around the world that were in evidence much earlier in the Canadian case. The ongoing integration of national economies and increased international cooperation have shifted priorities and interests of states in a direction where the level of trust is high, nationalism is less abrasive, and states are less confrontational and more prone to take a cooperative stance in world politics. The puzzle of the Canadian case, however, is why Canada, in the mid 1970s, turned inward and dramatically increased its regulation of foreign investment, only to return to a more liberally oriented FDI policy a decade later. My hypothesis is that the increased regulation was an anomaly - largely the result of international and domestic circumstances. The later deregulation came relatively quickly because the Canadian government realized that it was out of step with the globalization trend that was sweeping the world economy.

1.2. Definitions

It is necessary to define some concepts that this thesis will deal with. These are the definitions of foreign direct investment (FDI), multinational enterprises, and globalization.

Direct investment is defined as the investment by one firm in another with the intention of gaining a degree of control of that firm's operations. 'International' or 'Foreign' direct investment is simply direct investment which occurs across national boundaries, that is, where a firm from one country buys a controlling investment in a firm in another country or where a firm from one country sets up a branch or subsidiary company in another country. 'Portfolio investment' refers to the situation in which firms purchase stock/shares in other companies purely for financial purposes; that is, like any other investor, they build up a portfolio of company shares. However, these purchases are not made to gain control of the company, and it is the controlling nature of FDI that makes it interesting.10

Some scholars distinguish between multinational enterprises (MNEs), that operate in several countries but which are essentially extensions of firms rooted in the national economy and socio-political structure of their 'home' countries, and transnational corporations (TNCs), whose production and management structures, personnel, financing, strategy, and so on, genuinely cut across borders and nationalities - so that they become 'rootless' and potentially 'footloose'. I will throughout this thesis use the term multinational enterprise because it makes no difference for my purposes to distinguish between TNCs and MNEs. The important point to recognize is that these companies are foreign to the economy they invest in, and thus there is foreign influence/control over the recipient country's economy.

Finally, I define "globalization" as the increasing interdependence and interconnectedness of national economies. Globalization is characterized by an increasing movement of goods, services, capital, ideas and people across national borders; development of regional trading blocs; growth in the number and

expansion of MNEs; and a growing number of socioeconomic-environmental problems that require cooperation among several countries. International integration, which is implicit in the concept of globalization, has both micro- and macroeconomic dimensions. Integration at the micro level involves the creation and growth of MNEs through FDI, international interfirm agreements, licensing, sub-contracting, and/or acquisitions. At the macro level, integration results from the lowering of barriers to the movement of goods, services, capital, ideas and people. The factors that produce greater international integration at the macro level also result in more integration at the micro level. As pointed out in the 1993 World Investment Report, "Measures to liberalize trade can boost FDI by allowing TNCs to establish production facilities in low-cost sites from which they can export their output, by allowing TNCs to outsource inputs, by enabling the formation of regional networks, and by allowing the integration of production regionally or globally."^11

1.3. The Organization of the Thesis

The organization of this thesis is as follows. Chapter Two reviews some of the globalization literature and clarifies the globalization trends and how the global economy has changed over the past half century. Chapter Three analyzes the global trends of FDI and then focuses on the Canadian FDI trends and how they relate to the global ones. Chapters Four examines why Canada turned away from its FDI-friendly position and increased its restrictions on FDI. Chapter Five examines Canada's most recent shift, when it liberalized its FDI regulations and returned to a continental outlook, seeing the benefits of FDI as outweighing the costs. Chapter Six will present a summary of my findings.

Chapter 2: Globalization and Foreign Direct Investment

Globalization has become the buzzword of today and it is almost impossible not to see its consequences in our everyday lives. Goods, capital, people, knowledge, images, communications, as well as crime, culture, pollutants, drugs, fashions and beliefs, readily flow across territorial boundaries. Transnational networks, social movements and relationships are extensive in virtually all areas of human activity. The existence of global systems of finance, trade and production binds together the prosperity and fate of households, communities and states across the world. In light of these globalizing tendencies our old conceptions of the nation-state have become questionable. The supremacy of territorial boundaries, sovereignty, and autonomy might still be what we base international law upon but the reality is that the role of the state is in a state of flux. A valid question these days is what role the nation-state can have in a globalized world. Globalization of the market has certainly changed the parameters of state power.

This theme has been prevalent in the literature since Charles Kindleberger wrote "the state is about over as an economic unit" more than quarter of a century ago. Philip Cerny points out in the same vein that the role of the state as a general regulator of the national economy and as a promoter of the national interest in economic terms is eroded not only by the globalization of international finance, but also by the inappropriateness of state structures for effective control of both the design of the complex of local, regional, national, and transnational playing fields, and the market outcomes they produce. Others, like Michael Porter, are more hopeful and argue that globalization and the removal of protection and other distortions to competition arguably make states more important. National

differences in character and culture, far from being threatened by global competition, prove integral to success in it.\textsuperscript{14}

In this chapter I will examine the globalization of the world market and the role of FDI in this process. Furthermore, I will argue that Canada can be seen as a trail-blazer in the process of globalization. The wider purpose of this chapter is to create an understanding of the changing economic world in which Canada participates.

\textbf{2.1. The Meaning of Globalization}

The international system is no longer simply a state system. Instead, it is increasingly characterized by a plural and composite structure. The word 'globalization' is often used to represent this process of change. The concept is wide and comprises an array of intertwined processes. Claire Turenne Sjolander, for example, argues that globalization needs to be understood as a more comprehensive process than its economic manifestations would suggest. Globalization needs to be seen as an economic, political, social, and ideological phenomenon which carries with it unanticipated, and often contradictory and polarizing, consequences.\textsuperscript{15} Likewise, Cerny maintains that "globalization is neither uniform nor homogeneous; its boundaries are unclear and its constituent elements and multidimensional character have not as yet been adequately explored."\textsuperscript{16} This multidimensionality is the reason why it is so difficult to pinpoint the concept. There is definitely a risk of conceptual overload and a chance that careless usage may drain it of all relevance.

According to Anthony McGrew, "globalization refers to the multiplicity of linkages and interconnections between the states and societies which make up the

modern world."\textsuperscript{17} The term describes the process by which events, decisions, and activities in one part of the world can come to have an significant impact on individuals and communities in quite distant parts of the world. McGrew maintains that globalization has two discrete dimensions: scope (or breadth) and intensity (or depth). Globalization, on the one hand, defines a set of processes that embrace most of the globe or operate world-wide; the concept therefore has a spatial connotation. Economic, political and social activities are expanding around the world such that events, decisions, and activities in one part of the world can come to have immediate significance for individuals and communities in quite distant parts of the globe. On the other hand, globalization also implies an intensification in the levels of interaction, interconnectedness or interdependence among the states and societies. The deepening and expanding go hand in hand in processes of globalization. Even if we primarily live a local life, it is no longer possible to fully protect it from global phenomena.\textsuperscript{18}

Globalization has often been erroneously considered as a post-World War II phenomenon. But McGrew writes, "...global politics was not born in 1945, and... the contemporary epoch is not necessarily unique in terms of globalized interaction between societies."\textsuperscript{19} In fact, globalization has been evident in many previous periods of history and is perhaps most powerfully visible in the imperialism of the nineteenth century. In a similar vein, George Modelski conceives of the globalization process as a series of waves represented by the impacts of different and successive civilizations.\textsuperscript{20} Yet the historical dimension of globalization should not lead us to deny some of the distinctive dynamics and features of the contemporary global order. According to Hedley Bull, what "is in any sense new or recent in the

\textsuperscript{19}McGrew, 1992b, 319.
world political system of the nineteenth and twentieth centuries is its global or world-wide character, and, of course, it is only in this recent period that [post-1945] that the states system has itself become world-wide." Thus, there is a qualitative difference between these waves and the pervasiveness of the present wave of globalization suggests that the world is more globalized than ever.

Globalization has to be described in terms of its varied components and impacts across the globe. Some states are more deeply integrated into the global order than others. Further, within states some communities are involved in global networks while others are completely outside them. This unevenness can also be found across different issue areas. The same state may, for example, be highly integrated into one set of global activities but hardly involved in others at all. Coming to terms with the dynamics and consequences of globalization requires a keen understanding of the unevenness of the process.22

Globalization does not necessarily correlate with harmony in global politics or the road to the salvation of the world. It is inaccurate to conceive of globalization as a some kind of teleological process or set of processes. Beliefs that globalization incorporates some predetermined historical logic which is leading relentlessly to the creation of a borderless world, the end of history, or to some form of world government are simply not tenable. Historical evidence does not substantiate such views. Globalization is a dialectical process with both converging and diverging effects. Greater mutual awareness and interconnections among different societies can easily sow the seeds of conflict and tension. Hedley Bull, for example, observes that "awareness of other societies, even where it is 'perfect', does not merely help to remove imagined conflicts of interest and ideology that do not exist; it also reveals conflicts of interest and ideology that do exist." Globalization stimulates forces of opposition that may lead to an increasingly fragmented world. Cerny even argues

22McGrew, 1992b, 320.
23Bull, 270.
that "globalization can just as well be seen as the harbinger not of a new world order but of a new world disorder, even a 'new medievalism' of overlapping and competing authorities, multiple loyalties and identities, prismatic notions of space and belief, and so on."\(^{24}\)

Even if globalization does not necessarily encourage international cooperation, forebode the emergence of a world society or world government, or imply the end of the nation-state, they are, of course, all potential outcomes. Thus, globalization may be a necessary ingredient in creating a more integrated world community, but it is not by itself a sufficient condition for doing so. The reason is that intensification of world interconnectedness stimulates both cooperation and conflict. This is a crucial lesson for understanding the process of globalization. Globalization is essentially a dialectical process in that it produces opposing forces wherever its effects are experienced. For Cerny this dialectic is the paradox of globalization because rather than creating one big economy or one big polity, it also divides, fragments, and polarizes. Convergence and divergence are two sides of the same coin."\(^{25}\)

2.2. The Global Market-Place, Multinational Enterprises, and Foreign Investment

This section will focus on the relations among the global market place, multinational enterprises (MNEs), and foreign investment. Globalization is a multifaceted process that to some degree influences all aspects of society. It is now time to concentrate on economic aspects of globalization, but it is necessary to keep in mind that this is only one of its many dimensions and that these dimensions are constantly interacting. This type of globalization refers to the integration of markets on a global scale and the interdependence of consumers, producers, suppliers, and governments around the world.

\(^{24}\)Cerny, 1996a, 619.
\(^{25}\)Cerny, 1996a, 637.
The link between foreign investment and globalization is via international economic integration. This is often seen as the spread of market linkages through greater trade and factor flows, and government action to reduce obstacles to these flows is the main stimulus to increased integration. However, this type of shallow integration ignores participation in the international division of labor at the level of production. International production refers to a firm controlling productive assets in more than one country, whereby control is typically established through FDI, but can also be exercised through various non-equity forms. As such, international production goes beyond arm's length market exchanges by internalizing cross-border exchanges related to productive assets located in different countries under the common governance of MNEs. As soon as FDI becomes the chosen vehicle for establishing cross-border linkages, the character of international economic integration changes from shallow to deep integration. However, deep integration differs from shallow in ways other than the chosen channel of establishing cross-border activity. Because FDI, unlike market-based exchanges, does not end with the initial transaction, it establishes a more lasting linkage between economic agents located in different countries. Consequently, the type of strategy adopted by MNEs matters very much to the nature of deep integration and, by implication, to the way in which deep integration and shallow integration interact to establish a wider globalization process. Corporate strategies related to international production initially involve the common governance by MNEs of a limited number of corporate functions, often in the framework of a vertical integration of labor, and as more and more functions are included under the common governance - both along vertical and, increasingly, horizontal lines - international production takes on a more integrated character.26

Having established the link between foreign investment and globalization, some scholars have foreseen the emergence of a homogeneous marketplace or the

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26UNCTC, 1993, 118.
dominance of one type of corporate organization. Cerny, however, argues that economic globalization expands and multiplies the playing fields within which different market actors and firms interact. This leads to a transformation of the international economy from one made up of national economies interacting on the basis of national comparative advantage into one in which a variety of competitive advantages are created in ways independent of the nation-state as a social, economic, and/or political unit. The creation and manipulation of these competitive advantages can come about by and through different corporate forms, different optimal economies of scale in different industrial sectors, and different territorial and quasi-territorial bases.27

That economic globalization has taken place is obvious. World trade and foreign direct investment have grown faster than world output; major economies are more open; the importance of regional trading blocs and intracorporate trade are growing; the magnitude and speed of international capital flows are increasing; more international networking and strategic alliances among firms are occurring; and a heightened degree of international competitiveness and growing importance of knowledge-intensive industries are developing. These are all examples of the globalization occurring in the economic sphere.28 The next chapter will take a closer look on the both world and Canadian trends in foreign direct investment.

Multinational enterprises now function in a global, political economy. The economy is global, as opposed to international, because borders are disappearing between markets, and political because national politics and policies still matter. The MNEs operate with world-wide strategies, investments, and sales, and this make them the chief vehicle for increasing interconnectedness among national economies. In fact, the increased competitiveness of firms on a global scale as they contend for shares of the world market has forced nation-states to reconsider their

27 Cerny, 1996a, 626-627.
policies toward MNEs. Overall, states have moved from confrontation to cooperation with the global firm in their midst, from complex regulation to encouragement of entry, from taxing to subsidising, and from opposition to partnership.29

Economic integration and interaction have intensified dramatically among the economies of the world during the post-war period. Both the cause and effect of increased economic interdependence among firms and states can be traced in the rapid growth of world trade, of FDI stock and of various cooperative arrangements among MNEs. There has also been considerable growth in intra-regional trade in the Triad countries. The increased trade and investment linkages complement one another and create a cycle of increased economic interdependence among the trading partners.30

International political economy (IPE) scholars argue that increasing interdependence and globalization in the 1980s exacerbated the tension between states and markets as neomercantilistic states jockeyed for competitive advantages in a shrinking world. However, when scrutinizing the concept of globalization, the dominance of MNEs in the process becomes clear. Lorraine Eden argues that the globalization of markets is a multifaceted phenomenon that contains at least three components. The first, convergence, refers to the trend within the Triad countries for the production, financial and technological structures to approach a common standard. For example, consumer tastes have become more uniform within the Triad countries and as a consequence global products and markets have developed. The technology gap between the United States, Japan and Europe has substantially narrowed. Although some would argue that the United States is still the global hegemon, it clearly acts in a multipolar world. Income differentials have

diminished considerably and differences in tariff rates have narrowed both among countries and among product classifications. All these examples of convergence work to further encourage globalization of markets by making interaction and exchange cheaper, easier and faster.\textsuperscript{31}

The second component of globalization, synchronization, concerns the increasing macroeconomic tendency of the Triad economies to move in tandem, experiencing similar patterns in their business cycles. States are also increasingly using similar microeconomic and structural policies, such as liberalization, deregulation, and privatization, to encourage development and growth. One consequence of this synchronization and the increasing interconnectedness of the world economy is that it becomes more difficult for governments to hedge against business cycles and shun global trends by, for example, beggar-thy-neigbor policies. The welfare price for not taking part in the global economy has increased tremendously.\textsuperscript{32}

The third component of globalization, interpenetration, has received the most attention. It refers to the growing importance of trade, investment and technology flows, both inward and outward, within each domestic economy. Trade and investment flows have grown faster than world GDP since the 1950s and this trend has accelerated since the mid 1980s. Intra-industry flows dominate in the developed world.\textsuperscript{33}

These three components of globalization make clear the importance of MNEs as the engineers or agents of increasing globalization in the world economy. Investment, trade, and technology flows among the Triad economies are increasingly dominated by MNEs with global strategies. MNEs now dominate finance, production, technology, security, energy, and trade. This means that all

underlying structures of the global economy are in some way or another influenced by MNEs. Peter Dicken goes so far as to claim that the MNE is the single most important force in the accelerated development of the global economic system. However, it is not as homogeneous an institution as often depicted. Instead, there is a lot of variety among MNEs. A major cause of this variety lies in the nature of the home states. The home environment and its political, social, cultural, and economic characteristics do of course influence the MNEs. Although there are considerable similarities among MNEs, especially the giant ones, whatever their national origins, there is no doubt that different home states do cause some important differences among MNEs.\(^{34}\)

However, both states and the MNE's have played significant roles in the process of economic globalization. The state has played a role by reacting to opportunities and constraints of the new environment. This transformation entails a fundamental shift of organizational goals and institutional processes within state structures themselves as the welfare state has been replaced by the competition state. The welfare state was organized to take certain economic activities, like health care, out of the market and, hence, decommodify them. The competition state, on the other hand, works toward increased marketization to make economic activities located within the national territory or otherwise contributing to national wealth more competitive in international and transnational terms. The paradox is that as states have promoted competitiveness in an increasingly heterogeneous and crowded world, they have also without serious debate given up a range of crucial policy instruments.\(^{35}\)

MNEs have not been immune to the process of economic globalization. This process has required a fundamental reorientation of MNEs' international investment strategies that has in part involved the 'delocalization' of production. The economic crises of the 1970s forced MNEs to see national lines of production in

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\(^{34}\)Dicken, 86.

\(^{35}\)Cerny, 1996a, 633-634.
international terms. The MNE had to expand markets and improve productivity to survive, and their response to this challenge became the internationalization of production. The economic and political world order, *Pax Americana*, which emerged under the leadership of the United States after World War II, was based on the assumption of an exchange model of the international economy. This system improved over time and the ease and security with which goods, capital, and knowledge flowed across international borders increased remarkably through the work of international institutions, like GATT, and the spread of new production technologies. Thus, the economic and political world order facilitated the transformation of the international economy from one based on exchange to one based on production. The prerequisite for the fragmentation of the production process was the rapid technological advances that took place, and these advances made delocalization a viable strategy. It turned out to be advantageous for firms to establish parts of one production process in different locations around the world. Firms could now make use of different states' competitive advantages in different stages of the production process and hence improve both productivity and profitability. This development made it possible to locate labor-intensive activities in states with low wages and abundance of workers and environmentally hazardous process in states with lax or no regulation against pollution, and so on.\(^{36}\)

When trade was the primary engine of global economic integration and corporations were rooted in particular countries, negotiations were government-to-government. Each state's objective was to open foreign markets to the exports of its own companies or to protect its own companies from foreign competition at home. Success was measured by the extent to which they were able to sell their goods and services within foreign national markets and by how much of the world market share their own companies could command. In the new global economy, the old forms of government-to-government negotiating and keeping score of market

\(^{36}\)Sjolander, 605-606.
shares become obsolete. Global investment is supplanting merchandise trade as the major engine of world economic integration and the key to a nation's wealth and well-being. And negotiations between governments and global managers are replacing the old government-to-government talks.\textsuperscript{37} This change in nature of economic activity from trade to direct investment has consequently implied a change in the nature of negotiations. John Stopford and Susan Strange call it "triangular diplomacy". Diplomacy has taken on two additional dimensions beyond the traditional government-to-government negotiations. The dimensions are government-firm and firm-firm bargaining.\textsuperscript{38} Important bargaining now takes place between government representatives and the managers of global corporations. The government's position has shifted from protecting domestic corporations to providing the state's citizens with good jobs.\textsuperscript{39} The firm-firm dimension is where important partnerships and alliances are forged to meet the challenge of world market competition.\textsuperscript{40}

The crucial problem in the study of IPE is the tension between states and multinational corporations. Nevertheless, all the major perspectives in IPE—liberalism, nationalism, and Marxism—have different views of the MNE. The liberal perspective regards the MNE as an integrating force in the world economy because MNEs transfer resources between countries and they are a force of progress, increasing wealth and lessening income inequalities between developed and developing countries. Furthermore, MNEs are seen as generally beneficial in their roles as promoters of a more integrated world order and as counterweights to mercantilistic tendencies of nation-states. Nationalist and neomercantilistic perspectives view MNEs as potential threats to the power of the state because MNEs

\textsuperscript{39} Reich, 1995b, 174.
respond to global profit motives. This makes the conflict between state goals and MNE goals inevitable. For the state to maintain its autonomy and sovereignty, MNEs have to be regulated both nationally and internationally. The problem on which this perspective focuses is how to manage MNEs to ensure that they improve domestic industrial capacity, national sovereignty and state security. Finally, Marxist critiques, especially the Latin American dependency writings, view MNEs as oligopolistic transnational capitalists that systematically exploit Third World peoples and promote underdevelopment in the periphery and semi-periphery. MNEs act on command from their home states, promoting imperialism and permanently creating global income inequalities. Radical theorists argue that MNEs make alliances with transnational elites such as domestic capitalists in the semi-periphery, but that such development is impeded because it remains dependent on relations with the core.\textsuperscript{41}

But the ability of states to use MNEs for the promotion of national interests -- however marginal this ability ever was -- has steadily declined. With these enterprises standing at the hub of the world's trade and investment networks, they have become less responsive to national authorities, and may no longer possess a national identity at all. Robert Reich captures this insight with his question, "Who is Us?". Reich asserts that large corporations take a global -- as opposed to national -- view in searching for markets, employees, and new technology, and as a result their national identity no longer matters to them.\textsuperscript{42}

Globalization represents a potential crisis to liberal democracy as we know it. An accelerating divergence has taken place between the structure of the state and the structure of the financial and industrial markets. There is now a new disjuncture between the state's institutional capacity to provide public goods and the structural characteristics of a larger global economy. As international and

\textsuperscript{41}Eden, 1993b, 26-27.
transnational constraints limit the things that a state can do and, hence, what it can be expected to do, the role of the state changes to one of enforcing the decisions that emerge from the world markets and international regimes. Sjolander argues in the same vein that "globalization brings with it the internationalization of the state and the (globalized) diffusion of a neoliberal ideology, which increasingly constrain parties of the right and the left to adopt similar agendas, although their rhetoric may differ." This shows again how the dialectic works. Globalization may make the world more uniform but it can simultaneously plant the seed of a reaction and in the long-run its own destruction.

2.3. Canada - A Trail-Blazer of Globalization

The argument, set out in the introduction, that Canada in its FDI policy has been a trail-blazer of globalization needs elaboration. Canada possessed certain characteristics very early in its history that have became common in the rest of the world only in the last twenty-five years. The mental framework of globalization, in particular, became deeply rooted in Canada earlier than in the rest of the world. This section will venture deeper into this argument.

The development of Canada, from its colonial period to Confederation to the present, has occurred in large part as a direct result of foreign investment. The industrialization-by-invitation strategy that Canada implemented shortly after Confederation forced foreign companies to set up shop in Canada to get access to the Canadian market. FDI is usually the last step in market penetration but the Canadian strategy forced foreign companies the skip the trade stage to get access to the growing Canadian market. This strategy was forged primarily to increase the speed of Canadian economic development, but also to get access to capital, technology, and entrepreneurs.

\[^{43}\text{Cerny, 1995, 598.}\]
\[^{44}\text{Sjolander, 608.}\]
But it was really Canada’s colonial history that originally set the stage for its enduring openness to foreign investors. Ongoing friendly ties with its former colonial power, I believe, laid the groundwork for Canada’s ability to trust foreign investors later on. At the time of Canadian Confederation, the U.K. was the most industrialized, most powerful country in the world, while Canada was underdeveloped, underpopulated, and perhaps somewhat unsure of itself. Meanwhile, its southern neighbor, which had won its independence from the U.K. nearly a century earlier, was well on its way to becoming a major world power. Thus Canada sought to emulate the success of its role models, trusting these foreign investors and their expertise to help them build an industrialized Canada.

Another explanation for Canada’s early openness to foreign investment and influence in its early independence years is that Canada did not have to wage war for its independence and thus Canadians never developed a strong sense of nationalism or a fervent devotion to their independence. Canada did not abruptly cut its ties to imperial Britain to find its own way; rather, Canada quietly developed under the pseudo-parental guidance of the U.K. (and later, under the big-brother influence of the U.S.). These colonial influences linger in modern-day Canadian culture in Canada’s attitude toward foreign influence, most notably in the economic sphere.

Canada’s post-independence development relied heavily not only on British and American investment and influence, but also on the massive inflow of foreign human capital in the form of immigrants, and the wealth they brought with them. These immigrants’ awareness of the ethnic strife in their home countries, and the diversity of the new society they found themselves in, created a relatively accepting and tolerant attitude to foreigners and their differences. Further, Canadians cherish the ethnicity of their forefathers, which has been the basis for Canada’s multiculturalism policies. All of these factors have led to Canada’s ability to trust
foreign investors which has been a key contributing factor to Canada's openness to FDI.

In sum, this chapter has set out the major changes that has taken place in the globalizing world economy, made the link between FDI and globalization, and argued that Canada by its early openness to FDI became a trail-blazer of globalization. The next chapter will examine the global and Canadian trends in FDI.
Chapter 3: Trends in Foreign Direct Investment

This chapter will focus on FDI trends and outline major long-term and short-term developments. Special attention will be given to the surge in FDI the last two decades and whether it is likely to continue. The first part of this chapter will take a global outlook, while the second part will look more specifically at the Canadian situation.

3.1. Global Trends in Foreign Direct Investment

The ongoing process of globalization as well as regionalization of national economies tend to spur FDI. Steve Chan argues that the diffusion of production techniques, the standardization of production designs, the easing of transport and communication barriers, and the conventions of subcontracting and local sourcing have facilitated this investment, especially of the export-oriented kind. At the same time, signs pointing to possible regional trading blocs in Western Europe and North America have raised the prospects of protectionism, and the consequent fears of being excluded from lucrative foreign markets have fuelled defensive investment of the tariff-leaping kind.45

In the past, the growth of foreign direct investment has followed a cyclical pattern. It flourished particularly in the three decades prior to the first World War and the 25 years after the end of the Second World War. Since the mid 1980s it appears to be entering a new golden age. Each of these periods is characterized by a prosperous world economy, rapid technological development and a relatively free movement of assets, goods, and people across national boundaries. By contrast, MNE activity stagnated in the relatively restrictive economic and political climate of

the inter-war years; and in what might be termed confrontational, or anti-MNE, period of the 1970s.\(^{46}\)

In the first golden age of MNE activity (at the turn of the century), growth essentially occurred in the natural resource based sectors and was largely directed to territories owned or managed by the investing countries. Most of the high value secondary processing was conducted in the home countries. In the second period of booming foreign direct investment (1945-1970), investment was principally undertaken to service local foreign markets with goods and services which, in an earlier phase of their life cycle, had been supplied by the home countries. The present phase of MNE expansion (since the mid 1980s) is quite different from the other two. Now, the primary motive for FDI is neither to acquire natural resources nor to seek out markets. Instead, the prime motivational force behind FDI has been to restructure or rationalize existing investments to capitalize on the advantages of regional economic integration or to acquire new technological or marketing assets in order to pursue, maintain or advance a global competitive position.\(^{47}\)

World economic growth and the response of MNEs to technological development, international competition and liberalization propelled global FDI flows to unprecedented levels in 1995. Following the end of a decline in FDI in 1993, global investment inflows rose by 9 per cent in 1994 and by another remarkable 40 per cent in 1995 to reach a record of US$ 315 billion. Thus, FDI growth was substantially higher than that of exports of goods and non-factor services (18 per cent), world output (2.4 per cent) and gross domestic capital formation (5.3 per cent). Developed countries were the key force behind the record 1995 flows. However, the notable rise of FDI flows into developed countries did not detract from flows into developing countries. At US$ 100 billion, developing countries reached a record


\(^{47}\)Dunning, 1993, p. 122.
level in absolute terms in 1995 although their share of global flows declined slightly for the first time in six years.\textsuperscript{48}

World FDI inflows have been heavily concentrated over the past decade. The ten biggest recipients received 68 per cent of the total in 1995, compared with 70 per cent in 1985. The 100 smallest recipients remained at a mere 1 per cent during the same period. FDI is still very much a phenomenon of the developed world, even if some developing countries are catching up.\textsuperscript{49}

The surge in global FDI flows in 1995 partly reflects their cyclical nature. FDI flows respond to cyclical flows in economic growth with a one or two year lag. With the growth rates picking up pace again in 1993-94, it was expected to show in the FDI flows of 1995. However, there must be other factors at work with the upward trend in FDI flows because each cyclical upswing has led to progressively higher peaks in FDI.\textsuperscript{50}

During the 1970s and 1980s flows of FDI followed an upward trend averaging 13 per cent annually. There were two surges followed by falls; the first surge was from 1978 to 1981 and the second from 1986 to 1990. There are both short- and long-term factors behind these surges in FDI. More specifically, the influences on FDI fall into three categories: short-term, policy-related, and structural.\textsuperscript{51}

Rapid economic growth in the 1980s and the boom in mergers and acquisitions (M&As) undertaken by MNEs were among the prime factors that led to the surge in FDI flows between 1986 and 1990. The growth of FDI outflows is closely correlated with the growth of output. Thus, cyclical fluctuations in economic growth, both at home and abroad, affect an MNE's decision to invest abroad. The availability of investible funds from corporate profits or loans, both of which are dependent on conditions at home, will affect MNE's foreign investment decisions.

\textsuperscript{49}UNCTC, 1996, 4.
\textsuperscript{50}UNCTC, 1996, 4.
\textsuperscript{51}UNCTC, 1993, 91
Growing markets abroad can also give MNEs the impetus to invest, especially if domestic conditions are deteriorating. Growing foreign markets may be particularly attractive for MNEs based in countries experiencing a cyclical downturn. However, the interdependence of the world economy suggests that, as recession spreads, growth will slow down almost everywhere, and that will depress the flow of FDI world-wide. The growth of the world economy influences FDI flows with a time lag. After the end of the recession in the early 1980s, it took about two years before FDI flows started to rise again. Similarly, the downturn beginning in 1989-1990 led to a decline in world-wide FDI flows starting in 1991.52

FDI flows to different sectors are not all equally dependent on the business cycle. For FDI outflows from the major home countries, investments in services tend to be less volatile than primary- and secondary-sector investments. Typically, service MNEs rely more on FDI for delivering services to host countries than manufacturing MNEs because of the non-tradable nature of their output. Thus, a cyclical downturn is less likely to impact on FDI in services to the same extent as in manufacturing. Furthermore, because service firms are less transnationalized than manufacturing companies, they are willing to expand during periods of slow growth. Consequently, it seems that capital spending by service MNEs are less dependent on business cycles than are those by manufacturing MNEs.53

Another short-term factor influencing FDI during the late 1980s was a boom in M&As. MNEs saw M&As as a less expensive way to gain a foreign foothold than establishing new production facilities. Indeed, a majority of FDI in the United States and Western Europe took the form of acquisitions. The M&A boom and its subsequent decline coincided with the business cycle. It is difficult, however, to separate this cyclical impact on the rise and decline of M&As' activity from the influence of other factors such as interest rates and stock-value valuations. Nevertheless, it seems that the economic slow-down was linked to the slow-down

52UNCTC, 1993, 92-95.
of M&As because acquired companies tended to become less profitable and potential buyers were hampered by declining profits at home, although clearly other factors were also at work.\textsuperscript{54}

Fig. 1: The Average Annual Growth Rate of World GDP, World Merchandise Exports, and World FDI Outflows, 1985-90.\textsuperscript{55}

Short-term factors were, however, not the sole reason for the rapid growth of FDI in the period 1986-1990. Other factors that played a part included the initial reaction of MNEs to one-time policy changes, such as liberalization of FDI regulation, trade liberalization, and regional integration. MNEs may react quickly to policy changes that have an impact on their strategies, but their response usually continues long after the initial reaction to the new policy has taken place. The initial adjustment in the flow of FDI in response to policy changes was a factor that

\textsuperscript{54}UNCTC, 1993, 98.
\textsuperscript{55}Knubley, Legault and Rao, 147.
contributed to the surge of FDI. Nevertheless, it is the continuous response of MNEs to the one-time policy changes that explains upward trend in FDI flows.56

The links between FDI and international trade are close. In a historical perspective, the expansion of FDI in the 1980s had its parallel in the trade expansion of the 1950s and 1960s. While the trade expansion was fuelled by multilateral trade liberalization, the surge in FDI was to a large extent prompted by the global abolition of capital controls.57

Several linkages between trade and investment can be identified. Firstly, foreign investment can be trade substituting, when it goes into import-substitution activities aimed at the domestic market. Secondly, foreign investment can be trade promoting when it takes the form of offshore operations producing for the international market. Thirdly, foreign investment can be trade complementing when it is directed at providing backup and intra-industry support facilities in the export market. Finally, foreign investment can be trade diverting when it moves in to take advantage of unfilled quotas under preferential agreements. Hence, a case can be made to let trade and FDI share the same position on the international policy agenda.58

For the largest home countries of FDI, MNEs account for most exports and imports, while intra-industry trade accounts for between one fourth and one third of total international trade. Measures to liberalize trade can boost FDI by allowing MNEs to establish production facilities in low-cost sites from which they can export their output, by allowing MNEs to outsource inputs, by enabling the formation of regional networks, and by allowing the integration of production regionally or globally. Trade liberalization accelerated during the 1980s, especially with the developments within the General Agreement of Tariffs and Trade (GATT).

56UNCTC, 1993, 98-100.
58Oxelheim, 28.
However, the lack of trade liberalization or the fear of its reversal may also increase FDI flows. Non-tariff barriers or other restraints make it necessary for companies to preserve market access through FDI.\textsuperscript{59}

At least some FDI is motivated by actual or prospective changes in trade policy. On one side, some direct investment is clearly aimed at avoiding actual trade barriers or forestalling prospective barriers. For example, Japanese auto manufacturing operations in both the United States and Europe have been motivated to some extent by actual and prospective trade restraints. On the other side, actual or prospective improvements in access to markets have motivated direct investment. It seems that trade policy cannot be a major explanation of the surges in FDI since 1985. The most telling argument is that trade policy issues apply most obviously to manufacturing, while the surge is not concentrated in manufacturing investment.\textsuperscript{60}

Exchange rates are also an important factor for MNEs’ decisions to acquire assets abroad. If the host country currency falls against a MNE’s home country currency, that will boost the inflow of FDI, and vice versa. For example, the decline of the dollar against the yen in the second half of the 1980s made United States assets less expensive to Japanese investors, and was one reason for the growth of Japanese investment in the U.S. Furthermore, in early 1991 the dollar appreciated against all major currencies, and this was followed by a sharp drop in FDI into the U.S. Thus, there appears to be a close relationship between FDI flows and the exchange rate.\textsuperscript{61} However, other factors can have similar effects. For example, a large rise in the yen’s value will raise prices for Japanese exports so much that they

\textsuperscript{59}UNCTC, 1993, 99.
will find it difficult to retain their market share. As a result, operating in the United States become an imperative for many Japanese firms.62

The attitude of most governments toward foreign direct investment has changed radically during the last three decades. Partial evidence of this change is the liberalization of capital controls in developed as well as developing countries. However, trends for the two groups have diverged periodically. In the 1980s, opinions about the value of foreign direct investment were so positive that global FDI experienced a surge of unprecedented size. The shift in attitudes from the 1960s was substantial. U.S. control of Third World resources was a major issue and in the debates at that time FDI was claimed to be a tool of capitalism and exploitation and, as such, a way of controlling scarce resources and exploiting cheap labor in the host countries. Exploiters were said to pay no tax in the host country, repatriating all cash to the country were they were domiciled. For example, U.S. steel companies investing in Latin America were accused of belonging to this category. Although gains would be taxed at a higher rate at home, it was claimed that management repatriated gains out of prestige reasons. The use of transfer pricing was said to be a way of escaping all taxes in the host country whenever such taxes were imposed.63

The wave of growth in FDI during the latter part of the 1980s was in a way a reversal of earlier patterns. The United States now proved to be the principal recipient country, attracting investment from the leading firms of Europe and Japan. This role was unfamiliar to the United States and the public, ironically, reacted very much as the French had reacted to the establishment of U.S.-owned subsidiaries in the 1960s, and as, for example Mexico, India and Brazil had reacted to such subsidiaries during most of the postwar period. Foreign-owned enterprises were seen in some U.S. quarters as moles, agents of their home governments, to be used in some unspecified scenario of the future to compromise the interest of the

United States. And enterprises owned by Japanese business interests were regarded as particularly suspect.\textsuperscript{64}

In the early 1990s the attitudes around the world towards FDI are somewhat diverse. While most developing countries are in favor of inward investment and welcome MNEs, criticism of FDI is clearly being articulated in other countries, with the most important example being the United States. Inward investment is indirectly regulated in the European Union (EU) through the Merger Regulation of 1990, and it makes the "reciprocity of access" an issue of consideration in the treatment of non-EU firms. The dominance of outward investment over inward investment may make the Japanese government reconsider its attitude toward inward investment. Overall, the arguments raised against inward FDI in many developed countries are based on a nationalist fear that foreign investors are buying too much of the country's productive assets. On the other hand, there is a fear that outward investment will reduce investment in the country where the firm is domiciled. This argument most often boils down to a fear of losing domestic jobs, and at the beginning of the 1990s it is fairly common in smaller countries.\textsuperscript{65}

The trend towards a liberalization of FDI policies, which accelerated during the 1980s, especially in services, created new opportunities for MNEs and helped boost flows in FDI. There is strong evidence that the trend towards liberalization continues. In 1992, all countries on which data could be obtained moved in a liberalizing direction. Not only do all countries allow FDI, but they often compete to attract such investments. Privatization programs have complemented regulatory reforms to attract FDI. In 1990, more than 70 countries had active privatization programs, and they sold state enterprises to the total value of over US$ 185 billion.\textsuperscript{66}

The single market programs of the European Union and the North American Free Trade Agreement (NAFTA) among the United States, Canada and Mexico have

\textsuperscript{65}Oxelheim, 26-27.
\textsuperscript{66}UNCTC, 1993, 100.
triggered significant investment to and within the regions involved. The desire by MNEs to become regional "insiders" led to a faster growth in the EU than would have otherwise been expected. MNEs already located there began to reorganize and rationalize their investments, taking an EU-wide, as opposed to a national, approach. This led to a substantial rise in intra-regional investment flows and in cross-border M&As. Similar developments have taken place in North America.67

Economic integration can also increase the competition for investment. This is because reducing trade barriers among countries, as in the EU, makes more localities substitutable for each other as investment sites.68

The underlying trend of the growth of FDI flows is also a consequence of the changing structure of the world economy. Since the change of the world economy is long-lasting, it is plausible that the trend will continue even in the absence of short-term flows or policy-related factors. The fact that a sizeable stock of FDI is already in place is likely to lead to a self-sustained growth of investment and resource flows associated with the activities of MNEs. The constantly growing stock of FDI suggests that this stocks capacity to generate output and income will also continue to grow. A part of the generated earnings will be reinvested and, as earnings grow, an increase in FDI is likely. Furthermore, international production has become a central structural characteristic of the world economy. This is, at least partly, the result of a technological revolution in communications which has greatly improved coordination and integration between MNE parents and their affiliates. These technological developments have brought about changes in the organizational structure of MNEs, driven by heightened competition and the growing awareness among companies of the necessity to invest abroad in order to serve domestic markets better.69

67UNCTC, 1993, 100.
In the longer term some striking changes have taken place in FDI. Firstly, the rapid growth of FDI has been accompanied by big changes in its sectoral composition. During the 1950s FDI was concentrated in the primary sector and resource-based manufacturing. Today FDI is mainly in services and in technology-intensive manufacturing. This shift towards services accelerated during the 1980s. FDI in services represented a quarter of the world stock of FDI at the beginning of the 1970s. Two decades later the share was close to 50 percent and still rising. These shifts in the pattern of both inward and outward FDI broadly reflect structural changes in the nature of economic activity, with the primary sector declining in relative terms while services increase. However, the FDI change happened with a lag. The main home and host countries became predominantly service economies some time ago, whereas the surge of services FDI is a relatively recent trend. The reason for this lag is that FDI in many important service industries was initially prohibited on strategic, political, or cultural grounds. The rise of FDI in services had to wait for the liberalization of major service industries to catch up with the domestic process of structural change.

This section has pointed at several reasons for the surge in FDI flows over the last two decades. Although it is not possible to separate them and estimate each factor's value, it is apparent that the business cycle has a very important effect on short-term flows. There is a time lag of one to two years for FDI flows which reflects MNEs long-term investment decisions. Policy-changes and structural changes have also made an impact on the overall growth of FDI. It seems that policy and structural factors have had a longer-term influence on the growth of FDI flows.

Fig. 2: Inflows of Foreign Direct Investments, 1984-1995.

70UNCTC, 1993, 61.
3.2. Canadian Trends in Foreign Direct Investment

Throughout Canada's history, foreign investment has played a central role in its economic development. Since the sixteenth century the Canadian economy has relied heavily on other people's money. Foreign savings made possible the exploitation of Canada's great staples of fish, fur and wood, while providing the country with the capital to build railways and canals and even to finance the growth of municipalities. The nature of this inflow has changed over time. British capital dominated during the nineteenth century, but was superseded by U.S. investment in the twentieth century. By the turn of the century, virtually every town in central Canada aspired to be the location of the subsidiary of an American or British manufacturing company. As a consequence of this passion for foreign investment, 'branch plant' has become a distinctively Canadian phrase.73

Since Confederation most governments have emphasized the need for rapid Canadian development. This emphasis on growth led to the emergence of

important gaps as the demands of the economy normally exceeded the supply of domestic, human and non-human resources. The needed technology was not available from Canadian sources; capital to finance particular ventures could not be found; the entrepreneurial talent to identify and fill a particular need in the Canadian market seems to have been lacking; and Canadians tended to look to foreign sources for certain goods or services. The existence of these gaps made it considerably easier for foreign investment to penetrate the Canadian market.\textsuperscript{74}

At the end of 1995 the stock of FDI in Canada was estimated to have reached Cdn$ 168.1 billion, up 9.1\% from the previous year. The corresponding value of the stock of Canadian direct investment abroad (CDIA) amounted to Cdn$ 142.3 billion, up 7.6\% from the previous year. In the last two decades a faster growth of CDIA relative to FDI stock in Canada resulted in bringing about a better balance between Canada's inward and outward direct investment activity (see Chart 3). With CDIA expanding at a faster rate than FDI in Canada, the ratio of outward to inward direct investment increased from roughly 50\% in 1982 to about 73\% in 1992.\textsuperscript{75}

\textbf{Fig. 3: Foreign Direct Investment in Canada and Canadian Direct Investment Abroad, 1945-95.}\textsuperscript{76}

\begin{thebibliography}{99}
\bibitem{25} Industry Canada, 1994b, 238.
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Canada's external balance in year-end flows moved from deficit to surplus in 1975, indicating a significant shift in Canada's foreign investment position. Net flows have generally been outward ever since, averaging Cdn$ 3 billion per annum over 1975-1991. Part of this turnaround can be explained by periodic repatriations of foreign capital by U.S. subsidiaries, but a more important explanation lies in the investment behavior of Canadian firms. From 1987 to 1988, for example, gross outflows of CDIA grew from Cdn$ 9.3 billion to Cdn$ 12.9 billion (an almost 40% increase), while gross inflows fell from Cdn$ 10.2 billion to Cdn$ 8.1 billion (a decline of over 20%). Rapid changes of this magnitude can be explained almost entirely by the ongoing international trend toward large-scale corporate mergers.77

The change in the relative importance of Canada's outward investment flows over the past two decades is not unique but rather is consistent with global trends. There is a more balanced relationship between outward and inward investment among most western industrialized countries, related to a large extent to the fact

that U.S. dominance of world FDI has declined markedly. Japan, which has very little inward direct investment, is the exception to this balanced relationship.\textsuperscript{78}

While Canadian acquisitions abroad have recently exceeded foreign acquisitions in Canada, the prevalence of large-scale acquisitions in both directions is worth noting. In 1988, for example, at least half of Canada's gross outflows were generated by the purchase of Federated Department Stores of the United States (valued at US$ 6.6 billion in 1988) by Canada's Campeau Corp. On the inflow side a good deal of the post-1985 FDI in Canada can be traced to a relatively small number of major acquisitions, many involving well-known Canadian companies such as Mitel (telecommunications and electronics), Connaught Laboratories (pharmaceuticals), and de Havilland (aerospace).\textsuperscript{79}

In the mid-1980s, some fundamental shifts among the major sources of FDI in Canada are noticeable. Most important, the United States, which has traditionally been the dominant source of FDI in Canada, experienced a sharp decline in relative shares. Almost three-quarters of the total FDI stock in Canada in 1985 was of U.S. origin; by the end of 1992, however, less than two-thirds of FDI was accounted for by the United States. During this period, other industrialized countries, notably the United Kingdom and Japan, increased their shares of total FDI in Canada. The U.K. increased its share of total FDI from 9.8\% in 1985 to 12.5\% in 1992, and this 2.7 percentage point increase represents over half of the growth of the EC share of FDI in Canada during this period. Japan's share of FDI roughly doubled from 2.2\% in 1985 to 4.1\% in 1992.\textsuperscript{80} Globalization is the major driving force behind the diversification of FDI flows.\textsuperscript{81}

\textsuperscript{79}MacPherson, 70.
\textsuperscript{80}Industry Canada, 1994b, 239.
Until the early 1950s Canada followed Latin America as the most important destination of U.S. FDI. Between 1950 and the mid-1960s, however, Canada became the primary host country of American multinationals. Nationalization of utilities, petroleum and other industries by Latin American governments reduced both the presence of U.S. firms and the attraction of the region for future U.S. investments. Meanwhile, Canada remained open to American and other foreign businesses. In 1966 Western Europe became, and has since remained, the most important destination of U.S. investment. Since then Canada's position as a host of American capital has declined – from 31% of total U.S. FDI in 1965 to 21% in 1980, and to 15% in 1991. Neither the nationalistic policies of the Trudeau era (1968-84) nor the free-trade attitude of the Conservatives (1984-1993) has altered that long-term trend. The nationalizations and restrictions imposed by the Liberal government influenced a reduction in U.S. investment in Canada. The free trade friendly policies of the Conservatives did not, however, alter Canada's position as a less desirable destination of American FDI.\(^\text{82}\)

Canada's importance as a destination of overall global direct investment also changed dramatically over the past 30 years. In 1967, as the largest destination of international direct investment, Canada held over 18% of the world stock of inward direct investment. As other important host countries started to compete for global capital in the 1970s and 1980s, Canada's relative share dropped gradually from just under 16% in 1973 to just over 10% in 1980. In 1990, Canada accounted for only 6.6% of an estimated US$ 1.6 trillion of global investment, and Canada ranked behind the U.S., the U.K., and Germany as a recipient of global FDI. Nevertheless, Canada still has the highest gross, private non-residential capital stock of all major industrialized countries.\(^\text{83}\)

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\(^{83}\)Industry Canada, 1994b, 239-241.
Canada's trade and investment is, not surprisingly, concentrated within the Triad. The United States is of great importance to Canada both for trade and investment. Around three-quarters of Canadian merchandise exports go to the United States and almost two-thirds of Canada's imports originate in the U.S. Similarly, Canada's investment linkages with the U.S. are very strong. As mentioned above, well over 60% of the stock of FDI in Canada is from the U.S., and slightly below 60% of CDIA is located in the United States.84

Canadian investment relations with Europe are much stronger than its trade linkages. Europe (primarily the U.K., Netherlands and Germany) accounts for between 25% and 30% of Canada's total direct investment stock, but its share of total Canadian merchandise trade is only about 10%. An explanation for the discrepancy between Canada's trade and investment linkages with Europe is the large amount of intra-regional trade within Europe.85

Canada's commercial relations with Japan, the economic leader of the Asia Pacific Rim, are significant and growing. With respect to trade, the relationship is balanced, with Japan shipping manufactured goods to Canada and Canada shipping natural resources to Japan. In the case of investment, the relationship is one-sided with Canadian investment in Japan being relatively small. However, since the late 1980s and 1990s both Canadian investments in Japan and Japanese investment in Canada have grown substantially.86

However, Alan MacPherson argues that FDI continues to account for only a small portion of Canada's overall balance of payments and that, although FDI has been growing faster than merchandise imports and exports, the extent to which FDI has become a substitute for external trade should not be overstated. In 1987, for instance, gross outflows of CDIA amounted to only 9.6% of Canada's merchandise exports, and gross inflows amounted to only 11.3% of merchandise imports.87

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84 Industry Canada, 1994a, 10.
85 Industry Canada, 1994a, 11.
86 Industry Canada, 1994a, 11.
87 MacPherson, 71.
are, however, statistical problems. Figures for how much Canadian subsidiaries produce are not available, and this would be a more appropriate estimate of the trade-investment relationship. For example, by the end of the 1980s the value of goods and services sold by foreign affiliates totalled an estimated US$ 4.4 trillion, far greater than world exports, estimated at only US$ 2.5 trillion. In other words, production by foreign affiliates is of greater importance than exports in delivering goods and services to markets world-wide.88

Recent trends in CDIA stock values indicate a consistent role for the United States as a target for Canadian investment. While several Pacific Rim countries have received major inflows from Canada since 1975, the accumulated dominance of the U.S. market is unambiguous. Although the U.S. ranks second to Asia in terms of recent CDIA growth rates, its absolute importance is increasing. Approximately 50 per cent of CDIA in the United States remains concentrated in manufacturing, reflecting a tradition that goes back to the early 1960s. CDIA in U.S. manufacturing was in 1985 dominated by only 4 sectors – non-ferrous metals (28.6 per cent), chemical and allied products (23.4 per cent), wood and paper products (20.5 per cent), and metal goods (7.3 per cent). These four sectors account for over 90 per cent of CDIA in U.S. manufacturing, and broadly similar patterns prevail for CDIA to the rest of the world.89

The sectoral profile of Canada's investment position shows that the structures of CDIA and FDI in Canada are strikingly similar, though accumulated stock value of FDI in Canada has usually exceeded CDIA stock values in all major sectors but utilities. Partial evidence from Investment Canada suggests that CDIA in manufacturing is dominated by industries that feed directly from the resource sector, while FDI in Canada is concentrated in high value-added manufacturing. A series of micro-shifts suggests potentially new directions for CDIA. First, the fastest growth rates for CDIA are concentrated outside of North America. Second, several

88Knubley, Legault and Rao, 1994, 146.
89MacPherson, 73.
of Canada’s largest and most innovative firms are currently looking at new regional targets in Western Europe and the Pacific Rim. Third, many of Canada’s small and medium-sized manufacturers are considering FDI as a possible avenue for escaping high export-marketing costs. Together these factors imply a potentially new look for future CDIA, particularly in the sectoral structure of outward flows.90

Substantial changes have also occurred on the inflow side. While the regional focus of inward investment continues to mirror the distribution of GNP by province (Ontario and Quebec have a dominant role), recent capital inflows to all of Canada’s regions have tilted toward technology-intensive activities. With regard to metropolitan areas, Toronto has been the favored target for external investors of virtually all nationalities, suggesting a key position for southern Ontario and a relatively peripheral role for most other regions. Vancouver, with the recently received inflows from East Asia, is the only metropolitan area that could possibly emerge as a challenger to southern Ontario’s and Toronto’s supremacy. In short, inward investment may help to sustain and/or accentuate existing regional disparities within Canada, casting significant doubt on the extent to which peripheral locations, other than Vancouver, can attract new FDI on the basis of lower factor costs, public subsidies, or other price advantages.91

Large multinational firms have dominated CDIA for a long time. A glance at Canada’s 20 largest industrial corporations show a distinct bias toward resource-based activity, and this bias appears in the sectoral content of direct outflows. Companies such as Alcan and Noranda stand out as familiar examples, whereas such technology-driven firms as Northern Telecom represent uncommon exceptions. Though few of Canada’s largest corporations spend more than two per cent of their earnings on industrial R&D, mature enterprises with relatively small research budgets account for the bulk of Canada’s outward investment. This investment pattern is no big surprise given Canada’s resource tradition. At the

90MacPherson, 73-74.
91MacPherson, 74-75.
same time, however, the structure of CDIA raises strategic policy questions that parallel those in merchandise trade. Specifically, Canada's comparative advantage in FDI is concentrated in those sectors for which long-run income elasticities of demand are relatively weak. Inflows of foreign capital, in contrast, have recently been shifting toward technology-based ventures, notably in transportation equipment, biotechnology, and microelectronics.\footnote{MacPherson, 75.}

On the inflow side, FDIC has recently been characterized by M&As rather than by new plant construction. Over the period 1983-1990, for example, the share of acquisitions in the inward investment pie shifted from 8% to 36%, peaking in 1988 at 48%. Remarkable changes like this stress the old policy question whether an establishment's post-take-over performance matches, surpasses, or falls below that of its pre-FDI record. Entry by acquisition usually involves a less favorable benefits than entry by new plant construction. Investors from the U.S. and Europe are more prone to invest by acquisition, whereas Japanese and Pacific Rim corporations appear to prefer greenfield investments. The extent to which the two entry modes differ in their economic impact is empirically unclear. To complicate matters, a good deal of Canada's recent inward investment has taken place as a result of the modernization and/or expansion of subsidiary plants already operating in Canada. This situation poses a number of measurement problems in assessing the effects of FDI. For example, it is difficult to predict the long-run impact of Hyundai's 1989 decision to build a $320-million automobile plant at Bromont versus that of General Motor's $420-million upgrading (1987-89) of its existing Boisbriand plant. While a new plant construction is politically more attractive than most other investment paths, greenfield development can itself introduce significant problems. A new factory can, for example, be tailored to absorb key imports from foreign sources, leaving domestic suppliers with a smaller market than might otherwise be the case.\footnote{MacPherson, 76.}
Overall, foreign control of industries appears to be relatively much higher in Canada than in any other G-7 country. Notwithstanding the differences in measuring the foreign control data in the G-7 countries, the greater significance of foreign firms in the Canadian economy is not surprising, given that it has historically relied heavily on foreign capital for much of its development.\textsuperscript{94}

This chapter made the important observations that Canada has become a net exporter of FDI and that the U.S. continues to be central in Canada's inward and outward FDI. In real terms, however, foreign-owned companies still have more invested in Canada than vice versa, although the balance have improved significantly. Canada is no longer the largest host of FDI in the world in absolute terms. Almost all recent growth of Canada's inward and outward FDI can be traced to a merger thrust, based on major acquisitions. The popularity of investment by acquisition reflects an accelerating international trend toward industrial concentration, corporate integration, and oligopolistic competition. Next chapter will focus on the drive to regulate FDI in Canada in the early 1970s.

\textsuperscript{94}Industry Canada, 1994b, 242.
Chapter 4: Canadian Policy toward Foreign Direct Investment, 1945-85

Canada has had an ambiguous relationship with foreign investors and capital since World War II. On the one hand, Canada has been built on foreign capital and needs new investment to continue to prosper. On the other, Canada has become incredibly dependent on these investors and has actively searched for policies to lessen their control and create a more balanced relationship with the investors.

Over the years, Canadian policy on foreign direct investment has been largely one-sided. The focus of Canadian policy has been on inward FDI while little attention has been paid to outward FDI. Regulating inward FDI has been an important policy goal of the Canadian government for many years.\(^95\)

The first section of this chapter will outline the evolution of FDI regulation in Canada and more specifically how Canada went from being one of the most open countries in the world to one regarded as somewhat hostile to investment. The second section will analyze the record of the Foreign Investment Review Agency and its eventual disbanding.

4.1. Canada's Road to Regulation of Foreign Direct Investment

Foreign capital entering Canada has traditionally been treated with ambivalence. The Canadian attitude to foreign investment has been one of partial encouragement and partial control. However, on balance, Canada has presented a friendly face to foreign investors. The necessity of attracting foreign investment to foster economic development has never been seriously disputed. Canada, with its relatively small population and enormous natural resource endowment, has always stood in need of capital beyond its own means to finance the growth of its economy. In addition, with capital comes managerial expertise and technology, which have not always been available in sufficient quantity or quality from within Canada.\(^96\)

The uneven progress of industrialization in Canada had, by 1920s and 1930s, created some doubt about its policy of "industrialization by invitation." Few actually demanded an abrupt cessation or control of foreign investment. Instead, there were increasing reservations concerning the consequences of Canada's long-standing openness to foreign capital. This process was hastened by the second great surge of foreign investment entering Canada in the decade after World War II. By that time Canada had already moved to exclude foreign investment in certain key or sensitive areas of the Canadian economy, such as broadcasting and banking. These areas were deemed too important to national security to be under foreign control. The post-war decades were, consequently, characterized by an assessment of the net benefit foreign investment and increasing debate over means of controlling it in the future.\(^\text{97}\)

The public debate on foreign investment emerged in the 1950s. The early 1950s were years of immense vitality for the Canadian economy and this vitality prompted Canadians to re-examine the policies that governed their economic growth. In particular, the prominent and growing role of foreign capital, especially from the U.S., began to attract more public concern. Such concern drew, according to Christopher Beckman, on Canadians' well-established, if paradoxical, inclination to view the United States simultaneously as Canada's closest friend and greatest threat, a perception that was given increased prominence by political events (such as the pipeline debate of 1956) during the 1950s.\(^\text{98}\)

In response to these concerns and anxieties, the St. Laurent government appointed a commission to investigate Canada's economic prospects. The final report of this commission was presented in 1957 and contained only one chapter that directly addressed the subject of foreign investment in Canada. Nevertheless, the commission, under the chairmanship of Walter Gordon, provided the first step along the road to foreign investment control. The tone of the Gordon Commission's critique of foreign investment was distinctly moderate. The report

\(^{97}\)Beckman, 8.
\(^{98}\)Beckman, 12.
pointed out that "there are so many real advantages to Canada arising from the activities of foreign-controlled companies in this country, that conflicts or potential conflicts between the interests of Canada and those of the foreign owners seem somewhat small and unimportant in comparison." However, the report also drew attention to the fact that foreign investment had had a snowballing effect and that as a consequence the Canadian public was becoming aware of the dangers associated with high and concentrated levels of foreign ownership in the economy. The Gordon Commission also felt that the principal risk implicit in Canadians' reliance on foreign investment was a potential loss of economic self-determination. To remedy the allegedly negative effect of foreign investment, the Gordon Commission counselled against the adoption of a narrow nationalistic outlook and instead expressed the belief that "the best course both for Canada and for foreign investors with capital in this country will be for us to take action" along "very moderate lines." The Gordon Commission's recommendations contained no hint of compulsory control of investment entering Canada. Instead, the emphasis was placed on voluntary compliance. Foreign companies were encouraged to expand their use of Canadian managers and suppliers, to make full disclosure of the financial results of their Canadian operations, to include more Canadians on the boards of directors and to sell an appropriate interest in their equity to Canadians.

During the late 1950s, the public debate over foreign investment gained in intensity and, for the first time, began to have concrete implications for public policy. The federal government moved to ensure Canadian participation in certain industries which were considered to be vital to Canada's cultural and economic independence. Legislation stipulating that the majority of directors of insurance companies must be Canadians and the limitation of foreign ownership of television

outlets are examples of the government's attention to these issues in the late 1950s.101

The 1960s witnessed a rise of global concern over the spread of MNEs. The role of foreign ownership was subject to critical scrutiny around the world. Critics examined the MNEs in terms of their corporate citizenship and foreign ownership, and focused on both the economic advantages and liabilities they brought to the host country and also their ability to compromise a state's political and cultural autonomy. Partly as a result of such critiques and partly in an effort to avoid the adoption of strict, administered control mechanisms, some countries and international organizations, such as the Organization for Economic Cooperation and Development (OECD), moved to adopt voluntary guidelines for foreign companies. In Canada, this took the form of the "Winters' Guidelines" for good corporate behavior. These guidelines were announced in 1966 and gave subsidiary companies operating in Canada a series of goals designed to accommodate their own financial needs and the sensibilities of their host country. The guidelines were designed to encourage research and development in Canada, to permit Canadian equity participation in foreign-owned companies, to develop Canadian sources of supply, and to ensure international marketing of Canadian-made goods, but as occurs with most guidelines, they were purely voluntary and there was no enforcement mechanism.102

The hope of voluntary adoption of guidelines by foreign subsidiaries, however, had little effect on the rising tide of public concern over foreign ownership in the late 1960s. The widespread sense that more forceful measures were in order was given voice in 1968 by a federally-appointed task force chaired by economist Melville Watkins. What came to be known as the Watkins Report provoked strong public interest in the issue of foreign investment. The Watkins Report not only raised doubts about the economic implications of high levels of

101Beckman, 14.
102Beckman, 15-16.
foreign ownership, it also suggested that foreign ownership had "created widespread unease among Canadians as the continuing viability of Canada as an independent nation-state."103

The Watkins Report focused on some major issues concerning foreign ownership. Foremost among these issues were the question of extraterritoriality (the subjugation of important areas of Canadian business to decisions taken by parent organizations operating in different legal jurisdictions) and the lack of Canadian entrepreneurship, a failing the report attributed to the prevalence of foreign ownership. With the exception of the financial and broadcasting sectors of the economy, Canada had made no attempt to develop mechanisms for handling foreign takeovers within its economy. To remedy this situation, the report made proposals that were characterized more by a spirit of friendly persuasion and full disclosure than by rigid, enforceable controls. Foreign investors should, for example, have "good corporate citizenship" as their objective in Canada, while the Canadian government should encourage better economic efficiency in Canada. The Watkins Report's closing call for a "new national policy" drew attention to the connection between the impact of foreign investment and Canada's rather rudimentary set of national industrial policies. Without a clear understanding of Canada's overall economic priorities and strategies, any scheme of limiting or directing the impact of foreign investment raised questions of practicability.104

In the early 1970s, the issue of Canada's economic dependency and its industrial strategy remained very much in the forefront of public debate. A Parliamentary Committee, under the chairmanship of Ian Wahn, reported in 1970 on the implications of the economic dependency issue of Canada-U.S. relations. In doing so, it moved one step closer to advocating a measure of control of foreign investment. The Wahn Committee proposed "effective measures to protect

Canadian independence." Such measures should be "positive and not anti-American in nature." The Committee argued that a mixed approach containing certain defensive policies was needed until a greater degree of Canadian economic independence was achieved. Principal among these policies was a Canadian ownership law and the report went as far as to recommend that the federal government be able to establish trusteeship over foreign subsidiaries where extraterritoriality jurisdiction had been exercised.105

The Watkins Report's partial emphasis on government intervention set the stage for the recommendation of a 1972 task force headed by the Minister of National Revenue Herb Gray. The task force's report, known as the Gray Report, represented not just the culmination of a long-developing public policy debate on the place of foreign investment in Canada, but also the culmination of years of heightened public concern over the issue. Consequently the political reception of the Gray Report was to a large extent colored by the high public profile of the issue. The presence of articulate and well-organized lobby groups and the overall turn of the federal political events in the years 1972-74 virtually ensured that the foreign investment issue would become a matter for political action rather than public debate.106

The economic analysis of the Gray Report was in essence a thorough reiteration of the critique contained in the Gordon, Watkins and Wahn reports. The main substance of this analysis was to underscore the deleterious effects of foreign investment on the Canadian economy, an economy that was "miniaturized" and "truncated." The Gray Report was, unlike its predecessors, forthright in calling for direct government action to remedy the situation:

...there is the need to have the capacity to respond [flexibly] in dealing with foreign investment. If the problem is ignored entirely, and there is no capacity for the government to intervene, then the Canadian economy will remain exposed to the distortions of the international market place

106 Beckman, 18.
that stem from the intervention of other governments to serve their own national interests, from the nature of the multinational enterprise, and from the existence of international oligopolies in some industries.\textsuperscript{107}

The report suggested that intervention could take one of three forms. It could extend the established Canadian practice of delineating certain key sectors of the economy in which foreign ownership was either strictly prohibited or severely restricted. Alternatively, the government could introduce across-the-board ownership guidelines which would make it mandatory for Canadians to own a certain proportion of all firms "of economic significance" in Canada. Such guidelines might also stipulate minimum numbers of Canadian directors for "all significant companies in Canada." The key sector and mandatory threshold approaches were rejected by the report as being impractical and not sufficiently flexible to achieve the report's overall goal of a more efficient Canadian economy. Acknowledging that little could be done without jeopardizing investor confidence and rights to repatriate profits from those areas of the economy already under foreign control, the report opted for a screening process by which future foreign investment entering Canada could be reviewed.\textsuperscript{108}

The principal application of the review process would be in the area of new foreign-owned businesses being established in Canada. The review would be limited to "major new investments" and would seek to have "a moderate effect in strengthening the degree of Canadian ownership and control over time."\textsuperscript{109} In itself, the process would not increase Canadian ownership. This could only be achieved by means of other policy mechanisms. Screening of new investment would simply ensure that the disadvantages of foreign investment were minimized and the benefits fully captured.

The Gray Report recommended that administration of the screening process be entrusted to an administrative agency responsible to a minister, and hence to

\textsuperscript{107}Government of Canada, \textit{Foreign Investment in Canada}, (Ottawa: Queen's Printer, 1972), 439.
\textsuperscript{108}For further detail see Part 6, Government of Canada, 1972.
\textsuperscript{109}Government of Canada, 1972, 492.
Parliament and the people. The report believed that a completely independent tribunal would not be able to muster as much bargaining power as the government itself. The agency would be staffed by personnel with a wide range of expertise and have the power to negotiate with potential investors and to block or approve any investment. Approved investors would be subject to on-going investigation to determine the degree of their compliance with the conditions set by the agency at the time of their approval. The agency's dealings with foreign investors would be subject to commercial confidentiality and there would be no appeal procedure for rejected applicants.\textsuperscript{110}

Public and political reaction to the Gray Report was in large measure dictated by the foreign investment issue's high public profile and the precarious political balance after the 1972 federal election. According to Beckman, a Gallup poll from February 1972 revealed that 69\% of Canadians approved of the report's proposal for an investment screening process, while only 15\% rejected the idea and 16\% were undecided.\textsuperscript{111} The key factor in the situation was the New Democratic Party's (NDP) espousal of some form of foreign investment screening. A radical fragment of the NDP, the Waffle group, influenced NDP policy, and the NDP in turn made use of its position as the party holding the balance of power to exert pressure on the ruling Liberals. Under these circumstances, the Gray Report rapidly became a prominent political issue. The initial hurried attempt to give legislative shape to the Gray proposals failed completely and the government was unable to enact the bill before the October 1972 election. Nevertheless, the throne speech of January 1973 saw the reappearance of the Gray Report recommendations and the stage was set for Canada's introduction of foreign investment review legislation later in 1973.\textsuperscript{112}

4.2. FIRA's Record and its Fall

\textsuperscript{110}Government of Canada, 1972, 480-482.
\textsuperscript{111}Beckman, 20.
\textsuperscript{112}Beckman, 20.
The Foreign Investment Review Act's (FIR Act) approval on December 12, 1973, finally gave Canada a legislated means of reviewing foreign investment entering its territory. The Act focused on two types of foreign investment: the establishment of new businesses in Canada and the acquisition of existing assets within Canada by a foreign investor who had not invested in that field before. The crucial aspect of the screening process was the test for "significant benefit." The administrative mechanism created to receive and evaluate applications for approval was the Foreign Investment Review Agency, a federal agency under the jurisdiction of the Minister of Industry, Trade, and Commerce. All investments approved by the Agency must be shown to bring with them "significant benefit" to Canada. Administration of the Act was to begin in two phases: the first, beginning on April 9, 1974, was aimed at acquisitions of existing assets, and the second, beginning on October 15, 1975, targeted all new businesses.113

The FIR Act was designed to improve the structure of the Canadian economy by filtering investment from abroad. The purpose of the review was not to reduce foreign ownership in Canada, but to push foreign firms to alter their behavior and thereby increase the package of benefits the country obtained through foreign investment. Transactions of both major and minor socio-economic significance were encompassed by the FIR Act. That meant the government had to examine not only sizeable acquisitions but also new businesses, rescue operations and takeovers of small companies that lacked the technology, the funds, or the management and marketing expertise to expand. The examination of small transactions was criticized by certain business people and politicians. However, it was justified by the government of the day as a way to protect sensitive industry sectors and infant companies in which public funds had been invested. The government was also concerned that if small transactions escaped the review net, a large international

113Beckman, 20.
company might use a small investment as a foot in the door to expand without review.\textsuperscript{114}

As mentioned above, the Minister of Industry, Trade and Commerce was designated as the minister responsible for the administration of the Act. FIRA was established to advise and assist the minister, who, in turn, would report to cabinet, which had ultimate responsibility for the decision in any particular case. Hence, it is somewhat ironic that FIRA has been the target for both blame and credit regarding Canada's foreign investment regulation.

The eligibility criteria for triggering the review process were less than clear-cut and this has constituted one of the major criticisms of FIRA. Basically, foreign persons and corporations controlled by them had to go through FIRA. A non-resident Canadian was non-eligible; so were landed immigrants who never became citizens. According to FIRA, a corporation is foreign-controlled if just one foreigner owns as little as 5\% of the company's voting shares, or if a group of foreigners owns 25\% of a public company or 40\% of a private one. Questionable situations were settled at the minister's discretion.\textsuperscript{115}

Reviewable investments were evaluated by FIRA with respect to whether or not they constituted a "significant benefit" to Canada. In this regard, there are five broad criteria stated in the act:

\begin{enumerate}
\item the effect of the acquisition or establishment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada, and on exports from Canada;
\item the degree and significance of participation by Canadians in business enterprise or new business and in any industry or industries in Canada of which the business enterprise or new business forms or would form a part;
\end{enumerate}

\textsuperscript{115}Steven Globerman, "Canada's Foreign Investment Review Agency and the Direct Investment Process in Canada," \textit{Canadian Public Administration} 27, 3 (Fall 1984b), 316.
c) the effect of the acquisition or establishment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;

d) the effect of the acquisition or establishment on competition within any industry or industries in Canada;

e) the compatibility of the acquisition or establishment with national industrial and economic policies, taking into consideration industrial and economic policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the acquisition or establishment.\textsuperscript{116}

Typically, FIRA would review a proposal in consultation with the applicant. Agency personnel could suggest ways to improve the proposal in order to show significant benefit to Canada. For larger investments, and many smaller ones, the application proposal was sent out to the provincial governments where the investment was envisaged. A submission that had the support of a province would fare much better than one that did not.\textsuperscript{117}

Under the Foreign Investment Review Act (FIR Act), it was not necessary that an investor demonstrated benefits with respect to each factor. FIRA officials noted that the factors were given different weight according to the circumstances of individual cases. All undertakings were binding, however, if the investment was allowed.\textsuperscript{118}

Despite the broad scope of FIRA's potential powers, relatively few applications for new investments by foreigners were turned down by the Agency. But as the years went by, Gerry van Houten argues, its bureaucratic procedures were a convenient screen for hindering and frustrating attempts by MNEs to invest in Canada. At the same time, it became a front for Canadian business wanting to take over companies that otherwise would have fallen into the hands of much larger and wealthier foreign MNEs. This reduced foreign competition in the struggle for control of Canadian corporate assets and made it possible for Canadian firms to take

\textsuperscript{116}Globerman, 1984b, 316.
\textsuperscript{117}Globerman, 1984b, 316-317.
over enterprises at a cheaper price than they otherwise might have been forced to pay. This policy suited the interests of Canadian firms because it was less noticeable than direct government intervention and, consequently, faced less risk of retaliatory measures from abroad.\textsuperscript{119}

When a newly elected majority Liberal government regained power after a year on the sidelines in 1980, FIRA's relaxed attitude toward FDI changed. Elected on a nationalistic platform that involved calls for increased federal government involvement in the oil and gas sector and more stringent monitoring of foreign capital, the Liberals believed they were in a position to act strongly on their campaign commitments. They set out on a new course of policymaking symbolized by two major policy changes. The first of these was the establishment of a surprisingly nationalistic and interventionist program in the oil and gas sectors known as the National Energy Program (NEP). Part of the NEP's purpose was to increase Canadian ownership in the oil and gas industry by phasing out tax depletion allowances and replacing them with incentive grants based on the percentage of a firm's Canadian ownership. One of the most controversial aspects of this legislation was what industry spokespeople named the "back-in provision." It allowed the government through the NEP to claim retroactively a 25\% share of oil found on Crown lands (chiefly offshore and Arctic oil ventures). Foreign investors saw this as retroactive confiscation and protested the NEP measures strongly, as did the U.S. government.\textsuperscript{120}

The Liberal government's second major policy change was to increase the stringency of the review process by appointing Herb Gray as the minister responsible for FIRA. In a highly contentious cabinet report, Gray argued that the government would have to monitor the behavior of foreign subsidiaries extensively if it were to

\textsuperscript{120}Deigan, 9.
overcome Canada's structural impediments to sustained economic development.\textsuperscript{121} The refusal rate did increase slightly in nonresource sectors in 1980-81 and the review process was conducted much more meticulously, with only 54 of the average number of 63 applications that arrived each month being processed. This slowdown eventually caused a backlog of 400 cases and slowed the process considerably.\textsuperscript{122}

The reaction to the changed FIRA guidelines from domestic and foreign capital as well as the U.S. government was strong. In combination with the NEP, the increased stringency of FIRA's review process was viewed as intolerably nationalistic. The U.S. government formally challenged FIRA's legality in front of a GATT panel in 1982, and along with U.S. business it strongly protested the NEP.\textsuperscript{123}

In response to this vehement opposition to its policies, the Liberal government backed down on both the NEP and the tougher FIRA rules. The NEP was considerably liberalized and eventually rescinded by the new Progressive government elected in 1984. Gray's interventionist policies were rejected within the cabinet, and he was replaced by the more pro-business Edward Lumley, who sped up the review process and eased the stringency of the "significant benefit" test. In 1982 the approval process for small business applications was simplified and the administration of FIRA clarified. In addition a campaign was launched to proclaim that Canada was once again "open for business."\textsuperscript{124}

In hindsight, FIRA and FIR Act were never great obstacles to foreign investment in Canada. To begin with, there were major loopholes in what the FIR Act covered. The expansion of existing foreign-controlled businesses was, for example, excluded from the scope of the FIR Act. This was an important omission, because there was already a large stock of investment in Canada, and reinvested earnings provided the bulk of increased FDI flows during this period. MNEs that

\textsuperscript{122}\textsuperscript{}Jenkins, 117.
\textsuperscript{123}\textsuperscript{}Jenkins, 117.
\textsuperscript{124}\textsuperscript{}Jenkins, 117.
had set up operations in Canada before FIRA was created, like Ford and General
Motors, could still grow and expand without hindrance. Furthermore, foreign
investors who already had a business in Canada could establish a new but "related"
business without review. Notwithstanding its importance the concept of relatedness
was undefined in the FIR Act. It was up to the administrators of FIRA to give it
meaning and they chose a wide interpretation and, thereby, narrowed the scope of
the FIR Act even further. Although many complained that FIRA was arbitrary and
deterred potential investment, the Agency turned down a relatively small number
of foreign requests to invest in Canada. Particularly in the late 1970s, FIRA handled
the consideration of foreign investment applications liberally, approving the vast
majority of them. For this reason, FIRA was often described by critics as "toothless"
and a "rubber stamp."125

In a study by Christopher Beckman, investors identified several aspects of
FIRA's operation that created difficulties for them. First, the length of time FIRA
took to process applications ranged from one month to three and a half years.
Although the average review was completed in about six months, it was not
uncommon for respondents to wait at least one year before receiving a decision.
Second, many investors perceived rigidity in the screening process. FIRA's sole
reliance on the criterion of ownership as opposed to good corporate performance
was dissatisfying because those who had previously been through the review
process in Canada were treated exactly the same as those applying for the first time.
Third, investors stated that the negotiations concerning their applications were
conducted in a secretive manner and lacked the transparency to make the whole
process fair to all parties concerned. Fourth, investors complained that the Agency's
requests for additional concessions were unreasonable and did not take into account
the special circumstances a company faced at a particular time. Finally, FIRA was
conceived and designed to reflect political as well as administrative realities. Since

125Deigan, 5.
the style and objectives of federal governments would unavoidably change over time, a large measure of political freedom of action was built into the process. Consequently, the Agency suffered, in the minds of the applicants, from the weakness of unpredictability and inconsistency inherent in its political control.\textsuperscript{126}

It is impossible to give an objective picture of foreign investment regulation in Canada based on the views of the investors because it is in investors’ interest to complain, downplay, and exaggerate to get the most favorable deal in the negotiation game. On the other hand, it is the investors that make the decision to invest and it is therefore reasonable to believe that their perception of the investment climate will guide them in their decision. Thus, the objective view of foreign investment regulation under FIRA was rather uninteresting, while the subjective view had a great influence on the final outcome.

FIRA was criticized for its inconsistent treatment of applications. It has been suggested that the built-in vagueness of the acceptance criteria was intentional in order to keep the freedom to apply different criteria in similar circumstances. Flexibility in the application of the screening criteria enabled the government to use FIRA as another instrument for addressing short-run political objectives. This meant that FIRA, when facing political pressures, could sacrifice the efficiency and benefits of consistent decision-making on the altar of expediency. From the point of view of the government, consistency would be motivated by the objective of maximizing benefits to Canada from the direct investment process, while inconsistency would be motivated by an objective of exploiting the review process for political purposes. Steven Globerman draws the conclusion that foreign investors were justified in their complaint that it is not altogether clear what FIRA expected for approval. On the other hand, it cannot be argued that FIRA applied its acceptance criteria in a discriminatory manner to different groups of foreign investors. Nor were the discontinuities in FIRA’s behavior necessarily haphazard.

\textsuperscript{126}Beckman, 43-52.
Instead, the inconsistencies of FIRA's behavior appeared to be tied more to broad economic conditions. Thus, one could expect a more lenient review process when Canada's economy was in a recession and had to improve its economic situation and vice versa. FIRA was intentionally vague about its acceptance criteria to have the freedom to take different measures under different economic circumstances.127

The increase in concern over FDI that occurred in the late 1960s and 1970s is understandable, at the political and psychological level, as a response to the anti-American and anti-business sentiment that peaked in this period. The unpopularity of the Vietnam War was a contributing factor, as was the popularization of environmental concerns and the general fashionability of socialism. In most of the developing world there was a reaction against foreign investment.128

The major reason behind the burst of Canadian economic nationalism and consequently the creation of FIRA was, of course, Canada's very close ties with the U.S. As seen in the previous chapter, the economic integration is tremendous. Canada is especially sensitive to American economic and political trends. However, arguing that Canada is sensitive to the United States is not to say that Canada simply does whatever the U.S. desires. The reality is much more complex, and Canada's close relationship with the U.S. has led to episodes of both nationalism and liberalization. The nationalistic policy of FIRA was to a large extent a response to U.S. actions. Such highly publicized events as the U.S. government's insistence that American automobile companies cancel truck and car shipments to China and Cuba by their Canadian subsidiaries was especially irking to the Canadians. These shipments contravened the U.S. Trading with the Enemy Act and the American government ordered the parent companies to stop them. The resemblance to the recent Helms-Burton Act is striking. In both cases, it is the extraterritorial application of the law that is intolerable. Furthermore, the U.S. implemented

127Globerman, 1984a, 119-120, 128.
various domestic policies in the 1970s that lay bare Canada's extreme dependence on U.S. investment flows. Anxious to improve American balance of payments problems, President Nixon introduced tax legislation in 1971 that discouraged U.S. investment abroad by providing a 7% tax credit for domestic investment and encouraged exports as opposed to FDI through a tax credit on foreign sales. These maneuvers were combined with a 10% surcharge on imports to the U.S. from which Canada eventually was exempted but which highlighted Canada's fragile economic position. U.S. policies like this increased Canadian determination to reduce reliance on American trade and investment flows.\textsuperscript{129}

Nevertheless, throughout the 1980s American pressure was a constant liberalizing force in regard to Canadian investment regulation. The Reagan administration which took office in 1980 had little tolerance for Canada's economic nationalism. The administration was appalled by both the Canadianization strategies of the NEP and the more stringent application to FIRA. The Americans accused FIRA of distorting trade by placing local sourcing requirements on U.S. companies operating in Canada or by demanding that they export a percentage of their production. Although the U.S. government recognized that other countries frequently enacted such measures, Canada was expected to set a higher standard. It also perceived that the interventionist policies of the Trudeau government clashed directly with the long-term interest of the U.S. in terms of the international free flow of capital.\textsuperscript{130}

FIRA's role in the "Canadianization" of the oil and gas industry was also criticized by the Americans. Although there was no effect on Canadian ownership when a merger of two U.S. companies led to the indirect acquisition of Canadian oil and gas assets or when an American purchased a foreign-owned company in Canada, the Canadian government sometimes used FIRA to negotiate benefits consistent with the NEP. To receive approval for an acquisition, a U.S. company

\textsuperscript{129}Jenkins, 123-124.
\textsuperscript{130}Jenkins, 124.
might have to agree to sell the upstream assets of the Canadian business to Canadians, increase Canadian ownership or sell shares in another of its resource-based subsidiaries. Unfortunately for FIRA, the result was that the Agency became identified with the NEP in the corridors of Washington. There, FIRA was viewed as another instrument through which the Canadianization goals of the NEP were carried out. Some Americans also complained that FIRA was blocking investments in other sectors on the basis of undisclosed government policies.\footnote{Deigan, 10.}

An apparent flow of Canadian capital into the U.S. also vexed the Reagan administration. The highly visible takeovers of American firms by Canadian companies, such as Seagram's takeover bids on St. Joe Minerals and Conoco, and the Canadian Pacific purchase of the U.S.-owned company Canadian International Paper Company, were of course especially irksome. These bids caused an uproar in Washington, and adversely affected companies got sympathy in the U.S. Congress. The ability of Canadians to freely acquire U.S. firms was met by resentment by American companies, and they argued that they were restricted from doing the same thing in Canada.\footnote{Stephert Clarkson, \textit{Canada under the Reagan Challenge}, (Toronto: Lorimer, 1982), 57.}

A more profound reason for the changed attitude in the U.S. was the concern over their country's economic performance. Once the dominant force in world commerce, the U.S. was facing stiff competition from Europe and the newly industrialized countries (NICs). During the 1970s, almost two million manufacturing jobs had been lost because of imports, and the world market share held by U.S. manufactured goods had suffered a 23\% decline.\footnote{Deigan, 8.}

The Reagan administration responded to Canada's economic nationalism on three levels. On a national level, the Department of Commerce undertook a survey of U.S. companies with operations in Canada to determine how these were affected by FIRA. On a bilateral level, the Reagan administration held extensive
consultations with a number of high-level Canadian officials regarding investment policies. There was also consideration of taking action under the Section 301 clause of the 1974 Trade Act that allows the president to retaliate against countries using unfair trade practices. On a multilateral level, the U.S. government held consultations with respect to trade-related performance requirements associated with Canada and prepared a case which a GATT panel considered as to whether Canadian policies violated its obligations under GATT. More specifically, the case related to FIRA's export and "buy Canadian" policies. The case also pushed for an investigation by the OECD, with specific reference to Canada, into government intervention in trade and investment flows by applying discriminatory requirements. The Americans saw the Canadian action as part of a more general trend and won agreement by the OECD Trade Committee to initiate a study of trade-related performance requirements.\(^{134}\)

The U.S. eventually won a partial condemnation of FIRA from the GATT. While supporting FIRA's right to exist, the GATT panel said that its "buy Canadian" provisions did break international trade rules, although it had no authority to rule on export performance requirements. Ottawa's greater willingness to appease U.S. dissatisfaction came only after the election of the Mulroney government in 1984 when a free trade agreement with the U.S. became an explicit part of the Progressive Conservative policy agenda.\(^{135}\)

Barbara Jenkins argues that Canadian governments seem to have a "very bad sense of timing, and nationalist policies of this sort are economically risky." Real GDP growth was the lowest of all OECD countries (-3.3%) in 1982 and the unemployment rate rose to 11.9% in 1983. Interest rates rose from an average of 7.83% in 1974 to a peak at over 20% in 1981. Although Canada's economic stagnation was mirrored internationally, it is clear that slower economic growth and higher unemployment rates restrained the government's nationalist efforts.

\(^{134}\)Jenkins, 125.
\(^{135}\)Jenkins, 126.
considerably. Public opinion became more appreciative of FDI in Canada as well. Although surveys showed in 1984 that 50% of Canadians still believed Canada had enough or too much foreign investment and 36% thought Canadians should repurchase 51% control from U.S. firms, this was decisively lower than in 1975.\textsuperscript{136}

Although Canadian investment controls have received wide coverage in the foreign press, especially in the U.S., most countries possess some form of investment controls. This is not the place to make a comparative study of investment regulation across countries, but some brief remarks are necessary. In 1984, Canada and Australia were good examples of countries with wide-ranging and statutory foreign investment controls. In other countries, investment controls were more subtle in that a central agency did not exist to screen investment. However, while investors in such countries were not protected against government interference, protectionism often just found different expressions. For example, the U.S. has a myriad of legislative hurdles that investors must overcome before being allowed to proceed, and its laws and regulations are administered not by one body but by a host of different government bodies – sometimes in an even more discretionary fashion. It is frequently difficult for critics to even find out what the laws are, much less mount a sustained attack against them. Canada, however, was different. Canada had centred the most important of its regulatory powers within a single agency. Moreover, Canada had carefully spelled out through legislation and guidelines the procedure and criteria for obtaining governmental consent to an investment. Not surprisingly, FIRA quickly became a lightning rod. By 1984, some domestic critics were portraying FIRA as being responsible for almost everything wrong with the Canadian economy. The cycle was at this point complete. Born amid popular sentiments that overestimated the negative consequences of foreign investment, the impact of the agency, whose role was to curtail these consequences, was itself being misjudged. The perception that FIRA was a barrier to foreign

\textsuperscript{136}Jenkins, 130-131.
investment and that Canada did not want foreign investment was partly, if not substantially, incorrect. However, perceptions are one of the most important determinants of capital flows.\textsuperscript{137}

Legislative changes in FIRA's structure occurred after the election of Brian Mulroney's Progressive government in 1984. Worried by lower levels of foreign investment and the legacy of nationalism left by the Liberals, Mulroney sought to change the perceptions of foreign investors that Canada was a hostile site for investment. Thus, the new government enacted legislation that replaced the Foreign Investment Review Act with the Investment Canada Act, creating a new institution to be known as Investment Canada.\textsuperscript{138}

A parallel can be drawn between the economic policy changes that took place in Canada and in the developing world at this time. Thomas Biersteker has argued with regard to developing countries that the global recession of the early 1980s provoked a rethinking of the basis of economic policy. There was a window of opportunity because of a growing sense of failure, a belief that the policies of the past had failed in some way, and that something new should be considered. There was serious disillusionment with the outcome of economic nationalism. Nationalized firms had become fiscal burdens for the state and national self-reliance proved virtually unattainable. Three factors were of critical importance for the change to a new economic policy approach: the deep economic shock of the early 1980s, the fact that this system-wide shock coincided with the perceived failure of the past, and the ascendency of an epistemic community within the state committed to neoclassical ideas and reinforced strongly by the actions of international institutions.\textsuperscript{139}

Although there are many comparative differences between Canada and the developing world as a whole, this seems to be a plausible explanation for the

\textsuperscript{137}Deigan, 11-12.  
\textsuperscript{138}Jenkins, 117.  
development that occurred in Canada. The shift in approach by the new Conservative government was preceded by a deep Canadian recession in the early 1980s, there was alarming facts about slipping international competitiveness and a feeling of failure with Trudeau's economic nationalism, and the neoclassically schooled officials in government was the epistemic community that formed and carried through the change of economic policy. I will further examine the changes of economic policy in Canada in the next chapter.
Chapter 5: Liberalization of Foreign Direct Investment Policy, 1985-1995

In the mid-1980s, Canada made a symbolical break with the past, with regard to international investment policy. When the Progressive Conservatives came to power in 1984 under Brian Mulroney, they were determined to improve faltering relations with the United States in the short-term and shift the trajectory of national policies in the longer-term. Lorraine Eden and Maureen Appel Molot have tagged the Conservative national policies "market liberalism", as opposed to the "compensatory liberalism" that characterized Canadian policies between World War II and the early 1980s. The new policies were a package based on the commitments to liberalize, privatize, deregulate and downsize.\textsuperscript{140}

With the image of Canada as a good place for investment at an all-time low, the new Conservative government made changing foreign investors' perceptions one of its primary tasks. The government had a variety of alternatives available to it in this undertaking. The government felt it could probably achieve its goal through a public relations campaign or administrative changes to FIRA, but it wanted to be certain the change was decisive enough to create credibility. Although FIRA had essentially become defunct in the last years of the Liberal government, it was decided that the easiest way to change perceptions about Canada's approach to foreign investment was to abolish FIRA altogether and create a new, baggage-free institution. However, the new Investment Canada Act (IC Act) did more than simply replace FIRA. It effectively propelled Canada from one end of the regulation spectrum to the other.\textsuperscript{141}

The new Conservative government's Investment Canada Act radically changed the foreign investment review process. The IC Act also gave the new Investment Canada Agency a novel mandate. The Agency explicitly had to work to encourage Canadians and foreigners to invest in Canada and to conduct research

\textsuperscript{141}Deigan, 13.
and provide policy advice on investment issues. Investment Canada was to play, at least symbolically, both the role of Canada's economic guardian and its leading salesman in Canada's effort to attract foreign investment.142

When the pursuit of foreign investment began in 1985, it startled many Canadians. After many years of nationalist rhetoric, (like Pierre Trudeau's comment in 1982: "If we abolish FIRA now...we would be selling the birthright of our children."143) the announcement that federal government officials would encourage more foreign investment sounded revolutionary. The reality was not so dramatic, however. The scale and intensity of Canada's international marketing effort was certainly unprecedented, but the direction of actual government policy had shifted incrementally. Indeed, with the exception of two periods when nationalists in the Liberal Party were on top (1973-75 and 1980-81), the decision of the Conservatives to promote foreign investment did not really constitute a significant change in the Canadian government's orientation. The change had started in 1982, when Trudeau's government facing a recession, a crisis in Canada-U.S. relations, and threats of counter-measures against Canadian investment and energy policies, had to back down on a proposal to strengthen FIRA.144

According to Robert Kudrle, those in charge of Canadian policy had concluded that a small developed country could not maintain growing prosperity without embracing market-driven interdependence and that the intermittent use of government power to dampen market forces slowed growth. Canada was not alone in this change of outlook. Canada's rethinking in many ways resembles that of other small, rich countries such as Australia, New Zealand, and Sweden. This new perspective was, in turn, part of a broader preoccupation with markets that

142Deigan, 13-14.
144Deigan, 18-19.
dominated the attention of policy makers in the richer countries during this period.145

The attitude of the general public had also changed. In June 1984, a Gallup poll of 1000 people found that 67% wanted the prime minister to encourage more foreign companies to invest in Canada. In a Gallup poll in 1975, only 16% wanted more foreign investment, so this was a decisive shift in the public opinion. However, prior to 1984 many government officials and important Liberals had not changed their minds. They still thought that Canada's level of foreign ownership was too high. Three months later, the election of the Conservatives swept away the remnants of that thinking.146

This chapter will examine the liberalization phase of the Canadian foreign economic policy and how foreign investment regulations changed from the FIRA period. The next section will analyze why the Canadian economy changed its approach to the world. The following sections will examine the new investment screening process, the regulations that still are in effect in Canada, and the investment promotion mandate of Investment Canada.

5.1. Changes in Canada's Economy

There are more reasons for the new transformed public policy, than the recession of the early 1980s and the Conservatives election victory. They include the changes in the Canadian and global economies. Much had changed in Canada since the 1960s. Unemployment was high even in good times. Most labor-intensive production had relocated to Third World countries. Canada had, for example, been giving aid to South East Asian states, but with their newly-won riches Canada's approach changed to attracting both their investments and their entrepreneurs. Canada stood still while other states were catching up.147

146 Deigan, 20.
147 Deigan, 22-23.
While some Third World economies have changed drastically over 30 years, Canada's economy has not. For instance, in the mid-1960s, Canada exported wheat and industrial raw materials such as newsprint, asbestos, lead, nickel and wood pulp to South Korea, while South Korea sold textiles, clothing and rubber footwear to Canada. Canada still exports mostly raw materials and unfinished goods to South Korea, but South Korea's exports to Canada now consist mainly of highly technological, manufactured goods such as cars, television sets, computers, and microwave ovens.148

There is no simple explanation of this development. Some blame automation for the elimination of clerical and manual jobs, while others point to Canada's monetary, tax and industrial policies, the rapid pace of technological change, the high cost of Canadian labor, foreign protectionism, and excessive or insufficient foreign investment. With regard to foreign investment, continentalists argue that MNEs facilitate the spread of technology and make Canada more productive. For them, it is trade barriers that have kept Canadian companies from being more competitive in world markets. Nationalists have a different perspective. They argue that Canadian companies are inefficient because there are too many foreign-owned firms. Foreign ownership, the nationalists maintain, hampers Canada's innovative capacity because of foreign companies' reluctance to have R&D away from their home-country headquarters.149

There has been a relative levelling of factor endowments and costs (i.e. the cost of capital, know-how, level of technological achievement) in the world and this is one reason for new trade and investment patterns. Forces of convergence, like the diffusion of technology, for example, have narrowed the distinctions among countries. Only thirty years ago, the European countries, North America, and Japan had strikingly different industrial structures, income levels, and factor endowments. Today the similarities are remarkable. These forces have also affected

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148Deigan, 25.
149Deigan, 25.
the traditional bases of comparative advantage. In the past, these advantages have been founded upon disparities in the allocation of capital, labor and resources. These distinctions have become increasingly blurred over the last twenty years, and there has been a corresponding shift in trade flows and the location of industry. The experience of Canada illustrates this. During the 1950s and 1960s, Canada was an attractive place to establish a business. It offered political stability, an educated labor force, an excellent transportation system and an abundance of raw materials. Three decades later, Canada still offers almost the same enticements, although the Quebec issue raises questions about Canada's political stability. As well, Canada's enticements have declined in relative importance as other countries have reached a stage where they can trumpet some of the same advantages. A number of Third World countries have, for example, developed their own mining and resource-based industries and improved their educational standard. At the same time, the technology for producing cars, appliances, and other consumer durable goods has been standardized. Trade barriers have fallen and communications have improved. Attracted by the opportunities and the low wages in Third World countries, many owners of capital have established factories there. This has led to rapidly growing competition in the world. The increased competition has damaged Canada's labor-intensive industries (such as textiles, leather, and footwear) in particular, but has also hurt Canadian firms that produce consumer durables (like cars, appliances, and electrical goods) and intermediate manufactured products (such as chemicals, papers, and metals).150

Canada and the U.S. have chosen different ways to deal with the development of their economies. In the United States, at the national level, there is no agency that promotes foreign investment per se. The major reason is ideological and based on the premise that the total benefits from international investment are maximized if governments seek to take no action either to accelerate or hinder

investment into or out of their territories. The U.S. federal government has generally restricted itself to a passive policy of providing a good climate for business. However, the fifty American states disagree with their federal government, and most promote foreign investment by offering financial incentives.\textsuperscript{151}

As we have seen, Ottawa has pursued a different policy than the U.S. in the area of foreign investment. In 1985, the Canadian government adopted what Russell Deigan has called a new mercantilist policy, focusing on attracting foreign investment and organizing Canadian industry to meet foreign competition. Canadian companies were encouraged to enter into national and international partnerships and licensing agreements. Furthermore, the government stressed the importance of technology and the need for cooperation among industry, labor, universities, and government. This was a significant step for a Conservative government philosophically committed to laissez-faire and the notion that the market alone should decide which industries survive.\textsuperscript{152}

One reason the federal Conservatives adopted their proactive strategy of seeking foreign investment was because they had the support of a political culture quite different from that in the U.S. In Canada, the state has historically played a significant role in the economy. This role began with the National Policy in 1879, which was designed to foster manufacturing through erection of a high tariff wall. It continued through state ownership of businesses and a multitude of incentive programs. Generally, Canadian politicians of all stripes have accepted this degree of state intervention. Many business people, especially if they benefited, welcomed it. Thus, the loud and ideologically rooted debate that has taken place in the U.S. over industry policy and how to respond to changed economic conditions has been more muted in Canada.\textsuperscript{153}

\textsuperscript{151}Deigan, 30.
\textsuperscript{152}Deigan, 30-31.
\textsuperscript{153}Deigan, 31-32.
Another reason was that the economic problems Canada faced had not arisen in the U.S. Many of Canada's manufacturing industries had been established to serve a relatively small domestic market. This was partly a consequence of Canada's high tariff barriers erected earlier in this century, which persuaded foreign companies to set up miniature replica subsidiaries. Some of these subsidiaries were high-cost, low-volume producers, and they remained profitable because of Canada's tariffs. By 1985, tariffs were dropping among the members of GATT to a level where they would provide almost no protection at all. The government was concerned that if Canada did not become more competitive and protect its market share there would be a flood of imports. A related worry was that foreign parent companies would shut down their subsidiaries in Canada or relegate them to performing sales, distribution and service work.\textsuperscript{154}

It was the success of Japan that originally caused policy-makers in Ottawa to question mainline economic thought. Japanese development showed that industrial policies favoring some industries over others can have a significant impact on the ability of states to compete in the international market-place. Comparative advantages among states were not merely static or slowly evolving, but rather, partly dynamic. Some changes in comparative advantages could be engineered, and quite quickly. Japan had also demonstrated that technology, plus organizational and marketing skills could be more important than natural resources in determining which states became winners. Another insight was that the state, often regarded as dead weight by business people, could have a significant impact on economic success.\textsuperscript{155}

The policymakers thought that Canada should move towards an economy based on trade in high technology products, reduce their costs of manufacturing existing products, and establish a physical presence abroad. More trade shows and sellers' missions to bring together foreign buyers and Canadian manufacturers

\textsuperscript{154}Deigan, 32.
\textsuperscript{155}Deigan, 32.
would be required as well. To achieve these goals, Canadian industry would need to invest in the latest technology and switch to more capital and skill intensive means of production. At the same time, new competitive advantages would have to be created through R&D and entrepreneurship. This effort would require more risk capital on a continuous basis because technology is forever advancing. New markets in Europe, Asia and the U.S. would also have to be opened up and access secured through partnerships between Canadian and foreign firms. To raise the necessary capital, the government officials decided to encourage a massive inflow of foreign capital. Hopefully, it would go into productive capacity, such as new plants and machinery. In 1984, Canada spent far less of its GNP on R&D than the other OECD countries. The government also decided that another way to make Canadian companies more competitive was through the acquisition of more foreign technology. Technology can be transferred through direct investment, licensing, and importing the final product. By encouraging foreign investment, the Canadian government concluded that state-of-the-art technology could be brought to Canada. The final need was for entrepreneurship, and the government decided to try to import entrepreneurs from overseas, especially from Southeast Asia.156

With the introduction of the IC Act, it was clear that Canada had changed its approach to the global economy. The introverted development path was abandoned, and Canada put its hopes in global market forces to regain international competitiveness, growth, and continued prosperity. The next sections will venture deeper into the changes in the screening of foreign investment, the remaining regulations in Canada, and the promotional efforts of Investment Canada.

5.2. Screening by Investment Canada

Screening of major investments by foreigners is still one of the tasks of Investment Canada. This is the function that brought FIRA so many headlines and

156Deigan, 32-36.
eventually led to its demise. The screening activities of Investment Canada have generated less criticism, partly because its screen was made smaller and the mesh wider.

The IC Act eliminated the screening and evaluation procedure for a range of investments. Most new investments by non-Canadians only require a notification, which involves filing with the Agency a brief statement of information about the investment. Under the IC Act, it is the asset size of the Canadian business that decides whether an investment will be reviewed or not. However, all foreign investors do not face the same size criterion anymore. Depending on the nationality of the investor, the review process either shrinks or expands. For Americans, who are governed by the FTA, the criteria are minor. (With the ratification of NAFTA these rules also apply to Mexican investments.) Under the IC Act, filing is necessary to acquire direct control of a Canadian business if that business is worth $5 million or more, or to acquire indirect control\textsuperscript{157} if the business is worth $50 million or more. These changes meant that approximately 90 percent of foreign investment transactions were non-reviewable, although even under these new thresholds 90 percent of the transactional value would still be reviewed. Under the IC Act, no "new establishment" investments are reviewable, although special consideration is given to foreign investments and acquisitions in cultural industries and in oil and gas. This is a major change from FIR Act, under which all new establishments were reviewable. However, the real proof of Investment Canada's new leniency is in its review record. Since the election of the Mulroney government in 1984, very few foreign investment acquisitions or establishments have been denied. This is the result of the new "net benefit" criterion. It states that if there is any benefit of an investment, it must be approved. This is quite the change from FIRA's "significant benefit" criterion.\textsuperscript{158}

\textsuperscript{157}Indirect control is obtained when a foreign company gains control of a Canadian subsidiary through its acquisition of another firm.

\textsuperscript{158}Jenkins, 118-119.
As mentioned above, investment regulations applying to U.S. investors were further liberalized by the FTA implemented in January 1989. Under the FTA, U.S. investors must be provided with "national treatment," meaning that they must be treated similarly to domestic investors. However, there are numerous exclusions to the national treatment provision. For example, certain sectors, such as cultural industries, financial services and transportation, and businesses owned by federal and provincial governments are excluded from this provision. Furthermore, all existing legislation in both Canada and the U.S. is grandfathered after FTA, but all future legislation must meet the national treatment criteria. Although the IC Act was considered to be existing legislation, the Canadian government agreed to lift the review of thresholds for direct acquisitions by U.S. firms. Direct acquisitions under $150 million were to be made exempt from the review process by 1992. Review of indirect acquisitions was also completely phased out in 1992. The number of acquisitions subject to review is thus considerably reduced but acquisitions of the top 600 firms in Canada will still have to be reviewed.\textsuperscript{159}

The way of deciding who is in control of a corporation that invests in Canada has also changed with the IC Act. Under the FIR Act, \textit{de facto} control determined whether a corporation, partnership, or joint venture was foreign-controlled. This encompassed control through share ownership, but also control through other means, such as distribution agreements, family relationships, debt instruments, technical expertise, and financial clout. The IC Act has only few provisions regarding \textit{de facto} control and relies more on who is in control legally. Thus, the rules are not as correct in distinguishing real control, but because factual evidence of ownership is readily available the rules have gained greater clarity and certainty. Two attributes to which the business community attaches great importance.\textsuperscript{160}

Another major change that took place with the enactment of the IC Act concerns the decision-making process. Under FIRA, the government could give

\textsuperscript{159}Jenkins, 119-120.
\textsuperscript{160}Deigan, 41-42.
itself unlimited time extensions if it wished. The IC Act, on the other hand, keeps
the bureaucracy moving. Without the consent of the investor, the minister cannot
put off reaching a decision for more than 105 days. Under the IC Act, it is the
minister who makes the final decision instead of a committee of Cabinet as under
FIRA.\textsuperscript{161}

By introducing strict time limits, thresholds for review, and a new ownership
test to ascertain control, government officials involved in formulating the
legislation achieved two goals. They rendered the administration of Canada's
screening process more precise and transparent, and they blocked the possibility of
future regulatory creep back to a more interventionist state of affairs.

5.3. Regulations that still Apply in Canada

Although Canada has liberalized its FDI regulations considerably, some
industrial sectors are still covered by restrictions. Unlike the screening procedures in
which government bureaucrats or elected officials evaluate the pros and cons of an
investment proposal, legislation establishing key sectors that are off-bounds to
foreign investors represents an unequivocal barrier to inward FDI. The sectors that
are still regulated in Canada are also regulated in most other countries.\textsuperscript{162} Raymond
Vernon has argued that:

Most countries ... including the United States have had no hesitation in
deciding that it was worth any price to keep foreign-controlled interests
out of certain sensitive national industries. Accordingly, practically every
country limits the right foreign-owned subsidiaries to participate in
industries such as ordnance and aircraft, public broadcasting, coastwise
shipping, banking, and minerals exploitation on public lands.\textsuperscript{163}

While this generalization remains broadly correct, the blockage of those sectors
have softened greatly in some circumstances. Most protected sectors, whatever their

\textsuperscript{161}Deigan, 42-43.
\textsuperscript{162}Steven Globerman, "Regulation of Multinationals in Canada," in International Business in Canada:
Strategies for Management, ed. Alan M. Rugman, (Scarborough, ON: Prentice-Hall Canada Inc., 1989),
168.
\textsuperscript{163}Vernon, Raymond, Sovereignty at Bay: The Multinational Spread of U.S. Enterprises, (New York:
historical link to national security, now have no necessary connection with security at all. There are different justifications for protection in different sectors, but it appears that simple producer protection is most likely.

Restrictions on banking and finance are among the widely accepted and long-standing controls imposed on foreigners, perhaps because widespread fear of a largely invisible threat to national well-being. Globalization of financial markets makes regulations justified by national well-being seem obsolete. However, in recent years most countries have used access to their domestic markets as a bargaining chip in negotiating reciprocal rights elsewhere, an indication that national advantage rather than security or autonomy concerns lie behind most restrictions today. Historically, Canadian banking regulation has combined high concentration with a determination to avoid foreign control. Prior to legislation of 1980, banks could be chartered only by an Act of Parliament. To increase competition, a new category of banks was introduced which allowed for sole ownership by either a domestic or foreign entity. Nonetheless, the entrenched major banks continued to dominate the market. No more than 25 percent of the assets of a major bank could be owned abroad, and total domestic assets held by subsidiaries of foreign banks were capped. The FTA introduced national treatment of the U.S. which included a maximum 10 percent share of assets of the major banks by one owner, foreign or domestic. The NAFTA agreement also changed access to the market. When the agreement started, U.S. and Canadian banks could hold up to a 8 percent market share, but this will rise to 15 percent in 1999. Most restriction will then end in 2000.¹⁶⁴

Virtually all developed countries combine some direct government role with some form of discrimination in favor of national ownership in the broadcasting sector. Some Canadians may consider national security to be ample reason for limiting foreign investment in broadcasting, but the national autonomy motive is

¹⁶⁴Kudrle, 1994, 412-413.
key for most observers. Frost and Graham argue that Canadians are more sensitive to the question of national "identity" than are citizens of the other G-7 countries. This sensitivity results from a combination of periodic struggles with Quebecois nationalism and the desire of other Canadians to maintain certain cultural differences they perceive exist between themselves and their neighbours to the south.165 Today, broadcasting is protected as part of Canada's general posture toward "cultural industries", which also includes newspapers and periodicals, book publishing, printed music, film, video, and sound recording products. When Investment Canada replaced FIRA, provisions calling for the careful screening of both new businesses and acquisitions relevant to "Canada's cultural heritage or national identity"166 remained. Also, foreign ownership of both broadcasting and cable are capped at 20 percent. The Americans tried to remove protection in this sector during the FTA and NAFTA talks, but came away empty-handed. These industries still lie outside the agreements.167

Post, telephone, and telecommunication services is another area that in most countries has been operated by government monopolies and foreign ownership have been strictly controlled. The postal service is still a monopoly in Canada and not open to FDI. In recent years a few countries have privatized their telephone systems. The reticence of others is often based in part of the power over equipment purchasing that governments can exercise to favor domestic suppliers. While private firms continue to gnaw away on some profitable parts of what were previously monopoly services, only minor sentiments exist anywhere to abolish the core public monopoly. Canada is not different. Canadians accepted some U.S.-owned services before the FTA, although not the basic telephone services. In 1993, foreign

ownership of Canadian common telephone carriers is limited to a maximum of 20 percent, but through NAFTA there is a push toward liberalization.168

Foreign investment in the energy production and public utilities sector is usually limited by governments. In Canada public and private utilities are surrounded by both national and subnational regulations. Furthermore, all countries control foreign ownership of natural resources to some extent. After the introduction of the NEP in 1980, investment in the sector plummeted as a result of a combination of lower world energy prices, official discouragement of foreign investment, investor doubts about the future policy environment, and the investment capacity of Canadian firms, some of which became heavily burdened with debt after taking over U.S. assets. The scrapping of the highly criticized National Energy Program in 1985 was of great importance for Canada's liberalization in this sector. The FTA simplified energy trade, and it removed aspects of the incentive scheme that systematically discriminated on the basis of nationality of ownership. However, the requirement of 50 percent Canadian ownership for frontier activity and the policy of rejecting foreign acquisitions of healthy Canadian oil firms were retained.169

Historically, governments have kept strict regulations in the transportation sector for national security reasons. Air and water transportation are tightly regulated in Canada and foreign ownership is generally limited to 25 percent. In Canada the provinces play a large role in transportation policy. Some provinces employ a "public interest test" that allows incumbent firms essentially to veto new entrants. Ontario abandoned this practise in 1988. Transportation was left out of the FTA, but NAFTA advances transportation relations between Canada and the U.S. by including the sector in the dispute settlement provisions.170

Some regulation may have an indirect impact on FDI. In Canada, interprovincial barriers have made trade among them even less free than within the European Union and may be costing Canada 1 percent of national income. Such barriers deter MNE activity by balkanizing the national market in many sectors, particularly in those sectors dependent on discriminatory government procurement. Might also arise from the simple fact that investors are foreign. Different corporate tax rates among countries and the special tax treatment of foreign earnings by home and host countries may also provide a problem if no tax treaty exist. A satisfactory tax treaty existed already between Canada and the U.S., so the FTA did not deal with MNE taxes.  

One aspect of Canada’s FDI regulations is quite peculiar. All of the G-7 countries except Canada have broad legislative authority in place to block foreign investment for reasons of national security or national interest. Increasingly, agreements between countries maintain such a restriction (e.g. GATT, Treaty of Rome, FTA, NAFTA). There is, therefore, a need for a provision that contains a narrow definition of national security and applies only when the security of a country is legitimately threatened. In recent years, however, there has been an interesting evolution in thinking, particularly in the United States, with regard to what constitutes national security. Frost and Graham argue that:

Broadly speaking, national security concerns ... are shifting in the direction of economics in the sense that, relative to foreign policy objectives and other goals usually associated with national security, economic goals have become more explicit and more pronounced. This general shift reflects a growing realization that the strength of a national economy is inseparable from its national security.

The definition of national security and economic security are becoming more and more similar, and this development threatens to put the future of a liberal world in jeopardy.  

171Kudrle, 1994, 419.
173Frost and Graham, 443.
economy at the discretion of politicians. On the other hand, it might be a problem for Canada not having a national security clause, especially at the bargaining table.

Canada and the U.S. identified the same major national security threats over most of the post-war period and have worked effectively together to face them. Between Canada and the U.S. few barriers to MNE activity, now or earlier in the post-war period, can plausibly be based on immediate security concerns in either country. Nonetheless, effective policy tools are in place in both countries: assets can be commandeered in times of emergency, and well-tested techniques can be applied to protect both states against espionage. If the usual national security arguments for controlling foreign investment lack credibility among the NAFTA countries, autonomy must necessarily remain a concern for both Canada and Mexico.

According to Kudrle, the goal of autonomy can be considered in two dimensions: autonomy of action and autonomy of thought. For two countries that are similar in so many ways, Canada and the U.S. stand virtually at the opposite ends of the autonomy spectrum in both dimensions. Autonomy of national action has been reduced simply as a consequence of general interdependence. The efficacy of macroeconomic policy has, for example, diminished everywhere, but the change for smaller countries came earlier and was more forceful than was the case for larger ones. One of the motives underlying Canadian economic nationalism in trade and investment policy has emanated from a resistance to this loss of autonomy. However, the recent changes in policy have grown out of the recognition that nationalism demanded a high price in prosperity for only little autonomy gain. Autonomy of thought can be threatened by the international transmission of foreign tastes and values, and policies may be devised to resist it. As mentioned above, Canada attempts to meet this challenge by controlling not only MNE activity but also the content of broadcasting. These measures are augmented by an extensive subsidy system in support of domestic cultural and artistic production. Canada controls the mix of foreign and domestic cultural products on the basis of the
nationality of producers rather than the content of the product. Cultural protection can make good theoretical sense, but its manifestations through policy often suggest the triumph of producing interests in rejecting more efficient and effective policy. Subsidization of culture, furthermore, faces an inherent problem. The manipulation of money prices can promote approved consumption only to a certain extent. Most cultural products take time and require attention to consume. Public opinion will probably not support severe restrictions on foreign products (such as banning foreign satellite programs or restricting cable offerings) in favor of domestic substitutes. Therefore, even if the public enthusiastically subsidizes local output, its willingness to absorb that output tends to be quite limited.¹⁷⁴

Another policy pattern related to autonomy is the reaction of Canadians to foreign investment in natural resources. Foreign ownership restrictions on oil and gas are contained in both the FTA and the NAFTA. Canadian federal authorities defended the introduction of the National Energy Policy in 1980 by arguing that no other country allowed such extensive ownership of "crucial non-renewable energy resources". This is more of an emotional appeal than a solid argument. A strong case can be made that foreign exploitation of natural resources can be more easily monitored, with most significant effects measured and evaluated than perhaps any other kind of FDI. Considering the sophistication of the domestic regulatory mechanism in Canada, a scenario in which a foreign firm can work against the host nation's interests without detection is difficult to concoct and even more difficult to believe. On the other side of the argument stands the undeveloped energy production potential, which some analysts contend can only be realized with unrestricted foreign equity. Unlike the case of the cultural industries where the national purpose of FDI regulations can be quite convincingly stated, the restriction of foreign investment in energy and other natural resources seems to have only an emotional connection with any national goals.¹⁷⁵

¹⁷⁴Kudrle, 1994, 422-424.
¹⁷⁵Kudrle, 1994, 424.
5.4. Investment Promotion in Canada

Surveys in the mid-1980s showed that business people viewed Canada as a relatively unattractive location for investment. Its labor force was inefficient, its climate severe, and its market potential small. This concerned government officials. They saw these opinions as misperceptions of reality that could harm Canada's investment plans. The problem was how to dispel such images and communicate the message that Canada was receptive to foreign investment. The tools that government officials chose were the traditional ones employed in any awareness program. Ministers gave speeches overseas, printed promotional brochures, and organized seminars. Cause and effect are hard to determine when it comes to promotional campaigns. Nonetheless, after a survey in 1987, the Conference Board concluded that the government's "open for business" message had got through to the investment community. Although advertising might be effective, it is not sufficient for any government to merely announce that foreign investment is welcome. After all, image is only one determinant of investment flows. Comparative wage rates, transportation costs, taxation, access to markets, energy costs, and regulatory practices also influence decisions to investment. In addition, there is the quality of life, such as the number of cultural, educational and recreational facilities that a particular location offers. This is increasingly important to companies wanting to attract the best employees.\textsuperscript{176}

According to Louis Wells and Alvin Wint, there are three alternative short-term objectives for investment promotion activities. The objectives are image building, investment servicing, and investment generation. When government policy changes to encourage foreign investment, it is common that the promotional agency focuses on image-building with the objective of advising members of the investment community about the government's new attitude toward foreign investment and its interest in attracting investors. First, when there is a belief that

\textsuperscript{176}Deigan, 392-393.
an appropriate image has been formed in the minds of prospective investors, the agency shifts its focus and attention to investment generation. Investment Canada followed this development. Investment Canada's primary objective was to change the image of Canada as a place to invest, and consequently the focus was on image-building techniques. Investment Canada used advertising in general financial media, advertising in industry- or sector-specific media, and producing and distributing brochures as its primary image-building techniques. Already in Investment Canada's second year of operation the relevant officials felt that the awareness campaign had been successful and, hence, a clear shift in focus was made to attempt to generate investment.177

The investment promotion endeavor is not new in Canada. However, it took place at different levels before the mid-1980s. As long ago as the late nineteenth century, Canadian municipalities were pitting themselves against each other in fierce competition for manufacturing businesses. To entice industrialists, these local governments offered a variety of incentives or bonuses, such as cheap land, tax or utility concessions, as well as cash. Citizens of the time soon labelled the phenomenon "bonusing."178 In this century, central governments in Canada and other countries have used monetary, fiscal, and regulatory policies to attract selected forms of investment. Tax incentives and subsidies have been the most popular and probably the most wasteful means of doing this.

Investment promotion has a lengthy tradition, but some remarkable changes have taken place the last decades. Most noticeable has been the expansion in the scope of investment promotion. Before governments pursued a certain manufacturer in one country, whereas today the same governments pursue foreign investors of all kinds in more than a dozen of countries. Accompanying this

expansion has been a rapid growth of human and financial resources devoted to the development of investment promotion and the adoption of more sophisticated techniques. In part, this development has taken place because investment promotion, which used to be a concern of local governments, now is a central government activity in most countries. Investment promotion, always the subject of covert lobbying and shrewd tactics at the local level, has since the early 1980s become one of the most highly politicized activities of national and state governments. It is not unusual that even the most eminent government ministers are used as megaphones to convey the message that investment within their jurisdiction is both welcome and profitable.\footnote{Deigan, 374-375.}

Another break with the past lies in the strategy underlying investment promotion. Governments used to think that if they created a favorable business climate, market forces would attract foreign companies. Then the private sector would facilitate these companies to set up their businesses. When market forces did not operate as expected, governments used grants, subsidies, low interest loans, and tax concessions to entice foreign investors. Governments still use these traditional tools, and tax concessions are being employed more than ever. Just think of the mushrooming of free enterprise zones around the world.\footnote{Deigan, 375.}

Governments have taken on the new role of salesman and now aid foreign investors with everything from site selection, advice on regulatory procedures, and location of potential suppliers and partners. In most countries, this role change began quietly with the establishment of a reactive program. After receiving an unsolicited inquiry, civil servants would respond with information and assist the investor in arranging meetings with government officials. More recently, a number of governments have established proactive programs. Under these programs, government-employed personnel seek out and contact foreign business people who have never expressed any interest in investing abroad. These governments are
directly competing against each other, and the most sophisticated market techniques are used to present their country's opportunities and advantages.\textsuperscript{181}

Canada did not establish its Investment Development Program (IDP) until 1985. However, this was not the commencement of Canadian government-sponsored investment promotion campaigns overseas. During the previous decade, while the federal government looked disapprovingly at increased foreign investment, Canada's provinces had been developing programs to boost it. By 1985, Quebec, Ontario, Alberta and British Columbia had established a number of offices overseas and were busy making presentations to prospective investors. Some cities even sent their mayors on tax-funded sales missions to Europe and Asia. At the federal level, a limited effort had been undertaken for several years. The Department of Regional Industrial Expansion (later Industry, Science, and Technology Canada) was providing sectoral and regional information as well as advice on incentive programs to foreign investors who contacted it. Offshore, Canada's trade commissioners did some promotional work from their embassy offices in addition to their trade-related responsibilities. However, this multi-centred structure for promoting investment presented several problems. Most troublesome was the duplication, the lack of coordination, and a support system that was often weak or non-existent. For instance, Canadian embassies and consulates regularly received questions about wage rates, transportation costs, and incentive programs, but there was no centralized infrastructure within the federal government that compiled information for investors. Neither was there any federal organization willing to lead the individual investor through the red tape surrounding the establishment or acquisition of a business. Furthermore, there was little or no coordination. Representatives from the federal government, the provinces, and Canadian cities would visit companies abroad or attend conferences and trade fairs without contacting each other.\textsuperscript{182}

\textsuperscript{181}Deigan, 375-376.
\textsuperscript{182}Deigan, 381-383.
This state of affairs began to change in June 1985. FIRA was a few weeks from termination, and the two-headed creature Investment Canada was about to be born. As mentioned above, its mandate was both to screen and promote foreign investment. This twin mandate caused quite a stir. Some investors were surprised that FIRA’s replacement had been assigned both roles, and the bureaucrats in Ottawa realized that they had no choice but to bring some harmony in the promotional efforts of the federal government departments. The federal government brought the resources of three government departments (Investment Canada, External Affairs, and the department now called Industry, Science, and Technology Canada (ISTC)) together and created the Investment Development Program.183

The focus of the program was not clear. Parliament had given Investment Canada, or rather the minister responsible for Investment Canada, a mandate to:

1. encourage investment by Canadians and non-Canadians;
2. assist Canadian businesses to exploit opportunities for investment and technological advancement;
3. do research on domestic and foreign investment issues;
4. provide investment services; and
5. assist in the development of industrial and economic policies that have an impact on investment.

However, Parliament issued no further instructions and left it to the minister and government officials to determine the scope of the mandate and devise ways to encourage investment. It did not take long before they had defined this mandate in the broadest terms. They felt that Canada needed capital, technology and market know-how to become more competitive internationally. They expanded the concept of encouraging investment far more than a search for foreign capital. Anything from joint ventures, technology transfer agreements, licensing agreements, more R&D, and the training of employees was called an "investment" and became something to encourage.184

183Deigan, 383.
184Deigan, 383-384.
Before much could be done, there had to be a means of synchronizing the performances of the several actors. Investment Canada (general promotion), External Affairs Canada (embassies overseas), ISTC (industry sector experts), the National Research Council (technology transfer), Employment and Immigration Canada (business immigration program), and the Federal Business Development Bank were all important actors at the federal level, but there were also the provinces, municipalities, and private sector bodies that played a part. Some form of structural linkage was needed to organize a joint strategy and effort. Thus, in the summer of 1985, an "investment development steering committee" was created. Its task was to map out a strategy and a broad outline of projects and to advise the minister on goals. Investment Canada saw itself as coordinating Canada's promotional effort by becoming the focal point for the investment development activities of a number of federal government departments. At the same time, meetings took place between federal and provincial ministers responsible for economic development to coordinate federal and provincial programs encouraging investment. In the fall of 1985, federal and provincial ministers concurred on which countries Canada should focus its efforts to obtain more foreign investment. The U.S. was an obvious choice, and the others were the United Kingdom, France, West Germany, Japan, Hong Kong and the Netherlands. A few states, like Switzerland and South Korea, should receive a lesser degree of attention. However, little additional progress was made towards coordinating their respective programs. Although officers at different levels worked closely together, it was not done within the framework of one overall plan. As a result, several independent programs were designed to promote greater investment. The IDP and the business immigration program are the best known. Then there are the programs of the provinces and the municipalities, and the "industry sector campaigns" of ISTC.¹⁸⁵

¹⁸⁵Deigan, 384-385.
In 1988 the provinces combined spent $209.98 million on trade and investment promotion, whereas the federal government spent only $135.46 million. The provinces thus provide more than 60 percent of all Canadian funds devoted to trade and investment promotion. In addition the provinces made transfer payments to firms in the form of subsidies and capital assistance. It is very rare that provincial investment promotion efforts are coordinated with Investment Canada, although the agency is not opposed to such efforts in principle. The result of all these separate endeavors is of course a morass of competing promotional packages.  

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The objective of investment development is two-fold: first, to improve the competitiveness of key industries; second, to produce an economic environment that welcomes and rewards investment and a society that is more entrepreneurial in nature. Thus, there is both a marketing dimension and a policy development dimension to investment development. There are two strategies to achieve this objective. One strategy focuses on the investment environment, which includes taxes, interest rates, the exchange rate, labor cost, and the educational system. The theory is that providing the right environment will make domestic industry prosper. The sight of this prosperity showed result in more investment. The efficacy of this strategy depends on a government body's ability to monitor the investment climate of competing countries and its preparedness to challenge tactfully other branches of government when their policies adversely affect investment. The other strategy of targeted promotion is directed at selected companies. It requires a staff of investment counsellors at home and salespeople abroad. Strategic analysts are also needed to prepare presentations for foreign companies on how a particular location can improve their competitive position. Investment promotion provides an advantage to the states that first set them up, until all states have established their own. The Canadian government pursued the first strategy when it introduced its

186Jenkins, 147.
framework policies that included the reduction of corporate and personal taxes, the privatization of Crown corporations, the reduction of the number of regulations affecting the transportation, financial services and energy sectors, the replacement of the manufacturers' sales tax with the goods and services tax, the easing of the paper burden on small businesses, and the FTA. The marketing component of Canada's investment development program is an example of the second strategy.\textsuperscript{187}

As seen in this chapter, Canada continues to have barriers to FDI, while at the same time, intensive investment promotion efforts are being aimed at attracting inward foreign investment. The dual purpose of Investment Canada might seem like a policy contradiction. However, in maintaining these conflicting policy stances, Investment Canada is attempting to maximize the benefits associated with FDI, which include employment opportunities, technology transfers, and integration into the international production system, and at the same time guard against the perceived costs of FDI, which include loss of sovereignty and threats to national security. This policy duality needs careful examination to ensure that the interaction of the two approaches to MNEs does in fact produce the best outcome.

\textsuperscript{187}Deigan, 387-388.
Chapter 6: Conclusion

This thesis took as its departure point that international relations increasingly are characterized by globalization. The impact of globalization on international relations is so large that some scholars suggest that a paradigm shift might be in the making. The process of globalization has been a long-term upward trend, with periodical downturns. Since WW-II the speed of the process has increased dramatically. The formidable increase in FDI and cross-investment in the world have been important features of globalization and have led to deeper international integration.

Canada stand out in international comparison because of the significant foreign ownership and control it has allowed in its history as an independent country. From the moment of confederation Canada had a liberal attitude toward FDI, seeing it as a major vehicle for development. Thus, Canada used foreign capital, people, and ideas to develop its vast natural resources and to better the living standards of its inhabitants. The price for this, however, was considerable foreign ownership and influence over the Canadian economy.

The liberal approach to FDI that Canada pursued took much longer to evolve in other countries, but has become commonplace around the world in the last two decades. Why did Canada exhibit one of the major characteristics of globalization (i.e. allowing significant foreign control of its economy) earlier than other countries? This thesis has argued that Canadians accepted the mental framework of globalization remarkably early. Some of the significant features of this mental framework are an ability to trust, a muted nationalism, and an openness to other cultures and ideas. As this thesis has argued, all of these features developed as a result of Canada's colonial history with the U.K., its cultural ties with the U.S., and the immigrant nature of its society. These features facilitated Canada's open policy toward FDI by increasing the understanding of the benefits of diverse influences in a

society and economy, and by entrenching respect for other ways of doing business. In short, contrary to those who argue that Canada has been structurally destined to be dominated by the U.S., I have argued that Canada appreciated the virtues of international integration earlier than other countries and consciously took a global (or, in practice, continental) approach in its economic policies.

This thesis has dealt largely with the puzzle of why Canada, after its impressive industrial development through the use of FDI, turned away from its liberal FDI policy in the mid-1970s just as globalization began to build momentum around the world with more and more countries liberalizing their policies toward foreign investment. The obvious reason for why Canada changed its policy, instituting thresholds and performance requirements for FDI, was that it was attempting to diversify its economy and lessen its reliance on foreign companies for its economic well-being. However, with the increasing liberalization in all aspects of world trade and investment in countries around the world, it was not feasible for a small, open economy like Canada's to attempt to isolate itself from the world economy. As a result, this protectionist turn in Canadian investment policy failed within a decade.

Political leadership played a major role in building support for the new, restrictive regulations on FDI enacted in Canada in the 1970s. Pierre Trudeau's Liberal party formed the government from 1968 to 1979, then again from 1980 to 1984. At times the Liberals led a minority government supported by the New Democratic party (NDP), at other times it formed a majority government. Among his fellow Liberals, Trudeau associated more closely with the interventionist and anti-American left of the party than the previous prime minister and party leader, Lester Pearson. The NDP generally favored an even more interventionist and anti-American approach to investment than the left wing of the Liberal party, and this was very significant at the time because the Trudeau government required the tacit support of the NDP to stay in power for much of its tenure. Consequently, much of
the policy debate actually consisted of the centre-right of the Liberal party resisting the strong interventionist position taken by the Liberal Party's left wing and their NDP allies.

Anti-American political leadership acted to feed grassroots worries over the extent of foreign control and the influence of foreign economic decisions on the Canadian economy that had been growing since the early 1960s. Nationalists blamed Canada's continentalist policies for the degree of foreign control of the economy, and for the Canadian economy's lack of competitiveness as well as its sluggish growth. It was argued that foreign MNEs were exploiting Canada's resources without giving anything back. On top of this, the unpopularity of the Vietnam War, the popularization of environmental concerns and a general fashionability of socialism were important contributing factors for these anti-American investment sentiments. At this time, MNEs were overwhelmingly based in the U.S. and they were by far the major investors around the world, while only a very small percentage of the U.S. economy was controlled by non-U.S. companies. Oblivious to the quiet establishment of Canada's own MNEs and their investment in foreign economies, many Canadians became increasingly alarmed at what they perceived to be the Americanization of Canada.

Further, many Canadians were aroused by allegations that foreign firms in Canada discriminated against Canadians when filling senior management position, thus hindering the development of Canadian entrepreneurial expertise; that they bought goods and services from traditional foreign suppliers even when similar goods and services were available in Canada; and that they prevented Canadian subsidiaries from exporting because of the existence of affiliates abroad. But what probably agitated Canadians the most were suggestions that foreign MNEs centralized almost all R&D at their headquarters and that during recessions, subsidiaries' employees were the first to be laid-off. According to the exaggerated rhetoric of some nationalists at the time, Canadians were in danger of becoming
mere hewers of wood and drawers of water in a branch plant economy. In light of all this supposed evidence it was believed that Canada had to take serious and immediate measures to escape the grasp of U.S. neo-colonialism. The fact that Canada's relationship with the U.S. had played a large part in the creation of Canada's wealth and high standard of living was not acknowledged.

When the nationalists had acquired the upper hand in the government their attempt to reform the Canadian economy took full swing with FIRA and the NEP as their primary initiatives. Soon, however, it was clear that these measures were not sufficient to diversify the economy and restore international competitiveness, particularly in light of the world-wide recession in the early 1980s. It became clear that the cost of the new policy in terms of general welfare was very high. By 1982 the Liberal government realized their investment policy's failure and a more relaxed attitude toward FDI was taken. However, it was not until the Conservative election victory in 1984 and the enactment of the Investment Canada Act in 1985 that Canada returned to its continental, FDI-friendly approach.

This thesis has explained the liberalization of Canadian FDI regulation after this rather short period of confrontation between the Canadian government and MNEs in the light of globalization. The globalizing world should be seen as the framework within which Canada and other countries have had to adjust and change to function efficiently. It took time for the process of globalization to reach a critical mass where it became obvious that a country, like Canada, could refuse to play the global game only at a very high price. This is not to argue that globalization cannot be countered under any circumstances. I have argued that globalization is a cyclical process; it is thus likely globalization will face another downturn at some point in the future. However, for the time being, the economic and political will to counter globalization is not very strong. For a single, small country the economic and welfare costs of resisting opening their economies to globalization are presently too high, as Canada discovered.
With increasing economic interaction and integration, the room for national public policies to diverge from the global trends has, thus, disappeared. MNEs consider their international investment prospects carefully and they carry out cost/benefit analyses to ensure that they invest where their profits will be greatest. With unrooted MNEs searching the globe for the optimal soil for growth, governments must consider their FDI regulations in relation to those of other states, if they wish to attract foreign investors. Thus, FDI regulations are converging around the world and countries are looking for new ways to stand out as desirable in the competition for FDI. Some examples of attractive features are a well-educated/trained workforce, excellent infrastructure, stable political system, and so on.

Globalization has different implications for different countries. Small, open economies like Canada's are finding it increasingly difficult to insulate themselves against global downturns, upturns and other fluctuations. If their policies are out of step with what is globally regarded as reasonable, they may face an increase in interest rates or a drop in the value of their currency. While it is imperative that all states at the end of the twentieth century be on top of global economic trends and technological developments, it is even more urgent for small states. For countries with a large extent of GDP coming from international exchanges the stakes are even higher. On the other hand, a large country like the U.S. has more flexibility in its policy options because of the size of its domestic market and the dominance of its currency. But the influence of global trends has become greater and greater, even on the world's largest and strongest states.

There are, of course, many reasons for the change from confrontation to cooperation in the relations between governments and MNEs. One of the most significant factors behind this development is the changing role of the state. The process of globalization has, in large part, redefined the role of the state. Cerny, for example, argues that globalization played a decisive role in the metamorphosis of
the welfare state into the competition state. The crisis of the welfare state lay in its decreasing capacity to insulate the national economy from the global economy, and the combination of stagnation and inflation which resulted when governments tried to insulate their economies. The world since then has seen the rise of the emergence of the competition state. Rather than attempting to take certain economic activities out of the market as the welfare state was organized to do, the competition state has pursued increased marketization in order to make economic activities located within the national territory, or which otherwise contribute to national wealth, more competitive in international and transnational terms. The main dynamics of this process have included attempts to reduce government spending in order to minimize the "crowding out" of private investment by state consumption and the deregulation of economic activities, especially financial markets. The result has been the rise of a new discourse and the practice of embedded financial orthodoxy, which is in turn shaping the parameters of political action everywhere.189 In Canada the dismantling of the welfare state is still under way, but the shift from compensatory liberalism to market liberalism started with some rethinking of foreign investment policy and trade policies by the Trudeau government in 1982. This shift was cemented by the Conservatives election victory in 1985.190

Another important factor behind foreign investment liberalization and the shift from confrontation to cooperation is a change in economic ideas and thinking. MNEs were for a time regarded as instruments of a neocolonial U.S. But since the mid-1970s there has been a major qualitative change in the United States' relationship with MNEs. Instead of being primarily a home country for MNEs, the U.S. is now, like most other advanced countries, both a home and a host to MNEs on a significant scale. Ironically, some of the resentment toward MNEs and FDI in

190Eden and Molot, 233.
the 1960s and 1970s have been mirrored in the U.S. after the FDI flows turned and outward and inward FDI stock got closer to balance.

In the early 1980s, neoclassical economic ideas came to the fore in large measure through the influence of Margaret Thatcher in the U.K. and Ronald Reagan in the U.S. This ideas changed the approach to international economics and role of the state in national economies. In Canada, neoclassical economics took over the agenda with the Conservative election victory in 1985. Essential for this change, however, was the deep recession Canada suffered in the early 1980s. The Keynesian approach failed to lift Canada out of this recession and the Conservatives were able to win election based on the inadequacy of the Liberal's policies.

Competition for FDI has become commonplace among governments because they are desperately attempting to increase jobs, tax revenues, and technical capacities and to reorganize entire industrial sectors. However, there is a threat of a "race to the bottom", i.e. an erosion in regulatory standards, when countries compete for international investment and underbid each other to get an edge in the negotiations with MNEs. In order to prevent this governments will have to cooperate in either harmonizing their regulations or setting minimum standards or permitting discriminatory treatment of domestic and foreign suppliers. In the absence of international, GATT-type rules and enforcement mechanisms to control competition in international markets and regulate the activities of companies, global corporations will be able to dictate more aggressively the economic and social agendas for even the largest industrialized countries. As for Canada, any interventionist economic strategy will be doomed to failure if it does not satisfy the demands of mobile and unregulated capital.

The average Canadian citizen's attitude toward foreign investment has changed in the last two decades, from anti-American, nationalist and protectionist

to at least resignation that globalization is happening whether Canada is along for the ride or not. Thus the change is not as enthusiastic at the grassroots as it has been at the level of political elites, who are back to busily selling Canada's virtues to potential foreign investors. At the grassroots, many misunderstandings remain from the time of the inflammatory, nationalist rhetoric of the 1970s. For example, it is still a common perception among many Canadians that foreign-owned firms remain branch plants selling entirely within the Canadian market. According to Rugman, this perception stems from the fact that the foreign-owned firms originally were set up to bypass Canadian tariffs. However, this perception is no longer accurate. The foreign-owned subsidiaries are, in fact, as involved in international trade activity as domestically-owned corporations. However, many Canadians are ambivalent about foreign-owned firms in Canada. They believe economic and political problems are associated with them, and consequently favor some form of government control. But they are also aware of the benefits that such firms can bring and are reluctant to see them leave. Although the Canadian public still is quite sceptical towards foreign ownership, especially American, and MNEs, it has kept governments with market liberalistic views in office since 1984. This might be the case because the public believes the benefits will outweigh the costs, because of a lack of alternatives, or because foreign investment is not a priority of the public anymore. But, it seems reasonable to believe that the new economic thinking, the new rhetoric, and the failure of the old policies have had an impact on public opinion as well.

The liberal position taken by the Canadian government since 1984 is clearly part of a world-wide trend. This trend reflects a variety of pressures and opportunities such as the economic adjustments posed by growing internationalization, a process in which MNEs often play a major role. In addition, Canada had other reasons for moving from negotiating commitments from such

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firms to providing a more attractive setting for both foreign- and domestically-owned MNEs. Some reasons are worth highlighting. Firstly, foreign control of Canadian industry fell steadily from 1970 to 1990. Secondly, MNEs have concentrated their investments in fewer markets during the last decade or so, with the U.S. being the major recipient. Competition for such investment by Canada and other countries has increased correspondingly. Thirdly, Canadian-owned MNEs have matured quickly. The accumulated stock of overseas investment by Canadian MNEs is increasing rapidly and the balance between the stocks of outward and inward FDI has improved remarkably.193

Canadian governments have often expressed concerns about direct investment that are common among host or recipient countries. The changes just noted have led Canadian authorities to emphasize some of the concerns of an important home country for MNEs, particularly the need for a more stable or less restrictive investment environment for such firms. A second concern has been that portion of Canadian direct investment in the U.S. that is attracted there, at least partly, to avoid actual or threatened protectionist measures. Home countries usually prefer that their firms export rather than invest abroad. In effect, the FTA reduced the incentive for production-induced direct investment in the U.S., while guaranteeing a more stable investment climate for other more important types of direct investment.194 Thus, the healthier balance between the stock of inward and outward FDI in Canada has influenced the policies on FDI. With the very unbalanced relation in the early 1970s, Canada's "host country" concerns were very understandable and the Canada's policy modifications grew out of them. When Canadian MNEs turned the FDI flows outward there was a threat that they would be stopped because of reciprocal measures from the host countries of Canadian FDI.

194Safarian, 1991a, 152.
The new policies reflect the fact that Canada is both a host and a home country for FDI.

Efforts by the Conservative government during its term in office definitely liberalized the political environment for inward FDI. In this regard, they were in keeping with the policy direction taken by many other governments around the world. Indeed, in the past decade, numerous countries have relaxed legislative restrictions on FDI and/or on other aspects of MNE activities. In part, this liberalization was undoubtedly a response to the severe world-wide recession of the early 1980s. However, it may also reflect an assessment on the part of host-country governments that the benefits of MNE investment are enhanced more by broad-based policies to promote efficiency in the host economy than by regulations applied specifically to MNEs. Such broad-based policies include reductions in tariff and non-tariff barriers and non-inflationary monetary and fiscal policies.

Policymakers in Canada have to recognize that the variables propelling globalization are largely beyond their control. Thus, they have no choice but to accept globalization and all of its ramifications and strive to reduce the threats posed by globalization and exploit the opportunities which are offered. In addition, government policymakers will have to encourage Canadian companies increasingly to pursue global strategies. Global strategies offer more options, and in an increasingly uncertain environment these options have a greater value.

In light of all of these developments since the 1970s, a reversal of the liberal stance on FDI is not very likely in Canada, at least as long as globalization continues on its upward trajectory. Canada has entered into several new international legal regimes, like FTA, NAFTA, and the OECD codes, that are liberal in character. These agreements represent structural changes that will make it difficult for Canada

to reverse its position unilaterally and take a protectionist stance on foreign investment whatever political changes might occur within the country.
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