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A RULE OF REASON FOR INWARD FDI: INTEGRATING CANADIAN FOREIGN INVESTMENT REVIEW AND COMPETITION POLICY

Grant Bishop†

SUMMARY

The Investment Canada Act (ICA) needs an overhaul. This reform must include a paradigm shift in thinking to a much less restrictive view about the benefits of foreign direct investment in Canada. Currently, the ICA operates under the presumption that foreign firms behave detrimentally to the Canadian economy: foreign acquirers are required to show "net benefit" to Canada and may need to make onerous commitments for maintaining output or employment. This attitude, a holdover from the ICA's predecessor, the Foreign Investment Review Agency, has created an atmosphere which fosters protectionism and relies on economically incoherent factors to assess the merit of proposed transactions. It is time to shed that archaic attitude and adopt a more reasoned perspective.

Rather than requiring each proposed transaction to provide proof for the specific benefit to Canada, the ICA should assume that foreign acquisitions benefit Canada unless there is proof to the contrary. A more welcoming, balanced and rational perspective would be that foreign acquisitions actually improve the productivity of Canadian companies and contribute to the well-being of Canada's economy.

The ICA is flawed in other ways, too. Some reviews of proposed transactions have become unnecessarily fraught with politics. Think of the recent politically enmeshed fretting over the bid that the state-owned Chinese Offshore National Company made for Nexen Energy, or Malaysia's state-owned Petronas' bid for Progress Energy Resources Corp. Indeed, there has been

† The author's analysis and arguments in this paper are his own and do not reflect the opinions of any present or past employer.

a very real fear of traditionally Canadian-owned institutions losing their Canadian essence to foreign ownership. Then, too, there is the federal government's built-in ability to impose onerous conditions, or undertakings, on foreign acquirers. All this is clearly a deterrent to potentially beneficial foreign investment in Canada.

Canada needs a new regime without nationalism, protectionism and politics. Ideally, this new regime would require decisions based on economically-grounded criteria, with the onus placed on the federal government to prove that a given transaction would be detrimental to the domestic economy. This would shift the government's role from its current one, in which the minister of innovation, science and economic development approves a proposal deemed to be beneficial to Canada, and has broad powers to withhold federal approval. This leaves the rejected foreign acquirer with no impartial avenue of appeal, such as a specialized tribunal. The reforms to the ICA should also include establishing a specialized tribunal where foreign acquirers can challenge negative decisions, just as the Competition Act provides a means for challenging antitrust aspects of mergers and acquisitions more broadly.

There is extensive empirical evidence demonstrating that foreign investment is beneficial to Canada because it results in improvements in productivity and competitiveness. As well, foreign-controlled firms in Canada pay higher wages, make large investments in R&D, innovation and skilled labour, experience fewer layoffs during economic downturns, and impart their technologies to domestic firms, among other benefits. Indeed, from 1980 to 1999, 2/3 of Canada's manufacturing sector labour productivity growth came from foreign-controlled companies, even though they comprised only 40 per cent of that sector's employment.

Not only could the Competition Act with its tribunal model serve as a framework for these much-needed reforms to the ICA, but, as well, reform of the ICA should similarly entrench the promotion of competition, economic efficiency and domestic welfare as its core objectives. That translates to not treating foreign investment as an end in itself, but as a means to promote economic efficiency through competition in both markets for products and corporate control.

OVERVIEW

Canada's current regime for reviewing foreign investments under the *Investment Canada Act* (ICA)[1] inefficiently shields Canadian companies from acquisition by foreign investors. Premised on assumptions that foreign firms act differently than Canadian firms, the current factors for assessing the net benefit from a transaction under the ICA are protectionist, economically incoherent and inconsistent with the evidence. In contrast with the ICA's current presumption that the benefits to Canada from foreign acquisition of Canadian assets need to be proven for each transaction, acquisitions by foreigners presumptively improve the productivity of Canadian companies and the overall Canadian economy.

Moreover, the ICA has been increasingly criticized for its perceived unpredictability and opacity. In its current state, certain reviews can become mired in political considerations, and the government's ability to impose undertakings on foreign acquirers creates the risk of rent-seeking by politically connected interest groups. To this end, the ICA regime should be reformed in order that: 1) proposed transactions would be reviewed on economically grounded criteria; 2) the onus would be on the government to show net detriment to domestic welfare; and 3) that a negative decision concerning a transaction could be challenged by a specialized tribunal (similar to the regime for reviewing mergers under the Competition Act).[2]

Canada's regime for foreign investment review

Currently, foreign commencement of a business or foreign equity investments that result in a change of control of certain Canadian business assets must be reported to the minister of innovation, science and economic development. Beyond specified thresholds,[3] the particular investment is subject to review and approval. Under the ICA, the minister is to review the proposed investment and approve the transaction if "satisfied that the investment is likely to be of net benefit to Canada."[4] As part of the review process, written undertakings to the minister by potential investors are permitted and the ICA provides for remedies against an investor who later contravenes an undertaking.[5]

The ICA sets out potential factors for the minister to consider, including "the level and nature of economic activity in Canada," "the degree and significance of participation by Canadians" and "the compatibility of the investment with national industrial, economic and cultural policies."[6] The minister thus has a broad and discretionary basis to deny any

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1 RSC 1985, c. 28 (1st Supp.) (ICA)

2 RSC 1985, c. C-34.

3 Pursuant to ICA, s. 14.1, as of April 24, 2015, the review threshold is $600 million in enterprise value for investments to directly acquire control of a Canadian business by WTO investors that are not state-owned enterprises; and by non-WTO investors that are not state-owned enterprises where the Canadian business that is the subject of the investment is, immediately prior to the implementation of the investment, "controlled by a WTO investor." This review threshold will increase to $800 million in enterprise value in 2017 and $1 billion in enterprise value in 2019, with annual indexation to nominal GDP growth after 2021. For acquirers that are state-owned enterprises, the review threshold for 2016 is $375 million in asset value.

4 ICA, s. 16 (1).

5 Ibid., s. 39-40.

6 Ibid., s. 20.

proposed transaction. As such, in an albeit dated decision of the Federal Court of Appeal, decisions under the ICA have been held not to be subject to judicial review by the federal courts, and although current authorities would likely permit judicial review, a court would likely take a high level of deference to the minister's determination, functionally insulating the decision from any substantive challenge.[7]

Criticisms of current ICA regime

In the wake of the rejection or withdrawal of several high-profile transactions and with anecdotal reports that undertakings under the ICA have recently intensified (so-called "undertaking creep"), concerns have been raised about whether the ICA is economically coherent in its approach to evaluating foreign equity investments and, specifically, whether it is deterring beneficial foreign investments from Canada.[8]

Several authors have argued for significant revisions to the ICA, ranging from increased transparency around the minister's decisions to a full reversal of the current onus to instead requiring the minister to demonstrate net detriment. Notably, the reversal of the onus was also a recommendation of the 2008 Competition Policy Review Panel (CPRP),[9] which the present federal government has not yet implemented. However, the CPRP notably did not spell out any procedural machinery to allow a proponent to challenge the minister's net detriment determination. Other commentators recommend largely cosmetic changes to the net benefit test, arguing that a more precise prescription of the factors will provide sufficient certainty while preserving allegedly politically desirable flexibility for the minister.[10]

However, most commentators broadly accept the ICA's basic structure and, even where recommending a reversal of the onus, do not consider the institutional and procedural complements to make a net detriment decision justiciable. More fundamentally, most scholarship has neglected to question the ICA's implicit assumptions about supposed differences in economic behaviour between foreign and domestic firms. That is, subjecting foreign acquirers of Canadian assets – but not domestic acquirers – to the net benefit test presupposes that foreign firms may use those assets in a manner that is suboptimal for the Canadian economy. This paper argues there is no theoretical or empirical basis for such a presumption.

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7 *Baril v. Canada (Minister of Regional Industrial Expansion)*, [1986] 1 FC 328 (CA). This decision was based on an earlier version of section 28 of the *Federal Courts Act*, RSC 1985, c. F-7 that conferred jurisdiction for judicial review only of decisions "required by law to be made on a judicial or quasi-judicial basis." In Baril at paras. 4-9, the Federal Court of Appeal held that the minister's decision under the ICA was not judicially reviewable since it was not a judicial or quasi-judicial decision. Under the current version of section 18.1 of the Federal Courts Act, decisions of federal boards, commissions or other tribunals (as discussed in *Canada (Attorney General) v. TeleZone Inc.*, [2010] 3 SCR 585, 2010 SCC 62 at para. 3), include ministers among the panoply of federal decision-makers. Nonetheless, the minister's determination of net benefit under the ICA has not been subsequently challenged, and, given the nature of the decision-maker and the breadth of the factors prescribed in the ICA, would presumably be subject to a high level of deference on any judicial review.

8 Susan M. Hutton and Megan MacDonald, "Stocking Canada's Foreign Investment Review Toolbox: The Future of the Investment Canada Act," *Canadian Competition Law Review* 24, 2012, 117; Lawrence L. Herman, "Investment Review in Canada – We Can Do Better," *University of Calgary School of Public Policy Research Paper* 4(10), 2011; and Philippe Bergevin and Daniel Schwanen, "Reforming the Investment Canada Act: Walk More Softly, Carry a Bigger Stick," *CD Howe Institute Commentary* 337, 2011.

9 Competition Policy Review Panel, *Compete to Win: Final Report* (Ottawa: Public Works and Government Services Canada, 2008).

10 Dany Assaf and Rory McGillis, "Foreign Direct Investment and the National Interest: A Way Forward," *IRPP Study* 40, April 2013.

More recently, A. E. Safarian[11] and Steven Globerman[12] have argued that this asymmetric treatment for foreign acquirers is economically harmful for Canadian businesses, contending that Canada should not screen foreign investments except on national security grounds. Similarly, Matt Krzepkowski and Jack Mintz have outlined the economic arguments for the greater openness of the Canadian economy to foreign direct investment.[13]

This paper builds on this work by examining the legal structure of Canada's ICA regime and proposing a route for economically coherent legislative reform. Unlike Safarian and Globerman, this paper allows that there may be economic grounds for disallowing a foreign acquisition where there is a demonstrable theoretical and evidentiary basis for a likelihood net detriment to Canadian economic welfare from that acquisition.

Need for economically grounded reforms

The ICA's net benefit standard imposes an additional hurdle for foreign acquirers relative to a domestic acquirer, reflecting a presumption that a foreign investor has different objectives and behaviour than does a Canadian investor. Since acquisitions of control by a comparable Canadian investor are permitted without review, investments by Canadians are implicitly assumed to produce net benefits for Canada (except where these are prohibited under competition law). Moreover, the net benefit factors imply that foreign investors inherently make different (and presumptively detrimental to the Canadian economy) decisions about their investments and production than do Canadian firms.

While the ICA purportedly serves economic objectives, history shows that Canadian foreign investment review is premised on expressly protectionist aims. Drawing from theory and empirical evidence concerning foreign investment in Canada, this paper argues that the ICA's present presumption against foreign investments is economically incoherent, being premised on a blanket distinction between foreign and domestic investors that has no basis in economic theory or evidence. Indeed, economic theory would generally regard many of the present net benefit factors – such as those that relate to output, competition and productivity – as presumptively enhanced by a successful acquisition of assets. That is, whether foreign or domestic, a successful bidder will only be willing to pay a control premium where it expects to enhance the profitability of the acquired assets, and, in the absence of market failures, the successful investor will only accrue enhanced returns by improving the productivity of those assets.

Consequently, the present ICA regime arguably insulates Canadian managers from the full discipline of an open market for corporate control. Without the risk of displacement by a hostile acquirer, boards of directors may not have full incentive to rectify the under-performance of their companies. Especially in Canada's marketplace where there have historically been few activist investors, the ICA may insulate Canadian corporate boards

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11 A. E. Safarian, "Simplifying the Rule Book: A Proposal to Reform and Clarify Canada's Policy on Inward Foreign Direct Investment," *CD Howe Institute Commentary* 425, May 3, 2015.

12 Steven Globerman, "An Economic Assessment of the Investment Canada Act," Fraser Institute, May 2015.

13 Matt Krzepkowski and Jack Mintz, "Canada's Foreign Direct Investment Challenge: Reducing Barriers and Ensuring a Level Playing Field in the Face of Sovereign Wealth Funds and State-Owned Enterprises," *University of Calgary School of Public Policy Briefing Papers* 3(3), 2010; and Matt Krzepkowski and Jack M. Mintz, "Squeaky Hinges: Widening the Door to Canadian Cross-Border Investment," *CD Howe Institute E-brief* 69, 2008.

from hostile acquirers. Indeed, industry participants have noted that the unpredictability and highly political character of the ICA regime have deterred foreign activist investors from challenging Canadian corporate boards.[14]

The diminished competitive intensity may provide a candidate explanation for the chronic under-investment in research and development by the Canadian business sector,[15] the noted lack of appetite for risk among Canadian managers,[16] and Canada's laggard productivity performance.[17] Indeed, to the extent that the ICA shields Canadian firms (and their managers) from the discipline of competitive product markets (for which the ICA comprises a barrier to entry for foreign firms) and a rigorous market for corporate control (whereby laggard boards would be displaced), the ICA is at odds with the objectives of Canadian competition policy.

However, even while foreign investment should be presumed to contribute net benefit, various market failures or domestic welfare concerns might provide an economic basis for denying particular acquisitions. To this end, this paper surveys various classes of theoretically grounded concerns about the economic behaviour of foreign investors. These include anti-competitive conduct, knowledge externalities, or barriers to effective regulation or taxation.

Nonetheless, none of these classes of concerns provides a presumptive basis against foreign investments in Canada. That is, most foreign investments will be undertaken to increase the productive use of assets and will thereby enhance the allocative efficiency of the domestic economy. Indeed, where the concerns are related to the market behaviour of a commercial actor, an economically consistent approach for rejecting certain foreign investments should require a testable theory of harm and supporting evidence as the basis for anticipating a reduction in economic efficiency from the proposed transaction.

Merger review under Competition Act provides a model

Foreign investment review should be procedurally and substantively reformed so as to parallel the regime that presently exists for the review of mergers under the Competition Act.

Specifically, in the context of merger review, the Competition Act provides a robust legal framework for a specialized tribunal to evaluate the economic implications of proposed transactions. Indeed, the Competition Act was born of the desire for an economically literate antitrust regime that could consistently adjudicate disputed transactions on the basis of the latest advances in economic theory and evidence. As Lawson Hunter has chronicled, the 1986 enactment of the Competition Act rejected a model for direct ministerial review of mergers on an ad hoc, discretionary (and potentially politicized)

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14 Scott Deveau, "How Canada's Foreign Investment Rules are Curbing Activism," *Financial Post*, Aug. 7, 2014, http://business.financialpost.com/investing/how-canadas-foreign-investment-rules-is-curbing-activism

15 Council of Canadian Academies, "Innovation and Business Strategy: Why Canada Falls Short - Report of the Expert Panel on Business Innovation," June 2009, http://www.scienceadvice.ca/innovation.html.

16 Institute for Competitiveness and Prosperity, "Management Matters," *Working Paper* 12, March 2009; and Bill Currie, Lawrence Scott, and Andrew Dunn, *The Future of Productivity: Clear Choices for a Competitive Canada*. (Toronto: Deloitte Canada, 2009).

17 Don Drummond, "Confessions of a Serial Productivity Researcher," *International Productivity Monitor* 22, 2011,7.

"public interest" basis in favour of an independent, justiciable regime for merger review, featuring standards formulated on the basis of economic principles and analysis.[18]

Reforming the ICA for economic coherence and justiciability

Drawing from the experience with merger review under the Competition Act, the ICA should be reformed to a review framework by:

- Specifying economically grounded evaluative criteria, based in industrial organization and international economics, as the basis for any rejection of a proposed transaction;
- Reversing the onus so as to require the minister or an independent agency to challenge a proposed transaction under these enumerated criteria as a net detriment; and
- Creating a specialized tribunal process – possibly integrated into the Competition Tribunal's jurisdiction – to provide a consistent and transparent adjudication of whether the government has met the net detriment burden to deny a particular transaction.

This paper does not attempt to prescribe legislative wording, but drawing from economic literature on multi-national enterprises, suggests a set of economically coherent policy bases that could inform evaluative criteria. Specifically, concerns about economic efficiency might support rejecting transactions on the following grounds:

- Competitive concerns, involving the unilateral or joint exercise of market power in domestic or import markets;
- Positive externalities, involving the location of business activities that yield quantifiably significant social benefits in excess of the private benefits;
- Irreplaceable inputs, involving specialized products, scarce resources or critical infrastructure that are essential for particular products and industries;
- Information asymmetries and regulatory costs, involving the inability to effectively monitor corporate governance or enforce compliance for a particular foreign investor;
- Fiscal consequences, where these involve an identifiably suboptimal allocation of productive resources in order to avoid domestic taxation; and
- Non-commercial considerations and influence by foreign states, involving decision-making by the foreign investor that is undertaken for political, rather than commercial, objectives.

In such a reformed regime, analogizing to the framework of the Competition Act, economic efficiency and domestic welfare maximization should guide the interpretation and application of such criteria. Analogous to the substantial lessening or prevention of competition test for denying a merger under competition law, a reformed ICA could adopt "net detriment to domestic welfare" as a justiciable standard for which economic theory and evidence could be similarly adduced.

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[18] Lawson A.W. Hunter, "The New Merger Provisions of the Competition Act: Certainty or a Random Walk?" *Canadian Competition Policy Record* 58, 8(4), 1987, 59-60.

While economic efficiency would have primacy under such a framework, acquisitions of designated cultural businesses and those triggering national security concerns would be evaluated under separate tests (as these are presently) than the net detriment standard for foreign investments generally.

This paper then proceeds as follows: 1) examining the political origins and evolution of Canadian foreign investment review, as well as notable recent reviews under the ICA; 2) presenting the theory and evidence regarding the economic impact of foreign investment in Canada; 3) summarizing the conceptual and institutional history of merger review under the Competition Act; and 4) evaluating the present ICA framework and detailing recommendations for reform.

FOREIGN INVESTMENT REVIEW IN CANADA

Origins of foreign investment review

Canada's foreign investment review regime, originally enacted as the *Foreign Investment Review Act* (FIRA),[19] was conceived during the rise of economic nationalism in the late 1960s and was politically motivated by fears of domination by foreign (particularly American) ownership of Canadian industry. While the rigid protectionism underlying the FIRA was tempered by the ICA's less restrictive review process after its enactment in 1985, the ICA retains many of the stated objectives (and implicit assumptions) of the earlier regime.

Michael Bliss and Stephen Azzi provide historical background to the political context and nationalist discourse that gave rise to FIRA.[20] Bliss observes Canada's historically open orientation to imports of foreign capital; however, beginning in the 1950s, he charts how Walter Gordon, a prominent Toronto business leader who was later to serve as finance minister in the Pearson government, spearheaded the rise of economic nationalism in Canada.[21]

Following anti-American backlash arising from then-industry minister C.D. Howe's support for a U.S.-owned firm to build the first trans-Canada natural gas pipeline, Gordon was appointed to chair the Royal Commission on Canada's Economic Prospects in 1957.[22] While providing rather modest recommendations (e.g., for enhanced job opportunities and fuller

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[19] SC 1973-74, c. 46.

[20] Michael Bliss, "Founding FIRA: The Historical Background," in *Foreign Investment Review Law in Canada*, James M. Spence and William P. Rosenfeld, eds., (Toronto: Butterworths, 1984),1-11; and Stephen Azzi, "Foreign Investment and the Paradox of Economic Nationalism," in *Canadas of the Mind: The Making and Unmaking of Canadian Nationalisms in the Twentieth Century*, Norman Hillmer and Adam Chapnick, eds. (Montreal and Kingston: McGill-Queen's University Press, 2007).

[21] Bliss, 3. Bliss recounts that: "In the mid-1950s Walter Gordon, a management consultant with deep roots in the Toronto business community and strong personal contact in the Liberal party, began voicing concern about the degree of American ownership in Canada. He was joined by a few other Canadian businessmen, including some Canadian-born executives of branch plants, who began to worry about the possibility of poor corporate citizenship creating nationalist resentment."

[22] Ibid., 3-4.

corporate disclosure), the commission's 1957 report encapsulated the nationalist sentiment that would underlie the FIRA.[23]

Re-entering cabinet in 1967, Gordon established the Special Task Force on the Structure of Canadian Industry, chaired by Melville Watkins. Its final report hypothesized potential costs for foreign control and, contending that "No other country … seems prepared to tolerate so high a degree of foreign ownership as exists in Canada,"[24] recommended a new national policy with the centrepiece of "a special agency … to co-ordinate policies with respect to multi-national enterprise"[25] so as to regulate the flow of capital alongside that of goods.[26]

Following the transition to the Trudeau government, further study was undertaken by Herb Gray with recommendations in 1972 to establish a screening agency to oversee foreign direct investments into Canadian whereby foreign takeovers would be flexibly reviewed for their costs and benefits for the Canadian economy. Gray's report was particularly concerned with research and development and the exploitation of economies of scale; indeed, contending that a foreign investment review process "ought to be used as an economically rational instrument."[27]

Review during the FIRA period

Bill C-132 enacted the FIRA, receiving assent in November 1973, and created the Foreign Investment Review Agency. According to the FIRA, it was adopted by Parliament "in recognition that the extent to which control of Canadian industry, trade and commerce has become acquired by persons other than Canadians and the effect thereof on the ability of Canadians to maintain effective control over their economic environment is a matter of national concern."[28] The FIRA applied both to acquisition and new businesses, and the FIR

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[23] Royal Commission on Canada's Economic Prospects, Final Report (Ottawa: Queen's Printer, 1957), 390:

> "At the root of Canadian concern about foreign investment is undoubtedly a basic, traditional sense of insecurity vis-à-vis our friendly, albeit our much larger and more powerful neighbour, the United States. There is concern that as the position of American capital in the dynamic resource and manufacturing sectors becomes ever more dominant, our economy will inevitably become more and more integrated with that of the United States. Behind this is the fear that continuing integration might lead to economic domination by the United States and eventually to the loss of our political independence."

Later serving as finance minister during the Pearson government, Gordon attempted to impose a 30 per cent take-over tax on foreign acquisitions of Canadian businesses in his 1963 budget but was forced to abandon the measure after widespread opposition (Bliss, 5).

However, by the late 1960s, Bliss contends that anti-American sentiments had gained currency, and "[t]he notion of Canada as an object of American 'imperialism' became increasingly widespread." (Ibid., 6). Prominent Canadian economists argued that Canada was being dominated by branch plants for which American parent companies made key decisions (Azzi, *supra* note, 75, citing, in particular, Kari Levitt, *Silent Surrender: The Multinational Corporation in Canada* (Toronto: Macmillan, 1970)) and, according to sociologist Gordon Laxer, "Surviving the Americanizing New Right," *Canadian Review of Sociology and Anthropology* 37 (1) 1999, 64, cited by Azzi, 76), economic nationalism "became part of what it meant to be Canadian."

[24] Foreign Ownership and the Structure of Canadian Industry, Report of the Task Force on the Structure of Canadian Industry (Ottawa: Privy Council Office, 1968), 363.

[25] Ibid., 395.

[26] Bliss, *supra* note 13, 6.

[27] *Foreign Direct Investment in Canada* (Ottawa: Information Canada, 1972), 453-454.

[28] FIRA, s. 2(1).

Agency was mandated to review and advise the minister of industry, trade and commerce, who in turn would report to cabinet for the ultimate approval on any reviewable investment.

Under FIRA, only foreign investments of "significant benefit" to Canada were to be approved and whether a takeover would result in "significant benefit" was assessed based on its contribution to job creation, Canadian participation in management, competition with existing industries, new technology, and compatibility with federal and provincial economic policies.[29] FIRA permitted and provided enforcement measures for undertakings with respect to any aspect of the conduct of a business, including employment, investment, research and development, participation of Canadian shareholders and managers, productivity improvements, domestic sourcing of purchases, manufacturing and exports.

Through the late 1970s and early 1980s, the FIRA came under increasing criticism for the long review periods and uncertainty of the review process, with the perception that commitments sought by the FIRA Agency, frequently at the minister's request, were commercially unreasonable.[30] Of the reviewable proposed acquisitions between 1974 and 1981, approximately 82 per cent of the applications concluded in an approval while nine per cent were disallowed and nine per cent were withdrawn.[31] Similarly, of the reviewable new business applications between 1976 and 1981, approximately 83 per cent concluded in an approval while nine per cent were disallowed and seven per cent were withdrawn.[32] Evidencing the prolonged review process, there was significant carry-over between years, ranging on average as roughly 30 per cent of each year's new cases during the interval. For potential foreign investors, Globerman observes that the regime added both indirect costs from the protracted review process and direct costs from complying with undertakings, arguing that the regime effected transfers from foreign investors to the beneficiaries of the undertakings.[33]

Furthermore, Globerman notes that Canadian investors increased the average size of their domestic acquisitions following FIRA's enactment, while the average size of foreign acquisitions declined. He argues that, to the extent that FIRA constituted a barrier for

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29 Ibid., s. 2(2). Specifically section 2(2) of FIRA enumerated the following five factors as the basis for the review:
(a) 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;
(b) the degree and significance of participation by Canadians in the business enterprise or new business and in any industry or industries in Canada of which the business enterprise or new business forms would form a part;
(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; and
(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.

30 W. B. Rose, "Foreign Investment in Canada: The New Investment Canada Act," *International Lawyer* 20, 1986, 21-22.

31 Steven Globerman, "Canada's Foreign Investment Review Agency and the Direct Investment Process in Canada," *Canadian Public Administration*, 27, 1984, 313, 317, citing Foreign Investment Review Agency, *Annual Report*, various issues.

32 Ibid., 318, citing FIRA, *Annual Report*, various issues.

33 Ibid., 319, 324.

potential foreign entrants, it increased the incentive for anti-competitive acquisitions by Canadian-owned firms and that this evidence of consolidation was crudely consistent with that hypothesis.[34]

As well, a 1983 GATT dispute settlement panel also found the frequent use of undertakings for domestic sourcing (reported as given in 70 per cent of approved investments for a sample of applications during 1980-1982) to be inconsistent with Canada's commitments for equal treatment of domestic and imported products under Article III:4 of the General Agreement on Tariffs and Trade.[35]

From 1980 to 1982, as a reflection of the Trudeau government's policies to seek increased Canadian ownership and control of the economy, the review process became markedly more onerous.[36] However, the onset of a domestic recession in 1982 compelled a policy shift towards the attraction of foreign investment, resulting in the replacement of the minister responsible for the FIRA and expedited procedures for smaller transactions.[37]

Enactment of the ICA regime

Aiming to distance itself from the FIRA's stigma with foreign investors, the Mulroney government enacted the ICA as its first major piece of business legislation, stating that it would send "a message to the world that, once again, Canada welcomes investment."[38]

The purposive clause of the new ICA reflected this intention for greater openness.[39] The ICA created a process with prescribed timelines and review thresholds in order to allow smaller transactions to proceed without review. As well, the ICA enhanced the clarity of what change-of-control transactions would be within the scope of review. Nonetheless, the Mulroney government anticipated that, while only 10 per cent of foreign investment transactions would face a review, 90 per cent of the transactional value of foreign investments in Canada would be subject to review.[40]

The primary change was to amend the previous significant benefit threshold to the net benefit standard. Importantly, the enumerated (but non-exhaustive) five factors[41] for the

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34 Ibid., 327.

35 Canada – Administration of the Foreign Investment Review Act, ACTL/5504 - 30S/140 (July 25, 1983, adopted on Feb. 7, 1984). BISD 30S/140, 1984.

36 Rose, *supra* note 25, 21.

37 Ibid.

38 Statement of the Hon. Sinclair Stevens, minister for the department of regional industrial expansion (Dec. 7, 1984), cited in George C. Glover, Jr., Douglas C. New, Marc M. Lacourciere, "The Investment Canada Act: A New Approach to the Regulation of Foreign Investment in Canada," *The Business Lawyer* 41, 1985, 83-84.

39 On its enactment, ICA, *supra* note 1, s. 2, read:

> "Recognizing that increased capital and technology would benefit Canada, the purpose of this Act is to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada."

2009 amendments to the ICA revised this statement to incorporate national security (SC 2009, c. 2, s. 445).

40 Glover et al, *supra* note 33, 98.

41 The present sixth factor, pursuant to ICA, *supra* note 1, s. 20(f), was later added: "the contribution of the investment to Canada's ability to compete in world markets."

evaluation of net benefit were a near repetition of those specified in the FIRA.[42] This eased standard was regarded as a key signal of receptiveness to foreign investment.

Evolution of review under the ICA

Indeed, while self-selection (as under the FIRA) may have continued, in the initial two decades of the ICA, almost all applications under the ICA were ultimately approved, with undertakings as the anecdotal exception rather than the rule prior to 2000.[43] From 1985 until 2008, of over 1,500 non-cultural reviews undertaken by the minister under the ICA, only one proposal was disallowed.[44] Baldwin, Gellatly and Sabourin conclude that the relaxation in the regulatory regime for foreign investment corresponded with a general increase in assets under foreign control compared with the FIRA era.[45]

Notably, prior to the 2009 amendments, the ICA did not mandate public reporting,[46] and statistics on applications, approvals and undertakings are not publicly available. Nonetheless, much of inward foreign direct investments would appear to be subject to notice and review under the ICA: between 2005 and 2010, transactions involving the control of assets totalling $394 billion were the subject of notifications (comprising $146 billion of assets, of which $4 billion were new businesses and the remainder acquisitions) or applications (comprising $247 billion of assets) under the ICA.[47] This represents approximately 84 per cent of the net change in the value of Canadian business assets under foreign control during the 2005-2010 period.[48]

Details of undertakings are not available owing to confidentiality concerns regarding commercially sensitive information; however, after 2000, commentators anecdotally noted an increased tendency for Industry Canada to seek undertakings (particularly for maintaining head offices, employment and capital expenditure levels) prior to approving transactions.[49] Since undertakings are confidential, the federal government's 2009 enforcement of undertakings against U.S. Steel – and the subsequent litigation concerning the penalties for non-compliance – provides unique insight into the content of recent undertakings. For its 2007 acquisition of Hamilton-based Stelco Inc., U.S. Steel had provided 31 undertakings, including two that required minimum annual steel production

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42 As observed by Glover et al, *supra* note 33, 95.

43 Hutton and MacDonald, *supra* note 6, 118.

44 CPRP, *supra* note 7, 29.

45 John R. Baldwin, Guy Gellatly, and David Sabourin, "Changes in Foreign Control under Different Regulatory Climates: Multinationals in Canada," *Statistics Canada Analytical Paper* 11-624-MIE — no. 013, 2006.

46 ICA, *supra* note 1, s. 38.1 now requires that: "The Director shall, for each fiscal year, submit a report on the administration of this Act, other than Part IV.1 [investments injurious to national security], to the Minister and the Minister shall make the report available to the public." Despite this statutory direction, only the annual report for 2009-2010 has yet been made available: http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk81126.html (as of June 28, 2013).

47 *Investment Canada Act Annual Report 2009-2010,* Industry Canada, http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk81132.html#iau . Reported figures represent the asset value of the Canadian business to be acquired, based on the corporation's most recent audited financial statements, not on the purchase price.

48 Based on calculations using Statistics Canada, CANSIM Table 179-0004 Corporations Returns Act (CRA), major financial variables, annual. Admittedly, gross changes in foreign control of Canadian assets would have been the more appropriate denominator; however, such statistics are not available in Statistics Canada's CANSIM tables.

49 Shawn C. D. Neylan, "Capital Inflows Should Count As a Benefit to Canada under the Investment Canada Act," *Canadian Competition Record* 21(4), 2004, 61.

of 4,345,000 net tonnes and maintained an average level of employment at the Canadian business of 3,105 employees on a full-time equivalent.[50]

Despite the somewhat rubber-stamp perception of the ICA, Hutton and MacDonald observe that overtures by the state-owned China MinMetals' 2004 to acquire Noranda Metals reinvigorated interest by Canadian businesses and politicians in use of the ICA to block certain foreign investments.[51] As the Chinese Canadian Business Council later observed, this proposed acquisition was met with a "national outpouring of anxiety that Chinese ownership would either represent risk to Canada's security of commodities supply or would ignore Canadian corporate law …"[52] The bid was withdrawn reportedly for commercial reasons, owing to MinMetals having failed to secure requisite financing.[53] However, the episode is regarded as the political impetus for the government to issue guidelines in 2007 for investments by state-owned enterprises (SOEs).[54]

Furthermore, foreign takeovers of certain prominent Canadian-owned businesses have given rise to waves of nationalist sentiment and concerns about the hollowing out of corporate Canada.[55] In the mid-2000s, foreign acquisitions of firms like Hudson's Bay Company, Alcan, Falconbridge, Inco and Algoma Steel were given as examples of this perceived trend. [56] Certain Canadian executives, such as Dominic D'Alessandro, then-CEO of Manulife Financial, urged government to adopt more restrictive policies toward foreign direct investment, and Gordon Nixon, CEO of Royal Bank, announced that: "We have not only seen the disappearance of major Canadian household names, but the loss of Canadian presence in industries where we have long had traditional strengths."[57]

Following the Harper government's 2007 budget commitment to undertake a review of Canada's competition policies and foreign investment review process, evaluation of the ICA framework's efficacy was made a key aspect of the CPRP's mandate.[58] During its review, the CPRP received wide-ranging submissions on the appropriate policy balance for foreign direct investments.[59] In its final report in June 2008, the CPRP rejected the contention that

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50 Details of the relevant undertakings are provided in *United States Steel Corporation v. Canada (Attorney General)*, 2011 FCA 176 at para. 9, aff'g 2010 FC 642.

51 Hutton and MacDonald, *supra* note 6, 119.

52 Letter of Canada-China Business Council, "Re: Canada China Business Council Submission to Competition Policy Review Panel," Jan. 11, 2008, Industry Canada http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/vwapj/Canada_China_Business_Council.pdf/$FILE/Canada_China_Business_Council.pdf .

53 Jacquie McNish, "The Great Canadian Mining Disaster," *Globe and Mail*, Nov. 25, 2006, http://www.globeinvestor.com/servlet/story/GAM.20061125.RINCOFINAL25/GIStory/commodities/ .

54 Hutton and MacDonald, *supra* note 6, 137.

55 Oliver Borgers and Emily Rix, "Foreign Investment Screening under Canada's Investment Canada Act," *Canadian Competition Law Review* 25, 2012, 468, 470; Hutton and MacDonald, 119.

56 "Is Corporate Canada Being Hollowed Out?" CBC, May 7, 2007, http://www.cbc.ca/news/pointofview/2007/05/is-corporate-canada-being-hollowed-out.html .

57 Ibid.

58 Competition Policy Review Panel, "Terms of Reference," 2007, Industry Canada, http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/eng/h_00004.html .

59 The CPRP's discussion paper, "Sharpening Canada's Edge," Oct. 30, 2007, Industry Canada, http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/eng/00014.html#issues summarized the policy context:

> "In its current form, the review mechanism under the ICA has raised concerns from foreign investors over a lack of predictability regarding how the net benefit test will be applied and what combination of factors is required to be met. On the other hand, the flexibility inherent to the net benefit test provides the minister with discretion to ensure, on a case-by-case basis, that the FDI serves Canadian interests as they evolve over time."

the ICA was unduly restrictive relative to Canada's peer economies, observing Canada's relatively high FDI/GDP among industrialized economies and citing a Conference Board analysis of effective investment restrictiveness.[60] Nonetheless, to address the perceived restrictiveness, the CPRP made several recommendations for reform of the ICA to enhance Canada's attractiveness to foreign capital without undermining safeguards for its national interests.[61] These included raising thresholds for review and uniformity of thresholds among industries.[62] As well, the CPRP recommended enhanced use of guidelines and enacting reporting obligations to improve transparency and predictability – particularly recommending that the minister be required to provide public reasons for any rejection.[63]

Significantly, the CPRP recommended amending relevant sections of the ICA from "net benefit to Canada" to "contrary to Canada's national interest" in order to reverse the ICA's onus.[64] Notably, the CPRP did not prescribe any procedural or institutional reforms to accompany this recommendation.

Just prior to the CPRP's final report, in May 2008, then-minister of industry Jim Prentice rejected the proposed acquisition of aerospace technology manufacturer Macdonald, Dettwiler and Associates Ltd. by Alliant Techsystems Inc., a U.S. aerospace and defence firm. Commentators observed that this was the first time that a proposed non-cultural acquisition was rejected since the ICA's 1985 enactment.[65] No public reasons were given for the rejection, but reports indicated that concerns were that the sale of MDA's Radarsat 2 satellite to a foreign investor would potentially compromise Canada's exercise of sovereignty over its Arctic territory.[66] While national security grounds were not at that time an explicit basis for rejection under the ICA, commentators hypothesized that the acquisition was refused on national security grounds.[67]

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60 CPRP, *supra* note 7, 29, citing Andrea Mandel-Campbell, "How Canada Stacks Up," Conference Board of Canada, 2008. This evaluation was presented in contrast to the OECD FDI restrictiveness index, in which Canada has ranked as more highly restrictive than other OECD economies. As the OECD recognizes, the index considers only statutory barriers and not effective institutional restrictions or less formal political interference in the review of investments.

61 Ibid., 31. CPRP endorsed the approach outlined in J. Timothy Kennish, "Evaluation of the Operation and Effectiveness of the Investment Canada Act and Recommendations for Changes to this Legislation," research paper prepared for the Competition Policy Review Panel, March 2008. Specifically:

> "The Panel believes that Canada should retain an investment review process, but it should be one of exceptional application in keeping with the practices of similarly situated industrialized countries. Consistent with Canada's legal traditions and our international reputation for sound governance practices, the review process should be predictable, timely and transparent."

62 CPRP, 31-32. Prior to the 2009 amendments to the ICA, separate thresholds applied to non-federally regulated financial services, transportation services (including pipelines) and uranium mining (so-called "sensitive sectors"). The minister of finance is responsible for the review and approval of foreign investments involving financial institutions regulated pursuant to the Bank Act and the Insurance Companies Act, and such foreign investments are exempt from review under the ICA.

63 Ibid., 33.

64 Ibid., 32. The CPRP contended:

> "A number of issues would be addressed by these changes. First, it would align the test with Canada's basic policy premise that FDI generates positive benefits for the country. Second, it would counter the negative and misleading perception that the ICA discourages — and that Canada does not welcome — FDI."

65 Mark Katz and Jim Dinning, "Developments in Canadian Merger Control and Foreign Investment Review," *Lexpert* 52, June 2009, 54, http://www.dwpv.com/~/media/Files/PDF/Developments_in_Canadian_Merger_Control_and_Foreign_Investment_Review.ashx,6 .

66 Ibid.

67 Ibid.

Following the June 2008 final report of the CPRP, the Harper government amended the ICA by enacting Bill C-10 in March 2009. The amendments followed many of the CPRP's recommendations – specifically, increasing the review thresholds, eliminating differential thresholds for sensitive sectors (except for cultural businesses), requiring the minister to report annually on the ICA's administration (although not stipulating the content of such reporting), requiring the minister to provide both opinions about proposed transactions on prescribed timelines, and mandating the minister to provide public reasons for the disallowance of any transaction. As well, the Bill C-10 amendments established a discrete review process for "investments injurious to national security."[68] However, Bill C-10 did not enact the CPRP's reversed-onus recommendation and the reason for this decision was not clear.[69] More recently, in Bill C-60, which received royal assent in June 2013, the government amended the basis for the ICA's review thresholds for most non-SOE investors to enterprise value from the previous book value basis. The CPRP had recommended the move to enterprise value to reflect the value of intangible property and goodwill that would not be reflected in an acquisition target's book value.

Subsequent to the 2009 amendments, several other high-profile proposed foreign investments have raised the prospect of disallowance under the ICA. The 2010 bid by Australian mining company BHP Billiton for Potash Corporation came under intense public scrutiny, with the Saskatchewan government speaking publicly against the proposed transaction. According to MacKinnon, the company was a "swing producer" of potash, with its production influencing the worldwide price of the commodity, and the Saskatchewan government worried that a foreign acquirer might extract potash at a pace that would threaten provincial royalties.[70] In November 2003, the minister sent a notice to BHP, advising that the federal government was not satisfied that the acquisition would be of net benefit to Canada and providing 30 days for BHP to make additional representations and undertakings.[71] Ten days later, BHP withdrew the bid,[72] and, since no final decision was reached, the minister did not provide public reasons for his preliminary notice.

The bid by the London Stock Exchange for the Toronto Stock Exchange also raised public concern regarding the relocation of the merged group's headquarters, and the Ontario government expressed concern about the transaction, publicly referring to the TSX as a "strategic asset."[73] No decision was reached under the ICA since TSX shareholders rejected the proposed transaction in late June 2011.[74]

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68 Incorporated as ICA, *supra* note 1, part IV, 1.

69 Sandra Walker, "Amending the Investment Canada Act: An Assessment of the Government's Response to the Wilson Report," *Canadian Competition Record* 30, 2009, 33.

70 Janice MacKinnon, "The Potash Takeover Bid: The Deal that Wasn't," *Policy Options* 49, December 2010, 50.

71 "Minister of Industry Confirms Notice Sent to BHP Billiton," Nov. 3, 2010, Industry Canada, http://www.ic.gc.ca/eic/site/064.nsf/eng/06031.html .

72 Brenda Bouw, Tim Kiladze, and Steven Chase, "BHP Withdraws Potash Bid," *Globe and Mail*, Nov. 14, 2010, http://www.theglobeandmail.com/globe-investor/bhp-withdraws-potash-bid/article565929/#dashboard/follows/ .

73 Mark Katz, Elisa Kearney, and James Dinning, "Foreign Investment: A Recurring Nightmare for the Canadian Government?" 2011, https://www.dwpv.com

74 Boyd Erman and Karen Howlett, "Shareholders Reject Proposed Merger of TMX and LSE," *Globe and Mail*, June 29, 2011, http://www.theglobeandmail.com/globe-investor/shareholders-reject-proposed-merger-of-tmx-and-lse/article584975/#dashboard/follows/ .

Most recently, the concurrent bids by China's state-owned Chinese National Offshore Oil Company Ltd. for Nexen Energy and Malaysia's state-owned Petronas for Progress Energy Resources Corp. attracted substantial public interest. Although the government ultimately approved the acquisitions, the approval followed arguably politicized public discussion of the transaction.[75]

In respect to the transactions themselves, the federal government also announced that both acquirers had made significant undertakings, relating to governance, transparency and disclosure, commercial orientation (including "an adherence to Canadian laws and practices as well as free-market principles"), employment and capital investments.[76]

When approving the acquisitions in mid-December 2012, the government simultaneously issued a policy statement and revised guidelines for SOEs, also stating that: "Investments by foreign SOEs to acquire control of a Canadian oilsands business will, going forward, be found to be of net benefit on an exceptional basis only."[77] According to the revised guidelines, "investors will be expected to address in their plans and undertakings, the inherent characteristics of SOEs, specifically that they are susceptible to state influence. Investors will also need to demonstrate their strong commitment to transparent and commercial operations."[78]

Additionally, Bill C-60, receiving assent in June 2013, introduced a definition for "state-owned investor,"[79] specific review thresholds for SOEs,[80] and provision for the minister to deem an entity controlled by an SOE.[81] The Canadian Bar Association had criticized these amendments as creating further investor uncertainty because of the broad reach of the SOE definition and the ministerial discretion for deeming an acquisition to involve an SOE.[82]

75 The opposition NDP called for public hearings regarding the transactions, and Justin Trudeau (then a candidate for the federal Liberal party leadership) publicly endorsed the acquisitions. John Ibbitson, "What Would the Opposition Have Done Differently With CNOOC-Nexen?" *Globe and Mail*, Dec. 11, 2012, http://www.theglobeandmail.com/news/politics/what-would-the-opposition-have-done-differently-with-cnoocnexen/article6189130/#dashboard/follows/ .

76 "M&A Update: Investment Canada Act: SOE Guidelines and CNOOC-Nexen," Stikeman Elliott, Dec. 17, 2012, http://www.stikeman.com/cps/rde/xchg/se-en/hs.xsl/17141.htm

77 "Government of Canada Releases Policy Statement and Revised Guidelines for Investments by State-Owned Enterprises," Industry Canada, Dec. 7, 2012, http://news.gc.ca/web/article-eng.do?nid=711489 .

78 Industry Canada, *Investment Canada Act Guidelines: Investment by State-Owned Enterprises - Net Benefit Assessment*, Dec. 7, 2012, http://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/lk00064.html#p2 .

79 ICA, s. 3 "state-owned investor."

80 ICA, s. 14.1 (1.1).

81 ICA, s. 26 (2.31).

82 Letter from CBA - Competition Law Section to Industry, Science and Technology Committee and the National Finance Committee, May 17, 2013, Re: Bill C-60 — Part 3, Division 6 - Investment Canada Act Amendments, CBA, http://www.cba.org/CBA/submissions/2013eng/13_25.aspx .

THE ECONOMIC BASIS FOR FOREIGN INVESTMENT REVIEW

Empirical evidence on foreign direct investment

Despite public concerns about deleterious effects from foreign investments into Canada, the evidence is strongly that the foreign inflow of capital benefits the Canadian economy – particularly with respect to the direct productivity improvements and indirect competitive intensity for which foreign-controlled firms are responsible. Baldwin and Gellatly provide an extensive survey of the empirical evidence from Statistics Canada programs.[83] They outline the following conclusions:

- Compared to domestic firms, foreign-controlled firms are generally larger, have higher labour productivity, have greater capital intensity, pay higher wages and employ greater numbers of non-production workers. Such performance advantages persist even controlling for size and industry;
- Foreign-controlled firms are more likely to have a Canadian head office than are domestic firms, and foreign takeovers have indeed contributed to a net gain in head offices. Moreover, foreign establishments do not tend to be truncated branch plant operations, but rather make large investments in knowledge capital (i.e., innovation, advanced technology and skilled labour) in order to compete in innovation-intensive industries (indeed, exhibiting the incentives for "endogenous technological progress");[84]
- Compared to domestic firms, foreign-controlled firms are more likely to use advanced technologies, have a research and development division and to introduce world-first (rather than imitative) innovations;
- Foreign-controlled firms gravitate to industrial sectors where they can exploit comparative advantages (particularly where there are returns to scale and capital intensity or where competition involves technological innovation);
- Foreign-controlled firms have contributed to aggregate productivity gains in three ways: 1) by displacing less productive plants by competition for market share (particularly of importance during the 1980s and 1990s); 2) by diffusing new technological capabilities to domestic firms (so-called "knowledge spillovers"); and 3) restructuring following the acquisition of domestic assets.[85]

Several other empirical observations regarding foreign-controlled firm behaviour in Canada are particularly notable. First, following the free trade agreement (FTA) with the United States, foreign-controlled plants demonstrated greater plant-level specialization than did domestic plants, evidencing a productivity-enhancing restructuring to adapt to competition

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[83] John R. Baldwin and Guy Gellatly, "Global Links: Multinationals in Canada: An Overview of Research at Statistics Canada," *Statistics Canada Research Paper*, Catalog no. 11-622-MIE, no. 014, November 2007, http://www5.statcan.gc.ca/bsolc/olc-cel/olc-cel?catno=11-622-MIE2007014&lang=eng .

[84] Technological progress is "endogenous" in the sense that productivity-enhancing innovations occur as a result of risky investments in R&D for which any rational innovator requires an ultimate economic incentive.

[85] Baldwin and Gellatly, *supra* note 72, 7-10.

and rationalize integrated supply chains.[86] Such specialization was most apparent in industries that witnessed the greatest tariff reductions under the FTA, a finding consistent with the theoretical prediction of positive impacts from trade liberalization on productive efficiency.[87]

Second, following from more intensive investments in knowledge capital by foreign-controlled firms, establishments of foreign multinationals have more stable output in response to declining demand and lower employment volatility in response to output changes (i.e., fewer layoffs during downturns) than do domestic firms.[88]

Third, in manufacturing industries, foreign-controlled firms demonstrate a tendency towards entry by acquisition of existing assets rather than green-field construction of new plants, thereby contributing to productivity by restructuring operations and transferring market share to more efficient operations.[89] With higher plant productivity than domestic counterparts, foreign-controlled firms contributed roughly 2/3 of Canada's manufacturing sector labour productivity growth during 1980 to 1999 while only comprising 40 per cent of that sector's employment.[90]

Fourth, in the pursuit of innovation, foreign-controlled firms have comparable research linkages with universities relative to domestic firms, and foreign multinationals both engage intra-firm research networks and rely on domestic R&D units to a greater extent than domestic counterparts.[91]

Fifth, foreign-controlled firms also appear to contribute forward (downstream) and backward (upstream) spillovers to domestic productivity performance via inter-industry linkages.[92] Such spillovers may accrue from improvement in the quality or complementarity of intermediate inputs, or from intensified competition among domestic firms to supply to, or distribute for, the more productive foreign entrants.

Theoretical impacts of foreign investments

These empirical observations raise questions about the reasons for the differential performance of foreign-controlled firms operating in Canada. Rao, Souare and Wang

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[86] John R. Baldwin, Desmond Beckstead, and Richard Caves, "Changes in the Diversification of Canadian Manufacturing Firms and Plants (1973-1997): A Move to Specialization," *Statistics Canada Analytical Studies Branch Research Paper Series*. Catalog no. 11F0019MIE2002179, 2001.

[87] John R. Baldwin, Richard E. Caves, and Wulong Gu, "Responses to Trade Liberalization: Changes in Product Diversification in Foreign- and Domestic-controlled Plants," *Statistics Canada Economic Analysis (EA) Research Paper Series*, Catalog no. 11F0027MIE2005031, 2005.

[88] John R. Baldwin and Naginder Dhaliwal, "Labour Productivity Differences Between Domestic and Foreign-Controlled Establishments in the Canadian Manufacturing Sector," *Statistics Canada Analytical Studies Branch Research Paper Series*, Catalog no. 11F0019MIE2000118, 200.

[89] John R. Baldwin and Wulong Gu, "Plant Turnover and Productivity Growth in Canadian Manufacturing," *Industrial and Corporate Change* 15, 2006, 417.

[90] Baldwin and Gu, "Global Links: Multinationals, Foreign Ownership and Productivity Growth in Canadian Manufacturing," *Statistics Canada: The Canadian Economy in Transition Series*, Catalog no. 11-622-MIE2005009, 2005.

[91] John R. Baldwin and Petr Hanel, "Multinationals and the Canadian Innovation Process," *Statistics Canada Analytical Studies Branch Research Paper Series*, Catalog no. 11F0019MIE2000151, 2000.

[92] Wulong Gu and Yanling Wang, "FDI, Absorptive Capacity, and Productivity Growth: The Role of Inter-Industry Linkages," August 2006, SSRN, http://ssrn.com/abstract=924771 .

provide a survey of the economic explanations for the observed investment by certain multinational firms in acquisition of assets in foreign jurisdictions.[93]

In general, the literature explains this behaviour by two classes of models for multinational firms, in which the foreigner's decision to invest directly (rather than contracting with a domestic firm) results from: 1) some market failure that prevents a firm with firm-specific intangible assets (e.g., unique technology or managerial practices) from capturing the surplus by exporting or licensing; or 2) the allocation of steps of production according to the comparative advantages of different jurisdictions, while integrating of the steps within a single firm (acting as a contractual nexus) in order to solve contracting/monitoring problems.[94] The former class of model, following Krugman, explains horizontally integrated multinationals as engaged in a trade-off between geographic proximity to markets and economies of scale in centralized production; the latter class, following Helpman, explain vertically integrated multinationals as allocating production based on differences in productive factors and their costs.[95]

Absent some additional market failure, either class of explanation would generally indicate the *prima facie* efficiency of inward FDI. For horizontal acquisitions, foreign expansion into a domestic market would eliminate the double-marginalization that exists where the relevant product is exported or licensed and result in greater allocative efficiency. For vertical acquisitions, production is rationalized according to the comparative advantage of the given economy and, by reducing contractual frictions, the vertically integrated firm provides a channel for a more efficient allocation of resources and consequent gains from trade.

Where such horizontal or vertical integration is a foreign entrant's objective, any attempted acquisition of domestic assets should also be efficient (absent additional market failures). A rational investor will only bid a premium to acquire control of assets equal to the expected gain in returns from the acquisition, and, in general, a successful foreign investor (i.e. one who is willing to pay a premium for control of Canadian assets) must then expect to improve the productivity of the acquired assets.

Importantly, the present inclusion of the effect on employment as a factor in the evaluation of net benefit lacks an economic basis. To the extent that the factor is concerned with employment levels in the given enterprise, this consideration (and any complementary undertakings) is at odds with firm-level incentives to enhance productivity. Undertakings to maintain particular levels of employment and output (such as those enforced against U.S. Steel) inhibit firms from adjusting production and re-allocating labour in order to boost plant productivity. Research demonstrates the importance of labour reallocation (and particularly that within plants) as part of the creative destruction process for productivity

93 Someshwar Rao, Malick Souare and Weimin Wang, "Canadian Inward and Outward Direct Investment: Assessing the Impacts" in *Trade Policy Research* (Ottawa: Minister of Public Works and Government Services, 2010) ZDB-ID 20947239 315.

94 Ibid., 321-322.

95 Ibid., 323, citing Paul R. Krugman, "The 'New Theories' of International Trade and the Multinational Enterprise," in *The Multinational Corporation in the 1980s*, Charles P. Kindelberger and David B. Audretsch, eds., (Cambridge: MIT Press, 1983); and Elhanan Helpman, "A Simple Theory of International Trade with Multinational Corporations," *Journal of Political Economy* 92, 1984, 451.

improvements.[96] While distributional concerns and buffers for employment disruptions are important policy considerations, these should not be the focus of foreign investment review but rather addressed through fiscal measures for progressive income redistribution and social insurance.

Theoretically, the rational acquisition and reallocation of domestic assets by foreign entrants should *prima facie* enhance productivity of the assets themselves and intensify competition within the relevant industry. Absent additional market failures, such unit cost reduction would improve consumer surplus and, in competitive labour markets, wage gains should accrue with increases in labour productivity. However, such transitions would also involve short-term disruptions to firm-level employment as labour is reallocated. Yet, while foreign entry might intensify these processes, the efficient allocation of production within firms and displacement of laggard competitors is the broad objective of competition policy.

Channels for reduction of domestic welfare by foreign investments

Caves summarizes economically grounded policy justifications for the regulation of foreign investment.[97] As a preliminary, Caves notes that a domestic government is concerned with maximizing domestic income rather than global income. Notably, where the efficient allocation (for which domestic output and global welfare are maximized) diverges from the maximization of domestic income for a particular economy, a self-interested country would rationally pursue policies that produce the greatest increase in domestic income, even if less efficient.[98]

Drawing from Caves' arguments, there may be grounds to regulate particular foreign investments to the extent that a foreign acquirer might make use of particular assets in a manner that is suboptimal for the domestic economy. Again, given firms' profit- (and productivity-) maximizing aims in any acquisition, foreign acquisitions are presumptively beneficial for the Canadian economy. However, there may be circumstances in which there is a theoretical and evidentiary basis to believe that the acquired domestic assets might be utilized in a manner detrimental to aggregate domestic welfare.

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96 Steven Davis and John Haltiwanger, "Gross Job Flows," *Handbook of Labor Economics*, vol. 3(B) (Philadelphia: Elsevier, 1999), Chapter 41, 2,711, 2,761-2,768.

97 Richard E. Caves, *Multinational Enterprises and Economic Analysis*, (Cambridge: Cambridge University Press, 2007), 290-295.

98 Ibid., 290.
For example, J. N. Bhagwati and R. A. Brecher, "National Welfare in an Open Economy in the Presence of Foreign-Owned Factors of Production," *Journal of International Economics* 10, 1980, 103, provide comparative statics for domestic welfare before and after trade liberalization (notably, using models that do not incorporate endogenous technological progress): where foreigners supply capital, citizens supply labour and goods are capital intensive, trade liberalization may have the effect of diminishing domestic income as returns to capital rise and relative wages fall. Such a conclusion would need qualification where there were dynamic improvements in labour productivity from endogenous innovation. As well, withholding taxes on foreign repatriation of domestically sourced capital income could arguably be used to mitigate a portion these impacts – albeit with an efficiency/domestic welfare trade-off.
Additionally, following from the potential divergence in efficiency and domestic income, a purely self-interested country, who is concerned only with static (rather than dynamic) gains, should seek to monopolize its sales abroad while monopsonizing its foreign purchases. Similarly, such a self-interested economy would seek to ensure that economic rents from domestic technological advances or natural resources are captured domestically. However, Caves also observes the practical difficulty with enabling market power for such "national champions" vis-à-vis foreigners while safeguarding competitive domestic markets.

For example, there are several categories of rational conduct by foreign multinationals where domestic welfare could conceivably be impaired:

- The multinational might have anti-competitive motives, acquiring assets or establishing a business in order to exercise market power or raise costs for competitors. Such a prospective monopolist would be willing to pay a control premium for assets that reflects the expected monopoly profits and would outbid any competitive entrant whose expected profit from the acquisition would be limited to expected productivity gains;
- The particular assets might yield identifiable positive externalities for the domestic economy. For example, providing irreplaceable intermediation services for financial transactions or providing empirically quantifiable cluster effects or knowledge spillovers. If economies of scale are involved in R&D activities, there might be reason to suspect that a foreign acquirer would not take account of these externalities for the domestic economy when locating business activities and might centralize these in a foreign jurisdiction;
- Induced innovation models, where the direction of technological change responds to relative factor prices, also flag possible circumstances where a foreign multinational might not innovate optimally for the domestic economy. Specifically, with technological innovation requiring fixed R&D costs, multinationals might centralize R&D activities and innovate for the factor prices of a larger foreign market, resulting in a second-best innovation for the domestic market;[99]
- The impact on taxation revenues or regulatory effectiveness as a result of the changed structure of commercial activities may also be a concern. Domestic regulators might face informational asymmetries regarding the corporate governance of the given multinational, making enforcement difficult. The structure of intra-corporate activities to avoid domestic taxation might be a particular concern. As well, where rents from innovation or resource extraction are concerned, a government might be concerned that the multinational would structure worldwide production in a manner that minimized the rents accruing in the domestic economy;[100]
- Finally, there might be concerns about non-commercial considerations in decision-making by a controlling entity – for instance, where the acquirer's management has a high degree of integration with a foreign government with geopolitical aims. Notably, a foreign government's aim to secure particular inputs for its economy would not necessarily be an inefficient objective,[101] unless there was some anti-competitive effect of excluding other willing buyers from essential inputs.

[99] Syed Ahmad, "On the Theory of Induced Invention," *The Economic Journal* 76, 1966, 344, provides the seminal theory. Notably, Ian Keay, "Scapegoats or Responsive Entrepreneurs: Canadian Manufacturers, 1907-1990," *Explorations in Economic History* 37, 2000, 217, does not find historical evidence of such suboptimal technological change within Canadian manufacturing.

[100] For instance, where a multinational controls resource deposits in multiple jurisdictions and can influence the price of the commodity, it might have incentive to limit production in order to increase its economic rents and would allocate production to the lower royalty jurisdiction.

[101] For instance, to the extent that a state-influenced foreign firm sought to channel particular commodities to its home economy, it would face the opportunity cost of the going market price at which the commodity could have otherwise been sold.

COMPETITION LAW AS A MODEL FOR FOREIGN INVESTMENT REVIEW

While foreign investment is presumptively beneficial for the domestic economy, the previous section outlined circumstances in which there may be economically grounded policy bases for rejecting certain foreign acquisitions. The conceptual evolution of Canadian competition policy provides an analog for the reform of the ICA around economically coherent objectives.

As McFetridge recounts, the enactment of the Competition Act in 1986 ushered in a modern regime in which economic analysis was to be central in the design, interpretation and enforcement of competition policy.[102] As Hunter explains, the act put in place an economically literate regime for merger review, in which "the law is essentially an attempt to map the principles of industrial organization onto the legislative words and processes enacted by Parliament."[103] Economic scholarship has continued to guide the evolution of the modernized regime, informing amendments to the act that reformed provisions which were at odds with economic theory and which enhanced the scope for economic analysis.[104] Even more fundamentally, after being bedevilled by multiple disparate goals, Canadian competition law has converged on the predictable and logical objective of efficiently allocating society's productive resources.[105]

Indeed, the centrality of economic efficiency was set out in the 1969 report of the Economic Council of Canada, which provided the impetus for the modernization of Canadian competition law.[106] To this end, the council had recommended a two-track approach whereby criminal sanctions apply only to a limited range of per se illegal offences. For the reviewable practices track, the council recommended "the presumption would be that while the practices could well be harmless or even beneficial to the public in some circumstances, they could be harmful in others,"[107] and proposed the creation of a civil tribunal to review whether mergers and certain trade practices were "on balance in the public interest."[108]

Prior to 1986, mergers could be challenged pursuant to the monopolization offence in the Combines Investigation Act (CIA).[109] However, without evaluative criteria, the public detriment element of the offence proved an impediment to challenging mergers under the CIA – particularly given the criminal standard required.

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[102] Donald G. McFetridge, "Economics and Canadian Competition Policy," *Canadian Competition Law Review* 25, 2012, 540.

[103] Hunter, *supra* note 13, 60.

[104] McFetridge, 541.

[105] Ibid., 557-558, citing Thomas Ross, "Viewpoint: Canadian Competition Policy: Progress and Prospects," *Canadian Journal of Economics* 37, 2004, 252.

[106] Economic Council of Canada, *Interim Report on Competition Policy* 19*,* (Ottawa: Queen's Printer, 1969) :

> "Essentially we are advocating the adoption of a single objective for competition policy: the improvement of economic efficiency and the avoidance of economic waste, with a view of enhancing the wellbeing of Canadians."

[107] Ibid., 120.

[108] Ibid., 109-113.

[109] RSC 1970, c. C-23 [CIA], s. 33. Under CIA, s. 1, "monopoly" was defined as a situation where:

> "one or more persons either substantially or completely control throughout Canada or any area thereof the class or species of business in which they are engaged and have operated that business or are likely to operate it to the detriment or against the interest of the public …"

After several abortive attempts to reform competition law (culminating in the decision by the Trudeau government to stage amendment), the Mulroney government finally enacted the Competition Act and Competition Tribunal Act in 1986. Largely following the Economic Council of Canada's recommendations, Bill C-93 established the two-track approach and constituted the tribunal as the specialized adjudicative body, specifically intended to evaluate anti-competitive conduct through the lens of the statute's economic objectives.[110] Importantly, the Competition Act's purposive clause describes the promotion of competition, not as an end in itself, but as a means of achieving broader economic objectives – in particular, the efficiency of the Canadian economy.[111]

The new Competition Act bifurcated responsibilities: the Competition Bureau, under the Commissioner of Competition, is mandated to investigate and bring applications against anti-competitive behaviour; and, failing a negotiated resolution, the tribunal adjudicates any impugned conduct with independence and impartiality.

In formulating the Competition Act, direct ministerial oversight of mergers (analogous to the FIRA regime) had been considered and rejected as a model for merger review, owing to the uncertainty and potential for abuse in such a direct approach.[112] With the regime instead designed to safeguard the independence of both the commissioner and the tribunal, the drafters of the Competition Act aimed to ensure that decisions regarding challenges to mergers are made without political interference.[113]

Bestowing jurisdiction on the tribunal to assess the competitive effects of mergers, the 1986 amendments replaced the CIA's public detriment standard with the "reasonably likely to cause a substantial prevention or lessening of competition" (SPLC) test.[114] Section 93 of the Competition Act also sets out "an open-ended list of principled and economically literate factors to be used in assessing the likelihood of a so-called SPLC,"[115] and section 96 provides an explicit efficiency defence. As McFetridge observes, this established a "rule of reason analysis of mergers" with the tribunal directed to block those mergers where the SPLC resulting from the merger does not also result in efficiencies that offset these effects.[116]

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110 Minister of Consumer and Corporate Affairs, *Competition Law Amendments: A Guide* (Ottawa: Supply and Services Canada, 1985), 3:

> "The adjudication of civil matters by a specialized Competition Tribunal will permit more sophisticated judgment, a better understanding of the business reality, a more flexible process, and, above all, timely decision-making, which is consistent with the policy underlying the [Competition Act]."

111 Competition Act, s. 1, which reads:

> "The purpose of this Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy, in order to expand opportunities for Canadian participation in world markets while at the same time recognizing the role of foreign competition in Canada, in order to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide consumers with competitive prices and product choices."

112 Hunter, *supra* note 13, 60.

113 Ibid., 61.

114 Competition Act, s. 92.

115 Paul Collins and Michael Laskey, "Striking the Right Balance: 25 Years of Merger Review in Canada," *Canadian Competition Law Review* 25, 2002, 419-421.

116 McFetridge, *supra* note 91, 543.

Economic analysis has provided robust methodologies for the definition of geographic and product markets involved in mergers and the quantitative evaluation of competitive effects.[117] Economic theory and analysis also notably shaped the tribunal's application of the efficiency defence as exhibited by the Superior Propane case,[118] where the tribunal was required to determine the appropriate approach for balancing the expected anti-competitive effects of the merger against the prospective efficiency gains. Notably, in the recent Tervita case,[119] the Supreme Court discussed at length the commissioner's evidentiary burden for quantifying anti-competitive effects,[120] as well as affirmed the appropriateness of a forward-looking "but for" analysis of future market conditions by the tribunal in evaluating the prevention of competition through a merger. Even with open-ended evaluative criteria, the tribunal has made appropriate and rigorous use of economic analysis to regulate mergers in accordance with the statute's economic objectives.

Admittedly, the merger review process has produced relatively few decisions by the tribunal; since 1986, only six cases have been fully adjudicated.[121] Arguably, this was an intention of the design that encourages settlement but provides a consistent and principles-based litigation process where the acquirer and the commissioner cannot reach

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117 Ibid., 546-548.

118 Canada (Commissioner of Competition) v. Superior Propane Inc., 2000 Comp. Trib. 15 [Superior Propane (Tribunal)], rev'd by 2001 FCA 104 [Superior Propane (FCA)], redetermined by 2002 Comp. Trib. 16 [Superior Propane (Redetermination)].

The protracted contest involved an appeal by the competition commissioner to the Federal Court of Appeal (FCA) from the tribunal's decision and, after the FCA upheld the appeal, a redetermination by the tribunal. At primary issue was whether, in the balancing analysis for efficiency v. diminished competition, differential weights should be assigned to producer and consumer surplus or whether a "total surplus" standard should be employed.

Ultimately, the tribunal in Superior Propane (Redetermination) reiterated the view that the paramount objective of merger review under the Competition Act is economic efficiency (rather than consumer protection) (Superior Propane (Redetermination), Ibid., para. 343). Even while the FCA had directed a "balancing weights" approach, economic reasoning and evidence provided the basis for a consistent application of efficiency defence: largely following the analysis by Roger Ware, "Is Competition Economics 'Beyond the Ken of Judges'? The Federal Court of Appeal Ruling in Superior Propane," *Canadian Competition Record* 1, 2003, 20, the tribunal examined whether the set of weights that would be required to offset the efficiency gains were reasonable (Superior Propane (Redetermination), *supra* note 109, paras. 369-371), concluding that, in the particular case, the adverse redistributional effects were miniscule relative to the efficiency gains, and no reasonable assignment of differential weights between consumer and producer surplus would result in the offset of these gains. Indeed, Thomas Ross and Ralph Winter, "Canadian Merger Policy Following Superior Propane," *Canadian Competition Record* 7, 2003, 20, argue that Superior Propane (Redetermination) yielded a "surprisingly precise" approach to the efficiency defence that incorporated distributional concerns in an economically coherent manner.

119 Tervita Corp. v. Canada (Commissioner of Competition), 2015 SCC 3.

120 Notably, the hierarchy between qualitative and quantitative evidence in the Supreme Court majority's reasons in Tervita has been criticized. See: CD Howe Institute Competition Policy Council, "The Impact Of The Supreme Court's New 'Quantitative Evidence' Ruling On Business Mergers," June 10, 2015.

121 Collins and Laskey, *supra* note 101, 428.

a negotiated settlement. Despite certain arguable procedural deficiencies,[122] the tribunal provides recourse where a negotiated settlement cannot be agreed upon, thereby promoting accountability of the commissioner's decisions.

REFORMING FOREIGN INVESTMENT REVIEW

Following from the example of competition law and the economic grounds for rejecting certain foreign investments, Canadian foreign investment review should be conceptually reformed to: 1) imbed economic efficiency as its paramount objective; and 2) entrench economic analysis as the exclusive basis for approval or rejection of proposed non-cultural foreign investments where national security is not implicated.

Reversal of onus and economic criteria for net detriment

Substantively, the criteria for evaluating foreign investments under the current ICA are directly inherited from its highly restrictive predecessor statute, and, insofar as the ICA aims for economic efficiency and enhanced domestic welfare, the presumption against net benefit from those foreign investments beyond the review thresholds, as well as certain of the current factors for net benefit, are economically incoherent. Indeed, to the extent that the current review framework insulates domestic firms from competition from foreign entrants and diminishes the discipline from competitive product markets and markets for corporate control, the ICA counteracts the central objectives of Canadian competition policy.

Economic theory points to presumptive benefits from foreign acquisitions – as from acquisitions generally. Therefore, assuming that maximizing domestic welfare is the policy objective, grounds for barring foreign investments should be based in identifiable market failures or in empirically supported models for socially suboptimal behaviour by a foreign firm specifically.

The legal test should follow the economics, with the government responsible for demonstrating net detriment according to concrete criteria. To impose the burden for showing net benefit on an acquirer increases the potential costs of an acquisition and

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[122] Several commentators argue that defects in the tribunal's process have accentuated the tendency to settle rather than contest the commissioner's determinations (Ibid., citing Hunter, *supra* note 13). Especially for time-sensitive mergers, commentators note several deterrents to challenging the commissioner's determinations: the cost and delay of protracted proceedings (with contested merger proceedings lasting an average of 15 months); the transparency of tribunal proceedings (particularly for mergers, risking potential exposure of commercially sensitive information, such as business plans); the uncertainty of success given the paucity of precedents; and the lack of finality of tribunal decisions given the frequent appeals to the FCA (Calvin S. Goldman and Charles Layton, "Trials and Tribulations: A Quarter-Century of the Competition Tribunal," *Canadian Competition Law Review* 25, 2012, 522, 526-528; and Edward Iacobucci and Michael Trebilcock, "Critical Reflections on the Institutional Design of Canadian Competition Policy," *Canadian Competition Law Review* 24(1), 2011, 39.

Observing evidence that 99 per cent of notified mergers are resolved without tribunal involvement, Goldman and Layton, 528, (citing Trebilcock and Iacobucci, "Designing Competition Law Institutions," *World Competition* 25, 2002, 361, 374) argue for amendments to tribunal procedure to expedite its proceedings, broaden its scope (providing for references on discrete issues and oversight of the information request process), increase its competence (by prescribing expert qualifications for lay members) and provide a more deferential standard for appellate review (by inserting a privative clause).

makes the process susceptible to political capture by groups with private interests that are potentially at odds with domestic welfare generally.

With analogy to the SPLC standard for evaluating mergers, an appropriate economic standard for reviewing a foreign acquisition would be "reasonably likely to cause a detriment to domestic welfare." Similar to the regime for merger review under competition law, this would compel the government to adduce an economically grounded theory of harm and evidence to support the likelihood of that harm if the proposed foreign acquisition of domestic assets were permitted. Such theory and evidence would be contestable by the parties to the transaction, who could also adduce expert testimony to challenge the government's case – and its proposed undertakings – thereby ensuring the decision-maker's accountability.

Like the SPLC standard, a detriment to domestic welfare standard would provide an economically coherent benchmark that would be infused by economic theory and evidence in particular matters, allowing for expert debate about the features of the domestic markets implicated in a particular acquisition and the rational behaviour of the acquiring firm in allocating post-acquisition activities. Logically, establishing such a probable net reduction in domestic welfare would require demonstration that: 1) the assets will likely produce economic benefit for the Canadian economy in excess of their private value; and 2) relative to the counterfactual use of the assets, the foreign acquirer is likely to allocate the assets in a manner that deprives the Canadian economy of this value without any probable offsetting benefits.

Judicial/tribunal review and institutional independence

Procedurally, the current framework allows for highly discretionary decisions by the minister that are practically not subject to judicial or tribunal scrutiny. As such, the ICA risks politicized decision-making and the potential for regulatory capture by self-interested constituencies.

For instance, even if an acquisition is expected to produce productivity and wage gains and a more efficient allocation of labour overall, certain labour groups would still rationally oppose the transaction since their members may not be the immediate recipients of the gains. Similarly, incumbent corporate managers may lobby against the transaction if it threatens them directly (i.e. replacement following a hostile acquisition) or indirectly through intensified product market competition.

While the lack of disclosure around undertakings inhibits a full analysis, the observed undertaking creep flags the possibility that the minister's discretion for rejection is increasingly being used to extract and redistribute part of the expected gains from certain acquisitions.

An independent review process with recourse to review by a specialized tribunal would mitigate the risk of regulatory capture. Again, the institutional design of competition law provides a model: proposed mergers are reviewed by a politically independent Competition Bureau and its decisions may be challenged before the Competition Tribunal (excepting, as noted above, that present procedural obstacles exist for the tribunal's efficacy in contested mergers).

Rationale for reform

While the high rate of approvals under the ICA might indicate the lack of deterrent to FDI, this neglects the likelihood of self-selection out of the review process (i.e. either withdrawal of the proposal or the decision not to embark on an acquisition). While Canada's FDI/GDP share may seem adequate relative to peer economies, the appropriate comparison is the less restrictive counterfactual (i.e. how much FDI would Canada attract absent the ICA's restrictive elements). Moreover, as has long been a theme in competition policy, structural features (for instance, the degree of concentration in a market) may be inadequate proxies for the competitive intensity of the given market.

The lack of transparency and recourse to impartial, principles-based adjudication would create uncertainty for any foreign investor considering an acquisition. Investors have no alternative but to withdraw in the face of unreasonable requests for undertakings by the minister. To the extent that such requests for undertakings crowd out marginal investments, the review process may constitute a barrier to foreign entrants and place a damper on domestic competition.

Despite certain procedural deficiencies, the presumptions, process and institutions of merger review under Canadian competition law provide a workable model for the reform of foreign investment review. As indicated by the purposive clause in the Competition Act, competition is not an end in itself, but rather a means of ensuring the efficiency and adaptability of the Canadian economy.

Similarly, attracting foreign direct investment should not be conceived as an end in itself, but rather as a means of promoting economic efficiency through competitive product markets and markets for corporate control. Indeed, given the ideal overlap of objectives (i.e. enhancing domestic productivity) and centrality of economic analysis, a greater integration with Canada's framework for competition policy would improve the substantive coherence and procedural consistency of foreign investment review.

To this end, the ICA should be reformed to: 1) reverse the presumption against foreign investments, moving to a net detriment standard for rejections; 2) establish economically grounded evaluative criteria, to be interpreted based on economic efficiency and domestic welfare objectives; and 3) create procedures for adjudicating decisions under the ICA by an independent and impartial, expert tribunal. Adopting the Competition Tribunal as the venue for disputes under such a reformed ICA would be justified by the overlapping economic issues and evidence that might arise under both competition law and foreign investment review.[123]

Drawing on the evolution and conceptual underpinnings of Canadian competition policy, this paper has sought to plot an agenda for the modernization of foreign investment review and, even more ambitiously, points to the potential integration of the frameworks around coherent economic principles.

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[123] Assigning foreign investment review to the tribunal would leverage the tribunal's experience with applying economic analysis within legal disputes. This would have the collateral benefit of increasing the tribunal's potential workload (further justifying the appointment of expert lay panel members) and available jurisprudence.

About the Author

With experience in law, economics and geological engineering, Grant Bishop currently serves with the Calgary office of a global management consulting firm. He previously served as a judicial law clerk at the Federal Court of Appeal in Ottawa, articled at a major business law firm in Toronto, and held a policy research fellowship with the C.D. Howe Institute focusing on competition and regulatory issues. Prior to legal work, he served at the Bank of Canada, the World Bank and a major Toronto-based bank authoring economic studies, including on resource royalties, fiscal federalism, financial regulation, Employment Insurance and old-age pensions, household debt and long-run growth of the Canadian economy. During his engineering studies, he was involved in research regarding geotechnical risks to railways and remote oil and gas pipelines. His analysis and arguments in this paper are his own and do not reflect the opinions of any present or past employer.

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Calgary, Alberta T2P 1H9
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