Economic Sovereignty as a National Interest and the Harper Foreign Investment Review

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Abstract: The intervention by the Harper government to block BHP's attempted takeover of the Potash Co. in late 2010, warnings against any hostile bid for the troubled RIM company, and the long deliberations in last December's CNOOC-Nexen and Petronas-Progress decisions would seem to show that Conservatives are taking Canadian economic sovereignty seriously. This paper will examine the arguments and justifications for considering Economic Autonomy as a prime National Interest focusing primarily on recent developments in the strategic but vulnerable Canadian resource sector.

In the spring of 2013, the Harper government appears poised to amend the Investment Canada Act in a manner which may increase federal government control of foreign investment in Canada. The Harper government undoubtedly hopes the action will conclude its long entanglement with the whole issue and fulfill its pledge of a review of the investment rules. It has appeared to waffle on the issue, loosening the general threshold which requires a full review from $330 million to $1 billion, but blocking foreign acquisitions (MacDonald, Dettwiler and Associates and Potash Corporation) and warning off bids for RIM (Blackberry.) At the end of 2012, it allowed State Owned Enterprises (SOEs) to acquire Canadian energy companies (CNOOC Ltd.'s $15.3-billion acquisition of Calgary-based Nexen Inc. and Malaysia's Petronas $6-billion takeover of Progress Energy) while asserting that in future such takeovers would be allowed only under exceptional circumstances. "While insisting Ottawa welcomes investment by state-owned enterprises elsewhere in the Canadian economy, the prime minister signalled a clear preference for their acquisition of minority stakes and said Ottawa would assess whether an investment would leave the Canadian firm under the influence of a foreign government, even if it did not involve a majority interest."[1] Was the Conservative government at last acknowledging that economic sovereignty was at least as important a Canadian National Interest as Economic Growth?

For a party and a government which portrayed itself as putting Canadian interests first and viewing foreign affairs through a National Interest lens, this may have seemed a logical development despite its otherwise neoconservative, free-market ideological bent. This goal of this paper then is to show how this conflict can best be framed as a conflict between equally important National Interests.

Defining National Interests

Recent years have seen something of a revival in the use of the phrase "National Interest" in discussions of Canadian Foreign Policy. My own 2006 book[2] was an effort to revitalize Stephen

[1] Shawn McCarthy, "Ottawa to toughen rules for foreign investors," *Globe and Mail*, May. 06 2013, B1.
[2] Steven Holloway, *Canadian Foreign Policy: Defining the National Interest* (Toronto: Broadview Press, 2006.)

Krasner's 1978 work[3] which attempted to give theoretical heft to the term and return it to respectability. My study suggested that all states can be seen as pursuing five general types of National Interests:

NI1 National Security
NI2 Political Autonomy
NI3 National Unity
NI4 Economic Growth and Welfare
NI5 National Identity

2011 saw the publication of Greg Donaghy and Michael K. Carroll's edited volume, *In the National Interest: Canadian Foreign Policy and the Department of Foreign Affairs and International Trade, 1909-2009*. While the concept serves as the organizing device for the volume, the editors make no attempt to define it explicitly. One exception was Jack Granatstein's contribution, "When the Department of External Affairs Mattered – And When It shouldn't Have" where he stated --

> And what are those national interests? Here is my list with which, I suspect, few would quarrel seriously:
> 1. Canada must protect its territory and the security of its people;
> 2. Canada must strive to maintain its unity;
> 3. Canada must protect and enhance its independence;
> 4. Canada must promote the economic growth of the nation to support the prosperity and welfare of its people;
> 5. Canada should work with like-minded states for the protection and enhancement of democracy and freedom.[4]

His five national interests are nearly identical with the five I presented in my book: his number five merely focuses on one aspect of the "projecting of the Canadian Identity" in my list.

While Paul Heinbecker in *Getting back in the game: a foreign policy playbook for Canada* does not explicitly use "National Interest" as conceptual framework, he nonetheless spells out five guiding principles which overlap nicely with my own taxonomy. He says --

> Canadian foreign policy should,
>
> 1. protect the security of Canadians and advance their economic and social interests;
> 2. serve Canadian unity, respect the diversity of our population, and privilege neither founding nation nor any province, ethnic group, economic interest, or religion;
> 3. respect the Charter of Rights and Freedoms and promote and defend liberty, democracy, and human rights in the world;
> 4. defend our sovereign independence, while fostering and respecting international law and developing the treaty-based system of global governance; and
> 5. for both moral and self-interest reasons, assume our share of the responsibilities for the management of international affairs, including preserving peace and security, safeguarding the natural environment, and alleviating the poverty of people less fortunate than we are.[5]

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[3] Stephen Krasner, Defining the National Interest: Raw Materials Investments and US Foreign Policy (Princeton: Princeton University Press, 1978.)

[4] J.L. Granatstein, "When the Department of External Affairs Mattered – And When It shouldn't Have" in Greg Donaghy and Michael K. Carroll, eds. *In the National Interest: Canadian Foreign Policy and the Department of Foreign Affairs and International Trade, 1909-2009* (Calgary: University of Calgary, 2011) pp 69-70.

On the "practioners"-level, the current Harper government, early on, adopted a "Canada First" framework to justify its policies which seemed to harken back to Trudeau's early foreign policy approach of enumerating explicit guiding principles serving the National Interest. Both practices then fit nicely within a National Interest conceptualization of foreign policy.

The Theoretical Basis for National Interests

For the practioner, an immediate justification of the National Interest Approach is that it requires an explicit specification of overriding goals necessary to give coherence to the operations of any large organization. Borrowing from the managerial sciences, the Trudeau government also hailed the greater efficiency, effectiveness and rationality of pre-planned prioritization of objectives over the ad-hoc, reactive foreign policy of previous governments. The legacy of this public administration revolution can be seen in vocabularies of periodic policy reviews and the annual reports of Canadian government departments today.

While this take on National Interest gives us a process, can it also give us guidance as to the substance? What do typical principles look like? Can it produce principles that "rise above" parochial, particular, and partisan self-interested definitions? The question reminds us of the rhetorical danger of the concept: it is this very concern which Krasner addressed directly in his work. His statist approach located the specification of National Interests in a "relatively autonomous" state capable of sorting out the "utility for the community" from the "utility of the community." He thereby defined National Interests as possessing three components: links to the general welfare of the community, longevity and a consistent ranking.

The concept of National Interest can also be grounded in some of the other approaches of contemporary International Relations. Krasner's statist approach seems immediately to flow from the assumptions of the Realist approach, especially from the condition of system-level anarchy, the primacy of the nation-state and the resulting centrality of the calculus of power. To the realist, it is not surprising the lists of National Interests under our current world order usually give prominence to security, autonomy, unity, and growth. For logical coherence, in my own text, I grounded my list of generic National Interests in a deductive model derived from Realist assumptions. But in that work, I also suggested that alternative theoretical derivations were possible.

For example, we could derive generalized National Interests from a behavioural model, suggesting à la Easton, Almond, and Verba that all political systems (or states) fulfill certain basic functions or have basic needs. Borrowing from Maslov, we might then posit a hierarchy to these needs or functions which would provide a justification for Krasner's idea of a "consistent ranking." The Maslovian model might also provide an explanation for the lack of consistent empirical evidence of the ranking due prior need satisfaction or the particular context. Thus a typical college student may be prioritizing "sex" only because "food" and "shelter" are well slaked. Likewise, not all states need be as obsessed with security as Israel or the Koreas, or unity as Lebanon.

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[5] Paul Heinbecker, *Getting back in the game: a foreign policy playbook for Canada* (Toronto: Key Porter Books Limited, 2010) p186.

Likewise the traditional Internationalist or Idealist approach would develop the normative side of the National Interest. Consistent with democratic approaches, such a grounding would link them to public debate on what the general societal goals should be. Such an approach can be found in Habermas's ideal of a contested "Public Sphere" which, through critical debate, produces a public-minded "rational consensus." Similarly other Social Constructivists might emphasize the non-voluntaristic aspects of this type of social formation. Thus no single approach was a monopoly on the use of the concept of National Interest.

Political Autonomy as a National Interest

While basic survival of the state (or community) may logically seem to be the starting point of any list of National Interests, one of next immediate questions would "what kind of survival?" This question focuses on the political condition of the state in relations to other states. A political history of humankind reveals the existence of a variety of forms of dependency including provinces, semi-autonomous regions, colonies, protectorates, spheres of influence, allies, members of trade or currency blocs, and even "civilizations" and "like minded states." With the rise of nationalism and principle of "national self-determination" in the last century, the clear trend has been for all nations to possess a separate state and to possess sovereignty, defined, at a minimum, as ultimate sole lawmaking authority. Anti-colonialism is enshrined the United Nation system and even today "puppet" or "satellite" is one of the worse epithets with which a regime can be labelled.

But sorting out "control" of another political organization's decisions from mere factors of influence is not at all straight-forward. The conceptual ambiguity is made worse by sloppy popular usages and the obfuscatory purposes of many political and rhetorical tracts. Once two actors engage in any kind of exchange or interaction a potential for a loss of independence in action exists. Even superpowers could be described as militarily dependent on each other through arms races and deterrence calculations.

Keohane and Nye[6] provided one early attempt to clarify dependent economic relationships by distinguishing sensitivity (can feel effects of other's actions) from vulnerability (can not take remedial actions in response to those effects.) They and others also have also distinguished symmetric from asymmetric relations. In the former sensitivities and vulnerabilities are mutual whereas in the latter one party is affected more than the other. And there may be greater or lesser degrees of asymmetry.

Indeed there is great variation in the degree to which any political actor can be independent in the sense of domestic authority -- making domestic laws and decisions unconstrained by foreign factors or the desires of foreign actors. One crude first step then is to recognize autonomy as a seven point scale from 1) Autarky to 7) Formal Colony as I have presented it previously.[7]

1) Autarky
2) Relative Independence

[6] Robert Keohane and Joseph Nye, *Power and Interdependence: World Politics in Transition* (Boston: Little, Brown and Co., 1977.)
[7] Holloway (2006) p116.

3) Interdependence
4) Dependency
5) Sphere of Influence
6) Protectorate
7) Formal Colony

At one end, at least in theory, is Autarky or a condition of being total independent of foreign factors. One could imagine this situation in a system with only one state or a state which attempts to totally isolate itself from all external relations. Such isolationism was the intention of Tokugawa Japan in the 17th through early 19th century with its enforcement of closed borders. Other more recent examples of states seeking extreme "self-reliance" might be North Korea and Burma in certain period since independence. But such examples carry extreme costs and are rare.

As soon as a state opens its borders to the outside world, the potential for sensitivity and vulnerability exist to some degree. In case of "2) Relative Independence," this sensitivity is low relative to others and counter measures are available, making vulnerability low. This situation may exist where a state is attempting a policy of autarky or isolationism and not quite succeeding, such as North Korea in reality or the United States in the 1920s and 1930s. Some elements of this situation may also be present for the largest state in a region where all its relations are asymmetric in its favour. Historic examples might include the Imperial China, the Roman Empire, and other regional powers such as the US and Russia.

But as soon as the great power has one or more rivals, then mutual vulnerabilities make "3) Interdependence" a better characterization. Interdependence implies there are many linkages but in this situation, breaking economic ties with another state are likely to be mutually harmful. It exists in military matters for two states with nuclear Mutually Assured Destruction such as US and USSR (Russia) from at least the sixties. Economically the US relationship with Japan and with China and indeed with any of its major trading partners could be labelled as interdependent.

Since it is very difficult measure where symmetry blurs into asymmetry, the exact border with "4) Dependence" is hard to specify. Following Keohane and Nye, it is at a point where the vulnerability of one partner is far higher than the other. In practice, any state in a diverse system with numerous interactions with multiple states of varying relative powers will find itself in a complex situation of dependence and interdependence with different partners. For smaller, more dependent states, this opens up the classic "counterbalance" strategy for enhancing autonomy. Realignment is a constant feature of international diplomacy. Canada as a middle to small trade dependent state has historically fit this category. In the early 20th century, it leaned toward the US to enhance its autonomy *vis-à-vis* Britain. Trudeau's 3rd Option in the 1970s demonstrates the tactic of counterbalancing overdependence on the US as does Canada's recent pursuit of trade ties with the EU and China.

The last three steps represent a dramatic loss of autonomy: all three involve some ceding of decision-making authority by the weaker state. "5) Sphere of Influence," a phrase which is often ambiguously used, is best restored to its origins in late 19th Century China. Through an unequal (imposed) treaty with China, Russia's "sphere" over Manchuria meant that while that province remained under Chinese sovereignty, Russia had "right of first refusal" over any new economic investments or concessions there. Soon this meant Beijing was to exclude any but Russian economic interests there which triggered a rush by the other Imperialists for similar exclusionary agreements over particular provinces (Germany in Shandong, France in Yunnan, Japan in Fukien.) Some elements of this idea of an exclusive partner, might be apt for other situations. Weaker states in the currency blocs of the thirties might fit. Certainly the US has controversially been charged with having a "sphere of influence" over some or all of Latin America. But while some neighbouring states have been heavily dependent on the US market, they have usually not been required to have exclusive ties by the US. The exception during the Cold War was the US effort to prevent "another Cuba," that is to block ties by states in the region to its strategic enemy, USSR. Likewise Finland might be thus characterized as in the Soviet sphere, in the sense the Soviets would "exclude" its participation in Nato but not its economic ties to Sweden. Soviet control over the Warsaw Pact states must be seen as something more than a mere "sphere."

That would more characteristically be a "6) Protectorate." Here the dependent state more or less formally cedes decision-making authority over foreign and defence policy to one foreign state. In the 19th century Britain had protectorates over several smaller states such as Kuwait. In such states, existing domestic governments still exercised authority over internal laws and decisions which is what distinguishes this step from "7) Formal or direct rule colony." For Canada, this would mean that from the introduction of Responsible Government in the 1840s until the Statute of Westminster 1931, the label of British "Protectorate" would be better than "Colony" though its full application was weakening even before 1931.

The pursuit of Autonomy as a National Interest can be further broken down by issue areas such as political, military, economic and cultural policy. Since the Statute of Westminster and Canada's formal independence from Britain, the greatest potential threat to Canadian autonomy has been posed by the colossus to the south. In previous work,[8] I traced the history of Canadian counterbalancing policies and decisions in all four of these areas. For the rest of this paper, I will focus on developments and arguments concerning economic autonomy and specifically foreign direct investment (FDI) concerns.

Wave 1: The Americans are coming!... for our Canadian resource heritage

There was a time when Economic Sovereignty topped the political agenda in Canada. The Post-WWII world saw a huge outflow of US capital in the form of FDI. For a variety of reasons including proximity, cultural similarity, tariffs and access to the UK market, Canada became an even greater host to US branch plants than previously. US ownership as a percentage of Canadian firms peaked sometime in the late 1960s but opinion polls show public concern over the economic welfare (NI4) and autonomy (NI2) consequences of this first wave of the FDI issue carried well into the 1970s. Thanks to the Gordon Royal Commission on *Canada's Economic Prospects* in the late 1950s and the Watkins Task Force in the late 1960s, the issue became a central feature of the Liberal government's public policy.

Though much of the debate then centred on the economic benefits (jobs, investment) and costs (repatriation of profits and long term impact on the balance of payments), much of the hostility

[8] Holloway (2006) pp 115-176.

to US FDI arose over fears of a loss of economic and political autonomy. Opponents used words such as the "51st State" and "US colony" to characterize Canada's situation. Given the analysis above, such labels would seem inappropriate given the lack of direct political subordination implied in the proper use of the words "Colony," "Protectorate," or even "Sphere of Influence." Furthermore the decision-making "control" aspect of US FDI in Canada was widely dispersed among hundreds of corporate board rooms (though primarily in the US) and given the traditional laissez-faire and even adversarial relationship between US government and businesses, it posed more a structural than an instrumental (intentionalist) threat if any. Nonetheless, given the asymmetries in the relationship, Canada's position resembled more "4) Dependency" than "3) Interdependence" and the US government might enact regulations indirectly harming Canadian interests or even in confrontations find a way to use its investments for threats. US Congressional attempts to enforce its economic blockade of Cuba through extraterritorial regulations on US foreign branches were a case in point.

The Pearson and Trudeau governments took a series of actions and policies aimed at this economic dependency, including the 1967 amendment to Bank Act limiting foreign bank ownership to 25%, the Third Option of seeking counterbalancing economic ties, and creation of the Foreign Investment Review Agency (FIRA) to evaluate FDI proposals. As can be seen in FIRA's criteria for evaluation listed on Table 1, the Trudeau government saw the issue as a trade-off between growth (NI4) and autonomy (NI2) and not as an "all-or-nothing" proposition. Though most of the criteria seem only to cover NI4 concerns, the very creation of a governmental approval process demonstrates sovereignty and regulatory power. Criterion 5, 9 and 10 also all reflect NI2 elements.

Table 1 - FIRA Criteria

1) Increase Employment
2) New Investment
3) Increase Resource Processing or Use of Canadian Parts & Services
4) Additional Exports
5) Canadian Participation as shareholders, directors or managers
6) Improved Productivity and Efficiency
7) Enhanced Technology
8) Improved Product Variety
9) Beneficial Impact on Competition
10) Compatibility with Industrial & Economic Policy

Commentators in this first wave of FDI concern often highlighted certain industries as having very high rates of US ownership, especially in the resources sector, and therefore being more in need of "repatriation" because of their "strategic" role in the Canadian economy. The global oil shocks of 1973 and 1979 provided Canada both with the opportunity for great profits and the challenge of asserting national control over the 99% foreign-owned oil and gas industry. Trudeau governments, through actions such as the creation of PetroCanada and the National Energy Program, assisted the "Canadianization" of the oil industry, which later reduced foreign ownership to 53% by 1986 and 44% by 1999.[9]

[9] Holloway (2006) p163.

By the late 1980s, the first wave appeared to have run its course, with the relative economic decline of US Multinationals, the general decline of foreign-ownership in Canada and its diversification by nationality. Consequently, the Mulroney government re-balanced the NI2/NI4 trade-off in favour of the latter, by emphasizing greater openness to FDI, by changing FIRA into Investment Canada and by easing the process by raising the threshold for review and changing the criteria from a need to demonstrate a "significant benefit" to merely a "net benefit."

Wave2: The Chinese are coming!... for our Canadian resource heritage

The second great wave of public concern over foreign ownership is linked to the rise of China and that market's massive demand for raw materials and its impact on prices, creating for Canada a minerals bonanza. As in the latter half of the first wave, oil also has featured in this wave through the prosperous first decade of the new century, though the spectacular Chinese growth has affected demand for other Canadian resources including copper, aluminum, nickel and iron and steel. In both waves, Canadians have been more than happy to prosper from commodity exports, which also boost the balance of trade, and overlook the negative consequences of a rising dollar and the possibility of a "resource curse" harming other sectors of the economy. Indeed this latter effect was seen in the 2011 report[10] that Canada had returned to being primarily a raw material exporter after over a decade of manufactured goods being at the top of our exports. This manufacturing period had been brought on by the 1990s expansion of transportation sector exports to the US thanks to the FTA and a lower Canadian dollar and the relative quietude of Osama bin Laden.

But many Canadians in both waves, while happy to sell Canadian resources as exports, were not pleased at the increased interest by foreigners in buying the Canadian sources of those exports. One might therefore delineate the commencement of this second wave with the 2004 failed attempt by the Chinese state-owned (SOE) Minmetals to acquire Noranda from Brascan. This proved to be the opening shot in a devastating series of raids on historic Canadian enterprises resulting in the loss to foreign-ownership of nickel and copper giants Noranda, Falconbridge, and Inco, Canada's premier aluminum multinational Alcan, and basically all of the Canadian steel industry including Dofasco, Algoma and Ipsco. In a previous study, I compared the lists of top ranked mining and metals firms by revenues to show how in a very short period we went from an all Canadian to a nearly all foreign-owned lineup by 2011. Indeed, outside of gold mining, the sole remaining giant Canadian-owned miner, Teck Resources, sold out 17% of its stock to the China Investment Corporation in 2009.

Where were Canadian governments (Provincial and Federal) and the public during this blitzkrieg? I have recounted the specifics of this tragicomedy elsewhere.[11] It did not help that the takeover wave rose just as Canada experienced a series of minority governments at the Federal level. In the summer of 2005, INCO executives, correctly worried that Swiss Xstrata had designs on Falconbridge, approached the Martin government asking it to warn off a takeover bid by Xstrata and instead support the idea of the two Sudbury-based companies themselves merging to form a Canadian nickel national champion. Interestingly, these Canadian business leaders cited numerous examples of governmental intervention to bolster their request including past EU support for National Champions, the US government's disapproval of a Chinese bid for Unocal, and the Australian government's

[10] Barrie McKenna, "Canada just can't shake its reliance on commodities," *Globe and Mail*, May 30, 2011.
[11] Steven Holloway, "The Canadian Mining sector and the Absent Harper Foreign Investment Review."

public opposition to an Xstrata takeover attempt there the previous year. But the weak liberal minority government disappointed the Canadian executives with its limp responce: in October, Industry Minister Emerson rose in the house to say only that National Champions were a good thing and only one newspaper even carried the story.[12]

In February 2006, the nickel execs again approached the new Harper minority government to support their defensive union and to help lobby the US for regulatory approval but received only "indifference" from the "Boy Scouts" as one frustrated business manager put it.[13] Given their conservative laissez-faire ideology, and their desire not to rock the boat with Washington during the softwood lumber talks, it is not surprising that the Harper government gave ultimate approval to the foreign nickel takeovers and Alcan takeover in 2007.

In the Alcan case, the federal Liberal party now in opposition tried to make an issue of the takeover by proposing in May 2007 a 3-month moratorium on acquisitions by foreign firms[14] and July when the Rio Tinto bid loomed, NDP finance critic Judy Wasylycia-Leis labelled it "devastating" for Canada and explicitly used an appeal to the Autonomy National Interest: she "called on the Harper government to 'use the reins of power to curtail these kinds of takeovers' and continued 'It's not just the loss of a business, it's the further erosion of sovereignty and the ability to control our own destiny.'"[15] Finance Minister Flaherty countered that the "so-called hollowing out in Canada is really an open question"[16] and created a Competition Policy Review Panel to investigate, though his government approved the Rio Tinto takeover long before that panel issued its June 2008 report. Not surprisingly given its composition, that report provided after-the-fact support for the government based on a very general "Growth and Competitiveness" argument.[17] The Quebec provincial Liberal government at least attempted to extract promises for future investments and guarantees from Rio Tinto. But the results of such pledges are discussed below.

With the global Fiscal crisis, and economic downturn in China and elsewhere and the cooling of resource prices, the last five years have seen the cresting of the second wave. Thus the recent controversy over Potash and Tar Sands (Nexen and Pioneer) appear to be epilogues to the main acts.

Balancing National Interests: the Trade-offs between Prosperity and Autonomy

As I have shown elsewhere, National Interests are often at loggerheads and the true art in government is not in ignoring one interest for the sake of another but in finding the maximizing trade-

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[12] Jacquie McNish, "The great Canadian mining disaster," *Globe and Mail*, 24 Nov 2006, http://www.theglobeandmail.com/report-on-business/small-business/the-great-canadian-mining-disaster/article4301299/?page=all#dashboard/follows/ checked 9 May 2013.

[13] *IBID.*

[14] Andrew Willis, "Alcan needs time to kick-start Pac-Man defence," *Globe and Mail*, 29 May, 2007.

[15] Steven Chase, Andy Hoffman, Sinclair Stewart, "Alcan takeover fuels economic worry," *Globe and Mail*, 13 July 2007, http://www.theglobeandmail.com/news/national/alcan-takeover-fuels-economic-worry/article689502/#dashboard/follows/ checked 9 May 2013.

[16] *IBID.*

[17] LR Wilson, Chair of the Competition Policy Review Panel, "Hollowing out? The answer is more foreign investment, not less," *Globe and Mail*, 26 June 2008.

off point in the pursuit of both. To take but one example, a weak, vulnerable state might maximize its security (NI1) by offering itself as a protectorate or even as a colony of a powerful state. But in doing so, it sacrifices its autonomy interest (NI2.) Thus, most states prefer mutually contracted alliances which seek the most security with the least loss of independence. Such bargaining can be seen in Canada's sometimes tortuous renegotiations of its role in Norad over the years.

This security analogy also fits the economic relation with the US. The crux of the 1984 Free Trade debate was whether the economic benefits of greater access to the US market (NI4) could be gained without sacrifice of Canada's political independence (NI2.) Similarly in the first FDI issue wave, FIRA sought to implement, through its investment evaluation criteria, a means to maximize the NI4 benefits of FDI (investment capital, jobs, exports, technology, productivity) while minimizing the negative aspects of foreign control.

Similarly we can now analyse the consequences of the second wave, with its emphasis on foreign resource takeovers, as a trade off between NI4 and NI2. The case for open acquisition of Canadian companies was made in the 2008 Competition Policy Review Panel report which claimed that openness stimulated competition which "instills the discipline to remain efficient, [provides] the incentive to adapt to challenges and opportunities, and spurs the productivity improvements that underpin our quality of life."[18] Other supporters of the report commented on the "link between greater competition, enhanced economic performance and higher standards of living"[19] agreeing that Canada needed more international investment with fewer restrictions and that it should reject the "hollowing out" argument.[20] The latter commentator suggested that while the Harper government gave little public endorsement of the 2008 report, it has since appeared to be following its general "road map" as seen in its dismissal of suggestions it require domestic ownership of the assets of Nortel, its plans to open the airline industry to some foreign ownership, and its licensing of Globalive over the objections of the CRTC. The panel and its supporters would have the government go further in removing "red-tape," opening telecommunications and broadcasting, banking and financial services and air transportation and other restricted sectors, "reducing the number of [foreign investment] transactions that would be subject to review," and making it "more difficult for the Investment Review Division of Industry Canada to extract undertakings."[21] Just this year, there have again been calls to remove the 49% cap of the foreign ownership of uranium mines.[22]

Often these commentators don't bother to fully expound the reasoning, argument, evidence or limitations of the conventional free market growth model as if the reader already shares certain assumptions. It is often not clear whether distinctions in the type of investment (a new, "green-field" investment vs a hostile takeover, by a private firm or SOE) are important or how far the "openness" should extent. Ghemawat for instance sees unrestricted movement of all people across all international borders as an important component, something not all commentators would accept.[23] Such simplistic all-or-nothing positions are clearly incompatible with the more complex, trade-off approach employed here.

[18] LR Wilson, *op cit*.
[19] Paul Campton, "A critical step forward," *Globe and Mail*, Jul. 02 2008
[20] "Road map with real influence," *Globe and Mail* Dec. 29 2009
[21] Crampton, *Op cit*.
[22] Rod Nickel, "Uranium miners press Ottawa to change Cold War rules," *Globe and Mail*, Mar. 18 2013, B3.
[23] Pankaj Ghemawat, *World 3.0: Global Prosperity and How to Achieve It* (Cambridge: Harvard Business Review Press, 2011.) Ghemawat, unlike many, does at least make the full argument for openness and in a powerful manner.

Furthermore, there are evident contrary examples and limitations that must be confronted in the simple FDI = growth syllogism. First, green-field and hostile takeovers are two, very different investment situations with very different outcomes, positive and negative. It is true that both represent investment in the sense of inflows to Canada of capital which help the balance of payments, but only in the short-term. Furthermore the fact that the asset is now foreign owned signals a long-term stream of current account revenues out of the country (at least that is the expectation and motivation of the foreign buyer in the first place.) To the argument that acquisitions are not actually creating a new asset, proponents will say that the Canadian shareholders in Alcan can now put their capital in new investments that boost future Canadian growth. Yes, they might, but they might just as easily be spending it on current consumption or other foreign-owned stocks.

Further to the hostile takeover case, states have anti-trust, anti-monopoly departments and regulations because predatory business practices are a problem. When a would-be monopolist buys a Canadian competitor's plant to eventually shut it down, neither the National Interests of growth nor competition are being served. Yet, this has been alleged (to the embarrassment of the Harper government which previously celebrated the takeover) in the US-based Caterpillar Company's acquisition and closure of Electro-Motive Canada.[24]

Conflictive takeover situations, whether hostile or "white knight" in the case of Rio Tinto, create a whole series of unusual costs as the corporate combatants are diverted from their usual productive business to engage in elaborate offensive and defensive stratagems and poison pills and "Pac-man manouvers." As with interstate war, the economic rationality of this behaviour is questionable. Once Alcan was "put into play," its executives were bound under current rules to forget about the long-term good of the company, its workers and their communities and focus only on the short-term profit of its shareholders in evaluating rival bids. And this was despite the fact that Alcan was a perfectly health, ongoing business not in need of any foreign expertise, capital or restructuring. Certainly the claim that this corporate warfare leads to most efficient management always triumphing is disputed in any careful analysis of the convoluted events of the Alcan, Inco or Falconbridge takeover battles. In the "fog of war" of these cases, it is clear the outcomes were as likely (as in real war) to have been determined by chance, miscalculation, and deep pockets than by economic efficiency. In addition to these economic losses, one might naturally start from the assumption that mergers of health companies are more likely to *decrease* than to *increase* competition in the future. On top of this, the post-mortems of many large mergers show that they turn out to be disasters.

Consider the economic consequences for Canada of the Rio Tinto takeover of Alcan. As often happens in the heat of battle, the winner is widely believed to have grossly overpaid for the victory as Rio trumped Alcoa's initial bid of $27 billion with a final bid of $38 billion. Though it had to borrow heavily to finance the deal, Rio's management justified the high price on the basis of future sales to the Chinese market. Despite the fact that China was greatly expanding its own (state-owned) aluminum smelting, Rio argued that since its own (Alcan) smelters had the lower operating costs, that eventually Beijing would see the rationality of closing its new smelters and buying from Rio (!!!) This of course did not happen. In fact this "more efficient foreign management" soon embroiled itself in a legal battle with Beijing leading to the arrest of some of its Shanghai staff.

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[24] Karen Howlett, "McGuinty presses Ottawa on foreign-takeover rules," *Globe and Mail*, 7 Feb 2012, B6.

The floundering Rio next became a takeover target itself as its rival BHP Billiton (BHP) launched its own hostile takeover bid. But BHP quickly abandoned the bid due to Rio's crippling debt and perhaps a more realistic assessment of future global and Chinese aluminum demand. The last five years have seen Rio limp along selling off Alcan assets to stay afloat such as Alcan Engineered Products sold to an American firm in 2010. Despite the promises made, Quebec has been hit particularly hard: Alcan Cable with its plants in Jonquiere and Shawinigan were sold in 2012, the Beauharnois smelter was closed in 2009, and smelters in Shawinigan and Arvida are to follow in 2015. Arvida with its model company town was once the largest aluminum production centre in the capitalist world and has been proposed as a UNESCO World Heritage site. By 2013, with "so many rounds of asset sales, closings and job cuts … Alcan is today a shadow of the global giant Rio Tinto acquired in 2007."[25]

The results have been equally dismal in the steel and nickel takeovers.[26] Indeed in an ironic turn of opinion, given his past attacks on Canadian corporate hollowing out, *Globe and Mail* writer, Eric Reguly, makes a rather forced "silver lining" argument that Canadian investors showed good sense in selling out when they did.[27] But he ignores the fact that the takeover itself was a major cause of the fiasco. And it's also hard to believe that Alcan's Montreal based executives with main years of experience in riding out price downturns would not have found other remedial actions more agreeable to their home country's interests. Also Reguly's piece reminds us of the role of short-term greed (the 65 per cent premium Alcan shareholders received) but fails to acknowledge how the contested takeover situation itself can leave even patriotic investors with few good options.

Attempting to forestall some of these long-term negative consequences, governments have sought pledges and promises from acquiring firms before giving their approval. Such "undertakings" might including keeping the branch headquarters in Canada, maintaining Canadian staff, keeping specific facilities in operation or promising to invest certain amounts in Canada in the future. For example to hasten approval of its takeover of Nexen, CNOOC is believed to have made a confidential undertaking with Industry Canada to invest an additional $5 to $8 billion in the tar sands but *only if* oil prices remain high and within *no fixed time frame*. Publicly CNOOC undertook to list shares on the TSX, to make an effort to keep Nexen employees, and to maintain existing Nexen contributions to social and community projects. The conditional nature of these pledges is obvious and CNOOC successfully resisted the government's efforts to spell out tighter commitments.[28]

Indeed a 2010 study of the broken promises of four past takeover cases stated that "commitments made under the Investment Canada Act are difficult to enforce but also provide ample room to be breached, amended or even rescinded."[29] For example, in August 2000 when Billiton PLC of London beat out Canada's Noranda to acquire Toronto-based Rio Algom, it made a pledge to

[25] Pav Jordan and Jacquie McNish, "Alcan trouble for Rio Tinto; Tom Albanese out at Rio Tinto as Alcan bet goes awry," *Globe and Mail*, Jan. 17 2013.

[26] Pav Jordan et al, "A rush and a reckoning: Why writedowns are plaguing mining companies," *Globe and Mail*, 16 Feb. 2013, B6

[27] Eric Reguly, "Sometimes, investor greed pays off," *Globe and Mail*, REPORT ON BUSINESS Apr 2013 p22.

[28] Shawn McCarthy et al, "CNOOC promises billions in new spending - if oil prices stay high," *Globe and Mail*, 13 Dec. 2012 B1.

[29] Andy Hoffman, "Broken Promises…" *Globe and Mail*, 4 Oct 2010, http://www.theglobeandmail.com/globe-investor/potash/broken-promises-mark-foreign-mining-deals/article1742457/ [Checked 11 September 2011.]

Industry Canada to keep the Toronto Headquarters as its global base metals centre preserving 120 Rio jobs there. But less than a year later in March 2001, BHP Ltd. of Australia swallowed up Billiton and unencumbered by the latter's undertakings, moved the base metals HQ to Houston, Texas. It did voluntarily offer the Toronto staff jobs in Houston, but (not surprisingly) a majority gave up their corporate jobs rather than move.[30]

This brings us to the issue of control at the heart of Political Autonomy NI2 and the corporate "Hollowing out" argument. A major consequence of the second wave has been the loss to Montreal, Toronto and other Canadian cities of these pinnacles of corporate power, the company headquarters. This loss signals major political, economic and social costs to our centres of excellence. It means that career paths for the "best and brightest" now lead out of Canada. It means the loss of long profitable public relationships between headquarters like *Maison Alcan* and their home cities in terms of charitable contributions, renewal projects, research and development, and involvement as good corporate citizens. As a sovereignty issue, it means that at the ultimate decision level of the corporation, there is a loss of a uniquely Canadian consideration of interests. There may also be spillover effects into secondary pinnacle organizations: thus the loss to Canada of the largest global nickel companies was soon followed by the loss to Toronto of the world Nickel Institute when it moved to Brussels in 2009.

Finally this loss of professionals and top offices opens the discussion at another set of Canadian interests – Identity NI5. Has Canada also lost part of its historically cultivated resource expertise? The history of Alcan is intimately bound up in the history of Montreal and other cities of Quebec. As NDP finance critic Judy Wasylycia-Leis has put it, when such things are lost, "you lose the heart and soul of your country."[31]

Conclusions

This paper has attempted to show that a National Interest approach is a useful method to frame the ongoing debate about FDI in Canada as a balance between NI4 (growth and competitiveness) and NI4 (political autonomy and economic sovereignty.) It has reasserted the legitimacy and importance of the latter. Too often commentators have disparaged "political" considerations as somehow irrelevant to economic and business issues. Recent recommendations on foreign investment rules from the Institute for Research on Public Policy castigated the use of the "strategic sectors" idea to justify tighter controls in certain industries but later turned around and recommended "that Ottawa issue basic national security guidelines similar to those in the US"[32] admitting the legitimacy of such National Interests.

The Harper government's recent actions seem to indicate that it at last sees the link with NI2 at least in regard to Chinese SOEs. This paper has gone beyond this to raise questions about the alleged benefits to growth and prosperity (NI4) particularly when it comes to acquisition of existing

[30] IBID.
[31] Steven Chase, et al., 13 Jul. 2007 *op cit*.
[32] Barrie McKenna, "Ottawa urged to revamp foreign investment rules," *Globe and Mail*, 18 Apr. 2013, B5.

healthy businesses resulting from hostile bids.[33] In that light, a number of policy recommendations are proposed.

First, the Harper government is correct in asserting the need to carefully evaluate the autonomy considerations present in SOE type acquisitions of Canadian companies. Not all SOEs are the same and each must be evaluated as to the sovereignty threat implied. Even 33% minority shares may be too much in certain circumstances when there is no countervailing bloc of shares to negate unwanted political influences. In the first wave, an additional sovereignty issue was present in that foreign control threat was concentrated in one foreign actor (the US). With the diversity by nationality of second wave foreign takeovers, this is less of a consideration.

Second, economic sovereignty implies an ongoing regulatory authority for the state even in this age of globalization and even among advanced capitalist economies. Canada's economic partners show no sign of ending their final right to evaluate and approve large strategic economic transactions and neither should Canada. It is true that "national treatment" is a key principle of the WTO which Canada nominally accepts as a member. It was recently raised as an FDI issue by the EU in FTA negotiations with Canada (though it could be argued the EU's own implementation of the principle is not absolute.) But acceptance of "non-discriminatory treatment" does not in any way, mean that states abandon their sovereign right to regulate corporations generally and to block transactions that are harmful to their interests (such as monopolistic and predatory business practices.) This fact opens considerable room for manoeuvre as will be suggested below.

Third, in the cost/benefit assessment of foreign investment, Canada must continue to recognize the distinction between portfolio, green-field, and acquisition. These investment types rank on a scale from most desired to least with hostile bids on healthy firms at the far negative end. It's time for all states to re-assess the "benefits" of such hostile takeovers. The recent financial crisis has thrown into question the prevailing "big is beautiful" sentiment as seen in the G20's recent warning that Canada should not let its banks get larger through mergers.[34] Similarly it's time for all states to realize that their anti-trust regulators can "just say no" to big mergers rather than the current practice of allowing the acquisition after the sale of certain assets in the heavily concentrated industry. Instead of focussing merely on the debits of horizontal integration, they should also factor in the downside of vertical and conglomerate aspects of the merger. Thus one way for the Canadian state to block hostile takeovers without the discrimination charge is to tighten its anti-trust enforcement generally (regardless of nationality.)

There is much more that Canadian governments including the provinces could do to make hostile takeovers more difficult. In the recent INCO and Falconbridge cases, a simple, stronger warning signal may have been enough. Other stronger merger-proofing tactics should be considered. In 1979, the *Parti Québécois* government considered buying stakes (aka a "Golden Share") in strategic corporations such as Alcan to dissuade unbeneficial takeovers. During the 2012 provincial election, both *Parti Québécois* and the *Coalition Avenir Québec* revived the idea of the province

[33] Some may argue that few of the recent cases mentioned here are actually "hostile takeovers" because in each the final deal with a "white knight" has accept by the existing management. But this reasoning ignores the fact each acquisition began with an unsolicited hostile bid, which "put the company into play" requiring the management to "auction off" their company to highest bid, thus making the best of an undesired situation.

[34] Kevin Carmichael, "G20 eyes size of Canada's largest banks," *Globe and Mail*, 28 Aug. 2012, B1

buying stakes in strategic companies and Premier Charest suggested “a new law that would give Quebec companies more power to reject foreign takeovers.”[35] The new PQ government has since moved to introduce legislation to “give the board of directors authority to examine the impact of a hostile takeover on workers, retirees and suppliers and take into account their interests.”[36] Similarly last year, the Ontario Securities Commission was considering reforms to make “poison pills” more available to Ontario companies. Such tactics bring it more in line with the US, where the board of directors’ long-term interests are generally favoured over short-term shareholder profit in takeover battles.

Thus we see there is hope that the second wave has at last provoked a public reaction and more importantly remedial action by governments. Though it is too late to restore the Canadian crown jewels of Alcan, Inco, Falconbridge, and the steel industry among others, there may still be hope for government action to save Canada’s other resource strengths before a reheating of the Chinese and global economies. It must always be remembered that what is at stake is not an either/or issue of growth-openness versus autonomy-identity but a process of finding the balance for both public interests.

[35] Campbell Clark, “Quebec’s Charest proposes $1-billion foreign-takeover fund and new law to reject foreign advances,” *Globe and Mail*, 13 Aug. 2012

[36] Rheal Seguin, “PQ plans to protect corporations from hostile foreign-takeover bids,” *Globe and Mail*, 24 Nov. 2012, A11.