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Inward FDI in Canada and its policy context

by
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Canada has actively participated in the corporate globalization process and is a major importer of foreign direct investment (FDI). Canada's high levels of inward FDI (IFDI) over the past 25 years reflect its improved business climate, reduced restrictions on foreign ownership and a prospering economy. Like other developed economies, Canada experienced declining FDI inflows in 2008 and 2009, largely due to the dramatic fall in mergers and acquisitions (M&As) and the global economic recession. The outlook for 2010 and beyond however is promising because of the expected economic expansion in Canada and other countries, and improved global financial markets. Moreover, the Canadian Government has sent strong signals to foreign investors that Canada is open for business by, among other things, lifting restrictions on previously protected sectors and increasing the financial thresholds for the review of foreign investments.

Trends and developments

IFDI in Canada has risen steadily over the past decade, with cross-border M&As driving the most recent upsurge, especially in the primary sector. Canada is one of the G-7 economies most open to inward FDI: slightly more than one-fifth of Canada's total assets are controlled by foreign companies. The ratio of the IFDI stock to the Canadian gross domestic product (GDP) was 34% in 2008, compared with, for example, a ratio of 37% for the United Kingdom. The impact of the global financial and economic crisis reduced IFDI in 2008 and 2009. Nevertheless, though still weaker than in the previous year, the

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Canadian M&A market strengthened in the third quarter of 2009, posting a 27% increase in deal value over the second quarter of 2009.

Country-level developments

Between 2000 and 2008, Canada's stock of IFDI grew by 120%, reaching US$ 474 billion by the end of 2008 (annex table 1). By way of comparison, growth of U.S. stock was much lower, while that of the United Kingdom was slightly higher. In contrast, Mexico's inward FDI stock grew at nearly twice the pace of Canada's.

Between 2000 and 2008, Canada's IFDI flows were lowest in 2004 when they hit a negative value (because foreigners sold more of their existing interest in Canada than they bought), and highest in 2007 when they reached US$ 108 billion. There was a massive surge in foreign acquisitions of Canadian firms in 2006 and 2007, following the strong increase in commodity prices (annex table 2). In addition to the improved Canadian business climate, reduced restrictions on inward FDI also contributed to the rise in M&A activity.

IFDI in Canada is concentrated largely in the service sector (44%), followed by manufacturing (34%) and the primary sector (22%) (annex table 3). The manufacturing sector's share of the stock of inward FDI declined by 14 percentage points since 2000, due to a diversion of investments into the primary sector and, to a lesser extent, the service sector. Within manufacturing, the decline was most marked in the computer and electronics, transportation equipment, textiles, clothing, wood and paper industries. In the computer and electronics industry, Canada's IFDI stock in 2008 was lower than its 2000 level due to a post-2000 meltdown of asset values. In the primary sector, multinational enterprises (MNEs) typically invest in Canada's oil and gas and other mining industries. Cross border M&As boosted investment in 2007, driven by rising commodity prices.

Canada's IFDI stock comes overwhelmingly from developed countries. In 2008, these accounted for 92% of inward stock; however, this share was six percentage points below the 2000 level (annex table 4). Of this FDI, 58% came from the United States and 26% from European Union countries. Developing countries, on the other hand, accounted for only 5% of Canada's inward FDI stock in 2008, up from 2% in 2000. This growth is largely attributable to Brazil's growing investment in Canada. In more recent years, companies from Asia, particularly from China, and, to some extent from India, are acquiring Canadian companies especially in the resource sector.

The corporate players

Foreign affiliates are increasingly active in Canada. In 2007, 21% of assets and 29% of revenue in Canada were under foreign control. In 2007, about one-fifth of all foreign-controlled assets in Canada were in the primary sector, a disproportionately large share compared to its contribution to Canada's GDP, increasingly concentrated in the oil and gas and other mining industries. The shares of these two industries in foreign controlled assets rose by almost four percentage points between 2000 and 2007. The share of foreign controlled assets in the manufacturing sector, in comparison, declined from 33% in 2000 to 25% in 2008. The share of foreign assets in the service sector has remained more or less constant at 18%, and is concentrated predominantly in the wholesale, retail, real estate, renting, and leasing industries.

A list of the top 20 largest foreign companies operating in Canada (ranked by revenue) is provided in annex table 5. Among them, two are operating in the energy (oil and gas) and the metals and mining industries; three in the automobile industry; two in computer services; and one in the IT service industry.

There were 60 mega-deals (value of US$ 1 billion or more) with a combined value of US$ 275 billion announced in 2007 alone, a record high in terms of both volume and value. Of the total value of announced deals that year, 78% was cross-border in nature; all of the ten largest deals had an international component. The value of foreign-led acquisitions, the largest of which was worth US$ 48 billion (BCE) (annex table 6), surpassed the acquisitions by Canadians in foreign countries by a 2-to-1 margin. The pace of cross-border M&A activity declined dramatically in 2008 however, falling to less than one-third of its 2007 value. The decline continued through the first quarter of 2009, but had begun to rebound by the third quarter of 2009.

Annex table 7 provides a list of greenfield investments in Canada over the past three years (2007-2009).[1] In 2008, greenfield investments occurred mainly in the insurance industry, followed by the retail service industry. In 2009, in contrast, greenfield investment targeted the oil, metal and energy industries.

Effects of the current global crisis

The negative impact of the global economic and financial crisis is visible in the precipitous drop in inward FDI flows in 2009. These were negative in the first half of 2009, as sales of assets by foreign investors were higher than incoming FDI. In the first quarter, FDI inflows into Canada were only US$ 743 million, while disinvestment amounted to US$ 1.1 billon in the second quarter. FDI inflows rose to US$ 19.3 billion by the end of 2009, but flows were still less than half the level attained in 2008, which in turn was less than in 2007 (annex table 1).

The fourth quarter of 2009 was the third consecutive quarter in which the Canadian M&A market expanded, ending a volatile year on a positive note and possibly indicating that financial markets have stabilized.[2] Strong M&A activity in the third quarter reflected a continued improvement in a number of market fundamentals, including the financing conditions for buyers, buyers' confidence, and company valuations.[3] The third quarter's largest and second largest M&As included China's Investment Corporation's investment in Teck Resources Ltd. and the US$ 1.5 billion takeover of Eldorado Gold Corp. by Australia-based Sino Gold Mining Ltd. The largest inward cross border M&A in the fourth quarter of 2009 was Korean National Oil Corporation's US$ 4.1 billion acquisition of Calgary-based Harvest Energy Trust. Despite the improvements in M&A markets over

[1] Data on shares acquired and the transaction value are not available as they are confidential
[2] Crosbie, "M&A quarterly report-Q4/09", available at: http://www.crosbieco.com/pdf/ma/MA_Q409.pdf
[3] Ibid.

the second half of 2009, M&A activity remains well below the levels experienced prior to the global financial crisis and recession.[4] Consistent with the historical trends, the total number of acquisitions made by Canadian companies abroad exceeded the number of foreign takeovers of Canadian companies by a margin of 2.2 to 1.

The policy scene

Non-Canadians who acquire control of an existing Canadian business or who intend to establish a new Canadian business must comply with the Investment Canada Act (ICA). Canada has historically had relatively high regulatory barriers to inward FDI among developed economies, including in services such as banking. However, through recent amendments to the ICA, the Canadian Government has revised its approach to foreign investment regulation to create a more liberal regime aimed at increasing its share of IFDI not just from traditional sources, such as the United States, but also from emerging markets, especially Brazil, Russia, India, and China.[5] Review thresholds will be increased significantly, reducing the number of investments subject to a review. Nevertheless, Canada continues to rely on sector-specific restrictions and its powers to review sovereign investments and any other foreign investments with the potential to threaten national security. In particular, when guidelines were introduced in 2007, the ICA did not include a national security review power. However, the recent amendments have added a stand-alone national security review test to the ICA.

This test is separate from the net benefit test that is generally applicable to reviewable investments under the ICA, and applies to a much broader range of proposed transactions. The national security test subjects investments that "impair or threaten to impair national security" to Ministerial and potentially Cabinet review, though no definition of what constitutes "national security" is given in the ICA or the regulations made thereto.[6] However, it is possible that investments impacting Canada's sovereignty, national defense and potentially strategic sectors of the economy (such as natural resources), and investments by state-owned enterprises may be considered under the national security test. Concerns have been raised that the test has the potential to be used as a tool for protectionism, given the high level of discretion provided to the Government. However, to date there has been no action taken to substantiate this concern.

Conclusions

Canada's sound macro environment (including its fiscal, monetary and tax policies), its efforts to stimulate economic growth and open its borders to inward FDI, an improved business climate, and a favorable natural resource endowment all contributed to the large increase in FDI in Canada over the past 20 years. Like other developed countries, cross-border M&As into Canada, and hence inward FDI flows, were hit hard by the financial crisis and recession. The outlook for inward FDI in 2010 and beyond looks promising because of the expected expansion of the Canadian and other economies, the improved

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[4] Ibid.

[5] Note that these amendments were made in response to recommendations of the Competition Policy Review Panel. For further information see Competition Policy Review Panel, *Terms of Reference*, available at: http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/eng/h_00004.html.

[6] *National Security Review of Investments Regulation*, S.O.R./2009-271.

situation in global financial markets and increased demand for resources. Canada still has higher barriers to inward FDI compared to many developed countries in key services industries. Any progress on this front would be expected further to increase FDI in Canada.

Additional readings

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Statistical annex

Annex table 1. Canada: inward FDI stock, 2000, 2008

(US$ billion)

Economy	2000	2008	Growth (percent)	Share in GDP (percent)	
				2000	2008
Canada	215	474	120	33	34
Memorandum: comparator economies					
US	1,257	2,279	81	14	16
Mexico	97	295	203	20	27
UK	439	983	124	30	37

Source: UNCTAD's FDI/TNC database, available at: http://stats.unctad.org/fdi/. The GDP data for all countries are taken from World Bank's World Development Index.

Annex table 2. Canada: inward FDI flows, 2000-2008

(US$ billion)

Economy	2000	2001	2002	2003	2004	2005	2006	2007	2008
Canada	66.8	27.7	22.1	7.5	-0.4	25.7	59.8	108.3	44.8
Memorandum: comparator economies									
US	314.0	159.5	74.5	53.1	135.8	104.8	237.1	271.2	316.1
Mexico	18.0	29.8	23.7	16.5	23.7	21.9	19.3	27.3	21.9
UK	118.8	52.6	24.0	16.8	56.0	176.0	156.2	183.4	96.9

Source: UNCTAD's FDI/TNC database, available at: http://stats.unctad.org/fdi/

Annex table 3. Canada: distribution of inward FDI stock, by economic sector and industry, 2000, 2008 [a]

(US$ million)

Industries based on NAICS [b] classifications	**2000**	**2008**	**Growth (percent)**
Primary	***23,009***	***103,322***	***349***
Agriculture, forestry, fishing and hunting	764	1,145	50
Oil and gas extraction	15,194	69,494	357
Mining (except oil and gas)	4,184	25,634	513
Construction and utility	2,867	7,049	146
Secondary	***104,071***	***160,970***	***55***
Chemical manufacturing	13,347	23,492	76
Computer & electronic manufacturing	9,948	6,119	-39
Transportation equipment manufacturing	16,224	18,685	15
Other manufacturing—group 1 [c]	41,416	57,887	40
Other manufacturing—group 2 [d]	23,135	54,786	137
Services	***87,813***	***206,554***	***135***
Transportation and warehousing	2,014	4,265	112
Information and cultural industries	5,408	8,170	51
Finance and insurance	25,057	56,704	126
Management of companies and enterprises	17,881	57,014	219
Other services industries	37,452	80,402	115
Unspecified	0	2760	
All sectors/industries	**214,893**	**473,606**	**120**

Source: Statistics Canada: CANSIM, Table No. 376-0052.

[a] The original data were in Canadian dollars and were converted into US dollars using average annual exchange rates (Canadian dollar per US dollar of 1.485 for 2000 and 1.066 for 2008).

[b] North American Industry Classification System.

[c] Other manufacturing—group 1 includes nine NAICS 3-digit industries: (1) food, (2) beverage & tobacco, (3) textile mills, (4) textile products, (5) clothing, (6) leather, (7) wood product, (8) paper, (9) petroleum and coal product manufacturing. Other manufacturing—group 2 includes eight NAICS 3-digit industries. They are: (1) plastics and rubber, (2) non-metallic mineral, (3) primary metal, (4) fabricated metal, (5) machinery, (6) electrical equipment, appliance and component, (7) furniture related and (8) miscellaneous manufacturing.

[d] Other services industries include the following five NAICS industries: (1) wholesale trade, (2) retail trade, (3) real estate and rental and leasing, (4) professional, scientific and technical services, (5) accommodation of food services.

Annex table 4. Canada: geographical distribution of inward FDI stock, 2000, 2008

(US$ million)

Region/economy	2000	2008	Growth (%)		2000	2008	Growth (%)
World	**214,893**	**473,606**	**120.4**				
Developed economies	***210,599***	***435,973***	120	*Asia/Oceania*	*2,815*	*9,575*	240
Europe	72,073	142,921	107	Hong Kong , China	2,272	[a]	
European Union	64,579	124,376	98	India	12	959	7809
Austria	153	229	93	Malaysia	79	64	-20
Belgium	1,939	2,314	50	China	129	2582	1897
Cyprus	NA	1,749		Philippines	1	2	39
Denmark	261	841	223	Saudi Arabia	[a]	2	
Finland	339	1189	251	Singapore	98	179	82
France	24,914	17,392	-30	Rep. of Korea	156	810	418
Germany	4,966	8,793	77	Taiwan Province of China	65	91	39
Ireland	710	646	-9	Thailand	1	5	597
Italy	616	1,226	99	UA Emirates	[a]	4,883	
Luxemburg	2,012	5,311	164	*Latin America and Caribbean*	*1,245*	*12,462*	901
Netherlands	10,327	3,1754	207	Argentina	[a]	41	
Poland	8	7	-19	Bahamas	133	337	154
Spain	440	271	-38	Barbados	162	370	129
Sweden	1763	1600	-9	Brazil	418	11,182	2574
United Kingdom	16,131	51053	216	British Virgin Islands	63	249	293
North America	*130,405*	275,430	111	Cayman Islands	22	[a]	
United States	130,405	275,430	111	Chile	6	[a]	
Other developed economies	*15,615*	36,167	132	Colombia	2	1	-54
Australia	1,152	3,840	233	Jamaica	1	[a]	
Bermuda	1,391	1,964	41	Mexico	145	231	59
Israel	197	721	267	Nether. Antilles	228	5	-98
Japan	5,415	12,207	125	Panama	63	47	-25
Liechtenstein	86	169	97	Peru	1	[a]	
New Zealand	68	38	-43	Venezuela	3	[a]	
Norway	3,370	2,843	-16	***Transition economies***	***6***	***348***	5642
Switzerland	3,937	14,384	265	Russian Federation	6	348	5642
Developing economies	***4,139***	***22,683***	448	***Unspecified***	***149***	***14,602***	9712
Africa	*79*	646	713				
South Africa	79	646	713				

Source: Statistics Canada: CANSIM, Table No. 376-0051
[a] Suppressed due to confidentiality.

Annex table 5. Canada: top 20 largest foreign affiliates in Canada, ranked by revenue, 2008

Rank	Company	Industry	Revenue [a] (US$ billion)	% of foreign ownership
1	Imperial Oil Limited	Oil and gas	29.3	69
2	Husky Energy Inc.	Energy	23.2	71
3	Wal-Mart Canada Corp.	Consumer services	15.6	100
4	Novelis Inc.	Metals and mining	10.9	100
5	Honda Canada Inc.	Automobile	10.8	100
6	Direct Energy Marketing Limited	Energy	10.7	100
7	Ultramar Ltd.	Oil and gas	10.4	100
8	Costco Wholesale Canada Ltd.	Consumer services	9.5	100
9	Ford Motor Company of Canada, Ltd.	Automobile	7.8	100
10	Canada Safeway Ltd.	Food retail	6.4	100
11	Home Depot Canada	Retailing	5.7	100
12	Gerdau Ameristeel Corporation	Metals and mining	8.5	66
13	Cargill Limited	Financial services	5.5	100
14	Best Buy Canada Ltd.	Computer	5.2	100
15	IBM Canada Ltd.	IT Services	5.1	100
16	Toyota Canada Inc.	Automobile	5.0	100
17	Hewlett-Packard (Canada) Co.	Computer	4.9	100
18	Sears Canada Inc.	Retailing	5.4	90
19	Conoco Phillips Canada Resources Corp.	Oil and gas	4.7	100
20	HSBC Bank Canada	Banks	4.0	100

Source: Financial Post Magazine, FP 500, 2009, Toronto.
[a] "Revenue" refers to sales by the Canadian business only, and not to the global revenue of the parent companies.

Annex table 6. Canada: M&A deals, by inward investing firm, 2007-2009

Year	Acquiring company	Target company	Target industry	Source economy	Shares acquired (%)	Estimated/ announced transaction value (US$ billion)
2009	Canada Pension Plan (Canada)	Macquarie Communications Infrastructure Group (Australia)	Financial services	Australia	100%	7.6
2008	Teck Cominco Limited (USA)	Fording Canadian Coal Trust (Canada)	Mining	USA	100%	13.2
2007	Western Oil Sands Inc. (Canada)	Marathon Oil Corporation (USA), WesternZagros Resources Ltd. (Canada)	Oil and gas	USA	100%	6.6
2007	- Madison Dearborn Partners, LLC (Chicago, Ill, USA) - Providence Equity Partners Inc. (Providence, New York, Los Angeles, London, Hong Kong and New Delhi) - Ontario Teachers' Pension Plan (Ontario, Canada)	BCE Inc. (Canada)	Communications	USA, UK, India	- OTPP 52% - Providence Equity Partners 32% - Madison Dearborn Partners 9% - Other, unidentified Canadian investors hold the balance of the equity.	48.1
2007	Rio Tinto Group (UK)	Alcan Inc. (Canada)	Aluminum production	UK	95.82%	38.1
2007	The Thomson Corporation (Canada)	Reuters Group PLC (England)	Financial news	UK	53%	17.4
2007	The Toronto-Dominion Bank (Canada)	Commerce Bancorp, Inc. (USA)	Financial services	USA	100%	8.5
2007	IPSCO Inc.	SSAB Svenskt Stal AB	Steel pipe manufacturer	Sweden	100%	7.7
2007	Alcoa Inc.	Alcan Inc.	Aluminum production	USA	100%	33.0
2007	Ontario Municipal Employees Retirement System (Canada), Apax Partners (International)	Thomson Learning assets The Thomson Corporation (vendor)	Higher education	International: North America, Europe, Asia	100%	7.8

Source: Financial Post Crosbie: Mergers & Acquisitions database in Canada, 2009: available at: www.fpinfomart.ca

Annex table 7. Canada: main greenfield projects, by inward investing firm, 2007-2009 [a]

Investing company	Joint venture partner (if any)	Target industry	Home economy
2009			
Bruno Blervaque		Management	France
Shanghai Zhongrong Property Group	Baizheng Song	Metals and mining	China
Pilatus Energy AG		Oil and gas	UAE
Renewable Energy Holdings PLC		Energy	Isle of Man
Takeda Canada, Inc.		Pharmaceuticals	Japan
DEGI Homburg Harris Limited Partnership		Real estate	Germany
2008			
AXIS Reinsurance Company		Insurance	Bermuda
Dunlop Sports Group Americas, Inc.		Retail	UK
Partner Reinsurance Company Ltd.		Insurance	Bermuda
Partner Reinsurance Europe Limited		Insurance	Ireland
Great Lakes Pork, Inc.		Farming	US
Cardiff-Assurances Risques Divers		Insurance	France
Cardif Assurance Vie		Insurance	France
Triton Insurance Company		Insurance	US
Bed Bath & Beyond Canada L.P.		Retail	US
EDS Group Holdings Limited		Other	UK
Louis Dreyfus Canada Ltd.		Other	US
Lowe's Companies, Inc.		Retail	US
2007			
ABC Learning Centres Limited		Real estate	Australia
Plavor III B.V.		Real estate	Netherlands
Alan Minty		Oil and gas	UK
Concession A25, L.P.		Construction	US
CS Automotive Tubing Inc.		Automobiles	Republic of Korea
Universal Power Transformer Inc.		Energy	India
Dalkia International S.A.		Health care	France
PMI Mortgage Insurance Co.		Insurance	US
Host International of Canada, Ltd.	Cancouver Uno, S.L. and Aldeasa Canada Inc.	Retail	Spain
BBPP North America S.a.r.l.		Construction	Channel Islands
Laing Investments Management Services		Financial	UK

Source: Industry Canada.
[a] Data are confidential.