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EMERGING NEO-MERCANTILISM IN CANADIAN POLICY TOWARD STATE ENTERPRISES AND FOREIGN DIRECT INVESTMENT

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I. Introduction

Canadians have written many volumes[1] about their relative inability to preserve their domestic economy from the deepening entanglements of American foreign investment. They cite such highly visible names as Exxon and General Motors for special notice since their Canadian subsidiaries dominate their respective local industries. Canadian nationalists fear that these firms as well as others from the United States will rejuvenate the now discredited continental thesis, which calls for the economic merger of Canada and the United States into one highly-integrated North American market. So uneasy are Canadians about potential American challenges to their sovereignty that they have resurrected

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1. Americans are generally unaware of this literature; four books give a flavor of the controversy that raged in Canada between nationalists and those who favored continental ties with the United States. The first by D. W. CARR, RECOVERING CANADA'S NATIONHOOD(1971), is a well written, lucid analysis of Canada's chronic dependency upon the United States; it spells out clearly what alternatives are available to Canada should it decide to pursue a more nationalistic policy. It had an important influence on shaping the final outline of Canadian policy toward American foreign investment. The second, FOREIGN DIRECT INVESTMENT IN CANADA(1972)(the Gray Report) was another attempt in a long series of Canadian federal government reports, which date back to Walter Gordon's efforts in 1963, to show the magnitude of control that Americans had over Canadian minerals and industry, and to preserve what was left for Canadian initiative. The third, INDEPENDENCE: THE CANADIAN CHALLENGE (A. Rotstein & G. Lax eds. 1972), provides useful excerpts from important articles written by Canadians favoring nationalistic policies. The fourth by W. POPE, THE ELEPHANT AND THE MOUSE(1971), is a short piece that explains some of the historical patterns that brought Canada to its current predicament. Both the Rotstein and Pope books provide useful bibliographies for Americans who wish to carry out further study into the reasons behind current Canadian policy.

mercantilistic ideas long thought to be dead and buried. These nationalists are interested in "state-making," and to achieve this end they have established federal and provincial state enterprises to counter the influence of American controlled subsidiaries in their domestic economy. As a part of this strategy, these nationalists have sponsored the passage of a foreign investment code,[2] which will require American investors in Canada to form participation arrangements and joint venture agreements with Canadian businesses and state enterprises. No longer is investment in Canada a relatively simple decision for Americans, for the new Canadian business-government relationship alters former preconceptions. The scope of this article encompasses the changes that have occurred in American-Canadian relationships, the impact of these changes on the business-government environment in Canada, and the future for present and prospective United States investment in the Canadian economy.

II. Canadian Reactions to United States Economic and Cultural Activity North of the 49th Parallel

Canadians react to the United States with either envy or uneasiness. They admire United States technological prowess and its ability to maintain a high standard of living, and since Canadians also benefit from United States economic performance, some believe that they could benefit more if they were a part of a larger North American union. During the 1950's and 1960's, a few Canadian leaders championed continentalism, *i.e.* a more complete economic integration similar to the bilateral agreement on the free transit of automobiles and spare parts.[3] Moreover, in the late 1960's, there was the spectacle of a provincial premier calling for Alberta's political union with the United States. Such public repudiation of the ancient loyalty to Queen and country transformed Ontario's traditional anxiety over United States ability to alter Canadian cultural values into a national search to determine and preserve the unique characteristics of Canadian nationality. In the 1970's, however, thoughts of continentalism were diminished by

2. Foreign Investment Review Act. For an analysis of the Act and its requirements See Comment, *Foreign Investment*, 7 VAND. J. TRANSNAT'L L. 725 (1974).

3. Mcrory, *The United States-Canadian Automotive Products Agreement: The First Five Years*, 2 LAW & POL. INT'L BUS. 1 (1970).

two distinct influences, which drew Canadians closer together. "One [was] the growing recognition . . . of the great opportunities to be exploited in Canada in the next few decades, and the evidence that Canadians could exploit them more fruitfully for Canada. The other [was a] strong and growing national spirit that opposes selling out Canada's economic heritage, her unique culture, and her sovereignty without making some effort to preserve for Canada the great benefits she would thereby lose."[4] These two unifying concepts, to which federal prime minister Pierre Elliot Trudeau and his ruling Liberal Party subscribe, brought an end to Canadian flirtation with continentalism.

No doubt encouraged by the resurgence of national spirit and by the desire for Canadian exploitation of Canadian resources, three provinces—Ontario, Prince Edward Island, and Sasketchewan have enacted laws that place severe restrictions on the transfer of land to foreigners. Ontario charges nonresidents a twenty per cent transfer tax when they acquire vacation property. This tax constitutes a lien, which is a first charge in priority to others including mortgage costs. Moreover, Ontario imposes a 50 per cent tax on the gain from such a sale. Americans who own undeveloped land for the construction of shopping centers and industrial parks as well as those who own summer homes are liable for the two provincial taxes. These taxes are clearly prohibitive and are designed to discourage Americans from buying additional land in the province since 90 per cent of the land in the highly desirable southern Great Lakes region is already foreign-owned. Americans who supplied one-half of the 140 million dollars[5] recently invested in real estate in the greater Vancouver area, and similar sums in Calgary and Montreal, should be forewarned that over the long run their investments are not necessarily secure. For example, Nova Scotia recently expropriated American-owned seaside property because it felt that the Canadian federal government was not acting fast enough to screen land purchases by foreigners. This brought a strong statement from the Halifax Chronicle Herald, which stated that "the [expropriation action tells] Americans that they will have few rights and little protection if they purchase property or

4. CARR *supra* note 1, at 73.

5. All figures are quoted in Canadian dollars. On Sept. 14, 1974, $1.00US equaled $1.01300C.

invest in this province." In other words, debt capital is welcome, but equity investment is now highly suspect in many of Canada's provinces. Canadian nationalists are serious about inhibiting, in any way possible, the American cultural presence in Canada. For example, when the newly formed World Football League enticed three Miami Dolphins players to become the nucleus for the incipient Toronto Northmen, Canadian nationalists rushed in before the first kickoff and blocked this new form of American competition for the Canadian Football League. As a result of their efforts, the Northmen became the Memphis Southmen and Canadian football's only serious competition is still the National Football League whose games are viewed over American television.

Mordecai Richler, who is best known in the United States for his *Apprenticeship of Duddy Kravitz*, analyzes the cultural costs better than any other Canadian writer. He recently returned to his native Montreal after twenty years of expatriate living in London because he too desired to be a part of the emerging new Canadian national identity. He does not, however, let these loyalties blind him to the facts, and he cautions other Canadians to be objective. In writing about films, the arts, and the literary world, he points out that Canadian artists have been

> long, marvelously long on integrity [referring to the notion that they did not migrate to London or New York], but conspicuously short on talent. [Even with the aid of the Canadian Film Development Corporation, the Ontario Arts Council, and the National Arts Centre in Ottawa] nationalists still feel Canadian ownership is the answer to most of our problems . . . .
>
> That within ten years any publishing or distributing company operating in Canada be required to increase Canadian ownership and control to the standard presently set for the broadcast industry (*i.e.* 80 per cent) or cease to operate in Canada. That all mass paperback distributors in Canada be required within one year to increase to ten per cent the percentage of Canadian-written and manufactured books displayed in every outlet, and that this percentage rise to 25 per cent in three years and be subject to regular review.
>
> Others, more militant would even seek to impose a Canadian content and display quota on hardback bookshops; and our playwrights, newly aroused, are not far behind in their demands. They are now shamelessly set on gaining by stealth (or legislation, if you like) what talent alone has denied them . . . [According to Tom Hendry in *Saturday Night*, their latest manifesto calls for] theatres

> receiving subsidies be required to produce 50 per cent Canadian material . . . .
>
> God help us. As things stand, Canadian theatres . . . are pleading . . . for acceptable, even actable Canadian material . . . . The truth is, armed with a not inconsiderable bankroll and the best will in the world, they still cannot find sufficient Canadian material of quality, and I defy any nationalist to show me an indigenous play of talent—no, even of promise—that lacks a production.[6]

These are strong words, but they point squarely to the heart of the issue. Nationalism in its most blatant form sacrifices quality by shielding domestic efforts from the rigors of international criticism and acclaim. On the economic front, the question remains, will Canada's new laws regulating foreign investment and establishing counterbalancing state enterprises inhibit international trade and, thereby, stifle the Canadian economy?

III. Canadian Neo-Mercantilism

Economic policy reflects the conditions of the time in which it emerges. Not too long ago, internationalism reigned supreme in the western world, but now the power of the nation-state is on the verge of becoming predominant again, perhaps only temporarily, yet long enough to force some nations to follow practices, such as mercantilism, which Adam Smith challenged some 200 years ago. In essence, mercantilism[7] is "state-making;" its true end is political, *i.e.* the creation of a strong independent country that is autarkic in nature.

In such a situation, the Queen requires a set of industrial business resources that are under her government's control. This wealth is to be accumulated so that Canada's power increases, and since the country is in competition with other nations, it must not surrender its resources, such as its minerals, factories, and jobs, but instead it must hoard them as a sign that its wealth and concomitant power are increasing.

Today in Canada mercantilists attach preponderate importance to industrial business activities as the most acceptable form of

6. Richler, *Going Home Again*, N.Y. Times, Sept. 1, 1974, §7 (Book Review), at 10, 11-12.

7. For the reader who is unfamiliar with the tenets of mercantilism see J. Schumpeter, History of Economic Analysis 335-61 (1954).

wealth currently available. Are these *façons de parler* or are the neo-mercantilists confusing means with ends? Isn't the right mix of enterprise resources only a sign of wealth? Don't enterprise resources simply stimulate the economic activities of the country?

Assuming that industrial business resources are in some sense wealth, how does Canada acquire such wealth? It has petroleum, iron ore, and other critical minerals in quantities far in excess of the needs of its 22 million people. Therefore, Canada's task is to prevent the outflow of these minerals and natural resources to other countries or if they must, to trade them for industrial facilities and the jobs they represent to insure full employment in Canada. In addition, Canada must maintain a "favorable balance of trade," represented by the excess value of exports over imports. There must always be a balance of payments due Canada, and to accomplish this end, Canada must discourage trade with those countries that will render the balance unfavorable.[8]

The consequences of such a mercantilistic policy are readily apparent. Canadians must be discouraged from accepting foreign sports teams, books, plays, and other goods and services. They should produce what they need for themselves rather than depend upon others. Their industrial enterprises should strive to export the bulk of their production. The national and provincial governments must do everything in their power to further this policy namely, maintain high petroleum and mineral prices and import duties; grant patents of monopoly over land and air services; promulgate a code inhibiting foreign direct investment; and aid the creation of privileged state enterprises. These are only some of the more outstanding examples of how mercantilism is practiced in Canada today.

Are Canadians guilty of the folly of Croesus in thinking that wealth consists of minerals, factories, and jobs instead of the benefits that these economic resources bring? In fairness, it should be said that they value such resources as the means by which power can be attained, and given the circumstances of the time and the Canadian desire to get out from under the American embrace, their approach to the problem might be justified if it does not lead

8. For application of these ideas to government policies under consideration or now being pursued in the United States and in other western countries see Cobbs, *The New Mercantilism: Hoarding Jobs*, BUS. WEEK, March 31, 1973, at 38.

to a decline in the Canadian standard of living. As always, when one discusses why economic policy is changing within a country, it is necessary to look first at the political environment of the economy, for political forces determine the form, nature, and substance of economic policy. Only when this is understood is it possible to reflect upon why Canada, like other nations, is veering away from its post-Second World War allegiance to internationalism and accepting leadership from those nationalists who argue that new forms of national control must be brought to bear upon the economy.

IV. THE CANADIAN STATE AS ENTREPRENEUR

Nationalism in Canada has flourished in the past just as in the present, for Canada itself was formed because the Crown's English-speaking subjects in British North America felt threatened by America's growing dominance on the continent. Faced with the consideration that England had sold out British Columbia when a determined American president wanted to fix the boundary between that Crown Colony and the Oregon territory at the 49th parallel, the question was raised whether Ontario, which knifed into the American Midwest, could resist a determined army flush from its victory over the Southern Confederacy. Such an eventuality was not taken lightly, especially since American settlers were already pushing into the Red River area of the Hudson Bay Company's territories and calling for its formal annexation to the American union. Pushed by these events, Canadian nationalists in 1867 hurried to gain provincial and English acceptance of the British North America Act, the Canadian constitution, which incorporated the provinces of Nova Scotia, New Brunswick, Quebec, and Ontario into a new self-governing confederation.

While the United States Government espoused *laissez-faire* and permitted the private sector to dominate economic decisions, from its inception the Canadian federal government utilized its express and implied powers to become involved in the new national economy. The nationalists in Ottawa used their powers to inhibit the transfer of additional British land to United States citizens. As early as 1869, a mere two years after Confederation, Rupert's Land and the Northwest Territories were bought from the Hudson Bay Company, and one year later the English and French-speaking Red River settlements around Winnipeg and St. Boniface became the province of Manitoba. In 1871, Sir John Macdonald, Canada's first prime minister, promised British Columbia that if the latter would join Canada, the federal government would build a transcontinental railroad to Vancouver within ten years.

It is abundantly clear from Canada's history that the Canadians have traditionally engaged their government in speculative endeavors when it seemed that there was a lack of private Canadian resources and initiative and that such a deficiency might result in giving the United States a critical or perhaps fatal advantage over Canada. The construction of the transcontinental Canadian National Railroad was just the first example of this business-government relationship in Canada. Private interests saw nothing but ensuing losses for a railroad that would compete directly with American railroads, which were then fanning out from Chicago to various points along the West Coast from Los Angeles to Seattle. It would, of course, have been cheaper and more efficient to build spur lines off the Great Northern Railroad to provide connections with Winnipeg, Edmonton, and Vancouver. Such a scheme, however, would have strongly reinforced the developing north-south trading patterns found in the American and Canadian west, and consequently, might have led Manitoba and the settlements along the Saskatchewan River (now the provinces of Saskatchewan and Alberta) to federate with the United States rather than continue their affiliation with eastern Canada. As always, British Columbia would have continued its political allegiance to the Crown although for its own self-interest it would remain closely tied economically to the Pacific Slope states. By building the transcontinental Canadian National Railroad, the federal government and Toronto's Bay Street business interests forestalled the western settlements' decision of whether it was more beneficial to embrace or disregard Canada. Yet, despite the Canadian National Railroad and other federal policies, the north-south trading axis continues throughout the west to the chagrin of eastern Canadian interests.

This pattern of federal government involvement in national commerce, endorsed by Toronto business interests and aimed at stemming the north-south flow of men, materials, and capital and restructuring it into an intra-Canadian flow, reemerges continually in the twentieth century. Air Canada was chartered as a government corporation to link Canadian cities when air transportation became a viable alternative to ground transportation. The rationale for this venture was analagous to that of the Canadian National Railroad, *i.e.* to avoid the use of major United States cities as points of arrival and departure for passengers and freight moving from Halifax on the Atlantic to Vancouver on the Pacific. There are many other examples of state enterprises in Canada as well. Some are Crown Corporations and, thus, responsible to the party in power in the House of Commons, while others are not Crown Corporations, but are owned by the federal government through control of the corporation's common stock and still others are owned by the provinces. These firms have been established to carry out objectives that the governments involved deemed important to the maintenance of a Canadian or provincial way-of-life, separate and distinct from the demands of the international economy or the United States. Therefore, an examination of these various state enterprises is essential.

A. *Crown Corporations*

Besides Canadian National Railroad and Air Canada, the federal government owns firms in the following industries: banking, insurance, real estate, manufacturing, wholesale trade, retail trade, electric power, and communications. Within these general categories are included such firms as the Industrial Development Bank of Canada, Panarctic Oils, Eldorado Mining and Refining, Northern Transportation, Canadian Broadcasting Corporation, and Telesat. It is of significance to note that if one employs the International Monetary Fund methodology for measuring the financial performance of government enterprises and government-owned enterprises,[9] these firms have not succeeded in achieving profitability. Their overall average flow-of-funds ratio, *i.e.* the internally generated supply of funds, relating to receipts and expenditures on current account, was a negative 6.6 per cent during the late 1950's and 1960's.[10] Since current expenditures exceeded cur-

9. The difference between the two sets of enterprises is as follows: government enterprises do not keep their own reserves (apart from working balances) whereas government-owned enterprises do. Crown corporations include both types of enterprises. *See* A. Gantt & G. Dutto, *Financial Performance of Government-Owned Corporations in Less Developed Countries*. 15 I.M.F. STAFF PAPERS 102-41 (1968).

10. Duggal, *Performance of Government Enterprises in Canada*, 41 ANNALS OF PUBLIC AND CO-OPERATIVE ECONOMY 339, 341-42, 345 (1970).

rent revenues, these corporations required an average of six and a half cents of external resources for each dollar of commercial activity. For the same period, European state enterprises have achieved a positive mean flow-of-funds ratio of 0.7 per cent.[11] By comparison, the government-owned sector in the United Kingdom, France, Italy, Sweden, and the Netherlands is larger than in Canada; however Canada's public sector is larger than its equivalent in Belgium, Denmark, and Norway. It should be noted, however, that these ratios determined under the International Monetary Fund methodology do *not* include an allowance for depreciation, and thus comparisons with private-sector firms are inappropriate.

If the flow-of-funds analysis is broken down by sector, finance, insurance, and real estate provide a ratio of 13.6 per cent; manufacturing and wholesale trade 6.2 per cent; transportation 5.1 per cent; while communication provides a negative ratio of minus 85.5 per cent.[12] This means that federal enterprises in the first three sectors have been profitable, with those in the first sector being highly profitable. On the other hand, the communications firms, such as the Canadian Broadcasting Corporation, were not profitable and needed an average of eighty-five cents of external resources for each dollar of activity. Therefore, one may conclude that Canadian public services have been highly subsidized by federal taxes.

If the overall average investment ratio of federal state enterprises of 19 per cent is added to the negative flow-of-funds ratio of 6.6 per cent one can see that almost 25 per cent of each dollar of activity was financed by the Canadian federal government or from loans backed by the government.[13] This can also be broken down by sector. The investment ratios of the transportation and communication industries were both close to the national mean, or 15.3 per cent and 22.4 per cent respectively, whereas the ratio for manufacturing and wholesale trade was 1.2 per cent and finance 4.6 per cent. Thus, firms in the latter two industries have financed many of their new investments from retained earnings or from private external borrowing, while firms in the other industries have had to use the federal treasury as one of their principal sources of funds because of their unprofitability and their lack of promise for a

11. Gantt & Dutto, *supra* note 9, at 108.
12. Duggal, *supra* note 10, at 342, 345.
13. Duggal, *supra* note 10, at 343, 345, 351.

profitable turn around that would warrant large infusions of private capital. An additional reason for such a wide discrepancy between investment ratios in the transportation and communications industries and the wholesale trade and finance industries is that the first two sectors had underpriced their services, as measured by a low flow-of-funds ratio, which increased demand and the public's desire for more investment. There seems to be an inverse relationship between higher profits and low rates of investment both in Canadian federal enterprises and in the western world at large.[14]

Since the completion of this analysis of state enterprises the Canadian Government has withdrawn several of these enterprises from the status of Crown Corporations. The impact of this decision is that in the future these state enterprises will have to meet market tests of profitability and return on investment if they intend to generate sufficient capital for new investment. Such a transformation of government controlled firms into more market-oriented state enterprises is not uncommon in both Europe and Latin America. The significance of such a move is that, if successful, it will mean that these Canadian state enterprises may join the ranks of publicly owned firms, which compete with United States based multinational firms in the international economy.

B. *Canada Development Corporation*

In 1971, Parliament established the Canada Development Corporation as an autonomous mixed corporation[15] aimed at developing and maintaining Canadian control and management of private sector corporations by providing capital for investment and entrepreneurial activities deemed beneficial to Canada.[16] Although initially government owned, through a 250 million dollar subscription, the CDC is designed to combine the public and private sectors of the economy by obtaining public subscriptions and consequently over a period of years reducing the level of government

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14. *Id.*; Gantt & Dutto, *supra* note 10, at 112.
15. The CDC is a mixed corporation, *i.e.* it is structured as a private corporation but has state equity participation.
16. For a detailed analysis of the CDC's history, structure and objectives see Couzin, *The Canadian Development Corporation: A Comparative Approach*, 17 Mc Gill L.J. 405 (1971).

ownership to approximately ten per cent.[17] While the CDC was not established as a Crown Corporation, it is impowered to acquire, through the Governor General in Council, Crown Corporations at a reasonable fair market price.[18]

Over the last three years, through an active program of takeovers and new investments, the CDC has become a financial conglomerate with assets in excess of 800 million dollars and diversified holdings in six primary fields.

1. *Mining*.—In 1973, after a bruising battle in the United States courts, the CDC acquired 30 per cent of the shares of Texasgulf, Inc., a United States corporation with extensive holdings in Canada.[19] For its investment of 290 million dollars, the CDC received representation on the board of directors and a voice in the company's operations, which include extensive operations in Canada, such as Texasgulf's vast mining facilities at Timmins, Ontario.[20]

2. *Petrochemicals*.—Exercising its charter authority, the CDC paid 62 million dollars for 100 per cent control of Polysar,[21] a Canadian Crown Corporation, which has offices and factories in fourteen countries. Through an extensive acquisition program Polysar has acquired such United States corporations as Nye Rubber, Standard Brands Chemical Industries, Polytherm Plastics, and Solar Chemical Corporation. In addition to these holdings, Polysar will be a 51 per cent owner of the new petrochemical complex, Petrostar, at Sarnia, Ontario once the necessary arrangements are worked out with the government of Alberta to provide the new plant with an adequate supply of basic petrochemical feedstocks.

3. *Pharmaceuticals*.—Through the flexibility of its charter, the CDC has been able to diversify its holdings in various fields. For example, the CDC recently paid 25 million dollars for Connaught Laboratories of Toronto and 5 million dollars for Onnimedic Inc.

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17. *Id.* at 411.

18. *Id.*

19. Americans may find it useful to read about the CDC purchase of Texasgulf from a Canadian point of view. Robert Jamieson reported on these events in the August and September issues of Toronto's *Financial Post*. *See also* N.Y. Times, Jan. 20, 1974, §3 (Finance), at 7, col. 1.

20. N.Y. Times, Jan. 20, 1974, §3 (Finance), at 7, col. 1.

21. Polysar was called Polymer as a Crown Corporation.

of Montreal, expanding its interests into the health care field. In addition to these acquisitions, it also owns Raylo Chemicals and R&L Molecular, biochemical research firms in Edmonton, as well as 75 per cent of Dumex, a Danish drug firm. Through Dumex the CDC is investing in a joint venture in Brazil's pharmaceutical industry. From these efforts, the CDC hopes to create a Canadian pharmaceutical firm that will compete with United States companies in Third World markets.

4. *Venture Capital.*[22]—In conjunction with the CDC's charter policy of providing a Canadian source of venture capital, the CDC has invested in Canadian enterprises during their embryonic stages to encourage Canadian entrepreneurial activity. In light of this policy, the CDC paid 4.5 million dollars for a 35 per cent interest in Venturetek International Ltd., a Toronto-based corporation. Three of Venturetek's eight new companies are start-ups, and one of these, Pop Shoppes of Canada, a retail chain, has been very successful both in Canada and the United States. Further, the CDC paid 2 million dollars for majority interest in Ventures West, a Vancouver-based corporation. In the future, the CDC plans to invest in other corporations that are having problems maintaining adequate profits and a reasonable rate of return on their investments and considering the cost of money on today's market, the CDC represents the only viable alternative for most Canadian entrepreneurs. Moreover, the CDC makes its presence felt in these corporations by placing one of its managers as president of the corporations in which it has invested.

22. Because Canadian entrepreneurs believe that venture capital is scarce within Canada, major campaigns have been initiated to let them know that such capital is available from both private and government sources. This includes the publishing of a complete guide to Canadian capital, SOURCES OF VENTURE CAPITAL (P. McQuillan & H. Taylor eds. 1973), which lists private Canadian sources (at 71-125), provincial government sources (at 63-70), and federal government sources as well (at 55-62 and at 126-28). Knight, *The Supply of Venture Capital in Canada* 12, April 1973 (unpublished research paper in University of Western Ontario School of Business Administration Research and Publications Division) suggests that there is no shortage of venture capital only a shortage of venture capital management. This is reported also by Sinclair, *Canada's Real Problem is not Foreign Ownership*, Financial Post (Toronto), Sept. 29, 1973, at 20. Should this be the case, it would bode ill for the Canadian economy since through the new nationalistic policies Canada could be cut off from American venture capital management.

5. *Pipelines and other Transportation.*—The CDC is involved in the new Canadian Arctic Gas Study Ltd., which is examining the feasibility of an oil and gas pipeline through the Mackenzie Basin of the Northwest Territories. But in regard to another aspect of the transportation industry CDC has been excluded from participation in the government's plans to reshape the air frame industry, to bring it under Canadian control, and to make it internationally competitive.

6. *Oil and gas.*—Although the CDC is authorized by its enabling act to take over the government's Crown Corporations in this field, to date neither the federal government nor the CDC has made any significant moves to bring this industry under CDC's control. There is some discussion in Ottawa that Canada will charter a separate petroleum state enterprise rather than place oil and gas under the CDC's control.[23] The decision is still forthcoming and will depend, in large part, on the willingness of Alberta and other provinces to give up their control over oil and natural gas reserves to a federal government corporation. Initial indications, however, suggest that the provincial interests will not be pressured into giving up their control over these vital energy resources.

The above cited areas represent the CDC's fields of interest as well as its current list of subsidiary corporations. The CDC's investments are consistent with its policy of achieving profitability in its acquisition program for such profitable investments can provide the CDC with opportunities to strengthen Canadian participation in these industries both at home and abroad. These new subsidiaries should provide CDC with technical and financial strength to compete in the world's markets as well as a cash-flow sufficient to pay off the loans procured by the CDC to acquire these corporations. Moreover, the CDC has refrained from investments having marginal prospects for profitability. Although corporate profitability is one of the CDC's main investment objectives, profitability is not the CDC's sole criteria in managing its investments, for as law professor Ivan R. Feltham[24] stated when called as an expert witness by Texasgulf during the CDC takeover trial: "When there is a conflict between maximizing profits on behalf of the

23. Wall Street J., Oct. 3, 1974, at 7, col. 3.
24. Osgoode Hall, York University, Toronto.

shareholders and acting in the best interests of Canada, the CDC's representatives on Texasgulf's Board of Directors must opt for doing what is best for Canadian national interests."[25] So far this opinion has not been tested, but logic would suggest that a state enterprise or a mixed enterprise must subordinate its concern for profit to national interests when confronted with such a choice. Thus, this is the essential conflict that confronts all state enterprises no matter how independent they seem in their domestic market economy or in foreign markets.

C. *A National Air Frame Industry*

Recently, Ottawa decided to reorganize the Canadian air frame industry, which historically was comprised of many small-scale foreign-owned firms. The Canadian Government has decided that it wants to create one large-scale firm under national control that can compete internationally with the United States, Britain, and France. Pursuing this policy, the federal government purchased the British-owned De Havilland Aircraft of Canada Ltd., a subsidiary of Hawker-Siddeley Group Ltd., and plans to acquire the American-owned Canadair Ltd., a subsidiary of General Dynamics, for a total investment of 70 million dollars. Further, it is possible that the federal government will take over American-owned subsidiaries of United Aircraft and McDonnell Douglas as well. The government's intent is to create an attractive package that can be resold to private Canadian interests, but at present, both the CDC and Air Canada have been rebuffed in their quest to gain control of the government's assets in the air frame industry, which perhaps suggests that the federal government is trying to create some competition for its other state enterprises. Such a policy will be consistent with the actions of France and other governments to create two or more state enterprises in the same industry so that there will be more competition in the national market and several entries in the overseas export and foreign investment markets.

It is possible that Canada will be able to create an internationally competitive air frame industry, for the Canadians who worked for the former foreign-owned subsidiaries came up with new tech-

25. Texasgulf, Inc. v. Canada Development Corp. 366 F. Supp. 374 (S.D. Tex. 1973).

nological breakthroughs which in many cases were not marketed because their parent organizations preferred to utilize technology developed in Great Britain or the United States. Yet, even if this technological proclivity continues there is no guarantee that their advances will become the world's standard. There is, however, one significant problem, for without the incremental sales to United States and British defense industries that the former foreign-owned subsidiaries provided, it will be impossible for one large-scale Canadian air frame firm to break even.

United States investors should follow with great care the success or failure of this attempt to bring together small-scale firms, with dissimilar former owners and styles of doing business, and to meld them into one large unit of production. Any degree of success with this process by the federal government will only encourage such governmental action in other key industries.

D. *Provincial Enterprises*

These government-owned firms are involved in a plethora of activities, including forestry, mining and oil production, manufacturing, transportation, communications, electric power, wholesale and retail trade, finance, real estate, and personal services. Applying the International Monetary Fund methodology for measuring their financial performance, one will note that these firms have been more successful than equivalent federal state enterprises. The provincial enterprises overall average flow-of-funds ratio was a positive 17.7 per cent during the late 1950's and 1960's as compared to a negative 6.6 per cent for federal enterprises during the same period.[26] The significance of these figures is that the provincial enterprises exhibit overall profitability as demonstrated by the excess of current revenues over expenditures, though it should be noted that these figures make no allowance for depreciation.

If the flow-of-funds is broken down by sector, one finds the following ratios by industry in the order of their profitability:[27]

26. Duggal, *supra* note 10, at 344-45.
27. *Id.* at 345.

Industry	%
retail trade	42.7
electric power	36.7
mines and oil wells	36.5
communications	26.8
personal services	14.4
wholesale trade	12.4
forestry	11.8
transportation	7.5
finance, real estate	4.4
other utilities	1.0
manufacturing	0.3

If these percentages are compared to those given for the federal state enterprises, one can conclude that provincial enterprises in the communications industry are doing a great deal better than the Canadian Broadcasting Corporation. In all industries, except finance and real estate, the provincial enterprises are outperforming their counterpart federal enterprises.

If the overall investment ratio of provincial enterprises of 51.3 per cent, is broken down by sector, the following ratios by industry are found:[28]

Industry	%
other utilities	213.9
electric power	124.2
manufacturing	74.3
transportation	59.6
communications	54.6
wholesale trade	16.3
finance, real estate	10.9
mines and oil wells	9.4
retail trade	1.3
forestry	0.3

If these figures are compared to federal investment ratios by sector, in each case the provincial enterprises have a greater investment ratio than do equivalent federal state enterprises. In the case of the

28. *Id.*

provincial enterprises, however, there seems to be no discernible relationship between higher profitability as measured by the flow-of-funds ratio and low rates of investment. As a practical matter, provincial enterprises use a combination of retained earnings, private placement of debt, provincially backed debt, and outright provincial government transfers to generate investment capital. Such financial maneuvering is required since private capitalists are less willing to provide debt capital to the provincial enterprises than they are to provide federal state enterprises with debt capital. The rationale for this attitude perhaps stems from the occurrence of some notable failures among the provincial enterprises.

One such failure is Quebec's *Sociètè Generale de Financement*, a provincially owned conglomerate, which controls a half-dozen firms including those that it purchased, such as Marine Industries Ltd., Bonnex Inc., Cie. Biscuits Stuart Ltd., and David Lord Ltd. and those it established as new enterprises such as Sofegor Ltd., Cegelec Industries Ltd., Soma Inc., and St. Lawrence Fertilizers Ltd.—a joint venture with Noranda Mining Co. The parent corporation has had to call upon the provincial government to bail it out, for its decade-old experiment to merge public and private investment in an economic development corporation proved to be a failure. To minimize the impact of the corporation's failure all non-government common shares of the parent corporation, which are now in the hands of the credit unions, insurance companies, and the public at large, will be bought back by the provincial government. Those holding these shares of stock will be issued long-term bonds backed by the credit of Quebec. Such a return on investment is far less than the investors' initial expectation upon the commencement of this government-owned conglomerate. A second example is the loss that the government of Manitoba has taken in cost overruns while building a forest-products complex at The Pas.[29] The initial construction for the project was 80 million dollars, but the final cost may reach twice that amount. The provincial government has been unable to control with much effectiveness the process of ordering, installing, and operating, the project's machinery and consequently, the total project has been greatly delayed. It may be some time before private investors are again willing to assume that a provincial government has the managerial

29. Lamont, *Managing Foreign Investment in Southern Italy* 109-10, (1972).

capability to undertake such a large-scale investment project.

Despite these two well-known failures, the provincial governments are moving ahead to bring other vital industries under local government control. For example, Newfoundland has acquired Brinco's 57 per cent interest in the Churchill Falls Corporation, which controls power generated in Labrador for use in Canada and the United States.[30] Saskatchewan has initiated a policy, which if fully adopted, will give the provincial government a 50 per cent interest in all mining claims within the province. Quebec, through its *Société Québeçoise d'Initiatives Petrolieres*, purchased a 2.2 per cent interest in Panarctic Oils Ltd., a Crown Corporation, from Bow Valley Industries Ltd. The rationale for this investment of 7.9 million dollars is that it will give the province a small stake in the potential oil development of the Northwest Territories. Further, Alberta recently bought twenty per cent of Interprovincial Steel and Pipe Corporation to insure the availability of steel supplies for building its oil, pipeline, and petrochemical industry. In addition, Alberta also paid 36.7 million dollars for Pacific Western Airlines, Canada's largest regional carrier with routes throughout British Columbia, Alberta, and the Northwest Territories, so that the province would be insured of good transportation and the capability of moving its goods to Canada's population centers.

The success of these provincial investments has yet to be determined. Of the provinces, Alberta has substantial oil revenues that, over time, it may utilize to promote industrial development within the province. The other provinces, however, do not have these revenues to support their ambitious programs for attaining provincial control over key industries some of which are now in foreign hands. Rather, they are pursuing this course out of their concern about the future ability of Canada to regain control of its economic destiny. Hopefully, public money will not be wasted by these provinces as it was in the case of Quebec and Manitoba.

V. The Canadian Foreign Investment Review Act[31]

The recently promulgated foreign investment code, the Foreign

30. *Canada goes more nationalist*, The Economist, April 20, 1974, at 79-80 elaborates the neo-mercantilistic argument in analyzing the issues behind the take over of Churchill Falls Corporation by the government of Newfoundland.

Investment Review Act, is another means available to Canada's federal government to nationalize industry through state enterprise management, private-sector management, or a combination of the two. Since Ottawa's new Foreign Investment Review Agency (Agency) began operation on April 9, 1974, the outline of its influence is only barely visible. However, the policy underlying the Act is fairly clear. First, new foreign investment must be in harmony with the long-term economic policy and goals of the Canadian Government, and must be compatible with provincial goals and policies as well. Secondly, a preference will be given to non-United States investors. Thirdly, new investments must provide Canada with significant economic benefits before they will be approved. Such economic benefits include the following: bringing in new technology, which will increase output and create jobs; improvement of raw material processing; increasing Canadian exports; replacing imports with Canadian-produced goods; developing local suppliers; training more and better qualified managers and technicians; and bringing greater efficiency and competitiveness to Canadian industry. Although the rationale for the Act is evident, the actual course that will be pursued by the Agency remains open to speculation. Therefore, a consideration of the Act's requirements is necessary before one predicts the Agency's impact.

The thrust of the Act is to limit the acquisition of control of Canadian corporations by foreign or non-eligible interests.[32] Therefore, to invoke the application of the Act a certain threshold requirement must be met. In the case of a publicly held corporation,

31. Various issues of the Financial Post from January to May 1974, will provide the American reader with all the details behind various provisions of the code and how these will affect foreign businesses. *See also Canada's Code for Foreign Investors: An inheritance in pawn,* Financial Times, March 19, 1974, at 24. Hermann, *Canada explains new investment controls,* Financial Times, January 3, 1974, at 26. *Trudeau's new rules for foreign investors,* Bus. Week, August 24, 1974, at 58. *What the Code Requires: An insistence on full disclosure,* Financial Times, March 19, 1974, at 24.

32. A "non-eligible person" means: (a) an individual who is neither a Canadian citizen nor a landed immigrant, (b) a foreign government or government agency, (c) a corporation that is controlled in any manner that results in control in fact by persons deemed non-eligible if 25 per cent or more of the voting stock of a public corporation or 40 per cent of the stock of a close corporation is held by non-Canadians, or if more than 20 per cent of the directors or managers are non-Canadian. FIRA §3(2).

there is no acquisition of control, and no application of the Act, if shares representing less than five per cent of the voting rights of the corporation are acquired by non-eligible persons.[33] As for private or closely held corporations, control for purposes of the Act is not acquired when shares representing less than twenty per cent of the voting power of the corporation are acquired by a non-eligible person.[34]

Further, the provisions of the Act are brought into play, provided the requisite control is found, for all proposed acquisitions by non-eligible persons of enterprises with gross assets in excess of 250,000 dollars and annual gross revenue of 3 million dollars. To ascertain whether control will result from such an investment, the Act provides three presumptions. First, control is conclusively presumed if a non-eligible investor holds more than 50 per cent of the voting stock of the corporation.[35] Secondly, upon the acquisition of more than five per cent of the voting shares of public corporations or more than twenty per cent of the shares of a close corporation, a rebuttable presumption of control results.[36] Thirdly, if there is less than the specified five or twenty per cent ownership, lack of control will be presumed.[37]

While the above is just a skeletal outline of the Act's provisions, it is clear that its goal is to provide close scrutiny of (1) direct investment in or expansion of businesses in the Canadian economy by foreign corporations or interests and (2) indirect investment or acquisition by foreign controlled Canadian corporations. These parameters give the Act a broad application and insure that the Act will have a significant voice in foreign investment in Canada.

The Foreign Investment Review Agency has utilized its authority to promulgate regulations and has required that all corporations within the purview of the Act that seek approval of their investment plans must provide such information as the citizenship of their officers and directors, the volume of their goods and services marketed in Canada as well as a list of all corporate business interests in the dominion. In addition to such general information,

33. FIRA §3(3)b(i)A.
34. FIRA §3(3)b(i)B.
35. FIRA §3(3)d.
36. FIRA §3(3)c(i-ii).
37. FIRA §3(3)b(i)A-B..

Agency regulations require definitive information about the corporation's corporate methods of financing and of conducting research and development to determine the extent of Canadian involvement in these aspects of the corporate operation. Moreover, breakdowns on marketing, purchasing, and capital expenditures are required to provide the Agency with an estimate of the company's impact on the Canadian economy. Through the availability of this information, the Agency will be better able to determine whether a Canadian-based corporation is an independent entity or an appendage of a foreign corporate interest. Further, the Agency wants to evaluate the corporation's investment plans in the light of the beneficial impact such an investment will make—a process requiring a thorough grasp of the investing corporation's operation. The significance of these regulations is that without such information, the Agency may turn down an investment proposal or require a renegotiation of the plan along lines favored by the Agency.

As of September 1974, only one foreign firm has foregone an investment in Canada because of the Foreign Investment Review Act, Anil Pulp & Paper, which is owned by G.J. Jolly of India. Anil wanted to acquire Jannock Corporation's pulp paper assets in New Brunswick prior to September 30, 1974, but the Indian company could not get the Foreign Investment Review Agency to give its approval prior to that date and thus the company rescinded its offer to purchase.

Thus far, no United States investment has been turned away although some companies have had to revise their plans before being given permission to acquire Canadian-based corporations. Since none of these investments were in areas deemed sensitive by the Canadian Government, such as minerals or petroleum sectors, a real test case has not been presented to judge the impact of the Act. One can speculate, however, that United States investors will not be permitted to own the majority of the stock in any of these key industries. Instead, deals will be fashioned along the lines taken by other host countries in dealing with foreign corporations. Such an approach provides a further rationale for the establishment of state enterprises since they provide the national government with a vehicle by which they can negotiate joint ventures or other suitable relationships with these multinational firms to insure the benefit and protection of the national interest.[38]

38. For a discussion of what American firms must do to secure the best deal

The Foreign Investment Review Act is simply a device to curtail foreign acquisition plans until the Canadian government has had time to analyze the impact of such an investment and to consider the desirability of negotiating a participation arrangement for one of its state enterprises, if that is desired. Thus the Act should be viewed as a weapon used by the Government to protect the Canadian economy from further foreign incursions by controlling the terms for allowing foreign investment. Therefore, the Act should allow the Government to encourage investment in sectors needing additional capital while curtailing investment in capital intensive areas as well as encourage investment that involves Canadian participation and decision making, factors deemed to be of benefit to Canada. These elements of economic self-determination are essential in the nationalists drive to deploy Canadian petroleum, minerals, manufacturing, and labor in erecting a barrier behind which these resources can be used to build a stronger Canadian nation.

VI. Declining Foreign Investment in Canada

By the end of 1973, United States long term investment in Canada amounted to 28 billion dollars.[39] Although there have been additional investments by United States firms through 1974, principally through the utilization of the retained earnings of their Canadian subsidiaries, these investments are occurring at a decreasing rate. Given the need for additional output in the United States, United States corporations are reorienting their investment programs toward the United States with less emphasis on overseas operations, which represents a significant change from the past. Moreover, those American firms that are investing overseas are not choosing Canada because of the radical change in the Canadian investment climate. To clarify this point statistically, one should note that from 1970 to 1973, the United States share of total foreign investment in Canada decreased from 82 per cent to 78 per cent. In addition other foreign interests, the Germans in particular, have similarly perceived the new Canadian attitudes towards foreign investment. Thus, from 1970 to 1973, there was a decline in the

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for themselves in a contractual joint venture see Lamont, *Joining forces with foreign state enterprises,* HARV. BUS. REV. 51, 68-79 (1974).

39. Survey of Current Business (Washington, D.C. Department of Commerce, 1973). *See also* H. Solomon, *Financial Post*, 21 July 1973, at 19.

percentage of foreign ownership of Canadian enterprises from 36 to 34 per cent.[40]

Juxtaposed against these data are several events that reduce the import of the shift away from foreign ownership and its relationship to new foreign investment. First, in 1973 the CDC acquired a substantial interest in Texasgulf, thereby reducing foreign control in Canadian mining and smelting industries from 70 per cent in 1970 to 54 per cent in 1973.[41] Secondly, in 1973, the majority ownership of the stock equity in several Canadian-based corporations, such as International Nickel Co. and Alcan Aluminium Ltd., passed from United States to Canadian hands. These shifts in stock ownership were caused by the changes in Canadian tax rules on pensions and profit-sharing arrangements, and by the differing views of United States and Canadian portfolio investors on the value of the two stocks. The rate of increase of United States foreign investment in Canada has slowed. Such a slowing, at present, is a function of two factors: (1) the existence of a large stock of investment capital already in Canada attendant with a capital need in the United States; and (2) the increasing awareness of the difficult investing conditions for United States interests. The conclusion which should be drawn is that United States, European, and Japanese investors are reevaluating their responses to new Canadian investment opportunities and a few have decided that better opportunities lie elsewhere.

From the evidence seen so far, it is possible to conclude there will be a further decline in the rate of United States investment in Canada, for the possibility of additional nationalistic laws and interpretations of the Foreign Investment Review Act will tend to dampen United States interest in Canada. Moreover, it will take time for United States investors to develop a new pattern of doing business in Canada in conjunction with the federal and provincial enterprises. As a result of these impediments to foreign involvement in the Canadian economy, one can safely say that the Canadians will have to look to domestic sources for new investment capital and the management skills needed to create and operate profit-making businesses. Their success or failure will determine whether the Canadian economy will expand or become stagnant during the next few decades.

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40. *Id.*
41. *Id.*