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FREE TO CHOOSE?
GLOBALIZATION, DEPENDENCE AND CANADA'S CHANGING
FOREIGN INVESTMENT REGIME: 1957-87.

by

Elizabeth A. Smythe B.A. M.Sc.

A thesis submitted to the
Faculty of Graduate Studies and Research
in partial fulfillment of the
requirements for the degree of
Doctor of Philosophy

Department of Political Science,
Carleton University

Ottawa, Ontario

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**FREE TO CHOOSE?: GLOBALIZATION, DEPENDENCE AND
CANADA'S CHANGING FOREIGN INVESTMENT REGIME, 1957-1987**

submitted by

Elizabeth A. Smythe, B.A (Hons), M Sc

in partial fulfilment of the requirements
for the degree of Doctor of Philosophy

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ABSTRACT

This dissertation employs a combined international political economy and public policy framework to analyze Canada's changing foreign investment regime in the 1957-87 period.

In contrast to much of the previous scholarly work this research does not focus exclusively on investment screening. Instead, Canada's foreign investment regime is conceptualized in terms of three broad types of policy instruments and the differing levels of state intervention and coercion of private investors they involve. Changes in the pattern of policy instruments used to manage foreign direct investment (FDI) in the 1957-87 period are described. These changes are then accounted for by tracing the influence of three power-based relationships which are seen to act as constraints on the state's choice of policy instruments. The three relationships include:

1. Canada's changing relationship to international capital.
2. Canada's economic dependence on the United States as a source of capital and a market for the export of Canadian goods.
3. Canada's relationship to the international investment regime, which becomes increasingly hostile to national controls over FDI.

The impact of these factors, however, is mediated by a changing consensus within the Canadian state on its role in the domestic economy.

This dissertation addresses the question of how much room to manoeuvre sovereign states, such as Canada, have in their choice of economic policy instruments in an era of increasingly globalized production. It also calls into question the notion that multilateral fora and international organizations can provide an alternative for Canada to a bilateral approach to economic policy disputes. As such it challenges the idea that bilateral asymmetries and economic dependence can be counteracted through multilateralism.

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TABLE OF CONTENTS

Abstract	iv
Acknowledgements	v
Table of Contents	vi
List of Tables	x
CHAPTER ONE INTRODUCTION	1
The International Political Economy and Foreign Investment Regime Change	7
Research Design	23
Data and Sources	26
Conclusion	27
Endnotes	29
 CHAPTER TWO FOREIGN INVESTMENT REGIMES, ECONOMIC LINKAGES AND THE STATE: A FRAMEWORK FOR ANALYZING FOREIGN INVESTMENT REGIME CHANGE	
Introduction	35
State Intervention and Economic Development	37
The Nature of the Canadian State	38
State Intervention: A Comparative Perspective	41
Canadian State Intervention: The Policy Instruments	47
State Intervention: The Canadian Pattern	53
States and Foreign Direct Investment	58
The Pattern in OECD Countries	59
Policy Instruments - Access	63
Policy Instruments - National Treatment	68
Other Policy Instruments	71
The Pattern: Developing Countries	73
Conclusion	78
Classifying Foreign Investment Policy Instruments	80
Economic Linkages and Foreign Investment Regime Change	84
Explaining Foreign Investment Regime Change	94

Conclusion	101
Endnotes	103

CHAPTER THREE CANADA IN THE WORLD ECONOMY: ECONOMIC DEPENDENCE AND CHANGING INVESTMENT RELATIONS

Introduction	122
From Trade to Internationalized Production: The World Economy in the Postwar Period	123
Canada in the World Economy: The Maturation of a Host State	127
Canada in the World Economy: Trade Dependence	140
Conclusion	154
Endnotes	157

CHAPTER FOUR EXPLAINING FOREIGN INVESTMENT REGIME CHANGE: INTERNATIONAL CAPITAL AND STATE INTERVENTION

Introduction	163
Foreign Investment Regime Change: The Pattern	164
Conclusion	169
Foreign Investment Regime Change: Setting the Stage	173
Foreign Investment Regime Change: 1967-75	178
The Watkins Report	179
The Gray Report: Defining the Policy Options	183
From Policy Recommendations to Policy Instruments	192
Explaining the Decision to Screen	205
Foreign Investment Regime Change - Compensating For FDI	207
Screening and Compensating: The Transition - 1976-79	213
FDI Regime Change, 1980-85: Adjusting to the International Economy	221
Changing Investment Relations	221
Foreign Investment Regime Change and the Struggle Over Manufacturing Subsidiaries, 1980-82	225
Foreign Investment Regime Change: The Energy	

Sector, 1980-82	237
From FIRA to Investment Canada	243
Sectoral Measures - Culture and Energy	251
Conclusion	254
Explaining FDI Regime Change	255
Appendix A Inventory of Investment Policy Instruments	262
Appendix B Policy Proposals Regarding Changes to the Foreign Investment Regime.	271
Appendix C Position of Interest Groups on Foreign Investment Legislation	274
Endnotes	279
 CHAPTER FIVE ECONOMIC DEPENDENCE AND CANADIAN FOREIGN INVESTMENT REGIME CHANGE : THE BILATERAL DIMENSION	
Introduction	297
The United States and Investment Regimes	301
The US State and Canada's FDI Regime	307
Economic Dependence and the Decision to Screen FDI	311
Conclusion	315
US Opposition to Canada's FDI Regime, 1980-82	317
US Policy of FDI: Ensuring Open Access	319
Economic Dependence and FDI Regime Change: The Struggle Over FIRA	320
Conclusion	330
US Opposition to Canadianization of the Energy Sector 1980-82	330
Conclusion	337
Market Access and the Transformation of Canada's Foreign Investment Regime: 1983-87	338
US Investment Policy: The Link to Trade	344
Conclusion	347
Trade Negotiations and Foreign Investment Regime Change, 1985-87	348
Access	352
Discrimination	353
Compensation	354
Conclusion	354
The FTA and Canadian Investment Regime Changes	354

Conclusion	361
Appendix A Chronology 1980-87, Canada-US Relations and Investment Issues	368
Endnotes	378

CHAPTER SIX INTERNATIONAL INVESTMENT REGIMES: CANADA'S SEARCH FOR COUNTERWEIGHTS AND BALANCE

Introduction	394
International Investment Regimes	402
Canada, the OECD and the Codes	407
Conclusion	429
The United Nations and the Codes: The Quest for Balance	431
Conclusion	441
Trade, Investment and the GATT	442
Conclusion	456
Assessing Multilateralism: Canada and the International Investment Regime	457
Endnotes	462

CHAPTER SEVEN CONCLUSION

Introduction	474
Explaining Foreign Investment Regime Change	475
The North American Free Trade Agreement and Foreign Investment Regime Change	486
NAFTA and FDI Regime Change	487
Access	488
Discrimination	489
Other Additions	490
Explaining Negotiation Outcomes	491
Conclusion	498
The Uruguay Round and Foreign Investment Regime Change	499
Explaining Investment Outcomes in the Uruguay Round	502
Conclusion	504
Accounting for Foreign Investment Regime Change	505
Endnotes	510

LIST OF TABLES AND FIGURES

Table 2.1 Government Expenditures as a Per Cent of GDP, 1950-82.	42
Table 2.2 International Comparisons of Total Government Expenditures on a National Accounts Basis as a Per Cent of GDP/GNP.	43
Table 2.3 General Government Expenditure and Net Lending as a Per Cent of GDP as Current Prices, 1960, 1980 and 1987.	44
Table 2.4 Social Expenditure as a Per Cent of GDP in OECD Countries, 1960-85.	46
Table 2.5 Total Financial Aid to Industry, 1950-80 By Level of Government.	51
Table 2.6 Public Enterprise for 16 OECD Countries as a Per Cent of Total Investment in Rank Order, 1970-74.	52
Table 2.7 Flow of FDI into Selected OECD Economies as a Per Cent of Outflows.	59
Table 2.8 Per Cent Distribution of Inflows of FDI into Selected OECD Economies	60
Table 2.9 Inward and Outward Stocks of FDI for OECD Members.	61
Table 2.10 Inward Stock of FDI as a Per Cent of GDP - Selected OECD Member Economies.	62
Table 2.11 Number of Reported Discriminatory Measures as of 1983.	70
Table 2.12 Impediments to FDI by Sectoral Monopolies Reported to the OECD in 1981.	72
Figure 2.1 A Model of Foreign Investment Regime Change	100
Table 3.1 Gross Domestic Product and Population of Twelve OECD Countries, 1983-87	127
Table 3.2 Flows and Total Stock of FDI in Canada	129
Table 3.3 Change in the Book Value of FDI in Canada 1950-88.	130

Table 3.4 Foreign Direct Investment as a Per Cent of Gross Fixed Capital Formation.	132
Table 3.5 Ownership and Control of Capital Employed in Canada in Non-Financial Industries, Selected Years.	133
Table 3.6 Ownership and Control of Capital Employed in Non-Financial Industries by Sector, 1951-89.	134
Table 3.7 Per Cent of Foreign Ownership and Control of the Petroleum Industry Based on Upstream Revenues	135
Table 3.8 Outward Flows of Canadian Direct Investment Abroad.	137
Table 3.9 Canadian Direct Investment Abroad, 1950-88.	138
Table 3.10 Imports and Exports as a Per Cent of GDP, Various Years for the Largest OECD Countries, 1950-81.	142
Table 3.11 Canadian Trade Balance by Manufacturing Sector, Selected Industries, 1966-87.	145
Table 3.12 Canadian Trade With the United States - Selected Years, 1961-84.	147
Table 3.13 Canadian Exports to the United States as a Per Cent of Total End Product Exports - Various Years 1950-87.	148
Table 3.14 Trade Partner Concentration: Exports to the Largest Trading Partner as Per Cent of Total Exports for Twelve OECD Countries.	149
Table 3.15 United States Exports to Canada as a Per Cent of Total Exports, Selected Years, 1950-87.	150
Table 3.16 Canada's Balance of International Payments Selected Years, 1950-87.	152
Figure 4.1 Foreign Acquisition Activity 1950-75.	184
Chart 4.3 Comparison of the Gray Report Recommendations with Bill C-201 and C-132.	196
Table 4.1 Disposition of FIRA/Investment Canada Cases 1974-1988.	215
Figure 4.4 Comparison of the FIR Act and Investment Canada Bill.	247
Table 5.1 United States FDI in Canada, 1967-75.	307

Figure 5.2 Exports to the US as a Per Cent of Total
Exports 1950-87.

310

CHAPTER ONE

INTRODUCTION

This dissertation examines a broad range of Canadian federal state policy instruments adopted to deal with the impact of foreign direct investment (FDI)¹ on Canada in the thirty-year period, between 1957 and 1987. It accounts for changes in policy instruments employed by the Canadian state to manage FDI by focussing on a number of factors at the national, bilateral and international levels.

Canadian investment policy has been the subject of vigorous debate and scholarly research for many years. Much of it has focussed on the creation and demise of the Foreign Investment Review Agency (FIRA)² and the domestic forces, such as classes, class fractions, or public opinion³ which shaped Canadian investment screening policy. This dissertation differs from the previous work in two ways. First, it focusses on a broader range of policy instruments, beyond screening, which were employed by the Canadian state to achieve its objectives vis-a-vis FDI. Second, it attempts to analyze the relative contribution of changes in Canada's position in the international economy, its bilateral economic dependence on the United States and the changing international investment regime to help account for the choice of policy instruments and changes in them over time.

For many of the earlier studies which focussed on the

creation of FIRA and the rise of Canadian economic nationalism in the late 1960s and early 1970s, the decision to screen FDI was seen as a response to a particular set of class-based interests. In some studies, these interests were seen to emerge out of a context of economic dependence⁴ or as a response to the demands of new classes or public opinion⁵. While these studies sought to explain Canadian state action to deal with FDI, or the lack thereof, the nature of the Canadian state's choice of measures, as a response to these pressures, was not seen as problematic.

With the changes to Canadian policy on investment screening in 1985, 1987 and 1992 (as a result of the Free Trade and North American Free Trade Agreements) new research attempted to address why Canada liberalized its policy on investment screening, looking this time to changes in the international political economy and their impact on domestic interests and state managers.⁶ Again the actual choice of policy instruments, in this case a retention of a more limited screening function, vigorous promotion of Canada as an investment location, along with continued sectoral restrictions, was not the central focus of inquiry.

In contrast the public policy literature would regard the state's choice of measures as problematic. Thus an analysis of changes in Canada's foreign investment regime, I argue, can be facilitated by drawing on the public policy literature which addresses the forms of domestic state economic

intervention in addition to examining Canada's links to the international political economy. Public policy research tries to understand the forces shaping the particular ways in which states have intervened in their economies to achieve social and economic objectives.⁷ The focus on these different means of intervention helps to clarify the range of options available to states and identify domestic factors shaping the decision to use a particular instrument or set of instruments to achieve a policy goal. Different constraints and motivations have been identified in the literature as shaping the choice, including ideology, electoral expediency, the role of interest groups and legal constraints⁸. Policy instruments have been categorized according to varying characteristics including: first, the extent of coercion of private actors involved, that is, the use of sanctions of varying levels of severity by the state; second, the extent of visibility, that is, "the capacity to document and thus assess the associated costs of the use of an instrument⁹" and third, the level of the state's intrusion¹⁰, directly and publicly, on private economic decisions.

The consequence of combining a fuller conceptualization of Canada's foreign investment regime, in terms of the choice of policy instruments, with a more careful assessment of the influence of externally-based factors is a more complete explanation of Canadian FDI regime change. This, in turn, provides public policy analysts with a clearer specification

of the impact of externally-based constraints on Canadian state decision-making in an era of globalized production.

Clearly externally-based constraints have not been totally ignored in the study either of Canadian foreign or domestic policy. For some analysts, in the 1960s and 70s, the asymmetry of Canada's economic linkages with the United States and the high level of U.S. foreign direct investment¹¹ rendered any autonomy-seeking behaviour on the part of the Canadian state toward either U.S.-based multinational corporations, or the United States, unlikely or largely symbolic in intent.¹² More recently, coming from a different perspective, some policy analysts have argued that Canada's FDI regime is a response to forces of globalization and competitive pressures which have necessitated the liberalization of controls on the entry of foreign capital.¹³ Indeed the enhanced mobility of capital and the integration of production across national borders has led some pessimists to predict, once again, the demise of the nation-state as globalization renders governments incapable of carrying out policies.¹⁴

Both of these perspectives on external constraints are troubling. In the first, over two decades of vigorous policy debate in Canada and a number of state actions in the 1970s to deal with FDI are dismissed. The second perspective, on the other hand, fails to explain Canada's retention of a limited screening function and some sectoral controls on investment

through the late 1980s and into the 1990s, despite the forces of globalization and the enhanced mobility of capital. Nor can it account for the vigorous bilateral bargaining which occurred in the late 1980s to retain some of those controls. Yet a state-centric perspective, which might see Canada as a rather unconstrained international actor¹⁵, is equally untenable in the area of foreign economic policy, where capital mobility and Canada's dependence on the U.S. economy cannot be ignored.

More recently political economy scholars have acknowledged both the fact that Canada is a large, industrialized country with an increasingly internationalized economy and strong multinational firms of its own and that the Canadian state has played a role in "organizing Canadian capitalism".¹⁶ In particular the state has taken actions in the past to alter economic linkages with the United States and strengthen Canadian capital, while at other times the state has acted to reinforce economic linkages, suggesting that the economic relationship with the United States has not had an entirely determining effect on Canadian foreign economic policy. Yet the debate continues over what Canada's position in the world economy is and what that means in terms of the autonomy of the Canadian state.¹⁷ The structure of Canada's trade and investment relationships, particularly high levels of foreign control and export dependence on the United States, and how that has constrained foreign economic policies that

seek to adjust to changes in the global economy, has to be clarified.¹⁸ One of the objectives of this dissertation is to contribute to that effort through a study of changes to Canada's FDI regime.

To date most of the studies of Canadian foreign investment policy have ignored another externally-based factor which the international relations literature has addressed, namely multilateral coordination of economic policy and the formation of international regimes. The role of Canada in the formation of rules and norms on state treatment of foreign investors and the impact of these rules and norms on Canadian policy on FDI cannot be ignored for two reasons. First, a body of codes and rules on the treatment of foreign investment have begun to be formalized both in regional trade agreements¹⁹ and in multilateral economic organizations²⁰. Since they are closely linked to trade rules they are of great significance to Canada as an open economy, but one with high levels of foreign ownership. Second, many analysts of Canadian foreign policy have regarded Canadian participation in multilateral organizations as a method of pursuing Canadian interests which can provide an alternative to U.S. dominance of Canada, which arises out of the context of economic dependence. This dissertation, unlike previous studies, examines Canada's activities on investment issues within multilateral organizations and how these related to bilateral investment disputes. It assesses Canada's success at influencing the

development of an international investment regime and the impact of this regime on Canada.

The primary research question this dissertation addresses is why the Canadian state chose to intervene in the foreign direct investment process using a particular mix of policy instruments. Essentially the hypothesis is that three changing external relationships have influenced the Canadian state's choice of policy instruments to manage FDI. In particular these relationships have increased the cost over time of using policy instruments which discriminated against foreign firms or limited the access of foreign investors to the Canadian economy.

The International Political Economy and Foreign Investment Regimes

James Caparaso and Stephen Haggard²¹ have identified three power-based relationships in the political economy literature which, I will argue, are critical to understanding the Canadian, and other host states', foreign investment regimes. The first is the relationship between host states and international capital which has been analyzed typically as a bargaining relationship where the resources of both host state and capital may vary cross-nationally, by sector and over time²². The second is the bilateral economic relationship between dependent and dominant states which is centered around asymmetries of vulnerability to the disruption

of economic exchanges and the capacity of dominant states to impose costs through economic retaliation against defiant, dependent states. The third can be found at the multilateral level in the relationship between nation states and the development of international economic regimes and rules, some of which may be enforced by international organizations.²³

The focus on these three relationships is particularly apt for Canada. Canada's position in the international economy has altered considerably since FDI first became a policy issue in the late 1950s. First, Canada has moved from being a primary destination for foreign, especially United States-based capital, to being a capital exporter in its own right with a number of large Canadian-based firms that have become increasingly internationalized.²⁴ At the same time a large stock of Canadian corporate assets remain under foreign control. Second, Canada became an increasingly export dependent economy, centred on access to the United States market, especially for manufactured goods. Finally, multilateral fora have often been seen as a central focus of Canadian foreign policy and a useful counterbalance for Canada to the dominance of the United States in the bilateral economic relationship.²⁵ Canada was an active member of the major international economic organizations which began to address the issue of foreign direct investment in the 1970s and 1980s and sought to influence, and ultimately adhered to, the rules and norms which emerged.

None of these relationships, however, entirely determines the choices that host states make in the management of FDI for two reasons. First, as Caparaso and Haggard have noted, many actors have difficulty translating superior power, in the sense of capabilities, into control over outcomes. The use of economic power in the form of retaliation against host states may involve unacceptable costs to those attempting to use them. Second, host state policy preferences vary widely and change over time. There are many instances and much evidence of host state decisions, which, because of domestic imperatives, have defied the threat, or actual sanctions, of international capital, dominant powers or international economic institutions. Thus a knowledge of the sources and nature of host state policy preferences is vital to understanding changes in host states' FDI regimes and differences among them²⁶.

Canada was not unique in developing or altering national rules and regulations dealing with FDI, especially in the early 1970s, nor in significantly relaxing controls on access for foreign investors in the mid 1980s.²⁷ Many host countries imposed regulations on foreign capital in the 1960s and 1970s only to liberalize their investment regimes in the 1980s. Why did states seek to control FDI in the 1960s and 70s? The answer to this question is found in changes to the role of the state which occurred in the post-war period in many countries and the explosive growth and impact of FDI on

states.

The 1960s and 70s were periods of rapid growth in the intervention of states in national economies.²⁸ It was not the fact that states played an economic role that was new but, as Richard Ashley has suggested²⁹, it was the "utterly transparent and unconcealed economic role of the state," which has been particularly distinctive in many advanced capitalist countries in the later postwar period. The state's claim to the loyalty of its citizens, particularly in liberal democracies, today rests very heavily on its ability to secure and enhance their economic well-being. Increased state intervention at one point, however, does not necessarily mean enhanced autonomy later.

State intervention in society, initially indicative of capacity to shape internal political and economic practices, may eventually lead to commitments and obligations, especially with the creation of new and entrenched pressure groups, that bind the state in subsequent periods of decision. Ironically the 'strong' state over time may become enfeebled by its own action and thereby begin to look quite 'weak'.³⁰

Certain types of international economic linkages provide greater challenges to states in the promotion of national economic well-being than others. Foreign direct investment has helped generate very rapid shifts in the competitive position of countries and has also raised major questions about the capacity of states to control their national economies, just at the point historically when states had been seeking wider and wider control of domestic economic

activity.³¹

The 1960s and the 1970s saw increases in the total flow of foreign direct investment, largely to and from industrial, market economies. In 1960 these flows amounted to \$4.1 billion (U.S.) at current values. By 1979 the flow had reached \$47.2 billion.³² The rate of growth in real terms, however, slowed throughout the 1970s as flows became increasingly volatile. Inflows peaked in 1981 and fell by 13 per cent between 1981 and 1985, and became increasingly concentrated in advanced industrial economies, especially the United States.³³ In contrast, the value of the stock of investment abroad from developed market economies continued to increase from \$67 billion (U.S.) in 1960, to \$275.4 billion in 1975 and \$693 billion in 1985.³⁴

The increase in FDI in the world economy in the past four decades has had an important impact on states by widening the disjuncture between the international economy as a system of production and exchange and the nation-state as an entity with a territorially-fixed jurisdiction. Trade, as an arms-length process of exchange, increasingly became overshadowed by patterns of exchange that were organized and structured within a single entity having a transnational scope of production. A growing proportion of these international economic transactions, therefore, were taking place within a private corporation even though they involved goods and services crossing national boundaries. Such movements could

be insulated from normal market forces such as changes in demand, prices, or exchange rates. Even more important they could be impervious to state policies designed to alter the forces or incentives governing international exchanges.

This grouping of international exchanges within a single corporate entity and the growth of global systems of production resulted in both intraindustry and intrafirm trade.³⁵ As such it challenged the ability of states to influence the international distribution of economic gains associated with multinational corporate production using existing economic policy instruments. The policy responses were varied and were not confined, in the 1960s and 1970s, to limiting or controlling access of foreign investors to national economies.

Some countries eschewed control of access in favour of other policies designed to permit the entry of foreign capital, but to enhance the position of national capital vis-a-vis non-national capital.³⁶ Others sought to attract FDI through generous incentives, but to attach conditions to the incentives to enhance the local economic benefits. Still others controlled or limited the entry of foreign capital on a broad or sector-specific basis. Many states also tried to establish a new regime for international investment through the negotiation of investment codes within international organizations.

By the mid 1980s, in contrast, many states, including

the Canadian one, had moved to alter the extent of state control over the entry of foreign investment. But the state response to changes in the international economy, particularly to globalization and the enhanced mobility of capital, was not uniform or consistent across countries or sectors. In fact, in the case of the United States, pressures have increased to increase state control over the entry of foreign capital.³⁷ Moreover other, less transparent barriers to entry continue to exist and may be available to states as policy options in the management of FDI.

Clearly we cannot understand the extent to which the three relationships and external economic linkages constrain economic policies of host states without also examining the nature of the state and the development of its role in the national economy. This dissertation focusses on the three external linkages in the context of the Canadian state's changing role in the economy in the period under study.

Foreign Investment Regime Change and Economic Linkages: The Case of Canada

To explain the sources of change in Canada's foreign investment regime we must begin with the concept of foreign investment regime. The particular mix of investment policy instruments adopted by the Canadian state at any one time I call its foreign investment regime. David Jodice defines a foreign investment regime as "the set of rules, regulations

and behavioral norms under which foreign enterprises are expected to operate."³⁸ The concept employed here, however, includes other non-regulatory policy instruments used by the Canadian state to deal with the impact of FDI.

Foreign investment regimes, while involving state economic intervention are also a form of foreign economic policy, which includes the broader state goals, objectives and activities undertaken to influence the international distribution of production and wealth through influencing patterns of international exchange. Thus any study of foreign economic policy instruments must recognize that there are really two loci of state activity, one national and the other international.

Because the state's jurisdiction is mainly limited to its own territory, its primary power lies in controlling access to its territory and defining the conditions under which foreign goods and capital may enter the market and on what basis they can operate in competition with local goods or capital.

A second locus of activity exists at the interstate level and can include direct bilateral or multilateral interaction with other states to alter or develop the rules governing the movement of capital and goods (referred to by some international relations scholars as regimes³⁹). States can try to lessen or counterbalance other constraints on foreign economic policy by developing international rules

which reinforce or legitimize national policies.

Because FDI regimes involve the management of international exchanges in the form of capital and because trade and investment issues have become increasingly interrelated this dissertation has adopted a conceptualization of the types of policy instruments used to manage FDI which parallels concepts used within international organizations that deal with trade and investment issues⁴⁰. Thus instruments can be distinguished according to the point at which they are imposed, before or after goods, or in this case capital, have crossed an international border. In the case of trade, border measures, such as tariffs and quotas, target foreign goods and seek to control or limit entry. Similarly states may control or limit the entry of foreign capital and these instruments have been labelled, for our purposes, access instruments.

Other trade measures target foreign goods after they have entered a country and thus explicitly discriminate between national and non-national goods. Similarly investment instruments may be designed to deal with already-established foreign firms (EFCs) and may be distinguished by the extent to which they treat foreign firms, whose entry has already been permitted, in a different manner than national firms. Such investment instruments we refer to as discriminatory. Investment regimes can be categorized according to their reliance on these two types of policy instruments.⁴¹

International trade negotiators and the rules they develop attempt to minimize the usage of these instruments by defining the conditions under which border controls and deviations from national treatment (ie. discrimination) are permissible among states and not subject to retaliation. Thus there may be differential costs to states in the decision as to which types of policy instruments they use to achieve their trade objectives. In addition to these two broad categories, international trade negotiators and international trade rules have come to recognize a residual category of national policy instruments which, although they make no explicit distinction between national and non-nationally produced goods, have the intended, but indirect effect of influencing the flow of goods to the advantage of domestic producers⁴². Similarly a residual category of investment policy instruments can be identified for FDI which neither control the entry of foreign capital, nor target EFCs for discriminatory treatment. Instead they have an intended effect of either limiting the capacity of foreign capital to enter or compete in an economic sector, or compensating for what are perceived to be negative consequences to the nation arising from the presence of foreign capital. While there is no common term for such measures in the case of trade, I have labelled such investment measures compensatory. It is important to distinguish types of policy instruments since certain types of policy instruments may be less acceptable to

international investors, home states or international organizations because of the amount of coercion or extent of state intrusiveness they entail. They may, therefore, also have different costs attached to their use. Despite the fixation in Canada with the debate over the wisdom of screening FDI (a form of access control), the use of other instruments, including those involving discriminatory treatment of EFCs, or compensatory measures, has been quite common in many host countries.⁴³ All FDI regimes can be described in terms of the predominance of the types of measures employed, that is, control of access, discrimination and compensation, and the level of coercion and intrusiveness involved.

The task, then, is to explain why states adopt a particular mix of these policy instruments. Clearly the external relationships identified above cannot completely explain a state's choice of policy instruments to manage FDI since they do not provide an understanding of how the Canadian state, or any other, defined the national interest in terms of FDI, what its policy preferences were, or how acceptable trade offs were defined when pursuit of investment objectives came into conflict with other economic objectives. Thus these external relationships, I argue, are necessary but not sufficient to explain foreign investment regime change. What is also required is a clearer understanding of the forces shaping the intrastate consensus on what was an acceptable

level of state intrusion into the economy and coercion of private investors. The reasoning for this assertion is that, while it is an aspect of foreign economic policy, the FDI issue is, given the high level of FDI in Canada by the late 1950s, a major question of national economic development. Like other aspects of domestic economic policy in liberal democratic political systems policy on FDI will be shaped by a number of influences including prevailing ideas, the preference and influence of domestic groups and the nature of state institutions (especially the structure of the national executive and the nature of federalism). The state is not seen, however, as a unitary, rational actor, but rather as an arena in which actors have varying amounts of influence on issues and decisions emerge as a result of conflict and ultimately compromises. In the case of issues relating to economic development, including FDI, much of the struggle has been over the extent of direct federal state intervention or coercion of private investors involved in the instruments chosen to achieve a particular policy goal. Each decision, therefore, reflects the balance of power of those interests likely to be advantaged or disadvantaged by a particular choice of policy instrument. The external influences, in the case of FDI, also come into play during decisions as the perception of the likely costs of a particular choice of policy instrument, especially if these are seen to be increasing significantly, will tip the balance against a

particular choice.

The first of those external relationships is:

1. Canada's changing relationship to international capital, particularly the transition to a mature host country.

This includes changing inflows and outflows of foreign direct investment and the longer-term accumulation of stocks which I refer to as a maturing process. In the case of FDI the post-war period has seen the rapid growth and then stabilization of U.S. direct investment in Canada; increasingly high levels of foreign control and robust inflows of capital until the 1970s, thereafter declining levels of foreign control and increasingly volatile investment flows. The flows are indicative of Canada's relative attractiveness, at any point in time, as a geographic location for FDI within the world economy. The accumulation of stocks resulted in an augmented level of foreign control of the Canadian economy, in the 1960s and 70s, as well as an increased outflow of repatriated earnings. As the stock of foreign-based capital grew Canadian capital became more internationally mobile. The need to maintain investor confidence, yet maximize the economic benefits of FDI (particularly the location of capital accumulation), while minimizing the economic and political costs of even higher levels of foreign control, was the challenge the Canadian state faced. This trade-off for a dependent host state, between autonomy and economic well-being⁴⁴, arises partly because of the mobility of international capital and the availability of alternative

investment locations, both of which may vary over time and by sector.

The second factor:

2. Canada's economic dependence, particularly on access to the U.S. market, and the resulting ability of the United States, in periods of conflict over investment regimes, to employ the threat of economic sanctions against Canada.

The increased openness of the Canadian economy, and the deteriorating international competitive position of certain sectors and increased trade dependence on the U.S., also shape the mix of policy instruments that characterize Canada's FDI regime. The costs and likelihood of U.S. economic retaliation against Canada will act as a constraint on changes to Canada's FDI regime. The United States is the primary source of FDI in Canada and the major home state most likely to be affected by Canadian measures to control or manage FDI. However, there is no assumption made here that the U.S. state automatically intervenes in all cases at the behest of U.S.-based MNCs to protect their interests. Not all forms of host state control or management of FDI threaten the interests of foreign investors. Nor can we assume that the U.S. state perceives its interests to be challenged by all such measures. However, in instances where U.S. state interests or those of its investors are threatened, the increased dependence of Canada on the U.S. market created potential leverage for the United States in efforts to alter Canada's foreign direct investment regime.

The performance of the United States economy has had, and continues to have, a major impact on the Canadian economy, particularly on economic growth. Although Canada's investment in the United States is not insignificant nor its economy small, its economic dependence on the United States has not been balanced by any equivalent economic dependence on the part of the United States on Canada. The asymmetry of the relationship, as will be demonstrated, is clear and unequalled in comparable advanced industrial countries and constitutes an important fact that must be addressed in the study of Canadian foreign economic policy. The fact that the United States has been gradually losing its dominant position in the international economy, becoming itself the largest capital importer and facing, like Canada, increasing competition from foreign goods in its domestic market has not necessarily offset Canada's vulnerability to changes in the bilateral economic relationship.

The third factor:

3. The nature of the international investment regime and whether it would reinforce and legitimate Canada's FDI regime or delegitimize or prohibit the use of various policy instruments to manage FDI.

This refers to host state efforts to enhance the legitimacy of national controls over FDI by influencing the international investment regime. This dissertation examines Canada's role in this process and the extent to which such efforts were successful in building international support for

Canada's FDI regime in the 1970s and 1980s creating an offsetting counterweight to U.S. dominance in bilateral economic relations.

Many dependent host countries, or those involved in asymmetric economic relations, have attempted to use the weight of numbers or other democratic decision-making procedures within international organizations to try to alter or shape international economic regimes.⁴⁵ Not all of these efforts have been successful. Thus the emerging international rules or norms in international investment may constrain or reinforce host states choices of policy instruments to manage FDI.

The impact of the three factors on Canada's FDI regime in the 1957-87 period is examined within a context that addresses the way the Canadian state has intervened in the national economy in the period under study. I focus particularly on the forms and scope of intervention and how they reflected a shifting consensus within the state on the intervention necessary to secure economic growth.

This time period has been chosen because it fits historically with the development of FDI as a public policy issue in Canada, beginning with the Royal Commission on Canada's Economic Prospects in 1957.⁴⁶ It encompasses major changes in Canada's investment regime in the early 1960s, 1970s, in 1980 and 1985 which culminate in several provisions of the Canada-U.S. Free Trade Agreement negotiated in October,

1987. However, several subsequent changes have occurred during the writing of this dissertation as a result of the North American Free Trade Agreement and the Final Act of the Uruguay Round of multilateral trade negotiations at the GATT. While not the focus of this dissertation an effort is made in the concluding chapter to assess these developments in light of the framework of analysis presented in this dissertation.

Research Design

The study uses a non-experimental, historical case study⁴⁷ research design to assess hypotheses. It begins in Chapter Two by developing a framework which identifies the range of state policy instruments that have been employed in the management of economic development and foreign direct investment in the past three decades, based on cross-national comparisons and inventories of these instruments drawn from data provided by the OECD and the United Nations. I then examine the literature and the empirical data which deal with the link between changing patterns of investment flows and stocks, economic dependence, international investment regimes and changes in national FDI regimes. Based on this analysis hypotheses are developed about the way in which Canada's maturing investment relations, growing economic dependence on the United States, and the development of international investment regimes, in the context of the changing consensus on state economic intervention, affect Canada's FDI regime.

Chapter Three analyzes how Canada's position within the world economy has changed over the time period in question, relying on statistical data summarizing Canada's trade and foreign investment relations (both stocks and flows) in the period under study. In addition, evidence of the extent of asymmetry in the bilateral economic relationship with the United States is provided.

Chapter Four creates an inventory of Canadian policy instruments employed between 1957 and 1987 by agencies of the Canadian state to manage FDI or deal with its consequences. They are classified according to the types of instruments outlined in the framework and the extent of coercion and intrusiveness involved in order to determine what policy instruments dominated in particular time periods and how these changed over time.

I then assess the extent to which Canada's relationship to international capital has influenced the choice of policy instruments. Since there is clearly a great deal of slippage, and some time lags between broad shifts in the external environment and specific state policy, the two must be linked via an examination of the process of policy development and state decision-making regarding Canada's foreign investment regime. Two key decision periods, 1967-75 and second, 1980-85, which transformed the mix of policy instruments and significantly altered the investment regime, are examined to gauge the impact of changing investment

relations on the choice of policy instruments.

Chapter Five moves to a bilateral level of analysis in looking at the same two decision periods but focussing instead on the extent to which the choice of policy instruments was constrained by pressure emanating from Canada's relations with the United States. Finally I examine the culmination of Canada's FDI regime change in the 1987 Free Trade Agreement and whether investment regime change was linked to, and traded off, against trade dependence and the need for more secure access to the United States' market.

Chapter Six examines Canadian state efforts to develop an international investment regime in the 1970s and the 1980s which would be supportive of and legitimate Canada's FDI regime. Through a study of negotiations and disputes that took place in the OECD, the UN and the GATT I look at the results of these efforts and the extent to which they provided the Canadian state with a counterweight to bilateral asymmetry in the case of investment regime change, or whether they have served to impose further constraints on the Canadian state's choice of policy instruments in managing foreign direct investment.

Chapter Seven concludes with a review of the findings, and discusses their implications for future research. In particular the contribution of this study to three broad areas of research is assessed. These include the following:

1. Broadening the debate in Canada regarding policy on foreign direct investment and sensitizing public policy

analysis to the importance of international economic linkages and bilateral and multilateral constraints in shaping the choice of state policy instruments of economic intervention.

2. Defining the limits and meaning of Canada's economic dependence in determining the state's foreign economic policy behaviour in specific issue areas.

3. Identifying some of the limits to and myths of multilateralism by looking at the formation of an international investment regime. In particular, I assess the capacity of multilateral negotiations within international organizations to provide a counterbalance for a dependent host state such as Canada to the power of either MNCs or economically-dominant home states.

Data and Sources

For our evidence we rely on the major source material for the study of public policy in Canada. The material describing the changing role of the Canadian state and Canada's position in the world economy are drawn from published statistics on balance of international payments, government expenditures, external trade and foreign direct investment, as provided by various Canadian government reports⁴⁸ and those of international agencies.

Data relating to Canada's foreign investment regime includes official government policy statements on the objectives and nature of policy regarding foreign direct investment provided by state officials. These have been drawn from speeches, statements, press releases, parliamentary debates, committee proceedings, and, where available, internal departmental memoranda and reports obtained under the Access to Information Act. In addition, legislation defining the foreign investment regime, that is

legislation directed at non-nationally based capital, affecting either its entry or the conditions under which it competes with national capital, provides the basis for the inventory of policy instruments.

In the case of bilateral relations, U.S. investment policy toward Canada has been drawn from speeches, policy statements and congressional testimony of key U.S. officials responsible for investment policy and negotiations with Canada on investment issues.

For a determination of Canada's position on foreign investment regimes within international organizations such as the OECD the published documents of the international organizations themselves, the relevant speeches and statements of Canadian state officials and departmental memoranda have been used. In addition these data have been supplemented where possible by interviews with some of those officials within the federal government.

Canada's reliance on foreign direct investment has been a major policy concern for over three decades which has resulted in an abundance of public material, including government studies and task force reports, assessing the impact of foreign investment and discussing various policy options.

Conclusion

This is clearly not the first time that Canada's

policies on foreign direct investment have been analyzed. What is distinctive and original in this project, however, is the focus on a broader conception of the policy options to manage foreign investment than is evident in earlier discussions of the subject through a more specific conceptualization of foreign investment regimes. In addition it integrates the analysis of domestic, bilateral and multilateral influences in explaining changes in Canada's foreign investment regime. It also represents one of the few efforts to examine the Canadian state's activity within international economic organizations⁴⁹ on the particular economic issue area of foreign direct investment and raises the question of whether such efforts can offset bilateral asymmetry and enhance state autonomy on investment issues.⁵⁰

1. A typical definition is that provided by the IMF and employed by the United Nations Centre on Transnational Corporations: Direct investment refers to investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor, the investor's purpose being to have an effective voice in the management of the enterprise. The foreign entity or group of associated entities that makes the investment is termed the direct investor. The unincorporated or incorporated enterprise-a branch or subsidiary respectively -in which direct investment is made is referred to as a direct investment enterprise." See United Nations Centre on Transnational Corporations, Salient Features and Trends in Foreign Direct Investment (United Nations: New York, 1983) See in particular Annex I "Notes on Problems of Compilation and Comparability of Data on Foreign Direct Investment" 26-29.

2. John Fayerweather, Foreign Investment in Canada: National Policy Prospects (New York: International Arts and Science Press, 1973); Wallace Clement, Continental Corporate Power: Economic Linkages Between Canada and the United States. (McClelland and Stewart, 1977); Phillip Resnick, The Land of Cain: Class and Nationalism in English Canada, 1945-75 (Vancouver: New Star Books, 1977); Jack Layton, Capital and the Canadian State: Foreign Investment Policy 1957-82 Ph.D Dissertation, York University, 1984; Gordon Laxer, Open for Business: The Roots of Foreign Ownership in Canada (Toronto: Oxford Press, 1989); Claire Turenne Sjolander, Foreign Investment Policy-Making: The Canadian State in the Global Economy. Ph.D. Dissertation, Carleton University, 1989 and most recently, Barbara Jenkins, The Paradox of Continental Production: National Investment Policies in North America (Ithaca: Cornell University Press, 1992).

Economists have also addressed the issue of foreign investment screening. Much of the literature has examined the overall economic costs and benefits of FDI and the net costs or benefits to the economy of screening investment. For a survey see A. E. Safarian, Foreign Direct Investment: A Survey of Canadian Research (Montreal: Institute for Research on Public Policy, 1985).

3. See Resnick and Sjolander on the role of the new middle class, op cit., Layton, op cit., on the role of various class fractions and the need of the Canadian state for legitimation, and Fayerweather, op cit., on the role of public opinion. More recently, Sylvia Bashevkin has examined the role of interest groups, ideas and public opinion in accounting for the rise of economic nationalism. See True Patriot Love: The Politics of Canadian Nationalism (Toronto: Oxford Press, 1991).

4. See for example Clement and Layton, op cit.

5. See Resnick, op cit. and Fayerweather, op cit.
6. See Sjolander, op cit. and Jenkins, op cit.
7. For a review of this literature see Ken Woodside, "Policy Instruments and the Study of Public Policy," in O. P. Dwivedi and R. Brian Woodrow (eds.) Public Policy and Administrative Studies, Volume 2 (Guelph, Ont: Department of Political Studies, 1985), 42-52.
8. See Woodside, op cit., and M.J. Trebilcock, D.G. Hartle, R.S. Prichard and D.N. Dewees, The Choice of the Governing Instruments. (Ottawa: Economic Council of Canada, 1982).
9. Ken Woodside, op cit., discussing the work of Doern and Phidd, 44. Leslie A. Pal, citing the work on British public policy of Christopher Hood, provides a more elaborate categorization of instruments, distinguishing them further in terms of whether instruments are being employed to gather information about the policy environment or to implement a policy. He follows, however, Doern and Phidd in ranging instruments in terms of a coercion dimension. See Leslie A. Pal Public Policy Analysis: An Introduction (Toronto: Methuen, 1987) especially chapter seven.
10. Nicolas Baxter-Moore, "Policy Implementation and the Role of the State: A Revised Approach to the Study of Policy Instruments," in Robert J. Jackson, Doreen Jackson and Nicolas Baxter-Moore Contemporary Canadian Politics: Readings and Notes (Toronto: Prentice-Hall, 1987), 339.
11. See for example, Stephen Clarkson(ed.) An Independent Foreign Policy for Canada? (Toronto: McClelland and Stewart, 1988) and Ian Lumsden (ed.) Close the 49th Parallel: The Americanization of Canada (Toronto: University of Toronto Press, 1970).
12. See Clement and Layton, op cit.
13. See, for example, Stephen Globerman, "Government Policies Towards Foreign Investment: Has a New Era Dawned," Journal of World Business (Fall, 1988), 41-49 and Arpad Abonyi, "Government Participation in Investment Development," in Andrew B. Gollner and Daniel Salee (eds.) Canada Under Mulroney. (Montreal: Vehicule Press, 1988), 158-185.
14. The most recent example of this view is Richard J. Barnett and John Cavanaugh, Global Dreams: Imperial Corporations and the New World Order. (New York: Simon and Schuster, 1994), 19.

15. David Dewitt and John Kirton, Canada as a Principal Power (Toronto: John Wiley and Sons, 1983) have described this approach as the liberal-internationalist view and cite among the most well-known proponents John Holmes. See The Better Part of Valour (Toronto: McClelland and Stewart, 1970). In most of this work Canada is described as a "middle power."

16. Phillip Resnick uses this term to describe the role of the Canadian state in the 1970s in The Mask of Proteus: Canadian Reflections on the State (McGill-Queen's Press, 1990), chapter 8, "Organized Capitalism and the Canadian State".

17. On what Canada's position is see Daniel Glenday, "Rich but Semiperipheral: Canada's Ambiguous Position in the World Economy" Review XII: 2 (Spring, 1989), 209-261 and Phillip Resnick, "From Semiperiphery to Perimeter of the Core: Canada's Place in the Capitalist World Economy," Review XII:2 (Spring, 1989), 263-297.

18. Elizabeth Gidengil makes this point in summarizing the positions of what she calls the dependency and internationalist theorists, "Misplaced Polarities, A Comment on State, Capital and World Economy" Canadian Journal of Political Science XXIV:1 (March, 1991), 121-134.

19. For a discussion of investment in NAFTA see Robert Kudrle, "Regulating Multinational Enterprise in North America," in Lorraine Eden (ed.) Multinationals in North America. (Calgary: University of Calgary Press, 1994), 404-442.

20. See Fred Bergsten, "New Rules for International Investment," in Lorraine Eden, op cit., 391-400.

21. James A. Caparaso and Stephen Haggard, "Power in the International Political Economy," in Richard J. Stoll and Michael D. Ward (eds.) Power in World Politics (Boulder, Colo: Lynne Rienner, 1989), 99-120.

22. Ibid., 107-109.

23. For a review of this literature see, in addition to Caparaso and Haggard, op cit., Helen Milner, "International Theories of Cooperation Among Nations: Strengths and Weaknesses." World Politics (Spring, 1992), 467-496, John Ruggie, "Multilateralism: the Anatomy of an Institution," International Organization, 46:3 (Summer, 1992), 572-598.

24. See Franklin Chow, "Recent Trends in Canadian Direct Investment Abroad: The Rise of Canadian Multinationals," in Stephan Globerman (ed.) Canadian-Based Multinationals (Calgary: University of Calgary Press, 1994), 35-58 and Jorge Niosi, "Foreign Direct Investment in Canada " in Lorraine Eden, op cit., 367-390, along with his book, The Canadian Multinationals (Toronto: Between the Lines, 1985). In addition William Carroll, Corporate Power and Canadian Capitalism (Vancouver: University of British Columbia Press, 1986) has described the changing nature of Canadian capital.

25. See Tom Keating, Canada and the World Order: The Multilateralist Tradition in Canadian Foreign Policy. (Toronto: McClelland and Stewart, 1993) and Michael Tucker, Canadian Foreign Policy: Issues and Themes (Toronto: McGraw-Hill-Ryerson, 1980).

26. Lynn Mytelka, "The State and Foreign Capital in Advanced Industrial Countries," in A. Blais (ed.) Industrial Policy (Toronto: University of Toronto Press, 1985).

27. See Stephen Globerman, "Government Policies Towards Foreign Investment: Has a New Era Dawned," Journal of World Business (Fall, 1988) which outlines the liberalization of investment policies in the 1980s in many countries as does the United Nations Centre on Transnational Corporations, National Legislation and Regulations Relating to Transnational Corporations (Volumes I-VII), (New York: UN, 1983-89). These changes are summarized in United Nations Centre on Transnational Corporations: Transnational Corporations and World Development: Trends and Prospects (New York, United Nations, 1988).

28. This can be seen in the rapid growth of government expenditures as measured by the OECD.

29. Richard Ashley, "Three Modes of Economism," International Studies Quarterly, 27:3 (December, 1983), 463-496.

30. John A. Hall and G. John Ikenberry, The State (Minneapolis: University of Minnesota Press, 1989), 13.

31. Raymond Duvall and John Freeman, "The State and Dependent Capitalism," International Studies Quarterly 25:1 (March, 1981), 99-118.

32. United Nations Centre on Transnational Corporations, Salient Features and Trends, 1983, op cit., 4. and Transnational Corporations in World Development: Trends and Prospects. (UN: New York, 1989), 74.

33. UN, op cit., 1989, 75.

34. Ibid.

35. As much as 39 per cent of US imports and 36 per cent of US exports were estimated to be intrafirm transactions in 1977. See Marco Bonturi and Kitchiro Fukasaka, "Globalization and Intra-Firm Trade: An Empirical Note," OECD Economic Studies 2 (Spring, 1993), Table 1, 150.

36. See Simon Reich, "Roads to Follow: Regulating Direct Foreign Investment," International Organization 43:4 (Autumn, 1989), 546.

37. See Kudrle, op cit. and Edward Graham and Paul Krugman, Foreign Direct Investment in the United States. (Washington: Institute for International Economics, 1991).

38. David Jodice, "Sources of Change in Third World Regimes for Foreign Direct Investment, 1968-1976," International Organization 34:2 (Spring, 1980), 177-206.

39. Stephen Krasner, "Regimes and the Limits of Realism: Regimes as Autonomous Variables," International Organization 36:2 (Spring, 1982), 185-205.

40. These include the GATT, the OECD and the UNCTC all of which distinguish entry of goods or capital from treatment once inside a national market. See also A. E. Safarian, Governments and Multinationals: Policies in the Developing Countries (Washington, DC: National Planning Association, 1983) who makes a similar distinction.

41. Simon Reich argues that investment regimes can be distinguished according to how liberal access is and whether states discriminate in favour of domestically-based capital. See Simon Reich, "Roads to Follow: Regulating Direct Foreign Investment," International Organization 43:4 (Autumn, 1989), 543-584.

42. A whole host of such measures have become subjects of international trade negotiations and are touched upon in the Final Act of the Uruguay Round. Environmental, health, safety and regional development measures have all been identified at one time or another as having trade impacts, but are clearly less transparent to trading partners and international organizations.

43. UN, op cit., 1988.

44. See Michael B. Dolan and Brian W. Tomlin, "Foreign Policy in Asymmetrical Dyads: Theoretical Reformulation and Empirical Analysis, Canada-US Relations, 1963-72," International Studies Quarterly, 28:3 (Sept, 1984), 349-368,

who argue that these goals are in competition for subordinate states such as Canada.

45. See Stephen Krasner, Structural Conflict: The Third World Against Global Liberalism, (Berkeley: University of California Press, 1985).

46. Royal Commission on Canada's Economic Prospects, Final Report (Ottawa: Queen's Printer, 1957).

47. On the uses of single case studies for theory development in political science and international relations see Edwin Bock, "Improving the usefulness of the Case Study," in Donald M. Freeman (ed.) Foundations of Political Science: Research Methods and Scope (New York: The Free Press, 1977), 674-700, and Alexander George, "Case Studies and Theory Development: The Method of Structured, Focussed Comparison," in Paul Gordon (ed.) Diplomacy (New York: The Free Press, 1979), 43-68.

48. Including the Bank of Canada, Statistics Canada, Department of Finance, the OECD, the International Monetary Fund and the UN, especially the Centre on Transnational Corporations.

49. See Maureen Molot, "Where Do We, Should We or Can We Sit: A Review of Canadian Foreign Policy Literature," International Journal of Canadian Studies, (Spring/Fall, 1990), 76-96, who identifies this as an area requiring more research.

50. For a discussion of Canadian foreign policy literature see David R. Black and Heather A. Smith, "Notable Exceptions? New and Arrested Directions in Canadian Foreign Policy Literature," Canadian Journal of Political Science XXVI: 24 (December, 1993), 754-774, Maureen Molot op cit., and Michael Hawes, Principal Power or Satellite (Toronto: York University Research Programme in Strategic Studies, June 1984).

CHAPTER TWO

FOREIGN INVESTMENT REGIMES, ECONOMIC LINKAGES AND THE STATE

Introduction

This chapter develops a combined public policy and political economy framework to explain changes in Canada's foreign investment regime in the 1957-87 period. It begins by looking at the nature of Canadian state economic intervention and, more specifically, at the classification of economic policy instruments and their changing use in the implementation of economic development policy, since FDI policy instruments are, in essence, a subset of economic development policy instruments. Our analysis tries to go beyond the United States model of state intervention which, too often, serves as a yardstick in discussing the Canadian state intervention. Such a model, as Barbara Jenkins has pointed out, is atypical of states in the international economy.¹

The second main section examines the range of state policy instruments that have been employed in both OECD and developing countries to specifically manage FDI. It provides a description of these policy instruments and how the pattern of usage has varied across states and over time. The description also helps to broaden the discussion on FDI regimes which, in Canada, tends to focus on one policy

instrument, investment screening, without asking what other policy instruments have been, or might be, employed by the Canadian state. The first two sections provide a basis for the third section which develops a classification of types of FDI policy instruments. It is the pattern of usage of types of instruments which we call a foreign investment regime, our dependent variable.

The fourth section examines how both the specifically Canadian, and the broader international political economy literature, have linked postwar state economic intervention, particularly changes to foreign investment regimes, to external economic linkages. This provides a theoretical underpinning to the later hypotheses about how changes in the three external factors we outlined in Chapter One might be expected to influence Canadian FDI regime change.

The final section of the chapter outlines the relationship between our dependent variable, Canada's FDI regime change, operationalized as a changing mix of three categories of policy instruments, and the three external factors. This relationship, however, is filtered through the changing intrastate consensus on state economic intervention - especially as it relates to the extent of coercion of corporate actors and direct state intrusion in the economy implied in the policy instruments available to implement state policy objectives.

State Intervention and Economic Development

Why begin an analysis of Canadian foreign investment regime change with a discussion of the nature of the Canadian state and its pattern of economic intervention? There are essentially three reasons. First, as Chapter One indicated, FDI regimes can be considered an aspect of foreign economic policy where states are responsible for the management of market access of foreign goods, services and capital in order to maximize the benefit arising to the national economy. As such foreign economic policy is made in response to international forces². Yet, at the same time, policies on investment form an important part of national economic development strategies and, therefore, reflect the domestic society and the nature of the state imbedded in that society.

The second reason to look at the Canadian state and its pattern of economic intervention is that the analysis of the tools used in economic intervention provides the conceptual basis for our later classification of FDI policy instruments.

The third reason is that the studies which have compared the FDI regimes of advanced industrial states give strong evidence of the importance of state differences in accounting for the variation in FDI regimes. Simon Reich³ has compared the investment regimes of the United States, West Germany, France and Britain in the auto industry and found that the importance of liberal ideas and state structures helped account for the differing balance of access and

discriminatory instruments.⁴ Lynn Mytelka⁵ draws a similar conclusion that the history and nature of state intervention in the industrial countries she studied helps account for differences in FDI regimes.

The Nature of the Canadian State

How have public policy analysts viewed the state? Sylvia Bashevkin⁶ has identified two dominant approaches to explaining state choices and actions in the public policy literature. The first is the societal focus, based on the pluralist model, which sees policies as a reflection of the relative power of groups or social forces influencing the state. This view accords the state little autonomy.⁷ The second, a state structural approach, sees policies as shaped by state structures, competing bureaucracies and state policy preferences which are distinct from, and may even be at odds with, those of dominant groups in society. These two approaches, in her view, ignore two other important influences on policy. First the impact of dominant ideas articulated in elite, public and media opinion and reflected in the party-based process of electoral competition and, second, the impact of external linkages, particularly the reaction of international actors to Canadian policies. These must be integrated with the other two approaches, she argues, to fully explain policy action or inaction. The approach adopted in this dissertation is in line with what she calls this more "integrative approach" which seeks to combine

structural and societal approaches with an emphasis on the impact of external linkages.

In the case of state structures several aspects of the Canadian state need to be taken into account in understanding policy-making. Most critical are the parliamentary system and federalism. The parliamentary system gives rise to a policy process that is executive dominated, where bureaucracy and cabinet work closely together, the former providing policy advice and policy implementation, the latter being the politically accountable, priority setting and key decision-making body. Federalism, on the other hand, subdivides rule-making authority based on region. As such it runs counter to the tendency of centralizing power in a dominant executive at the national level.

At the level of Canadian society the key aspects which are relevant to understanding economic policy and the role of the state in the economy are the fact that the state is embedded in the capitalist system of production and heavily imbued with liberal ideology.⁸ These aspects act as a constraint on policy, but do not determine it. In addition, the regional unevenness of the Canadian economy, reflected in disparities of wealth and regionally-specialized production, is an important influence on policy, communicated through the federal system.

Within society the demands of various groups or classes are articulated through a party-based system of electoral

competition and non-electoral forms of representation. In this instance two factors are relevant. The first is the relative absence, in comparison to many European democracies, of a class-based party system and political discourse^f and the second, is the more fragmented organizational structure of economic interests, both labour and capital, than is prevalent in many European countries, for example.¹⁰

Within this societal context, the state is viewed, for our purposes, not as a monolithic, rational actor but as an arena of conflict and compromise, where various domestic interests are represented, albeit unevenly¹¹. In addition external linkages have an important impact on many policy issues which state decisionmakers must also take into account and adjust to. Although not monolithic, the state, as a network of institutions has a coherence, and can act. Decisions do emerge and policies change over time. Moreover, state structures evolve. For example, the dominance of institutions within the state will vary over time, in some instances as a result of changing societal or international influences.

In the case of economic policy and FDI regimes the key concern in this dissertation is the prevailing consensus within the state on the issue of the state's role in the economy in terms of two aspects, the level of coercion of private capital, and the extent of direct state intrusion in the economy. It is my contention that this consensus will shape the choice of investment policy instruments along with

the external factors outlined in Chapter One. What has the consensus on the state's economic role been? Has it changed over time and if so, how? One way of answering this question is to examine the nature of Canadian state economic intervention in the postwar period and the types of economic policy instruments that have been adopted by the Canadian state.

State Intervention: A Comparative Perspective

The changing form and extent of Canadian state economic intervention is reflected in the size of state expenditure at all levels in Canada, which, as a proportion of Gross National Expenditure, has doubled in the postwar period.¹² This reflects a similar trend among OECD member countries where expenditures rose, on average, by over 20 per cent to 47 per cent between 1960 and 1982.¹³ As Table 2.1 indicates, in Canada's case, expansion occurred in the 1967-1980 period, particularly at the local and provincial level. But as Howard and Stanbury have noted¹⁴, federal expenditures, since the 1980s, remained at a little over 40 per cent of total expenditures reflecting the growing importance of provincial state activity in the economy.

TABLE 2.1
Government Expenditure as a Per cent of GDP,
1950-82

	Federal	Provincial	Local
1950	11.5	5.7	4.9
1955	15.3	5.2	5.8
1960	15.0	7.3	7.3
1965	12.9	6.8	8.1
1967	13.5	8.3	8.6
1970	13.8	10.2	9.4
1972	14.8	11.0	8.9
1975	16.8	12.2	8.8
1977	16.1	12.4	8.9
1980	16.5	12.7	8.6
1981	17.5	12.4	8.5
1982	20.1	13.6	9.4

Source: R. M. Bird, Financing Canadian Government: A Quantitative Overview (Toronto: The Canada Tax Foundation, 1979) and D. Butler and B. Macnaughton, "Debating Directions for the Public Sector," in M. Whittington and G. Williams, Canadian Politics in the 1980s (Toronto: Methuen, 1984).

In comparison to the largest OECD economies, the so-called G-7, Table 2.2 indicates Canada's public expenditure has been consistently above the average of 36.7 per cent for the 1975-86 period.

TABLE 2.2

International Comparison of Total Government Expenditures
On a National Accounts Basis As a Per Cent of GDP/GNP

	Weigh Ave.	Can.	U.S	U.K.	Fran	Germ	Italy	Japan
	G-7							
Average 1970-74	32.4	35.9	31.2	38.1	38.6	41.2	33.7	21.9
Average 1975-79	36.2	39.5	32.1	42.6	44.0	48.0	40.3	29.2
1980	37.4	40.3	32.6	43.1	46.1	48.1	41.9	32.6
1981	38.5	41.2	33.0	44.4	48.6	49.1	45.8	33.6
1982	40.0	46.3	35.1	44.8	50.3	49.5	47.8	33.7
1983	40.1	46.9	34.9	45.2	51.4	48.2	49.0	34.1
1984	39.5	46.6	33.9	45.5	51.8	47.6	49.7	33.2
1985	39.8	46.9	34.9	44.3	52.1	47.2	51.1	32.6
1986	39.8	45.8	35.1	43.2	51.8	46.4	50.6	33.1
Ave. 1975-86	36.7							

Source: Department of Finance, The Fiscal Plan (February 10, 1989), Table A.3.2

In comparison, however, to the expenditures of a broader group of OECD countries, indicated in Table 2.3, Canada falls in the lower range, along with Germany, the United Kingdom, Norway, and Finland.

TABLE 2.3

General Government Expenditure and Net Lending as a per cent
of GDP at Current Prices 1960, 1982 and 1987.
In 1960 rank order with 1982 and 1987 rank in parentheses

	1960	1982	1987
1. France	34.6	50.7 (8)	51.8 (7)
2. Netherlands	33.7	63.7 (2)	60.1 (1)
3. United Kingdom	32.6	47.4 (13)	43.2 (14)
4. Germany	32.5	49.4 (10)	46.8 (11)
5. Austria	32.1	50.3 (9)	52.5 (5)
6. Sweden	31.1	67.3 (1)	59.9 (2)(1986)
7. Luxem.(1960-80)	30.5	54.3 (6)	51.7 (8)(1986)
8. Belgium	30.3	56.5 (5)	52.3 (6)
9. Italy	30.1	53.7 (7)	50.7 (10)
10. Norway	29.9	48.8 (12)	51.6 (9)
12. Canada	28.9	45.8 (14)	45.6 (12)
13. Iceland (1960-80)	28.2	34.4 (20)	33.3 (21)
14. Ireland (1960-81)	28.0	57.1 (4)	54.7 (4)
15. United States	27.6	37.6 (17)	36.7 (18)
16. Finland	26.7	41.3 (16)	42.0 (16)
17. Denmark	24.8	60.7 (3)	58.3 (3)
18. Australia	22.1	36.3 (19)	35.8 (19)
19. Spain (1964-81)	18.8	34.1 (22)	41.7 (17)
20. Japan	18.3	34.2 (21)	33.2 (20)
21. Turkey	18.0	-	-
22. Greece	17.4	37.0 (18)	43.0 (15)
23. Switzerland	17.2	30.0 (23)	30.1 (22)
24. Portugal(1960-81)	17.0	42.7 (15)	43.9 (13)(1986)
Ave. OECD	26.3		40.9

Source: Peter Saunders and Friedrich Klau, "The Role of the Public Sector: Causes and Consequences of Growth," OECD Economic Studies (Spring, 1985). OECD, Economic Outlook (OECD: Paris, Dec. 1989), 179.

Most of the countries spending over 50 per cent of GDP in 1982 were smaller European nations with the exception of Italy and France. There has been little change over time in the rank order of expenditures but some variation in the size of the increases, the largest occurring, again, in the smaller European countries such as Sweden, the Netherlands and

Denmark.

As Table 2.4 indicates the role of the Canadian state shifted, as it did for other OECD members, from a provider of traditional public goods, such as defence or public services, toward policies targetted at individuals and generally associated with the welfare state. But while social expenditures accounted for 12.3 per cent of GDP on average in the OECD in 1960, and increased to 24.6 per cent by 1985, Canada remained below the OECD average and well below many of the smaller, open economies of Europe.

TABLE 2.4

Social Expenditure as a Per cent of GDP in the OECD
Countries 1960-85.

	1960	1975	1980	1985
Australia	9.5	17.6	17.3	18.4
Austria	17.4	23.4	26.0	28.8
Belgium	n.a.	28.7	33.9	35.8
Canada	11.2	20.1	19.5	22.6
Denmark	9.0	27.1	35.1	33.9
Finland	14.9	21.9	22.9	22.8
France	14.4	26.3	30.9	34.2
Germany	17.1	27.8	26.6	25.8
Greece	n.a.	10.0	12.6	19.5
Ireland	11.3	22.0	23.8	25.6
Italy	13.7	20.6	23.7	26.7
Japan	7.6	13.7	16.1	16.2
Netherlands	12.8	29.3	31.8	30.7
New Zealand	12.7	19.0	22.4	19.8
Norway	11.0	23.2	24.2	23.5
Portugal	n.a.	n.a.	17.3	n.a.
Spain	n.a.	n.a.	15.6	15.2
Sweden	15.6	27.4	33.2	32.0*
Switzerland	8.2	19.0	19.1	20.5*
United Kingdom	12.4	19.6	20.0	20.9
United States	9.9	18.7	18.0	18.2
OECD Average	12.3	21.9	23.3	24.6

* 1984

Source: Organization for Economic Cooperation and Development, The Future of Social Protection (Paris: OECD, 1988), Table 1, p. 10.

As Barbara Jenkins has pointed out¹⁵, the process of opening Canada's economy through trade liberalization since the 1960s has not been accompanied by the compensatory policies of social welfare or adjustment to the extent that it has in the smaller open, industrial countries of Europe. Rather, in Canada's case, industrial adjustment was limited to incentives to business in the form of tax expenditures, grants and loans, an argument which both Table 2.4 above, and the data in the

next section support.

Canadian State Intervention: The Policy Instruments

The pattern of Canadian state intervention can be examined in more detail through an analysis of the policy instruments used to promote economic development within Canada. While the state can employ both broad framework policies designed to affect all actors and have a national impact on the nature of economic activity, such as monetary or exchange rate policy, it often employs more targetted policy instruments directed at groups or firms. It is these instruments that have been subject to much analysis on the part of public policy researchers. In particular analysts have identified types of policy instruments and the extent to which they involve differing levels of coercion¹⁶ (that is the use of sanctions), transparency or state intrusiveness into the realm of private economic decision-making.¹⁷ The policy instruments most commonly identified by analysts are exhortation (or suasion¹⁸), expenditures, regulation and state or public enterprise¹⁹.

Coercion can be defined as the extent to which the state seeks to alter behaviour through the application of sanctions. The more severe the sanction the higher the coercion involved. It is possible to scale policy instruments on two levels, first in terms of broad categories and secondly, in the way in which a particular instrument is applied to a targetted group. Thus regulatory policy instruments are generally considered

private actors to change their behaviour voluntarily it can also be used to gather information for later policy decisions or mobilize public support for a course of action that the state has already chosen.²²

Expenditure programs entice private actors to engage in certain types of economic activity in return for state grants, loans, loan guarantees or preferential treatment within the tax system. The state can also use its purchases of goods and services (procurement) in a strategic way to promote economic development. In 1986 all levels of government in Canada spent \$50 billion on goods and services.²³

Since the early 1970s, the Canadian state has relied on a mixture of direct and indirect expenditures through subsidies and other forms of assistance to promote economic development. Subsidies to business, as a proportion of GDP, saw a marked increase, more than doubling, in Canada's case, in the 1970-75 period from .9 to 2.3 per cent then stabilizing thereafter at a level slightly below the OECD average of 2.7 per cent.²⁴ In the late 1970s tax expenditures, that is, selective non-taxation or favorably lower rates of taxation to encourage certain types of economic activity on the part of individuals or firms²⁵, became an increasingly important form of assistance to business. From the mid-70s to 1980 tax expenditures for business more than doubled, with those applying to the resource sector and for research and development increasing most spectacularly between 1975 and

1984.²⁶ Tax expenditures are a less publicly visible policy instrument and provide the state with limited, indirect control over economic decisions. For those very reasons they have been favoured by business.²⁷

Grants have been used to promote activity in slower growth regions which fall below national averages for employment and income levels, to encourage new investment in innovative activity, or to enable firms to modernize or restructure to ensure competitiveness. Programs have been largely administered through the Department of Industry and its predecessors²⁸. One of the areas of most rapid growth has been export development. Between 1960 and 1980 state export assistance increased from 2.3 per cent of all federal financial assistance to 11.1 per cent.²⁹

The Canadian state also acts as a lender, sometimes at preferred interest rates, to encourage certain activity or, as a last resort, to ensure that high-risk activities are undertaken or to sustain an enterprise because it deems the consequences of its failure (for example unemployment in a particular region) to be unacceptable. Expenditures in this area have increased dramatically since the 1950s from 4.3 per cent of GNP to 18.5 per cent in 1980³⁰.

Total financial aid to business through expenditures, as Table 2.5 indicates, increased dramatically, particularly in the 1970s, with the vast majority of funding being federal.

TABLE 2.5

Total Financial Aid to Industry, 1950-80
By Level of Government

	Millions \$	% of GDP	% of Current Govt. Expend.
1950			
Total	88	.47	2.49
Federal	73	.39	2.07
Provincial	15	0.08	0.42
1960			
Total	357	0.92	3.63
Federal	319	0.82	3.25
Provincial	38	0.10	0.38
1970			
Total	925	1.06	3.32
Federal	724	0.83	2.60
Provincial	N.A.	N.A.	N.A.
1980			
Total	7,849	2.63	6.98
Federal	6,091	2.04	5.42
Provincial	1,758	0.59	1.56

Source: Andre Blais, The Political Sociology of Public Aid to Industry (Toronto: University of Toronto Press, 1985), Table 1-11, 34.

The creation of state enterprises engaged in competitive sectors of the economy is a state policy instrument that has received much attention in Canada³¹, and has been seen as a distinctive aspect of Canada's political culture and a historical response to American expansion.³² The 1960s to the mid 1980s saw substantial growth in the number of state enterprises in Canada, at both the national and provincial level, as well as in their scope of activity³³, and, as Table 2.6 indicates, provided among the highest proportion of total

investment in the major OECD countries.

Table 2.6

Public Enterprise Investment for 18 OECD Countries as a Per Cent
of Total Investment in Rank Order 1970-74
with 75-79 rank in parentheses.

	1970-74	Average 1975-79
Australia	18.4	18.7 (3)
Sweden	17.6	16.6 (5)
Italy	16.9	15.5 (8)
Austria	16.4	19.7 (2)
U.K.	15.5	18.3 (4)
Norway	14.5	19.8 (1)
Germany	13.7	12.6 (11)
Netherlands	13.5	13.7 (10)
Belgium	11.7	15.4 (9)
Finland	11.2	-
Spain		15.6 (7)(1978)
Canada	10.9	15.7 (6)
Japan	9.9	11.9 (12)
Ireland		11.8 (13)(1978)
France	7.3	10.8 (14)
U.S.	3.7	4.7 (15)

Source: Peter Saunders and Friedrich Klau, "The Role of the Public Sector: Causes and Consequences of Government Expenditure," Economic Studies (OECD, Spring, 1985).

State corporations have constituted some of the largest firms in Canada. Thirty-two federal and provincial wholly or partially-owned corporations ranked in the top 500 in Canada in 1985. In asset terms they remained between 20-25 per cent of corporate assets into the mid 1980s.³⁴ Some shifts were evident, however. Mining, electricity, power, communications, finance and manufacturing all increased as a proportion of state corporate assets by the mid 1980s, while transportation

has decreased.³⁵ But by the late 1980s the trend had turned to one of reorienting and ultimately privatizing a number of these corporations.³⁶

Our fourth category of policy instruments, regulation, involves the coercive use of state power to restrain or structure the choices of private companies or individuals in order to influence the nature of economic activity.³⁷ The use of regulation has grown significantly since the 1950s, most rapidly during the 1970s. Stanbury and Thompson³⁸ estimate that 29 per cent of GDP at factor cost was subject to direct regulation in 1980. Richard Schultz concurs in the view that regulation, as an economic policy instrument, was increasingly employed from the mid-1960s through the early 1980s, particularly by the Trudeau governments.³⁹

State Intervention: The Canadian Pattern

Does the usage of policy instruments described above reveal a pattern? Observers of Canadian state economic intervention, such as Michael Bliss, argue there is no evidence over time of a coherent, overall strategy of economic development. Rather the state is largely passive, reactive, confused, inconsistent and much of the intervention is ad hoc.⁴⁰ Atkinson and Coleman⁴¹ characterize industrial policy in Canada as reactive, in contrast to many European countries where a more anticipatory approach is evident. By reactive they refer to an industrial policy which is firm-centered, short term, relatively uncoordinated across sectors, the

product of a weak state.⁴² This reactive approach, in their view, is a function of structures, ideas and the societal factors which give rise to both a lack of capacity, particularly an absence of policy networks, which would permit coherent sectoral policies, and an unwillingness to undertake such policies.

Within this relatively reactive approach, however, there are periods of more intensive state action and economic intervention. There is evidence of variation both across time and across sectors. The 1960s and early 1970s can be contrasted with the 1980s as a period in a number of societal and structural factors were more supportive of a greater role for the state in securing economic development and national autonomy, even if such an effort was not based on any coherent or sectoral industrial strategy. However, from the end of the 1982 recession onward, a shift occurred. Looking at the past three decades, therefore, one can discern some patterns in the usage of Canadian economic development policy instruments.

Accepting the categorization of regulation and public ownership as more coercive and intrusive policy instruments than expenditures, the evidence indicates a trend dating from the 1960s and ending in the early 1980s of increased federal state economic intervention and coercion over private economic actors. As Woodside and Baxter-Moore⁴³ have pointed out there is wide variation within these broad categories of instruments in the way in which they are used and the level of sanctions

imposed on target groups. In the same period state expenditures in the form of subsidies, especially tax expenditures, also increased. The latter are generally considered to be less coercive, less visible to the public, less intrusive and generally favoured by business. The Canadian state thus relied on increased coercion in some areas, but at the same time, continued to rely on less coercive inducements reflected in expenditures, targetted primarily at the manufacturing sector. A closer examination of the period indicates that this increase in intervention was not consistent.

The early postwar period reflected an import-substitution strategy involving the protection of the domestic market from foreign goods and the encouragement of incoming FDI in resource and manufacturing sectors which had its origins much earlier⁴⁴. From the late '960s through the early 1970s a shift was evident, in the data presented above, toward a more active role for the state in the creation of new expenditure programs in the form of loans and grants to firms to assist regional and industrial development⁴⁵, along with a set of measures which Resnick labels "nation-building⁴⁶" involving mixed and crown corporations and new regulations to promote indigenous manufacturing and resource development.

This trend toward increased direct state intrusion in the economy, however, was interrupted by the 1973 oil price shock which brought increased inflation, slower growth and

retrenchment on the part of the state. Efforts to formulate an overall industrial strategy⁴⁷, which had been promised in 1971, were abandoned. This was followed by the imposition of wage and price controls in 1975, and, in their aftermath, an emphasis on the need to reinforce and support the market, and lower public expectations regarding the state's role.⁴⁸ At the same time regulation of the oil and gas sector and the creation of a new crown corporation (Petro-Canada) continued through the mid 1970s.

The 1980-81 period saw another outburst of state activity in the form of new proposals and programs designed to use federal state authority to manage, regulate and, if necessary, supplement private capital, especially in the resource sector. These included proposals to promote Canadian manufacturing, develop new technology, increase federal visibility in the regions and capture resource rents. The shift, however, was short-lived and confined largely to the energy sector.

By 1984 a further diminution of the state's role in the economy⁴⁹ was apparent in the move to a limited range of tax-based incentives and deregulation to promote economic development. State corporations became increasingly commercially-oriented and ultimately, in some cases, were privatized. By 1987 state assistance for domestic industrial development had been reduced to narrowly-targetted regional economic development programs, undertaken in cooperation with

the provinces⁵⁰, and a limited range of expenditure policies, especially defence procurement and export financing, that benefitted a small group of firms.⁵¹ Trade policy, in particular enhanced and secure access to the United States market, formed the main focus of a market-based industrial policy.⁵²

What accounts for the contrast in the two periods? Clearly contending ideas about the appropriate economic role for the Canadian state have been characteristic of Canadian public policy for some time and have generated division within the state itself and broader social forces. However, in the later period opposition to a stronger role for the Canadian state in the economy has emerged as a result of several factors. Canadian capital has become more concentrated, internationally oriented and, in the case of major corporations⁵³, better able to influence state economic policy over time⁵⁴, in contrast to an earlier period when, as Coleman has argued, business interests in Canada were divided by region, language, nationality of control and economic sector and less able to speak with one voice⁵⁵. In addition to the representation of corporate interests, structural changes included stronger, more assertive provincial states and greater influence to federal agencies less supportive of state intervention.⁵⁶ Moreover, elite, mass and public opinion played a role in reshaping this consensus, in a context of slower economic growth, increased international competition

and growing public sector deficits⁵⁷.

The result was a shifting state consensus on the extent of coercion of private economic actors and state intervention which was acceptable. The changes outlined in this section suggest that the consensus of the early 1970s was more conducive to the use of more coercive and interventionist economic development policy instruments than were the 1980s. Such shifts help explain why some FDI policy instruments may be found to be acceptable by state decisionmakers at an earlier point in time than at a later point.

An integrated explanation of Canadian foreign investment regime change must include an understanding of the nature of investment regimes and the range of instruments available to states. These are the focus of the following section which examines the distribution of FDI, and the policy response to it, in both the OECD and developing countries.

States and Foreign Direct Investment

Our examination of FDI policies includes both the OECD countries and developing countries largely to provide a broad variation in both patterns of investment and policy instruments. Developing countries provide a contrast to the OECD countries in both their relationship to foreign capital and the broader range of policy instruments, particularly access and discriminatory instruments, that have characterized foreign investment regimes.

The Pattern in OECD Countries

OECD countries have been hosts to 75 per cent of all investment flows, as well as the source of over 90 per cent of FDI⁵⁸ in the postwar period. But there have been major changes in the levels, distribution and balance of capital imports and exports among these countries such that, by the mid 1980s, the concepts of host and home countries were by no means as clear-cut as they had been in the 1960s.

Table 2.7 indicates the ratio of inflows to outflows of FDI for a number of countries expressed in per cent terms, with 100 per cent indicating an even balance, a lower figure indicating the predominance of outflows and a higher one indicating inflows.

TABLE 2.7

**Flow of FDI into Selected OECD Economies as
a Percentage of Outflows.**

	1960	1965	1970	1975	1979	1983
Australia	2047.4	1439.9	809.0	271.6	424.0	314.5
Belg-Lux	-	355.0	203.9	618.1	79.2	355
Canada	1328.9	427.6	287.1	84.3	78.7	7.4
France	-	89.8	166.3	123.9	125.7	102.0
Germany	154.0	295.2	68.2	62.5	23.9	52.1
Italy	-	160.7	550.9	181.3	66.3	56.0
Japan	-	61.0	26.5	-	.8	14.2
Netherlands	31.2	103.4	103.5	73.2	34.9	44.3
Sweden	69.0	85.3	50.7	18.0	5.1	4.9
UK	54.0	64.0	64.9	48.0	46.7	25.3
U.S.	10.7	8.3	19.3	18.3	39.9	225.0

Source: United Nations, Salient Features and Trends in International Investment (UN: New York, 1983).

Of the eleven larger economies only Australia and France

remained hosts in 1979, in terms of inflows, to be joined, after 1980 by the United States and Belgium, in contrast to 1970 when six countries would have been considered hosts.

As table 2.8 indicates two host countries of the 1960s and 70s, Australia and Canada, along with the UK, which had primarily been a home country, saw a dramatic drop in the share of incoming OECD investment they were able to attract, while the United States became a magnet for new FDI from other OECD countries in the 1980s. Other countries such as Japan and Sweden have remained remarkably stable over all.

TABLE 2.8

Per Cent Distribution of Inflows of
FDI into Selected OECD Economies

	1960	1965	1970	1975	1979	1980-83 (ave.)
Australia	18.1	10.8	11.9	3.8	6.5	4.9
Belgium-Lux.	-	3.4	4.2	8.3	4.8	4.8
Canada	32.1	11.7	11.5	5.9	6.7	-3.1
France (1961)	6.3	5.6	8.3	11.4	11.5	7.9
Germany	9.9	21.6	7.9	11.3	5.0	4.8
Italy (1961)	7.0	6.8	8.1	5.7	1.6	3.1
Japan	.3	1.1	1.3	2.0	.1	2.5
Netherlands	2.0	3.6	7.1	8.7	3.7	4.0
Sweden	.9	2.1	2.6	.7	.7	.6
U.K.	17.6	13.1	11.3	10.4	2.3	6.3
U.S.	14.7	9.8	19.5	23.4	44.0	52.6

Source: OECD, Recent Trends in International Direct Investment (Paris: OECD, 1987), Table 2, 13. and UN, Salient Features and Trends in International Investment. (New York: United Nations, 1983).

Stocks, as Table 2.9 indicates, changed much more slowly.

TABLE 2.9
Inward and Outward Stocks of FDI for OECD Members
Millions of U.S. Dollars

	1970		1975		1980		1983	
	In	Out	In	Out	In	Out	In	Out
Australia	5887	59	9330	1169	12663	2225	15813	2937
Austria			1810	303	3165	529	3432	794
Belgium		2223		3246	9600	5436		5747
Canada	26130	6119	36786	10356	51592	21598	59924	28795
Denmark	920	217	2458	914	4193	2065	3571	2232
Finland	131	117	292	318	540	731	396	1067
France		6909		11193		20810		29935
Germany		(1976)	26891	18416	36630	37955	32903	42201
Italy	(1971)	2319	3299		*5764	6972		8501
Japan			2084	8322	3270	19612	4364	32178
Lux								
Netherl.			10027	19092	19943	39930	18847	38900
Sweden		2194		3798	*1300	6000		
Switzerland				16900	*7700	27800		
Turkey								
U.K.	11439	21348	22512	30421	60009	77869	48795	87106
U.S.	13270	75480	27662	124050	83046	215375	135313	226117

Source: OECD, Recent Trends in International Direct Investment (Paris: OECD, 1987) and United Nations, Salient Features and Trends in Foreign Direct Investment, (New York: United Nations, 1983).

The 1970-83 figures indicate that a number of countries including Canada, despite the shift in flows, retained their 1960s position as host or home to large stocks of FDI. Conversely, both the United States and the United Kingdom, even with the increase in inflows of the 1980s, remained, in terms of the balance of inward and outward stocks, home countries. In 1980, fully 30 per cent of all affiliates of MNE's in developed, market economies were affiliates of U.S.-based companies. In twelve of the twenty-five OECD

economies, United States-based affiliates outnumbered by far those of other countries. In Canada, U.S.-based affiliates accounted for two-thirds of the affiliates of all foreign-based companies in 1985.⁵⁹ The United States still provided 35 per cent of all outward stocks of FDI within the OECD in 1985, a significant proportion, even if it is well below the peak of 47 per cent in 1960.⁶⁰

In absolute terms the stock of FDI in the United States in 1983 dwarfed that of other OECD countries including Canada. Table 2.10 indicates that the United States ranked considerably lower than other developed market economies in terms of the ratio of inward FDI to GDP, with the exception of Japan, even though the figure has more than doubled since 1975.

TABLE 2.10

Inward Stock of FDI as a Per Cent of GDP
Selected OECD Member Economies

	1975	1985
Australia	9.3	(1984) 8.4
Austria	4.8	
Canada	21.9	17.4
Denmark	6.5	
Finland	1.0	4.6
Germany	6.4	
Japan	.3	.5
Netherlands	11.5	12.4
U.K.	9.5	11.4
U.S.	1.8	4.7

Source: United Nations Centre on Transnational Corporations, Transnational Corporations in World Development (New York: United Nations, 1988) Tables 1.2 and 1.3.

Thus while there has been a dramatic shift in the position of

the United States in the increased proportion of FDI inflows it has attracted, it remained, on the basis of the proportion of the stock of FDI controlled abroad, the preeminent home country well into the late 1980s and a dominant stake holder of FDI in the world economy.

What types of FDI regimes have characterized the OECD countries and how have they altered over time, given the changing nature of investment flows among countries? Both the OECD and the UN have gathered data on FDI regimes and base their classification of policy instruments on the concepts of entry (often termed access or establishment) and national treatment.⁶¹ The former refers to the ability of goods or capital to cross international boundaries and the presence or absence of state barriers at the border.⁶²

Policy Instruments-Access

Entry or access policies of the OECD countries can be compared under three basic categories:

1. the use of targetted incentives to attract FDI and the nature of conditions attached to them.
2. the use of general regulations to control access for foreign investors and whether regulation is based on fixed rules or case-by-case assessment (often called screening)
3. sectoral specific controls or restrictions on incoming FDI.

The OECD defines incentives as "any government measures designed to influence an investment decision or having the effect of increasing the profit accruing to the potential

investment."⁶³ Measures that are targetted specifically at foreign investors and designed to influence the nature of the investment decision include financial expenditures, such as grants or loans, fiscal measures such as tax expenditures, or preferential treatment of some kind.

Virtually all OECD countries have offered incentives to investors designed to influence the geographic location of the investment, to encourage modernization and innovation or to stimulate new investment in a particular sector. The bulk of these programs, however, are neutral as to the nationality of the investor.⁶⁴

Only a few countries have created investment programs designed specifically to stimulate large-scale investment from outside. Ireland, Greece and Turkey have offered grants and tax incentives for projects above a certain size threshold to bring in new FDI to particular sectors and regions of the country.⁶⁵ Some of these incentives have been tied to performance, for example, increased exports. Belgium has also provided a set of tax incentives designed to encourage the location of head offices of MNCs within its borders.⁶⁶ This is not to suggest that other OECD countries have not sought to attract FDI. Almost all countries have an investment promotion function which is performed through foreign missions and diplomatic representation abroad and aggressively promote new investment in less developed or depressed regions. Clearly the existence of incentive programs is brought to the

attention of foreign investors, even though the programs themselves are neutral regarding the nationality of capital. In addition, many subnational levels of government in OECD countries aggressively seek out new investment and promote their locale internationally as a desirable investment location.⁶⁷ Despite the drop in overall FDI flows in the wake of the 1982 recession the OECD reported no trend to increased incentives. Rather more rationalized, simplified programs and a shift in policy emphasis away from targetted incentives toward a removal of regulations and other policy impediments to new investment to enhance the overall investment climate have been more characteristic.⁶⁸

A second access instrument, regulation of entry, can be classified according to the scope of coverage, that is, whether the rules cover the two main forms of investment, the establishment of new enterprises, either wholly foreign-owned or via joint ventures, and the acquisition of existing firms by foreign investors. Rules may cover only larger investments over a certain size threshold or include all investments and may also be sectorally specific. Second the regulations may establish a fixed set of rules regarding incoming investment, for example, a minimum level of local equity that is required. On the other hand regulations may provide for a case-by-case review process, structuring an implicit bargaining process between investors and state officials in which access or permitted higher levels of foreign corporate control may be

traded off for enhanced local economic benefits. Finally the administrative structure of the policy instrument employed may also be compared, particularly whether a separate administrative apparatus, distinct from other state agencies or bureaucracies, is created.

The OECD inventory of June, 1981⁶⁹ listed only eight countries which imposed general regulations requiring authorization of inward investment: Austria, Australia, Canada, Finland, France, New Zealand, Portugal and Spain. Of these, two had established regulations as part of a process of exchange controls (Austria, Finland) while the other six engaged in case by case screening of both acquisitions and new investment through either separate agencies (Canada, Australia, New Zealand, Spain and Portugal) or an existing ministry of economics (France). While Spain and Portugal also screened as part of an incentives process, Canada, Australia, France and New Zealand screened specifically to improve the benefits of an investment against some implicit or explicit criteria of benefit or the public interest. Screening processes in all six countries were instituted between 1967 and 1977 and at a time when each was experiencing strong capital inflows. In Australia, Canada and France there were growing concerns about increased foreign (particularly American) control of the economy.⁷⁰

As of 1981 six other countries had no general regulations requiring state authorization of incoming

investment: Germany, Italy, Netherlands, Switzerland, United Kingdom, and the United States. All could be considered, certainly on the basis of FDI stocks, to be home countries. However, in the UK inflows of FDI were surpassing outflows by the mid-1970s.

In between are the remaining OECD countries which required prior notification and some form of formal authorization for certain categories of investment. Sweden and Norway, for example, have long-established (1916 and 1917 respectively) regulations regarding any investment in natural resources which require non-residents to negotiate a concession. In the case of Japan severe restrictions on incoming FDI instituted in 1950 have subsequently been replaced by more liberal measures (1967 and 1980) which require only notification, but allow for discretionary intervention on the part of the government in a number of instances, especially in the case of acquisitions and prohibit investment in a small number of sectors. In addition 12 OECD countries, Australia, Austria, Belgium, Denmark, Finland, France, Italy, New Zealand, Norway, Portugal, Spain and Sweden, also restrict foreign investors' local borrowing to finance FDI.

Most common restrictions found in the inventory in all OECD countries were sector-specific, mostly in the service, transportation and natural resource sectors. Since many of these measures also apply to the investment activities of EFCs

they are discussed below.

Since 1981 there have been a number of changes in the control of access in investment regimes, particularly in those countries which had engaged in broad screening of incoming FDI. Canada (1985, 1987), Australia (1986) New Zealand (1985) and France (1984) have revised regulations in the direction of removing restrictions or conditions placed on access for certain categories of investment. Only Sweden moved from more sectorally limited to more general regulation of incoming FDI in the 1980s. In the case of Spain and Portugal, membership in the EC has resulted in the removal of EC investment from the regulation process.

Thus a small minority of primarily, host countries engaged in general regulation to screen FDI in the 1970s. The trend by the mid-1980s was to relax regulations affecting access, Sweden being the exception. This is not to suggest that numerous regulations do not continue to restrict FDI or that states are not able to engage in ad hoc intervention⁷¹, but that the process, even among host countries, has become increasingly selective. This trend coincided with a general transition of host economies to a more mixed pattern of inflows and outflows, as described above, along with a diversification sources of FDI as Japan, Germany and other OECD countries increased their capital exports.

Policy Instruments - National Treatment

Since 1975 the OECD has monitored the extent to which

member:: deviate from national treatment once foreign firms have entered. A 1983 inventory of OECD countries' treatment of foreign firms already established (EFCs) ⁷² revealed a pattern of common policy instruments used. These included tax measures, regulations regarding local financing of EFC activities, aids and subsidies, procurement⁷³ and regulations regarding investment by EFCs. The following table provides a count of the frequency of the use of each of these types of instruments as reported by member countries.⁷⁴

TABLE 2.11

Number of Reported Discriminatory Measures as of 1983

	Aids & Subsidies	Tax	Govt Procurement	Access to Local Financing	Investment Limits for EFCs
Australia	1	2	3	-	11 gen/sec
Austria	1	-	1	-	7 sec
Belgium	-	2	-	-	3 gen/sec
Canada	7 (oil&gas)	4	2	-	12 gen/sec
Denmark	-	-	-	-	-
Finland	-	1	-	-	10 gen/sec
France	-	-	2	-	19 gen/sec
Germany	1	-	2	-	6 sec
Greece	-	1	2	-	9 sec
Iceland	-	-	-	-	2 sec
Ireland	-	-	-	restricted	2 sec
Italy	1	-	1	restricted	10 sec
Japan	-	-	-	-	6 gen/sec
Luxemb	-	-	-	-	3 gen/sec
Netherlands	-	-	1	-	5 sec
New Zealand	2	1	1	notification required	7 gen/sec
Norway	1	-	-	-	10 sec
Portugal	1	-	3	restricted	13 gen/sec
Spain	1	-	-	-	11 gen/sec
Sweden	-	-	-	restricted	9 sec
Switzerland	1	1	-	-	13 sec
Turkey	2	-	1	-	6 sec
U. K.	1	1	-	-	8 sec
U. S.	3	-	4	-	20 sec
Number of countries employing measures	13	5	5		23

Calculated from OECD, National Treatment for Foreign-Controlled Enterprises (OECD: Paris, 1985). Tables I, II and III.

The most frequently used instruments were those involving sectorally-based regulations which restrict or control the investment activities of EFCs. In 1983 only 11 countries regulated all EFC investment, either in the form of

acquisitions or expansion into new areas of economic activity. For Australia, Canada, France and New Zealand this involved case-by-case screening similar to that for incoming investment.

Least frequent were discriminatory tax regulations, explained largely by the myriad tax agreements among the OECD countries which involve reciprocity. In the case of aids and subsidies about half of the OECD countries had discriminatory measures. In terms of countries, the United States and France imposed the highest number of measures restricting the investment activities of EFCs followed by Switzerland, Portugal, Canada, Australia and Spain. Both the United States and Switzerland have FDI regimes which involve liberal access in general terms, but extensive discriminatory sectoral regulation of EFCs. In contrast France, Australia, Canada, Spain and Portugal had a mixture of both access and discriminatory policies.

Other Policy Instruments

Beyond controlling access and discriminating against EFCs in terms of treatment, the OECD has also recognized that states have been involved in measures to mitigate the effects of FDI or limit or replace foreign capital using various compensatory policies. FDI can be virtually excluded from economic sectors to the extent that they are monopolized either by state, mixed or nationally-owned enterprises. Table 2.12 indicates the extent to which member countries have

reported such monopoly sectors to the OECD.

TABLE 2.12

Impediments to FDI created by Sectoral Monopolies Reported to the OECD 1981

	Public monopolies	Private/Mixed Monopolies
Australia	8	3
Austria	7(1986)	-
Belgium	8	2
Canada	5 (1986)	-
Denmark	2	-
Finland	7	-
France	10	-
Germany	4	-
Ireland	2	-
Italy	9	-
Japan	4	1
Luxembourg	3	-
Netherlands	6	2
New Zealand	5	2
Norway	10	2
Portugal	12	-
Spain	3	4
Sweden	8	3
Switzerland	6	2
U.K.	6	1
U.S.	0	1

Source: OECD, Controls and Impediments Affecting Inward Direct Investment (OECD: Paris, 1982 and 1987).

In addition to monopolies, states have intervened directly in commercial activities to create a national presence in various industries in the form of both wholly-owned state corporations as well as mixed public-private enterprises. While there are severe difficulties in making cross-national comparisons because of differing definitions of what constitutes state enterprises, there are some indications that certain states do use state intervention in a compensatory way vis-a-vis FDI. Other countries have clearly

been able historically to limit FDI by nationally-controlled monopolies in a number of sectors. This is especially the case for many of the European countries, both large and small, in contrast to the United States, Germany and Japan, which have few. State and mixed enterprises can also be a vehicle for the repatriation of economic sectors. In both Canada and France this was the case in the early 1980s⁷⁵ in selected sectors of the economy.

The pattern of FDI regimes within the OECD countries reflects the various roles these countries play as host and home countries and the changes in those roles which have occurred, often in response to prior investment regimes. In the case of Sweden, Norway and Japan, severe restrictions on FDI prior to the postwar surge in foreign investment ensured that these countries would not experience the penetration and rising levels of foreign control that those countries with attractive economies and few controls experienced in the 1960s such as Canada, Australia, the UK and members of the European Community.

The Pattern: Developing Countries

UN data on the eighteen countries which account for about 80 per cent of Third World FDI indicate that virtually all of these countries must be classified, in the 1960 to mid-1980 period, as hosts to FDI.⁷⁶ Not only are these countries primarily hosts to FDI, but they have been more reliant on

external capital sources including FDI, debt and development aid, because they have been unable, in many cases, to finance new investment through local sources such as savings.

There has been much variation in the overall flows of FDI going to developing countries and its distribution. In the 1960s and 1970s investment inflows to developing countries were fairly robust and continued to increase in absolute terms until 1981. In 1975 flows to developing countries represented 26 per cent of all FDI flows. By 1985 the share of FDI going to developing countries had declined to 23 per cent and was at only 59 per cent of its nominal level in 1981.⁷⁷ The distribution among developing countries had also changed. In the 1960s and 70s most of the FDI had gone to Latin America as part of an import substituting pattern of industrialization where FDI served the local market. Latin American investment flows dropped from 58.4 per cent of all FDI flows to developing countries in 1980 to 35.5 per cent by 1983, while Asian countries increased their share from 39.4 to 45 per cent⁷⁸. A number of these states adopted investment policies designed to both protect the local market for domestic producers and bring in export-oriented FDI in certain sectors.⁷⁹ But stocks of FDI changed more slowly. Even in 1983 Brazil and Mexico's stocks of FDI were much larger than those of the East Asian NICs.

Within developing countries, a broad range of incentives have been offered to attract foreign investors and influence

their performance, in contrast to many OECD countries. Incentives are of two types. First are those designed to increase the rate of return for foreign investors which include tax holidays, import duty relief, and cash grants. Many of these are conditioned by performance requirements regarding exports, local content, new technology or geographic location. A second type is designed to reduce the investors' risk by providing various guarantees, such as assuring the right of repatriation of profits or dividends or prompt, adequate compensation in the event of nationalization.

According to the UN review of state FDI regimes, there has been a greater tendency on the part of developing host states to regulate both incoming investment and the performance of EFCs to enhance their contribution to national economic development goals.⁸⁰ A number of states, in the 1970s created separate agencies to coordinate, evaluate, make recommendations, and approve incoming investment since centralized screening agencies were seen as an important method of strengthening host developing states bargaining power with foreign investors⁸¹. These states included Mexico, Indonesia, India, Nigeria, Korea and, until 1987, members of the Andean Common Market (ANCOM).

At the other extreme host countries such as Singapore and Hong Kong have had few or no laws on FDI and offer tax-based incentives, especially to export-oriented industries. In between are a group of countries which, while seeking to

attract foreign direct investment with generous incentives, also seek to limit FDI in some sectors and channel and control it in others and promote local capital as well. These include Brazil, Egypt, Taiwan, and Trinidad and Tobago. The use of incentives and a screening and bargaining process have resulted in the more frequent imposition of performance requirements to influence foreign investors than is the case for developed countries.⁸²

There is a striking similarity in the timing of the imposition of investment controls and subsequent changes to them. Of the eighteen developing countries which, according to the UN accounted for 80 per cent of the FDI going to Third World countries in the 1970s and 1980s, twelve had laws and regulations dealing specifically with FDI which were instituted in the period from the late 1960s to the mid-1970s ⁸³

Although developing countries instituted restrictions on the investment activities of EFCs in various sectors in the 1970s, they also placed much greater emphasis on controlling the behaviour of EFCs, including financial outflows from subsidiaries and the transfer of technology between parent and subsidiaries. In addition, there has been a greater emphasis on the repatriation of various sectors of the economy, particularly in the 1960s and early 1970s, which, in the case of resource industries⁸⁴, included expropriation. In other cases regulations required divestment (sometimes called fade-

out) or measures to increase local management or control (Nigeria).

While the 1960s and 1970s saw the institution of laws and agencies to screen FDI, the 1980s also saw some major changes in the foreign investment regimes toward greater liberalization.⁸⁵ Nine of the 18 countries studied by the UN have made alterations in the direction of fewer, more selective restrictions either on the sectors open to foreign investment or the level of foreign control of enterprises permitted since 1982. In the case of Andean Common Market (ANCOM) countries fade-out requirements for enterprises were eliminated in 1987 and some sectors have been opened to FDI which had previously been closed. On the other hand, several states, notably Argentina, Brazil and Mexico imposed new restrictions in informatics in the mid 1980s to create a national presence⁸⁶ in a sector which was seen as having strategic importance for economies.⁸⁷

These changes in the level of FDI flows and its distribution did not, however, lead to a wholesale abandonment of investment regulation by host states. In some cases new agencies have been created to streamline the investment authorization process⁸⁸ and better coordinate incentives for "one-stop-shopping" for investors. The relaxation of broad restrictions in favour of a more selective approach, on the part of some of the larger host states, may also be the result of increased technical capacity and bargaining skill which

permits them to be more selective.

An equally important element in understanding developments in the FDI regimes of developing countries in the 1980s was the debt crisis and the way in which it has both limited state options for obtaining additional capital⁸⁸ and increased the vulnerability of developing countries to pressure from international lending institutions, dominated by advanced industrial nations, to alter their investment regimes.

In a number of cases, such as Brazil, Mexico and Korea, state borrowing to finance the activities of state enterprises was part of a compensatory policy designed to ensure national control of important economic sectors. The resulting debt problems have led many host states to seek additional capital in the form of FDI⁸⁹.

Conclusion

Our review of FDI regimes in both OECD and developing countries has indicated that efforts to manage FDI were widespread, particularly in the 1970s, but in few cases did state policies seek to wholly exclude FDI. The broad regulation of access, however, to enhance local benefits of investment was more common in developing countries than in the OECD countries. Greater dependence on FDI in the developing countries led to greater efforts to both attract and control FDI. Developing countries attempted to both mediate the

impact of FDI to ensure benefits to the local economy and maintain autonomy⁸¹. As a result, a broader range of policy instruments tended to be used in developing countries. Only a small number of OECD host countries, including Canada, engaged in broad regulation of access in the 1960s and 70s. Few incentives were targetted at foreign capital and most states relied on sectoral specific, fixed-rule restrictions on incoming capital, discriminatory treatment of EFCs in various sectors, combined with compensatory instruments which, along with long-standing state monopolies, excluded FDI from key sectors and advantaged national firms.

Yet in both sets of countries the movement, in the 1980s, was to more liberal investment regimes with limited, more selective regulation. In the OECD this followed increasing cross-investment and a redistribution of investment flows, as a number of host countries matured and, in some cases, became significant capital exporters, while the major home country, the United States, became the major capital importer.

In developing countries there was no dramatic shift in the balance of inward and outward investment flows, but a drop in overall levels of new FDI by the mid-1980s and a redistribution of investment flows. Debt problems also played a role in forcing many states to make renewed efforts to attract FDI to meet capital needs and in providing international lending institutions with additional leverage

over developing country foreign investment regimes⁸². In both the OECD and developing countries changes in FDI regimes in the 1980s appeared to coincide with changes to investment relations.

Classifying Foreign Investment Policy Instruments

The chapter to this point has indicated that economic policy instruments can take varying forms which embody changing levels of coercion and state intrusion in the economy. The evidence indicates a shift on the part of the Canadian state in the 1970s toward more coercive and interventionist economic policy instruments and away from them in the 1980s. Second, our review of FDI policy instruments above indicates that investment regimes can vary in terms of the broad choice of access, discriminatory or compensatory policy instruments used. The use of access policy instruments was found to be more typical of developing countries and possibly related to differing relations to international capital.

State policy instruments controlling entry or access for foreign investors can be further categorized and ranged, like other economic policy instruments, along a coercion continuum beginning with policies that actively seek to attract or stimulate new, incoming foreign investment through expenditures in the form of incentives,⁸³ with no attempt to control or influence the behaviour of the investor. Further

along are policies that seek to both attract new investment as well as impose some control by attaching conditions to the availability of incentives²⁴. At the far right are policies that offer no incentives to attract foreign investment, but seek to manage foreign investment by imposing conditions on entry. Such conditions may limit the level of foreign ownership or control permitted the foreign investor within the subsidiary, or impose various performance requirements on subsequent operations. In these instances the trade-off which the state makes is one of permitting a higher level of ownership or control of the subsidiary in return for higher levels of local economic benefit. Finally states may go so far as to prohibit the entry of foreign investment.

incentives	incentives	conditional	restricted
	(conditional)	access	access

coercion			

As we move along the above continuum the extent to which the state uses either the denial of access to rewards (incentives) or the imposition of sanctions (the complete denial of access) to influence the behaviour of investors increases. Since the decision to invest is ultimately a discretionary one the capacity for state coercion, prior to the actual commitment of capital, is limited by the investor's ability to go elsewhere. Conversely the state may not desire or permit foreign investment in various sectors where the costs of such investment are clearly perceived to outweigh any potential

benefit.

Access instruments vary in the scope of investment decisions covered including new investment, or acquisitions, number of sectors and the size of the investment transactions. They also vary in institutional form and administrative processes, including whether the policy is implemented through a separate investment agency or through existing institutional arrangements. In addition the extent to which states rely on rules, that is, fixed criteria that define whether or not, or what form, of investments are permissible in which sectors, or a case-specific approach establishing implicit or explicit bargaining situations with foreign investors is important. Both the existence of a separate agency and the use of fixed or more discretionary regulation will also determine the extent to which the approval process is transparent⁹⁵ and certain from the perspective of the foreign investor.

In the case of discriminatory policy instruments the state may deny access to whatever benefit (for example, government contract, incentive, loan guarantee) is offered to firms that are defined, on the basis of their ownership or control, as foreign. Or the state may render such access conditional upon the achievement of various performance criteria which are not imposed on nationally-based firms.

Regulations affecting taxation, corporate disclosure, foreign financial transactions, technology transfer, and the approval of new or expanded investment projects may all be

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applied differentially based on ownership of the firm. Ultimately states may impose regulations to repatriate such firms by altering the very ownership structure of EFCs by requiring divestment, increases in local equity or, ultimately, expropriation.⁸⁶

Compensatory instruments may take any form such as suasion, expenditure, regulation and state enterprises. The key difference is that, while their policy objective is to deal with the acknowledged consequences or problems associated with FDI, they do not directly target incoming investment or EFCs. For example, a series of expenditures designed to alter corporate research behaviour, seen to be inhibited because of foreign ownership, would be a compensatory one if all firms (foreign and domestic-owned) could access the grants, but discriminatory if only Canadian-owned firms could do so. Similarly the establishment of a state enterprise to create a Canadian presence in a largely foreign-owned sector of the economy would be classified as compensatory.

Discriminatory policy instruments are sometimes used in coordination with compensatory ones to provide systematic support for national capital (the so-called national champions strategy) or to create or enhance the position of state enterprises within a sector, which may effectively preclude further FDI. This is more typical in Europe as our data indicate. In general only a minority of OECD countries have looked to access policy instruments, in contrast to developing

countries where they have been more prevalent. In both cases, however, there has been movement over time to lessen the extent of control of access or discrimination against foreign firms. The evidence above indicates these regime changes have coincided with changes in the international distribution of FDI. How have international relations scholars explained host state FDI regime changes over time or cross-nationally?⁹⁷ This question is the focus of the following section.

Economic Linkages and Foreign Investment Regime Change

This section reviews five approaches to the explanation of FDI regime change which all focus on some aspect of external linkages as playing a causal role. The first group, reacting to the growth in interdependence in the 1970s, argued that an increase in external economic linkages would spawn state efforts to exert control over these links which included FDI⁹⁸. Others, such as Jeanne Laux⁹⁹, have argued that the increase in economic interdependence gave rise to uncertainty for states and a lack of control of their economies. This trend resulted in statism, whereby the state "substitutes for private actors in order to fulfill economic functions"¹⁰⁰ - an example being Canada. Laux and Molot, and Duvall and Freeman¹⁰¹ have argued that state capitalism or state entrepreneurship, can be directly related to high levels of dependence on foreign capital. In each of these arguments the source for regime change appears to lie in the state's own

policy preference to preserve autonomy and not to have its origins in any broader societal influences.

The second set of arguments would also predict a state response to an influx of FDI in the form of controls over access and increased state economic intervention, but in this case the origins of the state's response would lie in the policy preferences of locally-based capital, to which the state responds. Peter Evans¹⁰² has argued that within advanced, industrial, core countries, a larger state sector is likely to be found in those countries most dependent on capital inflows and trade because of the need to ensure that investment provides maximum benefit to the local economy which, given the structural interests of MNCs, might not otherwise be the case. In addition, locally-based capital desires protection from transnational capital and, therefore, limits its opposition to increased state intervention. Such intervention in favour of indigenous capital is legitimized in the name of nationalism. Conversely capital-exporting countries, he argues, where large, transnational corporations are based, tend to face stronger opposition to state intervention. Myteika¹⁰³ made a similar argument that capital exporting states will not seek to limit FDI. Her hypothesis is based on three factors: the fear a capital-exporting state has of retaliation from other states against its foreign investment; the dominance of elites within the policy process of capital-exporting states who favour

economic liberalism; and the absence of a high level of incoming direct investment.¹⁰⁴ She tested the hypothesis that capital-exporting states adopt more liberal regimes towards foreign direct investment than do capital-importing states using cross-national data on investment flows and found no simple correlation between the two. However, she also notes the limitations of her data and the need to look at the role of the state in individual countries. If similar external linkages elicited different policy responses in countries¹⁰⁵ it suggests the need to look more closely at differences in the way in which states are linked to domestic economic interests and how they define policy preferences.

Much of the research on Canada's foreign investment regime has looked at domestic interests in accounting for the origins of the Foreign Investment Review Agency (FIRA), along with its impact on the economy and investment flows.¹⁰⁶ Domestic factors identified as accounting for FIRA's creation in the 1970s included elite¹⁰⁷ and public opinion as well as the state of the economy¹⁰⁸. The growing economic nationalism in the 1960s and 1970s, the context in which FIRA was created, was traced to the enlarging of a new middle class¹⁰⁹, itself a product of the growth of the public sector in the 1960s. Layton¹¹⁰ and Clement¹¹¹ have argued, however, that FIRA only served a legitimization function for the state and was not intended to seriously challenge the interests of foreign capital and its Canadian allies which were dominant.

In the 1980s analysts of Canada's FDI regime changes also identified shifts in the international economy, especially capital flows¹¹², the changing nature of FDI, and the increasingly internationalized Canadian corporate sector, as accounting for changes¹¹³. Virtually all of the Canadian studies focussed on the interests opposing or supporting investment screening rather than seeking to account for the choice of screening as a policy instrument.

A third body of research has looked at the state response to FDI more closely over time focussing on the conditions under which host states are likely to intervene to regulate or control FDI¹¹⁴ and the factors which account for successful outcomes, from the host state's perspective¹¹⁵. The recognition of the discretion that multinational corporations have in distributing benefits and costs of production, in this analysis, led to the use of state power to alter the distribution in the host state's favour. Thus, as Bergsten, Horst and Moran have argued:

To the extent that there is a monopoly of power within an industry, foreign investors enjoy discretion about the distribution of benefits of their investments (employment, taxes, exports). Both home and hosts, therefore, have an interest in forcing or enticing the investor to do something he or she would otherwise not do, so as to tilt the benefits towards them.¹¹⁶

Much of this work focuses on host state-MNC interaction over time within a bargaining power context. State bargaining power over foreign investors increased over time, a number of scholars argued, due to the immobility of capital after costs.

were sunk, especially in the resource sector, and the learning capacity of host states¹¹⁷. Lipson argued that increased host state regulation of FDI was a function of the enhanced competition among MNCs for access to foreign markets in the 1970s and their willingness to bargain with host states over benefits in return for entry.¹¹⁸

The bargaining argument suggested that host state intervention in the investment process would increase over time and that states would be able to successfully coerce investors into enhancing investment benefits and accepting controls and conditions on their performance. While this may have applied to the 1970s, it was not, in fact, the case in the 1980s. Globerman shows evidence of increased liberalization of investment regimes in the 1980s.¹¹⁹ Among the factors he cited accounting for liberalization of investment controls were adverse economic conditions, changing host state evaluations of the costs and benefits of FDI, and increased international competition among host states for FDI. Others challenged the notion that the bargaining power of host states would continue to increase, arguing that MNC's control of access to technology and growing mobility had, in fact, eroded host state power in the 1980s.¹²⁰ Thus in the bargaining power model the changes in FDI regimes are a function of the comparative capacity of host states to bargain with MNCs. Differences in state behaviour and investment regimes are tied to the host country's attractiveness as an

investment location. In a study of investment incentives Guisinger¹²¹ found that countries which provided attractive markets, resources or other inputs were able to offer lower levels of incentives and extract greater performance commitments from foreign investors than countries less attractive. Thus state behaviour toward MNCs may vary over time and across countries because of differences within the host state-MNC bargaining context, which may itself be a function of changing conditions within the international economy.¹²²

A fourth approach to the question of external linkages and FDI regime change has its origins in the political economy literature studies of dependence¹²³ and has examined the extent to which subordinate states' foreign policies have been compliant toward dominant states. Much of it has not dealt specifically with the question of the impact of vulnerability to pressure from a dominant partner on investment regimes.¹²⁴ A few case studies of expropriations and host state-MNC bargaining situations have addressed this issue, however. Bennett and Sharpe¹²⁵ argued, in the case of Mexican state negotiations with Japanese and American auto companies, that both Japan and the United States did exert pressure on behalf of their auto companies and that the structure of Mexico's dependent economic relationship with the United States did constrain the Mexican state, particularly in its ability to control the entry of foreign firms.

Others have challenged the notion that dominant home states are always able or willing to control profitable, private transactions (such as trade and investment) with dependent countries in order to enforce compliance.¹²⁶ The United States has used military and economic retaliation in the past against developing countries expropriating U.S. corporations without sufficient compensation,¹²⁷ but the evidence also suggests it has often refrained from doing so in specific situations and attempts to pressure host states have, in some cases, been opposed by MNCs.

Encarnation and Mason ¹²⁸, in a case study of the gradual liberalizing of Japan's FDI regime, found that external pressure was insufficient and ineffective until key Japanese-based firms, in an effort to get access to technology, supported liberalization. They challenge the widely-held view that the U.S., along with the OECD, had successfully pressured Japan to alter its investment regime. Thus while studies have indicated some bilateral influence on FDI regimes it has not been deterministic and is insufficient to fully explain FDI regime change.

Those analysts who have focussed on bilateral asymmetry, in the Canadian case, have not specifically linked asymmetry to the choice of policy instruments to control FDI. Black argued that economic dependence on the United States in the 1970s, in the context of bilateral asymmetry, generated popular pressure on the state to reverse the trend to greater

economic integration.¹²⁸ Other studies indicated that in investment disputes in the 1970s Canada was able to achieve successful outcomes in bargaining both with MNCs and the United States.¹³⁰ Dolan and Tomlin have argued that while asymmetry and economic dependence have not determined compliance on the part of states such as Canada they have created tradeoffs between autonomy and economic well-being.¹³¹ Stephen Clarkson¹³², on the other hand, has argued that U.S. pressure on Canada during the 1980-81 period caused Canadian decision-makers to abandon proposed changes to FIRA and ease existing regulations. In short, while there is a consensus that bilateral asymmetry is important there is little detailed or systematic analysis of how it has actually shaped the choice of policy instruments directly - something this dissertation tries to remedy.

The fifth aspect of external linkages that has been identified as important to understanding FDI regime change is the extent to which there are international rules, norms or expectations that may influence host states' choice of policy instruments to control FDI. Keohane¹³³ has argued that multilateral coordination of economic policies through international institutions has increased in the postwar period, although the strength of the regimes created has varied widely. Thus we would expect to see some attempt at multilateral coordination of foreign investment policies. Lipson¹³⁴ has argued that the international investment regime

was weak in the 1960s and early 1970s and unable to enforce the interests of capital-exporting states even where host states expropriated assets, largely because sanctions were not able to be effectively imposed (unlike in the case of debt). There were no central international organizations able to impose penalties. MNCs, unlike international banks, were not locked into interdependent networks and did not share complementary interests. In the 1970s MNCs were engaged in competition for market access. Few wanted overt home state intervention and to some degree were willing to adapt to developing state requirements. These factors provided some scope to developing states to undertake FDI management. At the same time the increased regulation of FDI by host states in the 1960s and 1970s and their move to use international organizations to legitimize further controls did cause home countries to seek international rules which would restrain host states and protect investors.

Developing host states were unsuccessful, as Krasner¹³⁵ has described, in their efforts to create a regime or set of international rules that would recognize and legitimate host state efforts to manage the entry and behaviour of foreign-based capital. Since the debt problems of the 1980s many developing host states have been under pressure from the International Monetary Fund and the World Bank to liberalize FDI controls as a condition of financial assistance. The creation of the World Bank's Multilateral

Investment Guarantee Agency, the strengthening of norms of national treatment and access for FDI in the OECD, and the linking of investment to trade issues in bilateral and multilateral negotiations are further evidence of the development and strengthening of an international investment regime supportive of the freer movement of capital in the 1980s. On the whole there has been little attention paid to the development of international investment regimes or how Canada has sought to shape them or been influenced by them¹³⁶ even though multilateralism has been seen to be a key feature of Canadian foreign policy, especially in the postwar period.¹³⁷

Our review has indicated that a number of external linkages have been identified as influences on host state foreign investment regimes. In particular, much of the literature has focussed on the host state's relationship to international capital and how this has shaped state policy preferences in conjunction with those of national capital. It has emphasized the attractiveness of the host country as an investment location and the host's need for foreign capital and the way in which these have affected host bargaining power in dealing with foreign investors. In addition the nature of the bilateral economic relationship between host and home countries, particularly the extent of host country economic dependence and vulnerability to home state pressure on FDI regimes has been identified as influencing, but certainly not

determining, host state investment regimes. Finally, the nature of the international rules or norms (regime) regarding FDI and whether they reflect the interests of capital importers or exporters has also been identified as an influence.

In the case of Canada, while various aspects of the first two of these external relationships have been examined to some extent in the literature the impact of international investment regimes has been largely ignored. Moreover, the analysis of Canada's FDI regime has been centered heavily on the creation, impact of, and changes to, the Foreign Investment Review Agency in the 1970s and 1980s and has not been linked to any analysis of the range of policy instruments which have been, or could have been, used to deal with FDI.

Explaining Foreign Investment Regime Change

Based on our review of the literature and the classification of FDI policy instruments which was outlined above a framework for the analysis and explanation of FDI regime changes can be developed.

The first external linkage which I focus on which shapes the choice of policy instruments is the host country relationship to international capital. FDI inflows and stocks are indicative of the extent to which investors perceive a particular host country to be an attractive location for investment. While the aggregate amount of international capital available for investment will vary with economic

conditions in the largest capital-exporting economies, relative shares of these flows among host countries will reflect the competitive situation of a country seeking to attract new investment. Stagnating or declining aggregate flows and enhanced international competition, therefore, will also shape the host state's investment regime by limiting the state's ability, as perceived by decisionmakers, to use control of access to extract greater benefits from foreign investors.

Large increases in outward FDI flows from host countries in a process of internationalization of national capital are also expected to generate changes in the foreign investment regime. The literature reviewed suggests that host state policy preferences will alter in conjunction with those of national capital exporters who wish to maximize their access to foreign economies and will lobby for more open access and national treatment at home.¹³⁰ In addition the increasing globalization of productive processes, competitive pressures and the enhanced mobility of capital require that liberal states be sensitive to the factors that cause investors, whether national or foreign, to shift production elsewhere. But the nature of the intrastate consensus on coercion of private investors and the level of state intervention required acts as an important intervening variable in shaping the choice of policy instruments.

Stocks of FDI, however, change much more slowly than

flows and, therefore, create a more complex situation. Liberal access at one point in time may later generate large stocks of FDI, requiring a more complex set of policy instruments to deal with FDI as foreign investment earnings are reinvested in the local economy and outflows, in the form of repatriated earnings and other remittances, increase. High levels of foreign control and the presence of large foreign firms would require discriminatory policies to seriously affect the behaviour of foreign investors. But the ability to control the behaviour of EFCs through coercive policy instruments is tempered to the degree that these firms are mobile, by the host state's alternative sources of investment and other economic benefits these firms generate, as well as by the intrastate consensus on coercion and intervention discussed above. While high levels of FDI inflows, together with high or increasing levels of foreign control, would likely result in more use of both access and discriminatory policy instruments, with a decline in inflows and an increase in capital flight, the host state would be expected to move away from access and discriminatory policies and employ non-coercive compensatory policies.

Canada has gone from a host, to a mature host country in the 1957-87 period. It has experienced strong (1960s), then later increasingly volatile international investment flows, with its large relative share of international investment flows declining dramatically in the 1970s. In the late 1970s,

of linkages is expected to act as a constraint on, but not the sole determinant of, host state investment regime changes.

Canada's economic dependence on the United States, particularly as a market for manufactured exports, has been increasing since 1957. Since the United States has been the predominant source of FDI for Canada we would expect that Canada's FDI regime would also be subject to increasing bilateral pressures should the regime be perceived to challenge U.S. economic interests.

International investment regimes have varied over time in their ability to constrain host state actions to control FDI. Host states have tried to play a role in shaping investment regimes, especially in the 1970s and 1980s, to enhance host state autonomy in dealing with foreign investors.¹³⁸ In contrast a strong regime protecting FDI, which has some sanctioning capability, may act as a constraint on the use of coercive access and discriminatory policy instruments¹⁴⁰ by increasing the perceived cost of using such instruments. We would expect, therefore, host states seeking to control access or discriminate against EFCs in their investment regimes would act multilaterally to develop rules supportive of state intervention and oppose rules to limit state regulation and protect the free movement of capital. As Chapter Six will indicate, Canada has been an active participant in the many efforts of international economic organizations to build regimes governing exchange, including those relating to

foreign direct investment. In the event that regimes protective of the rights of international capital to free access and national treatment develop and strengthen over time we would expect these to act as a constraint on a host state's choice of policy instruments by raising the perceived cost of their use. Again, however, a strong state consensus supportive of coercion and intervention and strong investment inflows may lead host states to defy or opt out of such regimes. Weak inflows and a state consensus less supportive of coercion and intervention would likely result in compliance with the international investment regime.

Strong and later declining investment inflows and increased trade dependence, in conjunction with increasing U.S. state opposition to Canada's FDI regime would lead us to expect to see the following patterns: more frequent use of access and discriminatory policy instruments involving more coercion of investors in the 1960s and early 1970s in Canada, giving way, in the 1980s, to a more limited investment regime relying on compensatory policy instruments and employing less coercion of investors.

The following summarizes the posited relationships in a diagram form:

Figure 2.1

A Model of Foreign Investment Regime Change

The broken lines indicate the fact that, over time, changes in Canada's FDI regime may have an impact on investment relations, may increase or diminish home state opposition and may lead to efforts on Canada's part to reshape international investment regimes to reinforce or legitimate Canadian FDI regime changes. The diagram is intended to simplify and clarify the relationships posited, and thus ignores some of the complexities of these changes and the time lags involved, for example, between changes in stocks and flows, and sectoral differences. In addition, the study

of Canada-U.S. relations has indicated constraints on the ability of the United States to translate bilateral disparities into power and the U.S. state's definition of its investment interests may well have changed over time.

Conclusion

This chapter has developed a framework to analyze changes to Canada's FDI regime in the 1957-87 period which combines a public policy analysis of economic policy instruments with the international political economy focus on the impact of external linkages on states. It began by reviewing the nature of the Canadian state, the extent of economic intervention and the types instruments used in the implementation of policies. A changing pattern in the use of coercive and intrusive policy instruments was noted, within the overall context of a relatively reactive, firm-specific industrial policy. A comparison was then made with FDI regimes in both developing and OECD countries which indicated that Canada's use of general investment screening was by no means typical of OECD countries, being more prevalent, in fact, among developing countries. This was followed by classification of FDI policy instruments, in terms of three broad categories which were then further analyzed in terms of more specific instruments and their characteristic differences in the level of coercion and intrusion involved. A review of the literature seeking to explain host state

investment policies in terms of external linkages followed. Based on this review the explanatory framework outlined three sets of external linkages that, I argue, can provide a more complete explanation of changes to Canada's FDI regime in the period under study. However, the framework also takes state differences into account in the analysis of foreign investment regime change by outlining the impact of a prevailing consensus within the state on the issues of intervention and coercion and how this might shape the choice of policy instruments.

In order to determine the impact of these factors on changes in Canada's FDI regime the next task is to identify and demonstrate the changes in those external linkages over the 1957-87 period. Chapter Three describes and analyzes changes in two of the three sets of external linkages, the changing nature of Canada's investment relations and the extent of economic, particularly trade, dependence on the United States.

1. She argues, correctly, that the US model is one reflecting its hegemonic position and that a broader comparison with the smaller, industrial economies of Europe highlights the very different direction Canada, given its size and vulnerability, has taken in contrast to these countries. See Barbara Jenkins, The Paradox of Continental Production: National Investment Policies in North America (Ithaca: Cornell University Press, 1992, 111.
2. See G. John Ikenberry, David A. Lake and Michael Mastanduno, "Introduction: Approaches to Explaining Foreign Economic Policy," International Organization 42:1 (Winter, 1988).
3. Simon Reich, "Roads to Follow: Regulating Direct Foreign Investment," International Organization 43:4 (Autumn, 1989), 543-584.
4. Reich found that the United States and Britain were characterized by liberal access and non-discrimination, even to the point, in Britain's case, of state acquiescence in the shifting of auto production jobs abroad. In contrast Germany's judicious use of liberal access and discrimination in favour of domestic firms resulted in the preservation of a competitive auto industry based in Germany. See Simon Reich, op cit.
5. Lynn Mytelka, "The State and Foreign Capital in the Advanced Industrial Capitalist Countries," in Andre Blais (ed.) Industrial Policy (Toronto: University of Toronto Press, 1986), 119-166.
6. Sylvia Bashevkin, True Patriot Love: The Politics of Canadian Nationalism (Toronto: University of Toronto Press, 1991), chapter two, 41-48.
7. See John A. Hall and G. John Ikenberry, The State (Minneapolis: University of Minnesota Press, 1989) Chapter one provides an overview of theories of the state and the issue of autonomy.
8. See Charles Lindblom, Politics and Markets. (New York: Basic Books, 1977) who argued that state policies in liberal democratic countries are inherently biased in favour of business because of the state's reliance on privately-controlled wealth to provide the level of investment necessary to ensure economic growth. See David Marsh, "The Politics of Private Investment," in Andre Blais (ed.) The Politics of Industrial Policy (Toronto: University of Toronto Press, 1985)

for further discussion of this question.

9. See Janine Brodie and Jane Jenson, Crisis, Challenge and Change: Party and Class in Canada. (Ottawa: Carleton University Press, 1988).

10. For a discussion of corporatism and economic interests in Canada see Keith Banting, (ed.) The State and Economic Interests. (Toronto: University of Toronto Press, 1986) and William Coleman, Business and Politics. (McGill-Queen's University Press, 1988).

11. This view of policy making is reflected in Rianne Mahon's study of textile policy, The Politics of Industrial Strategy: Textiles. (Toronto: University of Toronto Press, 1976).

12. For an examination of this growth and its implications see L. Howard and W.T. Stanbury "Measuring Leviathan: The Size, Scope and Growth of Government in Canada," as well as the Appendix in George Lerner (ed.) Probing Leviathan: An Investigation of Government in the Economy (Vancouver: The Fraser Institute); Richard Bird, "Government Intervention in the Economy: A Review of the Evidence," unpublished paper, Institute of Policy Analysis, University of Toronto, March, 1985; and Richard Bird, Financing Canadian Government: A Quantitative Overview (Toronto: Canada Tax Foundation, 1979); Dan Butler and Bruce McNaughton, "Debating Directions for the Public Sector," in Michael Whittington and Glen Williams (eds.) Canadian Politics in the 1980s: Agenda for the 1990s. (Toronto: Methuen, 1981), 1-32.

13. Peter Saunders and Friedrich Klau, "The Role of the Public Sector: Causes and Consequences of the Growth of Government," OECD Economic Studies (Spring, 1985), 16. The study does not include so-called off budget items and probably understates the state role in the national economy.

14. Howard and Stanbury, op cit. Appendix, 140.

15. See Barbara Jenkins, op cit., 112.

16. See for example, G. Bruce Doern and Richard Phidd, The Politics and Management of Canadian Economic Policy (Toronto: Macmillan of Canada, 1978) who provide a simple breakdown of instrument types on one continuum. Leslie A. Pal, citing the work on British public policy of Christopher Hood, provides a more elaborate categorization of instruments, distinguishing them further in terms of whether instruments are being employed to gather information about the policy environment or to implement a policy. He follows, however, Doern and Phidd in ranging instruments in terms of a coercion dimension. See Leslie A. Pal, Public Policy Analysis: An Introduction

(Toronto: Methuen, 1987) especially chapter seven.

17. See Ken Woodside, "Policy Instruments and the Study of Public Policy," in O.P. Dwivedi and R. Brian Woodrow, Public Policy and Administrative Studies (Volume 2) (University of Guelph, 1985), 42-57 ; Nicolas Baxter-Moore, "Policy Implementation and the Role of the State: A Revised Approach to the Study of Policy Instruments," in Robert J. Jackson, Doreen Jackson and Nicolas Baxter-Moore, Contemporary Canadian Politics: Readings and Notes (Prentice-Hall, 1987) and Leslie A. Pal op cit. for reviews of this literature.

18. Suasion is the term used by Stanbury and Fulton, while Doern uses exhortation. See Baxter-Moore, op cit.

19. There is some dispute over the treatment of taxation, in some cases being seen as regulation. Many analysts of taxation have seen targetted tax-based incentives as a form of expenditure. See Neil Bruce (ed.) Tax Expenditures and Government Policy. (Kingston: Queen's University Press, 1988). For our purposes targetted tax incentives are included under expenditures.

20. See Doern and Phidd, op cit. 97. Their classification includes taxation under regulation. The placement of public ownership has been challenged by other analysts, such as Baxter-Moore, op cit.

21. Baxter-Moore, op cit., 339.

22. Stanbury and Fulton have identified six types of suasion: pure political leadership; suasion with inducement; mass suasions-advertising; monitoring and information disclosure; consultations and the use of leaks. See W.T Stanbury and Jane Fulton, "Suasion as a Governing Instrument," in Alan Maslove (ed.) How Ottawa Spends (Toronto: James Lorimer, 1984).

23. See Management of Government Procurement: A Study of the Task Force on Program Review. (Ottawa: June, 1985). In the case of very large acquisitions, such as defence equipment, the federal state often negotiates offsets with the foreign sellers to maximize the Canadian employment arising from the purchase and may accord Canadian produced goods and services a price preference over imports. These purchases can sometimes be very controversial. See M. Atkinson and K. Nossal, "Bureaucratic Politics and the New Fighter Aircraft Decision," Canadian Journal of Public Administration. 24 (Winter, 1981), 531-62.

24. Ibid., 69.

25. A simple but useful definition is provided by the United States General Accounting Office which refers to the use of "exceptions to tax rules that reduce some people's income but not others. These exceptions have the same effect as government payments to the favored tax payers." See Howard and Stanbury, op cit. and Alan Maslove, "The Other Side of Public Spending: Tax Expenditures in Canada," in Alan Maslove (ed.) The Public Evaluation of Government Spending (Montreal: Institute for Research on Public Policy, 1979).

26. Maslove, op cit.

27. Ibid. These were far and away the most popular types of assistance requested by business in the Tier I sectoral consultations of 1978, see Douglas Brown and Julia Eastman, The Limits of Consultation (Ottawa: Science Council, May, 1981).

28. Which include Regional Industrial Expansion, Industry, Trade and Commerce, Industry and Regional Economic Expansion and Industry, Science and Technology.

29. Andre Blais, The Sociology of Public Aid to Industry (Toronto: University of Toronto Press, 1985), 34.

30. Economic Council of Canada, Intervention and Efficiency (Ottawa: 1982), 7.

31. Jeanne K. Laux and Maureen A. Molot have labelled this phenomenon "state capitalism" and defined it as "direct state intervention in production through commercial enterprises operating in profitable or competitive sectors of the economy," State Capitalism: Public Enterprises in Canada, (Ithaca: Cornell University Press, 1988).

32. Herschel Hardin A Nation Unaware (Vancouver: J. J. Douglas, 1974) and Hugh Aitken "Defensive Expansion", in M. Watkins and W. T. Easterbrook (eds.) Approaches to Economic History (Toronto: McClelland and Stewart, 1968). See Marsha Gordon, Government in Business (Montreal: C. D. Howe Research Institute, 1981) for a list of the various rationales or circumstances which resulted in the creation of corporations.

33. John Langford and Kenneth Huffman, "The Uncharted Universe of the Federal Public Corporations," in J.R.S. Prichard (ed.) Crown Corporations: The Calculus of Instrument Choice (Toronto: Butterworths, 1983), 219-301, counted 454 federal public corporations in 1980 including subsidiaries, of which 58 per cent were created between 1960 and 1980. The Economic Council, in a 1987 study, identified 527 federal and provincial corporations. See John Knubley, The Origins of

Government Enterprise in Canada. (Ottawa: The Economic Council of Canada, June, 1987), Discussion Paper No. 329. Vining and Bottrell counted 233 provincial corporations operating in 1980 of which 75 per cent had been created since 1960.

34. See the Financial Post 500 1985 and Economic Council of Canada, 1987 op cit.

35. Ibid.

36. Laux and Molot, op cit. and Allan Tupper and G. Bruce Doern, Privatization, Public Policy and Public Corporations (Halifax: Institute for Research on Public Policy, 1988).

37. See Richard Schultz and Alan Alexandroff, Economic Regulation and the Federal System (Toronto: University of Toronto Press, 1985), 4.

38. They use a combination of measures including the proportion of economic activity subject to direct regulation, governmental budgetary outlays on regulatory activities, and the number of statutes by which economic regulation is effected. See W.T. Stanbury and Fred Thompson, "The Scope and Coverage of Regulation in Canada and the United States: Implications for the Demand for Reform," in W.T. Stanbury (ed.) Government Regulation: Scope, Growth and Process. (Montreal: Institute for Research on Public Policy 1980), 17-67.

39. Richard Schultz, "Regulating Conservatively: the Mulroney Record, 1984-88," in Andrew Gollner and Daniel Sallee (eds.) Canada Under Mulroney: An End of Term Report (Montreal: Vehicule Press, 1988), 191.

40. Michael Bliss, The Evolution of Industrial Policy in Canada: An Historical Survey, Discussion Paper No. 218 (Ottawa: Economic Council of Canada, 1982); Michael Bliss, "Rich by Nature, Poor by Policy: The State and Economic Life in Canada," in R. Kenneth Carty and W. Peter Ward (eds.) Entering the Eighties (Toronto: University of Toronto Press, 1980); G. Bruce Doern, The Politics of Economic Policy (Toronto: University of Toronto Press, 1985).

41. Michael M. Atkinson and William D. Coleman, The State, Business and Industrial Change in Canada. (Toronto: University of Toronto Press, 1989, 23-31.

42. See Peter Katzenstein (ed.) Between Power and Plenty: The Foreign Economic Policies of Advanced Industrial Nations (Madison: University of Wisconsin Press, 1978) on strong and weak states and Helen Milner's critique of the term in Resisting Protectionism: Global Industries and the Politics of International Trade, (Princeton, N.J.: Princeton University

Press, 1988).

43. Ken Woodside op cit. Nicolas Baxter-Moore, op cit.

44. See Glen Williams, Not For Export (Toronto: McClelland and Stewart, 1984).

45. This was evident in the new economic departments created or reorganized, including the Department of Industry (1963, then merged with Industry Trade and Commerce in 1968) which was intended to stimulate growth in the manufacturing sector, and the Department of Regional Economic Expansion (1969), designed to address regional disparities through the promotion of economic development. Two advisory bodies, the Economic Council and the Science Council, were established in 1963 to improve the quality of policy advice and economic forecasting available to the government.

46. See Phillip Resnick, The Mask of Proteus: Reflections on the Canadian State (Montreal: McGill-Queen's Press, 1990), 167 and Langille "The Business Council on National Issues and the Canadian State", Studies in Political Economy 24 (Autumn, 1987), 45-72.

47. Doern, 1985 op cit. and French, op cit.

48. See Government of Canada, The Way Ahead, (Ottawa: 1976), and Brown and Eastman, The Limits of Consultation. op cit. Reassuring the private sector and some provinces about the federal state's economic role was clearly the goal of the First Ministers Meeting on the Economy in 1978. David Wolfe "The Canadian State in Comparative Perspective," Canadian Review of Sociology and Anthropology 26:1 (February, 1989)op cit. identifies 1975 as the turning point in Canadian state intervention.

49. Government of Canada, Economic Statement, November, 1984.

50. These are reflected in the federal- provincial Economic and Regional Development Agreements signed in the mid 1980s and the subsequent creation of the Atlantic Opportunities Agency and the Western Diversification Office.

51. See Jeanne Laux, "The Limits of Liberalism," International Journal XLVI:1 (Winter, 1990-91), 113-136.

52. For a discussion of why this occurred see Kenneth Woodside, "Trade and Industrial Policy: Hard Choices," in Michael M. Atkinson (ed.) Governing Canada: Institutions and Public Policy (Toronto: Harcourt, Brace, Jovanovitch Canada, 1993, 241-274.

53. See William Carroll, Jorge Niosi, Resnick, and Glenday op cit. The state has played a role in encouraging the formation of organizations. A. Paul Pross, Group Politics and Public Policy (Toronto: Oxford University Press, 1986) especially chapter ten. Efforts to organize economic interests include the 1976-78 tri-partite sectoral consultations Brown and Eastman op cit.

54. See David Langille, op cit. Clearly business interests have more influence than labour groups on economic development issues largely because of their strategic position in controlling the level of investment. This is a largely indirect form of influence. There is some evidence, however, that senior federal officials do, in fact, interact more frequently with, and are more attentive to business than to labour representatives. See A. Paul Williams, "Access and Accommodation in the Canadian Welfare State: The Political Significance of Contacts Between the State, Labour and Business Leaders," Canadian Review of Sociology and Anthropology 26:2 (May, 1989), 217-239.

55. William Coleman, Business and Politics: A Study of Collective Action, (Montreal: McGill-Queen's Press, '88), especially chapters ten and eleven and "Canadian Business and the State," in Keith Banting (ed.) The State and Economic Interests (Toronto: University of Toronto Press, 1985). See also Keith Banting's introduction "The State and Economic Interests," in the same volume. One of the few instances of unanimity was the introduction in 1971 of a new Competition Act. See W.T. Stanbury, Business Interests and the Reform of Competition Policy (Montreal: Institute for Research on Public Policy, 1978). The Free Trade Agreement in 1987 and the subsequent election was also a case where a number of sectors of capital united to promote the agreement and the reelection of the Progressive Conservative government. Even the Canadian Manufacturers Association, a past opponent of free trade supported negotiations and the agreement. Nonetheless brewers, food processors, some agricultural producers and auto parts manufacturers were among those opposing any agreement.

56. Budgetary deficits have persisted since the mid 1970s and gone from 3.2 per cent of GNP in 1976 to a peak of 8.6 per cent in 1985. Debt charges began to escalate in the mid 1970s when they stood at 5.7 per cent of GNP, to 19.3 per cent in 1987. See Department of Finance, "Canada's Performance and Prospects," The Budget February 20, 1990, 139 and 147.

57. Richard Johnston, Public Opinion and Public Policy (Toronto: University of Toronto Press, 1985).

58. OECD, Recent Trends in International Direct Investment (OECD: Paris, 1987). See Tables III.1 and III.3, 186-188.

59. United Nations Centre on Transnational Corporations, op cit. 1985, 25.

60. Ibid.

61. The OECD, as a result of decisions taken in 1976, has been active in monitoring both access and discriminatory policy measures. OECD members are required to report all incentives and disincentives affecting inward investment and any deviations from national treatment for EFCs. The published reports of the two watchdog committees, the Committee on Investment and Multinational Enterprises and the Committee on Capital Movements and Invisible Transactions provide much of the data for our discussion of investment regimes. See OECD, Committee on Investment and Multinational Enterprises, Investment Incentives and Disincentives: Effects on International Direct Investment (OECD: Paris, 1989) and National Treatment For Foreign-Controlled Enterprises (OECD: Paris, 1985); OECD Committee on Capital Movements and Invisible Transactions, Controls and Impediments Affecting Inward Direct Investment (OECD: Paris, 1987); Further discussion of investment laws are found in United Nations Centre for Transnational Corporations, National Legislation and Regulations Relating to Transnational Corporations, Volumes I-VII (New York: UN, 1983-89); Stephen Globerman, "Government Policies Towards Foreign Direct Investment: Has a New Era Dawned?", Columbia Journal of World Business (Fall, 1988), 41-49; Lynn Krieger Mytelka, op cit and A. E. Safarian, Governments and Multinationals: Policies in Developed Countries (Montreal: C.D. Howe, 1983).

62. For a discussion of these concepts see United Nations Centre on Transnational Corporations, New Issues in the Uruguay Round of Multilateral Trade Negotiations, Part IV "Key Concepts in International Investment Instruments" (UN: New York, 1991) Current Issues, Series A, No.19. For a more detailed discussion of these legal concepts as they apply in the case of state control of FDI see Cynthia Day Wallace, Legal Control of the Multinational Enterprise: National Regulatory Techniques and the Prospects for International Control (Martinus Nijhoff, 1982).

63. OECD, Investment Incentives and Disincentives: Effects on International Investment (OECD: Paris, 1989), 9.

64. OECD, Investment Incentives and Disincentives: Effects on International Direct Investment (Paris: OECD, 1989) and Investment Incentives and Disincentives, (1983).

65. Ibid.

66. See United Nations, National Legislation and Regulations Relating to Transnational Corporations (volume 6) (UN:New York, 1989), 210 on the Royal Decree No 167 of December 1982 regarding the tax regime for multinational groups.

67. Promotional activities and competition for investment can be quite fierce. The EC has attempted to limit the aggressive promotion of regions as investment locations by member countries and sub-national governments. See Guy de Jonquieres "A War of Diminishing Returns: Europe's Quest for Foreign Investment," Financial Times (London), November, 10, 1986. Most of the incentives involved are generally available regional development or innovation industrial incentives. US states have also been aggressive in the recruitment of new investment, especially in the auto industry. See Earnest Yanarella and William Green(eds) The Politics of Industrial Recruitment (Westport, Conn:Greenwood Press, 1990). In some cases non-tariff barriers have also been used, for example, against the Japanese to spur new FDI in Europe in lieu of exports.

68. Ibid.

69. OECD, Controls and Impediments Affecting Inward Direct Investment in OECD Member Countries (Paris: OECD, 1982).

70. For a discussion of Australia and France see Mytelka, op cit.

71. Safarian, 1983, op cit.

72. OECD, National Treatment for Foreign-Controlled Enterprises (April, 1985).

73. This refers not to discrimination against goods produced abroad in government purchasing, but against goods domestically-produced by foreign-owned or controlled firms.

74. The table gives a broad indication of the extent of discrimination but does not weight the significance of the measures either in their impact on the national economy or the proportion of foreign investors affected.

75. For a discussion of France see Alison Doyle, "The French Nationalizations: Mitterand Challenges the Multinationals," in Bart S. Fisher and Jeff Turner, Regulating the Multinational Enterprise: National and International Challenges (New York: Praeger, 1983).

76. United Nations Centre on Transnational Corporations, op cit. 1988. Although a few large corporations have become increasingly transnational in operations the general pattern is one of capital imports. Outward FDI from developing countries in 1985, for example, represented only 3 per cent of world stocks. A large proportion, moreover, was accounted for by only three countries Korea, Brazil and Mexico.

77. UN op cit. (1988), 81.

78. OECD, Recent Trends in International Direct Investment (Paris: 1987).

79. See Stephen Haggard and Tun-jen Cheng, "State and Foreign Capital in the East Asian NICs" in Frederick Deyo, The Political Economy of the New Asian Industrialism (Ithaca: Cornell University Press, 1987).

80. UN, 1988 op cit., chapter XVII.

81. Ibid.

82. The United States Department of Commerce, in a survey on performance requirements found that 3 per cent of US affiliates in developing countries were subject to requirements regarding exports versus 1 per cent in developed countries. In the case of employment requirements comparable figures were 15 and 4 per cent respectively. US Department of Commerce, Benchmark Survey (Washington, D.C. 1982).

83. In 1973 the peak was reached when Canada, India, Mexico and South Korea all brought in new legislation. See Dennis Encarnation, Dislodging the Multinationals: India's Strategy in Comparative Perspective. (Ithaca: Cornell University Press, 1989), 1.

84. United Nations, 1988 op cit.

85. The UN report of 1988 lists 90 developing countries which have amended or altered legislation in some way to lessen regulation of foreign capital. See UN, 1988 op cit., 281.

86. Peter Evans, "State, Capital and the Transformation of Dependence: the Brazilian Computer Case" World Development 14:7 (July, 1986), 791-808 and Mark Jacobsen, "Mexican Regulation of the Computer Industry," in Fisher and Turner, 1983, op cit.

87. Stephen Kobrin, "Expropriation as an Attempt to Control Foreign Firms: Trends From 1960-79." International Studies Quarterly (Sept., 1984), 329-348.

88. Dennis J. Encarnation and Louis T. Wells Jr. "Sovereignty en Garde," International Organization (Winter, 1985), 47-60.

89. FDI, while very significant to these economies, has been eclipsed in recent years by debt. The case of Argentina illustrates the trend. The stock of FDI as a per cent of GDP increased from 5.9 to 12.9 per cent in the 1975-85 period, while external debt went from 16.9 to 73.6 per cent of GDP in the same period. OECD, International Investment and Multinational Enterprises: Recent Trends in International Direct Investment (Paris, 1987) Table III, 7.

90. Aside from altering FDI regimes an increasing number of developing countries have entered into bilateral investment treaties with capital-exporting countries and have joined the International Center for the Settlement of Investment Disputes. UN, 1988 op cit.

91. This is not to suggest that such efforts were successful or that the policies adopted did not benefit a specific group, often the state technocratic elite or local capital. For an analysis of the impact of FDI and the limits of these efforts see V. Bornschier and C. Chase-Dunn, Transnational Corporations and Underdevelopment (New York: Praeger, 1985).

92. Lipson has suggested that, in contrast to the situation regarding debt, developing states in the 1970s were willing and able to challenge what had been the prevailing international norms for the treatment of foreign direct investment. See Charles Lipson, Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Century. (Berkeley: University of California Press, 1985)

His conclusion, however, ignored the possibility that the IMF and World Bank's central role in the debt crisis would give advanced, industrial, capital-exporting nations, as a group, additional leverage over FDI. This has indeed been the case and is reflected both in the IMF's imposition of conditions on developing countries receiving its assistance and the World Bank's efforts to eliminate performance requirements and establish the Multilateral Investment Guarantee Agency.

93. One of the most important set of regulations affecting FDI is the level of tariffs states impose on imports. Trade protection, in effect, forces the foreign producer, desirous of entering a market to forego exports in favour of FDI. As such it may also act as an incentive to investment and has been used by states to stimulate FDI as well as to protect a domestic market for the benefit of infant industries. Our analysis however, assumes the firm's prior decision to invest rather than to export and is oriented to analyzing how states

manage the investment process.

94. For a discussion of investment incentives and their relationship to foreign direct investment see the OECD, Incentives and Disincentives in the International Investment Community. (Paris: OECD, 1983) as well as Stephen Guisinger and Associates, Investment Incentives and Performance Requirements: Patterns of International Trade, Production and Investment. (New York: Praeger, 1985).

95. Transparency refers to the clarity of the intent and impact of policies to all parties affected; in other words winners and losers are clearly identifiable. Transparency is important in influencing the opposition or support policies generate both internally and externally. Policy instruments which entail specific legislation, articulate goals regarding economic development priorities for foreign investment and create new and separate administrative agencies for investment screening are more transparent than instruments that employ existing institutions in new ways to pursue implicit policies.

96. Instances the use of this instrument have diminished sharply since then. See United Nations Centre on Transnational Corporations, op cit., 1988.

97. Robert Gilpin argued that the multinational corporation stimulated the further extension of state power in domestic economies. See "The Politics of Transnational Economic Relations," in Robert Keohane and Joseph Nye (eds.), Transnational Relations and World Politics (Cambridge: Harvard University Press, 1971), 69. Stephen Hymer suggested that the outcome of an increase in internationalized production would be an increase in "voice" on the part of those domestic interests hurt by the process, such as labour or sectors of small capital which cannot exit. Such groups, of necessity, turn to the state to intervene and control the process of integration into the world economy. "International Politics and International Economics: A Radical Approach," in Leon Lindberg et al., (eds.) Stress and Contradiction in Modern Capitalism (Lexington, Mass: D.C. Heath, 1975). Katzenstein also identified a relationship between the size of the public sector and a state's position within the world economy for a group of advanced industrial countries which he labels the small, European states. These countries, where economies of scale cannot be realized except through exports, are characterized by high levels of trade dependence, specialization, chronic trade deficits and a welcoming of foreign capital. The dependence on external markets sets the parameters of commercial policy in these states by inhibiting policies of protectionism resulting in a liberal foreign economic policy. This is coupled with a policy of domestic compensation, reflected in a large welfare system and

increased state role in transfer payments. Peter Katzenstein, "The Small European States in the International Economy: Economic Dependence and Corporatist Politics," in John Ruggie (ed.) The Antimonies of Interdependence (New York: Columbia University Press, 1984) and Small States in World Markets: Industrial Policy in Europe (Ithaca: Cornell University Press, 1986).

98. Edward Morse, op cit. and "The New Nationalism and the Coordination of Economic Policies," in Werner Link and Werner Feld (eds.) The New Nationalism (New York: Pergamon, 1979). See also C. Fred Bergsten, "Coming Investment Wars," Foreign Affairs 53 (1974) and C. Fred Bergsten, Ted Horst, and Theodore Moran, American Multinationals and American Interests (Washington: Brookings Institution, 1978). Bergsten, for example, argued that the domestic pressures on the state to interrupt or distort international economic transactions would increase. In response to these pressures, he predicted states would take steps to enhance national autonomy and economic well-being by making access to national territory conditional.

99. Jeanne Kirk Laux, "Global Interdependence and State Intervention," in Brian W. Tomlin (ed.) Canada's Foreign Policy: Analysis and Trends (Toronto: Methuen, 1978), 110-137.

100. Ibid., 111.

101. Laux and Molot, op cit. especially 21-23 and Raymond Duvall and John Freeman "The Techno-Bureaucratic Elite and the Entrepreneurial State in Dependent Industrialization," American Political Science Review 77: 3 (September, 1983).

102. Peter Evans. "Transnational Linkages and the Economic Role of the State," in Theda Skocpol, Peter Evans and Dietrich Rueschemeyer (eds.) Bringing the State Back In (Cambridge: Cambridge University Press, 1985).

103. Lynn Mytelka, "The State and Foreign Capital in the Advanced Industrial Capitalist Countries," in Andre Blais (ed.) Industrial Policy (Toronto: University of Toronto Press, 1986), 119-166. The study, however, does not examine this relationship over time, but cross-nationally and looks at flows rather than stocks of FDI.

104. In essence her argument is similar to one that has been made regarding protectionist trade policies by Helen Milner. Milner has argued that it is the changing nature of domestic capital, particularly the extent to which firms become more international in their production which shapes, but does not determine trade policy. In her study of the United States and

France Milner found that differences in state structures were also relevant. See Resisting Protectionism (Ithaca: Cornell University Press, 1988).

105. See Jean Laux, 1977 op cit and Laux and Molot, 1988 op cit. In the case of developing states see Duvall and Freeman, op cit., on the entrepreneurial state.

106. For a complete listing of the numerous studies see A. E. Safarian, Foreign Direct Investment: A Survey of Canadian Research Montreal: Institute for Research on Public Policy, 1984.

107. Fayerweather, has examined both elite and popular attitudes to foreign investment in Canada through the 1960s and early 1970s to explain why increased public concern about FDI arose at a time when the level of foreign control in the Canadian economy had already begun to decline. Concern, he argues, arose because the method of investment, primarily takeovers, and the expansion of foreign corporations via retained earnings indicated that Canada no longer needed investment. In addition American policy initiatives, such as the economic measures of 1971, generated an increased awareness in Canada of the potentially severe negative consequences of closer economic ties to the United States. John Fayerweather, Foreign Investment in Canada: National Policy Prospects (White Plains, New York: International Arts and Science Press, 1973) and John Fayerweather (ed.) Host National Attitudes Towards Multinational Corporations (New York: Praeger, 1980).

108. Le Duc and Murray have argued that the variation in concern about foreign investment in Canada evident in the past two decades was primarily a function of public opinion regarding US FDI which itself fluctuated depending on prevailing economic conditions. Public concern about foreign investment declined when the economic situation deteriorated. Public concern was at its highest in the early 1970s and then later again in the early 1980s appearing to coincide with periods when major changes in Canadian policy toward foreign investment were made or announced. Lawrence LeDuc and J. Alex Murray, "Public Opinion and North American Integration: Pragmatic Nationalism," in John H. Pammett and Brian W. Tomlin (eds.) The Integration Question: Political Economy and Public Policy in North America (Toronto: Addison-Wesley, 1984), 129-143. For an overview of the trends in public opinion see David Elton, "Canadian Attitudes Toward Foreign Direct Investment," in Earl Fry and Lee Radebaugh (eds.) Regulation of Direct Investment in Canada and the United States (Provo, Utah: Brigham Young University Press, 1983). The electoral connection, however, is ambiguous. Poel and Munton, argue that in the 1972 and 1974 Canadian elections the

issue of foreign investment was poorly understood and ranked fairly low in the electorate's priorities. They found no evidence of a direct link between public opinion and the decision to introduce the Foreign Investment Review Act.

109. Phil Resnick has also focussed on the development of a new Canadian middle class, through the expansion of the state sector, to account for the rising tide of Canadian economic nationalism in the 1960s and early 70s. See Phil Resnick, The Land of Cain: Class and Nationalism in English Canada 1945-75 (Vancouver: New Star Books, 1977).

110. Jack G. Layton, Capital and the Canadian State: Foreign Investment Policy, 1957-82 Ph.d. Dissertation, York University, May, 1983.

111. Wallace Clement, Continental Corporate Power: Economic Linkages Between Canada and the United States (Toronto: McClelland and Stewart, 1977).

112. See Claire Turenne Sjolander Foreign Investment Policy: Making: The Canadian State in the Global Economy, Doctoral dissertation, Carleton University, 1989.

113. See Arpad Abonyi, "Government Participation in Investment Development," in Salee and Andrew Gollner (eds.) Canada Under Mulroney (Montreal: Vehicule, 1988).

114. In the past these efforts to assert control over international economic linkages such as trade or investment were often dismissed as simply the self-interested policies of politically dominant local elites or classes. Typical of this view is Albert Breton, "The Economics of Nationalism," Journal of Political Economy 72:2 (1964), 376-86; and Harry Johnson, "A Theoretical Model of Nationalism in New and Developing States," in Bruce Russett (ed.) Economic Theories of International Politics (Chicago: Markham Publishing, 1968).

115. In some cases states did not bargain but seized corporate assets. These state actions, more frequent in the 1950s and the 1960s, were also a subject of much research. Jodice found that the propensity of host states to nationalize increased with the level of economic development and the administrative capacity of the state in the host country in the 1960-1979 period. Moreover, failures of economic performance, especially in the foreign trade sector, were found to add an immediate incentive to host state takeovers. In the late 1970s, however, Kobrin notes that states moved away from these extreme measures and relied on their capacity to regulate and control the activity of MNCs. This suggests that a change in the mix of policy instruments is also a function of changing state capacity and resources. See

Stephen Kobrin, "Expropriation as an Attempt to Control Foreign Firms: Trends From 1960-79," International Studies Quarterly, 28, (Sept., 1984) 329-348. One of the few attempts to study an expropriation decision in Canada, at the provincial level is found in, Maureen Molot and Jeanne Kirk Laux, "Multinational Corporations and Economic Nationalism: Conflict Over Resource Development in Canada," World Development 6, (1978), 837-850 and "The Politics of Nationalization," Canadian Journal of Political Science 12 (July, 1979), 227-258. They discuss the case of the takeover of Saskatchewan's potash industry by the NDP government. In addition Quebec made similar moves against the asbestos industry. Many opponents of the National Energy Program have argued that the retroactive nature of the Canadian government's interest in petroleum production on Canada Lands also constituted expropriation.

116. C. Fred Bergsten, Thomas Horst and Theodore Moran, American Multinationals and American Interests. (Washington, D.C: The Brookings Institute, 1978), 312.

117. Most well-known is Theodore H. Moran, Multinational Corporations and the Politics of Dependence: Copper in Chile (Princeton: Princeton University Press, 1974), which discusses "the obsolescing bargain" in resource industries which results in enhanced power to host states over time. Stephen Kobrin, in an empirical study of manufacturing subsidiaries finds, however, that it does not hold particularly in technology-intensive and highly integrated industries where the bargaining position of MNCs has not eroded over time. Stephen Kobrin, "Testing the Bargaining Hypothesis," International Organization (Autumn, 1987) 41:4, 609-638.

118. Charles Lipson, Standing Guard (Berkeley: University of California Press, 1985).

119. Stephen Globerman, "Government Policies Toward Foreign Direct Investment: Has a New Era Dawned", Columbia Journal of World Business 23:3 (Fall, 1988), 41-49.

120. See Kenneth Thomas, "Recent Trends in MNC/Host Bargaining in OECD Countries", Paper presented at the International Studies Association in Vancouver, B.C., March 22, 1991. See also Douglas Bennett and Kenneth Sharpe, Transnational Corporations Versus the State: The Political Economy of the Mexican Auto Industry (Princeton: Princeton University Press, 1985).

121. Stephen Guisinger et al. Investment Incentives and Performance Requirements (New York: Praeger, 1985).

122. See David Leyton-Brown, Governments of Developed Countries as Host to Multinational Enterprise: The Canadian British and French Policy Experience Doctoral Dissertation, Harvard University, 1973, and Robert Black, Stephen Blank and Elizabeth Hanson, Multinationals in Contention (Ottawa: the Conference Board, 1978).

123. The distinction between dependence and dependency is outlined in James Caparaso "Dependence, Dependency and Power in the Global System: A Structural and Behavioral Analysis," International Organization 32, (Winter, 1978), 13-44. Part of this work focussed on the economic growth or income inequality in third world countries.

124. Dependence has been operationalized using measures of bilateral trade, investment and aid flows while the dependent variable has been measured by UN voting patterns or event-interaction data. See, in particular Neil Richardson, Foreign Policy and Economic Dependence (Austin: University of Texas Press, 1978); and Richardson and Charles Kegley, "Trade Dependence and Foreign Policy Compliance: A Longitudinal Analysis", International Studies Quarterly 24 (1980), 191-222. Also in the same vein see Adrienne Armstrong, "The Political Consequences of Economic Dependence," Journal of Conflict Resolution 25, 3 (1981) and James Lee Ray, "Dependence, Political Compliance and Economic Performance in Latin America and Eastern Europe," in Kegley and Patrick McGowan (eds.) The Political Economy of Foreign Policy Behaviour (Beverly Hills: Sage, 1981). These studies have also been criticized for ignoring alternate explanations of dependent state compliant behaviour and a tendency to black-box the dependent state. For a critique of Richardson and an elaboration of the competing theory that dependent-state behaviour based on a consensus between elites in dominant and subordinate states see Bruce Moon, "Consensus or Compliance: Foreign Policy Change and External Dependence" International Organization 39, 2 (Spring, 1985), 296-329.

125. Bennett and Sharpe, op cit.

126. Neil Richardson has moved in this direction in more recent work which attempted to test the relationship between expropriation of FDI and the relations between home and host countries. See Neil Richardson, "Foreign Policy Costs of Economic Nationalism: Poisoning the Well," in Charles Doran and Cal Clark (eds.) North/South Relations: Studies in Dependence Reversal (Boulder, Colo.: Westview, 1984). He finds no relationship between varying levels of expropriation and conflictual or cooperative behaviour, except in the case of petroleum investments.

127. See Lipson for a discussion of the U.S. use of foreign aid and trade sanctions under the Hickenlooper Amendment and the Trading With the Enemy Act. Lipson, op cit.
128. See Dennis Encarnation and Mark Mason, "Neither MITI Nor America: The Political Economy of Capital Liberalization in Japan," International Organization 44:1 (Winter, 1990), 25-41.
129. Robert Gilpin, "Integration and Disintegration on the North American Continent," International Organization 28 (1974), 851-874 and Naomi Black, "Absorptive Systems are Impossible: The Canadian-American Relationship as a Disparate Dyad," in Andrew Axline, James Hyndman, Peyton Lyon and Maureen Molot (eds.) Continental Community: Integration in North America (Toronto: McClelland and Stewart, 1974). Stuart Rothenberg also empirically examined the Canada-U.S. disparate dyad and found the likelihood of restrictions appeared to be related to the political salience of certain transactions. See Stuart Rothenberg, United States-Canadian Relations 1950-73: The Limits of Community Ph d. Dissertation, University of Connecticut, 1977.
130. See David Leyton-Brown, "The Multinational Enterprise and Conflict in Canadian-American Relations," International Organization, 28:4 (Autumn, 1974), 733-754 and Robert Keohane and Joseph Nye, Power and Interdependence: World Politics in Transition (Boston: Little, Brown and Co., 1977).
131. Michael Dolan and Brian Tomlin, "Foreign Policy in Asymmetrical Dyads: Theoretical Reformulation and Empirical Analysis-Canada-United States Relations 1963-72," International Studies Quarterly (Sept, 1984), 349-368.
132. Stephen Clarkson, Canada and the Reagan Challenge (Toronto: Lorimer, 1982).
133. Robert Keohane, "Multilateralism: An Agenda for Research", International Journal XLV, 4 (Autumn, 1990), 731-764.
134. Lipson, op cit.
135. Krasner, Structural Conflict, op cit.
136. See Robert K. Paterson, "Canadian and International Legal Regimes for Foreign Investment and Trade in Services." in A. Claire Cutler and Mark W. Zacher, Canadian Foreign Policy and International Economic Regimes, (Vancouver: University of British Columbia Press, 1992), 130-152 and Christopher Maule and Andrew Vanderwaal, "International

Regulation of Foreign Investment," International Perspectives (Nov-Dec, 1985), 22-28, two of the few studies.

137. See Tom Keating, Canada and World Order: The Multilateral Tradition and Canadian Foreign Policy (Toronto: McClelland and Stewart, 1993).

138. Peter Evans, op cit, 1985 has made this argument. Lynn K. Mytelka, op cit., 1985 has tested the relationship using cross-national data investment flows. Her findings indicated no relationship but she does suggest that a longitudinal study that takes into account the historical role of the state within a particular country is necessary to understand differing state policies on FDI and the role of domestic capital in influencing policy.

139. See Stephen Krasner, Structural Conflict op cit.

140. Lipson, op cit.

CHAPTER THREE

CANADA IN THE WORLD ECONOMY: ECONOMIC DEPENDENCE AND CHANGING INVESTMENT RELATIONS

Introduction

This chapter analyzes changes to Canada's external trade and investment linkages in the 1957-1987 period. As Chapter Two indicated, these are two of the three external linkages which, I have argued, influenced the Canadian state's foreign investment regime, particularly the choice of policy instruments. The changes in Canada's position in the international economy in the postwar period have been described and analyzed extensively¹ and are well known, especially as a result of the vigorous national debate of the past decade over trade policy. Our intent here, however, is to document the changes that are relevant to our explanation of FDI regime change and to provide the empirical basis for the analysis of the effects of these changes on Canada's FDI regime - a task undertaken in Chapters Four and Five.

The chapter reviews, first, the changing nature of Canada's investment linkages, especially the movement from a host country in the 1960s, a major recipient of investment inflows to, what we have termed, a mature host by the early 1980s, a country with a continuing large stock of foreign direct investment (FDI), but a declining share of world investment inflows and a growing role as a capital exporter in

its own right.

Second, the chapter provides evidence of the second external relationship, the increased trade dependence on the United States, defined in terms of the growing concentration on the United States as an export market, especially for manufactured goods. As I will indicate, this increased export dependence evolved within a bilateral context of asymmetry and an international context which placed growing pressures on Canada to enhance the competitiveness of its goods in both domestic and international markets. Trade dependence, I argue, has also shaped the choice of policy instruments used to manage FDI, particularly, as Chapter Five will indicate, as the treatment of U.S.-based FDI became more directly linked to secure Canadian access to the U.S. market.

I begin, however, by placing the description of changes to Canada's trade and investment relations within the broader context of postwar changes to the international political economy.

From Trade to Internationalized Production: The World Economy in the Post-War Period

The world economy has been characterized by a rising volume (and value) of economic transactions in the post-war period² Trade increased six-fold and, as a result, most economies, especially advanced industrial ones, became increasingly open to international exchange and dependent on trade. This period also saw unparalleled growth and prosperity for western industrial nations with growth rates in

the 1960s averaging 4.7 per cent for all OECD countries.³ However, this trend was interrupted by monetary instability in the early 1970s and a major oil price shock in the fall of 1973, which generated high rates of inflation and lower economic growth. As a consequence, new forms of trade barriers proliferated among countries, despite the continuation of GATT trade negotiations in 1973.⁴ This growing state effort to manage trade without the resort to tariffs became known as the "new protectionism".

By the mid-1970s the U.S. economy had become more open to and influenced by international economic exchanges and lost its overall preponderance in the world economy.⁵ While the United States had accounted for 70 per cent of total production of the largest seven western industrial economies in the 1950-67 period, this proportion had dropped to 40-45 per cent by the 1980s.⁶ The U.S. share of world exports also declined from 16.4 per cent in 1955 to 12 per cent by the end of the 1970s.⁷

By the 1970s the increase in exports from the newly industrialized countries (NICs)⁸ was also having an impact, especially since it was rapid, concentrated in certain industries, and displaced traditional domestic producers within OECD countries.⁹ The rise of the NIC exporters was facilitated by multinational corporations seeking to lower labour costs and to produce components as part of world-wide, integrated production processes.¹⁰

With the second oil price shock a renewed round of inflation and recession hit the world economy in 1980-82 affecting both trade and international investment. While the volume of world trade had grown an average of 5 per cent between 1977-78, in 1980 it registered a 2 per cent decline in absolute terms.¹¹ The large U.S. federal deficits and high real interest rates pushed the U.S. dollar dramatically higher after 1980. Large inflows of capital into the United States reinforced this trend.

By the mid-1980s, the United States' share of FDI had increased to between 40 and 50 per cent of world FDI inflows, in comparison to 10 per cent in the 1960s, much of it originating in Canada, Japan and Western Europe.¹² At the same time outward flows of U.S. FDI were falling off, although this was compensated for by the continuing substantial growth of U.S. stocks of FDI abroad through retained earnings. The deceleration of growth of FDI flows from OECD countries continued, but even more significant was the growing volatility of FDI flows.¹³ Much of this new investment was not drawn to host countries by the nature of the local market, but rather as part of the rationalization of a global production process.¹⁴

Increased competitive pressure from foreign goods in the U.S. market was also evident with the high value of the dollar resulting in record trade deficits.¹⁵ The United States' reaction to these competitive pressures was to put access to

the U.S. market at risk for many of its largest trading partners. But this effort was not unique to the United States. One study estimates that between 1974 and 1982 the proportion of trade falling under some government to government market arrangement grew from 13 to 30 per cent.¹⁸

Increasingly foreign states were relying on non-tariff barriers and domestic regulation to capture the benefits of globalized production. Efforts to further open foreign markets to goods, services and capital therefore, from the U.S. view, necessitated raising new items for the trade agenda including regulating foreign direct investment, and service industries.

In conclusion, economic growth and trade and investment expansion of the 1950s and 1960s gave way to recession, economic instability, a slowdown and increased volatility of FDI flows in the 1970s. Economic roles of capital importer and exporter changed in the world economy. By the 1980s the United States had become the major capital importer, with Japan, Germany and other countries playing the role of capital exporters. Access to the U.S. market for exports became less certain as economic conditions conducive to protectionism on the part of U.S. producers persisted. Because of the intensity of Canada's economic links to the United States, which I outline below, these developments had an important impact on Canada. It is to Canada's position in the international economy which I now turn.

Canada in the World Economy: The Maturation of a Host State

Any discussion of Canada's place in the international system must begin by acknowledging Canada's relatively large industrial economy. Table 3.1 indicates Canada was, in the period under study, one of the seven largest OECD economies.

TABLE 3.1

Gross Domestic Product and Population of Twelve Largest OECD Countries 1963-87

	Gross Domestic Product			Population		
	Billions of \$U.S.			(000,000)		
	1963	1980	1987	1963	1980	1987
United States	585.1	2,587.1	4472.9	189.4	227.7	243.9
Japan	58.4	1,040.0	2373.1	95.8	116.8	122.1
West Germany	94.5	819.1	1117.8	55.4	61.6	61.1
France	79.9	651.9	879.5	47.9	53.7	55.8
United Kingdom	84.1	522.9	669.8	53.8	55.9	56.9
Italy	45.3	394.0	758.1	50.4	56.2	57.3
Canada	42.8	253.3	410.9	18.9	23.9	25.6
Spain	6.8	211.1	289.2	31.1	37.4	38.8
Netherlands	14.5	167.6	213.2	11.9	14.1	14.7
Australia	-	140.0	193.7	7.2	14.8	18.2
Belgium and Luxembourg	19.1	121.1	144.9	9.6	10.2	10.3

Source: Department of External Affairs, A Review of Canadian Trade Policy: A Background Document to Canadian Trade Policy for the 1980 (Ottawa: 1983) and World Bank World Tables. Third Edition, (Washington, D.C: 1983, 1988).

However, it also indicates a growing gap between Canada and the other six over time and the huge size difference with the United States, its major economic partner. In addition, Table 3.1 highlights the significantly smaller population of Canada relative to the other six - a fact which affects market size and has implications for Canada's leverage on international

trade issues.

Despite the relatively large size of its economy, it is clearly in its patterns of economic interaction that Canada differs most strikingly from the other large industrial countries with which it is usually ranked. This economic dependence must be reconciled with the size and sophistication of the Canadian economy¹⁷ in a way that avoids being overly simplistic or deterministic¹⁸. In particular, the impact of FDI on the Canadian political economy in the post-war period and the intensity of Canada's asymmetrical economic relationship with the United States must be clearly understood.

Canada's relationship to international capital can be described in the postwar period as the development and maturation of a host country. The process begins with a high level of inflows of largely U.S.-based capital in the early postwar period, a result of deliberate Canadian state efforts to attract FDI. In the 1946-1956 period the total stock of foreign investment more than doubled from \$7.2 billion to \$15.6 billion. Foreign direct investment constituted a rising proportion of all foreign long-term investment, averaging between 50 and 60 per cent throughout the 1950s and 60s. Yet by 1980 direct investment constituted only 47 per cent of long-term investment.¹⁹

As Table 3.2 indicates gross inflows of new investment funds from outside the country fluctuated considerably from

the late 1960s until the mid-1970s and then increased dramatically in the period to 1981. The increase was, however, offset by equally large outflows, which resulted in 1978, and then again in 1981, 1982 and 1985 in negative net flows.

Table 3.2

Flows and Total Stock of FDI in Canada

	Gross Inflow Millions of Current \$	Gross Outflows	Net Flows	Total Stock
1958			450	12,872
1960			670	10,880
1962			505	14,660
1964	78	-508	270	15,961
1966	1275	-485	790	19,012
1968	1048	-458	590	22,552
1970	1340	-515	835	26,423
1971	1735	-855	880	28,003
1972	1444	-839	605	29,650
1973	1554	-724	830	32,873
1974	1701	-856	845	36,385
1975	1777	-1052	725	37,392
1976	1723	-1463	-260	40,326
1977	1873	-1373	500	43,710
1978	2729	-2644	85	48,296
1979	2819	-2144	675	54,322
1980	3940	-3355	585	61,707
1981	4032	-8632	-4600	66,613
1982	3058	-4483	-1425	68,850
1983	4012	-3712	300	77,000
1984	3743	-2043	1700	83,385
1985	3910	-6710	-2800	87,226
1986	8098	-6636	1550	92,401
1987	10280	-5880	4400	101,508
1988	8302	-3222	5081	110,122
1989	11376	-7946	3430	126,595

Source: Statistics Canada, The Canadian Balance of International Payments. Quarterly Estimates, Various Years and Canada's International Investment Position (Ottawa: Statistics Canada, July, 1978 and July, 1989).

Canada's maturation as a host country is reflected in the fact that the contribution of retained earnings of

foreign-based firms to the expansion of FDI in Canada became more significant over time relative to inflows, as Table 3.3 indicates.

Table 3.3

Change in Book Value of Foreign Direct Investment
in Canada 1950-88.

	Net Capital Inflow for Direct Investment	Net Increase Undistributed Earnings	Other Factors	Net Increase Book Value	Retained Earnings As % of increase in Book Value
(Millions of Dollars)					
1950	225	150	14	389	38.6%
1955	445	335	184	964	34.8%
1960	670	280	16	966	28.9
1961	560	240	65	865	27.7
1962	505	325	93	923	35.2
1963	280	435	127	842	51.6
1964	270	480	- 291	459	104.5
1965	535	735	125	1,395	52.6
1967	670	260	16	966	28.9
1968	590	810	435	1,835	44.1
1969	720	1,045	125	1,890	55.2
1970	835	905	194	1,934	46.7
1975	725	2,553	-2,274	1,004	254.0
1976	-300	2,744	478	2,922	93.9
1978	135	3,720	719	719	81.3
1979	750	4,783	481	6,014	79.5
1980	800	5,442	1,131	7,373	73.8
1981	-4,400	3,671	5,580	4,851	75.6
1982	-1,025	928	2,334	2,337	39.7
1983	300	3,838	229	4,367	89.6
1984	1,700	4,273		5,973	71.5
1985	-2,800	6,641		3,841	172.9
1986	1,375	3,800		5,175	73.4
1987	4,401	4,706		9,107	51.7
1988	4,800	3,814		8,614	44.3

Source: Statistics Canada, Canada's International Investment Position, Various Years.

The book value of the stock of FDI continued to increase in real terms despite changes in flows. At the end of 1980 it

had increased by 14 per cent to \$61,637 million. The increase of \$7,377 million was one of the largest ever registered and due mainly to undistributed earnings (accounting for \$5,300 million).²⁰ Over two thirds of the \$8 billion increase in book value for 1984 also came from retained earnings. This was the case for all of the 1970s and the early to mid-1980s when undistributed earnings, retained and reinvested in Canada, provided the bulk of the funds used to increase the size of foreign-owned assets in the Canadian economy. Only by the late 1980s were inflows again playing a major role in the growth of FDI.

As Table 3.4 indicates the actual flow of direct investment capital into Canada, if adjusted for inflation, declined through the early 1970s and provided a steadily smaller proportion of new domestic gross fixed capital during that decade, an indication that Canada was not maintaining its relative position as a preferred investment location over time.

Table 3.4

**Foreign Direct Investment as a Per Cent of
Gross Fixed Capital Formation**

Year	As % of domestic Gross Fixed Capital Formation	Gross Inflows (Millions 1971 Constant Dollars)
1964	7.0	914
1965	7.3	1,118
1966	8.3	1,437
1967	8.3	1,436
1968	6.6	1,135
1969	8.4	1,509
1970	7.4	1,366
1971	8.3	1,735
1972	6.3	1,383
1973	5.6	1,338
1974	5.0	1,231
1975	4.4	1,156
1976	4.3	1,066
1977	3.9	1,075
1978	5.2	1,433
1979	4.6	1,293
1980	4.2	1,278
1981	6.1	1,637
1982	4.6	1,150
1983	6.6	1,472
1984	5.9	1,351
1985	5.8	1,348

Source: Charles Barrett, Christopher C. Beckman and Duncan McDowall, The Future of Foreign Investment in Canada (Ottawa: The Conference Board of Canada, 1985) and Statistics Canada, Canada's Balance of International Payments (1987) and Fixed Capital Flows and Stocks (1987).

Because the Canadian economy itself continued to grow throughout the 1970s the proportion of total capital employed in Canada which was foreign owned decreased, as Table 3.5 indicates, after peaking in 1970-71.

TABLE 3.5

Ownership and Control of Capital Employed in Canada in Non-Financial Industries, Selected Years

Per Cent of Capital Employed Which is Controlled:
Outside Canada

1951	27
1955	30
1960	33
1965	35
1970	36
1971	36
1972	35
1973	34
1974	33
1975	33
1976	31
1977	30
1978	28
1979	28
1980	27
1981	25
1982	24
1983	24
1984	24
1985	24
1986	23
1987	23
1988	24
1989	25

Source: Statistics Canada, Canada's International Investment Position 1968-70, 1979-80, 1985, 1990 (Ottawa: Sept., 1975, July, 1984 and 1988, 1991).

There is variation in the level of foreign control across sectors. Two of the largest sectors, in terms of capital employed, having the highest levels of foreign ownership, are manufacturing and petroleum and natural gas, as Table 3.6 indicates. The significance of the United States, in terms of control of corporate assets in these sectors is also notable. This is not surprising given the fact that the United States has been the overwhelming source of Canadian FDI

throughout the postwar period, ranging from a peak of 86.6 per cent of all FDI in 1950 to 70.5 per cent by 1987.²¹

Table 3.6

**Ownership and Control of Capital Employed in
Canada in Non-Financial Industries by Sector
by Sector 1951-89.**

Per Cent of Capital Controlled In:

	Manufacturing			Petroleum and Nat Gas			Utilities		
	Can.	U.S.	Other	Can.	U.S.	Other	Can	U.S.	Other
1951	52	42	6	-	-	-	80	20	0
1954	46	45	9	-	-	-	89	11	0
1955	48	42	10	21	73	6	88	6	2
1960	41	44	15	27	64	8	94	5	1
1964	40	46	14	28	60	12	96	5	0
1965		46	13	27	58	15	96	4	0
1971	42	44	14	23	61	16	93	4	3
1972	41	44	15	26	58	16	92	5	3
1973	42	43	15	25	59	16	93	3	4
1974	43	43	14	25	59	16	96	4	-
1975	44	42	14	26	59	15	96	4	-
1976	45	42	13	32	54	14	96	4	-
1977	46	42	12	36	51	13	96	4	-
1978	47	41	12	46	41	13	96	4	-
1979	49	37	12	47	40	13	96	4	-
1980	49	40	11	50	38	12	97	3	-
1981	53	36	11	62	30	8	97	3	-
1982	51	37	12	64	28	8	97	3	-
1983	52	36	12	64	28	8	97	3	-
1984	52	36	12	64	28	8	97	3	-
1985	51	37	12	65	27	8	97	3	-
1986	51	34	15	66	27	7	98	2	-
1987	51	34	15	66	27	7	97	3	-
1988	51	34	15	58	34	8	98	2	-
1989	49	35	16	59	33	8	98	2	-

Source: Statistics Canada, Canada's International Investment Position, 1986 and 1990 (Ottawa, July 1989 and 1991) and previous issues.

Foreign control declined more slowly than in other sectors and the downward trend halted in 1987. In contrast the utilities

sector has remained predominantly Canadian-controlled, largely through state corporations at the provincial level.

As Table 3.7 shows, the levels of foreign ownership and control of upstream petroleum revenues reached their peak in 1971 and began to decline rapidly in 1977. This downward trend, however, was reversed in 1987.

Table 3.7

**Per Cent of Foreign Ownership and Control of
the Petroleum Industry Based on Upstream Revenues.**

	Revenues	
	Control	Ownership
1971	84.4	79.5
1973	84.0	78.7
1975	82.8	76.1
1977	87.0	73.7
1979	79.5	71.4
1980	76.9	71.6
1981	63.5	62.6
1982	61.7	61.0
1983	61.6	58.7
1984	59.5	57.5
1985	51.6	52.0
1986	51.2	52.0
1987	54.8	54.9
1988	62.4	57.9
1989	61.0	56.6
1990	59.1	56.0

Source: Department of Energy Mines and Resources, Petroleum Monitoring Agency, Annual Surveys. Various Years.

An examination of the role of foreign-controlled firms within the Canadian economy, based on their assets, provides a very similar picture. The foreign-controlled share declined from almost 34 per cent of assets in the early 1970s to 24.3 per cent in 1982 and remained at that level until a

wave of acquisitions in 1986 and 1987 resulted in an increase to 24.6 per cent²². The continued dominant position of large, foreign-controlled corporations in the Canadian economy in the 1980s is reflected in their over-representation among the top 100 enterprises in 1983, where they accounted for 42.5 per cent of sales, 51.9 per cent of the profits and 83.4 per cent of taxable income, despite accounting for only 23.2 per cent of assets.²³

Within sectors there is also great variation. In manufacturing where 40.2 per cent of all FDI was located in 1980, foreign-controlled corporations accounted for 44.3 per cent of assets, 50.4 per cent of sales and 63.3 per cent of profits. By 1986 their position, in terms of assets, had changed little at 43.8 per cent but they represented a smaller proportion of sales, 49 per cent and 48.1 per cent of profits.²⁴ In other sectors, such as utilities and railways, Canadian private companies and state corporations played a much greater role.

The distribution of foreign direct investment world-wide provides an indirect measure of the relative attractiveness of a particular country as an investment location. While Canada continued to be the host country with the largest stock of foreign direct investment in absolute terms, until overtaken by the United States in the late 1970s its share of international direct investment flows fell sharply from 26 per cent in the 1961-67 period down to 13 per

cent in the 1974-79 period, and 8.5 per cent by 1987.²⁵

Another reflection of the maturing of Canada's investment relationship is the increased outflows of Canadian-based capital in the form of foreign direct investment, as indicated in Table 3.8, particularly since 1978.

Table 3.8
Outward Flows of Canadian Direct Investment Abroad

	Net Outflows (Millions of Current \$)
1965	125
1968	225
1970	295
1972	380
1973	775
1975	630
1976	580
1977	540
1978	2325
1979	2550
1980	3150
1981	6900
1982	1075
1983	2875
1984	3800
1985	5100
1986	4521
1987	6009

Source: Statistics Canada, Canada's Balance of International Payments, Fourth Quarter, Various Years.

This trend is also reflected in the stock of Canadian direct investment abroad (CDIA) which, as table 3.9 shows, increased rapidly in the 1970s.

Table 3.9

Canadian Direct Investment Abroad, 1950-88

	Total Stock of Direct Investment Abroad	Per cent Annual Increase	Stock of Cdn. FDI in U.S.	Stock in U.S. as % of total.
	Millions of dollars			
1950	1,168	-	912	78.2
1960	2,467	-	1,618	65.6
1962	2,784	-	1,786	64.2
1963	3,082	10.7	1,822	62.3
1964	3,272	6.2	1,967	60.1
1965	3,469	6.0	2,041	58.8
1966	3,711	6.9	2,100	56.6
1967	4,030	8.6	2,190	54.3
1968	4,617	14.6	2,546	55.1
1969	5,211	12.8	2,979	57.1
1970	6,188	18.7	3,262	52.2
1971	6,538	5.6	3,399	51.9
1972	6,715	2.7	3,433	51.1
1973	7,835	16.7	3,926	50.1
1974	9,210	17.5	4,769	51.7
1975	10,526	14.3	5,559	52.8
1976	11,491	9.2	6,092	53.0
1977	13,509	17.6	7,116	52.7
1978	16,422	21.6	8,965	54.6
1979	20,027	21.9	12,104	60.4
1980	25,800	28.8	18,395	63.5
1981	32,578	26.3	21,831	67.0
1982	34,200	4.9	23,137	67.6
1983	37,793	7.1	25,516	69.6
1984	47,422		32,151	71.7
1985*	54,123	13.9	37,074	70.8
1986	58,492	8.0	39,424	71.0
1987	65,869		42,687	64.8
1988	72,174		46,168	64.0

Source: Statistics Canada, Canada's International Investment Position 1976, 1979 and 1980, 1981-84) (Ottawa: May, 1978, July, 1984, May, 1986, July, 1989).

*revised series of data begins

The growth of outward FDI in the late 1970s and early 1980s averaged 22 per cent per year since 1977, compared to an average of 10 per cent in the 1966-69 period and only 8 per

cent in the 1958-61 period.²⁶ Unlike U.S. investment in Canada, most of the increase in the book value of CDIA has been financed by capital outflows, not by retained earnings²⁷. In 1980 the United States was the destination for about 64 per cent of total Canadian direct investment, an increase in comparison to the 1950s and 1960s when it ranged from 45-57 per cent. By 1984 this proportion had increased even further to over 71 per cent of CDIA²⁸.

The proportion of Canadian foreign direct investment abroad accounted for by foreign-controlled Canadian subsidiaries has also been diminishing over time, an indication of the growing internationalization of Canadian-based corporations. In 1980 it totalled about \$4.3 billion or 17 per cent.²⁹

Manufacturing is still the most important sector for Canadian direct investment abroad although its share of the total diminished from 57.9 per cent in 1965 to 42 per cent in 1980, with a small increase to 45 per cent of FDI occurring in 1989.³⁰ Some of the recent increase was due to threats to continued secure access to the U.S. market for Canadian producers and an effort to cut costs. Second in importance is investment in petroleum and natural gas at 21 per cent in 1980.³¹ The bulk of FDI is generated by a few, very large enterprises. In 1982 only 6 per cent of the over 1,100 Canadian enterprises involved in investment abroad accounted for about 78 per cent of the value of Canadian direct

investment.³²

The United States is thus both the primary source of FDI for Canada and the primary destination of Canadian export capital. However, because of the size of the U.S. economy, the impact is quite different since FDI has formed a small proportion of total U.S. investment. Indeed all foreign direct investment in the U.S. economy was only about 2.5 per cent of U.S. domestic investment in 1984. Total U.S. employment accounted for by FDI in 1977 was 1.6 per cent and by 1981 it had increased to 3.1 per cent.³³ While American FDI in Canada in 1981 represented approximately 15 per cent of GNP, Canada's investment in the U.S. represented only 0.4 per cent of U.S. GNP³⁴. In its relationship to Canada, therefore, the United States has remained in the role of a home country and a stakeholder in any changes to Canada's investment regime, at the same time that it became a magnet for Canadian-based and overseas FDI, in competition with Canada as a potential investment location.

Canada in the World Economy: Trade Dependence

The second key aspect of Canada's position in the world economy in the postwar period is its level of trade dependence, particularly on the United States market. As Table 3.10 indicates it is smaller economies that tend to be more trade dependent. Relative to other large OECD countries, Canada's large economy is quite trade dependent. A Canadian government trade policy paper³⁵ estimated that more than 30

per cent of Canada's GNP is generated by the external trade of goods and services. Approximately 29 per cent of Canada's production was exported in 1980, well above the OECD average of 20 per cent³⁶. In contrast, as Table 3.10 indicates, the United States has, in the period up to 1987, remained the least trade, especially export, dependent of the OECD countries.

In Canada's case, the increased export orientation was due largely to the mining and manufacturing sectors.³⁷ Exports began rising as a proportion of GNP in the early sixties, led by the rapid increase in manufactured exports, which continued to increase further in the late 1970s as a result of the 1965 Canada-United States Auto Pact.

TABLE 3.10
Imports and Exports as a Percentage of GDP, Various
Years for Largest OECD Countries, 1965-81.

A. Exports of Goods and Non-Financial Services							
Country	1955	1960	1965	1970	1981	1985	1987
United States	5.0	5.1	5.1	5.7	9.6	6.0	5.7
Japan	10.5	10.8	10.5	10.8	15.5	13.5	9.7
Germany	19.6	19.0	18.1	21.1	29.6	27.9	26.3
France	13.7	15.0	13.8	16.3	21.9	19.0	16.2
U.K.	22.9	21.3	19.6	23.6	27.7	22.3	19.5
Italy	10.9	14.1	16.1	17.8	26.9	21.2	15.3
Canada	19.4	17.5	19.2	23.3	28.2	28.0	23.0
Spain	4.8	10.4	10.6	13.5	17.4	14.6	11.7
Netherlands	45.5	48.1	43.2	44.9	58.3	53.3	43.4
Australia	16.6	14.8	15.0	14.9	15.4	13.7	13.7
Belgium	32.1	32.8	36.3	43.9	64.8	68.2	59.7

B. Imports of Goods and Non-Financial Services							
Country	1955	1960	1965	1970	1981	1985	1987
United States	4.3	4.4	4.4	5.5	10.6	9.0	9.1
Japan	9.9	10.4	9.1	9.5	14.6	10.8	6.4
Germany	17.1	16.4	17.8	19.0	28.7	24.8	20.3
France	12.6	12.9	12.9	15.8	25.2	21.1	17.9
UK	24.3	22.6	20.3	22.5	24.7	24.8	22.9
Italy	12.1	14.3	13.4	17.2	28.8	24.2	16.4
Canada	20.3	18.7	19.4	20.6	27.1	22.1	21.3
Spain	6.2	7.5	14.0	14.4	19.7	17.9	16.8
Netherlands	44.7	46.2	43.9	46.6	54.6	50.4	42.7
Australia	18.7	17.8	17.4	15.1	19.2	13.5	13.9
Belgium	31.3	33.9	36.2	41.6	68.8	72.9	59.8

Source: OECD, OECD in Figures (annual supplement of OECD Observer various years).

In contrast to most other comparable industrialized countries a large proportion of Canadian exports are resources or resource-based products.³⁸ In addition Canada's export

products have generally been concentrated on a relatively few commodity groups. ... According to one 1980 study, "over 30% of total exports are accounted for by only three commodity categories: wheat, paper and paper-board products and road motor vehicles."³⁹ Figures for 1971 indicated that vehicles and parts, lumber, pulp and paper along with metal and minerals accounted for over 61 per cent of exports and, by 1987, still constituted over 55 per cent⁴⁰. The pattern for imports is complementary. In 1978 Canada imported, in terms of value, more goods per capita than any other industrialized country,⁴¹ with highly manufactured products accounting for 87 per cent of Canada's total imports, most of these coming from OECD trading partners, particularly the United States and Japan.

Canada's share of world exports actually diminished over the 1970's from 5.3 per cent in 1971 to 3.2 per cent in 1980 and, according to the United Nations, rose to 4 per cent in 1988.⁴² In the same period Canada's share of manufactured exports went from 5.9 per cent to 4.6 per cent⁴³ even though trade in manufactured goods has been an increasing proportion of trade among OECD countries. Canada's manufactured exports were still a much smaller proportion of total exports than any of the other G-7 countries at 67 per cent in 1988 compared to the next lowest of 79 per cent in the U.S. and the high of 98 per cent in the case of Japan, and significantly below the overall average for all OECD countries of 75.6 per cent.⁴⁴

The trend, in the case of manufactured goods, has generated concern on the part of some policy makers since world-wide demand for manufactured goods has increased more rapidly than demand for resources as incomes rise. Both the Science Council⁴⁵ and the Export Promotion Review Committee expressed alarm about the long-term consequences for Canada of its "huge trade deficit in technology-intensive manufactured goods" in the late 1970s. In fact, the growth of Canadian high technology exports has been sluggish, increasing from 11 to 14 per cent between 1966 and 1971, despite the huge increase in this market and a much larger proportionate increase for other industrialized countries and the East Asian NICs. According to a 1989 study by Magun and Rao⁴⁶ Canada's overall share of the world market in high technology goods has been decreasing since 1971. There has been an especially marked erosion in Canada's high technology exports to the United States, much of it to the benefit of Japan and Asian NICs.

This pattern is reflected in Table 3.11 which indicates that, with the exception of resource-related manufactures and motor vehicles and parts, Canada has persistent trade deficits in other manufactured goods in the 1966-87 period.

Table 3.11

**Canadian Trade Balance by Manufacturing Sector -
Selected Industries, 1986-87**

Millions of Dollars

Manufacturing Sector)	Average 1966-73	Average 1973-80	1980	1981	1986
Food and Beverages	232	265	709	1,280	670
Rubber and Plastics	-170	-458	-551	-480	-392
Textiles Industries	-413	-873	-1,083	-1,249	-519
Wood Industries	884	2,443	3,740	3,366	5435
Paper and Allied Products	1,856	4,744	7,929	8,294	10119
Primary Metal Industries	1,097	2,163	4,272	3,427	4741
Metal Fabricating Industries	-358	-785	-1,017	-1,151	-472
Machinery Industries	-1,523	-4,074	-6,864	-7,549	-6827
Transportation Equipment Industries	-188	-1,548	-2,401	-2,843	1161
Electrical Product Industries	-506	-1,587	-2,196	-2,559	-7128
Petroleum and Coal Products	-127	286	962	992	954
Miscellaneous Manufacturing	-584	-1,795	-2,609	-2,988	-3990
TOTAL MANUFACTURING	-774	-3,671	-1,792	-4,462	

Source: Department of External Affairs, A Review of Canadian Trade Policy: A Background Document (Ottawa, August, 1983) and Statistics Canada Exports: Commodities (1987).

While postwar multilateral trade policy opened sectors of the Canadian economy to foreign competition and opened other markets to Canadian products, this did not result in the diversification of trade relations in terms of trade partners. In fact, Canada became more oriented to the United States market, while Japan replaced the United Kingdom as Canada's second most important trading partner.

The full implementation of the tariff cuts agreed to in the 1979 Tokyo Round of Multilateral Trade Negotiations resulted in 80 per cent of Canada's exports entering the United States duty free and over 90 per cent at rates of under

5 per cent, making tariff barriers largely irrelevant to the movement of most goods in bilateral trade.⁴⁷ Moreover, as part of changes worked out in these negotiations GATT contracting parties faced an increasing number of rules governing and standardizing their trade relations. Nevertheless, a number of non-tariff barriers and other "orderly marketing arrangements" continued to protect various producers in Canada (for example, in automobiles and textiles) as well as block Canadian exports to other markets.

The increased dependence on the United States market is striking, as Tables 3.12 and 3.13 indicate. In 1961, only 54.5 per cent of Canada's exports went to the United States, but by 1971 it had increased to 67.5 per cent and averaged around the 70 per cent level in the late seventies and early eighties, until the peak of almost 78 per cent in 1985.⁴⁸ For Canada's manufactured end products the increase went from almost 54 per cent of Canadian exports in 1960 to over 90 per cent by 1987.⁴⁹

Table 3.12

**Canadian Trade with the United States - Selected Years
1961-84**

	Exports to the U.S.	Imports From the U.S.
	-----	-----
	as a	
	(% of total exports/imports)	
1988	73.1	61.2
1987	75.6	66.0
1986	77.2	66.9
1985	77.9	69.0
1984	75.7	72.6
1983	72.9	71.6
1982	68.2	70.5
1981	66.2	68.6
1980	63.3	70.2
1979	67.8	72.5
1978	70.3	70.7
1976	67.3	68.8
1975	65.1	68.1
1974	66.0	67.4
1973	67.4	70.7
1971	67.5	70.1
1966	60.5	71.5
1961	54.5	67.0
1955	59.8	72.9
1950	65.1	66.8

Source: Statistics Canada, Historical Statistics of Canada, 1983. and John Whalley et al. Canadian Trade Policies and the World Economy (Volume 9 of the Research Studies of the Royal Commission on the Economic Union and Development Prospects for Canada) (Toronto: University of Toronto Press, 1985), 18. and Statistics Canada, Exports by Country, 1989.

TABLE 3.13

Canadian Exports to the United States as a Per Cent of Total
End Product Exports - Various Years 1950-87.

Exports Year	End Product Exports to U.S. as Per Cent of Total End Product
1987	90.0
1986	90.4
1985	91.4
1984	90.5
1983	88.6
1982	83.1
1981	80.0
1980	77.0
1978	83.4
1975	80.7
1972	86.1
1970	83.8
1968	84.8
1965	65.2
1962	57.4
1960	53.9
1955	49.4
1950	39.9

Source: Statistics Canada, Export by Countries
(January-December), various years.

This trade dependence on the United States is unique and at variance with the trade patterns of the larger OECD economies, as Table 3.14 indicates, or even those of smaller European economies, often considered to be extremely dependent on larger trading partners. Moreover, because of the importance of foreign direct investment in Canada's industrial structure, a large portion of trade is intrafirm, estimates suggest as much as two thirds.⁵⁰

TABLE 3.14

Trade Partner Concentration: Exports to Largest Trading Partner as a Percent of Total Exports to Twelve OECD Countries.

Selected Years 1961-84

	Year							
	1961	1965	1970	1975	1978	1980	1984	1987
U.S.	17.4	20.4	21.0	20.2	19.7	16.0	21.4	23.6
		(Canada)						
Japan	25.3	29.8	31.1	20.2	25.8	24.5	35.6	36.8
		(United States)						
Germany	9.4	10.9	12.4	11.7	12.2	13.3	12.6	12.1
		(France)						
France	15.2	19.3	20.4	16.3	16.8	15.4	14.1	
		(Germany)						
U.K.	7.8	10.6	11.7	8.9	8.4	10.7	14.6	13.9
		(U.S.)						
Italy	17.8	21.2	21.6	18.6	19.0	18.4	16.1	15.3
		(Germany)						
Canada	54.6	57.8	62.3	62.1	67.4	61.0	73.4	72.8
		(U.S.)						
Spain	16.8	14.1	14.2	13.7	16.6	16.6	15.0	18.7
	(UK)	(Ger)	(U.S.)	(Fr.)				
Netherl.	23.1	27.8	32.6	30.4	30.8	29.9	29.7	27.4
		(Ger)						
Australia	19.8	17.4	26.2	29.2	30.4	26.6	25.8	25.6
		(UK)	(Japan)					
Belgium	23.4	22.1	24.1	22.3	22.9	21.2	19.7	20.5
		(Neth)	(Ger)					
Austria	27.5	28.6	23.4	21.8	29.0	30.9	29.7	35.0
		(Ger)						
Ireland	74.4	70.2	65.8	54.3	47.2	42.6	34.5	34.1
		(UK)						

Source: IMF, Directions of Trade Yearbook (Washington, DC: International Monetary Fund, various years).

In fact, in contrast to Canada's pattern, some small trade dependent countries like Ireland have, through membership in the EC, been able to lessen bilateral trade dependence. Canada stands out in its high level of export dependence on the United States, which increased further in the 1980s.

The increased level of trade dependence on the United States has made access to its market an important determinant of Canada's economic well-being. It was estimated, based on 1983 figures, that 22.5 per cent of Canada's Gross National Product and 2.5 million Canadian jobs were accounted for by exports to the United States. For the U.S. economy, exports to Canada represented about 20 per cent of exports and accounted for only 2 per cent of U.S. Gross National Product.⁵¹

TABLE 3.15
United States Exports to Canada as a Per Cent of Total Exports
Selected Years, 1950-87

Year	Exports to Canada as a Per Cent of Total

1987	23.5
1986	20.9
1985	22.1
1984	21.4
1983	19.1
1982	15.9
1980	16.9
1978	19.7
1975	20.1
1972	24.9
1970	21.0
1968	23.3
1962	17.8
1960	18.0
1958	19.1

Source: International Monetary Fund, Directions of Trade Statistics Yearbook (various volumes, 1987, 1982) and United Nations, Yearbook of International Trade (New York, 1960).

The composition of exports and imports for the two countries also differs in significant ways. In addition to vehicles and auto parts, a large proportion of Canada's trade

with the United States consists of natural and semi-processed resources such as natural gas, lumber and pulp and paper. The proportion has, however, dropped from almost 75 per cent of exports to the U.S. (in 1960) to 43 per cent by 1970 as exports of automotive parts surged (31 per cent) and those of other secondary manufacturing increased slowly. In contrast, a far larger proportion of U.S. exports to Canada are a broad group of manufactured finished goods, including capital goods (25-30 per cent),⁵² machinery, consumer durables and high technology goods.

The imbalance in the significance of bilateral trade to each of the partners, and Canada's dependence on a narrower range of export products, is clear. Thus, access to that market, for key sectors of the Canadian economy, has become necessary to ensuring growth. Changes in U.S. policy, therefore, which threaten that access, are of great concern to Canada. On the other hand, the significance of the Canadian market for U.S. producers has increased only marginally and its impact on the overall U.S. economy has been much smaller.

Moreover, Canada's balance of payments situation has further reinforced dependence on the U.S. market. As Table 3.16 indicates, throughout most of the post-war period Canada has had a balance of payments deficit.

TABLE 3.16

**Canada's Balance of International Payments,
Selected Years, 1950-87.**

	Merchandise Trade Balance. Transactions	Defecit on non- Merchandise	Current Account
Millions of dollars			
1950	+7	-326	-319
1960	-148	-1,085	-1,233
1965	+118	-1,248	-1,130
1970	+3,052	-1,846	+1,106
1974	+1,689	-3,149	-1,460
1975	-451	-4,306	-4,757
1976	+1,388	-5,230	-3,842
1977	+2,737	-7,036	-4,299
1978	+3,382	-8,684	-5,302
1979	+4,425	-9,931	-4,840
1980	+8,793	-11,118	-1,069
1981	+7,368	-14,686	-5,766
1982	+18,338	-16,763	+3,017
1983	+18,041	-17,348	+1,577
1984	+23,668	-19,056	+2,553
1985	+16,817	-20,503	-2,648
1986	+10,388	-19,956	-9,268
1987	+10,341	-19,942	-9,601

Source: Statistics Canada, Quarterly Estimates of the International Balance of Payments Fourth Quarter, 1985-87 and John Whalley, Canadian Trade Policy and the World Economy (Toronto: University of Toronto Press, 1985) Table 1-2, 17.

From 1950-70 the trend was toward a shrinking deficit which turned into a surplus in the early 1970s. After three years of surplus, again in 1982, 1983 and 1984, the account returned to a deficit. Within the account there has been a consistent pattern of a strong merchandise trade surplus (based in the 1950s and 60s on resource exports and, more recently, auto parts) which is offset by a chronic deficit on service and

other transfers many of which are linked to FDI. The 1981 deficit on services reached over 14\$ billion increasing to 20\$ billion by 1985. A major part of this deficit was composed of outflows connected with direct investment and the many other payments which subsidiaries make to their parent corporations. Since much of Canada's trade is with the United States the pattern is similar-a large, and in the 1980s, growing trade surplus with the United States and a large deficit on services.

Within the manufactured trade balance Canada has been in deficit, particularly in higher technology items, especially with the United States and Japan. While Canada has enjoyed trade surpluses in recent years in manufactured goods with the United States, these have been accounted for almost exclusively by motor vehicles and parts. As indicated above, the more general pattern of the 1970s and 80s has been one of deficits on most manufactured end products and especially technology-intensive goods, offset by huge surpluses on the export of resources in raw and partially-fabricated forms. With the United States alone the end-product trade deficit in 1986 was over \$5 billion, despite a \$6 billion surplus on auto parts.⁵³

Duncan Cameron⁵⁴ has argued that because of the structure of Canada's payments deficit, there has been a preoccupation on the part of state officials with the necessity to maintain a large merchandise trade surplus. The

increased dependence on access to the U.S. market since the 1960s has meant a growing preoccupation with access to a growing U.S. economy as the key to maintaining that surplus.

Conclusion

This chapter has analyzed two critical changes over time to Canada's economic linkages in the world economy which, I have argued, are important to an explanation of FDI regime change. These trends have been the subject of much debate and discussion in Canada and are widely known. Our purpose here, however, was to highlight the nature of these changes in the 1957-87 period in order to provide a basis for our analysis of their impact in Chapters Four and Five.

The first change was in the nature of Canada's investment relations. The Canadian economy has undergone a transformation in the period under study. In the earlier postwar period and well into the 1960s Canada was a major host economy, a preferred destination for foreign, especially U.S. capital. This was followed by, what I have called, a maturation process in the 1960s and early 1970s. This resulted in a declining level of FDI inflows in real terms and an eroding share of world FDI inflows, relative to other economies. This was accompanied by a levelling off of the already high level of foreign control, measured in terms of stocks of FDI, in key economic sectors such as manufacturing and energy. However, U.S.-based EFCs continued to play a

dominant role in the Canadian economy well into the 1980s. Finally Canadian-based capital rapidly increased its outward orientation, reflected in large outflows of FDI, beginning in the late 1970s, most of it destined for the U.S. economy, as the U.S. itself became a major host economy for FDI.

Our hypothesis, to be assessed in subsequent chapters, is that these changes affected the choice of policy instruments to manage FDI as they altered perceptions within the state on the ability of the state to bargain over access with foreign investors, and on the need to address the performance and behaviour of EFCs.

The second key change that this chapter has outlined is the growing export dependence on the U.S. market which has characterized the Canadian economy in the 1957-87 period. As this chapter indicated, the decline of import barriers to the Canadian economy generated competitive pressures while the decline in export barriers resulted in enhanced levels of export dependence, but not diversification of export markets. The Canadian economy became increasingly dependent on access to the U.S. market throughout the 1960s and 70s, especially in the manufacturing sector. The preoccupation with the U.S. export market was further reinforced by balance of payment pressures which required large merchandise export surpluses to offset a growing services account deficit, itself largely a product of the large presence of EFCs in the Canadian economy. It is within this context that the trade problems of the

United States in the 1980s and the threat of denial of access to the U.S. market must be seen. The combination of the important presence of U.S.-based EFCs in the Canadian economy, the role of the U.S. as the main source of FDI, throughout the postwar period, and the growing trade dependence on the U.S. market meant that the impact of any changes to Canada's FDI regime would fall mainly on U.S. investors. At the same time the trade relationship increasingly provided a potential tool of U.S. state influence over Canada's FDI regime.

The following chapter outlines the changes in Canada's FDI regime and traces how Canada's investment relations influenced the choice of policy instruments. Chapter Five will analyze the extent to which bilateral economic linkages, particularly trade dependence on the United States, helped shape Canada's FDI regime.

1. For the most recent survey see Maureen Appel Molot, "The Canadian State in the International Economy," in Richard Stubbs and Geoffrey R. Underhill (eds.) Political Economy and the Changing Global Order (Toronto: McClelland and Stewart, 1994), 511-523.
2. Jonathan Hein, From Summit to Summit: Policy-Making in an Interdependent World (New York: The Conference Board, 1980).
3. Joan Spero, The Politics of International Economic Relations (New York: St. Martin's Press, 1985), 117.
4. A GATT study of the 1975-77 period calculated that new restrictions were applied to 3 to 5 per cent world trade, and that most of these originated in the advanced industrial countries. Ibid, 114.
5. For an overview of this period see Michael Hawes, "Assessing the World Economy," in David G. Haglund and Michael Hawes (eds.) World Politics: Power, Interdependence and Dependence (Toronto: Harcourt, Brace, Jovanovitch, 1990). For a discussion of the US role and hegemony see Robert Keohane, After Hegemony: Cooperation and Discord in the World Political Economy (Princeton: Princeton University Press, 1984). A major debate has arisen over the nature of US hegemony, what it is, whether, in fact, it has declined and what the consequences are. For an overview of this debate see Michael Hawes, "Structural Change and Hegemonic Decline: Implications for National Governments," in Haglund and Hawes, op cit.
6. Mark E. Rupert and David Rapkin, "The Erosion of US Leadership Capabilities," Paul M. Johnson and William K. Thompson (eds.) The Rythms of Politics (New York: Praeger, 1985).
7. D.J. Daly and D.C. MacCharles, Canadian Manufactured Exports: Constraints and Oppurtunities (Montreal: Institute for Research on Public Policy, 1986).
8. Organization for Economic Cooperation and Development, The Impact of the Newly Industrializing Countries on Production and Trade in Manufactures (Paris: OECD, 1979). The ten NICs studied by the OECD increased their share of manufactured goods imported by OECD countries from 2.6 per cent in 1963 to 8.1 per cent in 1977.
9. United Nations Centre on Transnational Corporations, Transnational Corporations and World Development: The Third Survey (London: Graham and Trotman Ltd. 1985).

10. This trend was most apparent in industries such as electronics, automobiles, watches, heavy electrical equipment and construction equipment. See the United Nations Centre on Transnational Corporations Transnational Corporations and World Development. (UN: New York, 1983).

11. Joan Spero, op cit.

12. United Nations, "Changes in Patterns of Foreign Direct Investment: An Update," CTC Reporter (Spring, 1987).

13. OECD, International Investment and Multinational Enterprises: Recent Trends in International Direct Investment. (Paris: OECD, 1987).

14. Ibid.

15. For example in 1984 the US trade deficit reached \$123.3 billion and \$148.56 billion in 1985. With Canada alone it reached \$22.6 billion in 1985 and with Japan, \$50.2 billion. See United States Department of Commerce, 1985 United States Foreign Trade Highlights. Washington, D.C. 1986.

16. Spero, op cit.

17. James Eayrs argued in "Defining a New Place for Canada in the Hierarchy of World Powers International Perspectives (May/June, 1975) that Canada was, in fact, a foremost power. Peyton Lyon and Brian Tomlin in Canada as an International Actor (Toronto: Macmillan, 1979), argued that Canada in 1975 was "well up among those of the leading nations in world politics" and should be regarded as a major power. David Dewitt and John Kirton, Canada as a Principal Power (Toronto: John Wiley, 1983) claimed that Canada should be seen as a principal power, one among a group of leading powers which "stands in the top tier of the global hierarchy of power and act autonomously in the pursuit of their own interests". Changes in the international system in the 1970s were seen to work in favour of enhancing Canada's relative position and influence. Canada had a large economy, abundant energy resources, was a major international trader and had a wide scope of representation in postwar international organizations.

In contrast those who saw Canada as a mere satellite of the United States argued, especially in the late 1960s and early 1970s, that Canada's pattern of economic interaction with the United States was the main determinant of Canadian foreign policy, overshadowing any overall ranking of Canada within the international system and rendering the possibilities of an autonomous Canadian foreign policy extremely limited. For a review of these differing approaches see Michael Hawes, Principal Power, Middle Power or Satellite:

Competing Perspectives on the Study of Canadian Foreign Policy (Toronto: York University Research Programme in Strategic Studies, 1984). For research demonstrating Canada's economic dependence on the United States and the "structural asymmetry" of the relationship see Michael Dolan and Brian Tomlin, "Foreign Policy in Asymmetrical Dyads: Theoretical Reformulation and Empirical Analysis - Canada-United States Relations 1963-72," International Studies Quarterly (Sept, 1984), 349-368.

18. For a discussion of some of the limits of dependency approaches to the analysis of Canada see Duncan Cameron and Francois Houle (eds.) Canada and the International Division of Labour (Ottawa: University of Ottawa Press, 1985). especially Francois Houle, "La crise et la place du Canada dans la nouvelle division internationale du travail" and Diane Ethier, "L'economie politique canadienne et la nouvelle division internationale du travail." Also Elisabeth Gidengil, "Misplaced Polarities: A Comment on "State, Capital and World Economy", Canadian Journal of Political Science, (March, 1991), 121-134.

19. Statistics Canada, Canada's International Investment Position. (Ottawa: 1985). Statistics Canada defines foreign direct investment in the following way:

the book value, at a point in time, of long-term capital owned by foreign investors in incorporated or unincorporated entities in Canada, which are referred to as direct investment enterprises. The size and nature of the investment provide the foreign investor, on a lasting basis, the potential to influence or to have an effective voice in the management of the direct investment enterprise operating outside his own economy. This investment is normally identified by ownership of at least 10% of the equity of the concern in Canada. Direct investment covers the long-term capital provided by or accruing to foreign direct investors, comprising both long-term debt (bonds, debentures, loans, advances, etc) and equity (common and preferred shares and retained earnings (29).

20. Ibid, 29.

21. Jorge Niosi, "Foreign Direct Investment in Canada," in Lorraine Eden (ed.) Multinationals in North America (Calgary: University of Calgary Press, 1984), Table 1B, 370.

22. Statistics Canada, Corporations and Labour Unions Returns Act: Annual Report, Part I Corporations (Ottawa: 1990), 15.

23. Annual Report of the Minister of Supply and Services Under the Corporations and Labour Unions Returns Act, 1981 and 1983, Part I, Corporations (Ottawa: Minister of Supply and Services, March, 1984 and May, 1986).

24. Ibid., 18-26.

25. OECD, Committee on International Investment and Multinational Enterprises, International Investment and Multinational Enterprises: Recent International Direct Investment Trends. (OECD: Paris, 1981), 13. and Jorge Niosi, 1994 op cit., 378.

26. Statistics Canada, (1984) op cit., and Statistics Canada, Canada's International Investment Position, 1926-1970. (Ottawa: 1971), 68.

27. This trend has continued according to Franklin Chow. Between 1986-1992, 95 per cent of CDIA was financed by capital outflows. See Franklin Chow, "Recent Trends in Canadian Direct Investment Abroad: The Rise of Canadian Multinationals," in Stephen Globerman (ed.) Canadian-Based Multinationals (Calgary: University of Calgary Press, 1994), 36.

28. After 1984 the trend altered as the proportion of CDIA going to the US declined to 57.8 per cent by 1991. See Niosi, op cit. 1994, 378.

29. I.A. Litvak and C.J. Maule. The Canadian Multinationals (Toronto: Butterworth's, 1981), 9.

30. Statistics Canada, Canada's International Investment Position, 1989 (Ottawa, 1991), 13.

31. Statistics Canada (1984 and 1971) op cit. As large part of this investment has been located in non-industrial sectors including real estate, mineral leases and banking. Of the eleven foreign investment transactions in 1982 involving Canadian companies in the US which involved assets of over \$100 million nine involved real estate-primarily shopping plazas. See US Department of Commerce, International Trade Administration, International Direct Investment: Global Trends and the US Role Appendix B (Washington: 1984).

32. Statistics Canada, (1984), op cit.

33. Department of Commerce, op cit.

34. Alan Rugman, Outward Bound: Canadian Direct Investment in the United States (Montreal: C.D. Howe Institute, June, 1987).
35. Department of External Affairs, A Review of Canadian Trade Policy: A Background Document to Canadian Trade Policy for the 1980s (Ottawa, 1983), 23.
36. Ibid.
37. Bruce Wilkinson, Canada in the World Economy (Montreal: C.D. Howe Research Institute, 1980).
38. Despite a surge of manufactured exports in the sixties, by the 1970s 30 per cent of total merchandise sales abroad were still in mineral exports and a larger proportion of Canada's mineral exports were shipped abroad in 1980 in crude forms than in 1929. See Bruce Wilkinson, op cit.
39. V. Carbo and O. Havrylyshyn, Canada's Trade Relations With Developing Countries: The Evolution of Export and Import Structures and Barriers to Trade (Ottawa: The Economic Council of Canada, 1980), 74.
40. Statistics Canada, Canada's Balance of International Payments: Historical Statistics, 1926-1980 (Ottawa: Sept, 1981), 158.
41. Export Promotion Review Committee, Strengthening Canada Abroad (Chairman: Roger Hatch, Ottawa, 1979).
42. UNCTAD, Yearbook of International Trade (UN, 1988).
43. Ibid.
44. OECD, OECD in Figures, 1988 (Paris: OECD 1980), 61.
45. John Britton and James Gilmour, The Weakest Link (Ottawa: Science Council of Canada, 1978), 9.
46. The Economic Council reports that Canada's share of the world high-tech market has actually dropped from 2.6 per cent in 1986 from 3.5 per cent in 1971. Japan, not Canada, has been the prime beneficiary of the burgeoning U.S. market for imports. See a study by Magun and Rao reported in Economic Council "High Trade Trade: Serious Weakness to Solve" An Courant 10:2 (1988), 10-11.
47. For Canada 65 per cent of its imports from the United States would be duty free. Frank Stone, Canada, the GATT and the International Trading System (Montreal: Institute for Research on Public Policy, 1984), 183.

48. Ibid. and Globe and Mail, May 10, 1985 report of Statistics Canada figures.

49. Statistics Canada, Exports by Countries (Ottawa, 1986). The rapid increase in the bilateral trade of automotive products since 1965 has accounted for a very large proportion of this change.

50. Alan Rugman as cited in Earl Fry, "Investment Relations in North America: The US Perspective," American Review of Canadian Studies XVII:2 (Summer, 1987), 130-144.

51. Don Johnston, "Free Trade With the U.S. is a Must", Toronto Star April 10, 1984, A1.

52. Peter Morici, "US-Canadian Trade Relations in the 1980s," American Review of Canadian Studies XVII, 2 (1987), 158-180.

53. Statistics Canada, Quarterly Estimates of International Payments (Fourth Quarter, 1987).

54. For the constraints on Canada see Duncan Cameron, "Monetary Relations in the North America," International Journal XLVII, (Winter 1986-87), 170-198.

CHAPTER FOUR
EXPLAINING FOREIGN INVESTMENT REGIME CHANGE:
INTERNATIONAL CAPITAL AND STATE INTERVENTION

Introduction

This chapter has two purposes. First, it analyzes the changes in Canada's foreign investment regime, our dependent variable, in the 1957-87 period, as reflected in the changing mix of policy instruments used to manage foreign direct investment (FDI). This is done by classifying the policy instruments according to the three main categories and levels of coercion and intervention outlined in Chapter Two, and then tracing the pattern of their usage over time.

Second, the chapter analyzes the impact of three aspects of Canada's changing investment relations on Canada's FDI regime. It examines the impact of changes in inflows, changes to the stock of FDI and the increased mobility of Canadian-based capital on the perception within the state of Canada's attractiveness as an investment location. It looks at how, in combination with the changing intrastate consensus on the nature of state coercion and intervention, these changes influence the choice of FDI policy instruments. The chapter traces the impact of these factors on state decisions in two periods, 1967-75 and 1980-85, that changed the mix of policy instruments used to manage FDI.

Foreign Investment Regime Change: The Pattern

Appendix A provides a comprehensive inventory of the investment instruments that Canada has employed since 1957 in controlling FDI. It notes the date introduced, the nature and stated purpose, and the type of instrument. It also indicates major actions which change or alter those instruments. The inventory is confined to those actions and proposals emanating from the central decision-making and policy-implementing bodies of the federal state, the Cabinet, ministers and the senior bureaucracy, but not those of more arms-length state advisory agencies (such as the Science Council or the Economic Council).

The classification of instruments in Appendix A is based on the stated intentions of state actions which are derived from major policy pronouncements embodied in bills and laws, the statements of the responsible ministers accompanying their introduction (especially at second reading in the House of Commons), public statements by state representatives¹, and secondary sources. The following definitions and criteria were employed to establish the classification system. Three broad types of instruments related to FDI - access, discriminatory and compensatory are distinguished on the basis of the policy target. Access instruments are those that target incoming investors at the border. These might include everything from tax incentives designed to attract foreign capital, to a screening mechanism that sets conditions on

foreign investment coming into the economy or regulations which prohibit or limit foreign investment in a particular sector of the economy. Discriminatory policies target already-established foreign corporations (EFCs) within Canada and involve distinct and differential treatment of them in comparison with Canadian-controlled or state corporations. For example, measures might regulate their expansion, deny them access to tax expenditures, state grants or government contracts because of their ownership status. Compensatory policy instruments² do not make a distinction between foreign and domestic firms or investors, but identify problems of corporate behaviour and high levels of foreign control that are linked to FDI, and then use a range of non-discriminatory state instruments to alter corporate behaviour or the level of foreign ownership. For example, the creation and expansion of state corporations could alter the level of foreign control in a sector of the economy, while generous incentives might enhance the amount of research and development all, including foreign-owned firms undertake, in Canada, without, in either case, singling out or targetting EFCs.

Under the broad headings of access, discriminatory and compensatory policy instruments we look further at the specific instrument used which provides a rough indicator of the extent of coercion and state intervention the particular policy instrument entails. Coercion refers to the application of state authority to influence the decisions of private

investors through the implied or explicit use of sanctions, which in our case we have broadened to include a denial of access to various rewards or incentives. Thus under the discriminatory or compensatory policies are a range of instruments which vary in their level of coercion.

suasion expenditures conditioned-expenditures regulation
 -----coercion----->

In the case of access the range can be envisaged as follows:
 incentives, conditioned incentives, conditional access, restricted access

-----coercion----->

Moreover, within each type of policy instrument there can be further variation in the level of coercion in terms of the types of sanctions or the scope of activities they cover.

State intervention reflects "the extent to which various instruments, as a means of government intervention, intrude directly and publicly upon private decision-making"³ Again specific instruments can be ranged along a continuum in terms of this characteristic, as Baxter-Moore has done.

Indirect

Direct

Suasion, Tax Expend, Program Expend, Regulation, Taxation, Mixed, Public
 Ownership

-----intervention----->

The use of a specific instrument may also vary, for example, when state enterprises are used as tools to implement state

policy goals or are given a commercial mandate and operate at arms length from the state.

Appendix A lists 65 policy instruments dating from 1957, the beginning, as a consequence of the release of the Report of the Royal Commission on Canada's Economic Prospects, of sustained public debate about FDI and state attention to the issue. Clearly a number of measures involving state enterprises and regulation had been employed by the Canadian state prior to 1957 to limit foreign ownership, especially in the transportation and broadcasting sectors. However, access to new comprehensive data from the Dominion Bureau of Statistics in 1956 and the hearings of the Royal Commission created the basis for a sustained public debate on the general implications of high levels of foreign investment for Canada.

The simple counting of the number of actions gives us a rough measure of the three main types of policy instruments being used. Counting the relative usage of subtypes (eg. whether suasion or regulation) and the content of the change (for example limiting or increasing the scope of regulation) provides a rough measure of the extent of coercion or state intrusion. Such an analysis leads us to the following observations.

Mix of Policy Instruments

The thirty year period is characterized by a mixture of all three types of instruments, that is, compensatory, discriminatory and access. The breakdown is as follows:

- compensatory - 30
- discriminatory - 14
- access - 21

Trends over time

In the case of compensatory instruments 14, almost half were introduced in the period to the end of 1973; of these virtually all involved the use of tax expenditures or the creation of state enterprises. From 1969 to 1982 we see a more frequent use of state enterprises (7 actions) than in the earlier and later periods.

In the case of access instruments 4 were used prior to 1973 and tended to be regulations limiting foreign investor access to particular sectors such as finance and banking, the media, and energy. The major change, after 1973, is the use of more generalized control of access (3) to screen acquisitions and later, new investment across all sectors. From 1977 onward the actions taken tend to circumscribe the regulations of access either by altering the threshold for cases or streamlining the process.

The period since 1982 marked a shift away from the control of access in a general way culminating in the removal of screening for new investment in 1985, but retention of screening for acquisitions and a move to investment promotion. In terms of access it is acquisitions, as a form of investment, which are subject to screening for longer (1973- onward) than either new investment (1975-85) or the expansion of EFCs. Deregulation of access in the 1980s is limited in the energy and cultural sector.

Discriminatory policy instruments are generally more prevalent in the earlier period, 8 measures prior to 1971. Most of these involved suasion, and some tax expenditures. EFCs, outside of energy, in the 1970s and early 1980s, are subject to few discriminatory measures.

Trends in Coercion

From 1965-82 there was an overall increase in coercion as the state resorted increasingly to general regulation of access and discriminatory use of regulation (particularly in the energy sector and broadcasting) and targetted grants. From 1982 onward there was a trend toward declining levels of coercion and intervention on the part of the state reflected in the deregulation of access (1982, 1985, 1987), the partial abandonment of discriminatory regulation in energy (1985) and the move away from targetted grants back to tax expenditures in the case of compensatory instruments. Despite moving away from the use of access and discriminatory instruments there were few new compensatory instruments introduced to replace them.

Trends in Intrusiveness

The choice of policy instruments also indicates greater use of state enterprises and recourse to regulation in the period after 1969. A flurry of new or mixed enterprises are created (1969, 1971, 1974, 1975) and in the case of energy, given a repatriation role in the early 1980s.

After 1982 virtually all of the changes involve a more limited role or privatization of state enterprises. While this does not mean the state is not continuing to play a role in shaping investment activity, it does indicate a shift to policy instruments involving less direct state intervention.

Sectoral Differences

Sectoral differences are also evident in the pattern of policy instrument usage. The use of discriminatory policy instruments is much more prevalent and coercive in the energy sector than in manufacturing, where broadly applied compensatory instruments predominate. Similarly there is less use of regulation and a tendency to create mixed enterprises in the manufacturing sector than in energy.

Conclusion

This pattern raises several key questions and does not fully conform to our expectations. As Chapter Three indicated, the 1960s saw increased inflows of FDI and increasing levels of foreign ownership, peaking in 1971. In the case of manufacturing, foreign ownership levels were extremely high, reaching 58 per cent by 1972. Moreover, reinvested earnings of EFCs were providing the bulk of FDI by the mid 1970s. Our hypothesis, outlined in Chapter Two, indicated that in a period of strong inflows of FDI, along with high and rising levels of foreign ownership and control in the economy, the increased use of both access and discriminatory policy instruments would have been predicted as the state's likely choice of instruments to manage FDI. Our

assumption is that the perceived costs of using such instruments would be seen to be low and the state's capacity to bargain with investors high. Moreover, any attempt to manage FDI, given the dominant roles of EFCs in the economy, would need to include discriminatory policy instruments. Yet few discriminatory instruments are introduced in Canada in the late 1960s or early 1970s.

The 1967-75 period is characterized, as Appendix A indicates, by two key shifts in the pattern of policy instruments. First is a move from sectorally-based control of access to broader control of access through the screening of first, acquisitions (1973) and later, new investment (1975), which our hypothesis would have predicted, an approach premised on the ability of the state to successfully bargain with investors to enhance national economic benefits. Second is the creation and use of a number of mixed and state enterprises in a various sectors to ensure a Canadian presence, assist Canadian corporations and, in some cases, engage in repatriation of firms through acquisitions. What limited use there is of discriminatory policy instruments is confined to the energy and cultural sectors.

Why have manufacturing EFCs been subject to so little in the way of either discriminatory treatment or coercion, given the very high levels of foreign control of this sector? This is even more curious given the repeated identification of negative aspects of their impact on the Canadian economy⁴

during this period which included:

1. Low levels of research and development in Canadian industry especially by subsidiaries of multinationals.
2. Poor export performance and restrictions on exports of manufacturing subsidiaries.
3. Sourcing of inputs among subsidiaries which is externally-oriented and not integrated with domestic suppliers of inputs.
4. Lack of public disclosure of operations of wholly-owned subsidiaries.
5. High levels of foreign ownership and control in certain sectors and the lack of Canadian participation and representation within subsidiaries.
6. Size and inefficiency problems of firms in Canada.⁵

For most of the thirty years less coercive compensatory instruments, especially expenditures, suasion, state enterprises and relatively limited regulation have been employed to deal with these problems. What accounts for this pattern? Except in the case of energy, there is no evidence of any coordinated state policy which combined compensatory and discriminatory policies to advantage Canadian capital, a strategy, as Chapter Two indicated, which other states have employed.

In contrast to the earlier period, the later 1970s and early 1980s are characterized, as Chapter Three indicated, by stagnating investment inflows, declining levels of foreign control, and increasing outflows of FDI as the United States becomes a preferred location for world FDI inflows. Liberalization of access controls, as Appendix A indicates,

followed in 1982 and 1984 and conform to the outcomes we expected⁶. However, large acquisitions continued to remain subject to some regulation. Moreover, new discriminatory and coercive policy instruments, which would not have been predicted given investment flows, were introduced in 1980, but only in the energy sector, after proposals in the manufacturing sector were defeated at the Cabinet level⁷.

In order to fully establish the influence of changing investment relations on the choice of policy instruments and to fully explain the pattern of instrument usage that has been described I will focus the analysis on the two key periods of 1967-75, and 1980-85 and the policy making processes involving FDI. While the 1957-65 and the 1976-79 periods are discussed these are seen as times of transition leading up to the key decision periods. In each decision period I will examine the perceptions and assumptions about investment flows and stocks, and Canada's attractiveness as an investment location, and assess the extent to which these shaped the views of decisionmakers on the choice of policy instruments. However, as Chapter Two indicated, the views of decisionmakers on the role of the state, particularly on questions of coercion of private investors and direct state intervention, and how these also influenced instrument choice, must also be taken into account in any explanation.

The views, in both cases, are derived from public statements of those involved in key decisions, including

policy advisors and senior ministers, as well as secondary sources that have commented on the decision process. In addition a small number of confidential interviews have been used to supplement these sources⁶.

Foreign Investment Regime Change - Setting the Stage

While the focus of our analysis is the 1967-75 period we begin with a brief discussion of the investment regime in the early postwar period and the 1957 Royal Commission Report which initiated sustained attention to FDI as a policy issue in Canada. Prior to 1957 there were few restrictions on the entry of foreign capital into the economy and these were limited to sectors such as broadcasting and transportation. Low corporate tax rates, high tariffs and various tax incentives, along with an absence of restrictions, encouraged inflows. In addition, in the early postwar period, the United States had adopted a set of tax and other measures which encouraged U.S. corporations to invest abroad, particularly in resources. These helped to generate high inflows of U.S. capital into Canada.

The Royal Commission Report, outlined in Appendix B, reflected key assumptions and conclusions which defined the parameters of the subsequent policy debate over FDI.

The report drew three major conclusions:

1. Because of increased foreign control of the Canadian economy it was likely that the interests of the Canadian economy and that of large foreign-based corporations would, at some point, diverge.
2. Foreign investment, however, had been extremely beneficial

and was required in order to assure the further development of the Canadian economy.

3. Measures were needed to increase the level of Canadian ownership and control of its economic assets so that the decisions made in the corporate sector would more closely reflect Canada's economic interests.

The second and third conclusions however, reflected the trade-off which informs the whole report and subsequent policy on FDI, that is, the desire to manage or control FDI while remaining attractive to new capital. The report made this clear:

it is important that Canada should not discourage foreign capital by unfair discriminatory action and that the free movement of interest and dividends to foreign investors should not be interfered with by currency restrictions. Measures such as these would damage our national reputation for good faith and fairness in dealing with foreign investors who have placed their capital in Canada and could result in a slowing down in the rate of foreign investment in the future and thus in the rate of economic activity and expansion.⁹

Yet the report also acknowledged that, given the attractiveness of Canada to foreign, especially American investors, there was a modest role for the state to:

state the objectives and the wishes of Canadians in this matter without fear that by doing so we shall precipitate a flight of capital from Canada or a drying up of further inflows--providing we are fair reasonable about the way we go about it.¹⁰

Thus the commission's identification of the problems and its assumptions of continued strong investment inflows gave the state a limited role and only a modicum of leverage over investors. The experience of the early 1980s, particularly failed attempts at FDI regime change, also helped shape

official views of what was feasible in the way of policy instruments and where the limits of coercion lay. A modest set of measures adopted by the succeeding Conservative government in 1957 included tax incentives to encourage Canadian ownership and to counter "the dependence of foreign-owned companies on research done abroad," by encouraging capital expenditures on research and development in Canada (1961 and 1962 budgets) and providing alternative funding to assist firms in avoiding takeovers.¹¹ Regulatory measures were introduced to limit oil and gas leases on federal lands to companies with some Canadian ownership and to increase the monitoring of the operations of foreign-based subsidiaries. Key sector legislation also limited foreign ownership in the broadcasting and insurance industries (1957 and 1958).

Yet it was the 1963 budget of the then-finance Minister Walter Gordon which attempted to follow the recommendations of the 1957 Royal Commission in using conditional tax incentives. One measure, the takeover tax, was notable, however, in the punitively high rate of taxation (30 per cent) it imposed on takeovers of Canadian businesses by non-residents. This reflected the Minister's view that "non-resident takeovers of established Canadian companies rarely confer any benefit on the Canadian economy."¹²

Other measures included discriminatory rates on withholding taxes on dividends for companies with less than 25 per cent Canadian ownership, while decreasing the tax for those

with more than 25 per cent and making access to tax measures conditional on at least 25 per cent Canadian ownership and corresponding Canadian representation. These changes were prefaced in the 1963 budget speech by a long discourse on the levels of foreign ownership and control in the Canadian economy and exhortation to foreign-owned industries in Canada to act in the overall interests of Canada by increasing resource processing, local sourcing of inputs, and doing more research and development in Canada. But the method advocated to achieve this behaviour was limited:

Foreign investors can further the growth of this partnership by selling minority interests in their enterprise to Canadians and by electing a number of independent Canadian directors to represent these interests.¹³

It was the takeover tax, however, which aroused the most criticism from the parliamentary opposition and private investors¹⁴, both Canadian and foreign-based, and combined with other totally unrelated issues, caused the measure to be withdrawn. The strong and hostile reaction to such coercive, discriminatory measures from both the national and non-national business community was not lost on the government.

Additional key sector legislation limiting foreign ownership in the banking sector in 1965 also aroused a strong U.S. reaction. In 1966 came the first state effort, via suasion, to alter the behaviour of EFCs, particularly their repatriation of earnings. This came specifically in reaction to U.S. government guidelines of 1965 adopted to deal with a

severe balance of payments problem. The U.S. measures called upon corporations with investments abroad to minimize capital outflows and maximize inflows. The Canadian guidelines called upon subsidiaries to act as good corporate citizens and maximize their positive impact on the economy through local sourcing, increased research and development, increased local processing of resources and, most important, "retention of a sufficient share of earnings to give appropriate financial support to the growth requirements of their Canadian operations."¹⁵ The absence of any coercion is notable as is the creation of a unit within the Department of Industry to monitor adherence to the Guidelines through a discriminatory, but voluntary, annual survey of the largest subsidiaries.¹⁶

Efforts to spur research and development included the introduction of a new system of grants to replace previous tax incentives found to be largely ineffective, especially in the case of smaller companies. This program heralded the first attempt to address the chronic underspending (by international comparison) of Canadian industry on research and development.

Thus policies adopted had ranged from suasion to expenditures, often in the form of conditioned or unconditioned incentives, and procurement, conditioned to encourage more local research and development and specialization.¹⁷

New programs were also launched in the 1970s to spur and

assist private sector export efforts through assistance for marketing and export financing (1971 and 1974). In export development programs, research and development, and general industrial development programs there was no policy of discrimination against firms based on ownership.

Foreign Investment Regime Change: 1967-75

This section begins the examination of the first key period of decision, identified above. It begins with a brief review of the nature of Canada's investment relations then examines two studies of FDI which played roles in defining the policy options for decisionmakers.

As indicated in Chapter Three, the postwar period saw large inflows of foreign, mainly American capital, resulting in increasing overall levels of foreign control of the economy, which by 1971, had reached 36 per cent of total assets. In two major sectors, manufacturing and petroleum and natural gas, these levels were even higher (58 per cent in manufacturing and 77 per cent in oil and gas).

Gross inflows of new FDI continued to be strong until 1971 when they began to decline. Net inflows remained positive until 1976. Foreign inflows of capital were a source of about 8 per cent of gross fixed capital in the 1964-72 period, but dropped after that to less than 5 per cent by the mid 1970s. At the same time retained earnings of subsidiaries became the major contributor to the growth of

stocks of FDI. Deficits on non-merchandise transactions, particularly the outflow of funds connected to FDI in dividends and other payments, were also starting to grow rapidly.

For Canadian investment policy makers any policy seeking both to maintain direct investment inflows, while maximizing the attendant economic benefits, centres on the extent to which inflows are the major source of new capital for investment and are seen to be robust. Clearly investment inflows indicated Canada to be an attractive location for investment in the 1950s and 60s; but by the late 1960s much of the expansion of investment was being financed internally and levels of foreign control were climbing progressively. How were these considerations reflected in investment policy decisions? To understand that we begin in 1967 with the second study of FDI after the 1957 Royal Commission.

The Watkins Report

This study was part of an effort to further build consensus within the Cabinet on the need to act on the investment issue by the development of a white paper. Walter Gordon had insisted on this as a condition of his return to the Pearson government in late 1966.¹⁸ The study was to be submitted to a cabinet committee headed by Gordon and was to:

include the significance - both political and economic of foreign investment to encourage greater Canadian ownership of our industrial resources while retaining a climate favorable to the inflow of foreign

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investment as required for Canada's optimum development.¹⁸

The report, Foreign Ownership and the Structure of Canadian Industry²⁰, saw the state's goal regarding foreign direct investment to be similar to that identified by the Royal Commission in 1957, namely to maximize the benefits of FDI, primarily the economic growth it brought, while minimizing the costs, particularly those impeding the creation of a more independent national economy. Three specific policy objectives were derived from this goal including:

1. Ensure that EFCs behave as good corporate citizens as per the 1966 Guidelines (See Appendix A).
2. Improve the overall efficiency of the Canadian economy and the performance of Canadian corporations, both indigenous and foreign owned.
3. Encourage increased Canadian control of economic activity in ways that facilitate the achievement of greater national independence and economic growth.²¹

The report found FDI to be beneficial and that inflows should be welcomed. However, high levels of capital inflows, particularly from the United States were not expected to continue indefinitely. It also categorically opposed any policy seeking to substitute domestic for foreign capital in any major way as neither "feasible nor desirable".²² While the report did acknowledge Canada's ability to meet its capital requirements it was clearly of the view that the other benefits which FDI brought, in managerial and entrepreneurial skills, technology and market access were more significant than capital itself. There were no

recommendations to limit access of foreign capital, nor to use state enterprises or a combination of discriminatory and compensatory policies to enhance the position of Canadian capital.

The bulk of the report analyzed the extent of foreign ownership, its impact on the Canadian economy and the problem of the extraterritorial application of U.S. anti-trust and export laws. The basic conclusion was that government policy, not foreign ownership per se, was the source of the failure to maximize the economic benefits derived from FDI. The central thrust of its recommendations, therefore, was for a more vigorous pursuit of efficiency for all corporations through the reduction of tariff barriers and the strengthening of competition laws.

Discriminatory treatment of EFCs was to be limited to the monitoring of their behaviour by a new coordinating agency which would make the voluntary guidelines survey conducted by the Department of Industry (Trade and Commerce) mandatory, with additional financial disclosure. The new agency would also examine licensing agreements and market sharing arrangements to minimize restrictions on exports, facilitate export promotion and examine tax procedures to ensure that the state was receiving an appropriate share of revenues from the activities of MNCs.

The report also advocated limited compensatory measures to increase Canadian ownership through the creation of the

Canada Development Corporation (CDC). To get around the problems of the extra-territorial application of U.S. law to the export practices of Canadian subsidiaries, it suggested the establishment of a state export trade corporation.

The report was presented to the cabinet committee in January 1968 but there was little agreement on any action. It was tabled in the House of Commons on February 15, 1968 with a statement from Gordon that the report would "assist public discussion of this important subject" but the tabling did not "imply that the government concurs or has taken any decisions regarding its specific recommendations."²³ The report itself also made it clear that its authors did not speak for the government²⁴.

While the report did not result in any policy initiatives because of divisions in Cabinet, it did keep the issue of FDI on the policy agenda and defined it in terms of improving the performance of both EFCs and Canadian firms and not one of maximizing Canadian ownership or controlling access. Its recommendations were cautious in regard to monitoring the behaviour of EFCs, since changes in the overall policy framework, particularly in trade and competition policy, were seen to be the key to improved corporate performance.

Within three years of the publication of the report policymakers were again investigating the investment issue with a view to recommending changes, this time, focussing much more heavily on control of access. What had changed in the intervening period?

Canada remained a favoured location for foreign direct investment. While Canada's share of international foreign direct investment had dropped from its peak in 1960 (32 per cent) by the 1965-70 period, it was still at 11 per cent of total world FDI. However, the late 1960s witnessed a surge in foreign takeover activity of some large Canadian-owned firms. As Chapter Two indicated, the takeover (acquisition) is generally regarded by most states as the least preferable form of incoming FDI. It has often been perceived to bring in little new capital or other economic benefits in return for diminishing levels of national economic control. As Figure 4.2 indicates, the period of the late 1960s was one of corporate restructuring in Canada, much of it in a spillover effect from the United States which resulted in a very sharp rise in foreign (mainly American) takeovers of Canadian-owned companies.

FIGURE 4.2
Foreign Acquisition Activity 1950-75

No. of acquisitions

Source: Foreign Investment Review Agency, Foreign Acquisition Activity (Ottawa: Feb, 1977).

The growing public concern over takeovers and foreign ownership²⁵ was addressed by the Trudeau government in 1968, as part of the government's economic policy program and the Privy Council Office (PCO) role of setting priorities over and above departments such as Finance or Industry, Trade and Commerce (ITC). By November, 1969²⁶ the issue of foreign direct investment and the control of the national economy had been identified by the PCO as a priority problem. Takeovers, particularly that of Denison Mines, precipitated the timing, but the manner in which FDI was approached and the way in which policy was implemented were shaped by assumptions about the nature of investment relations and the appropriate level

of state intervention on investment matters.

After the intervention of March 2 blocking the takeover of Denison Mines²⁷, the Trudeau government announced on March 3, 1970 the establishment of a group of officials under the chairmanship of minister without portfolio Herb Gray to examine, "domestic control of the national economic environment and the problem of foreign ownership"²⁸ and to bring forward recommendations to the Cabinet. Unlike previous efforts this was not to be a task force of academic economists, or a process of hearings and consultations²⁹, but rather an interdepartmental review and analysis of a policy problem with specific recommendations to Cabinet³⁰. From the start, therefore, it was policy-oriented and confidential and signalled the government's intent to act.

The Gray report, as it is popularly known, was, in fact, the document that formed the basis for the Cabinet discussions of July, 1971³¹. It outlined Canada's relationship to international capital, assessed Canada's bargaining power with foreign investors, and laid out a set of specific optional policy instruments to control FDI, as well as analyzing the implications of each. Thus we must analyze its policy advice in some detail to understand the ultimate choice of policy instruments.

According to the report FDI brought with it a mixture of costs and benefits. The report concluded that while on balance there were overall benefits and FDI should continue

to have access to Canada, the state should pursue three basic goals:

1. To exercise greater control over the economic environment.
2. To maximize benefits and minimize costs
3. To retain and increase Canadian ownership where feasible and desirable.

The ultimate recommendations to cabinet were based on several assumptions:

1. Canada was an attractive location for investment because of its resource base and political stability. Access to Canada, therefore, was highly valued by investors and the state could use its control of access to influence the behaviour of investors.³²
3. Canadian ownership alone would not guarantee benefits to Canada. Any attempt to "buy back" the Canadian economy would be prohibitively costly and not the best use of Canadian capital. Resources could be better used to influence the performance of foreign-owned firms.
4. The benefits of FDI were not being maximized by a liberal access policy. State intervention would be required to increase benefits to Canada.
5. Maximization of benefits of FDI would involve broad measures of reform affecting the whole economy, not just screening FDI. Both efforts must arise out of a clearly articulated industrial strategy.
6. Many countries were already screening FDI, although not as explicitly. International capital was familiar with the process. International reactions, therefore, were of minimal concern.

From these assumptions³³ and a lengthy analysis of the operations of foreign-owned firms and the nature of foreign investment, the report recommended the establishment of a screening process where negotiators bargained for enhanced benefits from incoming investors in return for access.

Screening was preferred by the authors because it was seen as a "cost-free" instrument, unlike a fixed-rules approach which limited or completely restricted foreign ownership, was inflexible and risked foregoing some of the benefits of FDI, such as new technology and management systems.

The report went on to outline the possible scope of investment covered by a screening process, pointing out that this would determine the extent of the increase of government intervention in the economy which would result³⁴. The options outlined included: acquisitions (takeovers) of Canadian-owned or based firms by foreign interests, new incoming investment, new licensing and franchising arrangements, major new investments by already established foreign-based firms (EFCs), operations of EFCs and Canadian MNCs investing abroad. The authors argued that both takeovers and new investment should be reviewed, since to omit the latter would provide a means of circumventing blocked takeovers. In addition licencing contracts could also benefit from state bargaining in minimizing restrictions for the Canadian purchaser often imposed by the foreign vendor.

The report was more cautious regarding EFCs. Even though these corporations were already the most important source of growth of foreign control in the economy by 1971 and their investment was, in theory, no different than other foreign investment, the report warned of some problems in

screening their activities. For example, corporate opponents would regard any review of their activities as retroactive and distorting their competitive position in the Canadian marketplace by placing these firms at a disadvantage and most important:

It would represent a fundamental change in the rules of the game by the government. In particular, it would be more interventionist and would alter the traditional relationship between business and government.

Such a policy could conceivably create problems in relations with foreign governments if existing foreign-controlled firms sought to enlist the support of their governments, arguing that their normal growth in the Canadian market would be affected.³⁵

In the case of Canadian MNCs the report argued that any effort to scrutinize their activities abroad would involve a larger proportion of their operations, in comparison to foreign-based companies, and might promote capital flight.

The report also discussed a minimum threshold for new investment and acquisition cases. Preferring to confine the review to large transactions, it did allow that in some sectors and in cases of firms on the brink of expansion, a lower threshold might be appropriate.

A separate agency reporting to the minister and the Cabinet was the preferred mechanism for undertaking the screening function since those involved in bargaining would have much more clout with foreign investors than a body separate from the political level. At the same time it would be able to gain expertise and make the trade-offs in bargaining that economic departments (e.g. Finance), which

would be likely to look with favour on any investment, would be unable to do³⁸. The bargaining power of the state with investors was acknowledged by the report to vary by sector, less in manufacturing³⁷, especially in high technology areas, more in energy.

The report devoted relatively little attention to the potential impact of screening on inflows of new FDI or the impact of declining flows on the efficacy of the screening-bargaining process and the capacity of the state to trade off access for benefit. Clearly the issue of how screening affects inflows is crucial to the successful implementation of the process. Task force members insisted they had no desire to "snuff out" FDI.³⁹ Their cursory attention to the question of impact on inflows arose rather from a confidence in the attractiveness of Canada as a location for investment, primarily because of the size, affluence, stability, and resource base of the economy. In addition, screening was felt to be common in many other countries and familiar to MNCs. The process, if accompanied by clear guidelines and a clear pattern of consistent decisions over the years, would promote predictability and lower uncertainty for international business, which would see screening as an improvement over ad hoc state intervention regarding takeovers characteristic of the late 1960s³⁸.

The question of certainty raises the issue of how bargainers were expected to determine the significant benefit

to Canada and what performance improvements were to be traded off for access. The report set out six basic criteria in evaluating cases including:

- contribution to productivity and industrial efficiency,
- compatibility with the government's industrial strategy,
- contribution to the level of economic activity and employment,
- geographic location within Canada,
- the competitive impact of FDI and other economic benefits.⁴⁰

Any conflicts between, for example, efficiency and economic activity, would be resolved by reference to the government's priorities, which the authors expected to emerge from efforts underway at that point to establish an industrial strategy for Canada⁴¹.

The report also acknowledged that screening was only part of the process of controlling Canada's economic environment. It did recognize that a broad range of policy instruments were available to the state. Since the report defined and evaluated the options it is important to examine what was and was not recommended in terms of our other categories of compensatory and discriminatory instruments.

In particular, the issue of how to influence behaviour of subsidiaries and address the distortions arising from Canada's truncated branch plants, identified in the Watkins Report, had to be addressed. The task force reviewed Canada's industrial development programs, noting the high proportion of funds going to foreign-owned subsidiaries, but it ruled out any attempt to discriminate against EFCs in

access to the programs as this would not help promote research, development and innovation in the Canadian economy. However, it favoured using incentives with conditions as a lever to "help subsidiaries of foreign firms to rationalize and to specialize in particular products for world markets."⁴²

In the case of large procurement contracts the report favoured some modest preferences for Canadian-owned firms in certain sectors such as communications, but overall the costs of a generalized preference for Canadian-owned firms were felt to be too high and more performance-related conditions were seen to be preferable.

The report was also unequivocal in rejecting discriminatory tax measures based on ownership in any major way (except for small business) largely because of obligations created through international tax treaties, the difficulties and international hostility such measures would generate and the problem of targetting such broad measures to achieve specific objectives.

In sum the Gray Report, as a set of recommendations to Cabinet defined the policy issue, like the Watkins Report, primarily in terms of performance rather than ownership. It saw, in Canada's attractiveness as an investment location, leverage that could be used in bargaining with incoming investors to enhance the benefits to Canada from FDI. On the other hand, it largely eliminated discriminatory instruments as an option that was too costly, too interventionist and too

likely to bring foreign opposition and investor ill will. The behaviour of EFCs therefore, was to be shaped by a limited number of compensatory instruments⁴³, and some limited scrutiny of expansion and licensing agreements.

From Policy Recommendations to Policy Instruments: The Debate Over Screening

The work of the Gray task force, and the Cabinet debate on foreign investment policy took place within the context of a number of other initiatives including revisions to competition policy and the tax system. In addition, efforts were underway in 1971, later to prove unsuccessful, to develop an industrial strategy.⁴⁴ The Gray task force had proceeded on the assumption that such a strategy might be forthcoming and, while FDI policy would not wait for it, such a strategy was seen to be helpful in determining the trade-offs to be made in the bargaining process, and to provide the basis for a coordination among other measures used to address the investment issue.

The 1971 budget contained a number of modest positive measures, outlined in the Appendix A, which were intended "to increase the attractions to Canadians relative to non-residents to acquire equity in Canadian enterprise"⁴⁵ rather than investing abroad and "to encourage the growth of Canadian-controlled business."⁴⁶ These were followed by further regulations on Canadian representation on the boards of public corporations. Later in the year legislation to

strengthen the Canadian-owned periodicals press and broadcasting industry through new discriminatory regulations disallowing deductions of advertising expenses incurred by non-resident owned companies was also introduced.⁴⁷

In July, 1971 the Gray Report went forward as a lengthy cabinet memorandum.⁴⁸ Agreement on the need to act, and the establishment of an investment screening mechanism to deal with foreign takeovers was reached, but the issue of a further extension of the scope of coverage beyond takeovers was postponed until September because of Cabinet disagreement.⁴⁹ The leaked record of decision indicates that Cabinet also agreed to the development of other policy instruments. Finance was directed to examine, "measures which could be taken to improve the willingness and capacity of Canadian financial institutions to finance a greater proportion of Canadian business activity."⁵⁰ Industry, Trade and Commerce was directed to review extending the General Adjustment Assistance Program (GAAP)⁵¹ and various measures to assist industry in technology selection and Canadian sourcing of parts and components.

Further meetings of the Cabinet in the fall, rendered more complicated by the August 15 imposition of United States trade and balance of payment measures, centered around the scope of coverage for the agency. Meetings of November 4 and 10 focussed on the economic impact, particularly when ITC's survey on investment intentions appeared to show that the U.S.

surcharge and DISC legislation had resulted in a sharp reduction in planned business investment.⁵² Cabinet managed to resolve the differences resulting in a final decision to limit the scope of screening to takeovers which, according to one cabinet minister, was the result of opting for a "lowest common denominator of agreement."⁵³

The publication of a large portion of the leaked Gray Report on November 12, 1971 by Canadian Forum, amid much fanfare, put further pressure on the Cabinet to resolve outstanding differences. The leaked document made a broader range of screening options public before the final decision had been announced or the legislation drafted. Moreover, the publication coincided with the beginning of a federal-provincial meeting at which the Prime Minister and the Premiers were to discuss improved economic cooperation and consultation, which unilateral cabinet action on investment seemed to belie. The Cabinet then faced the dilemma of how to handle the uncertainty and raised expectations created by the leak and the possibility of an accelerated pace of takeovers prior to a public announcement of government intentions.⁵⁴ Cabinet finally decided to release the full text of the report in conjunction with a statement of intent describing the bill, which would be tabled shortly thereafter.

Accordingly on May 2, 1972 the report was tabled and the Hon. Herb Gray announced the government's decision to

review takeovers through the Department of Industry, Trade and Commerce to determine if they were of significant benefit. The takeover review process, he pointed out, "would permit the negotiating of greater benefits in Canada." Gray also indicated that the government would be pursuing other measures including international action and "Canadian initiatives." The latter was in anticipation of the criticism of the Conservative opposition on the lack of "positive measures designed to enable Canadians to participate in the development of Canadian industry and measures to enable Canadian industries to thrive."⁵⁵ The minister responsible, Jean-Luc Pepin, also felt obliged when tabling the legislation to explain the narrow scope of the bill. His main argument was that:

The extension of the review process to other forms of foreign direct investment could slow down the creation of new industry, partly through reduced business confidence at home and abroad and partly through the disruptive effects such a major intervention could cause resulting in fewer jobs being created.⁵⁶

The narrow scope of Bill C-201, in comparison to the Gray Report, had been the result of a strong disagreement over the extent of state intervention required to deal with incoming investment on the one hand and the concerns about the impact of investment regulation on the level of economic activity. The bill, however, was never passed.

What ultimately did pass was a bill that broadened the scope of coverage of screening, but once again left EFCs

largely untouched. Figure 4.3 outlines Bill C-201 and compares it with both the Gray report recommendations and the Foreign Investment Review Act (Bill C-132) which finally passed the House of Commons in November, 1973.

Figure 4.3

Comparison of the Gray Report Recommendations with Bill C-201 (1972) and Bill C-132 (1973)

Scope: Gray Rec: Screening to include takeovers (direct and indirect), new incoming investment and licensing and franchising agreements

C-201: Takeovers (direct and indirect)

C-132: Takeovers (direct and indirect), new incoming investment and expansion of EFCs into unrelated activity.

Threshold:

Gray Rec: Transactions of economic significance or of particular importance to policymakers.

C-201: Assets of \$250,000 or gross revenues of \$3 million.

C-132: For acquisitions same as C-201, for new investment no threshold.

Criteria for Significant Benefit:

Gray Rec: 1. Contribution to productivity and industrial efficiency.
2. Compatibility with the government's industrial strategy.
3. Contribution to the level of economic activity and employment.
4. Geographic location in Canada.
5. Competitive impact of FDI.
6. Other economic benefits.

C-201: a. Effect on the level and nature of economic activity in Canada, including employment.
b. The degree and significance of participation by Canadians in the business

enterprise and in any industry or industries in Canada of which the firms is a part.

c. The effect of the acquisition on competition within any industry or industries in Canada.

d. The compatibility of the acquisition with national industrial and economic policies.

C-132:

Paragraphs a and b identical to C-201 but addition of new

c. The effect of the acquisition on productivity, industrial efficiency, technological development, product innovation and product variety in Canada.

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

Form of Screening Mechanism:

Gray Rec: Separate administrative agency to be headed by a deputy minister and responsible to the minister and/or cabinet.

C-201: No separate agency to be created. Review process to take place in a branch of the Department of Industry, Trade and Commerce. Minister to make recommendation to Cabinet for decision.

C-132 Separate Foreign Investment Review Agency to administer review process and advise the minister who makes a recommendation to Cabinet for decision.

Source: Government of Canada, Foreign Direct Investment in Canada (Ottawa:1972), Bill C-201 and the Foreign Investment Review Act, 1973.

The most significant difference between C-201 and both the Gray Report and the later legislation was in the scope of investment transactions covered and in the creation of a separate agency to undertake the administration of the screening and bargaining process. What accounts for this broader coverage of the second bill? To what extent did interest groups such as business, or nationalist organizations like the Committee for an Independent Canada, rather than assumptions about Canada's investment relations or disagreements over the level of state intervention, shape the choice of policy instruments?

There are several indications that the influence of these groups, as well as that of provincial governments was marginal. First of all there is clear evidence of little consultation with private sector groups or the provinces during the process of indentifying policy options and formulating the initial bill. The leaked Gray Report of November, 1971 was met with surprise and shock on the part of the corporate sector. The period between its publication and the May 2 announcement was one of great uncertainty as to how the government would decide. Finance Department memos refer to a "sigh of relief" on the part of major business groups at the limited scope of action contemplated in Gray's May announcement.⁵⁷

Both Bills C-201 and C-132 eventually went to the House of Commons standing committee on Finance, Trade and Economic

Affairs where four provinces and a wide range of groups appeared. Appendix C provides a listing of the positions of major economic interests and various groups regarding both bills. A comparison with the major provisions of the final version of Bill C-132 indicates that the submissions and lobbying had limited impact, except in two areas.

Changes were made to the definitions of non-eligible persons and there were some technical amendments to clarify definitions and exempt certain activities not intended to be covered by the bill. These were the result of criticisms from a group of mostly Canadian banks, the insurance and securities industries and some real estate associations which had supported the overall principle of the legislation, but sought specific changes to the definitions, particularly of control and non-eligibility because of concerns about inhibiting the operation of capital markets, loan security or other transactions which they felt the bill did not intend to cover.

In addition the second bill did contain a stronger commitment to take provincial economic development policies into account in the screening process. This change resulted from a series of consultations starting in the spring of 1972 when Herb Gray, the task force minister, met with representatives of each province, after the first bill had been introduced⁵⁸. The issue of foreign investment was also discussed at a first ministers conference in 1973 after the

second bill was tabled. But the opposition of several Atlantic provinces, particularly New Brunswick, and Quebec to the second bill, fearing it would discourage investment, was ineffective. Ontario, Manitoba and Saskatchewan, which wanted stronger measures, including repatriation and more public ownership to increase Canadian ownership and control, also had little influence.

Similarly, groups representing multinational corporations, the petroleum industry and a mixture of large and small Canadian companies which opposed the overall thrust of investment screening, were also ineffective. The Canadian Manufacturers Association, Imperial Oil, the Independent Petroleum Association and the Canadian Chamber of Commerce opposed the extension of the legislation to new investment and unrelated expansion of EFCs, claiming it would harm the flows of incoming investment, cause foreign investors to see Canada as hostile to investment and hurt efforts, through corporate restructuring, to increase efficiency. The Chamber was particularly virulent in its attack on Bill C-132 calling the minister inflexible and asking that the bill be withdrawn, all to no avail.

The Canadian Labour Congress⁵⁰ and the Committee for an Independent Canada supported the bill, but called for changes including more monitoring of EFCs, less secrecy in the review process, stronger efforts to counter the extra-territorial application of U.S. law, the immediate proclamation of phase

II of the legislation, and other positive measures to increase Canadian ownership. Again they were unsuccessful and the thrust of the second bill remained untouched.

The change from the first to the second bill resulted from the minority government situation of 1972 and the need for NDP support in the House. The NDP had vigorously opposed bill C-201 calling it a sham and "one big zero," but had reluctantly supported bill C-132. They continued, however, to push unsuccessfully for a ten point program calling for increased surveillance of the operations of EFCs, screening their expansion, strengthening the CDC, using foreign exchange reserves to repatriate foreign-owned firms, and regulations to require increased processing of resources in Canada⁸⁰. In addition to the NDP influence, a group within the Liberal caucus (particularly Toronto MPs)⁸¹ and several ministers in Cabinet favoured broadening the scope of screening and creating a separate agency. The second bill, after all, did more closely coincide with the original Gray recommendations.

Clearly bill C-132 had broadened the scope of screening to answer critics both within and outside the party and to ensure the government's survival. Even prior to the minority situation however, the government had been contemplating other possible discriminatory and compensatory measures to deal with the foreign investment issue, recognizing the limited impact of confining screening to takeovers. A record

of a cabinet decision of June, 1972 does indicate that a range of options to develop further compensatory and discriminatory instruments were being considered. Cabinet initiated several policy reviews on:

measures to improve the willingness and capacity of Canadian capital markets to finance a greater proportion of Canadian business activity.

the development of an information system relating to all governmental assistance to foreign-controlled firms.

the advisability of favouring Canadian-controlled firms through public support for technological development and

creating a systematic government information program on technology.

the possible use of government procurement policies to support our Canadian enterprises.⁸²

Despite these reviews, however, no formal policies systematically favouring Canadian firms were ever brought forward. Nor did the minister's promise to introduce legislation on the registration of technology agreements come to fruition. Yet even the increased scope of coverage of Bill C-132 continued to avoid seriously impeding the activities of EFCs⁸³. In fact, concerns about the economic consequences of screening new investment caused the new minister of Industry, Trade and Commerce Alistair Gillespie⁸⁴ to reassure the House of Commons that screening "would give us the benefits of foreign investment and minimize the costs. Our objective is to introduce policy that will not have an adverse impact on employment and investment." This "major extension of the review process" would be accompanied by "support for the

development of Canadian-owned firms."⁶⁵

Gillespie made it clear that although Canada no longer lacked sufficient capital or savings to finance domestic investment, it could not afford the cost of repatriation, estimated at \$30 billion. The government was confident that the scope for increasing benefits through bargaining was greatest in the resource sector "where the advantage, the location of the resource is in Canadian hands." In the case of manufacturing the scope was more limited since "our position in this area is not overwhelmingly strong," focussing mainly on reducing "restrictions where foreign investors have not taken advantage of basic Canadian strengths."⁶⁶

In response to the question of why the government was not going further in its treatment of EFCs, Gillespie was clear, echoing the warnings of the Gray report about the extent of state intervention it would require:

Given the large number of firms that are already foreign-controlled in Canada, a review of the normal expansion would call for an enormous amount of intervention. I am not prepared to argue that the state should have such sweeping authority over normal private decision-making. It seems to me that there is almost an element of retroactivity in intervening in the process of normal growth.⁶⁷

When it later came to the question of defining the scope of EFC expansion that would be covered by the legislation, the definition of unrelated activities to be covered by the act was cast very narrowly in the guidelines tabled in 1975, when the second part of the act was proclaimed. In announcing the

proclamation of part II of the act to screen new and unrelated investment by EFCs the minister made clear once again that the purpose of the act was:

Not to block foreign investment from any source or to discourage it, but rather to ensure that such investment is of significant benefit to Canada. Since its beginnings Canada has had to rely heavily on foreign investment to help us develop this country. Clearly it has been beneficial.⁶⁶

He went on to indicate that the guidelines on related business would limit the scope of the agency's review of EFCs only to expansion into unrelated activities, defined in a narrow sense to exclude vertical integration⁶⁷ and:

to ensure that there will be no interference with investment for the maintenance and expansion of the ongoing business in Canada. This was clearly Parliament's intention when it passed the Act.⁷⁰

At the same time the minister tabled new "Principles of International Business Conduct" intended to update the 1966 Guidelines on good corporate behaviour of EFCs. The principles were voluntary, and the annual survey conducted by the Department of Industry, Trade and Commerce of EFCs was to continue. The new principles, as the minister pointed out, stressed more autonomy for subsidiary companies and the transfer of foreign-controlled technology to Canadians. Moreover, the issuing of the guidelines, in conjunction with new regulations and the announcement of the proclamation of Phase II of the act, were intended to provide "an indication of the sort of benefits the government looks for in assessing

investment proposals under the Foreign Investment Review Act."⁷¹ This was undoubtedly to make up for the absence of any articulated industrial strategy⁷² or even a set of priorities that could guide bargainers and provide applicants with some certainty and predictability in the process.

The Foreign Investment Review Agency did take the effect of new investment or an acquisition on research and development and export activity into account in reviewing cases.⁷³ This effort did not address the behaviour, however, of EFCs operating in Canada which, because of their size and market power, had a strong impact on patterns of exports, imports and research and development. Before a House of Commons Committee in 1975 the Minister responsible made clear that an important aspect of FIRA's efforts would be to improve Canada's international competitiveness through greater specialization in Canadian production.

Specialization is being further supported by the operation of the Foreign Investment Review Agency. When the agency screens a takeover of an existing Canadian corporation, the primary consideration is whether the takeover will be of significant benefit to Canada. Screening is an important lever in obtaining undertakings to specialize. Screening is negotiation.⁷⁴

EFCs, therefore, would only be subject to such bargaining regarding specialization in the event that they acquired a Canadian firm.

Explaining the Decision to Screen

In shaping decisions the high level of foreign ownership, strong inflows of capital, which were expected to

continue at high levels, and foreign acquisitions, which were increasing sharply, resulted in increasing public concern over foreign control of the economy. These factors both pressured the state into acting and shaped the choice of instruments. While there was a concern that too much intervention could hamper investment and economic well-being, there was a confidence in the attractiveness of Canada as an investment location. The process overseen by the new agency, bargaining with investors and making recommendations to Cabinet was intended to be a very transparent one indicating a serious government commitment to enhancing the benefits from FDI. Because it centered on bargaining its success depended on a healthy inflow of investment to ensure sufficient leverage over investors and an industrial policy to guide the trade-offs in the bargaining process. The latter would provide clear signals to, and therefore, lessen the uncertainty of foreign investors.⁷⁵

Only a limited range of policy instruments were defined as feasible in both the review process and Cabinet discussion. In particular, discriminatory and coercive policy instruments to alter the behaviour of EFCs were rejected largely because of the extent of state intervention involved and strong disagreement in Cabinet. While the initial state consensus formed around a lower level of state intervention in screening, in 1971 political pressures necessitated a modest expansion in scope. Overall the state kept intervention to a

modest level seeking to balance continued investor confidence and strong investment inflows against concerns about national autonomy and the distribution of investment benefits.

In the absence of any consensus regarding how to successfully influence the performance of EFCs in the manufacturing sector, a series of compensatory instruments involving suasion, incentives and limited regulation were adopted.

Foreign Investment Regime Change- Compensating for FDI

When Gillespie introduced the foreign investment review bill he had made it clear that the government would be moving on several fronts and that additional legislation would be forthcoming to provide for the registration of technology transfer agreements, to require a majority of Canadians on the boards of federally-incorporated corporations, and measures to increase Canadian ownership and control in resource projects. These were intended to partially address two other aspects of foreign investment that investment screening could not address, that is, how to increase levels of Canadian ownership in the economy and how to directly influence the behaviour of EFCs.

While discriminatory measures were rejected, the 1967-75 period did see two major initiatives to create compensatory instruments using state and mixed enterprises in two sectors of the economy where foreign ownership was very significant. While neither was directly connected to the policy review

process that had resulted in the creation of the Foreign Investment Review Agency, they are reflective of how intrastate disagreement over the question of state intervention shaped the policy instrument.

The Canada Development Corporation (CDC) began its lengthy genesis in 1963 as an initiative of Walter Gordon which had grown out of several private sector efforts to create a national development company. The CDC had been promised in every single throne speech since, but never implemented because of differences within Cabinet and with the business community over its form and ultimate role.⁷⁶ Gordon's version of the CDC would have had important repatriation and takeover prevention roles, along with helping to build and develop strong Canadian firms through the mobilization of Canadian capital and entrepreneurial skills⁷⁷. Strong bureaucratic, corporate and cabinet opposition, however, reshaped the CDC into a more limited domestic gap-filling, industrial development role by 1965. As a proposal it continued to develop slowly until 1971 when legislation finally appeared. To gain acceptance within the state and by private economic interests not only the role, but also the structure of the corporation had changed to that of a profit-oriented mixed (public and private shares) enterprise, where the government's role would diminish over time. As a policy initiative it appeared to answer the expectations that Gordon's proposal and the ensuing debate over FDI had aroused,

while limiting the actual extent of state intervention.

In introducing the CDC in Bill C-219 in 1971⁷⁶ the Minister of Finance made it clear that its goals would include: developing stronger, Canadian-controlled corporations; providing Canadians more opportunities to invest in Canada; acting as a catalyst for developing major projects; helping to rationalize and improve the competitiveness of Canadian industry; and amassing pools of capital to assist Canadian entrepreneurs. It would concentrate on new areas such as high technology, as well as resource processing, northern development and any industry where Canada enjoyed a significant comparative advantage. To a limited extent the CDC would act to create "national champions" but would not buy back foreign-owned firms or be an owner of last resort in the case of blocked takeovers. The bill created a mixed public/private corporation with two basic goals: to develop strong Canadian-controlled, private companies; and to mobilize the investments of Canadians to participate in economic development. Thus the corporation would act in a compensatory way to create, strengthen and expand Canadian corporations based on Canadian investment, to compete with foreign-based firms. Ultimately, but largely indirectly, this would result in increased Canadian ownership and control in certain sectors of the economy.⁷⁸ This was to be achieved within the context of a major state presence in the initial ownership and on the board, but a receding

influence over time and a strong mandate to operate in pursuit of profits for the benefit of private shareholders. The CDC provided a non-coercive state commitment to Canadian controlled-industry, at the same time that the extent of direct state influence was limited by its profit-oriented, mixed private and public form.

Thus new compensatory measures were brought forward to enhance the Canadian presence in the manufacturing sector, but the role of the mixed enterprise created was narrowly circumscribed and excluded aggressive repatriation of firms.

The energy sector, in contrast, was characterized by an increased use of coercion and state intervention based on the perception of strong bargaining power which rising world oil prices and energy shortages in the 1970s enhanced. The initial creation of Petro-Canada was, however, cautiously approached by the government. Although a government paper of 1973 ⁸⁰reviewing the issue of a state oil company had not made a recommendation, the developing energy crisis of that year and growing public concern over the security of oil supplies, the increased role of states in international oil trading, and the Canadian state's excessive dependence on the large multinational companies for basic information on the Canadian resource base, all made the issue more urgent⁸¹. In addition the government was in a minority situation, largely dependent on the NDP. While the intent to create Petro-Canada was announced in December 1973 the legislation did not

pass until 1975. In tabling the bill in 1975 the Minister of Energy, Donald Macdonald, made it clear that the overwhelming concern was to ensure security of oil supplies and a feeling that the private sector cannot be "relied upon to mobilize all of the enormous amounts of capital which will be required to secure energy development consonant with Canadian needs over the longer term."⁸² In addition, he argued "a majority of Canadians desire such a presence and a broadening of Canadian ownership in this industry." He went on to point out that, on a revenue basis, foreign ownership exceeded ninety per cent and that:

one way in which Canadians can assert their presence in this heavily dominated sector of our economy is by having a nationally-owned company which could bring together smaller Canadian companies into larger, more competitive joint ventures and the forming of various consortia.⁸³

In addition to increasing Canadian ownership, acting in a supportive way to smaller, private, Canadian companies, the new company would take over state interests in the Syncrude project and Panarctic Oils thus ensuring a Canadian state presence in the new frontier and synthetic technology.

The company was capitalized at \$500 million with authorized debt of \$1 billion giving it the required capacity to compete in the petroleum sector, especially in frontier activity. Unlike the CDC, it was created as a wholly-owned agent of the state with potentially broad powers. This generated much suspicion on the part of private companies, the Conservative opposition and oil-producing provinces⁸⁴.

Macdonald sought to assure them that Petro-Canada is "intended to stimulate the efforts of the private sector in a cooperative atmosphere to benefit all Canadians." Neither the Canadian or foreign-based firms opposed the bill in principle, but they expressed concern about the preferential position that Petro-Canada might enjoy, especially the forthcoming federal regulations for frontier operations.⁸⁵ Macdonald attempted to reassure critics that the main emphasis of Petro-Canada would be upstream supply and that it would operate along side of, not in place of, private companies.

While the NDP supported the bill they advocated a stronger repatriation role for the company, but the government no longer relied on them, having won a majority in the 1974 election. Macdonald did not focus on a repatriation role for Petro-Canada in 1975.

In summary, in the 1967-75 period the Canadian state chose to create a number of state and mixed enterprises in manufacturing, telecommunications, aircraft and energy in lieu of any serious attempt to control the performance of EFCs. Moreover, it was expected that increased levels of Canadian ownership would occur in only an indirect way⁸⁶ from screening and from the creation and expansion of new Canadian firms, either fully or partially publically owned, which would aid in the expansion of other Canadian-based firms and industries. Yet the high levels of foreign ownership and the large role that retained earnings played in expanding foreign

control, meant that such a limited policy would have limited impact.

Thus in the 1967-75 period, Canada moved from a fairly open foreign investment regime, with restricted access in a few key sectors and a limited range of passive, compensatory instruments emphasizing increased Canadian ownership, to a new regime based on access-oriented screening, increasingly interventionist compensatory instruments (especially state and mixed enterprises) and an emphasis on influencing the behaviour of incoming foreign investors.

Screening and Compensating: The Transition - 1976-79

The 1976-79 period must be seen as one of transition where major changes in Canada's relation to international capital were occurring and some of the limitations of the access-screening regime were slowly becoming apparent.

As Chapter Three indicated, the 1976-79 investment inflows show a mixed picture⁸⁷, with levels remaining flat until a large increase in 1978, flattening out again in 1979, albeit at a much higher level. The first net capital outflow, however, also occurred in 1976. Larger and consistent increases in both outflows and stocks of Canadian FDI developed in 1977 and continued through 1978. The relatively smaller contribution of FDI (both retained earnings and new inflows) to gross fixed capital is also evident, dropping from 8.6 per cent in 1969 to 4.6 per cent in 1979.

Overall levels of foreign control continued to decline. In the case of manufacturing the drop went from 56 per cent in 1975 to 51 per cent by 1979. In the petroleum and natural gas sector the drop was more dramatic going from 74 per cent to 53 per cent by 1979, reflecting the repatriation of energy EFC's resulting from acquisitions by the CDC and Petro-Canada.

There is no evidence, however, of any sudden or dramatic drop in new investment inflows after the proclamation of Phase II of the Foreign Investment Review Act⁸⁸. Yet the operation of the agency, in the absence of a clearly articulated industrial strategy, continued to cause concern on the part of some ministers that its operation was generating uncertainty and deterring potential investors.

This was reflected in several efforts undertaken by the agency to counter any negative perception of Canada's investment climate that the screening of investment might have generated, including the launching of a glossy publication in the autumn of 1977 intended to, "present a consistent, positive image of Canada as a place in which to invest"⁸⁹ In addition the agency closely monitored investment inflows to determine if there had, in fact, been a deterrent effect. According to FIRA's head at the time, sporadic complaints about FIRA made to ministers and concerns over its impact at the political level occasioned several studies, none of which found any evidence that the operation of the agency had reduced flows or indeed the investment activities or expansion of EFCs.⁹⁰

At the same time the agency and the government had to fend off critics of its very high approval rates. Table 4.1 indicates the variation in approval rates throughout FIRA and Investment Canada's history.

Table 4.1

**Disposition of FIRA/Investment Canada
Cases 1974-1988**

Acquisitions

Yr.	New Cases	Cases Resolved	Allowed as Per Cent of	% Allowed Mines/minerals	% Allowed Manufact.
			Resolved	Fuels	
1974-75	150	92	68.5	88.9	60.3
1975-76	144	153	71.9	70.6	83.3
1976-77	186	191	80.1	83.3	84.8
1977-78	299	265	90.9	78.6	93.2
1978-79	373	337	87.8	90.5	94.1
1979-80	380	387	85.5	68.0	86.7
1980-81	330	293	73.4	38.5	80.3
1981-82	338	314	79.0	18.0	88.0
1982-83	427	518	90.5	65.4	92.3
1983-84	461	468	91.9	94.1	100.0
1984-85	474	494	93.9	92.0	95.6
1985-86	128	105	100.0		
1986-87	192	160	100.0		
1987-88	197	178	100.0		

New Business

Fis. Yr.	New Cases	Cases Resolved	Allowed as Per Cent of Resolved	% Allowed Mines/Minerals Fuels	% Allowed Manuf.
1975-76	26	6	66.7		
1976-77	238	207	80.2	88.9	84.7
1977-78	333	337	89.0	83.3	83.0
1978-79	340	322	86.9	78.9	84.6
1979-80	404	410	86.8	84.2	85.0
1980-81	401	293	79.5	53.3	95.2
1981-82	401	405	65.4	70.0	83.0
1982-83	460	561	81.1	93.8	91.0
1983-84	512	493	86.8	83.3	93.3
1984-85	455	507	93.5	85.7	95.2
1985-86*	3	1*	100.0		
1986-87	2	2	100.0		
1987-88	4	2*	100.0		

* refers to new business related to national identity and cultural heritage

Source: Annual Reports, Foreign Investment Review Agency and Investment Canada 1974-1988.

The imposition in the act of very strict rules of confidentiality necessary to insure investor confidence and maintain inflows, also made it difficult for the agency or the government of the day to demonstrate the success of the bargaining process. The secrecy of the process left the acquirer in the dark as to what interests were opposing or seeking to counter the application before FIRA. The Canadian Bar Association was to be particularly critical of this aspect of the process in its later review.⁹¹

The desire to maintain the appearance of an objective and fair process, despite the ultimately political nature of the decisions on cases, kept the review process at arms length from other instruments of foreign investment policy. In

particular there was little coordination with the activities of state or mixed enterprises with a mandate to promote Canadian ownership. FIRA Commissioner Gorse Howarth made it clear in 1978 that in the case of takeovers FIRA, "did not take steps to bring situations or possibilities to the attention of CDC or any other Crown corporations or, indeed, any other potential investor in the private field."⁸²

A shortened review process was introduced in 1977 to deal with small business applications and a practice of issuing press releases indicating the benefits to Canada in cases which had been approved helped to address some of these problems. A surge of takeover applications in 1978 and budget cuts to the agency, however, created a large backlog of cases and delays increased. Several amendments to the act were prepared by the agency to streamline the process, but these never went forward because of an election in May, 1979, a change of government and the launching of further review of procedures, followed by another election.

The policy debate over how to improve the performance of EFCs took place within a context of high inflation, slow growth, expenditure constraints and growing concerns about Canada's trade competitiveness. Canada's performance in the export of end products had begun to deteriorate in relative terms in the early 1970s. In addition the prospect of further reductions in tariff barriers by the end of the 1970s, as a result of the completion of GATT negotiations in Tokyo in

1979, forced the state to confront the problem of ensuring competitiveness of Canadian products in both domestic and international markets⁹³.

Three aspects of the performance of EFCs had given rise to concern including: sourcing policies, export performance and industrial research and development. Appendix A indicates that changes to a group of compensatory instruments were adopted during this period which included changes to industrial grants and subsidies and new tax incentives. In virtually all cases the government of the day made it clear that these instruments would not be applied in a discriminatory way against EFCs.⁹⁴ The failure of compensatory policies to alter the behaviour of EFCs in the manufacturing sector was repeatedly documented, especially by the Department of Industry, Trade and Commerce in its annual survey of the performance of EFCs.⁹⁵ In some instances the frustration led officials to advocate more coercive and discriminatory approaches to address the problem, none of which was implemented.⁹⁶

In the late 1970s government tried to address the problem of the low level of research and development being done in Canada. Poor performance was tied to foreign ownership in both the Gray report and Science Council publications, as well as being acknowledged by a federal policy statement of 1978.⁹⁷ The April 1978 budget contained new tax incentives to encourage research and development.⁹⁸

The Conservative opposition, the Canadian Manufacturers Association and other high technology corporations such as Northern Telecom called for even richer tax credits, while the NDP called for more regulations to force EFCs to reinvest profits in research and development.

One idea which became a major policy focus to address these concerns was the concept of a world product mandate (WPM). The WPM referred to the exclusive right of a subsidiary to produce a particular product or line of products for the world market. This allowed both greater specialization and larger scale production for a subsidiary, resulting in lower unit costs and increased competitiveness and increased exports. In addition the research, design, engineering, production and marketing functions would all be carried out by the subsidiary itself thus increasing local research and development, and spinoffs in sourcing, in addition to increasing competitiveness.⁹⁹ Interest in promoting WPMs increased on the part of policy makers in Ottawa, some provinces, business organizations and other economic policy bodies.¹⁰⁰ The Science Council, the Ontario government and the Canadian Manufacturers Association all came out with reports and policy proposals in 1980 on WPMs.

The concept had been touched upon in the Gray Report, the 1975 Principles of International Business Conduct, and the early operations of FIRA, as discussed above. However, among the proponents of WPMs there was no consensus on the specific

policy instruments to be used to ensure that subsidiaries acquired these mandates. Discussions included options of using suasion, incentives, especially grants, and conditioned government procurement.¹⁰¹ By the early 1980s only a tiny proportion of subsidiaries had achieved these mandates and there was some caution about the extent to which this would be a panacea for the truncation problem of subsidiaries.

In the case of the biased sourcing problem of subsidiaries the state had also begun, in the mid-1970s, to go beyond suasion to use its other regulatory powers in the energy sector where it clearly identified more scope for influence. Regulations in leasing oil and gas on Canada Lands in 1976 were changed to permit the minister to take sourcing behaviour of corporations into account in granting oil and gas leases to foreign firms.¹⁰² In 1975 an interdepartmental, interprovincial committee on industrial benefits was formed to examine the performance of companies in resource development projects on Canada Lands, although it had little real power.¹⁰³ Later in 1978 a task force on major projects involving private sector and labour was also struck to examine ways to enhance the regional and industrial benefits from major resource projects particularly those involving foreign based companies.¹⁰⁴

The period from the mid-1970s to 1980 can be seen as one of fairly limited new policy initiatives in managing FDI and a switching back and forth between various instruments

including regulation, expenditure and suasion, all involving limited intervention and coercion to deal with that area not covered by FIRA or key sector legislation, that is, the behaviour of EFCs. At the same time the screening process came under increased pressure because of delays and secretiveness.

The short-lived change of government in 1979 did not significantly alter this pattern. While a major review of FIRA's operations was promised by the government,¹⁰⁵ and it initiated a study of the privatization of Petro-Canada¹⁰⁶ no action was taken before the government was defeated in late 1979.

FDI Regime Change, 1980-85: Adjusting to the International Economy

The second key turning point in Canada's FDI regime identified was the 1980-85 period. The following sections examine how both the changing nature of investment relations and a reemergence of a division over appropriate level of federal state intervention and coercion of investors within the state shape the mix of policy instruments. I begin, however, with a brief review of investment relations, the explanatory variable.

Changing Investment Relations, 1980-85

While the level of foreign ownership and control had dropped in the late 1970s, it remained at a high level in both manufacturing and petroleum and natural gas at 51 and 48 per

cent respectively, in 1980. Foreign control in the oil and gas sector, based on revenues, was still substantial at 76.9 per cent¹⁰⁷. Gross inflows of FDI increased greatly in 1978 staying high in 1979 and increased again in 1980, even in real terms, approaching the levels of the early 1970s. Net inflows also became positive in 1979 and increased in 1980. Yet Canadian outward FDI increased both in terms of stocks and flows, with especially large outflows in 1977-80. As Chapter Three outlined, Canada's share of international inflows had begun to drop significantly as the United States, from 1978 onward, began absorbing dramatic amounts of new investment. A growing amount of Canadian capital began to be exported in the form of FDI as companies sought to rationalize production and remain competitive in the U.S. market. Thus Canada was increasingly becoming a home state in its own right with the United States acting as the major magnet for Canadian capital, even as FDI inflows remained substantial.

As Chapter Three indicated, the 1980-85 period as a whole was one of large, erratic changes in the flows of capital into and out of Canada. The 1981-82 period saw very large net outflows of capital, partly as a result of the repatriation of several large foreign-based companies. As a result foreign ownership levels in the economy continued to decline, especially in the petroleum and gas sector, but still remained a significant component of the economy.

If we examine the cases that FIRA and the new Investment

Canada dealt with in that period, on an assets basis, in Table 4.2, it is clear that acquisitions dwarfed the inflows of FDI for new business for most of this period, although new business investment improves briefly in the 1983-84 period after the recession.

Table 4.2

Value of Reviewable Cases on an Assets Basis
Millions of \$

Acquisitions of Companies Controlled in:

	In Canada	Outside Canada	Total	New Business
1974-75	550.1	420.6	970.7	-
1975-76	239.5	430.9	670.4	
1976-77	249.5	843.2	1092.7	350.7
1977-78	410.8	1098.2	1509.7	797.4
1978-79	2136.9	3081.4	5228.3	355.0
1979-80	704.7	2827.7	3532.4	279.5
1980-81	614.8	3461.5	4076.3	1271.2
1981-82	6519.6	1936.9	8465.5	704.2
1982-83	1111.7	4213.0	5324.7	3448.0
1983-84	1529.2	2959.1	4488.3	2749.2
1984-85	1638.0	10242.4	11879.4	820.0
1985-86			9760.0	467.4
1986-87	8142.0	4337.0	12479.1	907.5
1987-88	15472.9	4757.4	20230.3	346.5

Source: Foreign Investment Review Agency, Annual Report (Ottawa, 1975-84) Investment Canada, Annual Report (1985-89).

Much of the erratic behaviour of FDI flows in the early 1980s is attributable to the recession and declining levels of economic activity, exchange rates and other factors. Yet the continued increase of Canadian FDI abroad, Canada's shrinking share of world FDI inflows, and record FDI inflows into the United States tended to reinforce a view in the business

community and the Conservative opposition that Canada was regarded as having a hostile investment climate in comparison to other OECD economies. Corporate policy institutes such as the European Management Forum ranked Canada lowest in the attractiveness of its investment climate while the Conference Board argued, in a study of FDI policy, that Canada faced increased competition in attracting foreign direct investment in the 1980s.¹⁰⁸

According to the OECD, Canada received an average of 3.1 per cent of world FDI flows in 1980-83, in contrast to 11.5 per cent in 1971. The United States, in turn, became the major host state attracting 52.6 per cent of all FDI flows in the early 1980s.

Also important in this period in understanding FDI regime change in the energy sector was the doubling of world oil prices in the 1978-79 period. This development posed a number of dilemmas for Canada as a petroleum producing and consuming economy. It created both a divergence of regional interests and, for the federal state, a potentially severe revenue imbalance because of the concentration of production in Alberta which owned resource rights and therefore, claimed the economic rents. Foreign ownership and control of the companies meant that the vastly increased private revenues, as a result of price increases, would leave the country. Thus the federal state saw a need to control the economic impact of price increases and at the same time capture a share of

resource revenues, as well as maximizing the share of the private sector revenues that remained in Canada.

Because of the different regional and revenue issues, and the evidence provided above of a very different pattern of policy instrument usage in the energy and manufacturing sector, the analysis which follows separates the two sectors, and begins with a discussion of manufacturing.

Foreign Investment Regime Change and the Struggle Over Manufacturing Subsidiaries, 1980 -82.

Policy discussions of foreign ownership and energy revenues and the broader question of EFCs and industrial policy took place in a period involving a Conservative minority government, an election, a Liberal government and new constitutional initiatives which were fraught with conflict. This period also coincided with a stronger provincial role in economic development, especially in resource-rich provinces,¹⁰⁹ which led to their increased demands for more consultation on economic development and trade issues.¹¹⁰

The outline of how the new Liberal government, elected in March, 1980 intended to resolve these problems was laid out in several election campaign speeches in February and March and repeated in the Throne Speech in April. The goals were to revitalize Canada's industrial capacity through the active involvement of the state in economic development, capitalizing on Canada's energy base and seeking to strengthen Canadian research and development. The state would encourage Canadian-

owned enterprises and "expand Canadian control of the economy while increasing the benefits for Canadians from the foreign investment already here."¹¹¹ Acknowledging the failure of past compensatory measures to alter the performance of EFCs, the Liberals promised that, if elected, the government would do more to ensure that EFCs expanded research and development in Canada through a strengthened FIRA whose:

mandate would include the periodic review of all foreign firms of large size to assess the performance of these companies in such areas as export promotion and research and development.¹¹²

The second main policy objective would be the Canadianization of the economy through the promotion of Canadian-based companies via discriminatory procurement policies, incentives to "encourage equity investment by Canadians in Canadian-controlled companies," discriminatory regulation and ultimately repatriation. In the case of FIRA the agency, would "publicize proposed foreign takeovers beyond a certain size once they have been submitted to the Agency to encourage counter offers."¹¹³

The Throne Speech of April, 1980 announced a program of action which would include measures "to promote a national development policy that will provide jobs, stimulate growth, build upon regional strengths, and increase Canadian ownership and control of our economy."¹¹⁴ In the case of energy, the government announced its intention to maintain and expand Petro-Canada as an instrument of public policy "to provide preferential rights for Petro-Canada and other Canadian

companies on federal lands and establish new and more demanding requirements for exploration and development of these promising frontier areas."¹¹⁵ The government announced the adoption of a specific goal of "at least 50 per cent Canadian ownership of the petroleum industry by the 1990s." The Government also reaffirmed its commitment to increase Canada's over-all expenditure on research and development to 1.5 per cent of gross national product. For exports further assistance would be provided in the form of a national trading company as well as increased assistance to small business, more simplified application procedures and increased policy coordination for export promotion. In addition, government procurement was to be "used vigorously, in a manner consistent with our international commitments, to encourage the creation and expansion of independent, Canadian-owned enterprises."¹¹⁶

The government proposed to amend the Foreign Investment Review Act to provide:

performance reviews of how large foreign firms are meeting the test of bringing substantial benefits to Canada. As well, amendments will be introduced to ensure that major acquisition proposals by foreign companies will be publicized prior to a government decision on their acceptability. The government will assist Canadian companies wishing to repatriate assets or to bid for ownership or control of companies subject to takeover offers by non-Canadians.¹¹⁷

Thus, in the case of EFCs, the proposals went far beyond the consensus of the Gray report and the establishment of FIRA which had precluded discriminatory instruments, the use of FIRA to monitor or regulate the operations of EFCs, and any

serious efforts to repatriate foreign capital. The emphasis on increased Canadian ownership and repatriation was strongest in the case of the energy sector where a commitment was made to achieve a 50 per cent ownership target (on a revenue basis) by 1990.

The major proponent of the industrial policy part of the Liberal election platform was Herb Gray, appointed Minister of Industry, Trade and Commerce. From the summer of 1980 through the spring of 1981 Gray and his department elaborated proposals to implement the new industrial strategy. Changes in Canada's FDI regime were to be an important part of the strategy. The selective acceptance of investments that involved "transfers of technology and access to foreign management skills and expertise"¹¹⁸ was key. In addition the policy would address the "persistent weaknesses" of the Canadian economy arising out of the performance of foreign-based manufacturing subsidiaries, including low levels of research and development, high import propensity, difficulties in exporting and the "inability to exploit our linkages between our natural resource wealth and the development of a healthy manufacturing sector."¹¹⁹

Achieving these goals would require improving the performance of EFCs, increasing Canadian ownership and maintaining investment inflows. The performance of EFCs was to be addressed through periodic reviews, but the extent of coercion or intervention that such a process would entail was

never made clear. Gray repeatedly stressed that these measures were not intended to burden good corporate citizens and prevent new investments of significant benefit to Canada. In a speech in Japan Gray went out of his way to reassure Japanese investors that Canada desired new investment, especially in the auto industry, and that policies of controlling access through screening and the monitoring of foreign investment are the norm in many countries, although Canada's were more open and visible internationally than most. The performance review of EFCs, he suggested, was to "bring about a better understanding by multinationals operating in Canada of what is expected of them and what they can do in this regard."¹²⁰

By spring 1981, further work on the proposals had led to revisions regarding FIRA's role in the strategy, especially in the preempting of takeovers and repatriation. The Minister indicated that "a more likely approach would be to have this handled by other than FIRA itself and likely through the Enterprise Development Program".¹²¹ In the case of performance reviews he indicated that the 1966 and 1975 Guidelines would serve as the basis of assessment:

The ideal envisaged would be that it would be something that would not lead to a mandatory compliance action by the government but rather that there would be some publication of the results of the periodic review so that public opinion would have its effects.¹²²

The intent was to monitor EFCs and use suasion if their performance was found to be lacking. State regulation was

only a last resort. Gray also made it clear that the confidentiality of business plans would be respected. Any publication of takeover bids by FIRA, in an effort to find Canadian buyers for firms, would be limited to the fact that an application had been made and would not divulge the acquirer's business plan or details of the negotiation of undertakings with the agency.

Gray's proposals went before Cabinet in early July, 1980. The memo outlined the structural problems that foreign-owned branch plants posed for the realization of Canada's industrial expansion, pointed out the failure of various compensatory expenditure programs to solve the problem and argued that FIRA, as then constituted, could not address the problem and advocated the monitoring of branch plants with an eye to framing "regulatory mechanisms".¹²³ Later elaborations also outlined a role for the CDC, similar to that of Petro-Canada, in repatriation and the promotion of Canadian ownership.

The proposals were ultimately defeated¹²⁴ in Cabinet in favour of an alternative based partially on proposals sponsored by Senator Bud Olson, Minister of State for Economic Development, for a less interventionist industrial strategy linked to the energy sector. In the autumn of 1981 Gray's proposal was discarded and a strategy which linked the industrial sector closely to the development of energy megaprojects was adopted.¹²⁵ State intervention, in the case of manufacturing EFCs, was to be limited to existing

compensatory measures and federal regulation of energy projects was to be used to promote improved sourcing of Canadian goods and services on the part of EFCs and Canadian firms involved in such projects.

The defeat in Cabinet can be traced to divisions within the state over the question of state intervention that the FIRA proposals involved and their impact on private investment. Olson was quoted as opposing its "anti-investment" element and Treasury Board President, Don Johnston warned, "we must not sabre rattle and drive away foreign investment."¹²⁶ The overall economic situation, particularly the alarming capital outflow in the summer of 1981 and drop in the dollar¹²⁷ also played a role. The Prime Minister publicly credited the drop in the Canadian dollar and the outflow of capital with affecting the decision to postpone changes to FIRA's mandate.¹²⁸ The division within Cabinet was also fed by a steady diet of criticism and opposition to the proposals on the part of business interests, the media and the provinces.

The virulence of opposition to the proposals to strengthen FIRA in 1980-81 is difficult to fathom, given what was actually proposed, unless it is understood in connection with the growing concerns about the delays and uncertainties of the administration of the screening process itself, and their perceived negative impact on Canada's attractiveness as an investment location and the opposition, both foreign and

domestic, which the National Energy Program (NEP) announced in October 1980, had aroused. The increasing length of time to resolve FIRA cases, 120 days on average by 1980, and confidentiality regarding the reasons for disallowance added further credibility to the argument that FIRA was deterring investors, which, though never proven, took on the aura of accepted wisdom in the business community.

There was, as Table 4.1 indicated, great variation in approval rates throughout FIRA's history. However, a large drop in approval rates for cases in the 1978-82 period and the dramatic increase in approval rates after 1983 indicate the occurrence of a policy shift. Approval rates for applications did drop significantly, particularly in the case of acquisitions of resource companies, where the rate plummeted from 91 per cent in the 1978-79 reporting year to 43.8 per cent in 1980-81 year.¹²⁰ In addition, the number of cases withdrawn had increased steadily from the start up of the agency to reach a peak in the 1980-82 period of over 100 cases annually, approximately 12 per cent of the total. Those involved in FIRA cases reported an increase in equity participation as a condition of approval in 1981 and an increase in the average time spent on cases to almost six months.¹³⁰ Figures on the length of time for decision, the approval and withdrawal rates and the anecdotal evidence indicate that there was, indeed, an increase in the application of pressure on investors to enhance performance as

well as efforts in certain sectors to increase the level of Canadian ownership through exclusion and repatriation. Assuming no change in the behaviour of investors, approval and withdrawal rates indicate an attempt to use greater coercion on investors in order to attain a higher level of benefit to Canada which an increasing number of investors were unwilling to meet.¹³¹ Thus criticism of the agency and changes to it must be seen as part of investors' resistance to what they perceived to be increasingly coercive state intervention over investment decisions.

For a number of private corporations and provincial governments the FIRA and NEP proposals indicated a significant shift for the federal state toward increased economic intervention and coercion intended to reassert the power and visibility of the federal state in national economic development, which they opposed. Several provinces had been highly critical of FIRA since the fall of 1978 and had, at a First Ministers Conference, succeeded in including it in the Economic Council's review of regulation.¹³² By 1981 the provinces were unanimous in urging that:

the pace and scale of efforts to increase the level of Canadian ownership must be carefully considered so as not to undermine other measures to inspire investor confidence.¹³³

The recession, which developed in the fall of 1981, further increased concerns about the impact on investment levels on economic activity.

There was strong opposition from Canadian and foreign-

based corporations united under the umbrella of the Business Council on National Issues¹³⁴ and other associations, including the Canadian Manufacturers Association and the Chamber of Commerce. They lobbied extensively against the measure particularly in the summer of 1980. The President of the Canadian Chamber of Commerce issued an ominous warning that "all those firms that have been here for years minding their own business will be swept into the net," and "not only do you have a gun pointing at you but the gun is loaded. They'd be gathering information so they can pull the trigger and make you perform in ways that you, in your wisdom, judge to be inappropriate."¹³⁵ Opposition to the FIRA proposals also came from groups such as the Canadian Bar Association which called, in September 1981, for administrative reforms of FIRA to eliminate uncertainty and delay and ensure operation in a more "open, meaningful and business-like manner." Their strongest opposition was to any performance review of EFCs as:

a discriminatory practice which should not form part of foreign investment review. Any such practice would not be consistent with the OECD Guidelines on Multinational Enterprises and National Treatment....If the government is determined to introduce a monitoring process it should apply to all corporations and should be administered independently of the Review Agency. Any legislation relating to monitoring should utilize existing vehicles such as Statistics Canada and CALURA.¹³⁶

The brief cited in detail the mounting international opposition expressed in the financial press of Europe, Japan, Germany, Great Britain and the United States as well as by

foreign government officials, all of whom claimed that the agency was discouraging foreign investors and that Canada was developing a reputation for a hostile investment climate.¹³⁷ Provincial officials echoed these impressions, often encountered during their own investment promotion efforts abroad.

The Conservative opposition spokesperson, Michael Wilson, who had been the Minister of State for International Trade in 1979 and had brief responsibility for FIRA, warned, too, that monitoring the operations of EFCs would be "a new departure for any government" and that instead the 1975 guidelines should be updated, a private sector advisory board to FIRA, similar to that of Australia should be created and tax incentives be used to stimulate greater Canadian ownership.¹³⁸

The Cabinet decision on economic development was articulated in the October 1981 statement and retreated completely from the campaign promises of March, 1980 and the Gray proposals of July, 1980. Instead it proposed an industrial development policy which would tie secondary manufacturing to resource development and monitor the sourcing behaviour of corporations through the establishment of an Office of Industrial and Regional Benefits within Industry Trade and Commerce. Thus suasion and regulation would be employed in a compensatory, not a discriminatory way, to ensure that corporations involved in projects sourced through

Canadian suppliers and local firms benefitted.¹³⁸

The budget of October, 1981 indicated a move away from proposals to enhance FIRA when it was suggested that the government was seeking:

to ensure that the administration of the act is timely and efficient. A review of administrative procedures is now underway to establish what changes in these procedures are warranted on the basis of the first seven years experience¹⁴⁰

and therefore, "no legislative action is intended on these measures until further progress on the major initiatives already undertaken by the government has been assessed."¹⁴¹

Throughout the winter of 1981-82 further criticism of FIRA from the United States and private investors abroad generated growing concern among provincial officials who pressured federal officials to increase efforts to reassure foreign investors¹⁴². A series of presentations to better explain FIRA to foreign investors were organized as was a defense of FIRA's practices against U.S. critics.¹⁴³ However, doubts were growing about FIRA's role given the changing international economy. There was a growing consensus among FIRA officials that with lower trade barriers Canada would no longer be attracting the old style branch plant investment to serve the Canadian market and would need to alter policies to ensure the attraction of the sort of investment necessary to develop new technology and restructure industries to ensure competitiveness.¹⁴⁴ By the summer of 1982 the agency felt abandoned by the government.

In June, 1982 further changes were made to FIRA regulations to raise the threshold for the review process for small business, and reduce the discretion in subjecting small businesses to a longer review in order to reduce the backlog and reassure investors. By the fall of 1982 senior government ministers and the Prime Minister himself were openly wooing top corporate leaders from the United States and abroad in an effort to reassure them that Canada welcomed foreign investment.¹⁴⁵ The final signal of total abandonment of any move to strengthen FIRA came in the appointment in 1982 of Ed Lumley, a former businessman considered to be less nationalistic, to replace Gray as minister, along with the replacement of long-time FIRA commissioner and chief defender, Gorse Howarth. His successor, Robert Richardson, went to great lengths to woo international capital back to Canada.¹⁴⁶

By 1982 FIRA was widely regarded within the Canadian state as a liability that was inhibiting foreign investment rather than maximizing its benefits to Canada.¹⁴⁷ The supposed deterrent effect of FIRA on FDI became the central criticism of screening from that point on. Lumley was already looking to alter the agency, establish a private sector advisory board and create a more positive investment image when the 1984 election was called.¹⁴⁸

Foreign Investment Regime Change: The Energy Sector: 1980-82

The second main attempt to alter the FDI regime was

centred on the energy sector and, in contrast to the proposed FIRA changes of 1980, was implemented fully, using a comprehensive range of discriminatory and compensatory policy instruments designed to Canadianize the oil and gas sector.

Major changes in the FDI regime involving energy were also initiated within the political leadership of the Liberal party while in opposition. While they later involved the Department of Energy, Mines and Resources there was virtually no other consultation with affected interests or provinces. Moreover, changes in energy policy had a number of goals in addition to those relating to FDI in the energy sector. In fact, for many critics in the industry and producer provinces the National Energy Program (NEP) measures relating to foreign ownership were seen as merely a smokescreen. They were regarded as a popularly-appealing rationale for policies that were primarily aimed at enhancing the control of the federal state over energy resources and the high resource rents which the doubling of oil prices generated. The focus here, however, will be only on those aspects of the program that related to foreign investment, both incoming investors and those already established, whatever the ultimate motivation for the policy may have been.

Our inventory of instruments indicates that, since the 1960s, the energy sector had been singled out as requiring special measures to ensure increased Canadian ownership and control. It was also one where many policy makers saw the

state as having significant leverage over foreign-based companies. By the government's own admission the more passive policy instruments which had been employed up to 1980 had not "been sufficiently conducive to increased Canadian ownership of the sector."¹⁴⁸

What made increased Canadian ownership urgent was the rapid increase in oil prices in the 1978-79 period. Since 1974 the oil and gas industry had been a capital exporter. While maintaining interest and dividend payments, the industry had exported over \$2 billion in the 1975-79 period. An even greater outflow was forecast. Moreover, higher values of these foreign-based firms, which oil price increases had generated, would shortly make future repatriation prohibitively expensive. The prospect of huge capital outflows, based on the exploitation of non-renewable resources revenues which taxpayers had partially financed through generous tax incentives, provided a strong argument for intervening to increase Canadian ownership. For only by increasing Canadian ownership would the capital accumulated from higher oil prices remain in Canada.

The establishment of Petro-Canada in 1975, and the development of a repatriation role for it after a federal state commitment to increased Canadian ownership of the petroleum sector in 1976 ¹⁵⁰, made it the logical vehicle for an aggressive repatriation effort. Beyond the hard realities of capital outflows the goal of repatriation and the enhanced

role of Petro-Canada in that process had proven consistently popular in public opinion polls. That popularity had also caused the Conservative government of 1979 to hesitate in implementing its election promise to privatize Petro-Canada¹⁵¹.

The energy proposals were elaborated in the document, tabled along with the budget in October, 1980 entitled The National Energy Program. The document called for an increase in the "opportunity for all Canadians to participate in the energy industry, particularly oil and gas and to share in the benefits of that expansion."¹⁵² and focussed almost exclusively on ownership rather than performance. From this goal the government derived three objectives:

1. At least 50 per cent Canadian ownership of oil and gas production by 1990;
2. Canadian control of a significant number of larger oil and gas firms; and
3. An early increase in the share of the oil and gas sector owned by the government of Canada.¹⁵³

In addition, the program outlined regulatory measures to ensure that the local industrial benefits from major projects would be maximized through the monitoring and regulation of the sourcing behaviour of large petroleum companies operating on Canada Lands.¹⁵⁴

To attain these objectives a plethora of instruments were used including suasion, incentives, state enterprises and regulation. Several were explicitly discriminatory toward foreign-owned petroleum companies operating in Canada. The

extent of the initiatives, the coercion and the use of discriminatory incentives and regulations marked a sharp departure from the prevailing practices of the decade prior.

The policies opposed most strongly by foreign investors were those which were discriminatory, interventionist and coercive. In particular the 25 per cent crown interest in production on Canada Lands was regarded by foreign firms as expropriation without compensation. Foreign firms also objected to the system of grants for exploration and development tied to a rating of the level of Canadian ownership in a company. These Petroleum Incentives Payments (PIP) replaced previous tax incentives. Grants were chosen for a number of reasons. Unlike discriminatory tax incentives, grants would not violate international tax treaty obligations, would be more visible and could be better targetted to aid Canadian companies, as well as inducing more activity in areas of federal jurisdiction in the north and offshore. Foreign firms could only benefit if they were willing to Canadianize or joint venture with Canadian firms.

The policies were expected to aid several Canadian companies which benefitted from favorable administration of the program. Dome Canada and Nova, in particular, responded by expanding through the acquisition of foreign-based firms and increasing activity in the frontier areas. The vast majority of much smaller Canadian firms, however, hit hard by the downturn of activity by the foreign majors and tax

increases, which the Canada-Alberta agreement had instituted, opposed the policy and regarded the extent of federal intervention in the industry with strong suspicion. Whatever benefits the NEP might provide were insufficient to offset the other costs imposed on them. By 1982 several aspects of the policy had been altered, partly because of the extent of the opposition and the softening of oil prices.

Among those abandoned were plans to discriminate against EFCs in gas export regulations, the appropriation of a 25 per cent crown interest in production on Canada Lands without compensation and the proposals to enhance the role of the FIRA. It is significant to note that each of these involved discriminatory measures. In addition foreign and domestic investors were reassured in 1981 that the NEP would not be applied to other sectors and that the pace of Canadianization of ownership would not be pressed further.¹⁵⁵

The failure of prices to continue their upward spiral and the severe recession of 1982 led to further changes in the tax burden imposed on the industry. Petro-Canada and the CDC continued the repatriation of the industry in 1981 and 1982 with the purchase of Petro-Fina, BP Canada and Aquitaine. This ended in 1984 with the return of tax revenues previously designated for Canadian ownership to general revenues.

Unlike Gray's proposals for changes to FIRA, the NEP was implemented using coercive and discriminatory instruments. Although EFCs were able to counter or circumvent many measures

the federal state¹⁵⁸ had developed a policy which used interventionist and coercive instruments in a coordinated way to counter the grip of EFCs in the energy sector. The opposition to an increased role for the federal state, however, was stronger than anticipated and combined with lower oil prices and the recession, which seriously eroded the federal state's bargaining power with corporations, necessitated moderation by the beginning of 1982.

On the surface the 1980-82 period does not conform to our initial hypothesis that declining investment flows would lead to liberalization of controls of access. In fact proposals were brought forward to increase the regulation of EFCs. In the case of manufacturing the proposals were a reflection of frustration with the failure of compensatory instruments rather. However, they were defeated in Cabinet largely because concerns about their impact on investment levels and the extent of state intervention they would involve. Moreover, the growing consensus among business, provincial leaders and the cabinet that the operation of FIRA was deterring investors resulted in changes in the spring of 1982. In contrast, in the energy sector, rising oil prices were seen to enhance the bargaining power of the state and the changes were implemented, despite opposition.

From FIRA to Investment Canada: 1984-85

By 1984 it was clear that further changes would be made to Canada's foreign investment regime whatever the election

outcome. With the election of the Conservative government in the fall of 1984 came a new initiative to limit the scope of FIRA's review powers.

The decision to replace FIRA with Investment Canada, and the Investment Canada Act itself, reflect both the perception on the part of state decision-makers that Canada's attractiveness as a location for FDI was declining and that the Canadian economy was vulnerable to capital flight, as Canadian firms became more globalized and drawn, in particular, to the United States. Decision-makers within the Canadian state had come to accept that the deterrent effect of investment screening was real and had become too costly in a globalized international economy.¹⁵⁷ An intrastate consensus emerged that Canada could no longer afford FIRA.

The figures on FDI inflows and outflows were frequently cited as evidence of Canada's decline as a desirable investment location. According to Sinclair Stevens, the minister responsible for FIRA, FDI flows indicated that foreign investors perceived "that Canada is not the most desirable place to be investing." According to Stevens:

when you have a net exodus of capital from this country it is time to say maybe we have been doing something wrong; it is time to be a little more positive; it is time to try to attract non-Canadian investment as opposed to driving it away.¹⁵⁸

When introducing the Investment Canada legislation in the fall of 1984, he presented IMF figures showing the decline in Canada's share of FDI in the 1970-81 period as well as data

from a Conference Board study, partly financed by the government and released to coincide with the legislation, which indicated that, for some investors, FIRA and the NEP were seen as deterrents to investing in Canada.¹⁵⁰

Yet the inflows had already been declining because of the recession in the early 1980s. My hypothesis would have suggested liberalization of Canada's investment regime well before 1984. What made change more likely than earlier was the new government and its determination to deregulate the economy and provide greater incentive for private investment.

Thus the new legislation on FDI also fit with the government's broader goals of decreasing state economic intervention and regulation and encouraging private sector investment, whether foreign or domestic in origin.¹⁶⁰ However, cabinet members perceived limits to deregulation of access. The major issue for the new Cabinet to decide was how to increase access in order to attract new investment, without seriously undermining the Canadian state's role in safeguarding sovereignty, defined in practical political terms as maintaining or increasing levels of Canadian ownership in the economy. Despite the inflated rhetoric of some members of the business community during the 1984 election, calling for complete liberalization of access, that option had never been on the policy agenda and was never proposed within Cabinet.¹⁶¹ There was a perception both within the state and among the more astute members of the business community that public

support for some form of state scrutiny of foreign investment, especially acquisitions, was still strong. As the Conference Board head put it:

It is not clear that a total abandonment of any mechanism to manage foreign investment is a feasible political option in Canada...There will remain a strong body of public opinion encompassing many Canadian business people, which favour an active government pursuing "significant benefit" from foreign investment. Moreover, virtually all other Western democracies have reserved some form of state control over the foreign investment process for their government.¹⁸²

The same sentiment was repeated by Sinclair Stevens on December 7, 1984, when the government introduced the Investment Canada bill, C-15. "Industrialized countries", he claimed, "do not simply throw their door open and invite others to take over the components of their economic, cultural and political sovereignty."

Despite the reluctance to totally abandon screening, as Figure 4.4 indicates there were significant differences between FIRA and the new Investment Canada (IC).

Figure 4.4

Comparison of FIR Act and Investment Canada Bill

Key Features	Existing FIR Act	Investment Canada Bill
Purpose	Level of foreign control a matter of national concern	Investment by Canadians and non-Canadians presumed to be of benefit to Canada
Scope of Review • New Businesses • Direct Acquisitions • Indirect Acquisitions	All All All	Not reviewed Reviewed if \$5M or more Reviewed if \$50M or more, or \$5M or more if Canadian subsidiary is more than 50% of total transaction
Scope of Notification	No separate provision as all investment reviewed	All new businesses and acquisitions below thresholds indicated above
Reserve Power to Review	None required	Any investment regardless of size in prescribed culturally sensitive sectors
Benefit Test	Significant benefit to Canada	Net benefit to Canada
Assessment Factors	Impact on: • economic activity • Canadian participation • efficiency and technology • competition • compatibility with federal and provincial economic and industrial policies	Impact on: • economic activity • Canadian participation • efficiency and technology • competition • compatibility with federal and provincial economic and industrial policies • compatibility with cultural policy • international competitiveness
Review Process • Consultation with • Cabinet • Decision by • Time frame	• Provinces affected • Departments affected In sensitive cases Governor in Council 60 days with unlimited extension by Government	• Provinces affected • Departments affected In sensitive cases Minister 45 days with extension beyond 75 days only with agreement of investor
Definition of Foreign Investor	Complex rules based on control-in-fact with presumptions biased against investor. No incentive for investors to Canadianize.	Simpler rules which take account of extent of Canadian ownership and employing more balanced presumptions. Modest incentive for investors to Canadianize.
Penalties	Criminal penalties	Civil penalties except for breach of confidentiality
Positive Role	None	Specific mandate to: • encourage investment for growth • provide information services • advise on opportunities and contacts

Source: Government of Canada, Expenditure Plan, 1985-86, Part III.

Most of the changes which were embodied in the legislation reflected the many recommendations from groups such as the Canadian Bar Association (1981) and the BCNI

(1983-84¹⁸³) and sought to address the supposed deterrent effect of FIRA¹⁸⁴. The legislation did not, however, go as far as many of these group advocated in the liberalization of access. Appendix C outlines the view of those groups which appeared before the House of Commons committee dealing with the legislation in early 1985. The contrast to the FIRA legislation of 1973 is apparent, particularly in the extent of consensus among business. The major business associations, which included both Canadian and foreign-based corporations, large and small, welcomed the legislation. They objected, however, to two provisions, the requirement that IC be notified of all new investments even those not reviewable, and the lack of a specific definition of "cultural identity and national heritage" investments which were reviewable on a discretionary basis, arguing that these provisions added to investor uncertainty. According to IC officials the intent of the first was to permit monitoring of inflows to assist in measuring the impact of economic policy changes on investor confidence. Monitoring was also important to members of cabinet who felt that many Canadians continued to be concerned about FDI and expected elected leaders to be closely monitoring foreign ownership levels.

The changes embodied in Investment Canada do not totally reflect the agenda of international capital, or those of large Canadian firms as articulated by sophisticated lobby groups such as the BCNI. The investment promotion program of IC and

the emphasis on investment climate are evidence of the strength of the view that Canada was now perceived to be an unattractive investment location. At the same time the continuation of a screening program for large acquisitions (the bulk of incoming investment by the mid 1980s) indicates that the large presence of foreign capital and the public concern it generated¹⁸⁵ made complete liberalization of investment policy unlikely. The Canadian state has continued to recognize that there is an interstate struggle over the benefits of investment in which it cannot be entirely neutral.¹⁸⁶

While retaining the central instrument of access-screening, the changes narrowed its scope to cover only larger direct and indirect acquisitions¹⁸⁷. New investment was exempted from screening except where it involved "cultural heritage and national identity"¹⁸⁸ which could be reviewed at the discretion of the minister. The significant benefit test was softened to one of net benefit and the criteria listed in the Foreign Investment Review Act used to determine benefit were retained, but a sixth dealing with "the ability of the investment to contribute to Canada's ability to compete in international markets was added."¹⁸⁹ The changes were expected to reduce the number of cases by 90 per cent, although in terms of assets, by only one third.

By far the most significant change, however, was the addition of a new function for the agency in promoting Canada

as an attractive location for new investment. It is outlined in the second section of the act. The new mandate included:

1. Encouraging new investment
2. Assisting Canadian business to exploit new opportunities for investment and technological advances
3. Carrying out research and analysis on international and domestic issues;
4. Providing investment information and other services to facilitate economic growth; and
5. Assisting in the development of industrial and economic policies.¹⁷⁰

The government claimed that the changes would "herald a new day for Canada. Investment Canada with its new mandate and new approach will help pull Canada out of its shell and will reinvigorate this country with a flow of goods, capital, technology and ideas." Most important the legislation would "send a message to the world that once again, Canada welcomes investment."¹⁷¹

While the investment promotion function had been carried out previously in a limited way by FIRA itself and the departments of Industry, Trade and Commerce and External Affairs, it had never been enunciated in legislation or accorded the priority and the resources now envisaged.¹⁷² Nor had FIRA ever been expected to act as domestic policy advisor and advocate of business investors within the government on how to stimulate more investment. The emphasis on investment attraction and the promotion of Canada as an investment location was based on the premise that inflows of new capital and technology would automatically have a positive impact.

Many of the other administrative reforms that had been

advocated by FIRA critics in the corporate community, as well as within the state itself, were incorporated into the new legislation, shortening the time for processing cases and significantly raising the threshold, particularly for indirect acquisitions. The latter, as the minister indicated, had been most troublesome in relations with foreign investors and their home governments, especially the United States. Yet they formed a major portion of acquisitions, in assets terms, and could not be easily ignored. Raising the threshold was one way respond to critic's concerns while retaining the right to scrutinize major acquisitions.¹⁷³

Sectoral Measures - Culture and Energy

Despite liberalization of access two sectors, culture and energy, remained subject to greater control and reflected the tension between investment promotion and the state's role in protecting sovereignty. Shortly after the proclamation of the Investment Canada Act a policy on publishing was announced which required joint ventures in the case of new foreign investment and divestment in the case of direct or indirect acquisitions. Departments such as Regional Industrial Expansion and External Affairs, the main articulators of the "screening as deterrent" argument in Cabinet, opposed the new policy arguing that it would send confusing signals to foreign investors and cause further conflicts with the United States.¹⁷⁴ Of particular concern was the case of the indirect

acquisition of Prentice-Hall by a U.S. firm. The publishing policy announcement unfortunately, in their view, coincided with the launching of the major investment promotion campaign of IC in Europe and the U.S. which involved glossy advertising, investment missions and major conferences, as well as the posting of former businesspeople to Canadian posts abroad as investment promoters. Nonetheless the publishing policy went forward.

A similar disagreement developed over the limits of deregulation in the energy sector later in October, 1985 as oil prices continued to soften. After a series of large-scale takeovers by foreign-based petroleum companies, the government enunciated its policy regarding Canadianization in the petroleum sector. The new policy was to involve non-discriminatory and significantly less interventionist and coercive policy instruments.¹⁷⁵ It replaced discriminatory PIP grants with non-discriminatory tax credits, and pledged to remove the Crown Share or "back-in" of 25 per cent. It retained the 50 per cent Canadian ownership requirements for frontier production, but eliminated the coercive and retroactive elements and ended special treatment for Petro-Canada, requiring it to "compete in the marketplace like other companies."¹⁷⁶ The changes significantly altered the FDI regime for energy in the direction of less coercive and interventionist policy instruments. However, the government did not renounce the goal of increased Canadian ownership of

the industry which the NEP had articulated.

A second policy announcement regarding the energy sector followed in December. As a result of the drop in world oil prices, the financial difficulties of Canadian oil companies and the opportunity presented for foreign firms to acquire new reserves cheaply through acquisitions generated fears that levels of foreign ownership would rise sharply in the petroleum sector with little attendant benefit unless the state intervened. Canadian ownership goals, which had been a politically popular aspect of the NEP, and had been never disavowed by the Conservatives, came into conflict with the desire to reassure foreign investors and maintain good relations with producing provinces, especially Alberta, which opposed energy investment controls.

The Cabinet decided to elaborate special guidelines for petroleum companies, emphasizing increased Canadian ownership requirements for indirect acquisitions, and approval of direct acquisitions only in the case of companies in "demonstrable financial difficulty." Alberta officials, and Canadian companies wishing to sell to the highest bidder, along with federal officials concerned about investment promotion, expressed concern about the policy to both officials and the Minister of Energy. While the policy was retained it was implemented in a way that was low-key and involved little coercion of investors through negotiations with foreign petroleum companies.¹⁷⁷

As Appendix A indicates the 1986/87 period also saw the development of a program of privatization of state corporations reflecting the desire to reconfigure the state's role and limit direct intervention through the vehicle of state enterprises, even in cases where the ultimate purchaser of the enterprise was foreign, as in the case of De Havilland. Yet in many instances the state placed restrictions on foreign share ownership in the privatization process, a form of restricted access for foreign investors¹⁷⁸.

Conclusion

The 1982-85 period does conform to our expectation that weaker inflows, stronger outflows and the perception that Canada's attractiveness as an investment location was declining would result in liberalization of access and less coercion of investors. However, liberalization of access was limited, largely for new investment and was accompanied by investment promotion. Acquisitions remained subject to regulation and special measures for energy and culture were developed. In both cases these resulted from compromises within the state on the extent of deregulation of the FDI regime which is compatible with the state's role in maintaining Canadian sovereignty.

Further changes to Canada's investment regime, especially the liberalization measures for acquisitions, both direct and indirect, and other restrictions on the imposition of performance requirements resulted from the negotiation of the

1987 Free Trade Agreement with the United States and are also listed in Appendix A. Since this set of changes was tied specifically to those negotiations, it is discussed in Chapter Five.

Explaining FDI Regime Change

Our analysis of the two key turning points in Canada's FDI regime, 1967-75 and 1980-85 has provided partial support for our initial hypothesis about the relationship between investment relations and FDI regime change. The hypothesis was that strong investment inflows and rising levels of foreign control would result in the adoption of policy instruments which both controlled access and discriminated against EFCs. Conversely declining inflows and rising outflows would result in a liberalization of access controls and the abandonment of discriminatory policy instruments. These changes were seen to be a function of the perceived bargaining power of the state vis-à-vis foreign investors. While overall the changes were in the direction expected our inventory indicated two unexpected outcomes. The first was the relatively infrequent use of discriminatory measures, especially in the manufacturing sector, most of which involved little or no coercion of investors. In contrast the energy sector saw, overall, more use of coercive and intrusive policy instruments, and an increased use of discriminatory instruments especially in the 1980-82 period.

Our analysis has also indicated the importance of the

nature of the intrastate consensus on the role of the state in the economy and the level of coercion of investors that is feasible or acceptable. This clearly shaped both the nature of the access policy instruments adopted and the reluctance to use discriminatory measures in the manufacturing sector.

The analysis of the 1967-75 period does indicate the important role that strong FDI inflows (especially acquisitions) and high levels of foreign control played in both pressuring the state to act to manage FDI and shaping the choice of policy instruments. Strong inflows created a perception that Canada's attractiveness as an investment location provided sufficient bargaining power over incoming investors to make the use of regulation of access feasible and likely to result in increased economic benefits for Canada. Having said that, however, it is clear that divisions within the state, among departments and reflected in Cabinet over the limits of coercion of investors remained and resulted in initially only limited control of acquisitions. The broadening of the coverage of screening to include new investment in 1973, which had been a recommendation of the Gray Report, was a function of the need for NDP support in the House, as well as divisions within the Liberal caucus itself. However, coverage was not expanded to include EFCs in any major way. Given the major role of EFCs in the economy and as a source of new investment the failure to use discriminatory measures to influence their performance is surprising and not

expected. In the case of EFCs the use of discriminatory policy instruments was largely excluded at an early stage of the decision process, because it was seen to involve an unacceptably high level of state intervention, which would severely damage investor confidence. Instead, the presence of EFCs was to be addressed in a dual manner. First, Canadian state and mixed enterprises in key sectors were created in energy, telecommunications and manufacturing which would compete with foreign firms, support Canadian firms and, for a limited period, act as vehicles of selective repatriation. Second, a series of non-discriminatory expenditure instruments were used, especially in the manufacturing sector, along with suasion. Only in energy and culture was discriminatory regulation used to limit the influence of foreign-based capital.

The origins of FIRA have been the subject of much analysis of Canada's policy on FDI. Many of the studies have seen its origins in the nature of classes in Canada. Clement and Layton¹⁷⁹ have argued that a capitalist class, dominated by foreign firms and their Canadian allies has been able to ensure that control of FDI remains weak, and that FIRA served a primarily symbolic function, appearing to preserve sovereignty while not impeding capital flows. However such an explanation, while it appears to account for the rather limited use of discriminatory policy instruments in manufacturing, cannot account for later developments in the

energy sector. By failing to disaggregate FDI policy in terms of the various instruments employed analysts tend to miss the changing mix of instruments across sectors and over time.

In addition there have been attempts to see FIRA as a simple response to rising public concern about foreign ownership in the late 1960s and the increased importance of what is often termed a new middle class in Canada,¹⁸⁰ tied to the postwar expansion of the state and para-state sector. Again, the problem for analysts is to explain why screening was chosen, as opposed to other policy instruments and why there was variation both over time and within sectors in the types of policy instruments employed.

A focus on external investment linkages, their change over time, and the nature of the consensus within the state on its role in the economy, particularly on the appropriate extent of coercion and intervention, along with a detailed analysis of the policy instruments used to control FDI, provides a more complete picture of why screening, and compensation emerged as the primary instruments, especially in the manufacturing sector in the 1970s.

The second period, 1980-85, also provides evidence of the importance of both investment relations and ideas about the role of the state in explaining changes to Canada's FDI regime. Again, however, the changes do not fully conform to our expectations either in the timing or in the extent of liberalization of Canada's FDI regime which resulted¹⁸¹.

Despite stagnating inflows, a drop in Canada's share of world FDI flows and soaring outflows of capital, the 1980-82 period sees proposals to alter the FDI regime in the direction of more discriminatory regulation which, in the case of manufacturing, are defeated within the Cabinet and, in the case of energy, are implemented. In both cases the opposition to these policies on the part of business groups, the provinces, foreign investors and the U.S. government was strong. The difference, in the two cases, lies in differing perceptions of the state's bargaining power as interpreted by Cabinet. While the proposals in manufacturing grew out of a frustration with the failure of compensatory instruments to alter the performance of EFCs, the weak economy, the resulting weak investment inflows and complaints about FIRA delays resulted in a consensus in Cabinet that Canada could not afford the potential economic cost of new discriminatory policies and their impact on investment. FIRA procedures must also send a more welcoming message to investors. In contrast, in energy a small group of officials and ministers, buoyed by soaring world oil prices, and concerned about federal government revenues and capital outflows in the windfall profits of foreign oil companies, articulate and implement an energy policy employing a broad range of coercive, discriminatory measures. These policies, however, are ultimately undermined by the softening of world oil prices.

The 1984 election of a new government resulted in proposals to significantly alter both FIRA and the NEP as part of a broader effort to limit the role of the state in the economy and stimulate new, private investment. In both cases, however, the state did not move to complete liberalization of access, despite the strong consensus within the state that Canada has become an unattractive location for FDI and must now actively compete to attract and retain new investment. In fact, there was a consensus within the state that complete liberalization was not preferable and that selected efforts must be made to restrict access in the interests of sovereignty. Thus the screening of acquisitions continued and special restrictions remained in both culture and energy, although the level of coercion decreased.

The argument that changing investment relations led to the liberalization of access is not new to this dissertation. Globerman, for example, and Jenkins¹⁸² see this as a fairly automatic response to falling capital inflows, rising outflows, the globalization of production and the increased mobility of capital. Yet, as our analysis indicated, the question remains why liberalization was incomplete in the late 1980s and why sectoral differences persisted?

Clearly the evidence indicates that changing investment relations have shaped Canada's FDI regime but not in a direct, immediate way. The impact of changing investment relations were mediated by the nature of the consensus within the state

about the appropriate level of state intervention and investor coercion which was feasible or desirable. These ideas set limits both initially on the choice of policy instruments used to manage FDI in the 1970s and on the extent of liberalization of access in the 1980s.

Are these the only influences which shape the choice of policy instruments? I argued in Chapter One that they are not. In fact, the impact of broader international economic and political linkages, as the literature reviewed in Chapter Two suggested, must also be taken into account. Given Canada's increasing dependence on economic relations with the United States, particularly on market access in the 1980s, we would expect that the impact of FDI regime changes on those relations would play a role in accounting for shifts in Canada's foreign investment regime and the choice of policy instruments. It is to this question that we turn in the next chapter.

APPENDIX A

Inventory of Investment Policy Instruments 1957-87*

1. 1957 Canadian and British Insurance Companies Act- prompted by a series of foreign takeovers, legislation required majority of directors be Canadian citizens and provided new provisions for companies to mutualize
compensatory - regulation-sectoral
2. 1958 Broadcasting Act restricted non-resident ownership of companies to 25 per cent.
access-regulation-key sector
3. Dec, 1960 Budget repealed differential withholding tax on dividend income paid abroad which had been encouraging wholly owned subsidiaries. Constituted a removal of discriminatory tax expenditure designed to encourage FDI.
access-removal of tax incentive to FDI-general
4. June 20, 1961 Budget
Out of concern that subsidiaries have "excessive dependence on research done abroad" provided accelerated rate at which capital expended on research can be written off.
compensatory-tax expenditure-general
5. enhanced resources also provided to Industrial Development Bank to assist in "avoiding and preventing takeovers by non-resident especially of family firms."
compensatory-expenditure-general
6. July, 1961 Final revision of Territorial Land Act Regulations required companies seeking mining production leases have 50 per cent Canadian ownership or be required to register on a Canadian stock exchange.
compensatory-regulation-sector
7. April 1962 Budget in wake of concern regarding the ineffectiveness of previous tax measures provided expenditure on scientific research for industrial purposes in the form of matching grants for specific projects.
compensatory-expenditure (grants)-general
8. April, 1962 Bill C-38, Corporations and Labour Unions Returns Act to provide for the reporting of financial and other statistics relating to the affairs of corporations and labour unions to understand "the extent of foreign control of various units operating in the economy and the effects of that control."
(Previous bill C-70 introduced in 1961 had been discriminatory requiring only foreign-controlled entities to report)
compensatory-regulation-general

9. June 13, 1963 Budget proposals included:
 exemption for foreigners from withholding tax payable on
 interest from sale of Canadian bonds and debentures abroad
 (intended to promote portfolio as an alternative to foreign
 direct investment)

compensatory-tax expenditure-general

10. increased withholding tax rate on dividends for companies
 with less than 25 per cent Canadian ownership while lowering
 rate for those with more than 25 per cent Canadian ownership

discriminatory-tax expenditure-general

(takeover tax based on the view that they "rarely confer any
 benefit on the Canadian economy" at 30 per cent levied on the
 sales of Canadian controlled corporations to non-resident
 controlled corporations. Takeover tax withdrawn by Min. of
 Finance June 19, 1963 citing administrative difficulties)

11. 1964 Legislation on Insurance, Loans and Trust Companies
 Act put limits on non-resident ownership of shares to 10 per
 cent for individuals and 25 per as a group.

access-regulation-sector

12. April 12, 1965 introduction of changes to the Bank Act
 limited non-resident ownership of bank shares to 10 per cent
 for an individual and 25 per cent for non-residents as a group

access-regulation-sector

13. June 4, 1965 Announcement of a Program for the Advancement
 of Industry and Technology "to promote the growth of Canadian
 industry by the application of scientific and technological
 advances in the development of new products and processes of
 benefit to the national economy."

compensatory - expenditure - general

14. June, 1965 Amendment to the Income Tax Act which
 disallowed the deduction of costs of advertising for Canadian
 businesses in foreign-owned periodicals and newspapers except
 for Time and Readers'-Digest

discriminatory -taxation -sector

15. March 31, 1966 tabling of Guidelines for Good Corporate
 Behaviour for Subsidiaries in Canada by Industry Minister.
 Intended to convey "what is expected of subsidiary companies
 as regards their responsibility to the Canadian community".
 Concern that subsidiaries are open to external influences not
 always consistent with Canadian interests. (Concern re U.S.
 encouragement of repatriation of earnings for balance of
 payment reasons)

discriminatory - suasion -general

16. March 31, 1966 Establishment of Guidelines division in the Department of Industry to periodically survey performance of companies on a voluntary basis.

discriminatory - suasion -general

17. October, 1966 introduction of Regional Development Incentives Act to replace tax incentives of 1962 with grants. (Incentives not fully taken up and of little help to small companies).

compensatory-expenditures (grants)

18. November 1967, announced new policy and Broadcasting Act - limited issuance of new licenses and renewals to Canadian-controlled corporations

access-regulation -sectoral

19. Nov. 10, 1968 amendments to the Canadian Corporations Act Intended to increase information on foreign-based subsidiaries by requiring increased disclosure even for private corporations in Canada.

compensatory-regulation-general

20. Telesat Canada Act, 1969.

To create mixed public private corporation to undertake and develop satellite communications system and technology. Bill provided for limit on foreign shareholding to 10 per cent. Corporation in its sourcing was also expected to sponsor the development of indigenous Canadian technology.

compensatory-mixed enterprise-sectoral

21. March 2, 1970 Cabinet intervenes to stop foreign takeover of Denison Mines (uranium) and initiates development of Guidelines limiting foreign ownership of uranium mining.

access-regulation-sectoral

22. December 1970 Energy, Mines and Resources Guidelines on processing products in extractive industries and equity participation of foreign investors in newly established enterprises.

discriminatory-regulation-sectoral

23. January 25, 1971 First reading of Bill C-219 to create the Canada Development Corporation. Second reading Feb 22, 1971 (Had been in every previous throne speech since 1963. Purpose to create a public/private mixed corporation to:
1. Help develop and maintain strong Canadian-controlled and managed corporations in the private sector of the economy and
2. To give Canadians greater opportunities to invest and participate in the economic development of Canada.

compensatory-mixed enterprise-general

24. June 18, 1971 Budget

-changes to registered retirement pension plans to limit foreign investment to 10% of assets to "channel investment retirement funds into Canadian development"

discriminatory-regulation-general

25.-lower tax rate on small corporations with less than \$400,000 taxable income. "It will not be available to foreign owned corporations or their subsidiaries....to encourage Canadian ownership of expanding business." If corporation subsequently acquired by non-resident tax savings must be repaid.

discriminatory-regulation-limited scope

26. Increased dividend tax credit "to increase the incentive of ordinary Canadians to invest in Canadian corporations.

compensatory-tax expenditure-general

27. Allow Canadian corporations to deduct interest on money borrowed to buy shares in other corporations to give Canadian companies equal footing in takeover bids with U.S. corporations.

compensatory-tax expenditure-general

28. January-April 1971 minister in discussion with companies to prevent Ashland takeover of Home Oil.

discriminatory-suasion-sectoral

29. January 24, 1973 First reading Bill C-132 Foreign Investment Review Act to create a Foreign Investment Review Agency to review all new investment by non-residents, acquisitions by non-residents and investment in unrelated activities by EFCs. First phase on acquisitions proclaimed April 4, 1974.

access-regulation-screening-general (acquisitions)

30. 1974 Act to amend Canadian Corporations Act requiring Canadians on boards for federally-incorporated companies.

compensatory-regulation-general

31. June 3, 1974 DITC Minister Gillespie announces government purchase of de Havilland from British owned Hawker-Siddeley and the intention of the government to acquire a purchase option on Canadair (subsequently purchased in 1976). Minister claimed that the corporate development of these firms is hindered because of foreign ownership and the government is acting with a view to restructure and develop a strong aerospace industry held by private Canadian interests.

compensatory-state enterprise-sectoral

32. March 12, 1975 Bill C-8 Petro-Canada Act to establish a national petroleum company under full state control with with

broad powers. Minister claims that national interest requires a significant degree of federal public enterprise to enhance energy security, engage in state-to-state oil deals and to broaden Canadian ownership in the sector.

compensatory-state enterprise-sectoral

33. April 19, 1975 First reading of Bill C-58 Amendment to the Income Tax Act to eliminate exemption of Readers' Digest and Time from provisions of the Income Tax Act disallowing deductions for tax purposes of advertising expenses incurred in non-resident owned periodicals aimed at the Canadian market. Extended these provisions to Canadian advertising in non-resident owned (ie. border) broadcasting stations.

discriminatory-regulation-sectoral

34. July 18, 1975 Announcement of the decision to proclaim Phase II of the Foreign Investment Review Act on October 15, 1975

to cover new investment and that of EFC's into new unrelated activities.

**access/discriminatory-regulation-screening-general
(new investment and EFC unrelated investment)**

35. Minister of ITand C also tabled Principles of International Business Conduct to update and replace Guidelines of 1966 regarding the responsibilities and activities of foreign-owned enterprises in Canada.

discriminatory-suasion-general

36. September, 1975 Minister of Indian and Northern Development to resource developers re government objective to increase local sourcing, especially goods and services with substantial level of technology and to increased participation of Canadian-owned firms in projects.

-Established Advisory Committee on Industrial Benefits from Natural Resource Developments on Canada Land.(interdepartmental and intergovernmental)

compensatory-suasion-sectoral

37. May 19, 1976 New Regulations for Canada Oil and Gas Lands contain measures to increase Canadian participation and content. -Minister empowered to require a 25 % minimum level of Canadian ownership in producible properties

access/discriminatory- regulation-sectoral

38.-use of Canadian goods and services as a" requirement for granting special renewals for permits; as a provision of new exploration agreements and work permits".

compensatory-regulation-sectoral

39. August, 1976 Petro-Canada purchases Atlantic Richfield Canada

**compensatory-state enterprise/expenditure to
repatriate-sectoral**

40. March 11, 1977 Announcement of a new small business, streamlined procedure for FIRA.

access-deregulation-limited scope

41. April 10, 1978 budget introduces special tax deduction of 50% of capital expenditure for research and development

compensatory-tax expenditure-general

42. June, 1978 Announcement of special measures to support research and development in Canada including increased use of procurement and contracting out.

compensatory-expenditure-general

43. December, 1978 Establishment of a Major Projects Task Force-business and labour. Terms of Reference to include establishment of an inventory of major projects and to recommend policies to increase benefits to Canadian industries and regions from projects, including increasing the participation of Canadian-owned firms and subsidiaries that have established core operations in Canada.

compensatory-suasion-sectoral

44. 1978-79 Petro-Canada acquires Pacific Petroleum.

**compensatory-state enterprise/expenditure-
repatriate- sectoral**

45. 1980 Revision of the Bank Act permits operation of foreign banks but limits their activities and maintains ownership restriction re chartered banks. Expects act to result in the reciprocal opening of other markets to Canadian banks.

access-deregulation-sectoral

October 28, 1980 Budget outlines the National Energy Program. One of the three major goals of the program was "to provide Canadians with an opportunity to participate in the energy sector, petroleum in particular, and share in the benefits of its expansion. Specific objectives included at least 50 % Canadian ownership by 1990 through the increased share of the oil and gas sector owned by the government of Canada and the acquisition of foreign-controlled firms. Specific measures and legislation included the following (46-50).

46. Establishment of system of incentive grants through Petroleum Incentives Program (Bill C-104, April 9, 1982) which required 50 per cent Canadian ownership to qualify and

increased with the level of Canadian ownership. Called Canadianization bill by the Minister was intended to ensure that benefits went to Canadian controlled companies, Canadian investors and foreign-based companies willing to Canadianize.

discriminatory- expenditure through conditional grants-sectoral

47. Monitoring of the oil and gas sector through changes to the Petroleum Monitoring Agency. Energy Monitoring Act, Bill C-106, April 19, 1982. Report on productivity, profits, research and development, reinvestment and levels of foreign ownership through the mandatory survey of companies both Canadian and foreign-based. Information used to determine a Canadian ownership rating for companies.

compensatory-suasion-sectoral

48. Expansion of Petro-Canada and increased Canadian ownership of the sector through state acquisitions. Bill C-103 April 7, 1982 established Canadian ownership account to use consumption tax revenues on oil and gas to finance the acquisition of several large foreign-owned companies.

Petro-Fina purchased by Petro-Canada in Feb. 1981.

compensatory-expenditure-repatriate-sectoral

49. Canada Oil and Gas Lands amendments provide for 25 per cent back in for the crown in all production on Canada Lands and 50 per cent Canadian ownership requirement at the production stage.

access/compensatory- regulation/state enterprise-sectoral

(Gas export regulations to give preferential treatment to Canadian firms. Never implemented)

50. Changes to FIRA to prevent foreign-owned petroleum companies expanding into unrelated areas of the economy and to prevent the use of their cash flows to buy already discovered oil and gas reserves.

access/discriminatory - regulation -sectoral

51. June 1981 Report of the Major Projects Task Force advocates the establishment of an independent Office of Regional Industrial Benefits and office is established in DRIE.

compensatory-regulation-sectoral

52. June 28, 1982 Budget announces changes to FIRA operations -"procedures must be timely and efficient and avoid extended delays"

-threshold for review of new investments under the small business procedure to be raised to \$5 million (assets) and 200

employees, for indirect acquisitions it will be \$15 million and 800 for indirect. Small business cases no longer subject to full review except in very exceptional circumstances.

access-regulation-general

53. April, 1983 budget contains further measures to increase scientific investment tax credit by allowing transfer of incentive in the form of 50% tax credit to investors.

compensatory-tax expenditure-general

54. December 11, 1984 Bill C-15 Investment Canada Act to replace the Foreign Investment Review Agency with Investment Canada to perform two functions:

- screen only acquisitions above million in assets, and indirect acquisitions over \$50 million to assure net benefit to Canada.
- investment promotion. encourage new investment in Canada and provide investor services

access-deregulation-limited to new (non-cultural investments)

55. April, 1985 Western Accord eliminates PIP grants and replaces with non discriminatory tax incentives.

compensatory-tax expenditure-sectoral

56. July, 1985 Statement of Policy on foreign ownership and the book publishing industry. Calls for joint ventures only in new investment and divestment within two years for acquisitions.

access/discriminatory-regulation-sectoral

57. October, 1985 government announces changes to Canada Lands policy

- to eliminate 25 per cent crown interest
- retain 50 per cent ownership requirement but less coercive measures to allow foreign companies to achieve level or get fair market value for their interest.
- end special treatment of Petro-Canada and give it a mandate to operate in commercial way like private companies.

access-deregulation-sectoral

58. December, 1985 Cabinet decides on policy regarding foreign acquisitions

- for direct acquisition of Canadian companies with producing reserves
- only permitted if in demonstrable financial difficulty
- for indirect, acquirer will be required to increase levels of Canadian ownership (through share issues) and increase investment.

access-regulation- screening (acquisitions)-sectoral

59. Jan, 1986-Sale of de Havilland to Boeing Corporation of

Seattle

**deregulates access-privatization of state
enterprise**

60. Dec, 1986 Sale of Canadair to Bombardier
privatization

61. Oct, 1987 Sale of Governments remaining share of CDC
privatization

October, 1987 Canada-U.S. Free Trade Agreement

62. Article 1607- raised threshold for reviewable acquisitions
by U.S. investors over four years increasing from 5\$million to
150\$ million

phased out all reviews of U.S. indirect acquisitions by 1992.

(Annex 1607.3 excludes the oil and gas, uranium and
cultural industries from Article 1607)

**access-deregulation-general (except energy, uranium and
cultural industries)**

63. Article 1602.2- Canada is prohibited from imposing
increased equity as a condition of approval for acquisitions
Article 1603.2- prohibits performance requirements relating
to exports, imports and local content.

access-deregulation-general

64. Article 1605- expropriation of EFCs is limited. Canada
must provide prompt, adequate and effective compensation in
cases of forced divestiture.

limits discriminatory/coercive use of state regulation

65. Article 1703 give U.S. firms access to invest in financial
services exempting U.S.-based financial institutions from
provisions of the Bank Act limiting foreign investment to 16
per cent of bank assets.

access-deregulate-sectoral

*This inventory does not include the numerous effort to
encourage companies to export, beginning in the early 1970s
with the creation of the Export Development Corporation and
various grants and tax expenditures to assist companies in
developing export market. While foreign ownership did raise
concern among ITC officials (see Glen Williams, Not For
Export) in the 1950s and 60s, in terms of subsidiaries'
disinterest in foreign markets it was never explicitly
identified as a reason for the programs. This is in contrast
to the case of research and development where foreign
ownership was repeatedly cited by official and cabinet
ministers as inhibiting R and D in Canada.

APPENDIX B

Policy Proposals Regarding Changes to the Foreign Investment Regime

Royal Commission on Canada's Economic Prospects- established in 1956. Final report, 1957 argued that levels of foreign ownership and control gave non-residents a large measure of influence over the Canadian economy. According to the report, decisions of foreign-based firms in areas such as exports, sourcing, pricing of inputs, and research and development, might not be made in the best interests of Canada.

The report proposed cautious solutions to the problems, all of them centered around measures to increase the level of private Canadian ownership in the economy, on the assumption that this would ensure that corporate decisions made would be in Canada's best interests. Recommendations were based on the view that foreign investment had been beneficial to Canada and new inflows would continue to be required. It was important, therefore, to preserve Canada's reputation as an attractive location for investment.

Three broad policy goals were outlined in the report. These included: shifting the balance of foreign capital in Canada toward portfolio rather than direct investment; increasing the extent of Canadian ownership and control in manufacturing and resource industries and ensuring Canadian control of the banks and financial institutions. The specific policy instruments to be used to attain these goals involved a mixture of regulation, conditioned-incentives and suasion. In the case of increased disclosure of the financial statements and operations of subsidiaries and the employment of Canadians in senior positions, the emphasis was heavily on suasion. For financial institutions key-sector regulations were favoured limiting foreign ownership. To increase Canadian ownership of equity, and encourage more portfolio investment and Canadian representation on boards, the commission recommended state use of discriminatory tax measures. These included charging a higher rate of withholding tax on dividends paid to non-residents, unless there was a minimum level of Canadian ownership (25 per cent), and making access to various tax incentives conditional on the company's level of Canadian ownership. A minimum level of coercion and state intervention was clearly posited. According to the report:

What is needed to begin with is to create a kind of climate, including an emphasis in the taxing statutes and in official attitudes which would encourage the changes which we contemplate. There should be no compulsion and we would not expect the companies concerned to act with undue speed.¹⁸³

The report expected no negative impact of such a policy on capital in flows, but warned that the public concern over foreign direct investment would not go away and the failure to act would lead to ultimately greater pressure and "create demands for action of an extreme nature."¹⁸⁴ Recommendations were never proceeded with as government defeated at the polls shortly after release of the preliminary report.

April, 1965 Throne Speech and resolution of April 26, 1965 appended to budget outlines proposal for a CDC to provide, "through savings of Canadians a supplementary source of financing for initiation or expansion of larger enterprise in Canada and for facilitating, in the case of offers to purchase or sell shares of such enterprises, the acquisition of such shares by residents rather than by non-residents." Not proceeded with.

Watkins Report was released Feb. 15, 1968.

Recommendations included:

1. creation of agency to coordinate policy on FDI and increase monitoring and disclosure of financial performance of MNCs, screen licensing agreements, promote exports and promote international cooperation re MNCs.
 2. measures to increase efficiency of companies including stronger competition laws and lower tariffs.
 3. create CDC.
 4. create state export agency to block extraterritorial export restrictions.
 5. Incentives to increase Canadian ownership
- Recommendations and report not acted upon by government of the day which claimed it did not represent government views.

July 1970 Report of House of Commons Standing Committee on External Affairs and National Defence to examine issue of foreign ownership and control. It recommended requirement of 51 per cent ownership of subsidiaries.

May 2, 1972 Report on Foreign Direct Investment in Canada (Gray Report) tabled in the House of Commons (contents leaked in November 1971 and published in Canadian Forum) along with Bill C-201 Foreign Takeovers Act.

-Report recommended:

Separate screening agency to cover:
new investment, takeovers and expansion of EFCs of significant size

-Act provided for review of proposals to ensure significant benefit to Canada through negotiations with acquirer. Agency to be part of DITC

Based on view that "Takeovers are the form of investment least likely to add significant benefit to the Canadian economy."

Act never passed (election).

1976 Policy statement An Energy Strategy for Canada calls for increased Canadian ownership.

September 5, 1979 appointment of task force to examine privatization of Petro-Canada. Recommendations never enacted.

October, 1979 Throne Speech mentions new policies on foreign ownership and FIRA.

November, 1979 Minister of Industry establishes a Parliamentary Committee to review the operations of FIRA (Government defeated and review did not take place).

October 1980 Speech From the Throne promised changes to the Foreign Investment Review Agency to include:

- Publication of major acquisitions prior to government decision
- Performance review of major EFCs
- Financial aid to Canadian companies seeking to repatriate assets or bid for companies that are targets of a foreign takeover.
- use of procurement to favour Canadian-owned firms.

Appendix C

Position of Interest Groups on Foreign
Investment Legislation

Bill C-201

Bill C-132

Atlantic
Provinces
Economic
Council

Concerned that investment review might inhibit investment in the Maritimes which are in need of capital. Bill is clearly the least govt can do given political pressure.

Fear that economic nationalism will solidify the regional economy. Government must take regional development needs into account

Chamber of
Commerce

Need national goals enunciated first especially if the criteria of assessment are to avoid being subjective. Change significant benefit test to no detriment. Threshold for the definition of a non-eligible person or company is too low for publicly traded corporations as is the definition of control for acquisitions.

Need an articulation of government priorities in an industrial strategy.

Survey of members shows they do not see foreign ownership requiring govt action.

Bill should not proceed. Foreign companies will be stifled in Canada. There will be lower inflows of new FDI as a result of the bill.

Toronto
Exchange

Stock

Threshold for non-eligible person or company and acquisition are too low, risks discouraging portfolio investment

Need more precision and clarification of definitions contained in the bill.

Support the principle of screening. Canada can now be more selective on FDI. Our capital markets have developed.

Some concerns over low thresholds for non eligible and control, might inhibit portfolio investment.

Investment
Dealers
Association

Too narrow a definition of non-eligibility
too narrow a definition of acquisition of control
inhibits the operation of capital markets.

Committee for
an Independent
Canada

Review will
not discourage incoming FDI.
Scope of the bill is too
narrow must cover new
investment and review the
expansion and performance of
EFCs
Need positive incentives to
increase Canadian investment
in Canada
Need senior official and a
separate agency to administer
the screening function.

Support bill with some
misgivings. Only a small
improvement over C-201
Need to have a detailed
review of EFCs.
Phase II of the legislation
should be proclaimed
immediately.
Need positive measures to
increase Canadian ownership

Canadian
Bankers
Association

Support principle of the bill
but the threshold for the
definition of non-eligible
person is too low.

Canadian
Congress Labour

Bill does not deal seriously
with foreign ownership and
control of the economy
Need to screen more broadly
for new FDI as well as
expansion of EFCs
Need a national industrial
policy
Should have separate agency
to administer the review
process and make
recommendations public. It
should also required
increased disclosure on the
part of EFCs.

Consider this bill to be an
improvement. But does not
deal adequately with extra-
territoriality.
Agencies reviews and reasons
for decisions should be made
public. This bill should not
hurt inflows which should
continue.

Independent
Petroleum
Association

Prefer to see positive
measures instead of screening
such as tax incentives to
encourage Canadian investment
Need a continuing inflow of
risk capital.
Threshold for non-eligible
persons is too low,
threshold for review of cases
in the energy sector is also
too low.

Positive policies are
preferable to restrictions
Threshold for non-eligible
definition should be raised.
US investors are now
apprehensive of the climate
in Canada.

Canadian
Manufacturers
Association

Benefits of FDI are far greater than costs. Support limited review of takeovers.

Provinces will resist any restrictions on capital inflows.

Criteria for significant benefit should include "availability of a market for the sale of the enterprise in Canada.

Threshold for cases is too low. Thresholds for

definition of non-eligible and control are too low.

Change significant benefit test to no detriment

Support the principle of screening but do not act to inhibit the flow of FDI.

Use a no detriment test for significant benefit especially for the unrelated expansion of EFCs or else it will hurt inflows.

Issue draft regulations to reduce investor uncertainty

Add marketability of sale in Canada to the criteria for significant benefit for acquisitions.

Increase threshold especially for new investment cases.

Canadian Bar
Association

rights of vendor and marketability of firms needs to be taken into account when assessing benefit.

Coverage of indirect acquisition raises question of extraterritoriality

Need to have a right of appeal.

Canadian Mining
Association

Business community will see this bill as a disincentive to invest.

Bill is negatively oriented.

Need more positive measures to encourage investment by Canadians.

Change test to no detriment.

Thresholds for definition of non-eligible person and control are too low.

4

PM-1 3½"x4" PHOTOGRAPHIC MICROCOPY TARGET
NBS 1010a ANSI/ISO #2 EQUIVALENT

PRECISIONSM RESOLUTION TARGETS

Interest Group Positions on Bill C-15, the Investment Canada Act.

Conference Board of
of Canada

Foreign direct investment is becoming scarce internationally and there is increased international competition to attract it.

Several aspects of FIRAs operations inhibited investors including delays, secrecy. process was seen as very arbitrary.

Changing the agency, on its own will not lead automatically to increased investment inflows.

Business Council on
National Issues

"Positive and enthusiastic" about Investment Canada, especially its investment promotion role.
-cultural identity and national heritage should be specifically defined
-eliminate the requirements that new investments must be registered with the agency. This creates suspicion and uncertainty for investors.
-Canadians had increasingly invested outside Canada because they lost confidence in Canada.

Canadian Chamber of
Commerce

Bill is a positive step to restore investor confidence
-we are uneasy and oppose the registration/notification requirement for new investment. The purpose of it is unclear.
-more limited definition for cultural identity and national heritage is required
-threshold for acquisitions is too low.

Canadian Bar Association We support the bill. It is a constructive and realistic approach to FDI. It incorporates many of our recommendations from 1981. Concerned that cultural identity and national heritage must be more specifically defined. Need to deal with third party interventions regarding acquisitions in the statute. We are concerned about the ability for the minister to authorize

publication of undertakings. Need to have positive measures, retain, for example, the Scientific Research Tax Credit, but control abuses.

Canada-US Chamber of
Commerce

Bill is a constructive step in promoting investor confidence. The \$5 million threshold for an acquisition is too low and should be raised. Cultural identity and national heritage need to be more specifically defined.

Executive Committee of
Schedule B (foreign)
Banks

- supports the bill
- should eliminate review of indirect acquisitions altogether
- definition of cultural and national identity

Blair, CEO Nova Corp

- absence of positive measures in the bill to encourage increased Canadian ownership
- state should use regulatory powers and suasion in resource projects to overcome the sourcing biases in procurement policies of EFCs but use minimal state coercion.

Science Council

Supports the liberalization of policy regarding new investment, the era of branch plants establishing behind tariff walls is over.

- limits should be imposed on acquisitions of smaller Canadian companies which had received federal money for research and development. These should be subject to screening
- state should keep the door to FDI open but use conditioned procurement, tax incentives to favour EFCs with world product mandates. Try to encourage better performance regarding research and development. Bargaining is a good idea
- problem with FIRA was that its process was arbitrary and too opaque for investors, made them unsure.

Canadian Federation
of Labour

Opposed to the bill
Provides no way to influence behaviour of foreign-owned subsidiaries, especially the blocking of exports by the parent

1. There are clearly a number of other economic policy instruments where FDI management may have been an implicit or ancillary goal even if it was never articulated as the primary purpose for the adoption of a particular policy instrument. Our inventory is confined to measures where the management of FDI was one of the goals explicitly articulated. As such our inventory may understate the number of measures used to control FDI especially in the case of compensatory instruments.

2. Ultimately almost any macroeconomic policy could be considered compensatory. Indeed reducing tariffs and strengthening competition policy have figured in many discussions of Canada's foreign investment regime. Our analysis, however, will be confined to more targeted policy instruments which seek to influence a particular problem of behaviour associated with the foreign subsidiaries and with high levels of foreign ownership and control in the Canadian economy.

3. Nicolas Baxter-Moore, "Policy Implementation and the Role of the State: A Revised Approach to the Study of Policy Instruments," in Robert Jackson, Doreen Jackson and Nicolas Baxter-Moore (eds.) Contemporary Canadian Politics: Reading and Notes (Toronto: Prentice-Hall, 1987), 336-355.

4. See for example, Glen Williams' discussion of internal memos of Industry, Trade and Commerce in Not for Export, op cit. (chapter 6) as well as many of the studies of the Science Council throughout the 1970s.

5. These are repeatedly addressed in the Report of the Royal Commission on Canada's Economic Prospects (Ottawa: November, 1957), 25, the Watkins report, Foreign Ownership and the Structure of Canadian Industry (1968) and the Gray Report, Foreign Direct Investment in Canada (Ottawa, 1975).

6. Both Claire Sjolander, Foreign Investment Policy-Making: The Canadian State in the Global Economy, Ph.D Dissertation, Carleton University, 1989 and Barbara Jenkins, The Paradox of Continental Production: National Investment Policies in North America, (Ithaca: Cornell University Press, 1992) have also linked the deregulation of control of access to changes in investment flows. Jenkins argues that weaker inflows resulted in an "immediate de facto liberalization under the Liberal government of 1983"(61). In fact, investment liberalization was underway somewhat earlier as we will later indicate. However, liberalization was not complete across sectors. Sjolander has argued that the change in investment inflows and the rise in outflows do reflect the declining attractiveness

of Canada as an investment location. The interpretation of this decline is however, filtered through changing class relations and the waning influence of the new middle class in central Canada.

7. G. Bruce Doern, "The Mega-Project Episode and the Formulation of Canadian Economic Development Policy, Canadian Public Administration, 26:2 (Summer, 1983), 220.

8. Eight in-depth interviews were conducted with officials from the Departments of Finance, External Affairs, Regional Industrial Expansion, and Investment Canada during the first week of October, 1985. In addition a number of documents were obtained under the auspices of the Access to Information Act.

9. Royal Commission, 1957, op cit., 25.

10. Ibid.

11. Canada, House of Commons, Debates, June 20, 1961, 6647.

12. Debates, Twenty-Sixth Parliament, First Session, Volume II, June 13, 1963, 1006.

13. Ibid., 1000-1001.

14. The New York Times, June 18, 1963 called the budget policies "setting up barriers against foreign investment. Canada is adopting a form of protectionism that represents a retreat to economic nationalism." In particular the outspoken reaction of Eric Kierans, then President of the Montreal Stock Exchange, in a letter to Gordon on June 18, 1963, which he made public, aroused controversy. Kierans claimed that "the financial capitals of the world have just about had enough of Canada." Kierans went on to argue that the measures would discourage non-resident investment, hurt the Canadian securities market and encourage more Canadian investment in securities in the United States. See Debates 26th. Parl. First Sess. vol. II, 1367 for a copy of the letter.

15. The guidelines and Industry Minister Winters' letter of March 31, 1963 outlining the governments' expectations regarding good corporate behaviour to foreign subsidiaries are reproduced in the Eleventh Report of the House of Commons Committee on External Affairs and National Defence, 28th Parl., 2nd. Sess., 1970, 43. (Known as the Wahn Report).

16. Called the Guidelines section, this unit later became part of Industry, Trade and Commerce and published several reports, both public and internal ones, on the behaviour of subsidiaries. See Wahn report., op cit.

17. See the federal government paper tabled in 1978 which enumerates the federal efforts in this regard and frankly acknowledges the role foreign ownership and control in accounting for a large part of Canada's relatively low level of expenditure on research and development in comparison with other OECD countries. Ministry of State for Science and Technology, Industrial Research and Development, 1978, and Debates, 30th Parl., 3rd. Sess., Vol VI, June 1, 1978. In 1975 the Industrial Research and Development Incentives Act (IRDIA) grants outlined in the inventory were terminated because of expenditure restraints, Debates, 30th Parl., 3rd. Sess., April 10, 1978.

18. The intent was to generate a White Paper to be submitted by the eight economists who served on the task force to a cabinet committee chaired by Gordon. However, opposition to the whole endeavour (particularly from Winters, the Industry minister) remained strong. The report, when completed, was felt to be too lengthy for its original purpose and continuing cabinet division prevented any government acceptance of it or its recommendations. It was finally tabled, referred to a committee accompanied by a statement saying that it did not reflect government policy. See Walter Gordon, A Political Memoir (Toronto: McClelland and Stewart, 1977), 311-13.

19. Ibid.

20. The Task Force on the Structure of Canadian Industry was headed by Melville Watkins, and included the following members: Bernard Bonin, Stephen Hymer, Claude Masson, Gideon Rosenbluth, Abraham Rotstein, A.E. Safarian and William J. Woodfine. A number of members such as Watkins, Rotstein and Hymer had concerns about the level of foreign ownership and its negative economic and social consequences. In contrast Safarian took the view, reflected in his book, Foreign Ownership and the Structure of Canadian Industry (Toronto: McGraw-Hill, 1966) that many of the criticisms of subsidiaries were misplaced, that FDI brought many benefits, particularly access to technology, and that many of the problems which had been identified had their origins in government policies which had generated inefficiencies in the Canadian economy.

21. Foreign Ownership and the Structure of Canadian Industry, Report of the Task Force on the Structure of Canadian Industry (Ottawa: Privy Council Office, January, 1968).

22. Watkins report, op cit., 91.

23. House of Commons, Debates. Feb 15, 1968.

24. See the title page of the report which reflects this.

25. CIPO data from Gallup reports show a marked rise between 1963 and 1967 in the number of Canadians surveyed who felt that Canada had enough US investment, going from 46 to over 60 per cent, and peaking in 1975 at 71 per cent. See table in Sylvia Bashevkin, True Patriot Love: The Politics of Canadian Nationalism (Toronto: Oxford Press, 1991), 96.
26. See Richard French, How Ottawa Decides (Toronto: Lorimer, 1984).
27. Press release, Prime Minister's Office, March 2, 1970.
28. Ibid.
29. In addition another investigation into the issue of foreign ownership had been under way since late 1969 by the House of Commons Standing Committee on External Affairs and National Defense under the chairmanship of Toronto Member of Parliament Ian Wahn. The Committee reported in July of that year and while many of its recommendations echoed the 1968 task force including establishment of a CDC and increased surveillance of EFCs, takeovers and new investment, one went well beyond it arguing for a requirement of fifty-one per cent Canadian voting shares in corporations. But the report was cautious on the means and time-frame to attain this policy goal because of the large amount of capital required and the likely negative impact on future US capital inflows. It advocated "a reasonable time period with due regard to varying circumstances including the availability of Canadian capital," with regulation only as a last resort. In sum a limited regulatory role for the state to increase Canadian ownership was envisaged with the scope of intervention limited and the extent of coercion left very unclear. Its recommendations were not acted upon since the Gray task force was underway by that time, but it continued to fuel the debate.
30. The group headed up by Joel Bell, of the Prime Minister's Office, included officials from a number of departments.
31. The contents of a cabinet document dated July 29, 1971 on "Domestic Control of the Economic Environment," were leaked to the Montreal Gazette and published on November 16, 1971.
32. Gray Report, op cit., 479.
33. The assumptions are partially reflected in the introduction of the report, "The Problem of Foreign Direct Investment in Canada," as well as throughout the body of the report itself. In addition, the same assumptions were reflected in discussions with a former task force member.
34. Ibid., 489.

35. Foreign Direct Investment in Canada (Ottawa: 1972), 470.
36. Interview with task force member, October, 1985.
37. See Foreign Direct Investment in Canada op cit., 479.
38. Interview with a member of the task force, Ottawa, October, 1985.
39. Interview with task force member in Ottawa, October, 1985.
40. Foreign Direct Investment in Canada, op cit.
41. Ibid., 457. Also confirmed in interview with task force member, October, 1985.
42. Ibid., 353.
43. Claire Sjolander, op cit. has argued that FIRA was the result of a watering down, at the political level, from the "extensive regulatory initiative proposed in the Gray Report." 378. However, a close reading of the report indicates the most extensive intervention, discriminatory treatment of EFCs, was ruled out prior to the political decision process by the authors of the report.
44. For a discussion of this effort in the Privy Council Office and the opposition it met in Finance and ITC see Richard French, op cit.
45. Budget Speech, Debates, 28 Parl. 3rd Sess., Vol. VIII, June 18, 1971, 6909.
46. Hon. Herb Gray in a speech in the House of Commons reviewing measures taken by the government "to foster and protect the national interest," in the face of foreign direct investment. Debates, May 2, 1972, 1828.
47. Introduced June 4, 1975. For discussion see Debates, 30th Parl., 1st Sess., November 12, 1975, 8989.
48. Confirmed in an interview with a task force member in October, 1985.
49. See "Sharp Contradicted by Documents," Montreal Gazette, (November 16, 1971) which reproduces the bulk of the text.
50. Ibid.

51. GAAP was a program established in 1966 to assist industries in adjusting to liberalization of the Kennedy Round of trade negotiations. It aided firms to restructure and in 1971 was extended to include firms whose access to external markets was hurt by foreign import surcharges.
52. See the public affairs newsletter, View From Ottawa (Nov, 7 and 15) which reports on the DITC investment figures as well as a Montreal speech of the Finance Minister Edgar Benson linking the declines in capital investment to US economic policies.
53. Donald Macdonald as quoted in Time May 5, 1972.
54. See the text of another leaked cabinet memorandum of February 14, 1972 as reprinted in the Toronto Star, February 23, 1972.
55. Speech of Robert Stanfield, Debates. May 2, 1972, 1830.
56. Debates, 28th Parl., 4th Sess., Vol. III, 2631.
57. Department of Finance, Memorandum, May 11, 1972.
58. Alistair Gillespie described this process when he appeared before the House of Standing Committee on Finance Trade and Economic Affairs, June 5, 1973.
59. See Miriam Smith. "The Canadian Labour Congress: From Continentalism to Economic Nationalism" in Studies in Political Economy 38 (Summer, 1992), 35-60, on the position of the Canadian Labour Congress.
60. Conservative opposition criticism centered for both bills on their lack of positive measures to encourage Canadian investment, the lack of adequate consultation with the provinces and the negative impact on less-developed regions, as well as general criticisms that the bill did not reflect the Gray report recommendations. At the same time they were not specific on positive measures to stimulate Canadian ownership. See speeches of Robert Stanfield, Paul Hellyer, and Marcel Lambert regarding C-201, Debates, May 29, 1972, 2656-2783.
61. Even within the Liberal caucus itself the limited scope of Bill C-201 had caused some consternation, especially for backbenchers in the Toronto area (such as Ian Wahn) who criticized it on second reading and supported the Committee for an Independent Canada's opposition to the bill in committee.
62. Summary of Cabinet Decision on Domestic Control of the National Economic Environment, June 15, 1972.

63. An official in Investment Canada confirmed that the legislation was never intended to impede the operations of these firms. Interview, October, 1985.

64. Gillespie as a backbencher had had a reputation as a moderate economic nationalist within the Toronto group of MPs. He gained some attention in 1970 by circulating a memo in caucus outlining a more nationalistic policy program on FDI.

65. House of Commons, Debates, March 30, 1973, 2777.

66. Ibid.

67. Ibid.

68. Statement of Alistair Gillespie, House of Commons Debates July 18, 1975, 7712.

69. There were six guidelines to determine relatedness of which the first two dealt with vertical integration. A new or acquired business was seen to be related if it produced "services used as inputs in the furtherance of or items of equipment or structure that became capitalized for the production, marketing or other activities of the established business" or it produced goods to be used as inputs in the production process. In addition other guidelines defined a new business as related if it resulted from research and development carried out in Canada by the EFC. In addition the door was left open in situations where an EFC could not meet these criteria to apply to the agency for a ministerial opinion, on the grounds that the guidelines were inappropriate to the applicant's particular economic or industrial situation. See "Related Business Guidelines," Canada Gazette, Part I, March 19, 1977.

70. Ibid.

71. House of Commons, Debates, July 18, 1975.

72. In March 1974 Gillespie had publicly indicated what had already become obvious, that no industrial strategy would be forthcoming from the government.

73. Section 2 of the Act outlines the factors to be taken into account when assessing significant benefit including: the effect of the acquisition on the level and nature of economic activity including the effect on exports from Canada; and the effect on productivity, industrial efficiency, technological development, product innovation and product variety. Foreign Investment Review Act.

74. Alistair Gillespie to the House of Commons Standing Committee on Finance, Trade and Economic Affairs, May 17, 1975, 38:6.

75. Gillespie expected that a system of rules of thumb would emerge in the process and investors would have a good idea of what was expected of them.

76. For an extended discussion of the CDC and its genesis see William Dinma, The Canada Development Corporation: Diffident Experiment on a Large Scale, Ph.D. Harvard University, 1973. For later developments see Stephen Brooks, "The State as Entrepreneur from CDC to CDIC," Canadian Public Administration 26:4 (Winter, 1983, 525-43), and Abraham Tarasofsky, Something Ventured: The Canada Development Corporation, 1972-1985 (Ottawa: Economic Council, June, 1987) discussion paper no. 339.

77. Dinma, op cit.

78. See the speech in the House of Commons of Finance Minister Edgar Benson, February 22, 1971, Debates.

79. House of Commons Debates February 22, 1971, 3637-3640.

80. Energy, Mines and Resources, Energy Policy for Canada (Ottawa: 1973).

81. For other factors affecting the decision to create Petro-Canada see Doern and Toner op cit., 91.

82. Minister of Energy, House of Commons, Debates Mar. 12, 1975.

83. Ibid.

84. This is clearly reflected in the testimony of various groups and the comments of Wester MPs during the meetings of the House of Commons Standing Committee on Natural Resources and Public Works, April 30, 1975.

85. Joint appearance of the Canadian Petroleum Association and the Independent Petroleum Association of Canada before the House of Commons Standing Committee on Natural Resources and Public Works April 30, 1975., 18:4.

86. The screening process included Canadian participation as one of its criteria. In addition the act was written in such a way as to cover the transfer of ownership of already-foreign owned firms to other foreign investors. A portion of these included indirect acquisitions whereby the parent company of a

firm operating in Canada changes hands. Under the act the fate of the Canadian subsidiary became reviewable and the new owner of the parent firm was required to apply. The ability of the agency to scrutinize these transactions allowed for the possibility of repatriating some EFCs. However, the main emphasis of the agency was on extracting further performance improvements or minimizing the damage to performance from the change in ownership. As will be discussed later FIRA and Investment Canada's screening of these transactions was very controversial, both with foreign investors and other states.

87. The following information is drawn from Tables 3.2-3.5 of Chapter Three.

88. See Barbara Jenkins, op cit. who draws a similar conclusion after examining flows.

89. The publication, called Foreign Investment Review was sent to Canadian posts and consulates and used in investment promotion activities outside Canada. It ceased publication in 1982. See the statement of Gorse Howarth to the House of Commons Standing Committee on Finance, Trade and Economic Affairs, March 22, 1977.

90. The studies are described in section 5 of the 1975-77 annual reports of FIRA. Using data on investment inflows as well as the Department of Industry, Trade and Commerce surveys on the capital expenditures and investment intentions of major corporations and US Department of Commerce data on the reinvestment of investment earnings of US subsidiaries operating abroad the agency concluded that the "available information does not indicate that the Foreign Investment Review Act is discouraging the kinds of new foreign investment needed in Canada or the investment plans of foreign-controlled businesses already-established in Canada." Indeed in the case of EFC's, increases forecast in their investment for the 1975-76 period were substantially higher than those of Canadian-owned firms.

91. Canadian Bar Association, Brief to the Hon. Herb Gray on the Foreign Investment Review Act, (September, 1981).

92. Gorse Howarth, before the House of Commons Standing Committee on Finance, Trade and Economic Affairs April 11, 1978, 20:5. Departments were also concerned about the lack of effective coordination. A June, 1979 survey of industry sector branches in Industry, Trade and Commerce indicated general support for the agency but a concern that the confidentiality provisions and FIRA's desire to remain at arms length from departments to maintain investor applicant's confidence hurt the effective development of industrial

policy. See Foreign Investment: Issues and Policy (Ottawa: Department of Industry, Trade and Commerce, April, 1980), 44.

93. See Strengthening Canada Abroad (Ottawa, 1979) and Science Council, The Weakest Link, (Ottawa, 1978).

94. Statements to this effect were made repeatedly throughout the decade including that of Jean-Luc Pepin when introducing export development programs in 1971: "we do not discriminate in any department on these matters," and by Edgar Benson, when discussing export financing, who declared that eligibility is not determined "by the control of foreign ownership of the supplier Canadian company," Debates 1971 and 1974. In the case of Industry, Trade and Commerce a 1980 report indicates "no formal or informal policy exists in the treatment of foreign-owned firms requesting assistance from Industry, Trade and Commerce" and industry sector branch officers in Ottawa, "have no official directive relating to the treatment of firms with respect to nationality of ownership." See Industry, Trade and Commerce, op cit, April, 1980.

95. For a documentation of the frustration of federal officials in the lacklustre export efforts of foreign-owned firms see Glen Williams, Not for Export (Toronto: McClelland and Stewart, 1984).

96. Stephen Langdon refers to the 1977 study of the Department of Industry, Trade and Commerce on export restrictions and recommendations by an Assistant Deputy Minister that EFCs not be permitted to obtain export financing or bid on CIDA contracts unless they could demonstrate their freedom to export. See his comments in the proceeding of the House of Commons of the Standing Committee on Regional Development, Feb. 27, 1985.

97. June, 1978 Policy statement on federal support for research and development and Discussion Paper on Industrial Research and Development, 1978, 2.

98. Budget Speech, April 10, 1978.

99. For a discussion of the meaning of the term and the difference from rationalization see Science Council, Multinationals and Industrial Strategy: The Role of World Product Mandates (Ottawa: September, 1980).

100. Science Council, op cit. Ontario Ministry of Industry and Tourism, Report of the Advisory Committee on Global Product Mandating, (December, 1980), Thomas Poynter and Alan Rugman, "World Product Mandates, How Will Multinationals Respond,"

Business Quarterly, (Autumn, 1982) and Patricia Johnston, "The Perils of Product Mandating, Policy Options (March/April, 1982).

101. See Susan Goldenberg, "Specializing at the Branch," Financial Times June 23, 1980. While neither Industry, Trade and Commerce nor Supply and Services practised discrimination they did try to encourage the increased autonomy of subsidiaries and the according of world product mandates to them. See the discussion of the Enterprise Development Program in ITC. Foreign Investment Policy and Issues op cit., April, 1980.

102. Energy, Mines and Resources, Proposed Petroleum and Natural Gas Act and New Canada Oil and Gas Lands Regulations (May, 1976).

103. Major Canadian Projects, Major Canadian Opportunities: A Report by the Major Projects Task Force. (June, 1981)

104. For background on the origins of the task force see Major Canadian Projects, Major Canadian Opportunities: A Report by the Major Projects Task Force. (June, 1981).

105. The new government established a special parliamentary committee to examine the goals and operations of FIRA but denied that it intended to eliminate FIRA despite contradictory statements by ministers. Opposition members and press reports quoted Ministers Crosbie and de Cotret as saying otherwise. The government did promise to implement some administrative changes to address the problems of secrecy and delay of cases. See Debates, November 22, 1979.

106. Report of the Petro-Canada Task Force, (Ottawa, Oct., 1979)

107. See Table 3.7, Chapter Three.

108. The Conference Board study was funded by the federal government, and both it and the EMF study were cited repeatedly by Sinclair Stevens the Minister of Regional Industrial Expansion in arguing the case for the Investment Canada bill.

109. Province-building as it has been labelled is described in Larry Pratt and John Richards, Prairie Capitalism: Power and Influence in the New West (Toronto: McClelland and Stewart, 1979).

110. Two conferences were held in February and November 1978 and are described in Douglas Brown and Julia Eastman, The Limits of Consultation: A Debate Among the Provinces and the Private Sector on an Industrial Strategy (Science Council,

May, 1981).

111. Trudeau's speech of Feb. 12, 1980.

112. Ibid.

113. Ibid.

114. Speech from the Throne, Debates, 32nd Parl., 1st Sess., Vol.I, April 14, 1980, 4-6.

115. Throne Speech April 14, 1980, op cit.

116. Ibid.

117. These proposals had been first outlined during the election campaign in a Toronto speech in October 1979. See Globe and Mail Feb. 13, 1980.

118. Speech of the Hon. Herb Gray on "Economic Nationalism and Industrial Strategies" Annual Symposium of the Ecole des Hautes Etudes Commerciales, Montreal June 3, 1980.

119. Ibid.

120. Speech to the Canada/Japan Businessmen's Conference, Tokyo, August 8, 1980.

121. Hon. Herb Gray to the House of Commons Committee on Finance, Trade and Economic Affairs, May 26, 1981, 57:9-10. The Enterprise Development Program was part of the regrouped industrial programs administered by Industry, Trade and Commerce.

122. Ibid.

123. The memo from the Department of Industry, Trade and Commerce, Framework for Implementing the Government's New Industry Development Policy During the Next Four Years and Proposals for Immediate Action is discussed in Glen Williams, Not for Export, op cit. and in G. Bruce Doern, "The Mega-Project Episode and the Formulation of Canadian Economic Development Policy, Canadian Public Administration, (Summer, 1983), 26:2, 220 and in the press, Financial Post (September 15, 1980).

124. For a discussion of the debate in Cabinet see Stephen Duncan, "Gray Unlikely to Get the Tougher FIRA he Wants." Financial Post, March 21, 1981.

125. Government of Canada, Economic Development for the 1980s, (November, 1981).

126. Wayne Cheveldayoff, "Stormy Debate Over Industrial Policy," Globe and Mail, March 10, 1980.

127. In July alone the Bank of Canada was forced to undertake substantial intervention of \$1.4 billion to slow the slide of the dollar. Finance Minister MacEachen was forced to ask the Canadian banks to cease their loans to firms engaging in major takeovers in the United States on July 29, 1981.

128. See quote in "Ottawa is Slowing Down its Plans to cut Foreign Ownership: Trudeau," Montreal Gazette (September 26, 1981).

129. See Table 4.1. Calculations are based on the agency's annual report. Overall approval rates dropped from over 85 per cent in the 1978-79 period to 73.4 in 1980-81. The major change was in the approvals for acquisitions and new business in resource industries. Rates for manufacturing dropped much less to just over 80 per cent in the 1980-81 period.

130. "FIRA the Paper Tiger that Comes to Life," Globe and Mail (July 18, 1981), B.1. Press reports at the time connected the delay in decisions to FIRA's efforts to find Canadian buyers. See "FIRA influence Aids Takeover by Executives," Globe and Mail (March 23, 1981). Commissioner Howarth denied that the agency engaged in any shopping around for alternate Canadian buyers and blamed the backlog of cases which had developed in the late 1970s and a lack of staff. See his testimony before the House of Commons Committee on Finance, Trade and Economic Affairs, May 1981.

131. There are, of course, limits to the ability to infer coercion without knowing fully the behaviour of both investors and administrators as Stephen Globerman has pointed out. See Stephen Globerman, "The Consistency of Canada's Foreign Investment Review Process: A Temporal Analysis," Journal of International Business Studies, XV: 1 (Spring/Summer, 119-129).

132. This resulted in the 1980 study by Frank Swedlove, Richard Schultz and Katherine Swinton, The Cabinet as a Regulatory Body: The Case of the Foreign Investment Review Agency (Ottawa: Economic Council) Regulation Reference, Working Paper No.6., one of the best studies of the problems in the administration of the agency.

133. Final communique, "Review of the Economy," Annual Premiers Conference, Victoria, B.C., August 12, 1981.

134. The BCNI speaking for the largest multinational corporations in Canada, both Canadian and foreign-based lobbied against Gray's proposals. For a discussion of the

growing influence of the BCNI in the 1980s see David Langille, "The Business Council on National Issues and the Canadian State," Studies in Political Economy 24 (Autumn, 1987), 41-85.

135. Vancouver Sun. (August 12, 1980).

136. Canadian Bar Association, 1981 op cit.

137. Those cited included Wilhelm Haferkamp, Vice-President of the European Community and US Commerce Secretary Malcolm Baldrige.

138. House of Commons, Debates, 32nd. Parliament, First Session, July 14, 1980, 2875.

139. Government of Canada, Economic Development in the 1980s (November, 1981).

140. Economic Development for Canada in the 1980s (Ottawa: October, 1981).

141. Ibid.

142. These often occurred at intergovernmental meetings called to deal with economic issues, some of which I attended on behalf of the Alberta government in the winter of 1982. Provincial representatives would recount complaints they had heard from visiting officials, usually from Europe or the United States about FIRA. FIRA officials would reply that such complaints were based on misperceptions about the role of the agency.

143. See the 1982 FIRA Annual Report. In addition a thirty-four page document, "Performance Requirements and FIRA: Responses to US Criticisms," was circulated to departments early in 1982 in an effort to provide Canadian ministers and officials with a rebuttal to growing US criticisms.

144. Interview with Investment Canada officials in October, 1985. This theme was repeated as well by ministers and many of witnesses appearing in support of the Investment Canada bill before the House of Commons Committee on Regional Development.

145. James Rusk, "US Corporate Elite Wooed," Globe and Mail (October 20, 1982) describes a meeting organized by the Niagara Institute between two dozen US corporate leaders with senior economic ministers and the Prime Minister as well as the Canadian Ambassador to the United States and fourteen Canadian consuls from major US cities.

146. Richardson went so far at the World Economic Forum in Davos Switzerland in February 1984 as to invite previously rejected investors to reapply claiming that FIRA in the past had been too bureaucratic and obstructionist.
147. Howarth refers to this in his March 26, 1985 appearance before the 1985 House of Commons Standing Committee on Regional Development which was considering the bill to create Investment Canada and was confirmed in interviews with FIRA officials in October, 1985.
148. Interview with Investment Canada officials, October, 1985 and speeches by Hon. Ed Lumley, 1983 and 1984.
149. Energy, Mines and Resources, The National Energy Program (October 28, 1980), 16-22.
150. Energy, Mines and Resources, An Energy Strategy for Canada (Ottawa, 1976) advocated increased ownership. FIRA also began pressing for increased Canadian participation in its significant benefit bargaining. Petro-Canada acquired Atlantic Richfield in August, 1976 and Pacific Petroleum in 1978-79. With these acquisitions it gained access to a downstream marketing network and increased visibility to the public.
151. See Doern and Toner, op cit., 100.
152. Energy, Mines and Resources, The National Energy Program (Ottawa: October, 1980).
153. Budget Speech, Debates, (October 28, 1980), 4185.
154. National Energy Program, op cit., 47.
155. Budget Statement October, 1981.
156. See Barbara Jenkins, "The Obsalescing Bargain: A Case Study of Canada's National Energy Program," International Organization 40: 1 (Winter, 1986), 139-166.
157. Interview with Investment Canada official, October, 1985. See also the comments of former FIRA Commissioner Gorse Howarth before the House of Commons Standing Committee on Regional Economic Development, April 1985. Clearly the nature of FDI had also changed with globalized production, a fact which FIRA had to acknowledge. See Ari Abonyi, "Foreign Investment Policy: The Gray Report in the Context of the Eighties, FIRA Working Document, August 23, 1984.

158. Sinclair Stevens appearing before the House of Commons Standing Committee on Regional Development, February 5, 1985 2:36-37.

159. The survey found that 11 per cent of respondents, or one in nine companies, had been deterred from investing in Canada because of controls and regulations. See Duncan McDowall, A Fit Place to Invest: Investors' Perceptions of Canada in a Changing World (Ottawa: The Conference Board, 1984).

160. Hon. Michael Wilson, Economic statement to the House of Commons, November 1984.

161. Despite a widespread perception that the Conservatives would get rid of investment screening and FIRA entirely the actual campaign commitment outlined in a party news release of July 18, 1984 was to "change FIRA into a business development agency which encourages job-creating investment in Canada." They further promised to "change the mandate of FIRA so it reviews only major transactions in key sectors of the economy - those of significant national interest." Finally, in a largely symbolic gesture, the Conservatives promised to change its name "a name which has become a symbol of the old Liberal ways." All this "to make it clear that a new Progressive Conservative government welcomes investment in Canada."

162. James R. Nininger, Globe and Mail, December 7, 1984.

163. See Canadian Bar Association, op cit and the Business Council on National Issues submission to the Macdonald Commission.

164. The literature review in Chapter Two cited the work of Peter Evans and Lynn Mytelka, both of whom linked FDI regime changes to corporate preferences. Mytelka has argued that as firms become more international they will fear retaliation abroad, limiting their access to other economies and, therefore, lobby for liberalization of the investment regime. In the comments of the major corporate interest groups in Canada on the proposed legislation that view was not articulated. More common was a concern about deterring new investment, interfering in investor's decisions and the incurring of US hostility.

165. As Sylvia Bashevkin indicated CIP0 surveys indicate that in 1981 67% of Canadians felt there was enough foreign investment and while this figure fell to 53 % in 1986 it has never fallen below 50% in the past three decades. See Bashevkin, op cit, 96.

166. See Investment Canada, International Investment and Competitiveness Working Paper No. 8 (October, 1991) which deals with the troubling evidence that not all FDI is of

unqualified benefit and that states do interfere in or restrict the investment process internationally. The report argues (p.45) that Investment Canada continues to play a role in enhancing the benefits of investment, albeit by negotiating "behind the scenes" with those acquiring Canadian firms.

167. Investment Canada Act, as passed by the House of Commons, June 6, 1985.

168. Ibid.

169. Ibid.

170. Investment Canada Act, 1985.

171. Statement of the Hon. Sinclair Stevens to the House of Commons, December 7, 1984.

172. In FIRA's case this consisted of the launching of a glossy publication in 1977 Foreign Investment Review. It ceased publication in 1982. Industry, Trade and Commerce's Annual Reports during the 1975-80 period indicated some focus on investment promotion. This role fell to External Affairs after the reorganization of departments in 1982. Investment promotion, however, was never as significant as trade promotion. In the early 1980s FIRA and DEA spent a far greater proportion of energy and resources on trying to enhance the image of FIRA abroad and countering what were perceived as misperceptions about its operations.

173. Ibid.

174. Most controversial was the letter of Ambassador Gottlieb to Sinclair Stevens August 6, 1985 which called the policy "ill-timed and unclear" and likely to hurt the painstaking effort to restore the confidence of US investors, who were bound to regard the policy as "retroactive and radical." The letter is revealing in its extraordinary sensitivity to the perceptions of the US corporate investment community. See Globe and Mail November 4, 1985.

175. Government of Canada, Canada's Energy Frontiers: A Framework for Investment and Jobs (Ottawa: Energy, Mines and Resources, October, 1985) For a discussion of the attitude of the Conservative Government to foreign investment in the petroleum sector see Hon. Pat Carney, Minister of Energy, Mines and Resources, "Notes for an Address to the American Petroleum Institute's Annual General Meeting", San Francisco, November 18, 1985.

176. Ibid.

177. Investment Canada dealt with three large takeovers involving :Chevron-Gulf Canada, Mobil-Canadian Superior and Texaco-Canadian Reserve. See Globe and Mail, "Mobil's Takeover Gets the Nod," (December 7, 1985) and "Investment Policy Grows Teeth," Financial Post (December 7, 1985). In each case the approval came after the acquirers made commitments to increase levels of Canadian ownership of the subsidiaries, particularly through the sale of shares. See also Energy, Mines and Resources, Energy in Canada: A Background Paper (Ottawa: 1987), 71.

178. Jeanne Kirk Laux, "Shaping or Serving Markets? Public Ownership after Privatization," in Daniel Drache and Meric S. Gertler, The New Era of Global Competition: State Policy and State Power, (McGill-Queen's Press, 1991).

179. Clement, 1976 and Layton, 1984, op cit.

180. Both Resnick and Sjolander, op cit. use this term.

181. Barbara Jenkins argues that the liberalization of Canada's FDI regime in 1985 is directly related to the drop in FDI inflows. However, her own graph of FDI inflows indicated the drop in flows began much earlier. Nor does she acknowledge that major acquisitions, a significant proportion of FDI, continued to be screened until the implementation of the Free Trade Agreement. See Barbara Jenkins, The Paradox of Continental Production: National Investment Policies in North America (Ithaca: Cornell University Press, 1992), 58.

182. See Globerman, 1989 op cit and Jenkins, 1994, op cit.

CHAPTER FIVE
ECONOMIC DEPENDENCE AND CANADIAN FOREIGN INVESTMENT
REGIME CHANGE

Introduction

This chapter assesses the impact of trade dependence on the United States on Canada's choice of policy instruments used to manage FDI. The potential U.S. influence over Canada's investment regime arises, I argue, out of the asymmetry in the relationship between Canada and the United States. This type of influence has been labelled "structural power" by Caparaso and Haggard¹. Structural power, they argue, is based on asymmetrical vulnerability and permits the dominant actor to impose economic sanctions on the subordinate actor which will alter the costs for the subordinate actor of taking certain actions which the dominant actor opposes.

Since the United States has been the main source of FDI in Canada in the postwar period, changes to Canada's FDI regime are more likely to affect U.S. interests than those of other home states. The initial hypothesis is that growing trade dependence on the United States, in a context of strong U.S. opposition to Canadian FDI regime changes, will afford the United States a means to impose sanctions on Canada. Canada's lack of alternative markets and high level of dependence on access to the U.S. market means that an interruption in market access would be potentially very costly

to the Canadian economy and therefore, affords the United States a very powerful sanction. Such sanctions would increase the costs for Canada of using policy instruments which limit access for U.S. capital or discriminate against U.S.-based EFCs, and thus act as a constraint on the use of discriminatory instruments. Over time, if this hypothesis is correct, increased trade dependence on the United States should result in the diminishing use of access and discriminatory policy instruments, and less coercion of U.S.-based investors.

As Caporaso and Haggard point out, however, the conversion of this structural power into control over outcomes, in our case defined in terms of the policy measures taken by Canada to control FDI, is by no means a certainty for the dominant state. In this dissertation I view Canada's economic dependence on the United States as influencing, but not necessarily determining, Canadian policy on FDI for several reasons. First the United States may not regard a particular Canadian FDI regime as negatively affecting its interests and may, therefore, accept or ignore changes in Canada's FDI regime. Second, even if the United States should find regime changes unacceptable, it may have difficulty finding sanctions which would be both effective against Canada and impose no costs on U.S. interests. Third, even if the United States found effective, usable, sanctions, the Canadian state might, in some instances, be willing to bear the

increased economic costs of using various policy instruments in order to take what it deems to be necessary actions regarding FDI. Such costs may be necessitated as part of the complex trade off between economic well-being and national sovereignty.

A second problem exists in determining whether or not U.S. sanctions, or the threat thereof, have shaped the choice of policy instruments. Even with a knowledge of U.S. preferences, evidence of U.S. influence attempts, and a Canadian decision which accords with U.S. preferences, it may not be U.S. structural power that is reflected in a changing mix of policy instruments. Rather changing Canadian state policy preferences, a result, for example, of strong domestic opposition, could also account for changes. In order to establish U.S. influence we must also be able to identify where there is a divergence in Canadian and U.S. state preferences regarding Canadian investment policy and trace the source of that change in Canada's FDI regime to U.S. influence.

In order to understand the nature of U.S. influence over Canada's FDI regime we first need to look at U.S. goals regarding international investment and how the United States viewed Canada's FDI regime, or changes to it. Second we need to identify U.S. influence attempts and examine the extent to which they shaped Canadian state's choice of instruments which controlled access, or discriminated against, already-

established corporations (EFCs). Finally we need to understand what Canadian state FDI policy preferences were, how Canada reacted to U.S. influence attempts, and what other factors were involved in shaping the Canadian state's ultimate decisions on investment policy instruments.

This chapter is divided into four parts. The first part provides a brief overview of U.S. policy preferences in terms of the three types of FDI policy instruments which we outlined in Chapter Two. The second and third parts examine the major turning points in Canada's FDI regime which we identified in Chapter Four, that is, 1967-75 and 1980-85. In each case I assess the extent to which U.S. influence, particularly that based on trade dependence, shaped that decision. The second period is subdivided, looking first at 1980-82 when changes were made in controls over access (FIRA) and new discriminatory policy instruments were imposed on investors as part of the National Energy Program (NEP). This period also saw an important shift in U.S. investment objectives to liberalize access and eliminate host state attempts to control investors' performance, which was accompanied by a much more vigorous effort to achieve these objectives vis-a-vis Canada and other host countries. I examine whether Canadian decisions on the choice of policy instruments in this period were influenced by the threat of U.S. sanctions. The second period from 1983 onward is then discussed as a time when the bilateral agenda was dominated by trade issues and investment

policy became increasingly linked to trade - an issue where the United States quite clearly, because of Canada's dependence on the U.S. market, had a potentially powerful sanction available to influence Canada's FDI regime. The extent to which the United States was able to use trade as a lever to alter Canada's FDI regime is assessed. The final section examines FDI regime changes which resulted from the negotiation of the Free Trade Agreement (FTA) in October, 1987.

The United States and Investment Regimes

As Chapter Two indicated, the United States was the preeminent source of FDI in the 1960s and 1970s. Although it remained the dominant home state in the 1980s, in terms of the size, number and economic influence of U.S.-based subsidiaries abroad, the United States also experienced large inflows of FDI during the 1970s and especially in the 1980s. As a host country, however, the United States still has a relatively small proportion of its economy under foreign control.²

Given its history as a capital exporter it is not surprising that the United States, throughout the postwar period, supported a liberal international regime for the unimpeded flow of investment capital.³ For the United States three aspects of foreign state FDI policies have been of concern: property rights (expropriation), access (right of establishment) and national treatment (discrimination). Both

national treatment and expropriation deal with foreign state behaviour toward EFCs, while access relates to host state control over the conditions of, and rights of, entry for foreign capital.

Sovereign states have an internationally-recognized right to control the entry to their territory, as well as to define the limits to property rights, including the expropriation of private assets for the pursuit of some public purpose. In the case of expropriation, interstate conflict has typically been generated by the issue of host state compensation of foreigners for the expropriation of their assets. The United States has sought to develop and impose an international standard of "prompt, adequate and effective compensation" for the expropriation of U.S. assets abroad.⁴

U.S. efforts to develop international norms and standards regarding access and national treatment (i.e. non-discrimination) have been more limited and more recent. While favouring free access for foreign capital, as evident in the U.S. drive to establish the OECD code on capital movements in 1961, the U.S. was generally willing to accept a more minimal, most favoured nation status, that is, equal treatment by the host state of all foreign capital, up until the early 1970s. In the case of national treatment of foreign investors, U.S. efforts to establish norms date from the early 1970s.⁵

From the early postwar period to the 1960s the greatest international challenge, from the U.S. perspective,

involved property rights. The U.S. state faced a wave of expropriations of U.S. corporate assets, particularly in the Middle East and Latin America in the 1950s and 60s. U.S. responses to these actions were shaped by a number of factors including changing corporate preferences, the varying costs and availability of appropriate sanctions against the offending states, and ultimately struggles within the Administration itself, particularly between the State Department and Treasury.⁶

By the early 1970s host states, as Chapter Two indicated, had moved away from expropriation as the primary policy tool for managing FDI, turning to more specific state regulation of both access for new investment and the performance of EFCs in order to enhance the local economic benefit from FDI. As host state regulation became widespread, achieving national treatment and unconditional access for U.S. investors (often called right of establishment) became an increasingly important U.S. policy objective for two reasons.

First, from the corporate perspective these host state regulations imposed additional costs on investors thereby affecting profits. Second, to the extent that corporations adhered to host state requirements in return for access, which they often did in instances where access was highly valued or vital for competitive reasons, it raised concerns for the U.S. state regarding the redistribution of economic benefits arising from the investment in favour of the host country.

Within the United States itself the domestic consensus supporting the free movement of capital in and out of the country broke down by the mid 1970s. Many groups, especially trade unions, feared the growing trend to shift production to low-wage economies. At the same time the growing influx of foreign capital involved in takeovers of large U.S. firms in key sectors, particularly after the oil crisis and price increases of 1973-74, raised concerns. Measures were adopted in 1975 to monitor the extent of FDI in the United States and create a cabinet committee which could deal with particular significant foreign acquisitions of U.S. firms.⁷ However, other congressional initiatives to create a screening mechanism and increase the Administration's power to monitor investment were strongly opposed by the Ford Administration as unnecessary and contrary to U.S. interests. Thus, while concern in Congress about both outgoing and incoming FDI increased, Administration policy continued to promote a more liberal international investment regime⁸.

Thus, U.S. foreign economic policy on FDI has, since the mid-1970s, been formulated by the Administration with a view to preempting congressional action to control incoming FDI, as much as it has been to eliminate foreign host state interference with U.S.-based direct investment. But the U.S. Administration has also used the threat of more extreme congressional action to pressure economic partners in bilateral negotiations⁹.

In seeking to influence host states to alter policies affecting home states and their investors, home states like the United States have several options available. These include, first, bilateral, reciprocal retaliation, often called "tit for tat"¹⁰. This involves direct retaliatory action against incoming investment from the host country, or host-country-based EFCs, if there are any operating in the home country. In the U.S. case the increase in incoming FDI has provided a basis for this type of retaliation. This option, however, has a number of costs for the broader goal of ensuring access for investors internationally. In addition for many host countries the extent of FDI in the United States may be minimal or insignificant in comparison to U.S.-based FDI in their economy.

Second, the home state may use other non-investment instruments of economic retaliation such as imposing or increasing barriers to imports, withholding international loans, export financing or foreign aid. In U.S. disputes with developing countries the latter three financial tools have been frequently used in the past, especially in disputes involving uncompensated expropriation. In the case of trade, however, there are both domestic and international constraints on the use of trade barriers in this way. Moreover, trade action can result in unacceptable domestic economic costs if it leads to an escalation of barriers or harms domestic consumers or producers. Third, the home state may use other

bilateral non-economic measures to pressure host states to alter investment regimes. In the case of Canada-U.S. relations this is often referred to as "issue linkage."¹¹ It is considered to be a difficult tool to use since it may impose domestic costs and could, if host states also engaged in the process, generate a serious overall deterioration of bilateral relations.

Finally, as Chapter Two indicated, home states may seek to use multilateral institutions and international regimes to pressure host states to alter policies or to strengthen or create new international rules to restrain host state behaviour. In cases where several host states are engaged in similar actions against foreign investors this may be an attractive option for the home state which carries fewer domestic costs than direct economic retaliation. But it is dependent on the ability of the home state itself, or in conjunction with other home states, to dominate the institutions in question and shape the international regime which emerges. Moreover, it presupposes an international regime sufficiently strong to impose sanctions on recalcitrant host states.

In sum there is a basis to our expectation that changes in Canada's FDI regime would be subject to U.S. influence. As a host state in the early 1970s Canada's desire to control FDI was in conflict with the U.S. objective, as the preeminent home state, to minimize such control. Second, as the dominant

economic actor in the bilateral context the United States did have a number of options to influence Canada's FDI regime.

I turn now to the question of what role the United States played in shaping change in Canada's investment regime in the 1967-75 period.

The U.S. State and Canada's FDI Regime, 1967-75

Table 5.1 gives a clear indication of the U.S. stake in any changes to Canada's FDI regime. U.S. firms have played the dominant role of foreign investor especially in the sectors where foreign control has been the highest, manufacturing and oil and gas. Clearly any measures meant to limit or control access for foreign investors or to discriminate against EFCs would be felt most directly by U.S.-based firms.

Table 5.1

United States FDI in Canada 1926-87

Year	U.S. FDI as % Total Stock FDI	U.S. FDI as % of Manufacturing FDI	U.S. FDI as % of Petro. and Gas FDI
1926	78.7	86.6	-
1939	77.5	86.9	-
1949	86.8	88.2	-
1955	84.6	83.8	93.3
1957	83.9	82.5	93.0
1960	82.5	82.6	86.6
1965	80.6	84.8	79.3
1970	80.6	84.8	80.5
1975	78.8	83.5	79.1
1980	77.8	83.3	79.4
1985	75.7	84.0	80.3
1987	70.5	78.5	75.8

 Source: Statistics Canada, Canada's International Investment Position: Historical Statistics 1926-1992 (Ottawa, March, 1993), tables 29-31, 101-109.

The changes to Canada's FDI regime in the 1967-75 period marked a departure from previous efforts to increase Canadian ownership of companies through a limited array of discriminatory and compensatory policy instruments and sectoral restrictions on access. Moreover, compensatory instruments had been found to be ineffective, allowing the level of foreign control of the economy to increase while problems of performance of EFCs, as identified by the Gray and Watkins reports, persisted. On the other hand, the attempted use of discriminatory instruments had aroused strong foreign (U.S.) and domestic corporate opposition in the mid 1960s.

As Chapter Four indicated, the Canadian state's policy considerations in 1971 centered around controlling access after a wave of acquisitions in the late 1960s. The Gray

Report, in recommending policy options to Cabinet, in fact, explicitly ruled out the two policy instruments most likely to have aroused the concern of both U.S.-based firms with subsidiaries in Canada and the U.S. state, namely, any systematic and widespread use of discriminatory policy instruments against EFCs, or the repatriation of foreign firms through extensive buy-back schemes or expropriation.

Did the rejection of these instruments result from concerns about likely U.S. retaliation if they were used? On the whole, for the Gray task force members in 1970-71 the costs of foreign state retaliation in response to any change in Canada's FDI regime was not a major concern. The likelihood of retaliation was considered to be very low, given the moderate policies being proposed, particularly in comparison to other state efforts to control FDI.¹² Of more concern to the Gray Report authors, because of the size and number of EFCs operating in Canada, was that discriminatory treatment of foreign firms in Canada would constitute a shift to a more "interventionist" government and "alter the traditional relationship between business and government in Canada."¹³ However, they were also concerned that such action would be viewed by MNCs as retroactive and unfair and might lead them to "enlist the support of their governments" and "create problems in foreign relations."¹⁴

Measures to repatriate foreign capital were dismissed in the Gray Report, as they had previously been by both the

Watkins Report and the Gordon Commission, as being prohibitively expensive and less effective than measures designed to influence the performance of foreign investors. The Canadian Cabinet decision to initiate a limited control of access through screening foreign acquisitions of Canadian firms, announced on May 2, 1972, was, however, partially affected by Canada's trade dependence on the United States and trade actions the U.S. took against Canada in August 1971.

Figure 5.2 graphs the trends in Canada's export dependence on the United States based on data provided in Chapter Three.

Figure 5.2
Exports to the US as % of Total Exports
1950-1987

As the graph indicates Canadian trade dependence on the United States market had been accelerating rapidly in the 1960s, especially for end products. The level of trade dependence meant that the Canadian economy would be sensitive to any U.S. trade actions.

On August 15, 1971 President Nixon announced a series of U.S. measures to deal with a severe balance of payments and other economic problems. These measures included a ten per cent surcharge on all imports and tax changes permitting the creation of Domestic International Sales Corporations (DISC) designed to encourage increased U.S. exports at the expense of new investment abroad. While these actions were broadly targetted at large western industrial economies to precipitate action on trade and exchange rate issues to help correct the U.S. balance of payments problems and avoid politically costly U.S. domestic economic adjustment¹⁵, they did affect the Canadian decision-making process.

Because of Canada's trade dependence on the United States there was an initial perception within the Canadian state that the impact of the U.S. measures on the Canadian economy would be very severe¹⁶. Efforts to negotiate an exemption for Canada failed; a series of bilateral negotiations ended in a stalemate and did not resume until early 1973.

Economic Dependence and the Decision to Screen FDI

A decision in principle to screen investment was made in

July 1971, but division within Cabinet continued over the scope of coverage and was not resolved until much later in the fall. The main debate in Cabinet centered around the scope of the access-oriented screening process and the type of investments it would cover, that is, acquisitions, new incoming investment, and investment of EFCs. It occurred after the U.S. trade actions of August, but was delayed and partially influenced by them.

Prime Minister Trudeau later admitted that because of the expected negative impact of the U.S. measures on the economy Cabinet was less inclined to be "tough" on foreign investment, fearing any further depression of economic activity and investment at a time of high and rising unemployment.¹⁷ As Chapter Four indicated, Cabinet was especially concerned about a fall survey of corporate investment intentions which appeared to indicate that the U.S. measures had had a depressing effect on planned business investment.¹⁸

There is no evidence that the United States contemplated any retaliatory action to the Canadian decision to screen acquisitions. The general notion that Canada had a right, and would be taking new measures in the future, to ensure national control of the economy had been raised by the Prime Minister in a meeting with President Nixon on December 11, 1971. This sentiment had also been affirmed by the U.S. President in a speech to Parliament on April 14, 1971 when he recognized that "No self-respecting nation can or should

accept the proposition that it should always be economically dependent on any other nation.¹⁹ Canada's actions were consistent with the U.S. state view that western economies had distinct economic interests and responsibilities and could no longer rely on the United States to maintain the postwar liberal international economic and security regime.

The U.S. Treasury acknowledged the Canadian government's right to adopt legislation on foreign acquisitions, at the time of the announcement, but expressed concern about the process of using access to bargain for benefits and enhanced performance of investors. However, officials expressed the hope that "negotiations with foreign investors would not produce results which would have the effect of distorting trade patterns." Treasury officials acknowledged that the measures proposed were milder than had been originally anticipated, given the Gray Report.²⁰

The U.S. state view of the Canadian announcement paralleled that of major U.S. corporations with Canadian subsidiaries and other large U.S.-based corporations.²¹ While both the corporate and U.S. state policy preference was for unimpeded access for investment, the Canadian action did not violate principles of national treatment for EFCs and was, in the view of U.S. state officials, quite moderate. The only potential threat to U.S. economic interests lay in the results of the bargaining process. Until the system had been in operation for some time, however, it would be impossible to

assess its impact.

The bill never passed the House of Commons and was replaced by Bill C-132 in January 1973 which included new investment and the expansion of EFCs into new lines of activity within the screening process. Screening for acquisitions began in 1973. However, in implementing the law there was caution. Regulations covering new investment were tabled in July 1975 and deliberately excluded most of the investment activities of EFCs. Again discriminatory measures likely to antagonize the United States or U.S.-based EFCs were eliminated. As a consequence, U.S. reaction to the screening of a broader range of investments was limited and confined largely to monitoring the operations of FIRA. U.S. state officials viewed the expanded scope of the screening process as a short-term reaction to the political situation of minority government. They expected, after the achievement of a Liberal majority government in 1974, that the agency would be administered in a way that would cause little concern, that is, that there would no discrimination among foreign investors and U.S. firms and U.S. trade interests would not be disadvantaged.²²

An evaluation of the operation of FIRA in 1976 by the State Department reflected the U.S. desire to ensure that the agency was not being used to discriminate against U.S. investment (that is, that the United States continued to be accorded most-favoured nation status) and that its bargaining

processes not distort patterns of production and trade to the detriment of U.S. economic interests. It was the view of the State Department that, after two years of operation, neither discrimination nor distortion had occurred.²³

Canadian officials continued to take care not to antagonize or alarm U.S. investors and officials. There was a concerted effort made on the part of Canadian ministers and FIRA officials to reassure U.S. investors that the regulations were being evenly applied. In November, 1974 when DREE minister Don Jamieson appeared to suggest that there might be a preference for non-U.S. foreign investment, the Acting Prime Minister, Finance Minister Mitchell Sharp, along with the FIRA Commissioner, quickly denied it. Annual reports of the agency also carefully documented the equal treatment of all applications. U.S. officials periodically reminded Canada about the need for non-discrimination and national treatment for EFCs through the mid-70s.²⁴

A number of compensatory policy instruments were also created by the Canadian government in the 1970-75 period to deal with FDI, including the Canada Development Corporation (CDC) and Petro-Canada. In creating them, the Canadian state initially eschewed any aggressive repatriation role, making any conflict with the United States over the question of adequate compensation unlikely. The only initiative in this period which did pose a major challenge to U.S. interests, particularly the commitment of the U.S. state to promote

national treatment of U.S. investment abroad, was the introduction of Bill C-58 in 1975, a discriminatory tax measure against the foreign controlled print and broadcast media.²⁵

Conclusion

Clearly in the 1970-75 period, as Figure 5.2 indicates, Canada was highly dependent on access to the U.S. market, with over 65 per cent of exports (over 80 per cent of end-product exports) going to the United States. The United States provided 80 per cent of Canadian FDI and was the home country most directly affected by Canadian investment regime changes. However, the U.S. did not undertake measures intended to influence the regime using trade sanctions. U.S. trade actions and Canada's trade dependence did, however, have an impact manifested in a more general concern on the part of the Canadian state over the economic dislocation that a severe, U.S.-initiated trade dispute in 1971, prior to the creation of FIRA, had already had on the Canadian economy. The concern about the state of the economy, in the wake of U.S. trade actions, helped ensure that the controls on access which were put into place were limited and did not discriminate against U.S. firms, even though political considerations had led Cabinet to widen the screening to cover new investment. Cabinet had been concerned screening investment could risk a slowdown of the economy, which was already facing higher unemployment and slower growth due to the trade situation.

Second, the policy instruments which would have seriously challenged U.S. state objectives at that time regarding the treatment of U.S. investors abroad, that is, expropriation and discrimination against EFCs, were ruled out as policy options by Canadian state officials at a very early stage in the process²⁶. The basis for ruling them out included concerns about the reaction of multinationals and their home states (in Canada's case quite clearly the United States), and also a broader concern about the scope of state intervention.²⁷ Thus U.S. influence and the Cabinet decision to minimize state intervention ensured that the resulting modest changes were within a range considered acceptable by the United States at that time. In 1973 the Canadian screening process did not arouse serious U.S. concern, although the U.S. state was opposed to host state limits on access. The one exception, bill C-58, which did involve discriminatory tax regulations, was subsequently vigorously opposed by both the U.S. state and broadcasting corporations.

U.S. Opposition to Canada's FDI Regime, 1980-82

In contrast to the 1970-75 period, the 1980-82 period saw a significant increase in the risk of U.S. state-based economic retaliation against Canada's existing foreign investment regime and proposed changes to it. In contrast to the earlier period, the early 1980s involved Canadian FDI regime changes which directly challenged, in the view of the

U.S. state, U.S. investment interests including discrimination against U.S.-based EFCs, increasing coercion of U.S. investors in the screening process and expropriation of assets without adequate compensation.

In addition these changes occurred at a point when the United States was facing the world-wide recession of 1980-82, the impact of increased openness of the United States economy, including severe trade imbalances and competitive pressures. This resulted in increased U.S. state attentiveness to investment and trade-related economic issues and a broadening of U.S. international investment goals.

As figure 5.2 indicated, Canadian trade dependence on the U.S. economy, after declining slightly in the late 1970s continued its upward trend. By 1981 over 66 per cent of exports and over 80 per cent of end products were going to the U.S. market.²⁰ Yet the extent of Canadian dependence on the U.S. economy had also been high in the 1970-75 period. What had altered markedly in the later period was the likelihood of U.S. state-based economic retaliation against changes in Canada's foreign investment regime.

As a consequence of Canada's dependence and the openness of the U.S. economy, access to the U.S. market provided an important source of leverage against the economic policies of any U.S. trading partners, including Canada, which were seen to have a negative impact on U.S. economic interests. The 1980s ushered in a period of increased emphasis on free and

fair trade, that is, on requiring foreign state economic policy adjustments to ensure the equivalent access for American goods, services and capital as the price for continued access to the U.S. market.²⁹

In particular the U.S. state sought enhanced foreign market access for U.S.-based service industries, reflecting the growing role of services in the economy and the perceived competitive advantage the United States possessed in this area.³⁰ Improved access for U.S.-based service industries also had significance for investment issues since state control over foreign investment access could pose a barrier to non-tradeable service exports.

U.S. Policy on FDI: Ensuring Open Access

U.S. investment priorities, as a consequence of changing trade interests, shifted away from a concern with property rights to more attention to access, both in terms of the right of establishment and state-imposed conditions on access for U.S. investors, along with national treatment. Minimizing the imposition of host state conditions on U.S. investors, many of which had trade implications, so-called performance requirements, formed an important element of U.S. trade objectives.³¹ In principle the United States opposed both the use of conditional incentives to attract FDI on the part of host states, and the more coercive use of the threat of access denial to obtain enhanced economic benefits for the host

economy. It was the latter, however, which was most strongly opposed by the U.S. state³².

Thus U.S. state officials viewed Canada's actions within a broader context as part of a wider problem of foreign state interference in international economic exchanges, especially in the Third World, with implications for U.S. efforts to shape international trade and investment regimes, particularly at the GATT. Canada was seen as a deviant, advanced industrial country in its behaviour towards foreign investors. In the view of U.S. state officials acceptance of Canada's increasing coercion of U.S. investors, control of access and discriminatory treatment of EFCs would set a precedent and weaken U.S. efforts to restrain these practices in developing countries.³³

Did the possibility of U.S. retaliation influence the choice of policy instruments, given Canada's trade dependence. Did it cause Canada to alter its FDI regime in response to U.S. threats? For fear of retaliation to have had an impact we must assume little willingness on the part of the Canadian state to incur economic well-being costs, in return for the attainment of other domestic goals. Second the United States would need to actually identify and employ appropriate policy instruments which would effectively target economic sanctions against Canada without incurring unacceptable economic costs in the United States.

The analysis of the impact of retaliation fears on the

choice of policy instruments begins with those decisions relating to control of access and the role of FIRA in investment screening.

Economic Dependence and FDI Regime Change: The Struggle Over FIRA

The Throne Speech of April 1980 announced that the "Foreign Investment Review Agency would be amended to provide for performance reviews of how large firms are meeting the test of bringing substantial benefit to Canada"³⁴. In addition to performance reviews of EFCs, publication of proposed foreign acquisitions prior to FIRA's decision, financial assistance to promote repatriation and the increased use of procurement to favour Canadian-owned firms were also proposed. The proposal to review the performance of EFCs was seen by both U.S. corporate and state officials as retroactive, discriminatory regulation of EFCs, the vast majority of which were U.S.-based. As early as April 21, 1980 United States Trade Representative (U.S. TR) Reuben Askew warned the Minister Herb Gray that such a review would be regarded as a "very serious matter" by the United States.³⁵

In addition to proposed changes in the range of investments subject to FIRA's screening, foreign investors and U.S. state officials objected to what were regarded as several recent changes in the operation of the agency in the 1980-81 period that, in their view,³⁶ increased the level of coercion of investors. These changes took the form of longer delays in

the resolution of cases, more extensive negotiations with investors over performance, particularly regarding technology transfer, procurement and levels of Canadian ownership, as well as increases in outright disallowance of certain types of investment (distributorships) or in key sectors (energy). As Chapter Four indicated, approval rates for applications did drop significantly, particularly in the case of acquisitions of resource companies, where the rate plummeted from 91 per cent in the 1978-79 reporting year to 43.8 per cent in 1980-81 year.³⁷

In addition the number of cases withdrawn had increased steadily from the start up of the agency to reach a peak in the 1980-82 period of over 100 cases annually, approximately 12 per cent of the total. Those involved in FIRA cases reported an increase in equity participation as a condition of approval in 1981 and an increase in the average time spent on cases to almost six months.³⁸ Figures on the length of time for decision, the approval and withdrawal rates and the anecdotal evidence indicate that there was, indeed, an increase in the pressure on investors to enhance performance as well as efforts in certain sectors to increase the level of Canadian ownership through exclusion and repatriation.

U.S. state officials were already attentive to changes in the operation of FIRA and the implications for U.S. international economic interests prior to the announcement of the NEP in October 1980. In fact, in response to a rising

number of corporate complaints, U.S. officials had recommended a policy of raising the issue of FIRA operations in bilateral meetings. There was a growing concern about the extent of delay, uncertainty for investors, and, in particular, the nature of the performance requirements being extracted from firms seeking to invest.³⁹

The announcement in November 1980 of the National Energy Program (NEP) and the proposed changes in FIRA were seen by U.S. state officials as part of a coordinated Canadian state attack on foreign private capital involving coercive and discriminatory state policy instruments, directly challenging U.S. international investment objectives⁴⁰. With the change in the U.S. Administration from Carter to Reagan had also come a shift in policy for FDI away from one of neutrality on outgoing and incoming investment, as enunciated in July, 1977 by the Carter Administration⁴¹. The new Reagan policy sought both to actively promote the benefits of incoming investment and act more aggressively to ensure access and national treatment for U.S. investment abroad.⁴²

The chronology in Appendix A, which covers the whole period from 1980-87, describes the sequence of events, and indicates the intensive U.S. state effort to alter Canada's regime in 1981 and 1982⁴³. U.S. actions ranged from diplomatic protests and bilateral discussions, warnings that investment issues could lead to a deterioration in bilateral relations, all the way to explicit threats of trade and other

economic sanctions, as well using multilateral fora to condemn Canada's investment practices.

The investment issue was increasingly tied to U.S. efforts to maintain the openness of the international trading system and mollify U.S. domestic protectionist forces through the aggressive pursuit of "fair trade"⁴⁴. Performance requirements, in particular, were considered to be unfair trade practices and were the subject of intensive bilateral discussions between the Canadian Minister Herb Gray and United States Trade Representative(U.S.TR) William Brock and Commerce Secretary Malcolm Baldrige in April, 1981.⁴⁵ Performance requirements and FIRA's practice of reviewing indirect acquisitions, even those "which do not increase the foreign presence in Canada," led the U.S. officials to suggest that "failure to deal with these types of problems could lead to FIRA becoming a significant irritant in our bilateral relationship."⁴⁶

More serious were U.S. efforts in the summer of 1981 to link investment to trade issues and threats of trade retaliation. In August, 1981 USTR began a study of FIRA's operations to determine if they distorted trade and sent questionnaires to major U.S.-based corporations with investments in Canada. The study was part of an effort to determine whether or not FIRA operations constituted "unjustifiable trade practices" that could be considered to have burdened or restricted U.S. commerce under Section 301 of

the 1974 Trade and Tariff Act. If a determination were made that this was indeed the case the U.S. President could take a range of retaliatory trade actions.⁴⁷

Reciprocal retaliatory action against Canadian FDI in the United States was also being considered in the spring of 1981, partly as a result of attempted hostile takeovers of U.S. corporations by Canadian firms and Congressional pressure on the U.S. Administration to take action⁴⁸. The U.S. Cabinet also directed the USTR and the Department of Commerce to develop a specific list of sanctions that could be applied against Canada's investment policy and informed Canadian officials early in September that this was being done.

By the end of the summer of 1981, however, it was clear that the U.S. state had rejected the option of reciprocal retaliation against Canadian investment in the United States, largely because it was considered to be ineffective. In the fall of 1980 the U.S. Commerce Department had surveyed U.S. embassies in 35 host countries to determine the effectiveness of restrictions on inward investment to the United States as a retaliatory tool against host countries. It concluded, based on the responses received, that such a policy tool would be largely ineffective since host states' economic development priorities, reflected in measures to control incoming FDI, were judged to be more important to them than the right of their nationals to invest in the United States.⁴⁹

Despite the large amount of Canadian-based FDI in the

United States U.S. decision-makers had determined that any restrictions against incoming Canadian capital would be welcomed by the Canadian state. Such restrictions would only slow down the growing capital flight from Canada, which was already having a negative impact on Canadian policy. Moreover, retaliation against incoming Canadian investment would counter the broader U.S. international objective of minimizing foreign state restrictions on foreign investment. Because of high inflows of FDI into the country and a number of hostile takeovers involving Canadian companies, the U.S. Administration was already under Congressional pressure to enact more restrictive measures against FDI.

The United States also began moving in the fall of 1981 to examine the multilateral option in pressuring Canada on FIRA. The United States decided to raise the issue of investment performance requirements at the next GATT ministerial meeting in the fall of 1982. According to U.S. officials the pursuit of Canada through the GATT would offer a useful test of the limits of the GATT rules while applying pressure to Canada at the same time. The case is discussed more fully in Chapter Six.

The Canadian state's response to U.S. criticism of FIRA, both in the GATT case and bilateral discussions, was to portray the level of coercion of investors involved in the anticipated review of EFC performance as minimal. Canadian officials described the undertakings foreign investors made to

FIRA regarding their performance as voluntary. Gray himself began talking of the proposed new performance review in less coercive terms as only a form of moral suasion through publication of the results as part of an effort to fend off domestic critics.⁵⁰

As our inventory of changes to Canada's FDI regime in Chapter Four indicated, by September, 1981, the Canadian Cabinet had decided not to proceed with the expansion of FIRA's activities. According to FIRA officials, as well as press reports, the decision can be traced to a desire not to be "provocative" and further antagonize the United States.⁵¹ The way in which the decision was quickly communicated first to U.S. officials, the Treasury Secretary and the U.S. President, prior to being made public in Canada, also indicated a desire to reassure the United States. The October 28, 1981 Canadian government statement on economic development⁵², tabled alongside the budget, indicated publicly that the proposals regarding FIRA were being shelved and the procedures and operations of the agency were under review.

Was U.S. opposition solely responsible for the shift in policy regarding FIRA? As Chapter Four indicated, the overall economic situation, particularly the alarming capital outflow in the summer of 1981 and drop in the dollar⁵³, and a severe split in Cabinet over the feasibility of such an enhanced level of state intervention also played a role in the decision. The Prime Minister publicly credited the drop in

the Canadian dollar and the outflow of capital with affecting the decision to postpone changes to FIRA's mandate. The Governor of the Bank of Canada had also criticized policies which were promoting Canadianization for the drop in the Canadian dollar in September.⁵⁴ Moreover, within Cabinet Gray was clearly in a minority in pushing the proposals. Canadian press speculation that the proposal was in trouble had begun in the summer of 1980 and opposition to it was strong from the business community, organizations like the Canadian Bar Association and eight provincial governments.⁵⁵ The proposed changes to FIRA were outlined in a Cabinet document in July, 1980 but were ultimately rejected in the fall of 1981.⁵⁶

Further changes to Canada's FDI regime emerged in the budget of June, 1982. The threshold for expedited small business cases was increased and applied to both direct and indirect acquisitions. Restraint was placed on the discretion of the minister to further subject any small cases to a full review. The budget also indicated that FIRA would "confine itself in an examination of undertakings to the key elements of an investment proposal⁵⁷."

The effect of these measures was to deal with the delay problem and ease access for smaller investors, since the expedited review process (only 21 days) offered little scope for extended negotiations over performance. Indeed in 1982-83, there was a 66 per cent increase in the number of cases resolved. The changes also took smaller indirect

acquisitions out of the extended review and negotiation process. Trade Minister Ed Lumley pointed out to an American business audience in July, 1982 that these changes would almost double the number of indirect acquisitions qualifying for the shortened procedures.⁵⁸ Lumley, a former businessman and generally regarded as less nationalistic than Gray was appointed as the minister responsible for FIRA in September. His appointment was viewed as a signal to both new investors and the United States that Canadian policies on FDI would be more sympathetic to incoming investors. The new minister went so far as to advocate the establishment of a board of labour, business and community representatives to advise on changes to the agency.

While these changes went some way toward responding to U.S. demands regarding the operations of FIRA, they did not fully meet two other key demands which appeared on the U.S. agenda in 1981, namely the elimination of the review of large, indirect acquisitions which resulted in no increase in the level of foreign ownership, and that of the imposition of trade-related performance requirements.⁵⁹ In addition, there was evidence in Chapter Four that procedural reforms to FIRA were in the works well before the U.S. demands were made. In late 1979 a number of amendments to simplify and speed up the process had been proposed by FIRA itself; however, elections and a minority government derailed the process.⁶⁰ Agency staff had been fully aware of the need to deal with a backlog

of cases, recognizing that the objective of FIRA had never been to deter beneficial incoming investment.

Further changes in FIRA occurred in the fall of 1982. Clarifications on the applicability of the FIR act were issued and a promise given to enhance "the openness and understanding both within and outside Canada of Canada's policies on investment."⁸¹

As Chapter Four has indicated, there was a large increase in FIRA approval rates for the 1982-83 and 1983-84 reporting years and a notable drop in the number of cases withdrawn. If we can assume largely unchanged behaviour on the part of investors, this indicates a less coercive approach on the part of the agency.

While the United States welcomed the changes to FIRA of June 1982, they did not alter the U.S. state's commitment to press its case regarding FIRA's performance requirements at the GATT. Eliminating performance requirements in foreign investment review in Canada and other host countries remained an important trade policy objective.

Conclusion

Did U.S. opposition and the threat of some form of trade retaliation result in the Canadian state abandoning plans to review the performance of EFCs and liberalizing access for foreign investors in 1982? Our evidence indicates that U.S. opposition was intense and that it did play a role, but only

in conjunction with other factors. These included a deteriorating economic situation, domestic opposition, concerns about capital outflows and, as Chapter Four indicated, opposition within Cabinet to increased state intervention, including expanding FIRA's mandate, to enhance the performance of manufacturing EFCs.

U.S. Opposition to Canadianization of the Energy Sector: 1980-82.

In contrast to the case of FIRA, the National Energy Program (NEP) was implemented with few major alterations, despite strong U.S. opposition to major discriminatory measures which, in the U.S. state's view, posed a direct challenge to U.S. investment principles of national treatment and adequate compensation in cases of expropriation. Similar to the FIRA case, U.S. state officials examined a range of actions including diplomatic protests, economic sanctions such as reciprocal retaliation against investors, trade actions and even issue linkage. Once again the United States also sought to use multilateral fora to pressure Canada to reverse its policies. In the NEP case, in contrast to FIRA, the United States was, by the admission of state officials⁸², unsuccessful in altering or stopping the adoption of discriminatory policy instruments by the Canadian state although a few proposed measures were dropped when the legislation was tabled.

The major discriminatory Canadianization measure, the Petroleum Incentives Payment (PIP) system of exploration and development grants based on the level of foreign control of a corporation, remained in place, as did the requirement of a 50 per cent Canadian ownership level at the production stage on Canada Lands. The crown interest provision of the NEP, a 25 per cent interest for Petro-Canada in oil and gas production on Canada Lands which applied to all companies (the back in), was regarded by the United States as uncompensated expropriation. Even it remained in place, albeit with some modification.

Among the proposed measures dropped from the legislation, however, were those dealing with procurement of Canadian goods and services by energy companies, the discriminatory licensing of gas exports, based on level of foreign ownership, and the constrained shares proposals⁶³. Moreover, limited compensation was provided to foreign investors for the 25 per cent crown interest, although it was referred to as an ex gratia payment, not compensation, by the federal government. The Canadian government also provided public assurance to investors, in the fall of 1981, that the NEP would not be extended to other sectors of the economy. There had been some speculation that the mining and manufacturing sectors would be future targets for a similar policy.

The fate of the NEP, in contrast to efforts to expand the

mandate of FIRA and increase coercion on investors, is contrary to our initial expectations, given the vigorous opposition of the United States to these changes and Canada's overall high level of trade dependence. With the high level of trade dependence the United States had a potentially powerful sanction if it chose to retaliate. Moreover, as Chapter Three indicated, Canadian FDI in the United States had also been increasing rapidly, in excess of 25 per cent a year, and over 67 per cent of it going to the United States. The importance of the United States as a destination for Canadian FDI provided an additional means of economic retaliation against changes to Canada's FDI regime.

The different fate of the NEP however, rests on two important distinctions from the FIRA case. First the U.S. state had even more difficulty identifying retaliation measures which would be effective in the case of oil and gas. Second the Canadian state, particularly at the Cabinet level, was strongly committed to and unified in its support for, the policy of Canadianizing the oil and gas industry. This stronger state consensus had its roots in the perception on the part of decisionmakers of greater bargaining power with both the United States and investors as a result of the rapid increase of oil prices in the 1978-80 period and the fact that action in the energy sector was tied to important domestic objectives⁸⁴. Most important among the latter was the policy goal of redressing the changing federal-provincial balance and

ensuring the federal government a large share of growing energy revenues. The Canadianization aspect of the policy was considered by those at the political level to be popular and an important counterweight to the more divisive domestic aspects of the NEP dealing with the redistribution of tax revenues.⁸⁵ The nature of the resource base, rapidly rising world oil prices, and the significant financial revenues available to the Canadian state to compensate for, and replace, private investment through the use of state corporations, also strengthened its position. As a consequence Cabinet was more willing and felt Canada able to bear increased costs which the use of a range of discriminatory FDI instruments might entail.

In September, 1981 the Cabinet reaffirmed its commitment to the policy and the Minister of Energy made very clear in several public statements, in response to belligerent speeches of several U.S. officials, that Canada was "ready to pay a price" if necessary, for the policy.⁸⁶ Both the Minister of Energy, Marc Lalonde, and the Prime Minister also went out of their way to suggest that the outcry against the NEP was based on the views of a few, large oil companies and some officials, but was not widely shared within the U.S. Administration⁸⁷.

What were the options available to the United States in seeking changes to the NEP? Reciprocal retaliation against Canadian energy investors operating in the United States was one of the major options available. Under a 1920 U.S.

statute, the Mineral Lands Leasing Act (MLLA), the United States could declare Canada to be a non-reciprocal country if it was determined by the Secretary of the Interior that Canada did not accord similar or like privileges to U.S. investors seeking mineral leases as were accorded to Canadian investors in the United States.

If this were found to be the case Canadian-owned energy companies would then be denied the opportunity to bid for leases for exploration and development purposes on U.S. federal lands and offshore. Several major U.S. corporations, which had been victims of hostile takeovers by Canadian firms, along with several members of Congress, demanded enforcement of the Act against Canada in the spring of 1981. U.S. officials, at first, acknowledged that such a threat might be useful in pressuring Canada to alter its policies, but as the review of Canada's status continued, officials unanimously opposed using this retaliatory measure.⁸⁸ This view was also shared by the vast majority of U.S. and Canadian-based corporations affected which, while strongly condemning the NEP and FIRA, opposed retaliation against Canadian energy investments in the United States.

Retaliation was felt by U.S. state officials to be largely ineffective. First it would have affected mainly medium-sized Canadian-owned firms which had, since 1980, greatly increased their drilling in the United States, because of the prospect of oil price deregulation. Keeping these

companies out of the United States and drilling in Canada would have aided the Canadian state's effort to maintain domestic energy investment. In addition it would have run counter to the U.S. effort to increase access for U.S. capital internationally and would have provided support for those in Congress seeking to limit foreign investment in the United States.⁶⁹

Trade retaliation was also a possible option. However, PIP grants to stimulate drilling in Canada were not easily linked to U.S. trade interests under existing legislation. In addition the United States was concerned with attaining secure supplies of energy in the wake of the oil crises of the late 1970s and the conflict with Iran. Thus interference with U.S. imports of oil and gas, or their transportation from Canada, was not a viable option either.

In the case of the multilateral option, the United States had institutions available to pressure Canada. The U.S. initiated an interdepartmental review of the NEP in 1981 with a view to linking it to a violation of Article 22 of the GATT. However, that aspect of the NEP that was clearly trade-linked, namely the procurement policy, was altered in May, 1981 to bring it into conformity with the GATT.⁷⁰ The United States was able to raise the NEP issue under the 1976 OECD Code on Multinational Corporations. However, Canada's obligations were somewhat limited because of the voluntary status of the code. In addition the status of Canada's reservation lodged

in 1976 regarding the national treatment aspect of the Code was in dispute. In any case no effective sanction was available under the auspices of the OECD. Even though there were institutions that could be used as a forum to critique the NEP there were few effective sanctions that could significantly increase the costs for Canada of using discriminatory policy instruments in the case of the energy sector.

Some U.S. officials also tried to use issue linkage by threatening to exclude Canada from G-7 trade talks scheduled to take place in Florida in 1981 as a retaliatory measure. USTR officials argued that by Canada's actions toward foreign investors it had forfeited the right to be part of the consultations of the major industrial nations⁷¹. This was a limited gesture not fully supported within the Administration. The chief advocate, USTR William Brock, was forced to retreat on the issue by State Department opposition and the arguments of the other major trading partners which were more receptive to Canada's protests.⁷²

Conclusion

Despite a continued high level of trade dependence on the United States the 1980-82 period did see some alteration in Canada's investment regime in the direction of increased coercion and discrimination against foreign investors, contrary to our initial expectations. However, in the case of FIRA and manufacturing EFCs, attempts to introduce new

discriminatory measures and to increase coercion of investors through the control over access were largely abandoned by 1982 and access was liberalized somewhat. Strong U.S. state opposition to these measures and their subsequent abandonment might, on the surface, appear to support the argument of the importance of U.S. influence. However, our analysis revealed that although U.S. opposition played some role it was in conjunction with a growing concern within the Cabinet about the extent of state intervention involved in these measures and its impact on the economy. In contrast, in the case of energy, the move to more coercive discriminatory measures withstood strong U.S. opposition for two reasons. First the difficulty of the U.S. state in identifying effective sanctions to use against Canada meant that it could not raise the costs of using these instruments and, second, the strong Canadian intrastate consensus on these measures resulted in a willingness to persist, even if U.S. retaliatory actions were able to increase costs.

In contrast the next period we will examine provided the U.S. with a context within which the potential leverage over Canada resulting from trade dependence could be directly brought to bear in influencing Canada's FDI regime. Again, however, this is partly a result of two aspects of a new emerging intrastate consensus in Canada; first, that secure access to the U.S. market was the key to economic development and second, that Canada could no longer afford the costs of

screening FDI as a result of its declining attractiveness as an investment location for international capital⁷³.

Market Access and the Transformation of Canada's Foreign Investment Regime: 1983-87

As Figure 5.2 indicates, the 1980-85 period was marked by a significant upward trend in an already high level of trade dependence on the U.S. market. By 1985 overall exports to the United States were in excess of 75 per cent of total exports. In the case of end products the figure was in excess of 90 per cent. Even more important, perhaps, for Canada's FDI regime was the fact that economic development policy within Canadian state became increasingly fixated, by the mid 1980s, on the need to secure continued access to the U.S. market for exports. This coincided with a desire on the part of the U.S. Administration and Congress to strengthen the link between trade and investment objectives within the U.S. state such that access to the U.S. market could become a lever to influence the investment regimes of U.S. trading partners. These developments created a situation in which Canada's trade dependence could be converted by the U.S. state into influence over Canada's foreign investment regime. Thus a trade-off of further liberalization of Canada's foreign investment regime for U.S. investors, in return for more secure access to the U.S. market for Canadian goods and services, became highly probable.

But Canada's trade dependence on the United States and

U.S. efforts to use market access as a lever cannot fully account for changes to Canada's FDI regime which were agreed to in 1987. Canadian state preferences regarding foreign direct investment also played a role in shaping the trade-offs which emerged from the Free Trade Agreement (FTA). We begin our analysis with changing Canadian state preferences in this period

The defeat in the Canadian Cabinet of a more interventionist and discriminatory state economic development policy was clear by the fall of 1982. It was replaced by a more outward, foreign-market-access oriented industrial policy which included enhanced efforts at export promotion and measures to secure existing, and gain new markets for Canadian products. Of growing concern were the protectionist pressures building in the United States Congress to use control over U.S. market access as leverage to gain increased access for U.S. goods, services and capital to other markets⁷⁴. Countries enjoying large trade surpluses with the United States, such as Japan and Canada, were particularly vulnerable.

An interdepartmental trade policy review initiated by the Canadian government in the fall of 1981 and released in August, 1983⁷⁵ recommended a two-pronged strategy for Canada of continued support for multilateral trade liberalization efforts and the initiation of limited, sectoral free trade negotiations with the United States. The bilateral review

acknowledged Canada's severe and increasing dependence on the U.S. market and argued that future domestic economic policy decisions would have to be much more sensitive to U.S. reactions. Policies, such as the NEP and FIRA, which had strongly antagonized the United States, would have to be avoided.

The review highlighted the problem of the uncompetitiveness of Canadian manufacturing, including EFCs. According to the report the solution lay in the development of world product mandates. However, the only way to encourage the necessary private sector investment to develop these mandates was the enhanced security of access to the large U.S. market. In the case of access the report favoured retaining FIRA, but focussing only on screening acquisitions because new investment (foreign and domestic) was vital to enhancing competitiveness and must be encouraged. At the same time the review acknowledged the strong U.S. state interest in enhancing foreign market access for U.S. investors, securing national treatment and eliminating any performance requirements for incoming investment. These bilateral differences on investment issues, according to the report, would persist. In the fall of 1983, based on the review's recommendations to Cabinet, Canada approached the United States with a view to identifying potential sectors for future sectoral free trade negotiations.⁷⁸ The United States' reaction to the proposal to begin exploratory talks on

sectoral free trade with Canada in the fall of 1983 was cautious but cordial. Ambassador Brock applauded the trade policy review and indicated a willingness to enter discussions. At the same time Brock made clear to Congress that the U.S. would seek to look well beyond tariff measures in the negotiations and include non-tariff barriers in the talks. Private sector consultations undertaken by USTR had indicated a continued concern on the part of many U.S. corporations with future Canadian policy on foreign direct investment. The sectoral talks, however, never developed beyond a preliminary stage before elections and new players on each side led to their suspension.

As Chapter Four indicated, legislation altering the scope of foreign investment screening in Canada was introduced in the House of Commons in December, 1984 by the new Conservative government. There was no direct tie to bilateral trade negotiations which had already been suspended well before the Canadian election in September. Rather the emphasis during parliamentary debate and discussion of the bill was on the need to enhance Canada's desirability as a location for the new investment thought to be necessary to ensure increased competitiveness.⁷⁷ The legislation reflected the need to compete more aggressively for increasingly scarce international investment and the perceived political necessity of maintaining a screening function, particularly for acquisitions and to protect Canadian

ownership in key sectors such as culture⁷⁸.

The legislation significantly enhanced access for U.S. investors. U.S. officials were informed about the contents of the legislation prior to its being tabled in the House of Commons⁷⁹. In addition to ending the review of new investment, except in cultural industries, the bill also established a threshold for both direct and indirect acquisitions of \$5 million and \$50 million respectively. It retained, however, the central notion of using screening to ensure some level of benefit in return for access and employed very similar criteria to those specified in the 1973 act in assessing benefit. Thus, it allowed for the continued imposition of performance requirements, which the U.S. opposed, in the case of acquisitions.

In late 1984 Canada also made changes to its energy policy. Promises to alter the NEP, particularly the "back in" provision, had been made by the Prime Minister to a New York business audience in December, 1984 and were implemented in the fall of 1985.⁸⁰ The elimination of the discriminatory PIP grants also occurred in the spring of 1985 as part of the energy agreement with Alberta. The 50 per cent Canadian ownership requirements for production on Canada Lands were retained; however, their implementation was altered to reduce the coercion involved and avoid any accusation of expropriation.⁸¹

Thus the changes in the 1984-85 period further altered

Canada's foreign investment regime in a less coercive, non-discriminatory direction while significantly enhancing access for foreign investors. However, they occurred before bilateral free trade talks were initiated and were part of a broader economic strategy centered around a diminished economic role for the Canadian state and a reliance on, and promotion of, private sector investment. They also reflected a consensus within the Canadian state, as Chapter Four indicated, that screening new investment was now too costly, given the level of international competition for investment, and the fact that FDI was no longer driven by tariff barriers. However, Canadian officials did expect changes to result in enhanced economic cooperation with the United States and to improve the prospects for bilateral trade initiatives which followed in the winter and fall of 1985.⁸² Several bilateral differences remained, however, in the area of investment. Indirect acquisitions continued to generate bilateral conflict, especially after the application of the July, 1986 Baie Comeau policy on book publishing acquisitions.⁸³

U.S. official reaction to changes to Canada's FDI regime in 1985 was extremely positive. The State Department welcomed "the encouragement of foreign investment and the removal of discriminatory treatment".⁸⁴ Officials remained concerned, however, about the extent to which performance requirements would be imposed, particularly as they affected U.S. trade.

U.S. Investment Policy: The Link to Trade

The United States' attitude to Canada's FDI regime reflected a U.S. investment policy which became more aggressive and closely tied to trade policy by the fall of 1983. A key policy objective, the elimination of all barriers to U.S.-based foreign investment, was reflected in the September 9, 1983 U.S. investment policy statement, the first in seven years. The statement was the result of a policy review, spearheaded by Treasury Secretary Regan which has been initiated in 1981 in response to changes in Canada's and other states' foreign investment regimes, and to the growing domestic pressure in the United States to limit or control incoming FDI. The statement strongly endorsed the free flow of foreign investment and committed the United States to several steps, both multilaterally and bilaterally, to achieve its goals. The United States called for fair, equitable, and non-discriminatory treatment of U.S. direct investment abroad and opposed foreign government practices, "which, distort, restrict, or place unreasonable burdens on direct investment."⁸⁵

The goals enunciated went beyond the standard call for national treatment of foreign investors and prompt, adequate and effective compensation in the event of expropriation. It included a demand for open access for U.S. investment abroad, similar to that accorded by the United States to foreign investors. This new, "right of establishment" was directly

tied in the document to eliminating "rules that prohibit service industries from doing business abroad."⁸⁶ Moreover, the document outlined multilateral and bilateral actions the United States was prepared to take to achieve these goals including, "unilateral actions against the use of performance requirements and similar policies, consistent with our international obligations."⁸⁷

The link to trade policy was further increased by trade legislation of 1984 which provided the authority under which the United States began formal bilateral trade negotiations with Canada. The concept of using U.S. market access in a retaliatory way to ensure reciprocal access for U.S. direct investment and the right of establishment had been embodied already in numerous trade bills proposed by Congress in 1983.⁸⁸ Most of these bills called on the U.S. Administration to identify foreign trade and investment barriers and then use the leverage of denying U.S. market access, unless substantially equivalent access was provided to U.S. goods, services and investment, by that foreign country.

Many of the bills, such as Senator Danforth's Reciprocal Trade and Investment Act, sought to enforce a right of establishment for foreign investment, particularly in service industries. Canadian officials were very concerned about this aspect of several pieces of legislation and, in letters to the heads of key House and Senate committees, argued that no such right of establishment existed in customary international

law.⁸⁹ Any attempt to enforce this right through retaliatory trade action, Canada warned the legislators, might ultimately impede multilateral progress on investment and trade in services issues.

Despite the ultimate defeat of most of these "reciprocity bills" in 1983 and 1984, the Trade and Tariff Act of 1984 did contain elements which linked trade and investment in U.S. trade policy, ensuring that investment issues would form a part of future bilateral and multilateral trade negotiations.⁹⁰ The Act specifically provided negotiating authority for future negotiations with Canada, clarified the scope and basic objectives of U.S. trade negotiations and, most important, the types of barriers to services and investment that could be subject to trade retaliation.

The Trade and Tariff Act required the United States Trade Representative to prepare an annual inventory of foreign barriers to U.S. exports and investment and report to Congress on actions taken to remove them. It also included foreign restrictions on investment as a category of unfair trading practices that could be liable to presidentially-initiated retaliation against imports. In the case of export performance requirements, imposed after the enactment of the legislation, the USTR was given specific authority to impose duties or restrictions on the goods and services of the country involved.

The Act broadened the President's trade negotiating

authority to include services, U.S. foreign direct investment and foreign export performance requirements. While seen by many foreign observers as less draconian than the bills which had preceded it, the 1984 Act, along with the policy statement on international investment, reflected the development of an aggressive bilateral, reciprocal approach to trade in goods, services and foreign investment on the part of the U.S. Administration.

Conclusion

Thus the 1983-85 period was one in which the Canadian state became increasingly preoccupied with ensuring access to the U.S. market, a market upon which it was becoming increasingly dependent by the mid 1980s. At the same time the Canadian state was moving to lessen coercion and discrimination against foreign investors and liberalize access. In contrast, the United States' investment objectives were broadening to include the elimination of virtually all host state controls over access, while U.S. trade legislation enhanced the ability of the U.S. to use denial market access as a lever in securing changes to host state FDI regimes. The more aggressive U.S. opposition to host state controls over FDI, the linking of trade and investment in U.S. foreign economic policy, and Canada's desire for secure market access created a situation where further changes to Canada's FDI regime might be demanded as the price to be paid for access to the U.S. market.

**Trade Negotiations and Foreign Investment Regime Change
1985-87**

Within Canada, access to the U.S. market became the focal point of an economic development strategy which centred around secure access to the U.S. market as the key to ensuring sufficient private sector investment for the necessary restructuring and enhanced competitiveness of the Canadian economy. A second review of Canadian trade policy, released in January, 1985 pointed to secure access to the U.S. market as the only means to new investment, as well as the only option to avoid further relocation of investment capital to the United States⁸¹. Unlike the 1983 review, however, the 1985 review offered virtually no discussion of policies on FDI as they might relate to trade negotiations, although it was already clear that the two countries differed on investment issues. What was clear to the government, however, was that there was widespread corporate support for a free trade agreement⁸² and that foreign-owned subsidiaries, according to the Trade Minister, "worry about current threats to access to the U.S. market. With assured and improved access to the U.S. market they are likely to stay and expand." Thus free trade, rather than promoting capital flight, was seen by Canadian officials as a way to prevent it.⁸³

Yet U.S. officials made clear, throughout 1985 and 1986, that they intended to include investment issues within the scope of any free trade agreement. Their objectives would

include the liberalization of access for U.S. investors to Canada, the elimination of all trade-related performance requirements, the recognition of the principles of national treatment and the right of establishment, especially for service industries.⁸⁴

Several aspects of Canada's FDI regime, in the view of U.S. officials, still caused difficulties for U.S. investors and U.S. state interests.⁸⁵ These included the screening of all acquisitions, the coverage of indirect acquisitions in the screening process, which was considered to be an extra-territorial application of Canadian law, and the requirement, under the Baie Comeau publishing policy, that foreign companies divest of any acquisitions within two years. The publishing policy was considered to constitute a form of indirect expropriation which failed to ensure adequate compensation for U.S. investors. Given the history of concern and political debate in Canada over foreign investment, there was also a desire on the part of the U.S. to preclude future policy reversals in Canada's FDI regime which might again limit access for U.S. investors.

While the United States' position on investment issues during the free trade negotiations was quite clear, Canada's, in contrast, was not. This was partly a reflection of the fact that decision makers were uncertain about the net impact of free trade on investment in Canada. The government was concerned about both the impact of free trade on new

investment coming to Canada and the risk of disinvestment, that is, the possibility that the removal of trade barriers could see a drastic restructuring of U.S.-based corporations. There were concerns that free trade might lead to the elimination of some EFCs operating in Canada and the concentration of North American investment in the United States, including that of Canadian-owned firms⁸⁶. The possibility of disinvestment was addressed through a number of government sponsored background studies in 1985 and 1986 which concluded that an agreement would likely result in "no change or further rationalization in a large majority of cases," and would have "a neutral effect on U.S. investment in Canada and a mildly negative impact on Canadian investment in the United States".⁸⁷

Canadian negotiations had also concluded, prior to the start of negotiations, that the United States would be seeking to negotiate investment issues and that their objectives would parallel their demands within multilateral organizations which included rights of establishment and national treatment, as well as an end to performance requirements.⁸⁸ Negotiators also expected that the special measures related to screening of investment in the energy and cultural sectors as well as indirect acquisitions would be raised by the United States.⁸⁹

The key question, therefore, for the Canadian state was whether Canada would accept the broadening of the agenda for negotiators to "embrace broadly defined investment issues or

should be restricted to those trade-related investment measures having a substantial impact on bilateral trade in goods and services."¹⁰⁰ Negotiations anticipated that some movement on investment access and national treatment would ultimately be required as a quid pro quo for greater security of access to the U.S. market. At the political level, however, there was a strong reluctance to even admit publicly that the investment issue was on the table, largely because of the government's sensitivity to the argument that the agreement would result in a loss of sovereignty.¹⁰¹

By late 1986 Canadian negotiations had developed a number of options and potential concessions on the investment issue. Initially they argued that they had only a mandate to discuss trade-related investment measures in the talks¹⁰². United States officials demanded that Canada discuss broader investment issues including full access for U.S. investors, which Canada refused to do. The Canadian negotiators finally took U.S. demands back to Cabinet May 21, 1987 and received some direction. A bilateral working group was established in late May, 1987 to explore the issues.¹⁰³ Ultimately the negotiators had the authorization to move on performance requirements and, if necessary, further on access and national treatment (with exceptions) to gain concessions on issues related to security of access to the U.S. market. The final push on investment came as part of the eleventh hour negotiations at the political level on October 4, 1987 and

investment concessions were offered by Canada as part of a package in return for U.S. moves on the bilateral dispute mechanism¹⁰⁴.

The changes in Canada's FDI regime which emerged as a result of negotiation of the 1987 agreement covered all three types of policy instruments that the Canadian state had, in the past, employed in its efforts to control FDI¹⁰⁵ and included the following:

Access

Under Article 1607¹⁰⁶ Canada agreed to amend the Investment Canada Act raising the threshold for reviewable U.S. acquisitions, over a four-year period, from \$5 million to \$150 million. The review of indirect acquisitions was to be phased out by 1992. Canada retained the right to require notification of new investment for the purposes of monitoring investment flows. Article 1603 considerably limited the scope of performance requirements over which the Canadian state could bargain with U.S. investors. All those relating to exports, imports, local content and procurement were prohibited, leaving only those involving technology, research and development and world product mandates. Moreover, performance requirements imposed on non-U.S. based FDI, if their impact was negative on Canada-U.S. trade, were also prohibited under Article 1607.2. In addition Canada was prevented from imposing increased Canadian equity requirements by Article 1602.2.

However, the Annex 1607.3 specifically excluded the oil and gas and uranium mining industries from these changes. Cultural industries were also exempted from all aspects of the trade agreement.

In chapter seventeen, Article 1703 provided improved access for investment in financial services and exempted U.S.-based financial institutions from the 1980 and 1984 changes to the Bank Act. Those changes had permitted their entry, but limited their operations and asset size.

Discrimination

Article 1602 committed Canada to national treatment for U.S. investors, meaning that Canada must accord them, "treatment no less favorable than that accorded in like circumstances to its investors."

Article 1605 also provided a guarantee to U.S. investors against expropriation in the case of forced divestiture. It used the typical language of the bilateral investment treaties, which the United States had signed with numerous countries, and embodied the norms of prompt, adequate and effective compensation.

Compensation

The main restriction on the Canadian state's use of state enterprises to compensate for FDI and its impact is Article 2011 which limited the creation of state policy instruments that have a negative impact on U.S. corporations.

Conclusion

Thus, as a result of the FTA, Canada was able to retain its screening instrument, but with the coverage of investment much more limited and the ability to influence performance circumscribed. In addition, Canada accepted the principle of national treatment, limiting discrimination. Sectoral restrictions were retained in two sectors, energy and culture, while access was liberalized in the financial sector.

The FTA and Canadian Investment Regime Changes

To what extent were these changes to Canada's FDI regime, particularly in the case of access and discriminatory policy instruments, a result of United States trade leverage, or was Canada already willing to alter certain aspects of its investment regime? Did the Canadian state resist certain U.S. demands? If so, were they successful in doing so?

In order to answer these questions we must begin by examining U.S. investment objectives during the negotiations and the extent to which they were achieved as a result of the agreement. Second we must examine the changes from the Canadian perspective and how they related to the policy instruments in use prior to negotiations.

According to the U.S. official responsible for the final negotiations on investment issues, Deputy Assistant Secretary for Trade and Investment in the U.S. Treasury Department, Robert Cornell, U.S. objectives were:

First, to prevent any backsliding by the Canadians and second, to build upon the liberalization already effected by the Mulroney Administration. We wanted to push the Canadians as far as we could to liberalize their standards, policies and laws regarding foreign investment.¹⁰⁷

In this effort to completely liberalize access he admitted, the United States was not totally successful in that Canadian negotiations, "resisted further liberalization mightily". This resistance took the form of conceding some liberalization of access, but bargaining hard over how that liberalization was defined in terms of the size of the threshold for reviewable acquisitions, and the timetable for phasing in the elimination of changes to indirect acquisitions.¹⁰⁸

Yet Cornell characterized the changes, given Canada's very different approach to the management of FDI from that of the United States as a "giant step forward" which, when implemented, would leave only "direct takeovers of about 600 of the largest firms in Canada subject to screening". This represented a reduction, he claimed, of 90 per cent from the universe of firms whose direct acquisitions were currently screened.¹⁰⁹

Cornell also pointed to Canada's acceptance of restrictions on the use of performance requirements as conditions imposed on investors in return for access. Performance requirements involving exports and local content, which were of most concern to the United States, were to be eliminated. Third party performance requirements that might affect U.S. trade interests would also be limited. Over all

in conjunction with the higher screening threshold, he argued, the burden of performance requirements was greatly reduced for U.S. investors. In the case of existing investment practices, Canada was prohibited, as Cornell pointed out, from making any existing provisions more restrictive, a provision which created an "upward ratchet" on liberalization¹¹⁰.

Canada also agreed to national treatment of EFCs, thereby foreswearing the future use of discriminatory policy instruments. Achievement of this long-held U.S. investment objective, Cornell argued, eliminated the possibility of forced divestiture and the imposition of minimum equity requirements on EFCs. In two areas where there had been problems in the past, U.S. officials identified some progress. In the case of U.S. firms indirectly acquiring Canadian publishing firms, Canadian law had required the U.S. firms to divest. Under the FTA the Canadian government would be bound to purchase these firms, based on a fair international market price, independently determined. This accorded with the long-held U.S. objective of establishing fair and adequate compensation as an international norm. Overall, however, the impact of some of these changes on Canada's FDI regime was limited by the overall exemption of culture from the agreement and the grandfathering of existing practices.

In essence the United States was successful in liberalizing access, limiting the scope of performance requirements, restricting discriminatory treatment of EFCs and

ensuring prompt, adequate and effective compensation in the case of forced divestment. Yet the U.S. acceptance of existing screening of acquisitions, and the broad cultural exemption, along with the oil, gas and uranium exemptions from investment liberalization, indicate that the U.S. negotiations were not totally successful in achieving their objectives. It is the exemptions and the recognition of a continuing, even if limited, screening function in the agreement which were, in fact, attacked in the U.S. Congress. Much of the criticism, however, was tied in with the efforts of Florio, Bryant and a number of other members of Congress to amend U.S. trade legislation to provide for more effective U.S. control over foreign acquisitions of U.S. firms.¹¹¹ From the perspective of these legislators the strong U.S. Administration opposition to their investment provisions to screen FDI coming into the United States was inconsistent, given the U.S. willingness to formally recognize the existing Canadian practice of screening acquisitions. From the perspective of U.S. trade negotiators, however, recognition of Canadian practices was a necessary evil of the agreement, and of strong Canadian sensitivity on the sovereignty question, and not a policy to be emulated.

To what extent did changes to Canada's FDI regime, as a result of the agreement, accord with Canadian policy preferences? From the Canadian perspective the increase in the threshold for reviewable investment was a logical and predictable response to U.S. negotiating demands, given the

trend toward higher thresholds and the expediting of smaller cases which has characterized changes in screening regulations since the late 1970s. The changes in the FTA essentially restricted the screening to about one tenth of the cases previously reviewed, a measure of success, in the view of U.S. negotiators, in enhancing access.¹¹² Canadian officials have argued, however, that on an assets-weighted basis the review still covers 75 per cent of cases. Ultimately more significant, from the U.S. perspective, was the total elimination of indirect acquisitions from review. These, by 1986-87, had reached well over \$4 billion annually, nearly one third, on an assets basis, of acquisitions and one quarter of incoming FDI. The size and significance of indirect acquisitions had made both Gray in 1981, and Stevens in 1985, resistant to the elimination of their review, even though, in Steven's case, he found the practice distasteful.

On the broader trade-related performance requirements, Canada appeared to have conceded the issue almost from the outset. Ambassador Gordon Ritchie, Deputy Chief Negotiator, implied before a House of Commons Committee, that the 1983 GATT ruling on FIRA (discussed in Chapter Six) had essentially already prohibited all of these measures (not, in fact, the case) and that Canada concurred with the U.S. desire to eliminate these practices internationally.¹¹³ Yet Canada's response to earlier U.S. objections to performance requirements and screening had been a different one. Canada

had argued that these were corrective actions necessary in view of the nature of intracorporate transborder transactions among multinationals, and particularly the tendency of EFC's to favour traditional U.S.-based suppliers to the detriment of competitive Canadian suppliers.¹¹⁴ Since the creation of Investment Canada, however, the emphasis in screening had been centered on technology and the increase in Canadian equity, discussed in Chapter Four.

In the case of the Baie Comeau policy of divestment of publishing firm acquisitions, Ambassador Ritchie argued that the agreement would permit stronger policy enforcement. The Canadian government would be able to acquire publishing firms from American companies for a price based on an independently determined fair market value. This would avoid situations where U.S. companies were given repeated deferrals on divesting when they claimed they were unable to find a Canadian buyer at the price being demanded and the Canadian government was unwilling or unable to coerce a sale.¹¹⁵

The formal commitment to national treatment was a major departure in Canada's stated policy on FDI. Since the 1960s Canada had strongly resisted unrestricted acceptance of the principle and, as Chapter Six will indicate, in 1985 launched a full reservation at the OECD on the national treatment aspects of the Code on Capital Movements. Having said that, my review of Canada's FDI regime in Chapter Four indicated that the use of discriminatory policy instruments, with the

exception of a period in the 1960s and the early 1980s, has, on the whole, been fairly limited. In several instances attempts to use discriminatory instruments against EFCs resulted in strong and sustained opposition both within and outside Canada. Canada's FDI regime has relied much more on the regulation of access, first on a sectoral, then a general basis, and compensating for the effects of FDI through expenditures and state enterprises. The discriminatory instruments remaining in place, as a result of the FTA, tended to be fairly limited in application or involve little coercion.¹¹⁶

The FTA also grandfathered existing policy instruments.¹¹⁷ Canadian officials have argued that the grandfathering constituted U.S. recognition and acceptance of existing investment practices which, given the aggressive opposition to any impediments to access which characterized U.S. investment policy in the 1980s, could be seen as a victory.

Compensatory instruments have not generally been an object of U.S. influence since they do not target EFCs or incoming investors. While article 2011 of the FTA did limit the scope of the Canadian state's ability to compensate in future for high levels of foreign ownership, it is, however, future bilateral or multilateral negotiations on the definition of subsidies which may ultimately define the parameters of compensatory policies.

In sum the changes to Canada's investment regime which resulted from the FTA have moved the Canadian state further along a trajectory already established by the policy changes of 1985, that is, further, but not complete, liberalization of access, special measures for cultural and resource industries and national treatment for foreign investors, which had been largely practiced, if not formally acknowledged. But the changes continued to reflect the conflicting policy objectives of opening access further, in this case to U.S. investors, in return for concessions which would make access to the U.S. market more secure, while safeguarding, or appearing to safeguard, sovereignty and autonomy. A policy of screening large, direct acquisitions remained in place and accounts of the negotiations suggest that Canada bargained hardest to retain this policy, particularly in those areas that have generally been the focus of more coercive and intrusive instruments namely, cultural industries (especially publishing and broadcasting) and energy.¹¹⁸

Conclusion

This chapter examined the question of whether Canadian trade dependence on the United States would afford the United States influence over Canada's FDI regime. Our expectation was that U.S. influence would move Canada's FDI regime in the direction of less coercion of investors, liberalization of access and limit the use of discriminatory instruments. The

analysis indicates some U.S. influence, but only under certain conditions.

In the earlier period our analysis indicates that, while Canada's trade dependence on the U.S. did shape the range of options, it was not as a result of U.S. efforts to influence Canadian investment policy per se. U.S. investment objectives in the earlier period were, in fact, fairly limited. The United States largely accepted some host state control of access, as long as U.S. investors were treated on a most favoured nation basis and compensation, in cases of expropriation, was prompt, adequate and effective. However, the U.S. trade action in 1971 against Canada exports occurred while Cabinet was deliberating over the scope of regulation of access in August. Moreover as Chapter Four indicated, there was no strong consensus within the Canadian Cabinet to move beyond limited control of access, for fear of its impact on investment, nor strong support for using the state aggressively to regulate EFCs or repatriate the economy. Thus U.S. trade action made decision-makers even more cautious, than they already were, in their treatment of foreign investors, fearing the impact of screening new investment on an already weak economy. The result was that the Canadian state chose to use control of access in a limited way, avoided use of discriminatory instruments, and left EFCs largely untouched.

However, in the later period the United States did seek

to influence Canada's FDI regime using Canada's dependence on the United States as an export market. In contrast to the earlier period the late 1970s and early 1980s saw strong U.S. opposition to Canada's FDI regime as a result of a broadening of U.S. state goals regarding foreign investment and perceived attempts by Canada to increase coercion of investors. The U.S. had become increasingly hostile to any host state control of access or the imposition of performance requirements in return for access, while continuing to seek national treatment of U.S. investors. State officials were prepared to use both bilateral and multilateral measures, especially those linked to trade, to coerce host state regime change.

Despite increased U.S. state attention to, and opposition to Canada's FDI regime the Canadian state did increase coercion over investors and adopt new discriminatory policy instruments in 1980. However, the capacity and willingness to resist U.S. pressure clearly varied by economic sector. Increased coercion of investors on the part of FIRA and the proposed discriminatory review of EFCs under the FIRA, and a number of other measures which were designed to repatriate the manufacturing sector and enhance the performance of manufacturing EFCs, were strongly opposed by the United States. U.S. actions included protests, threats of trade sanctions, issue linkage and attempts to use multilateral organizations to pressure Canada. These influence attempts, on the surface, appear to have been successful as the

proposed changes to FIRA were abandoned in 1981, general access for foreign investors was progressively enhanced, beginning with the small business measures of the 1982 budget, and coercion lessened. Yet the Canadian Cabinet had been split on the issue of regulating EFCs and uncomfortable over the level of state intervention this would entail, and concerned about the already high level of capital outflows and drops in the value of the Canadian dollar.

In the case of energy and cultural industries, the United States had less success in opposing the use of coercive and discriminatory policy instruments. Evidence indicates that the U.S. state had greater difficulty in identifying retaliatory options in the case of the NEP. Moreover, there was a stronger consensus within the Canadian state on important domestic energy goals, as well as those of Canadianization, and a sense that higher oil prices enhanced the state's bargaining power. In both cases, then, Canadian state preferences played a role in determining the outcome of U.S. influence attempts.

Further changes in 1985 to both FIRA and the NEP occurred within a context of increased apprehension over Canada's ability to compete as an investment location, much lower oil prices and fears of capital flight to the United States, which resulted in a state consensus that Canada could not afford general screening of investment and that Canada's bargaining power with investors was limited. In the meantime the United

States had become increasingly militant in its opposition to any host state control of access and the imposition of performance requirements. This was combined with a growing preoccupation, on the part of the Canadian state, with securing and enhancing access to the U.S. market. These two trends set the stage for the United States to use trade leverage in the context of the 1985-87 trade negotiations to alter Canada's FDI regime.

The United States was able to use its trade leverage to influence the nature of Canada's foreign investment regime, particularly in demanding liberalization of access, restrictions on the Canadian state's ability to impose conditions on investors in return for access, and gaining formal recognition of national treatment by the Canadian state. At the same time the United States could not eliminate the Canadian state's controls over access, especially in the case of acquisitions and special measures for the cultural and energy sectors. These changes thus narrowed the scope of control over access back to the original conception Cabinet had in 1972. However, in the case of discriminatory policy instruments Chapter Four indicated that, with the exceptions of energy and culture, the Canadian state used them infrequently. In the case of performance requirements, Canadian officials had indicated in 1985 that lower tariffs, enhanced competition for investment and globalized production had weakened their ability to bargain for enhanced

performance.

Thus the United States was able to push Canada in a certain direction in changes to its regime, but these changes were in line, one could argue, with pre-existing Canadian state preferences. Negotiations resulted in significant liberalization of access for U.S. investors to the Canadian market. It is also clear, however, that Canadian state preferences shaped the trade-offs. While many of the United States' investment objectives were achieved¹¹⁹ and the United States was able to shape Canada's FDI regime, it was largely in the direction of liberalizing access, not in abandoning screening or protection of key sectors.

U.S. influence over Canada's FDI regime, arising out of Canada's economic dependence, has been limited by two factors: first, the availability of effective and cost-free sanctions and second, the willingness and commitment of the Canadian state to resist U.S. demands, even if the cost of using certain policy instruments increases.

The United States' investment interests were not fully satisfied by the FTA. The United States continued to aggressively pursue liberalization of access both bilaterally and within international organizations. Remaining Canadian controls on FDI in 1989 were considered to be barriers to U.S. trade¹²⁰, unfinished business which the trilateral North American free trade talks addressed¹²¹. These talks are discussed in the concluding chapter, and evidence in that case

again indicates that Canadian state preferences, in this case strong opposition to the complete liberalization of access, especially in the cultural sector, helped shape the outcome of the agreement, despite the trade dominance of the United States.

Both Canada and the United States have also looked to international organizations to realize their objectives regarding foreign direct investment. In Canada's case, as a counterweight to U.S. influence and a source of legitimacy for its investment regime; for the United States as a way to limit host state controls over FDI and gain international acceptance of its investment objectives. Chapter Six addresses this aspect of Canada's changing foreign investment regime.

Appendix A**Chronology 1980-87 Canada-U.S. Relations and
Investment Issues**

**February
13, 1980**

Campaign promises made during Canadian federal election by Liberal party to increase Canadian control of the economy by enhancing the role of the Foreign Investment Review Agency and Canadianizing the natural resource industries.

April 14, 1980

Speech from the Throne reaffirms campaign commitments to amend FIR Act to include performance review of EFCs, publication of acquisitions prior to review, and assistance for repatriation. Also promises legislation to Canadianize oil and gas sector and provide preferential rights for Petro-Canada and other Canadian companies on Canada lands.

April 16, 1980

U.S. Administration officials prepare Trade Policy Committee paper recommending increased U.S. government emphasis on concerns relating to FIRA in bilateral relations with Canada.

April 21, 1980

Bilateral meeting of United States Trade Representative Askew with Industry Trade and Commerce Minister Gray to review U.S. concerns regarding FIRA. Amb. Askew warned that any use of performance reviews of U.S. firms operating in Canada would be regarded as a very serious matter.

Sept., 11, 1980

Joint meeting of U.S. Trade Policy Staff to develop coordinated response regarding FIRA

Sept., 15, 1980

U.S. delivered aide-memoire to Canadian government on the trade-related aspects of FIRA of concern to the United States.

October 7, 1980

Bilateral meeting of U.S. officials (Commerce, USTR, and State) with Canadian officials (ITC and DEA) on bilateral issues including FIRA.

October 19, 1980

U.S. Deputy Secretary of Commerce expresses concern publicly at a New York conference about increasing Canadian restrictions on foreign investment.

October 28, 1980

Canadian government announces National Energy Program (NEP).

Nov. 7, 1980

Bilateral meeting of Canadian and American officials on the NEP. U.S. officials are assured that the NEP would be implemented in a manner which took account of interests of trading partners and international obligations and are invited to comment on working documents available.

Nov., 19, 1980

Bilateral meetings of the Auto Pact, U.S. Deputy USTR strongly criticizes the NEP.

Dec. 5, 1980

Diplomatic note to Canadian Ambassador in Washington, Peter Towe from the United States Trade Representative expressing concern over Canada's investment, trade and energy policies embodied in the NEP and FIRA. Calls for a higher threshold, shorter review time and the publication of clearer policy guidelines for FIRA cases.

Dec., 17, 1980

Second bilateral officials meeting for consultations on the NEP.

Jan 30, 1981

U.S. Trade Policy Staff Committee approved the use of GATT Article 22 consultations if trade-related aspects of the National Energy Program were left unchanged.

Feb., 14, 1981

NEP proposal to discriminate against foreign-owned companies in the granting of gas export licenses is dropped by the Canadian government.

Feb., 18, 1981

USTR and State officials meet with Canadian trade official to express concern with NEP.

Feb., 23, 1981

Letter from U.S. State Department to Ministers MacGuigan and Lalonde claims that the NEP represents a sweeping deviation from the non-discriminatory principles regarding foreign investment (National Treatment) established by the OECD. U.S. officials later commented that they would like the implementation of the NEP to be as inoffensive as possible. Letter had been requested by Canada as written clarification of the U.S. position.

Feb., 25, 1981

Energy Minister Lalonde dismissed U.S. complaint and claimed that "everything that we have done is in accordance with our international obligations." He also claimed that Canada's energy policy was mild compared to that of some other countries.

Feb., 25, 1981

U.S. diplomatic note sent regarding a FIRA disapproval of a U.S. application based on the designation of transportation as a sensitive sector.

March 5, 1981

U.S. State Department letter sent regarding NEP and FIRA. Strongly worded note was sent without authorization of U.S. Secretary of State and withdrawn by the United States on March 10, 1981.

March 11, 1981

USTR and Secretary of Commerce met with Industry minister Gray to discuss the NEP and FIRA and gave him a letter regarding U.S. concerns with the NEP and raising the prospect of GATT consultations.

March 11, 1981

President Reagan and Prime Minister Trudeau meet.
No substantive discussion of the NEP and FIRA

March 11-4, 1981

OECD, Committee on Investment and Multinational Enterprises
consultations regarding Canada's NEP. U.S. complaints
supported by the UK and the Netherlands.

April 3, 1981

Aide-memoire sent to the Canadian embassy in Washington on
trade aspects of the NEP. Embassy never forwarded it to
Ottawa.

April 10, 1981

Meeting of USTR and Secretary of Commerce with
Minister Gray regarding the NEP and FIRA.

April 21, 1981

Letter from USTR and Secretary of Commerce
elaborating specific U.S. concerns regarding FIRA
decisions and cases and asking for bilateral
consultations on the issues they raised. Gray had asked for
specific complaints from the U.S. to serve as the agenda of
further meetings.

May 14, 1981

Energy minister Lalonde announces amendments to Bill C-48,
Canada Oil and Gas Act which would provide ex gratia payments
of compensation for the crown-share or "back in" to the House
of Commons Committee on Natural Resources. He also
introduces wording changes regarding the sourcing policies of
companies operating on Canada Lands to conform with GATT
requirements. Canadian Ambassador Towe conveys these changes
by letter to USTR Brock.

May 27, 1981

USTR Deputy meets with FIRA Commissioner and the Deputy of IT
and C and other Canadian officials regarding the operations
of FIRA.

June 1, 1981

USTR Brock, in letter to Towe, welcomes changes to NEP but

indicates that compensation not adequate and other concerns remain outstanding regarding discriminatory aspects of NEP and the operation of FIRA.

June 12, 1981

Bilateral meeting of officials regarding the NEP and FIRA. Further correspondence between Brock, Baldrige and Gray.

July 7, 1981

USTR outlines Reagan Administration's trade policy to Senate Finance Committee. It includes elimination of performance requirements and other trade-distorting investment controls.

July 10, 1981

Trudeau and Reagan meeting. NEP and FIRA are discussed.

July 22, 1981

Cable sent by U.S. Ambassador in Ottawa to Secretary of State and Secretary of the Interior Watt claiming that given Canadian policy on investment and the NEP there is no choice but to declare Canada non-reciprocal under the 1920 Mineral Lands Leasing Act (MLLA)

July 29, 1981

Finance Minister MacEachen meets with major Canadian banks and publicly appeals to them to refrain from further financing of large takeovers and repatriation of firms because of impact on the dollar. July had seen massive Bank of Canada intervention (\$1.4 billion) to slow the dramatic drop.

August 4, 1981

USTR Brock publicly announces a study of Canadian investment policy to determine if FIRA screening process distorts Canada-United States trade. Questionnaires to be sent out to U.S. companies.

August 6, 1981

U.S. House of Representatives Energy Subcommittee hearings on the MLLA. Interior Secretary Watt

5

PM-1 3½"x4" PHOTOGRAPHIC MICROCOPY TARGET
NBS 1010a ANSI/ISO #2 EQUIVALENT

PRECISIONSM RESOLUTION TARGETS

recommends against using the MLLA to retaliate against Canada as ineffective and inconsistent with U.S. policy on investment.

August 10, 1981

U.S. Treasury announces that the intracabinet Committee on Foreign Investment in the United States will review recent Canadian takeovers along with others involving French and Kuwaiti state corporations. Cabinet decision directs USTR and Commerce to develop list of sanctions for possible use against Canada.

August 27, 1981

Canada announces establishment of Committee on Industrial and Regional Benefits to review megaprojects and ensure Canadian suppliers and companies have opportunity to participate in the economic benefits.

Sept. 17, 1981

Finance Minister MacEachen meets with U.S. Treasury Secretary Donald Regan and indicates that the government had shelved any plans to strengthen FIRA.

Sept. 18, 1981

Meeting of Reagan and Trudeau. NEP and FIRA discussed. President was informed of decision regarding FIRA but the Canadian government's commitment to the NEP was reaffirmed.

Sept., 22, 1981

Speech of U.S. Undersecretary of State Myer Rashish in New York City refers to a crisis in Canada-U.S. relations and warns of widespread support in Washington for countermeasures.

Calls NEP "expropriation of American assets without full and adequate compensation." Seen by Canadian officials as very beligerent and indicative of the seriousness of U.S. concern over Canadian policies and frustrations with the lack of progress in bilateral negotiations.

Sept 26, 1981

U.S. officials indicate that there is still opposition within the administration to inviting Canada to trade talks involving the U.S., EC and Japan because of policies on investment and energy.

Sept, 26, 1981

Trudeau admits publicly that government will not proceed at the moment with changes to FIRA but remains committed to it. Blames the decision on the economic situation, particularly the falling Canadian dollar.

Sept. 28, 1981

Lalonde publicly responds to Rashish's remarks calling them "excessive and uncalled for" and affirms that Canada is prepared to pay the price of retaliation if necessary over energy policy.

Oct., 13, 1981

Treasury Secretary Regan meets with Finance Minister MacEachen and SSEA MacGuigan to discuss the NEP and FIRA

Oct., 15, 1981

U.S. Ambassador Robinson claims publicly that he has been told by highest authority that "FIRA will be reined in"

Oct., 21, 1981

U.S. Administration officials outline a shopping list of changes demanded in Canadian energy and investment policy to the House of Representatives joint subcommittee on International Economic Policy and Inter-American Affairs. List included: elimination of discriminatory aspects of Petroleum Incentives Program (Canadian ownership rating); national treatment for all goods and suppliers to Canadian energy projects; elimination of performance requirements for foreign investors and the elimination of FIRA review of indirect acquisitions that do not increase foreign control of assets. Officials continue to advise against retaliation against Canadian investment in the United States.

Oct., 30, 1981

Unconfirmed reports that Canada is again reviewing the issue of compensation for the "back-in."

Nov., 12, 1981

Canadian federal government releases Economic Development for the 1980s which contains reassurance of no more NEP's in other sectors and that no further changes to FIRA are

planned pending a review of its administration and procedures.

Nov. 28, 1981

Interior Secretary Watt formally solicits corporate and administrative comment on Canada's reciprocal status under the MLLA. Most corporate comment, while negative regarding the NEP and FIRA, recommends against declaring Canada to be non-reciprocal. Other departments and the Council of Economic Advisers also share this view.

Dec., 10, 1981

Brock letter to Ambassador Gottlieb regarding FIRA and Canada's international obligations.

Dec., 16, 1981

Brock reverses his position and sends invitation to trade talks set for January after other Administration pressure and the fact that the issue was clearly becoming a "matter of national honour" for Canada.

Jan., 8, 1982

U.S. requests formal bilateral consultations under GATT auspices regarding the Foreign Investment Review Agency prior to seeking a panel hearing.

Jan. 9, 1982

Gray calls the U.S. action a normal move in trade consultations.

Jan, 1982

The United States is successful in OECD Executive Committee at launching a new work program on investment issues.

Feb 3, 1982

Interior Secretary Watt makes a final determination that Canada remains a reciprocal nation under the MLLA.

March 1982

Meeting of Canadian and U.S. officials to review the Energy Security Act.

June 28, 1982

Budget announces a new small business threshold for FIRA cases and limits on the imposition of full review of small cases.

June 29, 1982

Trade minister Lumley meets with Brock. Brock calls FIRA changes "welcome step" but warns the United States still has concerns. Lumley outlines changes but affirms that FIRA is here to stay.

Sept., 1982

Lumley appointed Minister of I T and C and a new FIRA commissioner is appointed. New guidelines regarding ministerial opinions.

Dec. 22, 1982

Lumley announces forthcoming establishment of an advisory board for FIRA and issues further clarifications on policies.

July 12, 1983

GATT panel supports part of U.S. claim that procurement undertakings required by FIRA violate Article 3.

August 30, 1983

Canada releases trade policy review advocating sectoral free trade discussions with the United States.

Sept. 9, 1983

United States releases International Investment Policy Statement.

Feb 17, 1984

USTR Brock and Trade Minister Regan meet to discuss sectoral free trade.

October 22, 1984

Passage of U.S. Trade and Tariff Act.

Dec. 10, 1984

Investment Canada Act introduced in the House of Commons

Dec. 10, 1984

Prime Minister tells New York business audience Canada is "open for business" and promises to get rid of NEP back in.

January 25, 1985

Trade policy paper How to Secure and Enhance Access to Export Markets outlines bilateral negotiating options and initiates private sector consultations.

July 6, 1985

Canada's policy on foreign investment and book publishing is announced.

Sept 8, 1985

Commerce Secretary Baldrige meets with Investment Canada minister Stevens and complains regarding Canadian policy on publishing takeovers.

Sept. 26 1985

Prime Minister announces decision to initiate free trade discussions with the United States.

October 26, 1985

New less coercive and discriminatory investment regime on Canada Lands is announced by energy minister.

May 21, 1986

Free trade negotiations begin.

Oct. 3, 1987

Agreement reached on basic elements of FTA.

1. James Caparaso and Stephen Haggard, "Power in the International Political Economy," in Richard J. Stoll and Michael Ward (eds.) Power in World Politics (Boulder: Lynne Reinner, 1989), 99-120.
2. Estimates suggest that in 1985 the assets of foreign-controlled companies represented 1.6 per cent of the assets of all corporations in the United States. See Robert Lipsey, Changing Patterns of International Investment in and by the United States, (Washington: National Bureau of Economic Research, May 1987) Working Paper Series.
3. This is not, however, to suggest the absence of US state regulation of either incoming or outgoing capital. Restrictions on the entry of foreign capital exist in various sectors such as nuclear energy, which have a national security dimension to them. In addition in the 1960s and early 1970s the United States imposed voluntary or mandatory controls on outgoing capital. Most recent was the provision of the 1988 Omnibus Trade and Competitiveness Act of 1988 which included presidential power to block foreign investments through mergers, takeovers or acquisitions if they are deemed to be a threat to national security. For a discussion of U.S. policy see Edward Graham and Paul Krugman, Foreign Direct Investment in the United State, (Washington: Institute for International Economics, 1991) Chapter Six. Nor can it be argued that U.S. state interests in FDI can be reduced to those of large U.S.-based multinational corporations. Indeed, the relationship between U.S.-based multinational capital and the U.S. state has provoked much debate over the extent of U.S. state autonomy in foreign economic policy. See James Hawley, "Interests, State Foreign Economic Policy and the World System: The Case Of U.S. Capital Control Programs." in Pat McGowan and Charles Kegley (eds.) Foreign Policy and the Modern World System, (Berkeley: Sage, 1979), 223-254, Stephen Krasner, Defending the National Interest: Raw Materials Investments and U.S. Foreign Policy (Princeton, New Jersey: Princeton University Press, 1978) and Charles Lipson, Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries (Berkeley: University of California Press, 1985). For a discussion of the debate and the privileged position of U.S. business in the shaping of foreign economic policy see Kenneth Rodman, Sanctity vs. Sovereignty (New York: Columbia University Press, 1988) chapter six.
4. This was put forward as the international standard by U.S. Secretary of State Cordell Hull in 1938. See Rodman, op cit., chapter one, 38-41.
5. See the January 23, 1974 statement of U.S. policy "Foreign Investment and Free Capital Markets," by William Casey, at that time Undersecretary of State for Economic Affairs, before

the United States Senate Subcommittee on International Finance of the Committee on Banking, Housing and Urban Affairs.

6. The preoccupation with expropriation and Treasury's tough attitude was exemplified in the January 1972 presidential statement, "Economic Assistance and Investment Security in Developing Countries," reprinted in the Department of State Bulletin (February 7, 1972), which established a new interagency group to deal with the issue and broadened retaliation to include action within regional development banks to deny loans to states which inadequately compensated investors.

7. Called the Committee on Foreign Investment in the United States it was composed of the Secretaries of Commerce, Treasury, State and the United States Trade Representative. It met rarely, and was criticized sharply in a 1980 congressional report as being largely symbolic. See The Adequacy of the Federal Response to Foreign Investment in the United States (Washington: House of Representative, 1980) Report no. 92-1216.

8. See the submissions by officials to Congressional committees in 1975 some, reprinted in the Department of State Bulletin (1975).

9. For a discussion of this tactic see Jagdish Bhagwati and Hugh T. Patrick (eds.) Aggressive Unilateralism: America's 301 Trade Policy and the World Trading System (Ann Arbor: University of Michigan Press, 1990).

10. For a discussion of reciprocity and these concepts see Robert Axelrod, The Evolution of Cooperation (New York: Basic Books, 1984).

11. See Robert Keohane and Joseph S. Nye, Power and Interdependence (Boston: Scott Foresman and Co, 1989).

12. Interview with Gray task force member, October 1985.

13. Government of Canada, Foreign Direct Investment in Canada (Ottawa: Information Canada, 1972), 470.

14. Ibid. 470.

15. Thomas L. Ilgen Autonomy and Interdependence: US-Western Europe Monetary and Trade Relations, 1958-84 (Totawa, N.J.: Rowman and Allanhead, 1985).

16. Early estimates of over \$3 billion of exports being affected involving 40,000-100,000 jobs turned out later to have been overly pessimistic but indicate the degree of alarm

which the U.S. measures engendered. See William Dobell, Canada in World Affairs: 1971-73 (Toronto: Canadian Institute of International Affairs, 1985), 15.

17. Statement during a press conference November 17, 1971 as quoted in William Dobell, Op cit. 63.

18. See the discussion in chapter four, 178.

19. Text of President Nixon's Speech to the Canadian Parliament, April 14, 1971 reprinted in Department of State Bulletin, (May 8, 1972).

20. "Canada cautioned on US Trade Pattern," New York Times, (May 5, 1972).

21. Reaction from the United States Council of the International Chamber of Commerce and a host of large corporations indicates that they saw the proposed legislation as largely innocuous, responding to public concern while not impeding the inflow of capital. Most important it left the interests of EFCs unaffected. See "Canadian Plan Described as Mild by Businessmen" and "Businessmen in US Describe Canadian Screening Plan as Mild," New York Times (May 4, 1972).

22. See Subcommittee on Inter-American Economic Relationships of the U.S. Congressional Joint Economic Committee on "Canadian Foreign Investment Screening and the Role of Foreign Investment in the Canadian Economy", especially that of Richard Vine, Deputy Assistant Secretary of European Affairs, Department of State, Jan. 26, 1976 commenting on the origins of FIRA and what U.S. expectations have been. See also Business Week, August 24, 1974.

23. See the testimony before the Subcommittee on Inter-American Economic Relationships of the U.S. Congressional Joint Economic Committee on "Canadian Foreign Investment Screening and the Role of Foreign Investment in the Canadian Economy", especially that of Richard Vine, Deputy Assistant Secretary of European Affairs, Department of State, Jan. 26, 1976. Vine indicated no real Administration concern with the operation of FIRA which was echoed by most of the statements of corporate representatives.

24. See for example the speech of U.S. Ambassador, Thomas Enders to the Empire Club of Canada. "Canada Told to Resist Using Investment Laws Against US Firms." Globe and Mail (April 30, 1976).

25. The bill completed a process, begun in the mid 1960s under Finance Minister Walter Gordon, to ensure the continuation of a viable Canadian-owned print media through the use of tax regulations which discriminated on the basis of the level of foreign ownership of a firm. The initial measure is discussed in chapter four. It provoked a strong U.S. reaction, spearheaded by the politically influential Henry Luce, owner of Time magazine, which ultimately resulted in the exemption of Time and Reader's Digest from the legislation. The 1975 bill took away that exemption and extended the legislation to cover the broadcast media, hitting hard at the advertising revenue of U.S. border broadcasting stations. It met with strong U.S. opposition which reached its peak in the early 1980s when it became a case of cross-border trade in services more than an investment issue. For a discussion of the case see Isaiah Litvak and Christopher Maule, "Canadian International Media Firms and Canada-U.S. Relations," Behind the Headlines XXXIX: 5 (Toronto: CIIA, 1982) and David Leyton-Brown, Weathering the Storm: Canadian-United States Relations, 1980-83 (Toronto: C. D. Howe, 1985).

26. This is reflected in the truncated version of the Gray Report which formed the basis of the cabinet document outlining options and was confirmed in an interview with a member of the Gray Task Force in October, 1985.

27. See Foreign Direct Investment in Canada as discussed in Chapter Four.

28. See Tables 3.12 and 3.13 in Chapter Three.

29. For a discussion of the sources of these policy changes see Bhagwati et al, Aggressive Unilateralism Op cit., especially the article by Helen Milner, "The Political Economy of U.S. Trade Policy: A Study of the Super 301 Provision", 163-180.

30. US Secretary of Commerce, Malcolm Baldrige, commented on US trade policy before a Senate committee that "As the world's leading exporter and importer of services the US has a vital stake in eliminating barriers abroad which inhibit international exchanges of services." By 1980 services represented 65 per cent of US GDP and 71 per cent of employment.

31. In a statement of U.S. trade objectives before a Senate committee United States Trade Representative William Brock identified performance requirements as having "serious trade-distorting effects." The Administration, in its fifth trade objective was committed "to a reduction in government barriers to the flow of trade and investment among nations with an emphasis on improvements and extension of international trade

rules." See hearings of the Subcommittee on International Trade of the U.S. Senate Committee on Finance July 8, 1981, 97th Congress, First Session.

32. United States Trade Representative's Office, Annual Report to the President of the United States on the Trade Agreements Program November 1981 and 1982, see section on investment policy and Statement on U.S. Trade Policy, July, 1981.

33. U.S. officials claimed repeatedly that Canada's behaviour served as a model for many developing countries and contributed to U.S. difficulties in attaining international acceptance of more restraint. The claim that if Canada is allowed "to get away with it" it would have a demonstration effect was a strong factor in motivating U.S. state opposition to Canada's actions. See for example, the statement of Ray Waldmann, Assistant Secretary for International Economic Policy, U.S. Department of Commerce, "Because Canada is a major industrialized nation, what it does in the international economy is likely to give encouragement to others to do the same." Even more emphatic was Robert Carroll, a Deputy Assistant Secretary in Treasury who claimed, "We have been approached by developing countries who have advised us that if Canada, as a developed country, is allowed to continue their practices of the FIRA requiring that Americans and other foreign companies coming into Canada buy Canadian there is, indeed, no chance that efforts we have made multilaterally in the Gatt and other fora such as the OECD can ever be successful" Testimony before the Subcommittee on International Economic Policy and Trade of the U.S. House of Representatives Committee on Foreign Affairs, October 21, 1981.

While it is hard to believe that Canada had such influence this theme was frequently repeated by U.S. state officials in 1981 and 1982.

34. Speech from the Throne, Debates, House of Commons, April 14, 1980.

35. See the testimony of Deputy USTR, David Macdonald before the Subcommittee on Oversight and Investigations of the House of Representatives Committee on Energy and Commerce, June 19, 1981.

36. See the letter of April 9, 1981 to Herb Gray from Secretaries Brock (USTR) and Baldrige (Commerce) outlining specific U.S. cases and complaints about FIRA operations. Tabled as part of the hearings of the Subcommittee on Oversight and Investigations of the House of Representatives Committee on Energy and Commerce, July 9, 1981.

37. See Table 4.5 Chapter four. Calculations are based on the agency's annual report. Overall approval rates dropped from over 85 per cent in the 1978-79 period to 73.4 in 1980-81. The major change was in the approvals for acquisitions and new business in resource industries. Rates for manufacturing dropped much less to just over 80 per cent in the 1980-81 period.

38. "FIRA the Paper Tiger that Comes to Life," Globe and Mail (July 18, 1981), B.1. Press reports at the time connected the delay in decisions to FIRA's efforts to find Canadian buyers. See "FIRA influence Aids Takeover by Executives," Globe and Mail (March 23, 1981), B1. Commissioner Howarth denied that the agency engaged in any shopping around for alternate Canadian buyers and blamed the backlog of cases which had developed in the late 1970s and a lack of staff. See his testimony before the House of Commons Committee on Finance, Trade and Economic Affairs, May 1981.

39. See the testimony before the House Subcommittee on Oversight and Operations of the Energy and Commerce Committee, July 1981 which includes testimony of officials from USTR, Treasury, State and Commerce Departments on the nature of U.S. concerns and documents U.S. actions from early 1980 onward.

40. See the speech of Robert Hormats, Assistant Secretary for Economic and Business Affairs in September, 1981, reprinted in the Department of State Bulletin, November, 1981 as well as the later testimony of Commerce, Treasury and State officials before the House Committee on Foreign Affairs, Subcommittee on International Economic Policy October 21, 1981.

41. The policy announced on July 12, 1977 indicated it was not in the U.S. interest to either encourage or discourage inward or outward investment. It did, however, reiterate the view that a free flow of investment capital, allocated by market forces, was in the best interests of all countries and the United States.

42. See the testimony of Harvey Bale, Assistant USTR for Investment Policy to the Subcommittee on International Economic Policy of the Senate Committee on Foreign Relations, October 28, 1981. According to Bale a positive policy was now in place with three objectives: first to liberalize barriers and reduce distortions to international investment; second to encourage the greater role of FDI in developing countries; and third to maintain the openness of the U.S. economy to the contribution that incoming FDI could make to growth.

43. This period has been described as one of "crisis" in Canada-US relations by Stephen Clarkson, Canada and the Keanan Challenge (Toronto: Lorimer, 1982). Clarkson reviews all

aspects of the relationship. Chapters 2, 3 and 4 deal with the NEP and FIRA, although he does not specifically focus on the sources of change to Canada's foreign investment regime.

44. Judith Goldstein has identified fair trade and free trade as two deep ideological commitments embedded in the U.S. state. See Judith Goldstein, "Ideas, Institutions and American Trade Policy," International Organization 42 (Autumn, 1988), 179-217. A similar commitment to the free movement of capital can be also identified. This, like free trade, had come under attack domestically when foreign states were perceived to be manipulating economic linkages, such as foreign investment, to create a competitive advantage to the detriment of US economic interests.

45. See the letters of Brock and Baldrige to Hon. Herb Gray April 9 and 21, 1981 as reprinted in the testimony of David Macdonald, Deputy United States Trade Representative, to the House of Representatives Subcommittee on Oversight and Investigations of the Committee on Energy and Commerce, June 19, 1981.

46. Ibid.

47. "US Studies Canada Trade," New York Times (August 5, 1981), D2.

48. See Richard Corrigan, "Canadianization a Red Flag to US Firms and Their Friends in Congress," National Journal (August 1, 1981), 1369-1373.

49. See the testimony of Ray Waldmann, Assistant Undersecretary, U.S. Commerce Department before the House of Representatives Subcommittee on International Trade of the Committee on Foreign Affairs, October 21, 1981.

50. See "Gray Has a Report Card Scheme," Vancouver Sun (August 14, 1980) and his testimony May 26, 1981 before the House of Commons Committee on Finance, Trade and Economic Affairs.

51. Stephen Clarkson has claimed that U.S. opposition stopped plans to develop an industrial strategy, of which the expanded FIRA role was a part, "dead in their tracks" even though Canada was able to retain FIRA. See Canada and the Reagan Challenge (Toronto: Lorimer, 1982) This is somewhat of an overstatement since, as Chapter Four, indicated there was also some strong domestic opposition to these measures.

52. See Government of Canada, Economic Development for the 1980s, (October, 1981).

53. In July alone the Bank of Canada was forced to undertake substantial intervention of \$1.4 billion to slow the slide of the dollar. Finance Minister MacEachen was forced to ask the Canadian banks to cease their loans to firms engaging in major takeovers in the United States on July 29, 1981.

54. See quote in "Ottawa is Slowing Down its Plans to cut Foreign Ownership: Trudeau," Montreal Gazette (September 26, 1981), 11.

55. Large corporations and their associations (including the Canadian Manufacturers Association, the Chamber of Commerce and the Business Council on National Issues) lobbied extensively against the measure particularly in the summer of 1980. The President of the Canadian Chamber of Commerce issued an ominous warning that "all those firms that have been here for years minding their own business will be swept into the net," and "not only do you have a gun pointing at you but the gun is loaded. They'd be gathering information so they can pull the trigger and make you perform in ways that you, in your wisdom, judge to be inappropriate." Vancouver Sun, (August 12, 1980). The Canadian Bar Association also initiated a review of FIRA and the proposals and published a highly critical study in September, 1981. Because of the mounting criticism Herb Gray, the Minister of Industry, Trade and Commerce promoting the changes felt compelled to discuss them publicly even though they had not yet been considered by cabinet because of what he called "misperceptions" about the policy. "Gray Has Report Card Scheme," Vancouver Sun (August 14, 1980).

Only two provinces, Ontario and Manitoba, at the Annual Premiers Meeting on August 13, 1981 did not support the complete abolition of FIRA. Even Ontario by that point, however, was highly critical of its operation.

56. The opposition to the proposals had been reported even earlier. In March, 1981 there were reports that Gray's more coercive approach had been softened to one of moral suasion vis a vis EFC's. "Gray Unlikely to Get the FIRA He Wants," Financial Post, (March 21, 1981).

57. The new threshold was \$15 million and less than 600 employees. See Budget Speech, House of Commons Debates, June 28, 1982.

58. "Canada-US Trade Issues," Speech of the Hon. Ed Lunley, Minister of State for International Trade to the National Foreign Trade Council, New York, July 22, 1982.

59. Hyman Solomon, "The US is Pleased with a Softer FIRA," Financial Post, July 3, 1982.

60. See the testimony of former Commissioner Gorse Howarth before the House of Commons Committee on Regional Economic Development in March, 1985.

61. Foreign Investment Review Agency, Press Release, December 22, 1982.

62. By the spring of 1982 U.S. state officials openly admitted before congressional committees that these changes to the NEP were largely marginal and that the main substance of the policy remained intact, despite concerted U.S. efforts to alter it. See the testimony of various U.S. state officials before the Senate Subcommittee on International Economic Policy of the Committee on Foreign Relations, March 10, 1982.

63. Constrained shares refers to a proposal in the NEP which would have altered regulations making it easier for companies seeking to increase or ensure their level of Canadian ownership by restricting the ownership of certain classes of shares. U.S. officials feared it would lead to depressed prices of stocks held by foreign shareholders.

64. The Gray Report, and the statements of Minister Gillespie in 1973 openly acknowledged the view that in resource sectors, such as energy, the state had greater bargaining power. The rise in oil prices, and the shortages of the 1970s further strengthened that view which is reflected in the National Energy Program (October, 1980). Interviews also confirmed this perception. The popularity of the Canadianization elements of the NEP was confirmed repeatedly in polls. Clarkson, op cit., 79, credits this with strengthening Cabinet's resolve to withstand U.S. pressure.

65. Public opinion favoured the Canadianization aspects of the program consistently throughout this period, mistrusted multinational oil companies and favoured a stronger, state-owned Petro-Canada. See the Gallup Report of December 1981 reported in G. Bruce Doern and Glen Toner, The Politics of Energy (Toronto: Methuen, 1985), 257.

66. A State Department official on September 23 made a particularly strong speech and several public statements about the crisis in bilateral relations and in the growing clamour in Washington for retaliation. Lalonde reacted angrily but very firmly in a television interview and in a number of speeches. See "Canada Stymied by U.S. Snub," Vancouver Sun (September 26, 1981).

67. See "Ottawa is Slowing Down its Plans to cut Foreign Ownership: Trudeau", Montreal Gazette, September 26, 1981, where Trudeau refers to the fact that the oil lobby in the

U.S. is very vocal.

68. U.S. Ambassador to Canada Paul Robinson, at first seemed to favour declaring Canada to be non-reciprocal; however the State Department later changed its view and joined Commerce, and Treasury in opposing any such action.

69. See the testimony before the Senate Subcommittee on International Economic Policy, March 10, 1982, op cit.

70. The desire to conform with the GATT was made clear by Marc Lalonde, Minister of Energy, in his statement on amendments to Bill C-48 before the House of Commons Committee on Natural Resources, May 14, 1981.

71. "Canada Stymied by U.S. Snub," Vancouver Sun, (September 26, 1981), A1.

72. These included Japan and the European Community. As well the State Department and the White House supported Canada's inclusion when it became a sensitive issue. "US Bows to Canadian Pride in Trade Talk Row," Winnipeg Free Press (Dec. 30, 1981), 4.

73. Both Claire Sjolander, op cit. and Barbara Jenkins, op cit. also see this as the primary cause of liberalization at this point in time.

74. See Department of External Affairs, Canadian Trade Policy for the 1980s (Ottawa: 1983). Also see G. Bruce Doern and Brian W. Tomlin, Faith and Fear: The Free Trade Story (Toronto: Stoddart, 1991), chapters two and three.

75. Government of Canada, Trade Policy for the 1980s (Ottawa: Department of External Affairs, August, 1983) and A Review of Trade Policy: A Background Document to Canadian Trade Policy for the 1980s, (Ottawa: Department of External Affairs, 1983).

76. W. R. Hines, Trade Policy Making in Canada: Are We Doing it Right, (Montreal: Institute for Research on Public Policy, 1985), 73-74.

77. Sinclair Stevens, in announcing the legislation, claimed that the government hoped to spur an estimated \$16 billion in new investment by 1991 to significantly reduce unemployment. At least \$4 billion of this would need to come from outside.

78. See the speech of Sinclair Stevens to the Canadian House of Commons, December 7, 1984. The Conference Board had conducted a study of Canada as an investment location, with government funding which also drew this conclusion. See Charles Barrett, Christopher Beckman and Duncan McDowall, The

Future of Foreign Investment in Canada and Duncan McDowall, A Fit Place to Invest: Investor's Perceptions of Canada in a Changing World. (Ottawa: The Conference Board, 1984).

79. While not directly consulted on the legislation the broad direction of the bill was described to US Treasury officials by Michael Wilson during a visit to Washington prior to the bill's tabling in the House on December 10, 1984. See the exchange during question period between the minister and Steven Langdon, House of Commons Debates, December 10, 1984.

80. The Prime Minister called the back in "expropriating retroactively other people's property" in his speech. See "New Climate For Investment," Speech of Prime Minister Mulroney to the Economic Club of New York, December 10, 1984.

81. The changes provided for "reasonable commercial measures" to reach 50 per cent including a system of auction, reserve bids and if necessary, third party evaluation to achieve fair market value. See Energy, Mines and Resources, Canada's Energy Frontiers: A Framework for Investment and Jobs. (Ottawa: 1985).

82. Interview with officials in Department of External Affairs, October 1985. Prime Minister Mulroney had made improved relations a priority. There were some concerns, however, on the part of officials that expectations of FDI regime change were too high in the United States when IC was created and would be disappointed. This concern was reflected in DEA's reaction to the Canadian policy on publishing discussed below.

83. The Canadian policy was raised and criticized by US Commerce Secretary Baldrige in a September, 1985 meeting with Sinclair Stevens, the minister responsible for Investment Canada at the time. US officials complained again about the review of indirect acquisitions that result in no increase in foreign ownership. Moreover, the requirement that US corporations must divest of any Canadian publishing firm acquired within two years was considered too short a time period to ensure that US investors received fair market value for the assets. The case of Prentice-Hall was particularly controversial since it predated the policy and involved the politically powerful Gulf and Western conglomerate. The very high sensitivity to US pressure, especially on the part of External Affairs, was evidenced in a letter to Sinclair Stevens sent by Canada's ambassador to the United States, Alan Gotlieb on August 6, 1985 which called the book publishing policy "ill-timed and unclear" and "likely to hurt the painstaking effort to restore the confidence of US investors, who were bound to regard the policy as retroactive and radical." See "Washington Fuming Over Ottawa's Plan for the

Book Business," Globe and Mail, September 30, 1985 and "Publishing Policy Imperils US Ties Ambassador Says," Globe and Mail, November 4, 1985.

84. "US Welcomes Investment Bill" Halifax Chronicle Herald, December 8, 1984, D2.

85. Office of the President, International Investment Policy Statement, September 9, 1983 and the accompanying press release, "US Opposes Actions That Impede Investment Flows."

86. Ibid., 3.

87. Ibid.

88. Of most concern to US foreign trading partners, including Canada, was S2094 the Reciprocal Trade and Investment Act of 1982, reintroduced in 1983 and sponsored by Senator John Danforth.

89. See the letter of Ambassador Alan Gottlieb to Representative Pete Rostenkowski, September 15, 1983 as reprinted in the Subcommittee on Trade of the US House of Representatives, Committee on Ways and Means, Written Comments on HR 1571, The Reciprocal Trade Act, 1983. (November 4, 1983).

90. The description of the Act which follows is based on Rufus Yerxa, An Assessment of the Trade and Tariff Act, (Subcommittee on Trade, Committee on Ways and Means, US House of Representatives, Jan. 31, 1985.) mimeo.

91. Government of Canada, How to Secure and Enhance Canadian Access to Export Markets (Ottawa: Department of External Affairs, 1985).

92. In particular the Business Council on National Issues and the Canadian Manufacturers' Association were supportive. See G. Bruce Doern and Brian W. Tomlin, Faith and Fear (Toronto: Stoddart, 1991) chapter five. For a critical view of the role of these groups and their links to the US pro-free trade service industry see Linda McQuaig, The Quick and the Dead, (Toronto: Viking, 1991), chapters two and five.

93. Text of the Report by the Hon. James Kelleher, Minister of International Trade to the Right Honorable Brian Mulroney, Prime Minister of Canada (Ottawa: Department of External Affairs, September 26, 1985).

94. See the speech of Ambassador Clayton Yeutter to the Chicago Sun Times Forum on Canadian-American Trade Negotiations, October 30, 1986.

95. The October, 1985 National Trade Estimates report of the United States Trade Representative, which identified barriers to trade and investment as required by the 1984 Trade and Tariff Act, identified 21 measures for Canada of which three involved investment. These were unreasonable investment entry regulations, a lack of national treatment for foreign investors and performance requirements. See National Trade Estimates. (Washington: Office of the United States Trade Representative, October, 1985).

96. This is not to suggest that corporate restructuring, including disinvestment had not already occurred. Chapter Three indicated that Canadian firms had already been increasing investment in the US and relocating production. Some of this occurred as a result of the further lowering of trade barriers in Tokyo Round of GATT negotiations. See Isaiah Litvak, "Evolving Corporate Strategies, Adjusting to the FTA" in Fen Osler Hampson and Christopher J. Maule, After the Cold War: Canada Among Nations 1990-91. (Ottawa: Carleton University Press, 1991), 67-68. See also Glen William, Not For Export (Toronto: McClelland and Stewart, 1986) Second Edition, which in the final chapter "The March to Continental Free Trade makes a similar point, 176-178.

97. Government of Canada, Effect of Enhanced Trade on Investment: A Survey of the Evidence (Ottawa: April, 1986), Derek Chisom, Investment Responses by Multinational Enterprises to Three Canadian Policy Options for Canada-United States Free Trade. (Ottawa: Institute for Research on Public Policy, 1986) as well as Alan Rugman, Trade Liberalization and International Investment, Discussion Paper No. 247 (Ottawa: Economic Council of Canada, April, 1988).

98. Government of Canada, Investment Issues, (April, 1986). See also A Possible Canada-United States Trade Agreement: The Elements Involved. (April, 1986). Papers had been prepared earlier but not publicly released.

99. Government of Canada, Investment Issues, (April, 1986). See also A Possible Canada-United States Trade Agreement: The Elements Involved. The above were prepared as part of the background studies to the negotiations in 1985 and 1986 by various government departments and agencies and were ultimately publicly released in 1987.

The United States-Israel Agreement did include the right of establishment and national treatment.

100. Ibid.

101. See "Reisman and Carney at Odds Over US Free-Trade Demand," Ottawa Citizen. May 22, 1987 and "US Investment Explosive Free Trade Talks Issue," Toronto Star, May 24, 1987,

B1.

102. Conversations with Alberta intergovernmental officials indicate that these options were discussed at the regular meeting of federal negotiators and provincial trade officials, called the Continuing Committee on Trade Negotiations, in the fall of 1986.

103. "Free Trade Negotiators Establish Team to Probe Investment Issues," Globe and Mail, May 24, 1987.

104. For a detailed account of these negotiations see G. Bruce Doern and Brian W. Tomlin, op cit., 190-195. See also "Late Push by Baker Shows Reagan Wish for Canadian Pact," Globe and Mail, October 5, 1987.

105. For an assessment of the investment aspects of the agreement see Richard G. Lipsey and Robert C. York, Evaluating the Free Trade Deal (Montreal: C.D Howe Institute); Alan Rugman, "Multinationals and the Free Trade Agreement," in Marc Gold and David Leyton-Brown (eds.), Trade-Offs on Free Trade (Toronto: Carswell, 1988), 4-12 ; A.E. Safarian, "Foreign Direct Investment" in John Crispo (ed.) Free Trade: The Real Story (Toronto: Gage, 1988), 77-86 ; A.E. Safarian, "Investment Aspects of the Canada-US Free Trade Agreement," in Marray G. Smith and Frank Stone (eds.) Assessing the Free Trade Agreement (Ottawa: Institute for Research on Public Policy, 1987), 119-128 and Mel Watkins, "Investment," in Duncan Cameron, The Free Trade Deal (Toronto: Lorimer, 1988), 83-90.

106. Government of Canada, The Canada-United States Free Trade Agreement. (Ottawa: December, 1987).

107. See testimony of Robert A. Cornell, Deputy Assistant Secretary for Trade and Investment, US Department of the Treasury before the House of Representatives Committee on Energy and Commerce, Subcommittee on Commerce, Consumer Protection and Competitiveness, Washington, D.C., March 22, 1988.

108. See Doern and Tomlin, op cit.

109. Robert Cornell, op cit.

110. This assessment is, in fact, shared by a number of Canadian analysts of the agreement. There is strong division, however, on whether this is a severe limitation on Canadian sovereignty. Lipsey op cit., 1988 and Safarian, op cit., 1988, both critics of past Canadian FDI policy do see the agreement as restricting Canada's ability in the future to ever reimpose controls on access. However, they argue that Canada was able to retain a limited screening function and

they see the limits on Canada to reimpose restrictions as positive since they regard these policies as ineffective and not in Canada's economic interests. Watkins, op cit., 1988, on the other hand, agrees that the agreement limits Canada's ability to intervene regarding FDI in the future. He however, regards it as an unacceptable loss of sovereignty. Doern and Tomlin, op cit., 1992, concur that the investment provisions of the FTA are part of an overall loss of Canadian state capacity in the area of industrial policy. They argue, however, that other policy instruments may be available to the Canadian state to achieve its goals. Fred Lazar, "Investment in the NAFTA: Just Cause for Walking Away," Journal of World Trade 27: 1 (February, 1993), 19-35, sees the investment provision of the FTA as a restriction on any Canadian state intervention which seeks to control FDI, even if it is in response to domestic needs or pressures. He argues that the Mulroney government sought to limit any future Canadian government's ability to interfere in the movement of capital in the interests of large MNCs. As such the agreement, in his view, is a limitation on sovereignty and anti-democratic.

111. See Cornell's testimony and the comments of Congressmen Florio and Bryant in Cornell, op cit.

112. See the testimony of Stephen Canner, Director of the Office of Investment, US Treasury, to the Senate Committee on Banking, Housing and Urban Affairs, May 20, 1988.

113. See his comments before the House of Commons Committee on Bill C-130, 33rd Parliament, Second Session, July 12, 1988, 4:16.

114. This argument is forcefully made in: Foreign Investment Review Agency, Performance Requirements and FIRA: Responses to US Criticisms, (mimeo), 1982. This 34 page document was prepared in early 1982 and circulated to departments in an effort to provide some ammunition to ministers and official to rebut US criticisms.

115. See Ambassador Ritchie's comments before the House of Commons Committee on Bill C-130, 33rd Parliament, 2nd Session, August 4, 1988, 23: 65.

116. Such as tax measures designed to aid small Canadian-owned businesses introduced in 1971.

117. This included the tax measures favouring Canadian-owned periodicals and media in the deduction of advertising expenditures. Known as Bill C-58 American officials admitted they had failed in their efforts to eliminate this measure.

118. See Doern and Tomlin, op cit.

119. A briefing document on the agreement prepared for the US cabinet described US achievements as follows:

"We could not end the life of Investment Canada, their screening agency, but we greatly circumscribed the scope of its activities by limiting them to review only large acquisitions, disciplining heavily the use of performance requirements and prohibiting policies like forced divestiture and minimum Canadian equity holding." See "Gains in Energy Investment Seen for the US Report Reveals," Globe and Mail (October 16, 1987), A1.

120. See the report National Trade Estimates (Washington: Office of the United States Trade Representative, November, 1989).

121. This process is briefly discussed in the concluding chapter.

CHAPTER SIX
INTERNATIONAL INVESTMENT REGIMES:
CANADA'S FAILED SEARCH FOR COUNTERWEIGHTS AND BALANCE

Introduction

This chapter examines Canada's participation in the development of an international investment regime and the impact of the resulting international regime on Canada's national foreign investment regime. The chapter argues that the international investment regime is the third external relationship which has influenced the Canadian state's choice of policy instruments to manage foreign direct investment (FDI). The other two, Canada's changing relationship to international capital and Canada's trade dependence on the United States were discussed in Chapters Four and Five.

As Robert Keohane¹ has indicated, postwar economic policy coordination among sovereign states has increasingly occurred through the establishment of international institutions, particularly international organizations and international economic regimes. This is the case for FDI as for many other areas of international economic exchange. The argument, outlined in Chapter Two, is that international investment regimes, to the extent that they either delegitimize host state controls over FDI, or support and reinforce the legitimacy of their use, will act as a

constraint on host state choices. In essence, the development of a strong international investment regime, supportive of the free movement of capital and the rights of foreign investors, will increase the perceived cost to host states of employing coercive policy instruments which control or limit access or discriminate against already-established foreign corporations (EFCs). The perceived increased cost to host states arises either directly out of the sanctioning ability of international organizations or indirectly, through retaliatory sanctioning by other economic actors which the international regime authorizes. An additional cost of the violation of norms and rules lies in what Keohane has labelled "reputation as an unreliable partner"² which may prevent the state in question from participating in future agreements or, in effect, cause it to be excluded from regime-shaping organizations or processes.

In contrast, an international investment regime which recognizes and is supportive of host state efforts to manage FDI will legitimize the use of access and discriminatory policy instruments, thereby lowering some of the costs of their use.

Why would host states seek to influence the development of the international investment regime? Stephen Krasner³ has argued, in the case of developing host states in the 1970s, that the development of international norms and rules regarding FDI was an important foreign policy goal for two

reasons. First, many aspects of foreign direct investment could best be controlled multilaterally. Second, these states were weak and vulnerable to direct pressure, either from multinational corporations (MNC) or home states, to influence their FDI regime. Multilateral support for the establishment of international norms was seen as a way to enhance host state bargaining power vis-à-vis other actors and legitimate or reinforce national control efforts.

What was the motivation in Canada's case? While Canada was a major host country to FDI in the postwar period, it was clearly not a developing country. Yet it has played an active role in the multilateral effort to develop an international investment regime since the early 1960s. The reason for this effort lies partly in Canada's situation as a host to FDI, but also in its relationship to the United States and the central role that multilateralism has played in Canadian foreign policy.

Multilateralism has been described as a cornerstone of Canadian foreign policy in the postwar period⁴. Multilateral economic institutions have even been seen, as the national debate over the 1987 Free Trade Agreement indicates, to be an alternative approach to resolving economic disputes with the United States and one which held less risk of U.S. domination over Canada in comparison to the bilateral approach. It is often argued that such organizations provide the opportunity to resolve conflicts within a broader context where direct

United States pressure on Canada cannot easily be brought to bear because other members and their interests may be supportive of Canada's position⁵. Moreover, to the extent that the rules and norms developed in such organizations can bind or restrain the United States, they may afford an opportunity to influence U.S. behaviour which bilateral negotiations could not.

This discussion focuses on regimes as the outcome of conscious efforts of state actors as agents to create rules through bargaining and negotiating within international economic institutions.⁶ The rules, in turn, will shape state behaviour. Such an approach raises the question of whether regimes reflect a distribution of power or have a transformative effect on power-based relationships. The first view would suggest that "dominant states write the rules that conform to their interests and guarantee compliance through the exercise of power."⁷ Thus regimes may serve as a mechanism for legitimizing hegemonic power through the internalizing of norms⁸. Dominant states may see international organizations as instruments through which they can pursue their interests.⁹ The postwar system of liberal multilateralism in economic exchange is often viewed in this manner, reflecting a U.S. policy preference to build a normative postwar consensus on economic exchange, rather than using coercion to maintain the system.

In contrast, subordinate actors may view the negotiation

of international regimes as an opportunity open to them to achieve their objectives which may include challenging prevailing norms and transforming power relations. This view is at the basis of the belief that multilateralism may provide a counterweight to U.S. bilateral dominance. But is this the case, or is it that such organizations afford the United States an additional opportunity or tool in its effort to influence Canada's FDI regime¹⁰? Moreover there is a danger, as Keating has suggested, that Canada's strong commitment to multilateralism as a process and a desire for inclusion has sometimes caused Canada to undertake commitments which may sacrifice specific interests in the name of safeguarding a process¹¹.

Has the utility of multilateralism as a means of advancing Canadian foreign policy interests been overblown or has it proven to be effective? Despite the assertion of the importance of multilateralism and its potential for lessening U.S. dominance on economic issues, there has been relatively little examination of the extent to which Canada has been able to use its membership and activity in international organizations to effectively offset the bilateral dominance of the United States and achieve its objectives in specific economic issue areas by influencing the creation of international economic regimes. The case of foreign direct investment can shed some light on the multilateral argument. In order to do that, however, we need to examine the actual

pattern of influence on the investment issue within organizations and examine how the emerging international economic regime was shaped?

Thus the first question is whether or not Canada was able to shape the international investment regime which was emerging in the 1970s and 1980s¹². Or has the United States been able to use its influence in international organizations to create a regime which serves its interests and constrains Canadian behaviour that challenges those interests? The second question is whether the impact of whatever regime emerges actually constrains or enhances the Canadian state's choice of policy instruments which it could use to manage FDI. In order to answer these questions we need to examine three issues. First, what were the Canadian state's articulated preferences for an international investment regime in the 1970s and 1980s? Second, did the investment regime which emerged as a result of multilateral negotiations fit with, or conflict with, Canadian policy preferences? If it did conflict, to what extent, in Keohane's terms, did Canada undertake "inconvenient commitments"¹³ which might constrain the choice of policy instruments? Finally did Canada ultimately abide by those regime commitments?

To assess Canada's ability to use economic organizations to shape the international investment regime I examine Canada's activities on investment issues in three international organizations from the early 1970s to the mid

1980s, that is, during the major periods of change in Canada's foreign investment regime. The three international organizations, the United Nations (UN), the Organization for Economic Cooperation and Development (OECD) and the General Agreement on Tariffs and Trade (GATT) vary in membership, structure of influence, and the extent to which their rules could strengthen an international foreign direct investment regime by constraining state behaviour.

The extent to which any organization is able to play the counterweight function for Canada, or provide an additional avenue for U.S. influence over Canadian policy, will depend first on the nature of the membership and the real structure of influence within the organization. Influence, in this context, is broadly conceived to include shaping the agenda of negotiations and the process of negotiation, in addition to the outcome. Second, the counterweight function will depend on whether the organization is able to reach a consensus amongst its members that results in the development of rules or norms which influence members' behaviour. Thus where the United States has had more influence and stronger control over outcomes in an organization and its rules are binding, that organization is likely to be an ineffective counterweight for the Canadian state, being, instead, another means of influence for the United States over Canada. In contrast, where the United States has had less control over outcomes the more likely Canada would be able to shape rules that reinforce its

own investment regime and, if binding, limit the ability of the United States to challenge that regime.

However, the structure of influence alone has not been deterministic of Canada's success in a multilateral organization. Such a focus ignores the domestic aspect of determining policy preferences. It presumes that the relative priority of Canada's various goals and objectives on investment issues will be similar in the bilateral and the multilateral context and will permit clear and consistent trade-offs, making interstate host-country alliances easy to obtain. As we will indicate this was, in fact, not the case, especially where the membership of the organization was diverse and the range of host state interests very broad. For example, in contrast to its primary role as a host country in the bilateral context, Canada has been in an anomalous position, as both a host and home country, when dealing with investment issues in international organizations and has had to balance competing interests. As a source of FDI Canada has had concerns about the treatment and security of Canadian-based FDI, while as a host to FDI the Canadian state has sought international recognition of its right to regulate foreign direct investment coming into Canada.

This chapter is divided into four parts. It begins with a brief examination of international investment regimes from the mid 1960s to the early 1970s and the series of developments which precipitated both host and home state

efforts to build international investment regimes. The second part analyzes Canada's involvement, since the 1960s, in efforts to develop a set of codes dealing with FDI within the OECD - an organization of both capital importing and exporting countries, but one where capital exporters, led by the United States, have tended to dominate. The third section examines a similar effort in the UN where host countries dominated, but Canada's own position required it to balance home and host state interests vis-à-vis third world host states, and a lack of consensus doomed efforts to develop a code on FDI. The fourth section looks at the GATT, a trade organization of both host and home countries, but one which has increasingly been the focus of U.S. efforts to create binding rules limiting host state control of FDI. Finally I assesses the impact of the results of these efforts on Canada's domestic FDI regime.

International Investment Regimes

International regimes have been defined as "principles, norms and decision-making procedures around which actors expectations converge in a given issue area."¹⁴

Intergovernmental economic organizations are an important institutional component of regimes governing international economic exchanges. They serve two functions. First they are a forum for interstate negotiation on the agenda, process and norms and rules of a regime. They may also serve as a forum

for coordinating the supervision or sometimes the enforcement of the rules. Our focus is initially on the first function. For example, in monetary and trade issue areas the International Monetary Fund (IMF) and the GATT play important roles as fora for the interaction of member states and the supervision of a framework of rules and norms regarding exchange rates, balance of payments and trade issues.

In contrast, however, international investment relations have been characterized by a weak regime and lack of a specific economic organization governing international investment comparable to those in trade and monetary issue areas. While a limited system of international property rules existed in the nineteenth and first half of the twentieth century, it was directly enforced by the economic and military power of the major capital-exporting states¹⁵. In the postwar period, especially in the 1950s and 1960s, even these limited rules were frequently called into question as expropriations of foreign investment increased and the ability of major capital-exporting states to enforce the old rules waned.

Beginning in the late 1960s and early 1970s less developed host states moved away from policies which involved expropriation of foreign investment in favour of investment regimes which employed a complex variety of incentives and regulatory policy instruments.¹⁶ These new FDI regimes were intended to maximize host country economic benefits generated by FDI. MNCs often became involved in complicated

negotiations and arrangements with host countries, while the impact on home country interests was not always clear.

Events in the early 1970s however, precipitated action on the part of both host and home states to see their respective economic interests advanced by the development of multilateral investment codes. For dependent host states multilateral organizations became the focus of efforts to establish international norms that would restrain what they regarded as certain undesirable behaviour on the part of MNCs. In addition, host states sought to limit the possibility of home state intervention on behalf of MNCs, in opposition to host state regulatory efforts. International recognition of host states' rights to regulate the entry of FDI, and the behaviour of established foreign corporations (EFCs), and international acceptance of the primacy of host state legal jurisdiction in investment disputes were also important objectives.

Home states, in contrast, generally sought to ensure that their investors were favourably treated abroad and had recourse to international arbitration or other international remedies in the case of investment disputes. The United States, as the preeminent home state of the 1970s, was extremely active in pursuing these goals within international organizations.

Canada, as a major host state in the 1970s, was also active in efforts to develop investment codes and

international instruments to deal with investment issues. This is evident in Canada's involvement in the two major efforts to develop investment codes within the United Nations and the Organization for Economic Cooperation and Development (OECD).¹⁷

Canada had raised concerns internationally about the problems of MNCs on various occasions at the OECD in 1968 and later in 1972. The Gray Report had raised the issue of the establishment of an international code dealing with multinational corporations and foreign investment.¹⁸ The report argued that it would be to Canada's benefit if a code could be established which would place limits on the extraterritorial application of home state laws, provide for fair and equitable treatment of MNCs, and provide international recognition of the right of host countries "to fix rules to ensure adequate domestic control of the economy."¹⁹ The report, however, made it clear that, in the negotiation of any such code, Canada would not be able to accept any obligation to provide national treatment to foreign investors, but would be prepared to assure most favoured nation status to all sources of foreign direct investment.

A summary of decisions at a Cabinet meeting in June, 1972 on "Domestic Control of the National Economic Environment"²⁰ indicates Cabinet decided to direct External Affairs, in cooperation with Industry, Trade and Commerce and Consumer and Corporate Affairs, to outline the feasibility of

international arrangements to deal with anti-trust (an area of host and home state jurisdictional conflict), competitive investment incentives, improving information on MNCs and "the development of a code of foreign direct investment embodying certain principles of the rights and obligations of foreign investors, host and home governments."²¹

An interdepartmental committee of officials on international investment policy provided a mechanism by which the views of different departments could be coordinated. In the case of the OECD, a primarily economic organization, the main economic department, Finance played a key role. In the case of the UN, with its heavy emphasis on procedure and diplomacy, the Department of External Affairs tended to take the lead. In both cases consultations with Canadian business groups also took place through the Canadian Business and Industry Advisory Committee (CBIAC)²² whose members included major Canadian business organizations, such as the Canadian Manufacturer's Association and the Canadian Banker's Association. The UN and the OECD provided, however, quite different settings in which to address the issue of foreign direct investment.²³

The OECD membership includes European and North American countries as well as Australia, New Zealand and Japan.²⁴ With a few exceptions in southern Europe, all are advanced, industrial, capitalist economies, both large and small. From its very inception, the organization reflected the consensus

of liberal-democratic capitalist states on which its membership is based. In particular its goals included "efforts to reduce and abolish obstacles to the exchange of goods and services and current payments and maintain and extend the liberalization of capital movements".²⁵

The structure of influence is less clear, however. While all members are equally represented at the ministerial level of the Council, which renders the final decisions of the organization, the actual agenda and work program of the organization are usually based on an informal consensus but have, in practice, been heavily influenced by the largest economic actors in conjunction with the permanent secretariat of the organization, which is located in Paris²⁶.

The UN provided a very different context. Because of the broad-based membership and the wide divergence of interests between capital importing and exporting countries in the United Nations, Canada was under much less direct pressure from major capital exporters. At the same time views within the UN have been so much more fragmented and the emphasis so heavily on prolonged procedural debates that no agreement on a code has, in fact, been reached.

Canada, the OECD and the Codes

Much of the work of the OECD, since its founding, has involved economic policy coordination of member states²⁷. Since the late 1960s and early 1970s, when the developing

countries began to challenge the prevailing economic order, the organization has been used very consciously by its members to develop a policy consensus and coordinated positions on major international economic issues on the part of advanced industrial states, prior to negotiation in other intergovernmental economic organizations with broader membership such as the GATT, the World Bank or the UN.

In addition to coordinating positions the organization has also endeavoured to create norms and rules governing international economic exchanges, in line with its founding goals, through the development of various codes of conduct. Members are encouraged (since there is no mechanism to coerce) to adopt codes which specify certain national policy norms regarding international exchanges.²⁸ By adopting the code states can then join in the supervisory work of the committee which the code creates to oversee its implementation. In the case of international investment two codes have been developed.

The code on capital movements was created coincidentally with the establishment of the organization in 1961. The intent was to encourage member states progressively to remove all restrictions on the international movement of capital over time. Despite its enthusiastic participation in the OECD Canada was on the defensive almost from the start on investment issues because of its position as a host to large amounts of FDI. Pressure began in 1961 when Canada refused to

sign the OECD Code on Capital Movements, despite the strong push from the United States to get all members on board.²⁹

Although Canada supported the principles on which the Code was based, the uncertainty of the Canadian state over what future obligations it might impose on Canada, in the case of foreign direct investment, was the primary reason for its refusal to formally adhere to and sign the Code. Canada's representative made that clear in April 1961. He argued that high levels of FDI made Canada's position quite different from that of other members. Because of the amount of FDI in Canada the code would be "more onerous" for Canada and could potentially obligate the Canadian state to "permit the liquidation and transfer of accounts which at the end of 1960 were \$13 billion, or approximately 8 times (sic) our exchange reserves at the end of 1960"³⁰, he argued. Rather than adhering to the Code and then lodging reservations or resorting to escape clauses, which was the common practice of member states, Canada preferred to remain outside the code, but pledged to conform to its spirit in freeing the movement of capital. According to Canadian delegation reports, other OECD members reacted strongly to Canada's refusal to sign, to the point of suggesting that Canada was not committed to the new organization³¹. However, given that the primary concern of members in the early 1960s centered around freeing exchange transactions, Canada was, in fact, able to do that and satisfy the main concerns of other members.

Periodically over the succeeding years the issue of Canada's non-adherence to the code was raised, either by the Secretariat, by other members or, in the 1970s, by the Business and Industry Advisory Committee (BIAC), the multinational business lobby of the OECD.³² Despite these pressures the policy of non-adherence remained in place until the early 1980s.

While the Code covered capital movements it did not address the issues of the rights and obligations of foreign investors or the behaviour of governments toward foreign subsidiaries operating within their economies. The immediate impetus to address this issue came from outside the OECD. The efforts of third world countries to restructure the global economic system and limit the flagrant abuses of MNCs in a number of countries through their voting majority in the UN General Assembly had led to the establishment of a Group of Eminent Persons in 1972 to study the issue of transnational corporations³³ and their impact. With the release of their report in 1973³⁴ it was clear that UN action on a code was imminent. In order to counter the prospect of a code which did not represent the interests of capital exporters emanating from the UN, the United States began pushing other OECD member countries to address the issue³⁵.

In May 1973, largely at U.S. insistence, the OECD ministers initiated a work program for the OECD on the issue designed, according to the United States interpretation, to

"put a fence around the use of governmental policies that distort patterns of investment and trade"³⁶ and to explore the "elaboration of guidelines and consultation procedures with respect to the treatment governments give to foreign investors."³⁷

Negotiations on investment issues, however, involved member countries which differed in their economic size, their role as capital importers and exporters, and their overall responsiveness to the domestic constituencies, especially capital and labour, on investment issues. In addition lobby groups composed of labour in the form of the Trade Union Advisory Committee (TUAC) and business in the form of the Business and Industry Advisory Committee (BIAC) had formal consultative status to the OECD and could try to influence decisions.

Canada's position on investment issues was coordinated within an interdepartmental committee on international investment policy. The committee was established as a result of the recently published UN report, and Canada's need to formally respond to it, as well as the need to deal with activities taking place in the OECD. The committee was chaired by External Affairs and included officials from Finance, Industry, Trade and Commerce, FIRA, CIDA, Export Development Corporation, Consumer and Corporate Affairs and Regional Economic Expansion.³⁸ In addition, the committee met fairly regularly with CBIAC, the Canadian counterpart of

BIAC, which reflected the views of business, especially capital exporters. The committee met less frequently with representatives of Canadian labour who were not formally affiliated to the OECD Trade Union Advisory Committee and did not regard the code as a priority issue³⁹.

Work began in earnest for officials once objectives had been outlined for a work program on multinational enterprises (MNEs) by the OECD in the fall of 1974. Matters to be addressed by the OECD included the development of new measures: to reduce the negative economic impact of investment incentives and disincentives on member countries; to implement the principle of national treatment; to supplement existing machinery on international investment to enhance cooperation and to cover areas of concern not addressed in the earlier codes (ie the Codes on Capital Movements and Invisibles Transactions)⁴⁰.

While Canadian officials were supportive of efforts to deal with questions relating to the standards of behaviour of MNEs and the competitive use of incentives to attract investment, they were concerned about the principle of national treatment.⁴¹ At that time, however, they expected that a strong divergence of views among OECD members on the issue would ensure that little progress was made. Indeed the note from the Secretariat setting out the work program indicated strong disagreement among members on how binding any obligations should be and on the principle of national

treatment. Canadian officials expected to be able to take a "statesmanlike" approach to the issue, encourage delay and emphasize other areas of work.⁴²

The OECD working group's initial efforts centred on developing a text establishing acceptable standards of behaviour for multinational enterprises.⁴³ Initial drafts, however, particularly those reflecting U.S. priorities, were unacceptable to Canadian representatives largely because they contained references to measures to be taken by national governments to assure national treatment.⁴⁴ Canada wanted to establish the right of host states to control FDI and to assert the primacy of host state law in any MNE-host state disputes. Thus Canada supported a paragraph in the preamble to the text which recognized that "every state has the right to prescribe the conditions under which multinational enterprises operate within its national jurisdiction " but insisted on the removal of the final portion of the sentence "with the concomittant duty to treat multinational enterprises equitably and in accordance with international law."⁴⁵ Canada initially sought to limit the text on standards of behaviour (SOBs) to the obligations of MNEs alone, and to expunge all references to international law.

In these efforts Canada was joined and often supported by a number of smaller, host states including Australia. However, a strong coalition of host states was not easily maintained because of their different priorities on investment

issues. Small European states, such as Sweden, were supportive of efforts to secure the recognition of the right of host states to control FDI. Others, such as the Netherlands, were supportive on some issues, but only as part of a broader effort to toughen the standards for MNEs, especially in the area of financial disclosure and labour relations, a reflection of the more important political role of unions in these countries.⁴⁶ These were objectives, however, which the Canadian state did not share. Thus on some of the issues involved in the SOBs Canada, in fact, sided with the United States in opposition to the smaller European states. On others Canada opposed the United States strongly. Lining up beside the United States in seeking to minimize constraints on MNEs and strengthen those on host states were the United Kingdom and the Federal Republic of Germany, both significant capital exporters.

Capital exporting countries were supported in their efforts by international business. Late in the fall of 1975 the OECD working group met with the multinational corporate lobby, the Business and Industry Advisory Committee (BIAC) as well as the Trade Union Advisory Committee (TUAC). BIAC made it very clear that it would find any standards of behaviour for MNEs unacceptable unless they were balanced by commitments on the part of host states to the principle of national treatment. Such a balanced code was vital, they argued, to secure their cooperation in implementing the codes and to

assure host countries a continued healthy flow of investment. Given that a consensus had already been reached among OECD member states that any standards should be voluntary, members felt the cooperation of the umbrella organizations of international business to be necessary to give the standards credibility and encourage adherence.

The attitude of the MNEs reinforced the United States' position of insisting that any standards for MNEs must be balanced by state acceptance of the national treatment principle and commitments to further work to minimize investment incentives and disincentives. Throughout the fall of 1975 and the winter of 1976 the United States pushed this agenda and insisted on a single package approach to investment issues. Because action at the UN appeared to be imminent the United States insisted on a tight work schedule with a view to having an agreement by the time of the annual ministerial meeting in June 1976.⁴⁷

Canada continued, however, to argue for a separation of the national treatment and incentives and disincentives issues from the standards, subsequently renamed guidelines. Within Canada the Canadian Business and Industry Advisory Council, the Canadian affiliate of BIAC, largely dominated by MNEs, urged officials to support the national treatment package and soften the guidelines for MNEs even further.⁴⁸ It was clear to Canadian officials by late 1975 and early 1976 that a package was inevitable and Canada's position of refusing to

address the national treatment aspect was becoming increasingly untenable.⁴⁰

Officials then began to reassess their strategy and sought ministerial direction. If the Canadian delegation was to shape the national treatment instrument in any way, Canada would have to get involved. Canadian officials considered trying to divert discussion away from the principle of national treatment toward the acceptance of a commitment on the part of host states to some sort of minimum standard of treatment of foreign investors. Alternately Canada could participate in the actual drafting of the national treatment text with a view to ensuring that "Canada would retain considerable freedom to apply and further develop existing policies relating to the activities of foreign-controlled firms in Canada."⁵⁰ Being involved, however, risked being obliged in the end to accept the text Canada had helped create and, therefore, the principle. To continue to refuse to discuss it at all seemed, however, to be an increasingly untenable position. It risked Canada becoming isolated and being forced to ultimately reject the whole package, including the Guidelines for Multinational Enterprises, most of which were quite acceptable. Officials began to review the impact of the national treatment and incentives and disincentives parts of the package on Canada's existing investment regime and what constraints they might pose in the future in the event that Canada might later become involved in

discussions.⁵¹

In order to understand those constraints it is necessary to understand the OECD method of consensus-building among members in the pursuit of particular objectives. The measures proposed in the investment package were part of an effort to strengthen two norms among members, one of national treatment, that is treatment of foreign investors and MNEs no less favourable than that accorded to domestic investors and corporations, and the other, the free flow of international investment unimpeded by state regulation. The way in which these norms were to be established over time involved the standard OECD commitments to disclosure of existing measures which violated the norms in question, review by fellow members, standstill on new measures, and ultimately rollback of existing measures.

Members would be required initially to disclose all current deviations from these norms and ensure that the policy instruments involved were as transparent as possible, thus assisting scrutiny on the part of other member countries. Standstill would be achieved by making the introduction of any new deviations from the norms more onerous, through a requirement of notification and sometimes justification. For example, states employing new measures to control, limit or regulate FDI would be required to notify fellow members within a specified period of time. Members would then have to justify the need for new measures, with only a few reasons

(such as national security or severe balance of payments problems) being regarded as legitimate. Finally, through the periodic review of existing exceptions, states would be called upon to justify the status quo and the continued use of existing instruments. While not involving any sanctions the intent was clearly to put increasing pressure on states to move in the direction of the desired norm.

Experience with the Code on Capital Movements, which had been riddled with exceptions, deviations, escape clauses and reservations⁵², had convinced both the Secretariat and many home states of the need to place greater obligations of notification, consultation and justification on members within this new investment package. It was essentially these obligations that some host states, especially Canada, found difficult to accept. Canada's deviations from these norms were highly transparent, not based on national security or balance of payments rationales, and would likely, therefore, be the subject of repeated surveillance by the committee. In contrast, many of the measures of other members which were less transparent or justified as legitimate exceptions would receive very little scrutiny.⁵³

Memoranda to Canadian ministers in the fall of 1975 indicated real concern that the acceptance of the principle of national treatment would "imply that consultations on new foreign investment legislation would be conducted in a context in which other OECD members" such as the United States, "would

regard the Principle of National Treatment as having primacy over the attainment of national goals on foreign investment⁵⁴." Officials in Finance, External and Industry, Trade and Commerce recommended that Canada continue to work on the guidelines, which were becoming broadly acceptable, and try to explore other avenues in dealing with the non-adherence to the rest of the package.

On December 4, 1975 the interdepartmental committee reviewed Canada's options in dealing with the national treatment issue and concluded that the only politically realistic option, if Canada was to avoid being completely isolated and end up rejecting the package as a whole, was to become involved in discussions with a view to weakening the wording of the text.⁵⁵

Work then began on softening the wording and weakening the application of both the national treatment text and that on investment incentives and disincentives. Finance officials determined that approximately four tax measures might be covered by the national treatment and incentives and disincentives instruments in the investment package.⁵⁶ In addition, the extension of the FIRA review process in 1975 to include the expansion of EFCs into unrelated investments could be considered a deviation from national treatment. Moreover, officials fully expected that further Canadian state measures would be forthcoming on foreign ownership in the resource sector which would probably also come within the scope of the

two instruments. Minimizing obligations of consultation and justification in the texts, therefore, was a high priority for Canada.

By March, 1976 progress had been made in weakening the national treatment instrument so that it would allow for significant departures and exempt existing legislation. New legislation conflicting with the standard would require notification within 30 days and consultation with any member state which might be affected and requested it. Finance officials acknowledged that this would result in "considerable international pressure on member states whose new legislation conflicts with the standard." But the failure to resolve disputes over a member state's legislation would not "result in counter-measures", in other words, retaliation by those members opposing it.⁵⁷

The United States took the lead role in pushing the national treatment instrument, proposing numerous draft texts. In particular they sought a declaration in the text of the norm of national treatment and the requirement that states notify, justify and specify the duration of any exceptions to the norm. In addition the United States sought to establish a periodic review of the application of the national treatment standard "with a view to reducing or eliminating measures which constitute exceptions thereto⁵⁸." Work on the issue in Committee on Investment and Multinational Enterprises (CIME) came to center on the U.S. approach of trying to develop a

text which strengthened the obligations of members and Canada's attempt to obtain a weaker, much less onerous text. Canada participated with the proviso that this process in no way prejudged Canada's ultimate position which might be to refuse to adhere to the package as a whole or to some portions thereof.

Within the Canadian state, however, there was division over the issue of ultimate adherence to the national treatment standard. Industry, Trade and Commerce felt that the text was weak enough to permit adherence. External Affairs supported that view and felt that acceptance of a weakened national treatment text was vastly preferable to rejection of the package and isolation within the OECD on investment issues. External officials felt such a result would run directly counter to efforts to strengthen links with European countries which Canada had been seeking as part of the overall effort to diversify economic and diplomatic relations known as the Third Option. Finance, on the other hand, was not enthusiastic about adherence fearing the implications of any notification, consultation and justification provisions for Canada's flexibility in its investment and taxation policies.

Canada countered the U.S. proposals with an insistence that the form of the text on national treatment should be that of a recommendation to members rather than a declaration. Declarations had been a recent (1974) OECD innovation which, while not legally binding, did indicate "a firm political

determination"⁵⁰ on the part of member states to carry out the policy in question, unlike recommendations which implied no such commitment. Canada also argued that any national treatment standard "does not affect rights of members to regulate the entry of foreign investment or the conditions of establishment for enterprises," and that states may find it necessary from time to time to depart from it. Review of the application of the standard should be undertaken with a view only "to minimizing economic difficulties" arising from exceptions, not to extend the standard or roll back exceptions.⁵⁰

On the question of the declaration the United States would not budge. On the splitting of the package and Canada adhering to only one portion, the United States took an all-or-nothing approach, trying to pressure Canada through the threat of exclusion, arguing that without adherence to the whole package, Canada should be excluded from participation in the committee.⁵¹ Given the importance of this issue to Canada, the Canadian delegation found such an approach totally unacceptable and reasserted its determination to participate whether or not it adhered to the whole package at the June meeting of ministers.

In the final package Canada was able to achieve only some of its objectives, including the elimination of a reference to the norm of national treatment and the goal of rolling back existing exceptions, as a result of intensive negotiation.

However, the United States was able to retain the commitment to national treatment in the form of a declaration and to insert under the record of the Council's decisions the objective of extending the application of national treatment. By May 1976 the Canadian Cabinet had still not made a decision whether or not or how Canada would adhere to the investment package.⁶²

Canadian officials began reviewing the options, legal precedents and mechanisms with the Secretariat by which Canada might opt out of the Declaration on National Treatment seeing no further changes in the text being likely.⁶³ Cabinet met in early June to make a final decision. The Guidelines for MNEs presented few problems since they were generally consistent with Canada's Principles of International Business Conduct (the Gillespie Guidelines) issued in July, 1975. Although the OECD guidelines were somewhat weaker and put less emphasis on subsidiary autonomy, the standards of behaviour for disclosure, restrictive business practices, financing, taxation, labour relations, science and technology were broadly acceptable to Canada. In the case of incentives and disincentives the instrument called for transparency of measures and consultation, but was broadly acceptable to Canada in that there were no provisions for any kind of sanction should the consultations fail to resolve differences among members. It was largely confined to information gathering at that stage.

National treatment did, however, present a real problem. Cabinet was split.⁶⁴ The Minister of Finance was strongly opposed to adhering to the package at all while both the ministers for External Affairs and Industry, Trade and Commerce favoured acceptance. The final decision to lodge a reservation on the national treatment portion partially resolved the problem. To the Finance minister the whole exercise, however, had been a failure. The guidelines, in his view, were too watered down while the national treatment declaration imposed unacceptable obligations.⁶⁵

Canada continued to negotiate until the last possible moment to weaken the form of the investment package from that of a declaration by member states to only a recommendation. When that effort failed Canada took the step of reserving its position by way of a statement issued by the Secretary of State for External Affairs after the June 21 ministerial meeting in Paris. The statement noted:

that Canada will continue to retain its right to take measures affecting foreign investors, which we believe are necessary given our particular circumstances.⁶⁶

Canada's position was in opposition not only to that of the United States and other capital exporters, but also to the multinational lobby BIAC and its Canadian affiliate CBIAC, both of which had tried to convince ministers and officials to adhere to the national treatment declaration. Conscious of Canada's image regarding foreign investment the Minister's

statement went on to "underline that Canada continues to welcome foreign direct investment" and "that for the most part we do not differentiate between Canadian and foreign-controlled capital."⁸⁷

In 1979 OECD ministers again reviewed the investment instruments and decided to increase surveillance efforts in order to extend the application and scope of national treatment. In addition, changes were made to strengthen the procedures for consultation as well as to initiate a study of investment incentives and disincentives. Canada, again, felt it necessary to issue a statement reaffirming its 1976 reservation that "Canada retains the right to take measures affecting foreign investors which it considers to be necessary in its particular circumstances."⁸⁸

Canadian state officials had initially expressed concern that Canada's form of adherence could lead to ambiguities. The status of Canada's reservation and declared right to take any measures necessary to control FDI was unclear, given that Canada had signed the agreement which included a commitment to accord national treatment to investors.

The question of Canada's adherence and its status did arise in 1980. In December, 1980 the United States and Britain called for Canada to notify and consult with members of the CIME regarding the National Energy Program which had been announced the month before. Both countries questioned the discriminatory nature of the policy and its violation of

the national treatment standard, arguing that Canada was obligated by its adherence to the 1976 investment package⁶⁹. Canada argued that at that point in time only a statement of policy intent existed. There was not as yet any requirement to notify or consult member countries. Canada also argued that the 1976 declaration indicated only a conditional adherence to the investment instruments⁷⁰. In addition, Canada pointed to numerous other member states' deviations from the standard, including British regulations on oil and gas production and U.S. regulations, particularly those at the state level, which discriminated against foreign investors.

The NEP was raised again in March 1981 and this time Canada formally notified members of the new policies, admitting that they constituted a deviation from national treatment, but seeking to justify the measures as necessary. Canada also argued that its reservation in 1976 did not constitute full acceptance of the standard and allowed for deviation. Again Canada also sought to demonstrate that it was not alone in enacting such measures. Since no sanctions are provided under the declaration and Canada had, in fact, complied with the notification requirement the United States could take no further action on the matter.

Within the CIME Canada continued to push for a more complete disclosure of investment measures on the part of other states, including those which were less transparent or were considered to be justified exceptions under the

investment instruments. In this Canada was partially successful when a survey of exceptions was undertaken in 1983 which did include all measures, even those taken by some member states on the basis of national security or public order requirements.

In the case of the Capital Movements Code there was also a move within the OECD in the early 1980s to clarify its application to include the "right of entry" of foreign capital, again at the urging of the United States. Since this Code is binding on those members adhering to it, it was not surprising that Canada had resisted periodic pressure to sign.⁷¹

In the wake of the world recession and the sluggish growth in private investment, the June, 1982 OECD ministerial meeting reiterated the need to improve the effectiveness of the various instruments dealing with investment. The fact that Canada was the only OECD member that had not signed the Code came up again for discussion.⁷² The Canadian government agreed to review the matter once more and initiated an interdepartmental review which concluded that in most areas covered by the code, Canada was already adhering in practice. The right of the Canadian state to impose conditions on the access of foreign investors remained an area of concern. In the case of the Capital Movements Code reservations and derogations from the Code were a long-standing practice on the part of members. Thus Canada had the option to apply for a

full reservation on its investment screening and still adhere to the code, sending what was felt to be a positive signal to foreign investors.⁷³

Clearly Canada's concerns about the costs of not signing and the desire to demonstrate it was not an "odd person out" on investment issues at the OECD prevailed. The 1982 period was, of course, also the turning point for changes to Canada's screening process. By the summer and fall of 1982, as Chapter Four indicated, the Canadian state had promised to streamline FIRA's operations and was openly wooing foreign investors.

As a result of its policy review the Liberal government announced its intention to sign the code at the OECD ministerial meeting in the spring of 1984 and in July, 1985 the Conservative government signed it. Even though the new government had initiated major changes liberalizing Canada's foreign investment regime in the fall of 1984, because of the "right of entry" provision in the code, Canada lodged a full reservation regarding inward direct investment. The Canadian statement noted the high level of foreign control of the Canadian economy and existing policies which restricted inward investment.⁷⁴ Like the Declaration on International Investment and Multinational Enterprises the Code works on promoting liberalization of government policies toward foreign direct investment. By signing, even with a reservation, Canada was able to be involved in the work of the Committee on Capital Movements and Invisibles Transactions, which was

becoming increasingly involved in trade and investment related issues involving services, matters of great concern to Canada. But as a result of signing Canada was put in a position of potentially being subject to pressure from other committee members to liberalize remaining investment controls.

Since the 1980s the OECD has moved further in the direction of strengthening the Capital Movements Code, and the National Treatment instrument of the Declaration. The CIME has also become involved in work aimed at limiting the use of trade-related investment measures (TRIMS), all of which reflect the investment agenda of the United States. While Canada, since the 1980s, has largely concurred in these measures, its few remaining investment regulations continued to come under scrutiny.

Conclusion

The above discussion of the OECD indicates that Canada had limited success in its efforts, in the 1970s, to shape the code on MNEs in any meaningful way that would strengthen or reinforce the recognition of host state rights to maximize investment benefits through the use of instruments which controlled investor access or discriminated against foreign firms. Canada was able to weaken the wording in the Code on controlling investment access and the declaration dealing with national treatment, but it was fundamentally unable to alter the content in terms of the norms articulated nor to unbundle

the package to allow for only partial adherence.

The experience at the OECD was not one where the multilateral setting provided many possibilities of member coalitions to offset the dominance of the United States and other capital exporters, partly because of the diverse concerns of capital importers. In addition, as Chapter Two pointed out, Canada's highly transparent controls over investor access which explicitly focused on the maximization of economic benefits, contrasted with the more narrowly sectoral and less transparent policy instruments used by many European states, many of which were based on a security rationale and therefore, accepted as legitimate. Although the declaration of 1976 was not binding, its clear intention was to submit member's policies to repeated peer scrutiny. Transparent policies, such as Canada's, would clearly be under pressure.

The U.S. strategy of setting an agenda which included national treatment, pushing for a tight work schedule and insisting on a single package put Canada in a difficult situation. Canada's fear of exclusion and isolation at the OECD, reflected repeatedly in departmental memoranda and minutes of officials' meetings, led officials to see adherence to the single package, even though it included national treatment, as a less costly alternative. Thus the norms which the code embodied delegitimized, rather than reinforced, Canada's national investment regime.

The United Nations and the Code: A Quest for Balance

The situation in the United Nations and the efforts of the Commission on Transnational Corporations to develop a Code of Conduct stands in sharp contrast to the OECD's efforts. The nature of the membership of the General Assembly and the balance of influence resulted in a very different agenda on investment issues, a much slower schedule of negotiation and a very different outcome. In the case of UN efforts to deal with transnational corporations (TNCs) the impetus within the Economic and Social Council (ECOSOC) of the General Assembly resided much more with dependent developing host states. It was, in fact, the prospect of Group of 77 action within the UN that provided the urgency for OECD efforts to deal with international investment issues. The intent on the part of the major capital exporting members of the OECD was to preempt, or at the very least, influence UN efforts by developing a consensus position on investment that would unify the advanced industrial countries when the issue came up for discussion in ECOSOC.

UN efforts can be traced to a series of major conflicts between dependent host states, TNCs and home states over host state expropriation of foreign capital, contract renegotiations, in the case of natural resource investments, corrupt practices of TNCs, and TNC and home state interference in the political affairs of host countries⁷⁵. The specific action which initiated work on an investment code was the

decision of ECOSOC in July 1972 to establish a Group of Eminent Persons to study the role of TNCs and their impact on the development process and to submit recommendations to the United Nations on appropriate international action regarding TNCs and foreign investment.

The Eminent Persons Group reported in May 1974 and recommended the establishment of both a Commission on Transnational Corporations, composed of elected UN member states, and a research and information centre on TNCs to be staffed by technical experts. In addition the report recommended further examination of a code of conduct for TNCs as one method of dealing with some of the problems associated with international investment and the operations of TNCs.

In December, 1974 a 48 member Commission on TNCs was established along with a Centre on Transnational Corporations (CTC). Most developed countries were less than enthusiastic about developing a code of conduct for TNCs. For the group of 77, however, it was a top priority.

The divergence in positions on issues related to TNCs was strongly evident by 1976 when a number of member states submitted outlines of their areas of concern for discussion at the first meeting. The extreme views on each side were represented by two papers. The first, submitted by a group of Latin American and Caribbean members⁷⁸, led by Argentina, called for subsidiaries of TNCs, in the event of any disputes, to be subject to the "exclusive jurisdiction" of host state

laws.⁷⁷ In addition it demanded that TNCs cooperate in the renegotiation of concessions on the part of host states and abstain from interference in the internal affairs of host countries. Home states were similarly required to restrain from interference in host-TNC disputes. Appropriate compensation, in the case of expropriations, was to be determined by host states in accordance with the Charter of Economic Rights and Duties. Permanent sovereignty of host states over natural resources was again asserted. In addition, TNCs were required to act in such a way that they contributed positively to host state economic development priorities, in particular, that they "conduct their operation in a manner that results in a net receipt of financial resources for the host country"⁷⁸. Other requirements included contributions to host state efforts to develop science and technology and refraining from engaging in restrictive business practices.

These demands and the critical approach to TNC operations on the part of the Group of 77 were met by a strong reaction on the part of the major home countries, led by the United States. These countries sought to restrain host state regulation of TNCs and particularly, in the case of expropriation, to establish the U.S. standard of prompt, effective and adequate compensation which was discussed in Chapter Five. The contrast in objectives was clear. The United States, France, the Federal Republic of Germany, Italy

and the United Kingdom submitted a quite different list of concerns which began with:

Host country legislation and regulations which may discriminate, either in favour of TNCs or against TNCs as compared to domestic enterprises, in the treatment of enterprises on the basis of whether or not such enterprises are under foreign control.⁷⁸

Second was a concern that any expropriation of foreign assets on the part of host states be non-discriminatory and accompanied by prompt, adequate and effective compensation. In addition the document called for recourse to third-party arbitration in the case of investor-host state disputes, preferably through the International Center for the Settlement of Investment Disputes (ICSID)⁸⁰. The fourth concern was the impact of host state investment regulation and the non-observance of contracts on a stable investment climate. Clearly the thrust of the document was one of protecting the interests of foreign investors and minimizing host state intervention, a far different approach than that of many developing countries.

It is within this context of very strongly opposed views on foreign investment that the Canadian position must be seen. Canada was clearly an advanced, industrial country, with significant direct investment abroad, some of it in less-developed countries. Yet, at the same time, Canada was host to a large stock of FDI, most of it in the form of U.S.-based EFCs. Thus Canada was in a much more ambiguous position than was the case at the OECD, where Canada's position as a host

state in relation to the other large industrial economies guided its response to investment issues in the mid 1970s. At the UN Canada was both a host and home country relative to the largest industrial countries and the G-77. It clearly did not share many of the strongly critical attitudes or concerns of many of the G-77 regarding foreign direct investment, but neither did it fully share the objectives of the United States-led home country group.

When Canadian officials first analyzed the Eminent Persons Group Report and the likelihood of further UN action on MNCs they expressed concern about how Canada would be able to develop a coherent position, given the "rather schizophrenic nature of Canada as host and home to MNEs,"⁸¹ as well as being both a large industrial country and a major raw material supplier.

Canada sought and won election as one of the ten developed countries on the Commission and has served almost without interruption since its establishment in 1974. At the first meeting of the Commission in 1976 the extreme polarization of the G-77 and U.S.-led capital exporting countries' views was evident to Canadian officials as was the desire on the part of the developing countries to undertake work on a code. Canada initially expressed no view on the merits of a code per se, but did support the establishment and work program of the Centre on Transnational Corporations. Canadian officials felt they had been successful in managing

to maintain good relations with both developed and developing country groups. This reflected a growing desire in the mid-1970s on the part of Canadian state officials to play a role in the north-south dialogue by identifying areas of possible Canadian cooperation with developing countries.

Prior to the second meeting of the Commission, Canada had identified its objectives⁶². These included efforts to maximize the positive economic effects of the activities of TNCs on host countries and to minimize the negative impact through a pragmatic approach to international discussions seeking to reconcile the operations of TNCs and host state economic and political objectives. This, in Canada's view, would include the recognition that host countries needed to be able to fashion the terms of entry of TNCs.⁶³ Canada was enthusiastic about efforts to help developing host states through technical assistance designed to strengthen their capacity to negotiate with TNCs. This would help ensure that the resulting terms of entry would be more commensurate with host countries' national development priorities. Canada was willing to lend its expertise, especially regarding the establishment of screening mechanisms.⁶⁴ (Given the very recent creation of FIRA this attitude was not surprising.)

In addition, Canada decided to play a positive role in supporting and actively participating in efforts to negotiate a code of conduct for transnational corporations, because of the significance of the issue for Canada, and its recognized

expertise.⁶⁵ At the same time officials were wary that many aspects of developing state demands regarding the code and the obligations to be imposed on TNCs might ultimately be unacceptable to Canada⁶⁶. On the other hand, any demands by home states that sought to embed a strong standard of non-discriminatory or national treatment for foreign investors in the code, would be equally unacceptable⁶⁷.

During the second session the Commission approved a resolution giving the highest priority to negotiating a code and established an intergovernmental working group. The group immediately began discussions with a view to developing an annotated outline for a possible code. Member states submitted their views on a code in January, 1977. The Canadian document indicated its view, similar to that of the United States and most industrial countries, that the code should be voluntary and form "a framework of balanced expectations and responsibilities to which governments might agree and TNCs would be expected to adhere,"⁶⁸ which would apply to all (including state-owned) corporations. Canada called on host states to agree to deal with TNCs in a predictable and responsible way and for home states to refrain from influencing operations of their nationally-based enterprises abroad. On issues such as TNC involvement in host state political processes, disclosure of information, and the requirement that TNCs contribute positively toward host state balance of payment objectives, Canada sought to weaken the

imperative wording of developing host country texts. On issues such as host state rights to control incoming investment, however, Canada's position was closer to many developing countries. In Canada's view sectoral restrictions on FDI and control of entry and expropriation with "suitable and equitable compensation"⁸⁸ were the prerogatives of host states. Canada's position on national treatment was equally clear:

Canada has a long-standing difficulty with the principle of national treatment. This difficulty arises from the high proportion of foreign direct investment found in Canada, a situation unparalleled in other industrialized countries. Canada has taken the view that national goals can be best served in the circumstances if some restrictions (ordinarily upon entry) are applied to foreign direct investment.⁸⁹

The progress of negotiations was slow. By 1979 the intergovernmental working group had made limited progress in outlining the issues which had to be dealt with as part of a code even though major issues such its status (mandatory or voluntary) and coverage (whether only private corporations or also state-owned corporations) remained unresolved. Based on the working group's discussions the Swedish Chairman drafted a set of formulations⁹¹ dealing with activities of TNCs, treatment of TNCs and intergovernmental cooperation. The first section included calls for TNCs to respect national sovereignty of host states, to adhere to their economic development goals, to refrain from interfering in their internal political affairs and to abstain from restrictive

business practices. As was the case at the OECD the guidelines for TNC activity were among the least controversial aspects of a code and both the developed and developing countries were able to come to agreement on many aspects fairly quickly.

The second section on the treatment of TNCs was much more controversial. It was here that developed home states and developing hosts parted company. The United States, along with the United Kingdom and the Federal Republic of Germany, generally sought to embed standards derived from conventional international law in the case of expropriation, and third-party arbitration (preferably through the International Center for the Settlement of Investment Disputes) in the case of host-TNC investment disputes. Both of these proposals were strongly opposed by the G-77. It is here, too, that Canada's own ambiguous position as both home and host country was evident. Canada opposed national treatment and clearly supported the rights of host states to discriminate against TNCs and regulate them, particularly their access. At the same time Canada did see the need to reassure foreign investors through the use of transparent and predictable regulation and host state commitments to accord TNCs fair and equitable treatment. Canada, like most Latin American countries, was not a member of ICSID², and had generally upheld the primacy of host state jurisdiction.

Developed and developing states remained far apart on

many of these issues. Despite having made some progress by the early 1980s negotiations were losing any momentum with little hope of a consensus developing in the near term. United States officials, who had been very sceptical of the process, became even less willing to compromise in the interests of reaching agreement during the Reagan Administration.⁹³ Efforts to restart the negotiating process in 1984 and 1985 ended in further deadlock although agreement was reached on coverage (that state corporations would be included) and compromise on a voluntary code seemed likely. Host state jurisdiction, expropriation and national treatment all remained unresolved.

Changes in the international economy, particularly recession and third world debt, had some impact on the urgency of the desire to control or regulate TNCs. In addition, by the early 1980s it was clear that the United States intended to pursue its investment objectives in other ways, such as through bilateral negotiations where it had greater influence over and more confidence in the outcomes, or through organizations like the GATT where its economic influence could be felt.⁹⁴

Canadian officials managed, in their view, to resolve some of Canada's home-host ambiguities and develop a coherent position on the code. They were on the defensive regarding Canada's investment regime less than was the case at the OECD. Developing countries put up strong opposition to U.S. demands,

such as national treatment, which Canada also opposed. On many issues, however, Canada did have similar views to the United States. Nonetheless officials felt they were able to bridge the gap between the two sides.⁹⁵ They were sympathetic to developing country needs to manage FDI for economic development purposes, while also being strong advocates of fair and consistent treatment of MNCs. But while the weight of developing countries members was clearly more than able to counterbalance home-country influence it did not ultimately result in successful negotiations. Canada was seeking to develop a balanced code which both treated foreign investors fairly, but recognized host state rights to regulate them in the interests of national economic development objectives and norms. Such a code has yet to be achieved.

Ultimately the attempt on the part of host states to use the UN as a negotiating forum for regime transformation failed, according to Krasner⁹⁶, because it attempted to challenge postwar liberalism and ignored the distribution of power on which it was based. While capital exporters, particularly the United States, were unable to control the agenda, or influence outcomes because of the broad membership and cooperation among host countries, they, in turn, were unable to force a resolution of the outstanding issues.

Conclusion

In the UN, as well as in the OECD, Canadian efforts to

obtain codes that fully reflected Canadian interests were unsuccessful. In the case of the OECD the process moved in a direction that threatened to further isolate Canada from key OECD players. In the UN, while Canada has been able to balance competing home and host interests, the process bogged down and resulted in no agreement and the United States shifted its efforts to organizations where it had a better hope of controlling negotiation outcomes, such as the General Agreement on Tariffs and Trade. The use of the GATT as an organization in which to address investment issues provided the United States with additional means to limit Canada's capacity to control foreign direct investment. Thus Canada's trade interests, particularly its trade dependence and vulnerability to trade-related measures, increasingly came to shape the national investment regime in the 1980s.

Trade, Investment and the GATT

Like the United Nations, the GATT involves a broad set of member countries in its agreement, including developed and developing countries.⁸⁷ It operates, however, on a very different basis from the UN involving a series of contractual agreements among trading partners based on principles of non-discrimination (most favoured nation) and national treatment. It has, as its primary objective, the freeing of international trade, initially through the lowering of trade barriers and establishing mechanisms for the settlement of trade disputes.

Its structure is much less institutionalized than that of the UN. A member's influence in the periodic rounds of trade negotiations varies with the leverage that market access provides. Thus the largest economies and trading blocs tend to dominate on many issues.⁹⁸

In the late 1970s increased state efforts to manage international trade and repeated deviations from the norms of the GATT led to real concern on the part of many members that international trade rules were being eroded. Many smaller, trade-dependent members supported efforts to strengthen the GATT, in order to restrain repeated violations of its founding principles.

Canada has strongly supported the GATT since its inception and participated in the major rounds of tariff negotiations.⁹⁹ By the 1980s Canada sought, in the context of growing protectionist trends exacerbated by the recession, to strengthen the GATT process - particularly in the area of dispute settlement and to bring areas such as agriculture within the scope of GATT negotiations.¹⁰⁰

The United States also sought to initiate a new round of trade negotiations in the 1980s to both counterbalance domestic protectionist pressures and to bring more discipline to the aggressive use of agricultural export subsidies on the part of the European Community. In addition, the United States, as Chapter Five indicated, saw the GATT as an alternative organization to deal with host state regulation of

foreign direct investment, particularly trade-related investment measures (TRIMS).¹⁰¹ The United States sought to establish that host state efforts to extract enhanced performance from multinational enterprises through increased local sourcing, processing and exports constituted, in effect, a violation of several articles of the GATT.¹⁰² Thus the dispute with Canada over the operation of the Foreign Investment Review Agency (FIRA), discussed briefly in Chapter Five, provided a useful case with which the United States could test the limits of the GATT's rules and apply additional pressure on Canada to eliminate performance requirements from the screening process.

If the United States had lost at the GATT it would have severely weakened U.S. multilateral efforts to limit Canada's ability to manage FDI, and it would have provided strong international recognition of the rights of host states to impose conditions of access on foreign investors in an effort to promote domestic economic development.¹⁰³ Canada, along with a number of developing countries had resisted U.S. efforts to have the GATT launch a formal study of TRIMS in 1982. Canada argued for a broader approach to investment which also considered the concerns of host countries with issues such as transfer pricing. But Canada had also long supported the strengthening of the GATT dispute settlement process to make it binding upon the parties involved. In Canada's view a stronger dispute settlement process in the

GATT would help smaller states offset the bilateral asymmetries in trade disputes. Thus, although there were risks, Canada agreed at the outset to be bound by the results of the panel decision on the operation of FIRA.

The U.S. initiated consultations with Canada on FIRA under Article XXIII in January, 1982. When these did not resolve the dispute the United States initiated its case. In March, 1982 the GATT Council agreed to establish a three member panel to hear the case. Although the panel members were from smaller and less-developed countries they acted as independent experts and not as instructed delegates.

Several other GATT members from less developed countries, particularly Argentina, expressed doubt that the GATT had any competence to deal with investment questions.¹⁰⁴ As part of its strategy the United States complaint against Canada was confined to two very specific trade-related issues involved in the administration of the Foreign Investment Review Act and did not question Canada's right to screen investment.

The U.S. complaint centred around the specific undertakings investors made to FIRA in order to establish the nature of the significant benefit their investment would bring to Canada, which was the key criterion for gaining access. Once an investment was approved, these undertakings became binding on the firm and were monitored by FIRA. The United States argued that such undertakings, which often included commitments to purchase Canadian goods, to source through

Canadian channels, or to manufacture goods in Canada to displace imports, violated sections of Article III of the GATT which requires contracting parties to give no less favorable treatment to imported products than like products of national origin.

FIRA undertakings also dealt with exports and in these instances, the United States argued, Canada was violating Article XVII which prohibited government interference with the operation of commercial considerations. The inflexibility of binding commitments related to export targets, the U.S. contended, could lead to dumping of products abroad.

The United States also argued that although the undertakings regarding sourcing included qualifications as to commercial availability of inputs, these were vague and the negotiation process itself was one of using an implied benefit or penalty (ie. denying or allowing market access) to cause firms to bind themselves to future commitments that might not have been made in the light of normal commercial considerations.

FIRA officials provided the GATT with evidence on a sampling of cases which indicated that obtaining undertakings related to sourcing was a major aspect of the screening process. About 70 per cent of the cases sampled involved commitments to purchase either Canadian goods or services.¹⁰⁵ Only 44 per cent of cases involved export commitments. Of these, about two thirds were either of a more negative sort,

that is, commitments that MNCs would not restrict exports or commitments to actively pursue export opportunities. Few cases involved quantified export targets.

Canada, in its submission to the GATT, questioned the competence of the GATT to deal with the investment issue and argued that undertakings made by investors involved no coercion on the part of the agency. Commitments were voluntarily made by firms, according to the submission, in order to specify the significant benefit that an investment would bring. Canada pointed out that the legislation made no mention of undertakings. Commitments become legally binding only to ensure that they were, in fact, valid and not based on inflated or excessive claims made by a firm merely to obtain approval. Canada's submission also pointed to the agency and the government's flexibility in renegotiating undertakings, especially when, because of changes in market conditions, firms were unable to live up to previous commitments.

Canadian officials initially felt fairly confident that the U.S. arguments would be rejected.¹⁰⁶ However, in July 1983, the GATT panel found, in the case of undertakings related to sourcing requirements, that FIRA's administration did indeed violate sections of Article III. In the case of exports, however, the finding went against the United States. Given the importance of Canadian sourcing undertakings in most FIRA cases and the generally weaker U.S. argument and evidence in the case of exports, the ruling was clearly a defeat for

Canada.

Some hope was held out that the full GATT Council, where many developing countries were represented, would not uphold the ruling. In 1984, however, the ruling was upheld. Although FIRA officials claimed that, in fact, the decision would in no real way alter FIRA's behaviour¹⁰⁷, a change was made within FIRA's administration such that any future undertakings regarding sourcing included the commitment by firms only to offer a "full and fair opportunity to Canadian suppliers." This clearly implied a much weaker obligation on the part of firms.

At the same time that the United States was pursuing Canada's investment regime under the GATT it was also trying to launch a new round of GATT negotiations which would include both TRIMS and trade in services. Including investment within the GATT was attractive to the U.S. because the GATT, unlike the OECD, provides for the enforcement of rules by sanctioned trade retaliation on the part of members. Such a situation affords large market economies, like the United States, Japan and the European Union major influence because of the attractiveness and large size of their markets. Sanctions which deny access to their trading partners can be very effective. If the GATT were to adopt rules on investment measures which reflected the interests of capital exporting, home countries, it would have major implications for host countries. Host countries, especially if highly dependent on

market access to the large economies, would find the costs of using prohibited measures to control FDI coming from the large economies very high. As such these rules would form a major constraint on host states' choices of policy instruments.

The issues of services, another priority for the United States at the GATT, also had an investment dimension. Although the U.S. enjoyed a trade surplus in services, several large U.S.-based service industries felt prevented from further expansion abroad because of foreign state regulation of service industries which denied them market access.¹⁰⁸ An important aspect of attaining such access was international recognition of a right of establishment for foreign-based firms offering non-tradeable services. This clearly had direct implications for host state rights to control or limit the entry of FDI.

In September, 1981 the United States proposed a work program to the Consultative Group of Eighteen of the GATT¹⁰⁹ which included both trade in services and trade-related performance requirements imposed on foreign investors. The intention, according to a Senior Treasury official, was to ultimately address a list of investment-related concerns through the GATT including the right of establishment, national treatment and nationalization. For the United States the GATT was the preferred venue for the negotiations because, unlike the OECD, its rules could be made binding and its members included developing countries, the chief abusers of

trade-related investment measures.¹¹⁰ Clearly the United Nations Conference on Trade and Development and the UN Commission on Transnational Corporations were less desirable because of the dominant role played by developing-country members. The developing country-members at the September 1981 GATT meeting strongly opposed the U.S. work program.

United States officials persisted. In March, 1982 Ambassador Brock made it clear to the U.S. Senate that both negotiations on trade in services and trade-related investment measures were priorities for the November 1982 GATT ministerial meeting.¹¹¹ Specifically, the United States would seek "a political commitment from ministers to initiate a work program on investment policies with a particular focus on trade-distorting practices such as performance requirements¹¹²." In the case of services, which were "a top priority", the United States wanted to obtain specific commitments to a work program that would examine the GATT articles and codes and their applicability to services within a specified time frame.

Canada's reaction to the U.S. initiatives on services and investment was cautious. The Trade Minister indicated Canada's willingness to "study the problems relating to trade in services in the GATT" and indicated that the Canada was in the process of defining its interests on the issue.¹¹³ On investment measures Canada argued that any program of study proposed would be "unbalanced unless it were to address, at

the same time, the behaviour of multinational corporations¹¹⁴."

Canada's trade priorities, as outlined by the Minister of State for International Trade in June 1982¹¹⁵, were more concerned with negotiated limits on the use of safeguards (emergency measures against injurious imports), strengthening of the dispute settlement mechanism, agricultural trade (especially restraints on European Community export subsidies), improved foreign market access for processed resources and the strengthening of some existing GATT codes, for example, the Aircraft Agreement.

At the November, 1982 meeting, which Canada chaired, opposition to the United States' proposed work program was very strong from several developing countries, particularly in the case of services and investment. Brazil and India led strong opposition to any discussion of investment issues. In the case of services there was a fear on the part of developing countries that they would be forced to open key economic sectors, such as banking, communications and transportation to foreign companies, in return for access to developed country markets for their goods.¹¹⁶ A limited compromise on services was finally achieved. The final declaration merely referred to national studies on services to be undertaken by members. There was no mention of investment issues at all in the final declaration.¹¹⁷ The work program which was agreed to included measures still unfinished from the

1979 Tokyo Round including safeguards, agriculture, a review of certain codes and dispute settlement. A review on progress was scheduled for 1984.

The results of the meeting must be seen as a partial defeat for the United States.¹¹⁸ Ambassador Brock's disappointment on the investment issue was clear and he warned that the United States would "protect its interests" and if necessary, pursue its "legitimate complaints perhaps in a more unilateral and confrontational manner than would have occurred, if the GATT ministerial had made more progress in this area."¹¹⁹ The United States thus continued a policy of both strengthening its pursuit of its service trade and investment objectives on a bilateral basis, while also continuing to work multilaterally, especially in the GATT, to gain acceptance for its agenda.

By the fall of 1983 Canada was addressing the possibility of negotiating an international framework for trade in services.¹²⁰ By 1986 several developments had strengthened the prospect for trade in services and investment issues to become an accepted part of future GATT negotiations. The United States had been at least partially successful in its case against FIRA at the GATT, a case which had been specifically undertaken to test the limits of the applicability of GATT articles to investment issues. At the same time some of the opposition from developing countries to any discussion of the investment or services issues had begun

to fragment. This was partly because of some divergence of interest between certain newly industrializing countries and some of the other developing countries, also partly because U.S. bilateral pressure on some countries had been effective. Moreover, the United States itself was willing to compromise somewhat on its demands.

By 1986 Canada's position had also shifted reflecting the loss of the GATT case in 1983, the shift in its own domestic FDI regime in fall of 1984 and the decision, in September, 1985 to initiate free trade discussions with the United States. In addition, Canada saw that the launching of a new round of trade negotiations in 1986 would address a number of key Canadian objectives including trade in agriculture.

Thus Canada supported the Uruguay Declaration of 1986 which included both trade in services and trade-related investment measures on the agenda. This was not achieved, however, without the very strong opposition again of a number of developing countries. Reacting to their concerns about the prospect of being pushed by developing countries into trading off services for market access for goods, ministers agreed to the demand of many developing countries to completely separate the two negotiation processes.

The second part of the declaration dealt with trade in services which were to be negotiated by a separate Group on Negotiations on Services. The aim was to:

establish a multilateral framework of principles and rules for trade in services, including the elaboration of possible disciplines for individual sectors, with a view to expansion of such trade under conditions of transparency and progressive liberalization and as a means of promoting economic growth of all trading partners and the development of developing countries.¹²¹

The declaration thus allowed for the separation of goods and services in the negotiation process. It also suggested the acceptability of more limited, sectoral-based discussions instead of the broad package approach favoured by the United States.

Investment measures were included as an area to be discussed in a review of GATT articles. The commitment in the declaration, however, was quite vague stating only that:

Following an examination of the operation of the GATT articles related to the trade-restrictive and distorting effects of investment measures, negotiations should elaborate, as appropriate, further provisions that may be necessary to avoid such adverse effects upon trade.¹²²

A negotiating group was subsequently established to be chaired by Japan.

Finally in October 1987 the negotiation of the Canada-U.S. Free Trade Agreement, with its inclusion of investment and services, indicated a further shift in Canada's position on international investment within multilateral organizations. It included a commitment made that Canada and the United States would endeavour, as part of the Uruguay Round, to "improve multilateral arrangements and agreements with respect to investment." ¹²³ While the wording was vague the intent

was clearly to limit Canada's ability, during the Uruguay Round, to take any strong position in opposition to U.S. objectives regarding investment measures. At the same time by signing the FTA Canada had already agreed to significant limits on its ability to impose performance requirements on foreign investors, an issue which was soon to be raised at the GATT.

Negotiations on investment issues began in 1988.¹²⁴ Discussions initially centred around the contentious issue of defining the universe of investment measures which could be considered to be "trade-related", in particular, trade distorting. Essentially the measures in question are host state policy instruments which seek to control the behaviour of foreign investors. In particular, incentives, conditioned incentives, and performance requirements, typically imposed as a condition of access, were the instruments the United States wanted to eliminate. In terms of our categories, these are access instruments, although they may also be applied in a discriminatory way to influence the behaviour of EFCs.

Not all measures, however, necessarily have a trade impact. For example, one could argue that local equity requirements would not. Clearly, however, requirements to source locally, or export certain amounts of goods would. The key dispute over TRIMS at the GATT centred around what measures would be prohibited and how their impact on trade would be determined. The United States had the objective of

trying to identify a large number of FDI policy instruments which could be subject to retaliation based on their trade impact. Conversely a number of host countries, primarily developing countries, totally opposed the inclusion of TRIMS in the GATT, or sought a smaller, definitive list of a priori prohibited measures, confined to those instruments which had a clear, direct impact on trade. This was, in essence, the division which existed at the beginning of the protracted negotiations. Since the resolution of the TRIMS issue takes us beyond the period under study we will assess its impact briefly in the concluding chapter.

Conclusion

The case of the GATT illustrates the trade-off Canada has had to make on investment and trade interests and the extent to which more binding rules can act as a constraint on host state choices. Canada's commitment to strengthening dispute settlement in the GATT in 1982 and its confidence that it would win the case led it to be willing to be bound by a decision. Given the importance of trade and Canada's dependence on the U.S. market the FIRA requirements on sourcing, as a result of the U.S. victory, were too costly to retain in the event of GATT sanctioned retaliation. Moreover, despite taking several years and requiring some compromise, the fact is the U.S. initiative to get TRIMS on the GATT agenda was ultimately successful¹²⁵ and led to the negotiation

of TRIMS at the Uruguay Round raising the possibility of further constraints on host state FDI policy instrument choice.

Assessing Multilateralism: Canada and the International Investment Regime

Did the negotiation of rules and norms on foreign investment within international organizations provide Canada with an opportunity, in the 1970s, to shape an emerging international investment regime? Was Canada able to counterbalance U.S. pressure in opposition to its FDI regime within the multilateral context these organizations provided? The answer to both questions is clearly no. In fact, in both the OECD and the GATT Canada found itself in the role, not of initiating proposals on the foreign investment regime, but, in fact, responding to U.S. initiatives and pressure, some of it more intense than in the bilateral context. Thus Canada was repeatedly put on the defensive in both the OECD and the GATT and faced unpleasant trade-offs of investment controls for other foreign policy or trade objectives.

In the case of the OECD the investment issue was dealt with in the early 1970s largely at the behest of the United States, supported by other capital exporters. It also took place within an organizational context which was basically hostile to national controls on foreign investment. Dominated as it was by large capital exporters, Canada was on the

defensive on investment issues in the OECD and was unable to build effective alliances with smaller host states. In the case of the 1976 Declaration and the issue of national treatment the negotiations became, in effect, a bilateral Canada-U.S. conflict. Fearing isolation within the organization Canada signed the declaration leaving the status of its adherence to the national treatment norm ambiguous.

In contrast, the United Nations provided a context where sovereignty afforded equal membership rights and allowed the Group of Seventy-Seven to dominate the agenda and push for the negotiation of a code. While Canada was able to carefully balance its ambiguous position as an advanced industrial host and home country, the process of negotiation ultimately failed. While host state influence was clear it was of a negative sort, insufficient to produce a code, never mind one that might effectively bind either MNCs or home states. By the 1980s the United States was aggressively pushing for protection of the rights of foreign investors as no agreement became its preferred outcome in the UN context. The United States also shifted its initiatives on investment issues to bilateral approaches and other international organizations where it had a higher probability of controlling the outcome.

The U.S. strategy was particularly effective where Canada's trade interests were put at risk, as the 1983 GATT case reflects. Moreover, the United States was also successful in getting the GATT to address TRIMS, even if it

was through a two-track compromise.

Have Canada's failed efforts to develop an international regime more supportive of host state investment controls in the 1970s and the U.S. success in using the GATT to deal with investment measures in the 1980s had an impact on Canada's investment regime? As Chapter Four indicated, Canada's FDI regime shifted toward liberalization in the 1980's, but the shift cannot be accounted for only by the evolving international investment regime.

The Canadian state was already re-examining Canada's FDI regime and a belief was growing among department officials and political leaders, both Liberal and Conservative, that Canada could not afford controls on access or discriminatory regulation of foreign firms. This was reflected in Canada's shift in signing the Capital Movements Code after twenty years of refusing to do so and Canada's acquiescence in the discussion of TRIMS at the GATT.

What then has been the impact on Canada of this international regime which favours the freer movement of international capital? The GATT case led directly to the altering of a FIRA regulation, while in the OECD the codes led to increased scrutiny of Canada's remaining investment controls and pressure to remove them. Moreover, the development of this regime increases the cost to Canada of any future measures which, should domestic preferences change, seeks to increase control over the entry of FDI or

discriminate against foreign firms. Any such measures would be regarded by Canada's economic partners as illegitimate and in violation of established international norms. The costs involved in using such policy instruments might include a damaged reputation as a desirable investment location or exclusion or isolation in international fora where Canada desires participation or membership. Like the Free Trade Agreement the international regime may have a ratchet effect in the direction of liberalization of Canada's investment regime.

The analysis of these three cases of international organizations indicates that multilateralism is not necessarily an alternative to the bilateral economic relationship or a mechanism for compensating for, or counteracting, the asymmetries of that relationship. While this does not mean that multilateral approaches to negotiating rules of exchange or facilitating international economic coordination or cooperation should be abandoned, it does mean that all such efforts must be based on a realistic understanding of the limited extent to which, and the conditions under which, state actors have been able to use such organizations to build regimes that can have a transformative effect on power relations. Rather than counterweights, these international organizations have, to some extent, been mirrors of patterns of international influence.

The following and final chapter reviews the evidence presented on the influence of the three external factors discussed in Chapters Four, Five and Six and assesses their contribution to an explanation of Canadian foreign investment regime change. It also briefly examines further investment regime changes which have occurred since 1987 as a result of the negotiation of the North American Free Trade Agreement and the Final Act of the Uruguay Round of multilateral trade negotiations.

1. Robert Keohane, "Multilateralism: An Agenda for Research," International Journal XLV: 4 (Autumn, 1990), 731-764.
2. Robert Keohane, After Hegemony (Princeton: Princeton University Press, 1984), 259.
3. Stephen Krasner, Structural Conflict: The Third World Against Global Liberalism (Berkeley: University of California Press, 1985).
4. Tom Keating calls multilateralism one of the "most prominent and persistent themes in the practice of Canadian foreign policy", see Canada and World Order: The Multilateral Tradition in Canadian Foreign Policy (Toronto: McClelland and Stewart, 1993), 10.
5. This argument was made frequently in the debate over the Free Trade Agreement. See for example Duncan Cameron, "Introduction," The Free Trade Papers (Toronto: Lorimer, 1986), xviii.
6. This approach is often labelled the "new insitutionalism" and is critiqued in Alexander Wendt and Raymond Duvall, "Institutions and International Order," in Ernst-Otto Czempiel and James Rosenau, Global Changes and Theoretical Challenges (Toronto: Lexington Books, 1989), 51-74.
7. Caporaso and Haggard, op cit., 109.
8. See G. John Inkenberry and Charles A. Kupchan, "The Legitimation of Hegemonic Power," in David Rapkin (ed.) World Leadership and Hegemony (Boulder, Colo: Lynne Rienner, 1990), 60-61.
9. For a discussion of how the United States has viewed organizations see Margaret P. Karns and Karen A. Mingst, "The United States and Multilateral Institutions: A Framework for Analysis in Margaret P. Karns and Karen A. Mingst (eds.) The United States and Multilateral Institutions: Patterns of Changing Instrumentality and Influence (New York: Routledge, 1992), 1-24.
10. As Bruce Doern and Brian Tomlin point out multilateralism has often been exaggerated and underestimates the extent to which international organizations have served as a forum for bilateral negotiation. See G. Bruce Doern and Brian W. Tomlin, Faith and Fear: The Free Trade Story (Toronto: Stoddart, 1991), 63.
11. Tom Keating, op cit., describes Canada's desire to preserve the habit of consultation even at the expense of principle in his concluding chapter, 246.

12. For a recent discussion of this regime see Robert K. Patterson, "Canada and International Legal Regimes for Foreign Investment and Trade in Services" in Claire Cutler and Mark Zacher (eds.) Canadian Foreign Policy and International Economic Regimes (Vancouver: University of British Columbia Press, 1992), 130-152.

13. Robert Keohane, op cit., 739.

14. Stephen Krasner, "Structural Causes and Regime Consequences: Regimes as Intervening Variables," International Organization 36: 2 (Spring, 1982), 185-205.

15. See Charles Lipson, Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Century (Berkeley: University of California Press, 1985).

16. For a review of the literature on changing trends in expropriation and their causes see Charles Kennedy, "Relations Between Transnational Corporations and Governments of Host Countries: A Look to the Future." Transnational Corporations 1:1 (February, 1982), 67-81.

17. These were, of course, not the only organizations dealing with investment issues. Members of the International Labour Organization negotiated a "Tripartite Declaration Concerning Multinational Enterprises and Social Policy," which dealt primarily with employment and labour relations. In addition the United Nations Conference on Trade and Development also began negotiations in the mid-1970s on technology transfers and restrictive business practices, the latter resulting in an agreement in 1980. The UN Commission and OECD efforts, however, were the broadest, most comprehensive approaches to address both MNC behaviour and that of host and home states in dealing with direct investment.

18. Government of Canada, Foreign Direct Investment in Canada. (Ottawa: Information Canada, 1972).

19. Ibid., 392.

20. Copy of the summary of Cabinet Decision on Domestic Control of the National Economic Environment, June 15, 1972 obtained in the files of the Department of Finance under the Access to Information Act.

21. Ibid.

22. As the Canadian counterpart of the Business and Industry Advisory Committee of the OECD CBIAC's members included major corporations and business organizations and represented their interests before international organizations such as the OECD

and the United Nations. In 1984 the organization was restructured and became the International Business Council of Canada.

23. The following account of Canada's activities at the OECD and the United Nations is based on documents from the 1968-85 period obtained under the Access to Information Act. These included written memoranda on international investment issues from the Department of Finance which included the minutes of meetings of the Interdepartmental Committee on International Investment Policy. Briefing books for meetings of the OECD Committee on Multinational Enterprises and the Committee on Capital Movements and Invisibles Transactions were obtained from the Department of External Affairs, along with telexes to and from the Canadian mission to the OECD in Paris and the UN in New York. These were supplemented with interviews with a number of officials in those departments, including the officer who chaired the interdepartmental committee in the 1974-77 period.

24. When founded in 1961 it had 20 members. In 1985 total membership was 23 listed as follows: Australia, Austria, Belgium Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Netherlands, New Zealand, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States.

25. Taken from Article 1 of the founding charter of the organization as reproduced in OECD, The Organization for Economic Cooperation and Development (Paris. OECD, 1963).

26. See John Robinson, Multinationals and Political Control (New York: St. Martin's Press, 1983), Part III which deals with the OECD code. Interviews with officials indicated that decisions were often by consensus but that the United States often set the agenda, while the Secretariat played a major role in developing the work program.

27. See Robert Wolfe, "The Making of the Peace, 1993: The OECD in Canadian Economic Diplomacy," Paper presented at the Annual Meeting of the Canadian Political Science Association, Ottawa, June 4-6, 1993.

28. For a discussion of how the OECD code uses peer review and surveillance to build norms see Robert Wolfe, op cit., 14-16.

29. See A.F.W Pluntre, Three Decades of Decision: Canada and the World Monetary System, 1944-45 (Toronto: McClelland and Stewart, 1977), 132.

30. OECD, Statement of the Representative for Canada, Mr. Louis Rasminsky to the Committee for Invisibles Transactions April 20, 1961, 4.

31. Plumtre, op cit.

32. Files indicate a request from the OECD Secretary-General in 1968 and 1972. The latter involved pressure from BIAC encouraging the invitation to Canada. See Telex Feb. 29, 1972 from External Affairs to Canada's OECD mission in Paris.

33. There are several terms used by international organizations when referring to multinational corporations. In the UN the term transnational corporations is used while in the OECD the term multinational enterprise is favoured. Since these terms are essentially interchangeable we will, in discussing the negotiations within these organizations, do so in the terms they use.

34. United Nations, Multinational Corporations and World Development, (UN: New York, 1973). For some recent useful summaries of the sequence of developments in the UN and the OECD see Christopher J. Maule and Andrew Vanderwal, "International Regulation of Foreign Investment," International Perspectives, (Nov/Dec., 1985); John M. Kline, International Codes and Multinational Business (Westport, Conn: Quorum Books, 1985), John Robinson, Multinationals and Political Control, (New York: St. Martin's Press, 1983) and Werner Feld, Multinational Corporations and UN Politics: The Quest for Codes of Conduct, (New York: Pergamon Press, 1980).

35. John Robinson, op cit., Part III, Chapter 8, "The Guidelines Paternity," 113-118.

36. Statement of the Hon. William J. Casey at the 4th Special Session of the OECD Executive Committee on 5th July, 1973.

37. Ibid.

38. Department of External Affairs, Memorandum to the Deputy Minister of Finance, June 17, 1974.

39. According to the chair of the officials committee in 1975-76, interviewed in 1985, the Canadian Labour Congress did not see the issue as a priority and did not have a direct and ongoing link to TUAC.

40. OECD "Issues Pertaining to International Investment" Note of the Secretary-General (Paris, Oct. 9, 1974).

41. Department of External Affairs, letter summarizing minutes of the October 16, 1974 meeting of the Interdepartmental Committee on International Investment Policy, Oct, 24, 1974.

42. Ibid.

43. The Committee on Investment and Multinational Enterprises was formally created on January 21, 1975 by a resolution of the organization with its first meeting of permanent representatives in March. Work had been well under way, however, by that time.

44. Canadian representatives opposed any "references to such features as the principle of national treatment, Canada's opposition to which is well known or to agreements regarding official incentives and disincentives for investment as the standards should be addressed strictly to the purpose for which they are intended." In addition attempts to establish intergovernmental consultations in the case of host-MNE disputes were considered inappropriate, raising the spectre of home (i.e. U.S.) interference. See Government of Canada, Canadian Position on Standards of Behaviour May, 1975. This paper was prepared by the Interdepartmental Committee on International Investment Policy and presented by the Canadian delegation to the OECD secretariat and the working group.

45. Ibid.

46. Differing positions were reflected in the competing drafts of various aspects of the code which were circulated among member countries in 1975 and 1976 as part of the negotiations. Copies of these drafts were obtained from the files of the Department of Finance. See also Robinson, op cit.

47. See Robinson op cit., 113-118. Virtually all of the memoranda cited below by Canadian officials make reference to the tight work schedule which, despite Canadian efforts to slow it down, went forward apace.

48. Department of Finance, Memorandum to M. Russell, "Minutes of Meeting with CBIAC", September 4, 1975. CBIAC met several times with officials, but were not able to persuade them to drop their opposition to national treatment. A reflection of the differing positions of the state and large corporations, at this time, on the question of FDI.

49. Department of Finance, Memorandum to the Deputy Minister, "OECD Discussion on Investment Issues," December 11, 1975.

50. Department of Finance, Memorandum to the minister, "OECD Discussion of Investment Issues," November 13, 1975.

51. Department of Finance, Memorandum to M. Macpherson, "OECD Discussion of Investment Issues: The Principle of National Treatment", December 3, 1975.

52. For a history and listing of these see OECD, Code of Liberalisation of Capital Movements, (Paris: OECD, March, 1982).

53. Interview with the chair of ICIJF, October 1985. Similar comments were made by officials in Investment Canada who were also interviewed. Memos cited above indicated that officials in all departments saw this imbalance as a problem for Canada.

54. Department of Industry, Trade and Commerce, Memorandum to the Minister, "OECD Investment Issues", November 10, 1975.

55. Department of Finance, Memorandum to File, December 11, 1975.

56. These included:

1. the small business tax rate which applied only to Canadian-controlled corporations.
2. the dividend tax credit which applied only to dividends from Canadian-controlled corporations.
3. the 1971 pension measures which limited foreign investment to 10 per cent in pension funds eligible for tax savings
4. the disallowance of advertising expenses incurred by Canadian residents using foreign-owned newspapers or broadcast media (Bill C-58)

Department of Finance, Memorandum to the minister, March 3, 1976.

57. Ibid., 2.

58. OECD, Committee on Investment and Multinational Enterprises, National Treatment, Revised Text, based on a draft elaborated by the United States Delegation (March, 1975) paragraph 10, p. 3.

59. Department of Finance, Cabinet Briefing Note, date June 21, 1976.

60. Department of External Affairs, memorandum, "Draft of National Treatment Text", April 20, 1976.

61. Telex from External Affairs in Ottawa to the Canadian Delegation to the OECD discussing the U.S. position and advising on what Canada should respond at CIME committee meeting. April 28, 1976.

62. Department of Finance, Memorandum to the minister, "OECD Investment Issues," May 10, 1976.

63. Canadian Delegation to the OECD, Telex to Department of External Affairs, Ottawa, May 17, 1976. This reviews the legal options and procedures under the OECD rules whereby members could lodge a reservation.

64. Confirmed in interview with official in External Affairs who chaired the interdepartmental committee in 1975-76, October, 1985.

65. Department of Finance, Memorandum to the Minister, June 17, 1976. The memo contains the minister's handwritten notations that the whole exercise was an utter failure.

66. Statement by the Secretary of State for External Affairs, the Hon. Allan J. MacEachen at the OECD Ministerial Meeting in Paris June 21, 1976.

67. Ibid., 2.

68. Statement by the Honorable Flora MacDonald at the OECD Ministerial Meeting, Paris, June 13, 1979.

69. See Gary Hufbauer and Andrew Samet, "Investment Relations Between Canada and the United States," in Atlantic Council, Canada and the United States: Dependence and Divergence (Ballinger, 1982), 110.

70. Ibid.

71. Files indicate a request from the OECD Secretary-General in 1968 and 1972. The latter involved pressure from BIAC encouraging the invitation to Canada. In each case the response indicated that Canada's concerns remained the same as in 1961 and Canada's policy on non-adherence remained unchanged. See Telex from External Affairs in Ottawa to the OECD delegation, February 29, 1972. Requests also came in 1978 and again in 1982, which was the one Canada finally acceded to, initiating a review of policy which resulted in the 1984 decision to sign.

72. This process was described to me by an official in the International Economic Relations Division of the Department of Finance, October, 1985.

73. The discussion of Canada's OECD activities is partially based on interviews with Department of Finance officials in the fall of 1985 as well as OECD documents.

74. Department of External Affairs, "Canada Adheres to OECD Capital Movements Code," July 18, 1985. Communique no. 109.

75. For a review of these disputes and the case study literature on them see Charles Kennedy, op cit.

76. Contributors included Argentina, Brazil, Barbados, Brazil, Colombia, Ecuador, Jamaica, Mexico, Peru, Trinidad, Tobago and Venezuela.

77. See Areas of Concern Which Could be Used as a Basis for Preliminary Work on a Code of Conduct (United Nations, January, 1976), 1.

78. Ibid.

79. Areas of Concern which Related to Relations Between Transnational Corporations and Governments (United Nations, January 1976), 1.

80. The International Center for Investment Disputes was founded in 1965 under the auspices of the World Bank.

81. Department of External Affairs, "Summary of the June 20, 1974 Meeting of the Interdepartmental Committee on International Investment Policy," June 26, 1974.

82. Department of External Affairs, Briefing Document Prepared for UN Delegation (undated, Fall 1975).

83. Interview with the official in the Department of External Affairs who chaired the Interdepartmental Committee on International Investment Policy (ICIIP) which coordinated Canada's negotiations on the code at the United Nations. October, 1985.

84. Department of External Affairs, Briefing Document Prepared for UN Delegation (undated, Fall, 1975) and interview with official, October, 1985.

85. Ibid.

86. Ibid.

87. This was made very clear in the instructions to the Canadian delegation negotiating at the UN. See Department of External Affairs, Memorandum to the Permanent Mission of Canada to the United Nations, New York, "Canadian Position on the Code of Conduct: Preliminary Comments on the UN Document, 'Transnational Corporations - Issues Involved in a Code of Conduct,'" (January 6, 1977), 8.

88. Ibid., 9.

89. Ibid.

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PM-1 3½"x4" PHOTOGRAPHIC MICROCOPY TARGET
NBS 1010a ANSI/ISO #2 EQUIVALENT

PRECISIONSM RESOLUTION TARGETS

90. Ibid., 8.

91. Commission on Transnational Corporations, Code of Conduct: Formulations of the Chairman (New York: United Nations, January 1979), Document E/C. 10/ AC. 2/8.

92. The center established under World Bank auspices in 1965 is based on reciprocity and Canada has generally been unwilling to give up any prerogatives regarding its jurisdiction. FIRA officials had been particularly leery of ICSID Latin American states have generally taken the view, known as the Calvo doctrine, that host state law prevails in any disputes.

93. Some members of Congress and former officials involved in negotiations have argued that the United States has become increasingly inflexible and unwilling to compromise on the central issues. See the testimony of former US negotiator Seymour Rubin, before the House of Representatives Subcommittee on Oversight of the Committee on Foreign Affairs, May, 1987.

94. See Rubin testimony, op cit., 1987.

95. Interview with chairman of ICIIP October, 1985.

96. Krasner, 1984, op cit.

97. As of 1988 there were 96 Contracting Parties to the agreement. GATT Information Service, (Geneva: 1988).

98. For a discussion of negotiations at the GATT see Gilbert Winham, International Trade and the Tokyo Round of Negotiations (Princeton: Princeton University Press, 1989).

99. For a review of Canada's post-war involvement in the GATT see Tom Keating, op cit., Chapters 2, 8 and 10.

100. See Frank Stone, Canada, the GATT and the International Trading System, (Ottawa: Institute for Research in Public Policy, 1984) and Jock Finlayson and Stefano Bertusi, "The Evolution of Canadian Postwar Trade Policy," in Claire Cutler and Mark Zacher, Canadian Foreign Policy and International Economic Relations (Vancouver: University of British Columbia Press, 1982).

101. See United States Trade Representative William Brock's statement to the Subcommittee on International Trade of the Senate Finance Committee, March 1, 1982 on "The U.S. Approach to the 1982 Meeting of Trade Ministers of the GATT."

102. See Brock's statement to International Subcommittee, op cit, 1982.

103. Because of the opposition the US encountered it was unsuccessful in the November 1982 GATT ministerial in getting the TRIMS issue included in the final declaration. See Gilbert Winham, "GATT and the New Trade World," International Perspectives, 1983, 3-6.

104. The subsequent discussion of the case is based on the General Agreement on Tariffs and Trade, Canadian Administration of the FIRA: Report of the Panel (Geneva: June 25, 1983), which provides a summary of the arguments of each side, along with third party interventions, such as that of Argentina.

105. General Agreement on Tariffs and Trade, Canadian Administration of the FIRA: Report of the Panel (Geneva: June 25, 1983), 4.

106. Interview with Investment Canada officials, October 1985.

107. See "Canada to reword FIR Act before the final GATT decision," Globe and Mail, January 20, 1984, B1.

108. Geza Fetekeky, International Trade in Services. (Washington: Ballinger for the American Enterprise Institute, 1988), especially the appendix "The History of a Campaign: How Services Became a Trade Issue." Mr Fetekeky was a senior official with USTR and was extensively involved in trade negotiations at the OECD and the GATT.

109. The Consultative Group includes the United States, Japan, the European Community, Canada, Australia and a number of developing countries such as Argentina, India, Brazil, Nigeria and the Philippines.

110. See the comments of Marc Leland, Assistant Undersecretary for International Affairs in the Treasury, to the United States Senate Finance Committee May 2, 1982.

111. See United States Trade Representative William Brock's statement to the Subcommittee on International Trade of the Senate Finance Committee, March 1, 1982 on "The U.S. Approach to the 1982 Meeting of Trade Ministers of the GATT."

112. Ibid.

113. Hon Ed Lumley, Minister of State for International Trade, "The Trade Challenge," Speech to the Toronto Chamber of Commerce, June 22, 1982, 5.

114. Ibid. See also Winham, 1983 op cit., on Canada's concerns regarding investment.

115. Hon Ed Lumley, Minister of State for International Trade, "The Trade Challenge" Speech to the Toronto Chamber of Commerce, June 22, 1982.

116. See the comments of Rodney de C. Grey, "The Service Industries, a Note of Caution About the Proposal to Negotiate General Rules About Traded Services," in John Whalley (ed.) Canada and the Multilateral Trading System (Toronto: University of Toronto Press, 1985).

117. See Winham, op cit., 1983 on Canada and developing country opposition.

118. Testimony of United States Trade Representative, William Brock to the Senate Committee of Finance, January 25, 1983 on the "Administration's Assessment of the 1982 GATT Ministerial Meeting."

119. Ibid.

120. Government of Canada Trade Policy in the 1980s, 1983.

121. General Agreement on Tariffs and Trade, Ministerial Declaration on the Uruguay Round (Geneva, 1986).

122. Ibid.

123. Article 1610 of the Canada-US Free Trade Agreement (Ottawa: Department of External Affairs, 1987).

124. For a discussion of TRIMS and the GATT see United Nations, Centre on Transnational Corporations, New Issues in the Uruguay Round of Multilateral Trade Negotiations (New York: UN, 1990) and Theodore Moran, The Impact of Trade-Related Investment Measures on Trade and Development (New York: UN, 1991), especially the appendix which deals with the GATT negotiations. See also Phedon Nicolaides, "The Changing GATT System and the Uruguay Round Negotiations," in Richard Stubbs and Geoffrey Underhill (eds.) Political Economy and the Changing Global Order (Toronto: McClelland and Stewart, 1994), 217-229; and Stephen D. McDowell, "India, the LDCs and GATT Negotiations on Trade and Investment in Services," in Stubbs and Underhill, op cit., 497-510.

125. The Final Act of the Uruguay Round in late 1993 did, in fact, include a section on TRIMS and will be discussed in the concluding chapter.

CHAPTER SEVEN

CONCLUSION

Introduction

This dissertation has sought to account for the changes in Canada's foreign direct investment (FDI) regime in the 1957-87 period by combining an analysis of policy instruments drawn from the public policy literature with an international political economy perspective which focusses on three sets of external linkages. As Chapter One indicated, this is clearly not the first attempt to analyze these changes. Nor is it the first to suggest that FDI regime changes are connected to changes in the ebb and flow of FDI, the globalization of production, or the nature of the Canadian state¹. Two aspects are distinctive in this effort, however. The first is the focus on analyzing the FDI regime in terms of the changing types of policy instruments available and explaining the Canadian state's choice of policy instruments. Second this dissertation examines multilateral efforts to coordinate national policies on FDI. It assesses Canada's efforts in this area and the impact that the resulting international investment regime has had on the Canadian state's choice of policy instruments.

The first section of this chapter will review the framework of analysis, the hypotheses offered to account for FDI regime change and assess the findings in terms of our expected outcomes.

Canada's FDI regime did not stop changing in 1987. Since writing the final draft of this dissertation further changes occurred as a result of the approval of the North American Free Trade Agreement (NAFTA) and the recent agreement at the GATT on Trade-Related Investment Measures (TRIMS). Since these two sets of changes have their roots in the period up to 1987 and may shed some further light on the sources of FDI regime change, they will be analyzed briefly in the second and third part of this chapter.

The final portion of the chapter addresses the contribution of this research to the study of both public policy and Canadian foreign economic policy. It questions the extent to which changes in the international political economy, such as the globalization of production, have limited states' choices of policy instruments. It also critically examines assumptions about the relationship between bilateral and multilateral negotiations in the achievement of Canada's foreign economic policy objectives.

Explaining Foreign Investment Regime Change

This dissertation identified three factors as the most useful in accounting for changes in Canada's FDI regime in the 1957-87 period. These are:

1. Canada's changing relationship to international capital, in particular, the shift from the primary role of host (destination) to one of a home (source) for capital while retaining a large stock of foreign capital, dominant in a number of sectors.

2. Growing trade dependence on the U.S. market in a context of increasing competitive pressures and import penetration which have provided the U.S. state with potential influence, in the event of conflict, over Canadian foreign investment regime change.

3. The creation and development of an international investment regime reflecting norms supportive of liberalization of access of FDI and national treatment of EFCs and increasingly tied to market access for goods and services as a means of enforcing adherence to norms.

Although the three factors are listed separately they are interconnected and the relative weight of their influence has varied over time, with bilateral trade dependence and the international regime becoming increasingly significant since the mid 1980s. Moreover, I argued that the impact of these factors must be analyzed within a context of the changing Canadian intrastate consensus on the nature and level of state economic intervention, which forms an important intervening variable critical to any understanding of how the three sets of external factors shaped the choice of policy instruments.

As Chapter Two indicated, national FDI regimes can be described in terms of three broad categories of instruments used by the host state, which we labelled access, discriminatory and compensatory, as well as by the extent of coercion and state intervention embodied in these instruments. The hypothesis in relation to our first set of linkages, the relationship to international capital, predicted an increased usage of increasingly coercive access and discriminatory policy instruments as capital inflows increased and levels of foreign ownership rose. The argument was based on a notion

that the attractiveness of Canada as an investment location, and the perceived stronger bargaining power with investors on the part of the state, would lead to efforts to use access as a bargaining chip. In addition, the dominant role of already established foreign corporations (EFCs) would require the use of discriminatory instruments to influence behaviour. Conversely, a decline in inflows would be expected to lead to an abandonment of these instruments as the state perceived its leverage to be declining and began to fear capital flight to more attractive locations.

As Chapter Four indicated, the trend to increased use of access and discriminatory policy instruments began in the late 1960s and peaked in the early 1980s. However, the relatively infrequent use of discriminatory policy instruments in the manufacturing sector, where foreign ownership was high and the Canadian state had concerns about EFC performance, was not as expected. An analysis of the decision process in the 1967-75 period revealed the importance of our intervening variable, the nature of the intrastate consensus on state intervention and coercion of investors. Divisions over the nature of state intervention, how coercive investment controls should be, what types of investment and which sectors of the economy they should cover were reflected in Cabinet in 1973. Extensive discriminatory treatment of EFCs was ruled out as a policy option early on in the process, largely because it was considered too interventionist for the Canadian state to

contemplate. Of great concern for decision makers was the potentially negative impact of the policy instruments on private investment levels. Thus the resulting reluctance to use discriminatory policy instruments, except in a few sectors, and the adoption of a limited screening function, and compensatory measures, created a regime which could be highly transparent, highly sensitive to investment inflows and would leave the performance of EFCs largely untouched.

Declining investment inflows, rapidly increasing outflows of FDI, and the declining relative share of world FDI which Canada was able to attract in the late 1970s would, according to our hypothesis, be followed by a decline in the use of access and discriminatory instruments. Investment inflows, in fact, levelled off by the mid-1970s and were extremely volatile in the later 1970s, overshadowed by large and growing outflows of FDI. But FDI policy changes lag, and in one case (1980, discussed below), move opposite to the predicted direction in response to the behaviour of international capital flows².

A decline in the use of access and discriminatory policy instruments did begin in the post-1982 period. Major changes in 1985 included the abandonment of the screening of new investment and the creation of an investment promotion function for Investment Canada. This was followed by limited liberalization of access in the energy sector, new regulations restricting FDI in publishing and finally the 1987 Free Trade

Agreement (FTA) which limited screening of U.S. investment to large, direct acquisitions and restricted the use of performance requirements.

An analysis of decision making does indicate that there was a strong perception among state decision makers that Canada could no longer afford to screen or discriminate against foreign capital, particularly in the manufacturing sector. However, the importance of our intervening variable is again reflected in the case of energy. Despite strong opposition, both domestic and bilateral, and weakening capital inflows the Canadian state did introduce a series of more coercive and discriminatory measures in the form of the National Energy Program (NEP) in 1980. In this case, however, important domestic objectives and strong public support for the Canadianization measures strengthened the resolve of the federal state to incur the increased costs that adopting such policy instruments might entail.

Our second external relationship involved Canada's high and growing trade dependence on the U.S. market. I had hypothesized that such a dependent, asymmetrical relationship, would, in a context of strong U.S. opposition to Canada's FDI regime, lead to changes in the direction of less use of coercive, access and discriminatory policy instruments. The argument was that, as the dominant stakeholder of FDI in Canada, the U.S. had a direct interest in Canada's FDI regime and being the primary, almost sole, market for Canadian goods,

had a potentially powerful sanction to use in the event of an investment dispute. As such U.S. opposition would raise the cost to the Canadian state of using discriminatory and access instruments against U.S. investors.

As Chapter Three indicated, Canadian trade dependence on the United States increased sharply much earlier in the 1960s and 1970s and cannot be seen, therefore, as a direct cause of the liberalization in Canada's FDI regime. However, what did change in the 1980s was the level of attention and extent of hostility to Canada's FDI regime on the part of the United States. The United States also linked liberalization of access for its foreign investors to trade policy, ultimately using access to the U.S. market for Canadian exports as a way of influencing Canada's FDI regime. However, the relationship is again mediated by the nature of the intrastate consensus on intervention and coercion. This is especially the case in the energy sector where, despite strong U.S. opposition, the Cabinet remained firm in its resolve to proceed with the NEP largely because of its importance to domestic economic goals and its popularity.

In contrast, in the case of the 1980 attempt to enhance the mandate of FIRA, strong U.S. opposition did play a role in convincing Cabinet to retreat on the issue. However, there was already a split in Cabinet over the extent of intervention the Gray proposals of 1980 would have entailed, especially in the manufacturing sector, and eroding confidence in the

ability of Canada to bargain with investors over access.

In 1987 however, the linkage of trade and investment issues, as a result of changes in U.S. trade policy, was complete. In this context Canada, given its desire for a trade agreement, ended up trading its FDI regime off against more secure market access, liberalizing the investment regime for U.S. capital in the process and further limiting its ability to influence the performance of investors. Nonetheless, Canada bargained to maintain control over large acquisitions and retain restrictions in the energy and culture sectors. Trade dependence alone, thus, did not fully determine the FDI regime.

Our third hypothesis dealt with the international FDI regime and the extent to which it either legitimized and reinforced host state use of policy instruments to control FDI or supported the interests of capital exporters and delegitimized the use of certain FDI policy instruments. An international investment regime, protective of foreign investors, which delegitimized host state control efforts, I expected, to the extent that such a regime was binding, would impose further costs on host states and constrain their choice of these policy instruments. The evidence indicates that, on the whole, the 1970s were somewhat more permissive of host state efforts to manage and control FDI. Concerns about home country intervention and the behaviour of MNCs led host states including Canada to try to strengthen the international regime

to reinforce and legitimize their investment controls. However, these efforts in broadly-based organizations like the UN failed. Meanwhile capital-exporting states, led by the United States in the OECD, were able to develop norms more protective of foreign investors and hostile to host-state regulation. Canada's FDI regime, as a result of these developments, came under pressure and Canada was ultimately forced to acquiesce, in a somewhat ambiguous way, to a set of non-binding rules which did not reflect its interests as a host to FDI in order to avoid isolation within the organization.

In the 1980s the momentum of international FDI regime building moved to organizations like the GATT where the United States was able to gain a partial victory in the 1983 GATT case which further circumscribed Canada's ability to use control of access to impose performance requirements on incoming investors. Again Canada had faced the prospect of trading off investment controls against the objective of strengthening the dispute settlement mechanisms of the GATT. Since that time the United States has been able to further pursue restrictions on host state investment controls through the Uruguay Round of multilateral trade negotiations which, in 1986, included TRIMS on the agenda.

The emerging norms and rules on FDI have increasingly focussed on transparency of investment controls, the progressive elimination of performance requirements, and

narrowing of the legitimate grounds for host country exemption from liberalization of access or national treatment. The intent has been to increase the costs of violations of such norms for host states, limiting their ability to alter national investment regimes, even in the context of strong domestic pressures to do so, thus enhancing the security of foreign investors. In Canada's case the change in FDI regime has been in the direction of liberalization, the expected outcome, given an international investment regime which is increasingly hostile to host state efforts to control FDI.

The development of the international investment regime also highlights the issue of how effective multilateral organizations are as a counterweight for Canada to U.S. dominance in the bilateral relationship. The case of the OECD and the GATT suggest that there are limits to the extent to which multilateral organizations can play a counterweight role for two reasons. First they may be dominated, or heavily influenced by the United States and like-minded actors and secondly, they may put Canada in a situation where other interests, such as strengthening the organization or ensuring inclusion, may override investment policy interests.

In sum, the changes in Canada's FDI regime correspond to our expectation that increased U.S. opposition, declining investment inflows and an international regime more supportive of the interests of foreign investors and capital-exporting countries would result in liberalization. However, as

Chapters Three, Four and Five indicated, changes in the level of FDI inflows into Canada or the growth of export dependence on the U.S. market do not correspond one to one with changes in the FDI regime.

As the findings indicate in relation to our first two factors the costs to the state of implementing policies that involve coercion of foreign investors and intrusion into the foreign investment decision-making process, be they declining investment inflows or increased insecurity of access to the U.S. market, increased. However, increased costs alone cannot account for a policy shift unless the additional costs presuppose the Canadian state's unwillingness to bear them in order to attain a particular policy objective. As the research on economic sanctions and economic dependence suggests, states have borne severe economic costs in order to undertake or continue policies seen to involve important national priorities. Any explanation, therefore, of FDI regime change must take the domestic context into account. In our case we have done so through a focus on state economic intervention and the extent to which there is a policy consensus in the federal state. Such a consensus may be formed as the result of pressures from various groups in society, struggles within the bureaucratic organizations which may be reflective of broader social struggles, as well as intergovernmental conflicts which, in the Canadian context, also have a role in shaping economic policy. As Chapter Two

indicated, the consensus on the economic role of the Canadian state has shifted over the time period analyzed in a significant way. It has, however, fluctuated within the bounds of a liberal-capitalist society without the strong corporatist structures of small European countries.

The consensus on direct intervention in industrial policy was stronger in the early 1970s which facilitated the development of new instruments to control investor access. In contrast, the post-Keynesian, neo-Conservative consensus of the mid 1980s, with its emphasis on framework policies and little direct intervention³, was clearly more conducive to liberalization of investment controls. Yet the Canadian state is not a monolithic actor and the decisions which emerge on investment policy instruments are often the result of divisions within Cabinet and the bureaucracy which produce, as they did in 1972, a lowest common denominator or, as in 1980, severe disagreement over the manufacturing sector. Moreover the firm-centred, case-by-case approach of FIRA and the unwillingness to coordinate the FDI regime with the operation of the state corporations also precluded a serious effort to create national champions in the earlier period and resulted in an FDI regime very different from those of European host countries.

At the same time a strong consensus at the Cabinet level on the need for a federal presence in energy sustained a policy on FDI for several years that came under strong attack

from a number of provinces, the U.S. state and much of the oil and gas industry. Thus an understanding of changes in the nature of the intrastate consensus on the role of the state in the economy is necessary to any explanation of foreign investment regime change, even when external forces are bringing pressure to bear on Canada's FDI regime.

The North American Free Trade Agreement and Canadian Foreign Investment Regime Change

The North American Free Trade Agreement (NAFTA) which was negotiated in 1992 resulted in further change to Canada's FDI regime. To what extent can these changes be explained in terms of our second external factor, that is, Canada's trade dependence on the United States? The following analysis addresses this question by, first, briefly reviewing the changes to Canada's FDI regime which occurred as a result of the agreement, then assessing the extent to which these changes can be accounted for by U.S. efforts to use Canada's dependence on the U.S. market as leverage over Canada's FDI regime.

Canada's trade dependence on the United States was high on the eve of the Free Trade Agreement and remained so in 1991, not unexpected given that the FTA further integrated the two economies. In 1991 74.9 per cent of Canadian exports were going to the United States⁴. Moreover, the United States continued to dispute Canada's screening of access and

sectoral limits.

The legislation implementing the FTA which passed the U.S. Congress in September 1988 recognized the remaining investment restrictions in Canada and required that any future negotiations with Canada involving investment would have to include as U.S. objectives:

(sic.)B. The elimination or reduction of measures grandfathered by the Agreement that deny or restrict national treatment in the provision of services

C. Elimination of performance requirements

Liberalization of investment rules, including the following:

- a. the elimination of direct investment screening.
- b. the extension of the principle of the Agreement to energy and cultural industries to the extent such industries are not currently covered by the Agreement.
- c. the elimination of technology transfer and other performance requirements not currently barred by the Agreement and
- d. the subjection of all investment disputes to dispute resolution under chapter 18 of the Agreement.⁵

This then constituted, from the American perspective, the unfinished business on investment issues of the FTA.

NAFTA and FDI Regime Change

The August 12, 1992 agreement did result in the achievement of many of the United States' investment objectives. In contrast, however, the U.S. was unable to achieve an elimination of Investment Canada's screening role or the cultural exemption of the FTA, which was, in fact,

expanded to intellectual property.

The following provides a brief examination of the main investment provisions of the NAFTA in comparison to the FTA and to United States and Canadian investment objectives.⁶ Provisions related to investment are included in Part Five of the NAFTA with chapter eleven devoted specifically to investment measures.

Access

In the case of access the United States was unsuccessful in eliminating the screening functions of Investment Canada and the threshold for reviewable acquisitions remains unchanged. Mexico's adoption, however, of a similar commitment to review above the \$150 million value, albeit phased in over a longer period of time⁷, does constitute a major liberalization of access to Mexico for U.S. and Canadian investors. The United States was more successful in further limiting the imposition of performance requirements. Article 1106 (f and g) adds two additional restrictions covering technology transfer and world product mandates; however, a reservation in the annex limits this restriction in the case of Investment Canada. The United States was unsuccessful in eliminating the cultural exemption of the FTA, although the special restrictions on oil and gas acquisitions were unilaterally removed (as described below). In actual fact the structure of the investment chapter gives the appearance of liberalization by providing for national treatment and

limitations on performance requirements as a condition of access, up until article 1108 which then references the numerous reservations and exemptions to these principles listed in a huge set of annexes which accompany the chapter. The reservations exempt, in fact, the operations of Investment Canada, the Mexican National Commission on Foreign Investment, and numerous U.S. sector specific regulations on access from the provisions of the chapter.

What has altered, however, is the definition of investor, which has been broadened, and the emphasis on investor security and additional rights of access for EFCs operating in North America, which are now covered by the measures liberalizing access. As a former USTR negotiator has noted:

Sony U.S. would be an investor of the United States for purposes of investing in Canada or Mexico under the agreement.⁸

Discrimination

As in the FTA all three countries commit themselves to the principle of national treatment of investors and the provision of prompt, adequate and effective compensation (Article 1110) in the event of expropriation, based on market value of assets. Article 1109 elaborates on restrictions on state interference in the transfer of funds between subsidiaries and parent corporations. Again, however, the annexes provide numerous exemptions from the national treatment principle particularly in the case of Mexico.

Compensation

The NAFTA does not significantly alter the situation prevailing in the FTA but recognizes, again by way of exemption, the ability of states to protect or limit foreign ownership through specific sectors reserved exclusively to state ownership (by far the largest number being Mexico's- Annex III-M-1). In addition the agreement exempts the limitations on foreign ownership in the regulations governing the privatization of major state enterprises in Canada (Annex 1-C-14).

Other Additions

From Canada's perspective the most significant addition to the investment chapter is not in the area of access, but in the emphasis on dispute resolution. Fully half of the chapter eleven deals with this issue and commits Canada and Mexico, in the case of such disputes, to binding arbitration under the rules of the International Centre for the Settlement of Investment Disputes and the United Nations Commission on International Trade Law. Again, however, Annex 1138.2 provides a blanket exemption for both Mexico and Canada's screening agencies from this process. In other words, an unfavourable decision by Investment Canada could not be challenged by the investor under the arbitration and dispute resolution provisions.

In addition to the provisions for dispute settlement the NAFTA tries to significantly clarify and render more precise

the nature of all exceptions to the basic principles of national treatment and liberal access through the so-called "list it or lose it" provisions. Article 1108 extends the investment provisions to local and state or provincial governments and requires that all exemptions be listed in the annexes or declared within two years of the agreement coming into force to qualify as permissible under the agreement.

Explaining Negotiation Outcomes

NAFTA's impact on Canada's foreign investment regime is a limited one, in comparison to the FTA. The major emphasis of the agreement's investment provisions is on dispute resolution and transparency of investment regulation, and locking in existing measures, all of which provide additional security to investors, rather than on the liberalization of access (with the exception of Mexico). In fact, critics have suggested it leaves investment restrictions intact, and, with its recognition of the numerous U.S. sectoral restrictions based on a national security exemption, may leave the door open to further restrictions in the United States⁹. If we compare the outcome of the NAFTA to the U.S. list of unfinished business of 1988 we can see that a number of U.S. objectives, in Canada's case, were not achieved.¹⁰

The United States' limited success in further liberalizing Canada's investment regime does not conform to our expectation that Canada's trade dependence would provide

the United States with leverage over Canada's FDI regime. As Chapter Five indicated, however, dominant actors are not always able to identify and employ sanctions against subordinate actors. Secondly subordinate states may be willing to incur the additional costs of employing certain policy instruments to achieve national objectives. Chapter Six also reviewed the argument that a multilateral process might allow for a rebalancing of the asymmetry of the bilateral context. In this case the question of whether Mexico's presence made a difference can also be raised. Thus two factors might account for the different outcome from 1987, differing Canadian policy preferences and the different bargaining context which the presence of Mexico provided.

I turn first to the structure and process of the 1991-2 negotiations to examine how these might have affected the outcome. Clearly the presence of Mexico, a higher priority target for the United States in terms of investment liberalization, and the chief demandeur of enhanced and more secure access to the U.S. market made it, rather than Canada, the focus of U.S. pressure.¹¹ Given the asymmetry of the economic relationship between Mexico and the United States and the greater desire for an agreement on the part of Mexico¹² the United States could be fully expected to have the upper hand in negotiations.

However, the addition of Mexico provided another, primarily host country with a similar, asymmetrical and

politically-sensitive relationship with the United States. Moreover, Mexico historically had extensively regulated, but not excluded, foreign capital and used the state to intervene in a number of economic sectors. Thus of even higher priority for both business¹³ and the U.S. Administration were Mexican regulations which, despite the reforms of 1984 and 1989, still provided more extensive restrictions and regulations through screening, performance requirements and sectoral controls than did Canada's investment regime. As Chapter Six indicated, the United States had argued within international organizations, such as the OECD, for a virtual right of establishment for foreign direct investment with limited exemptions justified only on the basis of national security - the primary basis of numerous U.S. sectoral exemptions. In the case of performance requirements imposed on investors as a condition of access, the United States's main target was Mexico which, unlike Canada, retained a host of conditions of trade balancing, exports, local content and technology transfer. In Canada's case permissible measures, as a result of the FTA and the 1983 GATT decision, were limited largely to technology transfer, world product mandates and increased Canadian equity.

However, Canada, similar to the situation in the UN with the G77, was, in relation to Mexico, more of an industrialized, home country. Despite some shared characteristics the large differences between Mexico particularly in levels of development, wages, per capita

incomes and the weaker role of the judiciary and administrative law limited somewhat the extent to which Canada and Mexico would take similar positions, even on investment issues. Canadian corporate interests and Canadian negotiators viewed Mexico as a potential host to Canadian investment in sectors such as financial services and energy and shared the U.S. objectives of removing investment restrictions and enhancing investment security.

A second important difference in the context of negotiations from 1987 was the fact that Canada already had a trade agreement with the United States. The existence of the FTA played a role in defining the parameters of negotiation, particularly whether the provisions of the FTA were seen to be a floor (that is, a minimal opening position), the U.S. view, or a ceiling (the maximum concession possible). For example, on the investment screening side, Canada was aided by Mexico's adoption of the FTA provisions as the maximum standard of liberalization, similar to Canada's view of the FTA as a ceiling, coupled with an insistence on a longer phase-in period of the \$150 million threshold.

A final contextual difference was in the timing, and, what we might call, the political capital the United States had invested in these negotiations. The pressure on the Bush Administration to conclude an agreement in the summer of 1992 provided an opportunity to Canada to continue its resistance to further liberalization of access. Progress in the talks

thus slowed considerably at the point at which politically the U.S. Administration was most eager to see a successful conclusion in order to have an agreement to announce prior to the Republican National Convention in Houston (August 17-20) and to meet, if possible, the August 6 deadline for notification to Congress if the President wanted to sign a final agreement prior to the November election. As time pressure mounted on the U.S. Administration, Canadian Trade Minister Wilson stressed the need to ignore time constraints in order to craft an acceptable agreement and speculated that negotiations might continue into September¹⁴. This tactic was helpful to Canadian negotiations as the three countries tried to resolve the remaining, outstanding issues - one of which was investment screening.¹⁵

The second explanation for the different outcome from 1987 can be found in the nature of Canada's policy preferences in negotiating NAFTA. Mexico ranked only 17 among Canada's trading partners and was the destination for only a small proportion (about 2 per cent of Canadian export capital¹⁶). Canada, however, feared the potential negative impact of a U.S.-Mexico deal on its competitive position in the U.S. market and on Canada's attractiveness as a North American investment location.¹⁷ Canada's objectives in the negotiations thus were limited and of a largely defensive nature. According to the Trade Minister:

The first was to gain access for Canadian goods, services and capital to the rapidly expanding Mexican

market on an equal footing with our United States competitors; second to ensure that Canada remained an attractive location for investors wishing to serve the North American market and finally, to preserve all the benefits we had negotiated in the FTA and where possible to make improvements to FTA provisions from a Canadian perspective.¹⁸

Despite U.S. pressure on investment screening Canada was determined to retain the process, out of concern on the minister's part that any further concessions on the issue would be politically costly. The already significant liberalization of Canada's investment regime as a result of the 1987 agreement meant that any further concession might be perceived in Canada as submission to U.S. pressure on matters of sovereignty.¹⁹ Hostile public opinion²⁰ increased the fear of the government that any further concessions on screening and cultural industries would be viewed as unacceptable sacrifices of Canadian sovereignty.

The fact that Canada's negotiating position was driven by domestic concerns was reflected in the March 25, 1992 announcement by Energy Minister Jake Epp that special restrictions on oil and gas company acquisitions over \$5 million, which had been exempted from the FTA investment provisions, would now be removed. The liberalization of the rules, done to shore up Conservative support in the West where the Reform Party had been making inroads, and to provide a new source of capital to a depressed industry, was a subject of contention within the Cabinet²¹. Trade negotiators had asked Wilson to try to delay the change and avoid a unilateral

concession in the midst of NAFTA negotiations but were unsuccessful. This left the screening issue, the question of arbitration and national treatment exemptions as areas where other concessions might have to be made. However, the unilateral concession on energy investment put more pressure on Canadian negotiators to limit further concession in the investment area.

Thus of the many issues negotiated within the NAFTA investment was one of the last to be resolved because of a number of major differences among the three countries and, in Canada's case, a refusal to move on the elimination of the investment screening function of Investment Canada.

By the end of the 1991 and the early months of 1992 major areas of differences on issues in the negotiations had been identified. In the case of investment virtually the whole of the thirty-six page draft was bracketed, indicative of much disagreement.²² On issues such as arbitration and the resolution of investment disputes Canada and Mexico opposed U.S. proposals. On performance requirements Canada sided with the United States seeking to further limit Mexican regulations. In the case of national treatment all three countries accepted the principle but disagreed about the list of sectors or industries to be exempted from the principle. Canada's strong insistence on the retention of its overall cultural exemption was not strongly attacked by the U.S., according to Canadian officials²³, on the assumption that

Canada would be forthcoming with investment concessions elsewhere. This was not to be the case, however, since as indicated above, Canada continued to resist further concession while time pressed on the U.S. negotiators.

Conclusion

Thus the NAFTA case, unlike the FTA case, does not indicate that the United States was able to use its dominance to achieve some of its main policy objectives vis-a-vis Canada. While the U.S. was able to make significant progress on dispute resolution, it was unable to remove either investment screening or the cultural exemption.

At the same time, it could be argued that both the FTA and the unilateral lifting of restrictions on investment in the oil and gas sector in March 1992 have left Canada with a screening process that operates largely at the margins of the foreign investment process, preoccupied with investment promotion and monitoring. No acquisition applications have been refused by Investment Canada and those that have involved undertakings have been restricted to a very few areas²⁴. Moreover, the emphasis on transparency and standstill on investment restrictions embodied in the NAFTA suggest that the elimination of those remaining exemptions will form the agenda for future bilateral and multilateral negotiations.

What the case does illustrate, in conformity with the findings of Chapter Five, is that the nature of the state's policy preferences and the extent to which they are strongly

held plays an important role in explaining why economic dependence does not always translate into subservience among subordinate actors in asymmetrical bilateral relationships. The presence of Mexico, moreover, raises the issue of whether having more than two actors at the table makes a difference to subordinate states and brings us to the question of multilateralism and recent FDI regime changes as a result of the GATT negotiations.

The Uruguay Round and Foreign Investment Regime Change

This dissertation has argued that the nature of the international investment regime plays an important role in shaping the choice of policy instruments used by host states to manage FDI. Our initial hypothesis was that a regime which is hostile to host state investment controls would act as a constraint on the choice of policy instruments since it would increase the costs of using measures prohibited by the regime. As Chapter Six indicated, host and home states have engaged in negotiations throughout the 1970s and 1980s seeking to shape a set of international rules on FDI. The rules which have developed could be characterized as increasingly hostile to host state investment controls and the expectation was that these rules would impose further constraints on host states. This, in fact, proved to be the case for Canada. Moreover, our findings challenged the view that multilateral approaches to bilateral disputes might afford Canada the

capacity to resist U.S. influence. I argued that the nature of influence within the organization, Canada's policy preferences and the extent to which it was forced to trade off competing policy objectives all played a role in determining the extent to which multilateral approaches to investment issues could serve as a counterweight to U.S. influence.

The Final Act of the Uruguay Round negotiated in December, 1993 has resulted in additional rules on FDI²⁵. Does the outcome of the GATT negotiations lead us to reassess our conclusions in Chapter Six? The following section will briefly address this question. I begin with an overview of the new investment rules of the GATT and then provide an analysis of how this round of multilateral negotiations fits with our framework and findings.

The Final Act of the Uruguay Round codifies GATT competence in the area of investment, building on the precedent of the 1983 Canada-U.S. dispute over FIRA. The Uruguay Round Final Act identifies TRIMS as a violation of GATT article III (national treatment) and requires all member states to notify the GATT of non-conforming measures and eliminate them within two years (five for developing countries)²⁶. Such measures include all requirements for local sourcing of inputs or domestic content in return for access. In addition, so-called "trade balancing" regulations which force foreign investors to balance imports with exported product and similar restrictions on foreign exchange are also

prohibited. A total of five measures are identified as prohibited in an illustrative list. The rules only cover trade in goods and do not prohibit requirements to export in return for access. However, the list of prohibited measures is not exhaustive and may be added to at the end of a five-year review by a committee on TRIMS which has been created, composed of member countries.

Perhaps even more far-reaching are provisions of the Final Act which put investment under a strengthened dispute settlement process and permit cross-retaliation against members who violate the provisions of the agreement²⁷.

The investment provisions of the GATT fall somewhat short of the very ambitious U.S. proposals made at the beginning of the negotiations, although they have been hailed by U.S. officials as a significant achievement of the U.S. objective to impose discipline on host states and limit the trade distortions. U.S. officials argue these have cost the United States losses in exports and increased the costs of U.S. investors doing business abroad²⁸.

Canadian negotiators have expressed satisfaction with the outcome of the negotiations²⁹ pointing out that the rules are, in comparison to the NAFTA, very limited in the number of measures they prohibit and thus will not have any impact on existing Canadian investment policy. Canada did not fully support the more ambitious U.S. effort to create a very comprehensive and broad list of prohibited measures.

The following briefly examines the negotiations seeking to explain the failure of the United States, in this instance, to achieve its goal of a much broader agreement on TRIMs which might have further constrained Canada's choice of policy instruments.

Explaining Investment Outcomes in the Uruguay Round

In contrast to earlier trade negotiations at the GATT, the Uruguay Round has been characterized by both a large number of very diverse participants and a complex negotiating agenda.³⁰ As Chapter Six pointed out, however the GATT tends to be dominated by the larger economies, and the dynamics of their trade disputes, particularly those involving the United States and European Union.³¹

TRIMs ended up on the agenda, as Chapter Six, indicated as a result of a compromise and were characterized by two very opposed positions articulated by the United States, (often supported by Japan) and a group of twelve less developed countries (LDCs).³² The two sides differed on the question of measures to be covered. The United States took a broad approach wanting an extensive list of measures covered, including those that did not have a direct trade impact. The LDCs, in contrast, opposed the idea of restricting investment measures at all, arguing that only on a case-by-case basis, when there was clear evidence of trade distortion, should measures be prohibited. The United States also wanted

immediate prohibition of measures, while LDCs favoured a lengthy phase-out period for developing countries. LDCs also argued that restrictive business practices of multinational corporations must be taken into account as justification for host state investment measures. In between the two sides were the European Union, the Nordic countries and Canada.

Canada as home country, and a host that had abandoned the use of performance requirements as a result of the FTA and NAFTA, did support limits on trade-distorting investment measures. At the same time, its continued limited screening of access and history as a host country put it at odds to some extent with the U.S. position. Like the other European countries Canada preferred a limited list of prohibited measures clearly tied to the relevant GATT articles.

Ultimately the two opposing sides were unable to resolve their differences. As a result of the Brussels meeting in 1990 there was a push from the GATT Secretariat to get some items resolved on the lengthy agenda. In the case of TRIMS this led to a compromise position which the chair of the negotiating group presented to the group.³³ This position was embodied in the "Dunkel Draft" Final Act of December 1991³⁴. The 1993 Final Act is virtually identical to the 1991 version on investment issues.

For many countries, including the United States and Canada, higher priority issues such as agriculture and services and the severe disagreements they entailed

overshadowed the TRIMS negotiations. The net result was an early compromise that created rules on TRIMS, but limited their coverage, while leaving the door open to extend coverage in the future. Canada thus avoided any trade-offs of investment against other important issues.

Conclusion

The TRIMS case suggests that under some circumstances multilateral fora may play somewhat of a counterweight role. This clearly, as suggested in Chapter Six, will be a function of the structure of influence and the nature of Canada's policy preferences. In this case one might suggest that the size and complexity of the negotiations limited U.S. influence and the pressure to resolve some issues earlier allowed Canada to avoid issue linkage and the need to trade off other issues against investment.

However, it is also clear that Canadian concerns have altered substantially since 1983³⁵. Canada has largely abandoned the use of performance requirements as a result of the GATT decision, the FTA and the NAFTA, and as a result of a perception on the part of state officials that globalization and changes to the nature of international firms have limited the ability of the state to bargain for enhanced performance.

The NAFTA and GATT agreements further limit, but do not totally eliminate, the use of access instruments or the designation of special sectors such as culture, where liberalization has been limited. The focus of negotiation has

shifted, however, to enhancing investor security through dispute resolution mechanisms now that liberalization of access has been largely achieved. In both cases Canada has sought to retain the screening policy instrument although its effectiveness has been reduced greatly.

Accounting for Foreign Investment Regime Change

This dissertation has illustrated the importance of including and integrating a broad range of domestic and external factors in accounting for the development of foreign economic policy, in particular, Canada's foreign investment regime change. As such it has implications for several areas of the study of international relations, and more specifically, both Canadian political economy and foreign policy, as well as the study of Canadian public policy.

First, the focus on the choice of policy instruments and the extent of state coercion and intrusion in the investment decision process they entail, brings some of the public policy literature into the discussion of political economy and foreign policy. In the case of FDI this is a welcome addition since even the most thorough attempts to analyze the origins of, or changes to, Canada's policy on foreign direct investment tend to focus almost exclusively on FIRA/Investment Canada and investment screening without ever really analyzing why screening incoming investment was chosen as the main policy instrument³⁸.

On the other hand this study also sheds some light on the

conditions under which economic dependence, especially trade dependence, has shaped the choice of economic policy instruments. Increasingly the public policy literature has acknowledged external pressure on economic policy generated³⁷ by changes in the global economy and our enhanced vulnerability to bilateral economic pressures. But it is also clear from this dissertation that these pressures are insufficient to explain regime change in and of themselves. The process of liberalization and the easing of restrictions and coercion of foreign investors, has not been a smooth, inevitable one. Rather it has involved disagreements and struggles within the society, and reflected within the state, over the role of the state in the economy and the requirement, on the part of elected officials, to be both promoters of economic growth and guardians of national sovereignty. It is not enough, therefore, to argue that globalization will inevitably and inexorably define Canadian economic policy because of our open economy and reliance on foreign markets.

The globalization imperative argument, in the case of foreign economic policy, absolves governments and citizens of debating the priorities and addressing the trade-offs that must accompany any decisions on what policy instruments to use to achieve national economic goals. Such economic determinism puts forward one particular set of policy options, which may serve the interests of a few in the society, as unquestionable and beyond the realm of political contention. Yet, as this

dissertation has argued, states have a variety of means at their disposal to adjust to and deal with changes in the international economy which must be debated in a democratic political system.

This dissertation has also shed much light on the important impact of international economic regimes on Canada. Much of Canada's activities in international economic organizations go unnoticed in the popular press and undebated, unless, as in the case of the recent GATT agreement on agriculture, or continental trade negotiations, major domestic interests are affected. Canadian officials are often making important decisions that will possibly constrain the future choice of economic policy instruments outside of public scrutiny and with little public awareness of the trade-offs involved. This dissertation contributes to a better understanding of Canada's negotiations on investment issues within international economic organizations, an area which has been studied very little. In particular it provides a contribution to the discussion of multilateralism as a perceived alternative or counterweight to Canada's growing economic integration with the United States.

Chapter Six has illustrated that international economic organizations may provide very different contexts within which to negotiate international economic regimes and, in many instances, reflect, rather than counteract or transform, prevailing patterns of international influence. Canada has

not been completely successful in using such organizations to counter U.S. influence, as the case study of negotiations of a code for multinational corporations in the 1970s indicated. The policy implication of this research is not one of withdrawing from, or lessening our involvement in, such institutions, given their growing importance in international economic regime building³⁸. It does, however, call for a more realistic assessment of the limits and possibilities for such organizations in achieving our national economic goals, what trade-offs may be required, and a more careful assessment of how our bilateral and multilateral initiatives are interrelated.³⁹

Given the globalization of production, the blurring of host and home country roles in the international economy, the liberalization of investment regimes and the dilemma of sorting out "who is us"⁴⁰ one might ask how any further study of changes to Canada's investment regime can be justified, especially given the plethora of analyses that have gone before. There are two reasons that can be identified. First, analysis of a policy, in particular critiques of state economic policy, necessitates some discussion of alternatives and an understanding of why a particular policy was chosen, while other possibilities were excluded, and the implications of those decisions. Despite the sound and fury of the debate in Canada over foreign direct investment there has been relatively little analysis of the types of policy instruments

that have been used in the past, or might be used in the future to address the concerns about the impact of FDI. A second reason to revisit the issue of FDI regime change is to contribute to a broader debate about the meaning of territoriality and sovereignty, given the enhanced mobility of capital and the new forms of international investment that are developing, and how much room states have to manoeuvre⁴¹. Most students of foreign investment trends would agree that despite the mobility of capital and the blurring of nationality of ownership states will continue to be attentive to, and try to influence, where production and capital accumulation take place.

1. See Barbara Jenkins, The Paradox of Continental Production: National Investment Policies in North America (Ithaca: Cornell University Press, 1982) and Claire Turenne Sjolander, Foreign Investment Policy-Making: The Canadian State in the Global Economy (Ph.D. Dissertation, Carleton University, 1989).
2. Jenkins, op cit., 115, calls the NEP "surprising" in this context. However our inventory of policy instruments does show a trend to more discriminatory, coercive and interventionist policy instruments in the energy sector throughout the period under study.
3. See G. Bruce Doern and Richard Phidd, Canadian Public Policy: Ideas, Structure and Process (Second Edition) (Toronto: Nelson, 1982).
4. See Maureen Molot, "The Canadian State in the International Economy," in Richard Stubbs and Geoffrey R. D. Underhill (eds.) Political Economy and the Changing Global Order (Toronto: McClelland and Stewart, 1994), 512.
5. United States Congress, United States-Canada Free Trade Implementation Act PL 100-449 (Sept, 1988) Title III.
6. For two very different evaluations of the NAFTA provisions see Canadian Centre for Policy Alternatives, Which Way for the Americas: Analysis of the NAFTA Proposals and the Impact on Canada (November, 1992) and Michael Gestrin, and Alan M. Rugman The NAFTA's Impact on the North American Investment Regime (C.D. Howe Commentary 43, March, 1993).
7. See Government of Canada, North American Free Trade Agreement Annex I Mexico, I-M-4 (October, 1992).
8. USTR negotiator Dennis Price as quoted in International Trade Reporter, (September 12, 1992).
9. See Rugman and Gestrin, op cit.
10. For a brief comparison of the two agreements see David Leyton-Brown, "The Political Economy of North American Free Trade," in Stubbs and Underhill, 1994, op cit., 352-365. For a more detailed analysis of the negotiations see Elizabeth Smythe, "Unfinished Business, North American Free Trade and Canadian Foreign Investment Regime Change." Paper presented at the Annual Meeting of the Canadian Political Science Association, June 8, 1983, Ottawa.
11. For a similar argument about the whole agreement see G. Bruce Doern and Brian W. Tomlin, "Free Trade Revisited", in The World in 1993 (Globe and Mail, Report on Business

Magazine, January, 1993.

12. Mexico had initiated talks with the United States to address problems in its economy and enhance the security of access to the US market. As part of the process domestic economic reforms in Mexico involved liberalization of the foreign investment regime in an effort to repatriate flight capital, deal with the capital shortage and debt problems. For a critical discussion of the Mexican initiative see Jorge Castenada, "The Clouding Political Horizon," Current History (February, 1993), 59-66. Major changes in regulations under the 1973 Law on Foreign Investment were made in 1984 and again in 1989. Gary Hufbauer and Jeffrey Schott, North American Free Trade: Issues and Recommendations (Washington: Institute for International Economics, 1992), chapter four provides a good description of Mexico's reforms.

From the United States' perspective, while it had no major initial stake in an agreement, such an agreement offered the prospect of greater access for US goods and capital into the Mexican market. In addition it would solidify and reinforce free market reforms in Mexico which the US administration viewed favourably, help to address the debt problem, stem the tide of illegal immigration, and possibly strengthen Republican political support in border states and among Hispanics.

13. The Business Roundtable, analagous to the Business Council on National Issues in Canada, in a letter to Carla Hills of January 1992 indicated that one of the five elements they saw as necessary in a NAFTA was substantial liberalization of investment controls with Mexico. They also indicated that they saw the FTA as inadequate in this regard. The full letter is reprinted in Inside US Trade (Feb. 14, 1992).

14. See a report on his comments in Inside US Trade, July 20, 1992.

15. "Struggle to Clear NAFTA Hurdles," Financial Post, August 3, 1992, 1.

16. Lorraine Eden and Maureen Appel Molot, "The View from the Spokes: Canada and Mexico Face the United States," in Stephen J. Randall et al, North America Without Borders (Calgary: University of Calgary Press, 1992), 69.

17. Hon. Michael Wilson, Minister for International Trade, speaking to the House of Commons Standing Committee on External Affairs and International Trade, November 17, 1992, 13:7.

18. House of Commons Standing Committee on External Affairs and International Trade (November 17, 1992), 13:7.
19. See "Wilson Facing Hard Decisions," Globe and Mail, July 16, 1992, B4.
20. For example, an August 1992 Angus Reid poll indicated 53 % opposition and only 41% support for NAFTA. Canadian Free Trader (December, 1992).
21. "Ottawa Set to Open Oil Patch to Further Foreign Investment", Globe and Mail, March 21, 1992 and Globe and Mail, op cit August, 5, 1992.
22. For the full text of Feb. 21 see Inside US Trade (March 27, 1992).
23. "Ottawa Sets Sights on Investment Canada," Globe and Mail, August 5, 1992.
24. Investment Canada Annual Report 1991-92 (1992) Appendix, Table I, 45.
25. See the General Agreement on Tariffs and Trade, Final Act: Agreement on Trade-Related Investment Measures (GATT: Geneva, December 15, 1993) Doc. MTN/FA-11-A1-A7. The GATT has been reformed, restructured and renamed the World Trade Organization.
26. Final Act, 1993, op cit
27. See Thomas L. Brewer, "Foreign Direct Investment Dispute Settlement Procedures: The Changing Institutional Framework," Paper presented at the Annual Meeting of the International Studies Association, Washington, D.C. March, 1994.
28. See the comments of Christopher Lion, Office of Multilateral Affairs, US Department of Commerce, "Trade-Related Investment Measures" Business America (January, 1994), 8-10.
29. The following summary of Canada's position and views is based a telephone interview with an official in the Department of Foreign Affairs and International Trade in July, 1994.
30. See Phedon Nicolaides, "The Changing GATT System and the Uruguay Round of Negotiations," in Stubbs and Underhill, 1994, op cit, 235.

31. For a discussion of this aspect of the GATT see Gilbert Winham, International Trade and the Tokyo Round of Trade Negotiations. (Princeton: Princeton University Press, 1989).

32. This account of the issues and the negotiations is based on United Nations Centre on Transnational Corporations, New Issues in the Uruguay Round of Multilateral Trade Negotiations (New York: UN, 1990) Theodore Moran, The Impact of Trade-Related Measures on Trade and Development (New York: UN, 1991), especially the Appendix on negotiations.

33. Interview with official of the Department of Foreign Affairs, July, 1994.

34. See Draft Final Act (Geneva: GATT, December 3, 1991).

35. See the discussion of Canada's position in Chapter six and the statement of the Minister of International Trade.

36. see Jenkins, op cit and Sjolander, op cit.

37. See Doern and Phidd, op cit, 248, who argue that virtually all economic policy decisions have been increasingly affected by international forces.

38. See Claire Cutler and Mark Zacher (eds.), Canadian Foreign Policy and International Economic Regimes. (Vancouver: UBC Press, 1992) Introduction.

39. See Cutler and Zacher, op cit who argue that the bilateral-multilateral tension has resulted in policy inconsistency on Canada's part.

40. This is part of the debate about foreign investment in the United States. Robert Reich has raised the issue of the blurring of firm ownership in recent books and articles including, "Who is Us" Harvard Business Review (January-February, 1990), "Who is Them" Harvard Business Review (March-April, 1991), 77-88.

41. See the debate involving Robert Reich, op cit, Nathan Kapstein, "We are US: The Myth of the Multinational" National Interest (Winter, 1991-92), 55-62, and John Ruggie, "Territoriality", International Organization (Winter, 1993), 140-175 and the subsequent exchange in that journal with Kapstein.

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