Carleton University

The Hollowing-Out of Corporate Canada: Quantitative vs. Qualitative Analysis

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Abstract

In the past few years some of Canada's largest, best-known corporate names have been acquired by even larger global competitors, leading to claims that Canada is being hollowed-out. It is the hypothesis of this thesis that concerns over the widely feared hollowing-out of corporate Canada are overstated; however there are still several grave causes for apprehension.

This thesis is designed to explore the debate on the hollowing-out of corporate Canada, by examining the facts, arguments, perceptions and assumptions made for, and against, the phenomenon.

My thesis is situated within the theoretical context of Bob Jessop's "Schumpeterian Workfare State", as an explanation for this behaviour, exercising the state's "new role" as an accumulation regime. It then finishes with the risk-assessment question with which Canada is faced: are the benefits of foreign direct investment (FDI) worth the potential risks of being hollowed-out?

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Chapter 1: Introduction

In the past few years some of Canada's largest, best-known corporations have been acquired by even larger global competitors. With the increasing loss of head offices and reliance on foreign capital for tax revenues, some observers have worried that Canada is reverting to its "branch-plant" past in the global economy. The argument that the recent wave of corporate takeovers by foreign firms is leading to a "hollowing-out" of corporate Canada, while nothing new, has elicited a number of responses from all sides of the political spectrum, represented by Statistics Canada, the Canadian Council of Chief Executives (CCCE), and the Canadian Centre for Policy Alternatives (CCPA).

Canada is faced with a risk assessment decision: Are the risks of potentially being hollowed-out greater than the benefits of foreign direct investment (FDI)?

Hollowing-out has become an increasingly sensitive issue in Canadian politics lately; "an Ipsos Reid poll found that 56% of Canadians believe that foreign ownership is a real problem, while only about 16% say that the takeovers are a good thing and that Canada should be trying to attract more foreign investment" (Gray, Canadian Business Online, June 2007). The Canadian Press-Harris-Decima poll was surprising, not in that it found Canadians getting worried about the so-called "hollowing out" of corporate Canada, but that such a large portion of respondents - 72 per cent, including 66 per cent of Conservative supporters - said they want the government to act.

The Claim

By comparing quantitatively supportive and qualitatively critical arguments and assumptions in the debate, from many different "realities" and perspectives, this thesis

will seek to provide an explanation: that there are many positive, neutral, and negative effects associated with FDI, while placing emphasis on merger and acquisition (M&A) activity in particular. These realities reflect evidence from different schools of thought, such as political science, economics, political economy, management, business, etc.

It is the hypothesis of this thesis that the widely feared hollowing-out of corporate Canada is not happening; however this claim needs to be qualified greatly, for there are still several grave causes for concern. This thesis will contrast quantitative and qualitative elements and criteria that are important for untangling the debate, and the verification of the hollowing-out phenomenon.

Admittedly, much of the quantitative evidence of the issues surrounding hollowing-out seems to discount the phenomenon as a legitimate cause for concern. However, it is the over-emphasis on quantitative analysis alone which was the impetus for this thesis. The debate within Canada on the "hollowing-out" of the economy has been heavily dominated by quantitative analysis and discussion. This emphasis on quantitative analysis has led to a vacuum within debate, in that the qualitative effects, or consequences, are not given proper attention. What is "hollowing-out"? Is this happening to Canada and why?

This thesis is not intended to be a criticism of foreign investment as a negative practice. On the contrary, it will start from the position that foreign investment can be, and is, a useful tool for economic and social development. Isolationism and protectionism are no longer practical policies in a globalized economy. However, the need for a thorough discussion regarding the costs and benefits of accumulation regimes, and their effects, is always necessary. This thesis is designed to therefore express the many

perspectives and much evidence gathered for and against, the hollowing-out phenomenon and reveal their respective assumptions and evidence.

Outline

Chapter one deals with previous literature relevant to my thesis. Chapter two will illustrate how I attempt to use Bob Jessop's 'Schumpeterian Workfare State' (SWS), and Stephen McBride's "paradigm shift" as the theoretical foundation as a partial explanation for Canada's recent experience in M&A activity. Chapter three discusses the quantitative side of the hollowing-out debate: agents, literature, claims and evidence. Chapter four presents a qualitative analysis and arguments that are more supportive of hollowing-out concerns. Chapter five attempts to answer the risk-assessment question that Canada is faced with: are the benefits of FDI greater than the risks of potentially being hollowed-out? Although it will be established in this thesis that hollowing-out of corporate Canada is not happening, in Chapter five a risk-assessment of the situation will assert that the benefits of FDI only marginally outweigh the costs of potentially being hollowed-out. Finally, Chapter six will reiterate and reflect on the conclusions of the previous chapters.

Quantitative vs. Qualitative Perceptions

The impetus for this thesis was the need to call attention to the space within the discourse on the hollowing-out debate, which seems to rely heavily on arguments that are largely quantitative in nature, and miss important qualitative aspects.

For the purpose of this thesis, quantitative analysis is defined as the examination of phenomena using actual observed, measurable data with an intention to explain

historical behavior and/or predict the future behavior of some phenomenon. This is seen in the research and reports written by Statistics Canada, CD Howe Institute, the Department of Finance, and Institute of Canadian Competitiveness and Prosperity, which value quantitative approaches and evaluations. It also reflects schools of thought which are rooted in the orthodox economic analysis.

Conversely, qualitative analysis, while more subjective and experiential in nature is nevertheless important to the debate, for its emphasis on characteristics for which precise numerical identification is not appropriate; rather it emphasizes a more descriptive and contextual analysis, for which traditional economic analysis is not as useful. Therefore, it is necessary for alternative schools of thought to emphasize the arguments and perspectives which would not normally be accounted for. The data presented in Chapter 4 is deemed to be qualitative, not because of the method by which the information was obtained, but rather because of the content of the data itself, which presents corporate Canada's experience in a much different light.

Agencies rooted in quantitative, or orthodox economic analysis have generally maintained that the hollowing-out thesis is bogus. These agencies come from the perspective that the openness of an economy is in one way determined by the sum of outflow/inflows of FDI into and out of the country. Some of the most "open" economies in the world, from this type of measurement, include Luxembourg, Hong Kong, Singapore, Iceland, and the Netherlands. As a specific example, "foreign ownership of the UK corporate sector (excluding unquoted companies) increased from 30 percent in 1995 to 50 percent in 2007... The UK government expressly welcomes FDI through various regulatory and tax policies" (Mintz and Tarasov, 2007:5). Paul Kellogg writes

that, the "hollowing out arguments qualitatively tend to see a link between the national-base of corporate control, and sovereignty over the economy. But what about the state? If the state is sovereign, and can still direct economic policy, doesn't that mitigate the "qualitative" issue of loss of economic control?" (Nov. 3rd, 2007).

The trouble with purely quantitative arguments is that they depend on the time period chosen. It is not difficult to prove both sides of the argument by picking the period accordingly. Various studies of inward/outward FDI in Canada has pointed towards several different trends, and therefore different viewpoints on the legitimacy of the hollowing-out debate. For example, Statistics Canada takes the long historic view, however the hollowing-out thesis focuses on the most recent surge in foreign acquisitions. At the time of writing, if we take the most recent 18 month period for which data is available, foreigners actually spent $66 billion more on Canadian acquisitions than vice-versa.

More importantly, the actual point of Canada's hollowing-out is not about the number of firms Canada is buying/losing but about the disproportionate loss of the country's biggest and best companies. Here, it will be important to discuss the size of acquisitions, the strategic importance of Canadian acquisitions, weakening Canadian capital markets, the number and position of Canadian global industry leaders, and the need to present a global perspective on the hollowing-out trend.

Essentially, it is misleading and flawed to count the number of headquarters without asking what type/size the company is that chooses to headquarter in Canada. This includes the type, size, and community impact of corporate headquarters (which have been impacted in several negative ways). The list of potential negative impacts to Canada

could include the loss of top management jobs, community philanthropy, high caliber boards of directors, quality jobs in supporting industries, large cap listings on the Toronto Stock Exchange (TSX), and control of financing for large projects.

The Competition Policy Review Panel (CRPR) was tasked by the Conservative government to study the many issues Canada is facing in light of the most recent takeovers of its largest corporate entities. The CRPR looked at overall FDI investments in and out of Canada, M&A activity in particular, and tried to situate Canada's experience into the much broader global FDI flows, finding that that the "largest part of the FDI flows into Canada is M&A activity. Canada accounted for 5.2 percent of world M&A activity at the end of 2006, higher than its share of the global economy (3.2 percent). Recent firm and industry growth has been driven by M&A activity as many global industries seek to grow rapidly through consolidation…" (CRPR, 2007:12).

Again, M&A activity is only a portion of FDI investment in Canada. The CRPR found that, "the number of foreign firms acquired by Canadian firms between 2001 and 2006 significantly exceeded the number of Canadian firms acquired by foreigners. However, the total value of Canadian acquisitions over this period was only slightly higher than the total value of foreign acquisitions of Canadian firms, despite significant foreign acquisitions of Canadian companies in 2005 and 2006" (CPRP, 2007:14). This is a significant factor when considering the qualitative nature of the debate; that Canadian firms are acquiring more firms at smaller values, as opposed to foreign firms acquiring fewer, but larger Canadian companies.

Definitions of Hollowing-Out

Each dimension of hollowing-out phenomenon has its own assumptions, evidence, evaluations, and is directed to a particular audience. The very definition of hollowing-out itself depends on the ideological perspective from which an analysis is being performed. Therefore, a proper study of whether or not hollowing-out exists cannot occur without first realizing that there is more to the debate than mere orthodox economic analysis.

A paper written by Baldwin, Beckstead and Brown for Statistics Canada in 2003 titled "Hollowing-out, Trimming-down, or Scaling-up? An Analysis of Head Offices in Canada, 1999-2002", defined hollowing-out as "to be associated with the decline in the management function. In particular, it is related to the movement of head office employment, and especially senior management functions, out of Canada" (Baldwin et al., 2003:iii). This has been the general public understanding of hollowing-out. They contend that hollowing-out is only one of three possible explanations for the change in the management function of firms in Canada: hollowing-out, trimming-down, or scaling-up.

For Baldwin et al., trimming-down refers to the potential decline of head office employment caused by increased management efficiencies with firms" (Baldwin et al., 2003:2). Scaling-up becomes a more complicated topic to necessarily define:

> However… head office employment may also have scaled-up because investments in information and communication technologies have made it more efficient to concentrate management functions in head offices rather than in production units. In this sense, scaling-up may be associated with the increasing management reach of head offices. It is always possible of course that the scaling-up of head office management is being accompanied by a certain amount of transfer of management function abroad (hollowing-out), but the balance of factors in this case suggests this is probably not very important. (Baldwin et al., 2003:7)

In 2001, the Conference Board of Canada, a research organization studying the effects of the increasingly changing global economy, defined "hollowing-out" as "the movement out of Canada of either a corporate head office or, at least, the senior operating team of an organization (i.e., the decision makers)" (Hynes, 2001:1).

However, the term "hollowing-out" must be situated within the much broader context of corporate transformation. Changes in corporate governance occur for many reasons, and the Conference Board of Canada defines corporate takeover effects (CTEs) as "the collective term for the effects (impacts and consequences) – positive, negative, and neutral – that result from change to corporate control, governance, structure, functions and operations made by new owners after they take over a company" (Grant, 2008:3). These effects may have many implications, which include: headquarters, professional jobs, management, communities, shareholders, etc.

Therefore, hollowing-out would refer to the negative effects of changes in corporate control; the actual extent of which "depends on the nature of the post-acquisitions decisions made by the new owners. Their decisions may result in negative effects on governance, head office functions and responsibilities, services acquisitions, line management, operations, employment, capital spending, community involvement…" (Grant, 2008:3).

Many commentators have expressed great concern over outsourcing of private firm functions. It is a different kind of phenomenon that has nothing necessarily to do with the nationality of ownership. Oddly enough, what should be considered is a hollowing-out in Canada that can actually result from Canadian investment in the United States. That's when the U.S. subsidiary, because of the size of the American market,

becomes more important than the Canadian operation and, while the legal head office remains in Canada head office functions de facto shift to the United States. This means that, so far as "hollowing-out" is concerned, Canadian investment abroad does not necessarily offset the effects of FDI in Canada; indeed, it could actually add to the "hollowing-out". In effect, a small(er) country may have problems as a base for global companies.

Ergo, the concept of hollowing-out, while invariably negative in concept, has multiple meanings, of which this thesis will attempt to address the most serious and largest in scope.

Origins of Concern

The concern regarding the hollowing-out has been the most recent increase in the number of foreign takeovers of key Canadian economic icons. Debate has been split on the benefits/consequences of this phenomenon. However, the actual point of Canada's hollowing-out is not about the number of firms Canada is buying/losing but about the disproportionate loss of the country's biggest and best companies.

More specifically, concerns about head office employment extend from the national down to the local scale as cities are often anxious to expand their head office base. This interest stems from three factors. First, head offices are thought to bring with them prestige that adds to a city's image as a centre of knowledge and capital accumulation. Second, head offices generate demand for financial and business services, which form an increasingly important part of urban economies. Finally, head offices

provide relatively high paying jobs that add to a city's economic base (Brown and Beckstead, 2006:3.2).

Would it be wrong to say that governmental reviews of foreign acquisitions are a reflection of the pressing political issues within that country, specifically since 2004 Australia has reviewed 4,830 proposals. Of those, 4,447 were approved (3,452 with conditions), 64 rejected, and 319 were withdrawn (the remainder were judged exempt). Of the conditional approvals, 3,399 were in the real estate sector. Why would this be the case? The sensitivity and sustainability of the country's natural environment has been a key political issue for many years.

Foreign ownership of Canadian assets has always been a staple of this country's experience. In terms of composition across industrial sectors, Canadian assets under foreign control have been relatively stable at approximately 21 percent since 2000: "FDI in manufacturing is about 49 percent of total output. The other main sectors with a relatively high foreign presence are oil and gas, at almost 40 percent, wholesale trade at 37 percent, transportation and warehousing at almost 26 percent, and finance and insurance at about 15 percent" (CPRP, 2008:12).

Theory

The phenomenon of foreign ownership as practiced by the multinational corporations is at the very core of corporate globalization. Therefore, my thesis is situated within the theoretical context of Bob Jessop's "Schumpeterian Workfare State" (SWS), whereby Canada would prove to be an example more so than other countries of this paradigm, by encouraging the influx of foreign capital and takeovers, as part of the state's

"new role" as an SWS accumulation regime. Canada is in essence, by moving towards a SWS structure, encouraging openness and liberalization, specifically through corporate mergers and acquisitions. It is recognized that the SWS as Jessop defines it is not entirely responsible for Canada's experience in M&A activity, although it does play an important role. Proper credit must be given to large external factors, such as the logic of competition in the world market and the broader geo-political and geo-economic dimensions.

Foreign ownership as practiced by the multinational corporations is at the very core of corporate globalization. To quote Jessop: "It is innovation-driven structural competitiveness which is becoming central to the successful performance of the economic functions of the contemporary capitalist state" (Jessop, 1993:17). The link between foreign ownership and innovation in this case then is that foreign firms are on average more productive than domestically owned firms.

In his own words, the goal of the SWS is to: "promote product, process, organizational, and market innovation and enhance the structural competitiveness of open economies mainly through supply-side intervention; and to subordinate social policy to the demands of labor market flexibility and structural competitiveness" (Jessop, 1993:9). The mergers and acquisitions of foreign and domestic firms would fall into this realm of supply-side intervention. This it not to say that corporate takeovers have never existed prior to this transition; however, the recent surge in acquisitions of Canadian firms over the past several years has led Canadians to question the causes for this increase. Jessop's SWS can be seen as an explanation for this recent phenomenon, and will be the theoretical basis for this thesis.

Quantitative Arguments

The *Economist* magazine claims that "hollowing-out" fears are unfounded, based on the facts that "Canadian companies and pension funds are snapping up assets abroad and all the available evidence points to the beneficial effects of foreign investment" (The Economist: *Bell Canada: Hollowing out?* July 3rd, 2007). It goes on to claim that fears of American dominance are deeply rooted in Canadian culture, and therefore, economic nationalism has been a strong staple in much of Canadian politics. Polls suggest that Canadians are torn between the potentially plentiful benefits of foreign investment, and the desire to maintain iconic Canadian businesses under national control. An example being the Canadian owned Telus bid for BCE, which would have "limited competition and could have led to an increase in fees and the loss of jobs" (The Economist: *Bell Canada: Hollowing out?* July 3rd, 2007).

In a paper written by Baldwin, Beckstead, and Brown in 2003 for Statistics Canada, the authors contend that by measuring counts of head offices and their employment: "Overall, the paper finds that there are relatively few sectors or enterprises with patterns of decline in their head office function" (Baldwin, 2003:ii).

The CD Howe Institute maintains that, since the 1990s, Canada has actually been a "hollower-out" of other countries. This is substantiated by statistics such as those put out by Statistics Canada, illustrating that net outflows of FDI have been greater than net inflows, on average, from 2001-2005 (Mintz and Tarasov, 2007), and that the situation of FDI outflows/inflows in Canada is no different from the majority of other, particularly EU member states, with similar rises and falls from 2001-2005.

According to a report that the CD Howe Institute put out in the summer of 2007, "Canadian companies acquired 23 foreign companies with assets in excess of $1 billion each, for a total of more than $60 billion in assets (UNCTAD, various years). This compares with the 25 foreign acquisitions of Canadian corporations worth more than $1 billion each, for a total of about $75 billion" (Mintz and Tarasov, 2007:5). The validity of the statistic is limited in scope, due to its analysis of firms with a market capitalization value over $1 billion only and does not include data on transaction values under $1 billion.

The Institute's position on the topic of "hollowing-out" is to be expected:

> To improve its performance, therefore, the Canadian economy needs to become better integrated with world capital markets, and Canadian businesses need to be able to participate more fully in global supply chains. Canadians thus should pay little attention to those who call for more barriers to FDI, which serve mainly to shield domestic businesses from beneficial international competition, limit their access to international management and technology, and make it more difficult to achieve cost efficiency. Instead, given the significant economic benefits of FDI, Canada should pursue integration with world markets with relish (Mintz and Tarasov, 2007:6).

Echoing the Institute's findings, an article published in The Gazette in August 2007 read, "We're only 46th when it comes to inbound foreign investment, but we're a healthy 13th in outbound investment. That is, while foreign investment equaled about two per cent of our GDP, Canadians invested almost twice as much - 3.8 per cent - elsewhere, good for 13th place among those 73 countries. Canada is a net exporter of capital" ("Foreign Investment is Healthy", August 2007). In the context of this thesis, the "export of Canadian capital" refers to Canadian based companies investing in firms abroad.

Qualitative Analysis

The qualitative aspects of the debate, although much more difficult to quantify and therefore present as evidence, are nonetheless significant, and merit review. Much of the qualitative evidence is anecdotal, or refers to matters which may be more difficult to quantify. For example, the importance of corporate headquarters (CHQ) to a community, city, or country, is something that many statistical researchers would find difficult to explain, but chief executive officers (CEOs), who may be closer to understanding the complexities of the benefits of having a CHQ located within Canada have greater experience in the matter, and have a different opinion on the hollowing-out debate. Therefore, the loss of any large CHQ from the perspective of the firm's top executives may be a greater loss than typical statistical analysis can measure or appreciate.

The study of the hollowing-out of corporate Canada has taken many forms. Harry Arthurs writes that "changes in governance structures, in turn, have particular consequences for global cities like London, New York or Tokyo [and lately, Toronto]" and that "by intensifying concentrations of economic power within and around transnational companies, globalization may… contribute to a hollowing out not only of business communities but of cities, regions and countries around the world" (Arthurs, 1998:3).

His arguments on the restructuring of corporate governance sit within the broader scope, and debate, on the effects of the hollowing-out of Canadian head offices, as they are largely defined in the mainstream media. His analysis constitutes a very real shift in attitudes of company directors – "a 1994 survey of CEOs of Canadian foreign-owned subsidiaries reports that a significant number (over 40%)… perceived that during the past five years, their autonomy had been diminished…" (Arthurs, 1998:17). This reflects a

highly subjective and experiential argument made by Canadian corporate leaders, who claim to be losing control over their own affairs.

Finally, Arthurs suggests ideas that are different from most mainstream thought in Canada, that fears of hollowing-out immediately lead to protectionist measures: "it is not that an ardent host-country nationalist will necessarily corrode strong corporate loyalties or subvert corporate plans. On the contrary: utilization of local methods, vocabularies and contacts may be the best way, in specific contexts, to achieve transnational goals" (Arthurs, 1998:19). He is emphasizing alternatives to reports and sentiment from agencies such as the CD Howe Institute, and others, that Canadian economic nationalism has little to provide Canadian firms in terms of a competitive edge. This is an important admission for my thesis, which seeks to provide substantiation to alternatives to traditional neoliberal solutions to problems with a political-economic spin.

Additionally, there is a detectable current of national resentment against the rise of foreign acquisitions over Canadian firms recently. When asked to define Canadian identity, the short answer is often a curt, "Well, it's not American". There is a deep rooted concern over foreign, particularly American dominance in our politics, economy, and even our culture. This sentiment is not entirely unfounded, and has even become the centre of the debate of foreign investment.

In a piece written by Julie White, called "Losing Canadian Culture: The Danger of Foreign Ownership of Telecom" for The Canadian Centre for Policy Alternatives (CCPA), White "considers the danger posed to Canadian culture by foreign ownership of the telecommunications industry", claiming that "trade negotiations to promote more

foreign involvement in the provision of telecom services, including foreign ownership, threaten our cultural expression" (White, 2005:1).

Where is there a balance to be found between welcoming foreign investments, and maintaining national cultural expression? Organizations such as the Canadian Conference of the Arts (CCA), have "looked at the level of Canadian content in music, books and television productions, comparing Canadian-owned and foreign-owned companies. In each case, the Canadian companies provided far more Canadian content. The CCA argues strongly for maintaining the foreign ownership restrictions in the broadcasting industry" (White, 2005:8).

Still, White's analysis of the foreign takeover of Canada's telecom industry rests on speculation of what *could* happen if the limits on foreign ownership are lifted, rather than citing more concrete evidence. In a globalized world economy, what would stop Canadian bands, or performances from being signed by multinational firms (of any national stripe), or Canadian culture disseminating around the globe? While it is perhaps not within in the scope of her paper, there is no mention of the level of Canadian content displayed in the United States, or around the world.

However, the danger remains that the removal of foreign ownership restrictions on Canadian telecom firms could mean "Canadian companies would be maintained as satellites within the larger orbit of foreign corporations and vital financial and creative decisions would be made in New York, Paris or Los Angeles, rather than in Montreal, Winnipeg or Toronto" (White, 2005:8).

Flipping the argument that Canada's economy is being actively hollowed-out by foreign companies on its head, writer Andrea Mandel-Campbell suggests that Canadian

businesses have let themselves become complacent, and therefore more likely to be picked off in the global economy: they have let themselves be hollowed-out.

She argues that this attitude of ambivalence stems from Canadian corporate culture being satisfied with merely the domestic market, while many sectors are protected by federal legislation barring foreign takeovers.

With reference to the Canadian government's inability (or unwillingness) to promote global leaders, largely through basing industrial policy on nationality rather than competitiveness, she quotes John Hancock, a Canadian trade counselor at the WTO who says, "We are like Gulliver – we've tied down our multinational companies and made them less competitive. In the name of protecting our sovereignty, we've diminished it" (Mandel-Campbell, 2007:290).

Mandel-Campbell's work is relevant to provide another perspective to the hollowing-out debate. If Canada's companies are lacking in competitive fervor, what should the government do to promote it? To quote Jack Mintz, and in the spirit of conducting good research, "a study that starts with the premise that both outbound and inbound FDI are good for the economy might lead to policy actions that make sense" (June 18th 2007, Canadian Business magazine).

Many CEOs in Canada, the perceived captains of industry, and some of the most visible faces and names in the global economy, have been split, particularly with Canada, on the existence of hollowing-out. Some argue for continued reliance upon traditional market forces to guide economic development, emphasizing that foreign investment into Canada, under any national banner, is a good thing, so long as it makes Canadian firms more competitive.

For example, Ian Telfer, the CEO of Goldcorp has said that "the loss of head offices is a problem, but the solution is not to hide behind Ottawa. Foreign ownership limits would raise the cost of capital for every miner. It's to have bigger, more aggressive Canadian companies - and not have themselves so easily picked off."

Alternatively, others have argued that Canada is losing out, citing the recent rise of foreign acquisitions of Canada's largest economic icons. The "loudest" proponents of the hollowing-out argument include: Gerald Schwartz of Onex Corp., who said "When a head office leaves Canada, so do all the support positions at accounting firms, law firms, recruiters and other key suppliers of head office intellectual capital" and Dominic D'Allesandro of Manulife, who said that "What if we were to consider ... adopting ownership restrictions for certain sensitive sectors of our economy that would be similar to those that now apply to our financial institutions? I sometimes worry that we may all wake up one day and find that as a nation, we have lost control of our own affairs."

Opinions on this issue are expectedly varied among the political parties as well. Current federal Liberal party leader Stephan Dion called for a review of the Investment Canada Act, which the Conservative led Canadian government has finally agreed to. A government led task force, reviewing the ICA and Canadian competitiveness issues will have completed its analysis sometime in 2009.

Predictably, the NDP's position is more supportive of the hollowing-out thesis. The party's position is neatly summed up by their finance critic, Judy Wasylycia-Leis: "It has become apparent in the last few months that we're facing a serious threat in terms of Canadian ownership and control. If your core is owned by foreign nationals, you lose the ability to shape your own destiny."

The Conservative government led by Stephen Harper, along with Canadian Investment, Industry, and Heritage departments, believe "hollowing-out" to be not only non-existent, but rather the expected and understandable flow of investment in and out of countries. The Canadian government's position has been that hollowing-out at home has largely been over-dramatized, and that Canada has actually been a "hollower-out" of other countries, by tallying the number of Canadian acquisitions overseas, and their total value.

Emphasizing the difference between quantitative and qualitative statements, the Prime Minster's claims contradict research studying the long-term performance of acquisitions overseas. In a paper that studied the long-term effects of 267 foreign acquisitions of Canadian firms from 1980 to 2000, Andre, Kooli and L'Her found that, "First… Canadian acquirers significantly underperform over the post-event period… We also find that cross-border deals perform poorly in the long run" (2004:24). While noting that the number and total value of Canadian acquisitions have increased substantially between 1980 and 2000, the authors conclude that long-term performance underperforms, lending little weight to the argument that Canada is indeed "hollowing-out" other countries.

Mel Hurtig, a noted Canadian publisher and author, has expressed the current of nationalist sentiment that permeates the debate over hollowing-out, and the demise of Canadian competitiveness and prosperity: "[a] major problem with excessive foreign ownership is the loss of jobs that results when foreign corporations buy parts and components and services offshore or from the U.S. when similar-quality goods and services are available in Canada at competitive prices."

The next chapter will expand upon the factual data (both objective and subjective), and the theoretical concepts of Bob Jessop and Stephen McBride chosen to lay the basis for contextually understanding the hollowing-out debate and phenomenon.

Chapter 2: Theory and Fact

The phenomenon of foreign ownership as practiced by the multinational corporation is at the very core of corporate globalization. Multinationals comprise a significant portion of, as well as much of the dynamism within, global FDI flows. A multinational firm is "one that engages in FDI and owns or controls value-adding activities in more than one country" (Baldwin and Gellatly, 2007:14).

My thesis is therefore situated within the theoretical context of Bob Jessop's "Schumpeterian Workfare State" (SWS), whereby Canada would prove to be an example more so than other countries of this paradigm, by encouraging the influx of foreign capital and takeovers, as part of the state's "new role" as an SWS accumulation regime. Canada is in essence, by having moved towards a SWS structure, encouraged openness and liberalization, specifically through corporate mergers and acquisitions; but it is still recognized that Canada has a considerable level of foreign investment and ownership restrictions for many "sensitive sectors".

This chapter will rely heavily on the work of Jessop's SWS (1993), his revised conceptualization of the SWS into the Schumpeterian Workfare Post-National Regime (SWPR, 2002), and Stephen McBride's Paradigm Shift, whereby Canada has had a shift in the overriding political-economic ideology from the 1970s "protectionist" approach, to one of liberalization, openness and integration; specifically, with regards to foreign investment and ownership.

The SWS, and later the SWPR, have been selected for the purposes of this thesis to highlight the state's role in emphasizing a more liberalized investment regulatory framework (from FIRA to the ICA), designed to place greater importance on national

innovation and competition, through the specific act of encouraging greater influence and activity by foreign firms and investors in Canada. McBride's Paradigm Shift will be useful to help illustrate the shift from the KWS to the SWS, as it relates to Canada's specific experience.

In Jessop's own words, the goal of the SWS is to: "promote product, process, organizational, and market innovation and enhance the structural competitiveness of open economies mainly through supply-side intervention; and to subordinate social policy to the demands of labor market flexibility and structural competitiveness" (Jessop, 1993:9). The mergers and acquisitions of foreign and domestic firms would fall into this realm of supply-side intervention. There is a nuanced argument being made here: the state adopts a more laissez-faire attitude to economic issues, however, it can control its entrance into the global economy. Canada is making the transition by making itself more open to the forces of globalization, and the competition of the market or corporate control.

This it not to say that corporate takeovers have never existed prior to this transition; however, the recent surge in acquisitions of Canadian firms over the past several years has led Canadians to question the causes for this unprecedented increase. Therefore, Jessop's SWS should be seen as a partial explanation for this recent phenomenon, while much credit will also be given to the global functionings of the geo-political and geo-economic realms.

This is in contrast to what Jessop referred to as the "Keynesian Welfare State" (KWS), whereby the state pursued objectives to "promote full employment in a relatively closed national economy primarily through demand-side management, and to generalize norms of mass consumption through welfare rights and new forms of collective

consumption" (Jessop, 1993:9). This is not to say that Schumpeter had advocated the SWS explicitly, but rather, shows that his economics was used to justify the sorts of political and economic policies which the SWS entails, and more specifically, to exist in stark contrast from the Keynesian accumulation regime of the Fordist period. "Schumpeter has a key role here as an emblematic thinker in shaping, directly or indirectly, the new understanding of competitiveness and linking it to long waves of technological innovation and capital accumulation" (Jessop, 2002:120).

While Jessop's concept refers to the "hollowing-out" of the nation state and its roles in particular, it is possible to draw correlations between the SWS, and the hollowing-out of corporate Canada debate in this thesis. Jessop sees "hollow corporations" as "transnationals headquartered in one country whose operations are mostly pursued elsewhere" (Jessop, 1993:23), which is an essential claim for those who are opposed to, or skeptical of, foreign ownership of Canadian industries.

Perhaps the most significant point to take from Jessop is that nation-states can lose autonomy over their economy as they make the transition from KWS to SWS; however, their role shifts to one of "managing the process of internationalization itself... This not only involves advancing the interests of home-based multinationals but also means creating conditions favourable to inward investment" (Jessop, 1993:14). While Canada has done much to promote and serve the interests of the domestic business community to a much greater extent since the transition to neoliberalism, through deregulation and large corporate tax cuts, past federal governments have stressed the need to become more "open for business", as the present Finance Minister Jim Flaherty repeatedly claims.

Mel Watkins accurately explains that, "For Schumpeter, entrepreneurship and innovation were central to economic growth. They were the creative side of the "creative destruction" that inhered in the process of capitalist development; "competitiveness," the buzzword of our times, conjures up both the good (the drive for efficiency) and the bad ("down-sizing" and low-wage competition)" (1997:34). Schumpeter's concept of the entrepreneur is an important element of the hollowing-out debate. For reasons that will be touched upon later in greater details, author Andrea Mandel-Campbell claims that Canadian CEOs, its entrepreneurs, have not been doing "their job", and have settled into a mindset of mediocrity, and have lost the desire to take risks. This, she claims, is due in large part to Canadian culture's antipathy to the aggressiveness of many entrepreneurs, most traditionally embodied in US firms and CEOs.

More recently, Jessop has shifted his conceptualizations of the SWS to the SWPR. This concept goes beyond the SWS by accentuating a more nuanced and updated emphasis on the desire to create a societal environment which encourages and fosters the concepts of innovation, entrepreneurship and competition at multiple levels throughout society. However, since the SWPR contains the same core elements and constructs of the SWS (competition, innovation, etc), I have decided to continue on with the older, more general SWS concept as my theoretical foundation for this thesis.

However, it is possible to utilize some key aspects of the SWPR in several ways by emphasizing what is still true and evident, even in the SWS model which is slightly older: that "managing the fundamental contradiction between the increasingly social nature of productive forces and the continuing and private nature of the social relations of production and the appropriation of surplus labour", is the hallmark of the paradigm shift

which has occurred in Canada. Jessop expands that this has been accomplished, generally speaking, in several ways:

> ...liberalization and deregulation of foreign exchange movements and redesign of international financial architecture with the effect of internationalizing and accelerating capital flows; modifying institutional frameworks for international trade and FDI; promoting the space of flows in this context by organizing conditions favourable to the international mobility of technologies, industrial and commercial capital, intellectual property, and at least some types of labour-power... (Jessop, 2002:273).

While it is not possible to explore all the social and economic policies in which Conservative and Liberal governments of Canada, over the past few decades, have contributed in their own ways to this paradigm shift, the intention has been made clear: "Canada is open for business".

Paradigm Shift

Jessop's argument is further substantiated by Stephen McBride's book Paradigm Shift: Globalization and the Canadian State. In it the author argues that there has been a "paradigm shift" in the ideology of the nation state in Canada, in that moderate state interventionism associated with Keynesian economic theories has been replaced by an economic orthodoxy that confines the state and trumpets the virtue of market solutions: "thus Canadian Keynesianism was to a certain extent subsumed by an "export-led growth theory" in which a liberalized international economy would be a major contributor to full employment" (McBride, 2005:35).

Jessop even acknowledged this paradigm shift, "from a Fordist growth model based on mass production, scale economies, and mass consumption to one oriented to flexible production, innovation, scope economies, innovation rents, and more rapidly

changing and differentiated patters of consumption" (Jessop, 1993:14) in his own writing on the transition from the KWS to the SWS.

"With the election of the Mulroney government, the state, reflecting the articulated demands of the Canadian business, adopted a neo-liberal economic strategy that removed constraints on foreign investment, dismantled FIRA and the NEP, and opted for continental free trade. The shift to a free-trade strategy was assisted by the conclusions of the Macdonald Report, whose findings appear to have been wholly influenced by orthodox free-market economists and the wishes of the business community" (McBride, 2005:48).

Mel Watkins expands upon this point, and connects the SWS to Canada's specific experience: "The Canada Development Corporation and Petro-Canada were privatized. FIRA was renamed Investment Canada, and was explicitly assigned the task of getting more foreign investment. Since its creation, it has approved every application for foreign investment that has come before it; it is nothing more than a giant rubber stamp that can function without human intervention" (Watkins, January 2008).

While not many would be unfamiliar with the move towards open markets and deregulation as part of the process of neoliberalism, Canada can be specifically singled out because of its own policies and practices that conspire to make Canadian companies the easiest to acquire. According to SECOR consulting, Canada's defenses to corporate takeovers are weak relative to other jurisdictions, leaving the majority of Canadian firms that are not protected industries, more vulnerable to takeovers. This point will be expanded upon later on in greater detail.

Neoliberalism

Jessop recognizes that no dominant form of the SWS has emerged, and has illustrated three most notably distinct types: neoliberalism, neocorporatist, and neostatist. Unlikely to be found in pure form, "the particular strategy mixes to be found in individual cases will depend on institutional legacies, the balance of political forces, and the changing economic and political conjunctures in which different strategies are pursued" (Jessop, 1993:29).

Neo-liberalism is concerned to promote market-guided transition towards the new economic system (e.g. Reaganism in the USA). The public sector is faced with a mixture of privatization and liberalization. For the private sector it means deregulation and a new legal and political framework which provides support for market solutions. Neo-liberalism also means the reorientation of state activities to the needs of the private sector and welcomes internationalization.

Jessop goes on to write that, "Neoliberalism also involves a cosmopolitan approach that welcomes internationalization of domestic economic space in the form of both outward and inward investment and also calls for the liberalization of international trade and investment within regional blocs and more generally" (Jessop, 1993:29). This approach is visible in the Canadian experience, with the majority of foreign investment and head offices generally located in large urban areas. Also, the emphasis on outward and inward investment merits great attention, as the removal of restrictions on the international flows of capital across borders can have many positive, neutral, and negative effects. It is this multiplicity of effects, taken in the form of corporate mergers and acquisitions, which is currently under review and scrutiny in Canada.

The GATT

This shift can be seen in Canada, specifically, by looking at the abandonment of FIRA (the Foreign Investment Review Agency) enacted under the Trudeau period, and the implementation of the Investment Canada Act (ICA). Created after World War II in 1945, and signed by Canada in 1947, the General Agreement on Tariffs and Trade (GATT) was designed to create a general consensus among signatory countries on liberalized international trading systems. "Yet, the logic of Keynesian economic development strategy was based on sustaining economic growth by using the national state… Keynesianism, which had been predicated on a form of state economic management, had provided a rationale for continued "statism" in Canada" (McBride, 2005:49).

"Under the GATT, compliance with dispute-settlement rulings was imposed largely through moral suasion and consensus, and countries could delay or avoid compliance… Indeed, because panel decisions had to achieve consensus in the GATT council, decisions could, in effect, be vetoed by a country that lost its case. The impact of this practice was limited, however. Virtually the only entities to exercise this right were the United States and the EU" (McBride, 2005:157).

Part of the specific shift occurred in Canada when a judicial panel concluded that FIRA was inconsistent with Canada's obligations under the GATT. In order to bring itself into compliance with that decision, which was adopted by the GATT contracting parties in 1984, Canada repealed the FIRA and enacted the Investment Canada Act in 1985:

> …a GATT dispute settlement panel considered a complaint by the United States regarding certain types of undertakings which were required from foreign

> investors by the Canadian authorities as conditions for the approval of investment projects. These undertakings pertained to the purchase of certain products from domestic sources (local content requirements) and to the export of a certain amount or percentage of output (export performance requirements). The Panel concluded that the local content requirements were inconsistent with the national treatment obligation of Article III:4 of the GATT(1) but that the export performance requirements were not inconsistent with GATT obligations. The Panel emphasized that at issue in the dispute before it was the consistency with the GATT of specific trade-related measures taken by Canada under its foreign investment legislation and not Canada's right to regulate foreign investment *per se* (WTO website: Technical Information on Trade and Investment).

Article III:4 of the GATT states that: "The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use" (WTO website: Technical Information on Trade and Investment).

The immediate result of the ruling was that FIRA was abolished, and was replaced with the Investment Canada Act (ICA), which was more in line with Canada's commitments under the GATT. The practical implications have been that Canada has not blocked the foreign acquisition of a domestic firm in the more then 20 years since its inception. "The panel decision in the FIRA case was significant in that it confirmed that existing obligations under the GATT were applicable to performance requirements imposed by governments in an investment context in so far as such requirements involve trade-distorting measures" (WTO website: Technical Information on Trade and Investment).

Honouring its obligations under the GATT, Canada became more committed to the path of neoliberal development, and its eventual signing of the North American Free Trade Agreement (NAFTA).

Ideologically speaking, much the credit for the shift occurred in 1984, when Donald Macdonald led a Royal Commission on the Economic Union and Development Prospects for Canada. Before the conclusions of the report were presented, he leaked his "leap of faith" to the media, and "announced that he favored free trade between Canada and the United States as the principal long-term solution to Canada's economic problems" (McBride, 2005:59).

The main argument put forth by the Royal Commission was that, "Canada was a trade-dependent nation particularly reliant on the American market, and the threat of rising protectionism jeopardized that trade. A free-trade deal with the United States was a way of guaranteeing Canadian access to that market" (McBride, 2005:59).

Innovation

Innovation is not a new buzzword within the business community; however, this idea has permeated all levels of government, such that public policy has been directed towards aggressively creating a more innovative environment within Canada. Under Chrétien's Liberal majority government, "In February 2002 the federal government launched its innovation strategy which aims to move Canada to the front ranks of the world's most innovative countries" (Innovation Canada, www.innovationstrategy.gc.ca., 2007-05-1).

The rhetoric carries on into the present Conservative government, with the Minister of Industry Jim Prentice emphasizing that, "Canada welcomes foreign investment and all of its benefits, such as creating jobs, spurring innovation and enhancing productivity" (Industry Canada new release, December 7 2007).

As Jessop explains, for Schumpeter, "It is the supply of innovation that was central to his analysis of capitalist growth dynamics.... And it is innovation-driven structural competitiveness which is becoming central to the successful performance of the economic functions of the contemporary capitalist state" (Jessop, 1993:16). Schumpeter listed several ways in which entrepreneurial innovation occur, one of which is "the conquest of a new source of supply of raw materials or half-manufactured goods, again irrespective of whether this source already exists of whether it has first to be created" (Jessop, 2002:122). Although Schumpeter wrote this in 1934, he must have known that merger and acquisition (M&A) activity was an essential and natural component of the capitalist mode of production. The takeover of firms or sources of production, "irrespective of whether this source already exists", emphasizes this point.

For Jessop and his SWS concept:

> States have a key role here in promoting innovative capacities, technical competence, and technology transfer so that as many firms and sectors as possible benefit from the new technological opportunities created by research and development activities undertaken in specific parts of the economy… the state must get increasingly involved in promoting effective national and regional innovation systems… states must shift industrial support away from vain efforts to maintain declining sectors unchanged… [And finally] the crucial point is that state action is required to guide the development of new core technologies and widen their application to promote competitiveness (Jessop, 1993:13).

The argument could be made that the recent upsurge in foreign acquisitions, to which the hollowing-out concerns refers, is an example of the state shifting support away from

industries that are no longer profitable under domestic control. Foreign firms will buy out a Canadian company, under the impression that they can improve performance, productivity, and profitability of the acquired company. For the sake of national competitiveness, the state must relinquish itself of these "old relics", and this can mean creating a regime of accumulation whereby mergers and acquisitions are promoted and encouraged, except for certain sectors under strict foreign-ownership rules, which are deemed to be necessary for the national security of the state.

When referring to "sunrise" and "sunset" sectors, it can be argued that Jessop is referring to the state's encouragement of M&A activity, so as to promote the "sell-off" of declining sectors to the highest bidder (in this case, foreign hands), while promoting the development of more profitable sectors, which would ideally be domestically controlled. Statistics Canada emphasizes this point in their latest research paper "By 1999, the United States' share of direct investment in Canada stood at 75%. Growth in this inward investment was concentrated in financial industries and in so-called New Economy sectors (communications, electric and electronic products industries)" (Baldwin and Gellatly, 2007:15).

Finally, Jessop states that "it no longer appears so self-evident that national economic space provides the best starting point for pursuing growth, innovation, or competitiveness. Instead the problem becomes one of managing the national economy's insertion into the global economy in the hope of securing some net benefit from internationalization" (Jessop, 1993:14). As Canada continues to ride the neoliberal wave that began in the 1980s, and with the most recent data on the country's trajectory of M&A activity, it becomes clear that Canada has not been managing its transition and

responses to the large external forces of capitalism as well it could have. It is here that the point of this thesis becomes clear, and the question becomes obvious: are the risks of being hollowed-out greater than the benefits of FDI?

Competition Policy and Process

It has been stated that Canada's competition policy and process is such that it favors the foreign acquisitions of Canadian firms, which would seem to validate this thesis' interpretation of Jessop's SWS. According the Canadian Council of Chief Executives (CCCE):

> Canada has a reasonably sound regime to promote healthy competition, but it must be continuously adapted to the changing realities of the global marketplace. Mergers and joint ventures must be judged on their ability to enable Canadian firms to be more nimble competitors on the global stage, and not by applying an excessively rigid definition of competition within the domestic market (CCCE website, April 16 2008).

The organization goes on to list several important recommendations on their website, to promote Canadian competitiveness: 1) Important areas of the Canadian economy, such as communications and airlines, should be opened to greater degrees of foreign competition; 2) The competition policy regime has the potential to replace countervail as the means to deal with dumping and promote healthy competition across borders; 3) In particular, Canadian competition law and practice must keep abreast of developments in our most important market, the United States, while avoiding the litigious excesses of the American system. In short, Canada's competition policies and processes have been reframed to suit a more innovation/competition driven approach to capital accumulation.

Foreign Investment Review Agency (FIRA)

FIRA was the agency created in the 1973 under the Trudeau Liberals to screen and scrutinize foreign investments within Canada. "FIRA is perhaps the most visible example of a regulatory policy that was primarily and explicitly implemented to alter the environment for FDI in Canada; under FIRA, foreign investors were required to demonstrate that FDI inflows would result in 'significant benefit to Canadians'" (Baldwin et al., 2006:4).

From 1975 to 1985, FIRA established the broad regulatory framework governing the investment activities of foreign multinationals. Foreign capital came under greater scrutiny than in times past, and foreign investors bore an increased administrative and regulatory burden. While FIRA's mandate was wide-reaching, Canada's investment regulatory regime also included a sizable array of sector specific policies that were tailored to the idiosyncrasies of different industries. Many of these centered on industries that are widely regarded as strategically important to the Canadian economy, such as financial services, telecommunications and oil and gas industries. The last of these, the energy sector, is examined herein. Levels of foreign investment in the energy sector have traditionally been high, with foreign-owned firms controlling a relatively large share of industry assets and revenues. "The 1970s and 1980s saw regulatory initiatives put into place that were designed to limit the foreign presence in this sector. The National Energy Program, the most visible of these policies, was implemented in 1980 with multiple objectives, one of which was to encourage the Canadianization of the petroleum industry" (Baldwin, 2006:4).

Investment Canada Act (ICA)

The ICA provides a regulatory framework whereby the Government of Canada can review large-scale foreign investments in Canada which exceed a designated financial threshold. It is the tool by which the government can review, and if deemed necessary, block a takeover or investment proposal by a foreign company.

The threshold for notification and review of direct large-scale foreign investment from WTO countries (currently 151 members) has risen steadily over time, from $172 million in 1997, to the projected level of is currently $295 million in 2008. "The amount is equivalent to the growth in Nominal Gross Domestic Product at market prices as published by Statistics Canada for specified periods, multiplied by the amount determined for the previous year" (ICA website, 2008). For non-WTO countries, it is $5 million. Review of foreign investment at a lower financial threshold is required in financial services, transportation services (including pipelines), uranium and culture. Approval of the acquisition is granted when the Minister is satisfied that the investment is likely to be of "net benefit to Canada".

Table 1: Thresholds for Review under the *Investment Canada Act*

	Specified Politically Sensitive Industries		**Non-politically Sensitive Industry**	
	Direct	Indirect	Direct	Indirect
WTO Investor	$5 million	$50 million	$295 million*	Not reviewable
Non-WTO Investor	$5 million	$50 million	$5 million	$50 million

Source. Nicholls, 52:2007
* Updated from ICA website 2008

The ICA also differentiates between politically sensitive and non-sensitive industries. Aside from selected cultural industries (such as book, film, audio or video music recording, "sheet" music publication, and radio and television), politically

sensitive industries include: uranium businesses, financial services and transportation services (Nicholls, 2007).

As a component of Industry Canada created in 1985, by "[r]ecognizing that increased capital and technology would benefit Canada, the purpose of this Act is to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada" (ICA website, 2008).

In the course of a review, the responsible Minister considers factors such as:

- the impact on the level and nature of economic activity in Canada
- participation by Canadians in the newly acquired business and the sector of which they are a part
- the impact on productivity, efficiency, technological development and innovation
- the impact on domestic competition
- compatibility with industrial, economic and cultural policies
- the impact on Canada's ability to compete globally (Industry Canada news release, December 7th, 2007).

Investments into so-called "cultural industries" are protected under the ICA as well. These include businesses involved in: "publication, distribution or sale of books, magazines, periodicals, newspapers or music in print or machine readable form. Also covered are those involved in the production, distribution, sale or exhibition of film or video products or audio or video music recordings" (ICA, Cultural Sector Investment Review, 2008). Responsibility for review and decisions on investments into these areas was transferred from the Minister of Industry to the Ministers of Heritage in 1997.

In December 2007, the government announced new guidelines on investment in Canada with regards to foreign state-owned enterprises (SOEs), or sovereign wealth

funds. The purpose of this review was driven by the acknowledgement that SOEs function and perform under different sets of criteria, in contrast with traditional free-market principles. In other words, SOEs could be under the "control" of foreign governments, which may have ulterior political motives. These new considerations will be included within the scope of the ICA as part of a new expansion to include a "national security" test for foreign investment, which would bring Canada in line with the majority of other developed nations, which already have a government mandate to deny a foreign investor, on grounds that it would threaten the country's national security.

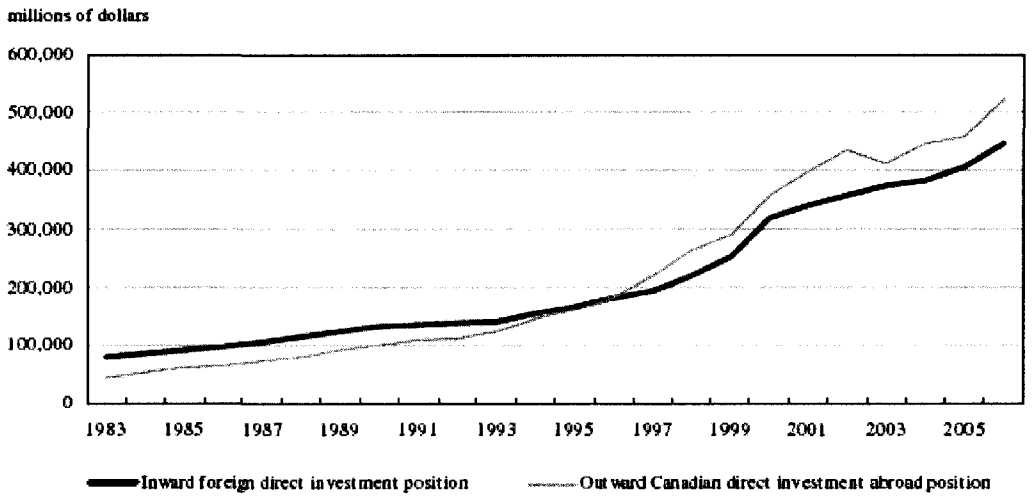
Foreign Investment in Canada

Governments have always had tools at their disposal for the creation, and handling of, domestic and foreign investment in their countries. Historically, Canada's experience has been to promote more stringent rules on foreign investment. For example, "The NEP utilized the federal state to promote indigenous capital over foreign business interests: the state was employed primarily to advance the interests of private capital accumulation" (McBride, 2005:38).

Over time, two potential Canadian strategies emerged: "...one, sometimes partially endorsed by the Liberal Party, was a nationalist-inspired industrial strategy that would actively use the state to stimulate the economy and promote domestically controlled capital accumulation; the other, gradually embraced by the Progressive Conservatives, by contrast came to view the state as a major cause of the crisis and based its cure on free-market solutions" (McBride, 2005:37).

A decade following the inception of the ICA under Brian Mulroney, inward and outward FDI levels in Canada began to takeoff at an extraordinary pace.

Figure 1: Inward vs. Outward FDI Levels

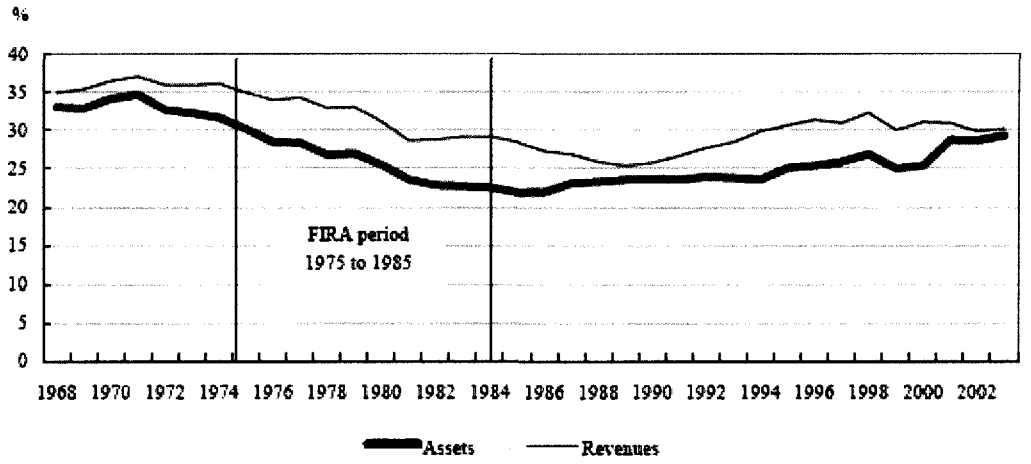


Overall, the stock of Canadian direct investment abroad currently exceeds the stock of foreign direct investment in Canada. "Statistics Canada indicates that Canadian direct investors held foreign assets totalling C$523 billion at the end of 2006, whereas FDI in Canada reached only C$449 billion. Americans are still the lead investors in Canada, and directly held investments of C$274 billion in 2006. Canadian direct investment in the U.S. totalled C$224 billion in 2006, an increase of C$19 billion from 2005" (CPRP, 2007:13).

Foreign Ownership

Statistics Canada takes the long-term study and analysis of foreign ownership trends in Canada:

Figure 2: Foreign Ownership of Non-Financial Assets and Revenues



The graph above indicates the percentage of foreign ownership of assets and revenues for non-financial industries, over the past 40 years. Foreign firms began increasing their share of assets and revenues in the 1990s to levels reminiscent of the 60s and early 70s. Declines in foreign ownership and investment occurred most markedly in the FIRA period from 1975 to 1985.

Historically speaking, according to McBride the "high level of American foreign ownership in Canada has had less to do, then, with a conspiracy on the part of merchant capital than it has had to do with Canada's location next door to the major twentieth-century capitalist power at the very time it was attempting to industrialize and expand its international presence (McBride, 2005:33).

The CPPR determined the level of foreign ownership in Canada across industry sectors:

> Canadian assets under foreign control have been relatively stable at approximately 21 percent since 2000. FDI in manufacturing is about 49 percent of total output. The other main sectors with a relatively high foreign presence are oil and gas, at almost 40 percent, wholesale trade at 37 percent, transportation and warehousing at almost 26 percent, and finance and insurance at about 15 percent (CPRP, 12:2007).

Mergers and Acquisitions

"Most sales and acquisitions of existing direct investment happen in the cross-border mergers and acquisitions (M&A) market. This was especially the case in 2001 when M&A deals accounted for 80 percent of total worldwide FDI flows" (Guillemette and Mintz, 2004:4). Mergers and Acquisitions (M&As) are often the most quoted subcomponent of FDI flows in the media, because they involve the key words such as "takeovers" of "traditionally held Canadian companies" which grab much public attention. Many firms seek to expand quickly through consolidation. "Many of the benefits of mergers that typically arise in deals within a country — economies of scale that reduce unit costs, better management, increases in market power that allow a company to improve its bargaining position with respect to consumers and suppliers, access to specific resources, and often lower tax bills — also apply to crossborder deals" (Aba and Mintz, 2002:1). Canada's experience has been mixed over the medium-term, with the recent short-term losses being the most noticeable.

The connection is claimed to be that Canada's recent M&A experiences can be attributed to, what McBride calls the "paradigm shift", from a KWS, to Jessop's SWS. "According to data from Statistics Canada, M&As accounted for 51 percent of inward FDI into Canada between 2001 and 2006, but accounted for 71 percent of inward FDI in 2005 and 2006. By contrast, Canadian direct investment abroad in recent years has not been driven by M&A activity, instead primarily occurring through other investment flows such as the investment of capital into existing foreign affiliates" (CPRP, 2007:12).

The chart below illustrates Canada's medium-term experience with cross-border M&A transactions, from 1994-2007 (CPRP, 2007:39).

Table 2: Canadian Acquisitions Abroad vs. Foreign Acquisitions in Canada

	Canadian Acquisitions Abroad		Foreign Acquisitions in Canada	
	# of deals	Value ($M CAD)	# of deals	Value ($M CAD)
1994	277	11,693	151	12,186
1995	212	22,226	169	31,352
1996	284	23,361	178	18,423
1997	324	29,289	186	29,851
1998	332	58,125	205	28,662
1999	296	51,103	227	39,802
2000	333	57,447	278	102,807
2001	253	35,009	175	52,476
2002	263	30,039	135	13,889
2003	252	49,982	100	16,950
2004	279	55,946	119	24,328
2005	413	39,058	147	63,880
2006	533	89,744	188	114,091
2007-YTD	278	64,348	129	155,014
Total	**4,329**	**617,370**	**2,387**	**703,711**

Source: *Financial Post Crosbie: Mergers & Acquisitions in Canada database.*
*The data are based on announcements. They include minority purchases of stock where it represents an equity interest of over 10 percent (excluding announcements that are under $1 million). They are adjusted to reflect bidding up of prices, competing bids, and withdrawn or failed deals.
**Until July 30, 2007.

In the aggregate over the 13-year analysis, Canada purchased 4,329 companies abroad, totaling $617,370,000 million dollars. This is compared with 2,387 Canadian companies purchased by foreign firms, worth $703,711,000 million dollars for the same length of time. These statistics coincide with the earlier graph that shows the levels of FDI in and out of Canada for the over the same period. Bearing in mind that M&A activity only constitutes a part of overall FDI investments in a country. According to data from Statistics Canada, M&As accounted for 51 percent of inward FDI into Canada between 2001 and 2006, but accounted for 71 percent of inward FDI in 2005 and 2006. "By contrast, Canadian direct investment abroad in recent years has not been driven by M&A activity, instead primarily occurring through other investment flows such as the investment of capital into existing foreign affiliates" (CPRP, 2007:12).

Finally, the CPRP recognizes the qualitative differences when interpreting M&A statistics, citing that, "the number of foreign firms acquired by Canadian firms between 2001 and 2006 significantly exceeded the number of Canadian firms acquired by foreigners. However, the total value of Canadian acquisitions over this period was only slightly higher than the total value of foreign acquisitions of Canadian firms, despite significant foreign acquisitions of Canadian companies in 2005 and 2006" (CPRP, 2007:14).

In summation, Canada's regulatory regimes have made many sectors of the countries economy more open to takeovers from larger foreign firms, while there are still many industries that are protected by Canadian legislation. Overall, it must be recognized that accumulation regimes and regulatory frameworks are only one of several possible reasons for the decline and resurgence of foreign ownership levels within Canada over time, particularly within the past 40 years. However, it is through these regulatory frameworks that countries govern, or control their transition into a global economy, and how they handle external shocks caused by global capital flows.

This chapter has attempted to portray Jessop's SWS conceptualization as an appropriate example of how Canada is engaging with a more globalized economy, and internationalized forms of capital. Canada's choice of regulation and accumulation regimes has made Canadian firms more susceptible to foreign acquisitions.

The next two chapters will expand upon and illustrate many of the quantitative and qualitative aspects of the current debate in Canada, to differentiate and determine if this increase in M&A activity is indeed leading to a hollowing-out of Canada's economy.

Chapter 3: Quantitative Analysis and Assumptions

As was mentioned in the previous chapter, there are numerous external geo-economic and geo-political factors which can contribute to the rise and fall of foreign ownership and investment in Canada, that go beyond the country's investment regulatory regime. As Baldwin, Gellatly and Sabourin point out, "Relative wage costs, the costs of raising investment capital, the dynamism of host economies, tariff policies, exchange rate differentials, hedging considerations—each of these can be expected to influence how multinational firms allocate their investment expenditures" (2006:7). Canada's investment regulatory regime is only one, however quite considerable, part of the explanation for the recent surge in foreign takeovers of Canadian firms.

Bearing this in mind, this chapter will analyze the quantitatively based arguments surrounding the hollowing-out debate, which are used primarily to disprove the existence of the oft-quoted phenomenon. It will examine the particular agents emphasizing this line of thought, as well as the research and facts they rely upon. This chapter will analyze and express arguments which not only attempt to refute the hollowing-out phenomenon, but which also highlight the benefits of foreign ownership and foreign economic activity. The evidence suggests that hollowing-out is not occurring; however, this tends to ignore other realities and consequences involved with foreign mergers and acquisitions in Canada, which will be expanded upon in the next chapter.

Global Leaders

Ontario's Institute for Competitiveness and Prosperity (ICP) examined Canadian-owned globally competitive companies (defined as Canadian owned and headquartered

firms that rank in the top five of their respective industry, as measured by the worldwide revenue earned in their industry, and having more than C$1 billion in annual sales in that industry). Canada had only 14 such global leading firms in 1985, but this number had grown to 46 by 2003.

The Institute also noted that the number of global-leading Canadian firms has declined since 2003, falling to 39 such firms at the end of 2006. This decline has coincided with several recent high-profile foreign takeovers. There has nevertheless been a significant net increase since 1985 in the number of Canadian firms that are global leaders.

Additionally, when this analysis is expanded to include firms with revenues over $100 million, the results further indicate a positive trend in the number of global firms found in Canada. Specifically, the ICP found that when identifying Canada's global leaders, there has been significant growth, from 33 such firms in 1985, to 86 in 2003, which decreased slightly to 71 as of May 2007. These firms were selected for, "having revenues over $100 million, being one of five largest by revenue globally in a specific market segment, as well as a public or private Canadian controlled company on Report on Business Top 1000 or Financial Post 500 lists" (ICP, May 2007).

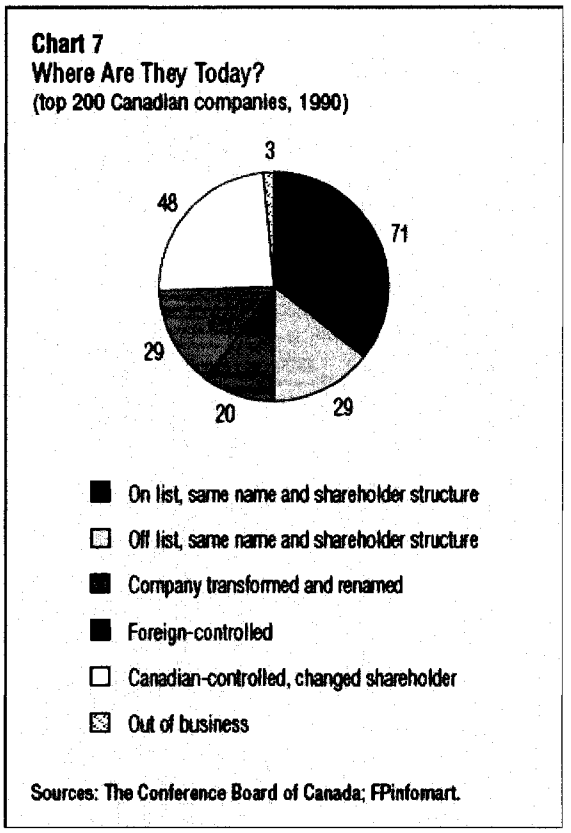
What can be inferred from these studies is that there has been significant change in merger and acquisition (M&A) activity over the past two decades. Global leaders in Canada in 1985 may not necessarily be global leaders in 2007. Of the 33 global firms identified in 1985, 17 no longer exist in 2007 (16 departures plus a merger of two into one). With respect to the drop in 15 global firms on the list from 2003 to 2007, 12 can be

attributed to foreign takeovers, two to Canadian mergers, and one that failed to meet the criteria by no longer being in the top 5 globally in their industry.

However, this should not detract from the obvious fact there has been a net growth by more than doubling the number of category-leading Canadian firms since 1985, suggesting that Canada has benefited competitively from globalization, building leading-edge globally-competitive companies, although this growth has been far from smooth. As a result of two decades of corporate consolidations and foreign acquisitions, several of Canada's global-leading companies operating in 1985 were no longer global leaders in 2005. In other words, while Canada has created a sizeable number of new global leaders in recent decades, it has also lost several leading companies. This has been attributed the recent "hollowing-out" craze that has occurred in the past few years.

An interesting level of analysis for this debate is the "Where Are They Now?" question. This involves taking a sample group of firms from a previous point in time, and studying what became of them over time. The Conference Board of Canada (CBofC) recently published its report on the hollowing-out phenomenon, and involved a brief sampling of 200 of Canada's largest firms in 1999, and looked at the condition of the same firms in 2007.

Figure 3: Where Are They Today?



According to the Conference Board, "Change was concentrated in four sectors, where there were significant alterations in the number of companies still in the "top": finance and insurance (reduced by 36); professional, scientific, and technical services (increased by 14); mining, oil, and gas (increased by 11); and utilities (increased by 11)" (Grant and Bloom, 2008:33).

Of the top 200 firms that were analyzed in 1990, about one-third (71) remained on the list, with the same name and shareholder structure. Roughly 30 firms fell off the list due to poor economic performances, but still exist to this day. In the end, only 29 firms (15%) were subject to foreign takeovers, while 139 of the firms studied (70%) still on the list, remained in Canadian hands. Given the potentially volatile nature of M&A activity

in a global economy, these figures do not represent a serious concern to the economic base in the form of multinational enterprises (MNEs).

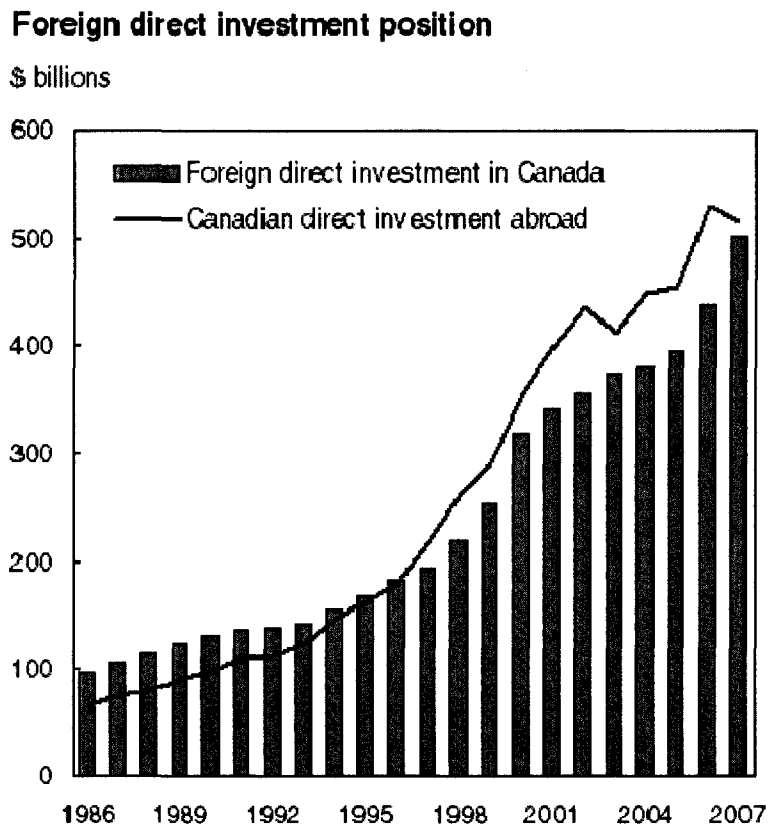
FDI Levels

The significance of FDI to a country's development cannot be understated. FDI flows "capture the period-specific sum of new inward funds – inflows of long- and short-run debt and equity into Canadian companies from non-residents – along with the domestic profits generated by foreign investments in Canada that are not transferred or repatriated to foreign countries" (Baldwin and Gellatly, 2007:14).

A direct investment in another country is defined as having at least 10 percent ownership of the voting equity in an enterprise, resulting in a lasting interest: "This lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise, as well as a significant degree of influence by the investor on the management of the enterprise" (*The Daily,* 2008:6).

The chart below indicates Canada's FDI position from 1986 to 2007. According to Statistics Canada, the rise in FDI in Canada was driven mainly by the continued wave of takeovers of Canadian firms by foreign investors. They go on to say that, "On the other side of the ledger, Canadian direct investors' holdings amounted to $514.5 billion, a decrease of $15.4 billion compared with 2006. This was only the second decline in this series, with the previous one occurring in 2003. On both occasions, the appreciation of the Canadian dollar played a significant role" (*The Daily,* 2008:6).

Figure 4: Foreign Direct Investment Position

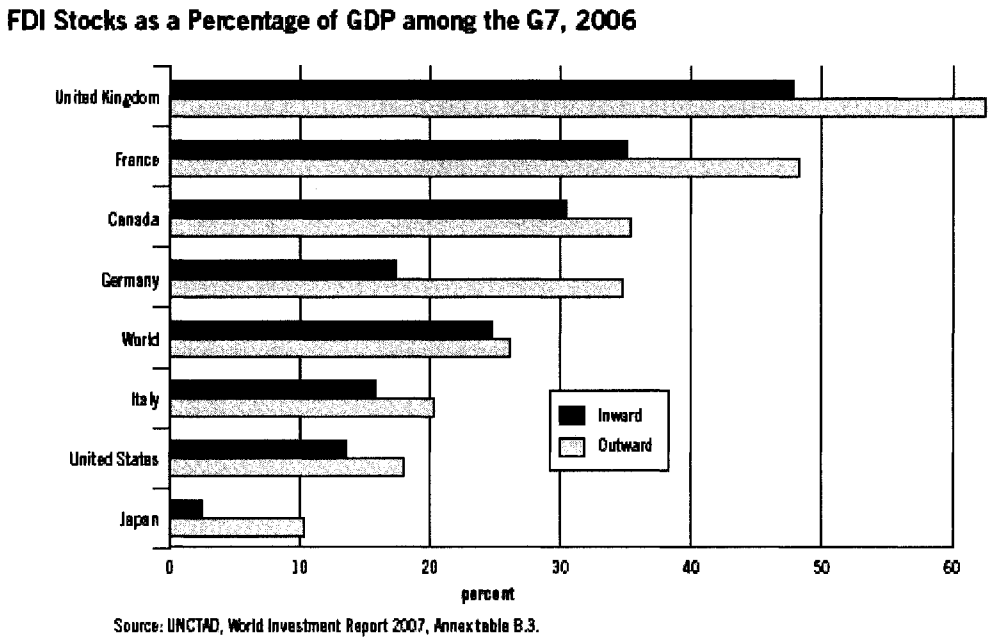


A recently released report indicated that Canada's "net direct investment position, the difference between Canadian direct investment abroad and foreign direct investment in Canada, narrowed to $13.7 billion at the end of 2007, down from $92.2 billion a year earlier" (*The Daily*, May 6th 2008). This drop is to be expected when seen in the context of the hollowing-out debate. However, it is also seen from this perspective as an anomaly, and not indicating a trend in FDI levels in Canada, which has been quite unarguably upwards.

When considering the significance of FDI, it is important to consider the international context. The graph below ranks FDI stocks as a percentage of GDP for the G7 nations in 2006. Canada's stock of FDI is high, at over 30% when compared with

other developed nations, such as Japan, which is around 2%. "Canada ranked as one of the top 10 global destinations in terms of the total value of inward foreign investment flows between 1996 and 2005. Despite being the smallest economy in the G7, Canada nonetheless ranked fifth in terms of inward FDI flows over this period, ahead of larger economies such as Japan" (CPRP, 2007:11).

Figure 5: FDI Stocks as a Percentage of GFP among the G7, 2006

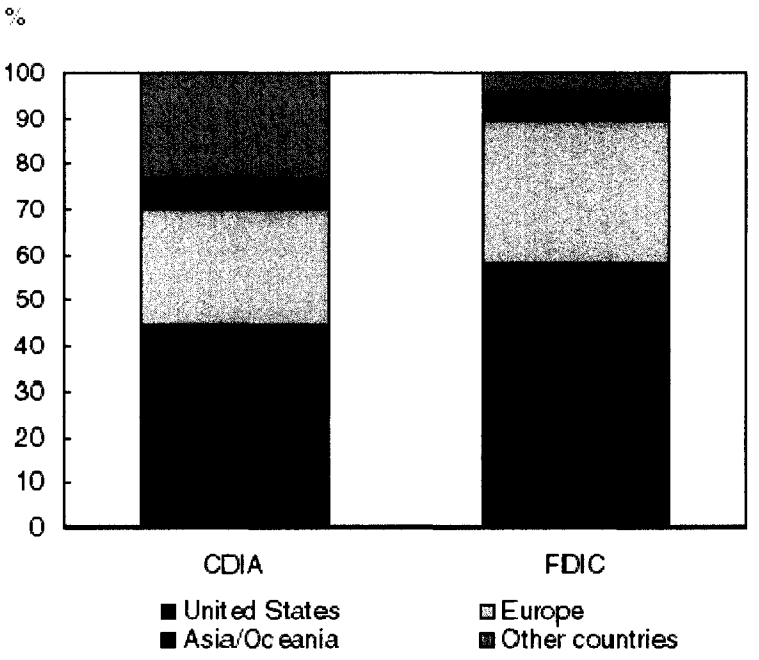


FDI flows have been a significant component of economic growth and effectiveness within Canada. As the C.D. Howe Institute reports, with the constant threat of takeovers, "Less efficient managers are pressured to perform better or be replaced by stronger leadership, thereby increasing shareholder wealth" (Mintz and Tarasov, 2007:5). Additionally, continuous studies have shown that foreign firms often perform more efficiently than domestic firms in terms of productivity. They also might have "better access to international technological and research and development markets, creating

better opportunities for innovation and knowledge acquisition from outside Canada" (Mintz and Tarasov, 2007:5).

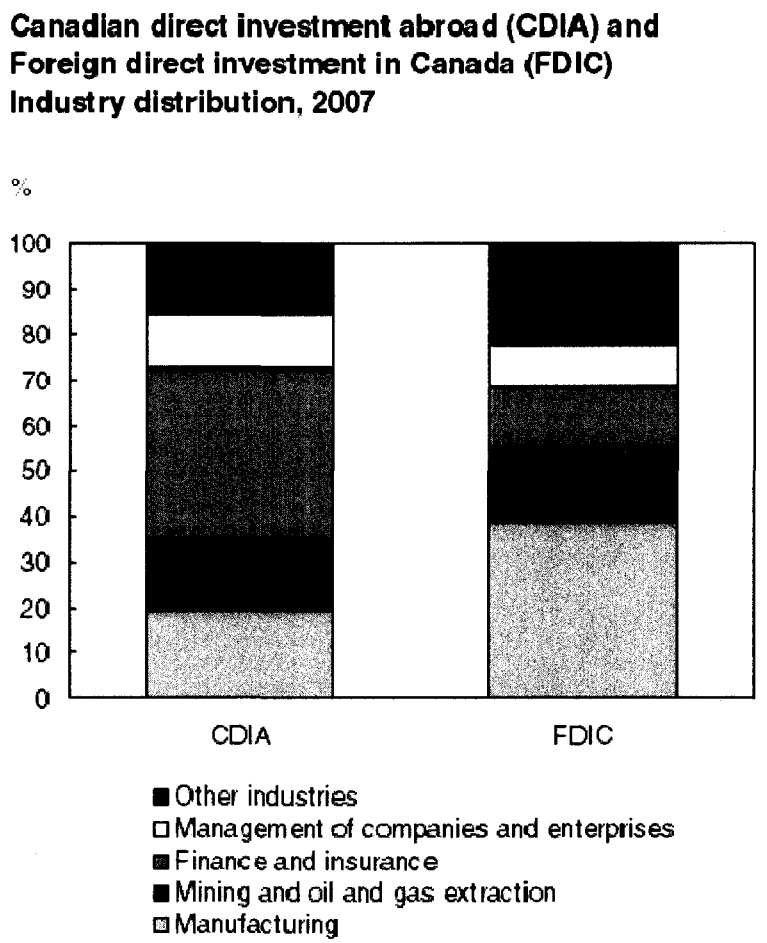
The following chart looks at the distribution for foreign direct investment in Canada, and Canadian direct investment abroad.

Canadian direct investment abroad (CDIA) and Foreign direct investment in Canada (FDIC) Geographical distribution, 2007



The following chart indicates the major industries for which foreigners invested in Canada, and in which Canadians invested abroad.

Figure 6: CDIA and FDIC Industry Distribution, 2007



Foreign corporations directed the majority of their investments into Canada's manufacturing, and oil and gas sectors (55%). Financial, insurance and management industries combined amounted to 22.7% of FDIC. On the other hand, CDIA was more heavily invested in management, financial and insurance industries (49.4%), while manufacturing, mining, oil and gas extraction received roughly 35% of CDIA.

Canada's Merger and Acquisitions (M&As) Experience

The chart below looks at the number of deals in Canada worth over $500 million, and involved purchasing a stake of 50% or greater, indicating a complete change in ownership.

Table 3: Mergers and Acquisitions over $500 Million Greater than 50 Per Cent Stake, 1994-October 2007

Table 13
Mergers and Acquisitions Over $500 Million Greater Than 50 Per Cent Stake, 1994–October 2007

	M&A deals			Value (constant 2007 $ billions)	
	1994 to 2004	2005 to October 2007*	Total	Average per deal	Total
Foreign acquires Canadian	92	62	154	2.9	441
Canadian acquires foreign	133	53	186	2.1	394
Canadian acquires Canadian	128	72	200	1.9	385
Total	353	187	540		1,220

*Includes 16 pending transactions for 2007 (four Canadian acquires Canadian, six Canadian acquires foreign, and six foreign acquires Canadian). Noteworthy is the inclusion of acquisitions of Bell Canada, Alcan Aluminum, Husky Injection Molding, and Stelco. This sample is the basis for other analysis and is henceforth referred to as the "540 Sample."
Sources: The Conference Board of Canada; Financial Post Crosbie: Mergers & Acquisitions in Canada; Statistics Canada.

The data from this chart is quite telling. During the years 1994-2004, the number of Canadian firms acquired by other Canadian firms (200) was greater than the number of Canadian firms acquired by foreign firms (154). However, the average value per acquisition was higher for foreign firms over the same period, indicating that the deals were for the larger, more valuable Canadian firms. This point will be expanded upon further in the chapter on qualitative analysis. The chart makes the distinct point of looking at the number of deals during 2005-2007 because it involved the most recent upsurge in foreign ownership and takeovers, of some of Canada's best known firms (e.g. Inco, Falconbridge, Alcan, etc.), and therefore some of the greatest concerns over hollowing-out.

This also leads to another major criticism against hollowing-out, by illustrating that there are a larger number of domestic firms being taken over by larger Canadian firms, rather than foreign companies. In effect, if there were to be any "hollowing-out", it would be done through domestic M&As, not through foreign competition, as the chart above illustrates. This is possible, since firms are likely to consolidate in their respective industries; there would be a certain amount of redundancy in operations when one firm has taken over another. This would result in a loss of jobs at certain levels of management (managers, legal, and human resources) in the acquired firm, since these functions would already exist in the acquirer.

Number of HQ's and Employment

One of the main concerns from the hollowing-out supporters is that the change in control of companies, from domestic to foreign, is leading to a decrease in Canadian head offices and head office employment. Statistics Canada has tested this hypothesis several times, and found it wanting. Experience has shown that the foreign acquisition of a domestic firm can have expansive or contracting qualities; ie. The foreign firm can either close a domestic headquarter, or expand or create a new one, to manage its new operations. Management functions (and subsequent professional services) could be consolidated into the acquiring firm's home base, or on the other hand, expanded to oversee the new functions.

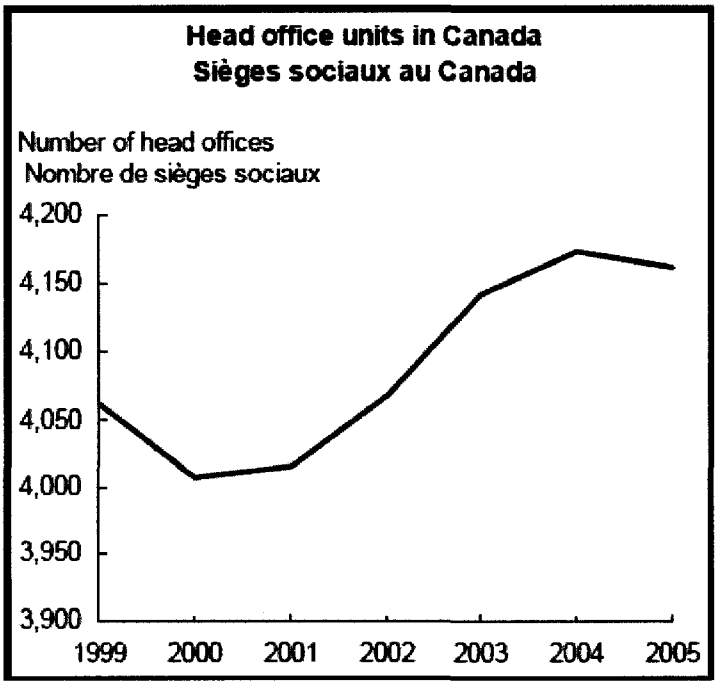
Statistics Canada has tested the degree to which a change in control has effect over this, by asking what happens to head offices when control shifts from domestic to foreign (and vice-versa) and observing whether this is associated with an increase in the

rate at which head offices are closed and whether employment grew or declined in head offices that remained (Brown and Beckstead, 2006:3.6).

They found that, "Of the 164 head offices that switched from domestic to foreign control between 1999 and 2005, 21% (34) were closed, resulting in a loss of 1,709 jobs. It should also be noted that 38 head offices were added when firms switched from domestic to foreign control, resulting in 2,346 additional jobs. As a result of a change in control from domestic to foreign, more head offices were created than lost and they employed more workers than those head offices that were lost" (Brown and Beckstead, 2006:3.6).

The graph below shows the number of head offices in Canada (both foreign and domestic) from 1999 to 2005. Head office numbers continue to grow in Canada, albeit with slight declines from 1999-2000, and then 2004-2005. Over the 1999-2005 period, head office counts grew by 4.2% (Brown and Beckstead, 2006:3.3).

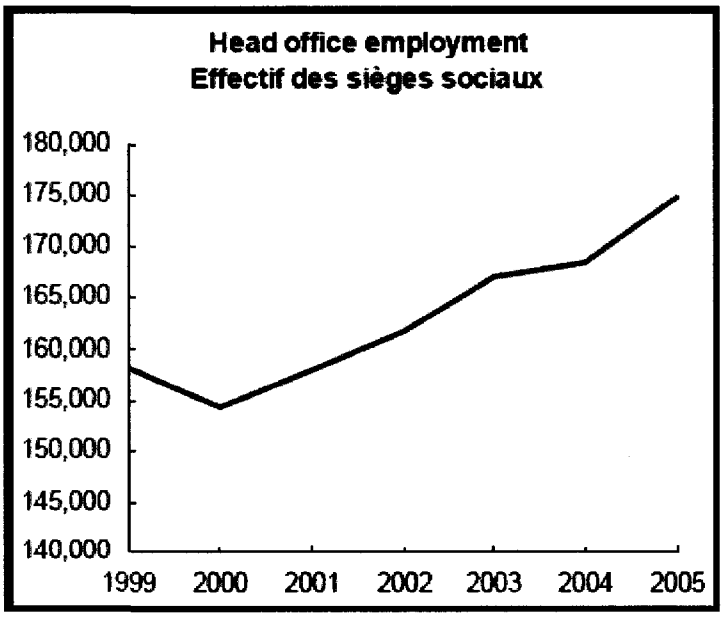
Figure 7: Head Office Units in Canada



"Finally, Beckstead and Brown (2006) explicitly examine the head-office characteristics of foreign multinationals over the period 1999 to 2005. They find that much of the dynamism in Canada's head-office sector actually comes from foreign-controlled firms. The head offices of foreign-controlled firms accounted for six out of ten new head-office jobs created during this period. The effect of foreign takeovers has not been to reduce the number of head offices in Canada nor head-office employment. As a result of foreign takeovers, more new head offices were created than lost, and aggregate employment in head offices was just as high after the takeovers had occurred as before" (Baldwin and Gellatly, 2007:35).

The graph below illustrates the level of head office employment in Canada (again, in foreign and domestic firms). Like head office units, there was a decrease from 1999-2000, but there was no decrease from 2004-2005.

Figure 8: Head Office Employment in Canada

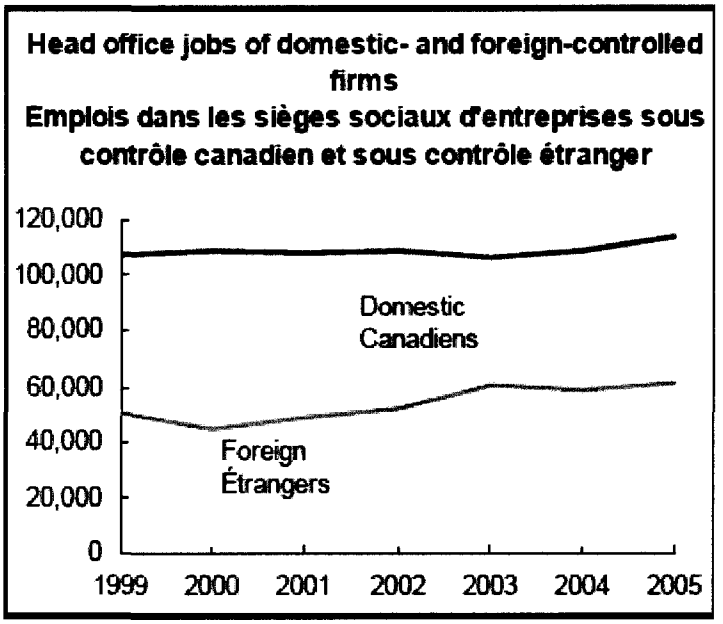


Given that head office employment has been increasing in the aggregate, particularly from the arrival of and acquisitions by foreign controlled firms, it would be premature to surmise that Canada's economy is being hollowed-out in this respect.

The loss of Canada's corporate headquarters and headquarter jobs is touted as being one of the fundamental arguments supporting the hollowing-out phenomenon. With the large increase in foreign takeovers, Canada has been called an "incubator" for firms to grow from small to medium-sized firms (on the world stage), and are then ripe for acquisition before being able to truly go global. Hollowing-out partisans cite that foreign takeovers result in the loss of head-office jobs, functions, and standing in Canada. However, the empirical evidence, compiled mainly by Statistics Canada suggests otherwise. Just the opposite: the number of headquarters and head-office jobs has been steadily increasing in Canada.

While a closer examination of the above graphs indicate that domestic head office jobs are in no real threat of being displaced by foreign firms, the graph below illustrates the levels of head office jobs of domestic and foreign controlled firms. The researchers concluded that "nearly 66% of the gain in head office jobs since 1999 was from foreign controlled firms. The head office employment of domestically-controlled firms increased by 6%, while the head office employment of foreign-controlled firms increased by 21%" (Brown and Beckstead, 2006:3.4). A gain in a foreign firm's level of employment does not equate to a loss within a domestic firm.

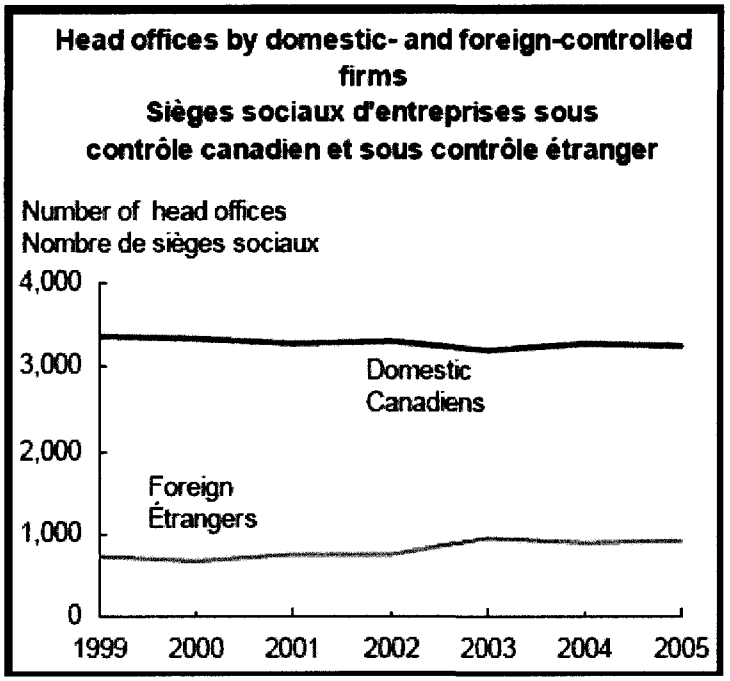
Figure 9: Head Office Jobs of Domestic-and Foreign-Controlled Firms



Between 1999 and 2005, the net gain in foreign head offices was 191. Most of these gains resulted from births of new foreign head offices exceeding exits. Over the period, 281 foreign head offices exited, while 419 entered. This net gain was 138 head offices or about 70% of the total gain in head offices. The remaining gains in head offices (53) resulted from more head offices switching from domestic to foreign controlled (130) than from foreign- to domestically-controlled (77) (Brown and Beckstead, 2006:3.5).

The graph below charts the level of domestic and foreign firm head offices in Canada. Between 1999 and 2005, both foreign and domestic head office numbers have been relatively stable.

Figure 10: Head Offices by Domestic- and Foreign-Controlled Firms



Foreign-controlled head offices increased their employment by about 11,000 workers between 1999 and 2005. These gains can arise from three sources: (1) employment in entering foreign head offices exceeded employment in exiting head offices (births-deaths); (2) net gains in employment for foreign head offices that continued over the period (continuers); and (3) from the switching of head offices from domestic to foreign control (control change) (Brown and Beckstead, 2006:3.5).

As Baldwin and Gellatly illustrate explain:

> Foreign-controlled firms are more likely to have a Canadian head office than are domestic firms. The head offices of foreign-controlled firms accounted for six out of ten new head-office jobs created from 1999 to 2005. The effect of foreign takeovers has not been to reduce the number of head offices in Canada or head-office employment. As a result of foreign takeovers, more new head offices were created than lost in the post-1999 period, and employment in head offices was as high after the takeovers as it was before (2007:8).

By this line of reasoning, Canada's economy is not being hollowed-out. Just the opposite, research would indicate that Canada is continuing to be an attractive place for companies to set up a head office.

Head-Office Functions

The significance of the management function has been at the centre of the debate regarding the importance of head offices to Canada's economy. Hollowing-out is perceived to be associated with the decline in the management function, as well as ancillary services, such as legal and accounting services. In particular, it is related to the movement of head office employment, and especially senior management functions, out of Canada.

A head office has been classified by the Business Register of Statistics Canada as a type of production unit, and is only counted as such, if it is physically located away from its production facilities. By this measure, only large, multi-enterprise firms are counted. Within the Business Register, "production units are defined as economic entities that combine labour and capital, together with other inputs, to produce a specific set of goods and/or services" (Baldwin, Beckstead and Brown, 2003:3).

Index Composition

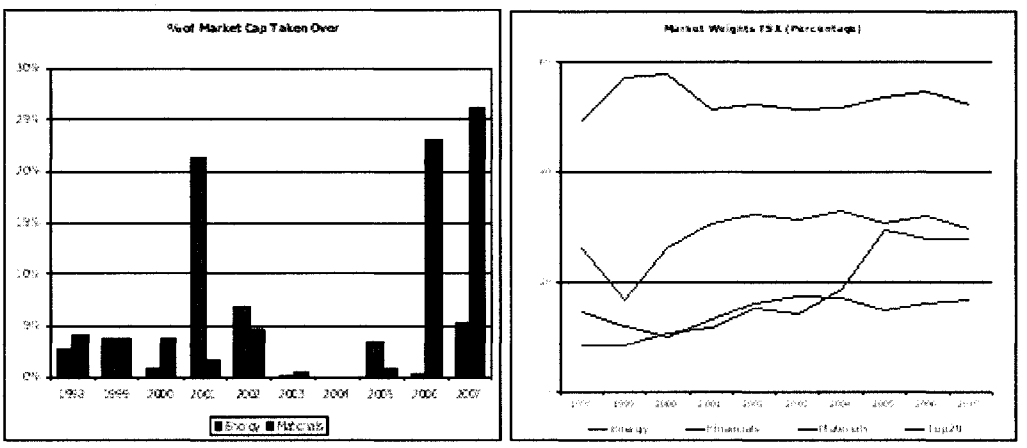
Another issue that has become worrisome in Canada due to the recent rise of foreign acquisitions is the impact on the investment choices available to fund managers and retail investors, when the TSX loses large cap listings. Small and mid-size stocks tend to exhibit greater stock market volatility than large cap stocks.

Not true, according to Peter Lindley, who is head of Investment Management Group, with State Street Global Advisors Canada. Hollowing-out, and foreign investment in certain sectors in Canada over the past few years, particularly in the energy sectors as demand for those commodities increases, is not something to be concerned about:

> In fact, the index composition has remained remarkably stable over the years.... That is not to say that there are not challenges in the index composition, far from it, but we believe the causes of these challenges are not created by corporate takeovers. In fact, we believe the largest problem in the composition of the Canadian stock market index is caused by federal protectionism of the financial services industry. This means there is an over-reliance on the financial services sector, which encompasses a significant portion of the top 20 sized companies (less than 10% of the number of companies in the S&P/TSX Index), and accounts for 50% of the index weight (Lindley, May 30th 2008).

As the charts below indicate, foreign ownership has not had a seriously detrimental effect on the composition of the energy and mineral sectors, which have experienced the highest levels of M&A activity recently.

Figure 11: Index Composition 1998-2007



Source: SSgA, Bloomberg, February 2008

Innovation and Profitability

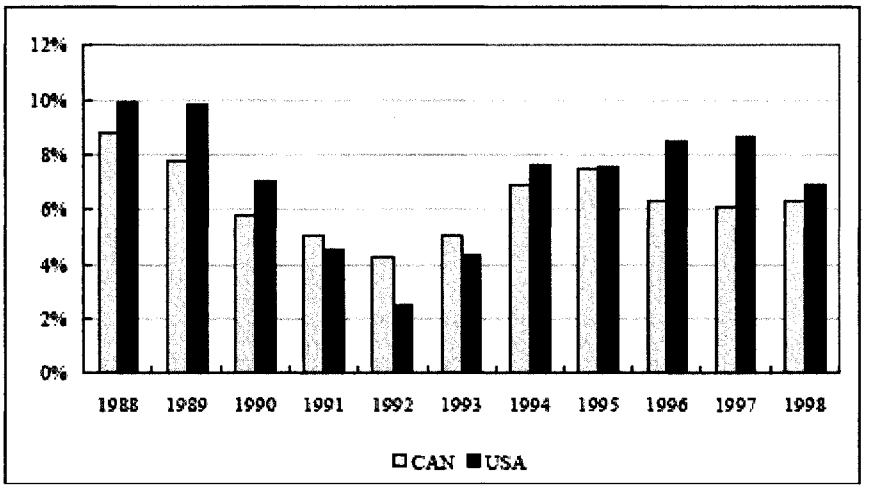
Mainstream economic literature has long emphasized the benefits of multinational enterprises (MNEs) over domestically-controlled firms, with regards to productivity, research and development (R&D), efficiency, and profitability:

> It is a stylised fact of the multinational enterprise literature that, on average, foreign owned companies outperform domestic firms. A substantial body of work has shown that the affiliates of multinationals typically enjoy higher productivity, pay higher wages, and usually enjoy greater profitability than their indigenous counterparts. (Warren, 2005:7)

A paper by Paul Warren with Statistics Canada analyzed over 2,000 similar Canadian and US controlled firms during the periods of 1990-1998.

The graph below illustrates the comparative profitability, as measured by calculating the average return on capital employed for Canadian and American firms over this period.

Figure 12: Annual Return on Capital Employed, Large Non-Financial Enterprises



In this Statistics Canada paper, 'profitability' is redefined as the "return on capital employed":

> This ratio measures how well management has employed the assets under its control, by calculating the percentage return on total capital provided by the owners and lenders (i.e., the creditors). The earnings figure is before taking into account after-tax interest expense (payments to lenders) and dividends (payments

> to owners). The ratio indicates how many cents are returned to every dollar of capital invested. (Warren, 2008:12)

The graph illustrates that during the years in question, except for 1991-1993, US controlled firms created larger returns on capital employed. Domestic firms were, for the most part, marginally less profitable than their US-owned counterparts. So not only is hollowing-out not happening, but the foreign firms are actually more productive and profitable, on average, than their domestic counterparts.

Conclusion

Taken together, the above facts, statistics, and arguments create a compelling case for the disproval of the hollowing-out phenomenon. Bearing in mind that this claims this phenomenon has been taken place go back into Canada's history over more than 40 years ago, and has been reoccurring ever since, it is more plausible that "hollowing-out" is actually more of a "churning effect", which involves the constant creation, and takeover, of new and old companies. However:

> The overall impact of any negative corporate takeover effects resulting from foreign takeovers is mitigated by two considerations. First, foreign takeovers are only one component of M&A activity in Canada. Second, M&A activity, including both Canadian and foreign takeovers, does not affect the vast majority of head offices. Most companies are not going through a major change process, and for those that are, M&A is only one of several options (including restructuring and foreign direct investment) they use to gain control over corporate entities or to transform themselves (Grant and Bloom, 2008:48)

Lamentations will always exist when a notable Canadian icon is lost in the global game of corporate control, many of which, this thesis will now explore in the following chapter.

Chapter 4: Qualitative Analysis and Assumptions

This chapter will focus on the qualitative arguments of the hollowing-out debate, which tend to be very critical of the idea of increased foreign ownership and control of Canada's domestic industry, and other sensitive sectors. Concerns of this hollowing-out have been deemed to be largely non-economic in analysis, which has resulted in a gap of understanding from both debating sides of this issue, in which political economy as a discipline can help to bridge.

The argument being made here is that quantitative analysis alone of the hollowing-out debate is not sufficient to explain the numerous factors involved, and cannot appropriately account for additional concerns. This chapter will delve deeper into many of the qualitative arguments accentuated by hollowing-out supporters, by illustrating those concerns in a more contextual, qualified manner, while also relying on data and figures for explanation. Therefore it is essential to recognize that the facts behind the numbers matter when studying mergers and acquisitions in Canada.

For example, the size of the acquisitions is one of the major concerns of the hollowing-out thesis; foreign firms are acquiring Canadian companies that are on the threshold of becoming global actors. Canada's much smaller acquisitions abroad suggest that Canada is an "incubator" for global companies, which are acquired as soon as they are about to become international players.

It is important to bear in mind the question of "who" is supportive of the hollowing-out phenomenon: New Democratic Party (NDP) and other politically left-wing groups, nationalist writers and activists, and many corporate executive officers (CEOs), which often makes for strange bed-fellows, are amongst the most vocal members in this camp.

Kenneth Smith, a founding partner of SECOR Consulting in Toronto writes, "Unfortunately, the "hollowing out" of the Canadian economy may become our new reality. Canada is investing internationally, but foreign companies are buying ours at a faster and accelerating rate. Worse, control of the largest Canadian companies is being taken abroad, and soon to follow will be the decision making, the headquarters, the highest paying jobs and the supporting professional services" (March 30th 2007, Financial Post).

Most recently, Competition Policy Review Panel (CPRP) has published its final report to the Canadian government on the topic of foreign ownership and investment, competition policy, Canada's investment regulatory regime, as well as the hollowing-out debate. Within the pages of this document, which the government has also expressed a great deal of interest in its findings, the panel has made many recommendations it believes to be essential to the overall improvement of the standard of living of Canadians. The findings of this report will make a substantial contribution to my research, as well as help to illustrate many of the qualitative aspects of the debate.

The arguments are deemed qualitative, because of their inherently anecdotal, experiential and contextual nature. This however, does not reduce their validity. Another difference between the two sides of this debate is the time period chosen. While the quantitative side (StatsCanada) takes the long-term view of foreign direct investment (FDI) and merger and acquisitions (M&As) stretching back up to 40 years ago, the qualitative arguments rest upon more recent data: specifically, the loss of some of Canada's biggest firms in the last few years.

Additionally, global rankings are of considerable importance. A recently released study by PriceWaterhouseCoopers indicated that the number of Canadian companies among the world's 40 largest public mining companies fell from twelve in 2003 to six in 2006 (PWC, 2007). These top 40 mining companies represent over 80% of the global industry by market capitalization.

"Hollowing-out" in this context can be seen as the negative effects which occur during and after a takeover of a Canadian firm. This includes perceived changes in governance, head office functions and responsibilities, services acquisition, line management, operations, employment, capital spending, community involvement, and other types of corporate activity.

There is further lamentation that the loss of our largest companies is weakening our role in global capital markets. For example, London is almost catching up with Canada as a mining finance centre, raising $10.8 billion compared with $12.5 billion in Canada last year. While this doesn't look bad, Canada has over 1,200 mining companies listed on the Toronto Stock Exchange (TSX) and the TSX Venture Exchange, compared with only over 220 on the London Stock Exchange and the Alternative Investment Market (AIM). This has resulted in a huge imbalance in the financing available to Toronto and London based mining companies.

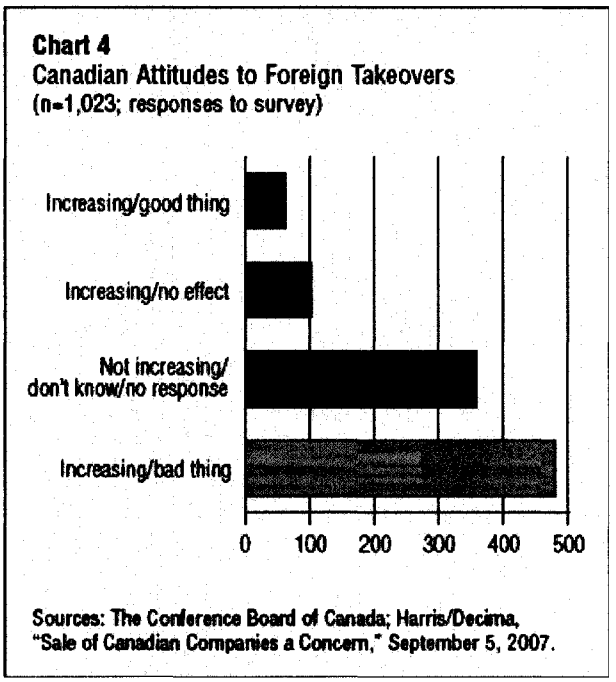
These are but some of the concerns that Canadians have expressed in the past few years, as Canada continues to open itself up to foreign investment and ownership; which begs the question, is hollowing-out really just about foreign direct investment (FDI)? The answer is less than clear, as the rest of this chapter will illustrate.

Public Perceptions

The Canadian public has perceived the accelerated rate of corporate takeovers of domestic firms, particularly large corporate icons, as overwhelmingly negative, or at the very least, they remain skeptical that benefits of these takeovers are being experience Canadian society at large. Foreign takeovers of Canadian 'household" economic names, such as Falconbridge and Inco, or retailers like the Hudson's Bay Company, had long histories in Canada, and have been anchors of communities across the country. The concern over these takeovers in the public is understandable.

A survey done in 2007 by Harris/Decima asked Canadians about the level of foreign investment in Canada, and their opinion on the matter. The results of the poll are quite striking:

Figure 13: Canadian Attitudes to Foreign Takeovers



Overall, "less than half of the respondents thought that foreign investment was increasing and was a bad thing. This cannot be interpreted as a ringing endorsement of inward FDI, but it reveals that many more Canadians appreciate the value of foreign capital investment in Canada when it does not carry with it the strings of control that support M&As" (Grant and Bloom, 2008:26). Nearly half (47%) of the respondents felt that foreign takeovers were increasing, and were a negative experience for the economy, while 35% of those polled said foreign takeovers were not increasing, or they were not sure.

The Harris/Decima survey also revealed that Canadian's are highly aware of foreign investment issues, particularly in the resource sector, which has seen the most M&A activity in recent years. Additionally, in another survey, respondents were concerned about the level of investment of Chinese state-owned firms: "More than two-thirds of respondents would like new rules to further restrict foreign government interests from buying a Canadian mining company (69 per cent), oil and gas company (73 per cent), or forestry company (74 per cent)… A poll by Ipsos-Reid found that 45 per cent of Canadians were concerned about the level of Chinese investment in Canada" (Harris/Decima, 2007).

Additionally, several reasons most often cited by the public for the hollowing-out of corporate Canada, or changes to the corporate landscape include:

- Technology is rendering national head offices unnecessary;
- Domestic companies have limited access to competitively priced, Canadian capital;
- Consolidation through mergers and acquisitions in the United States is nearing its limit. American companies are looking for new opportunities and Canada is a logical focal point;
- Canadian companies are known to be well managed which enhances their value to investors;

The value of the Canadian dollar has declined in relation to the US dollar [although this line of reasoning is less prevalent today, where the Canadian and US currencies are on relatively on par] (Azer, 2008:8).

Global Context

It is important to situate Canada's experience in a global context. Recently, many developed countries have bemoaned the hollowing-out of their own economies, begging the question to be asked: if everyone is being "hollowed-out" by everyone else, who is in fact losing out? The answer to this question is a matter of degree: "What's happening in Canada is reflective of the global rise in M&A transactions seen to date in 2007. According to Dealogic, the value of deals in 2007 surpassed USD 2.1-trillion as of April 30 -- 63% higher than the same period in 2006" (Blake et al., 2007). Of course, the real issue is the facts behind those numbers: "KPMG notes the real story is in the dollar value of the deals. Outbound deal values from Canada were about USD 51-billion over the last two years, which KPMG considers a sign that Canadian companies are maturing to the point where they are "world-class players"" (Blake et al., 2007).

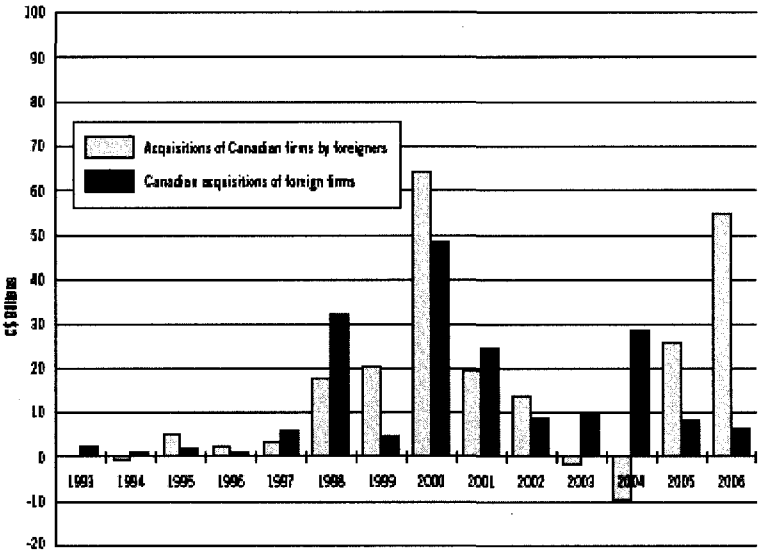
Mel Hurtig is an ardent Canadian nationalist who has been quite vocal on the hollowing-out debate: "Well over half of all manufacturing in Canada is foreign-owned. In comparison, among the other 29 OECD countries, all of the following are below 4%: Japan, Germany, the U.S., Poland, Norway, Italy, the Netherlands, Finland, the United Kingdom, France, Sweden, and the Czech Republic. No other major industrialized country has a level of foreign ownership of its manufacturing even a third as high as Canada's" (Hurtig, 2006:3). In comparison, in the United States, there's not one major

industry that is majority-foreign-owned or controlled. "Seven smaller industry groupings have majority foreign ownership, but overall only industry employment is in foreign-owned firms" (Hurtig, 2006:2).

Foreign Takeovers: Canada's Experience

"Since 1999, 62 of Canada's largest companies – representing 27 percent of the public float of the TSE's main index – have disappeared through mergers and acquisitions. Of this total, 53 percent – 70 percent by value – were bought by foreign firms" (Azer, 2003:3).

Figure 14: Canadian vs. Foreign Acquisitions, 1983-2006



Source: Statistics Canada, CANSIM Table 376-0036.

A negative value for Canadian inward M&A activity could indicate net repatriation of assets of foreign-owned companies operating in Canada. Inward M&A is defined within Canada's Balance of International Payments system as the difference between the sales of existing interests in Canada and the acquisitions of direct investment interests from non-residents.

This chart illustrates the net value of foreign acquisitions in Canada, and Canadian acquisitions abroad from 1993 to 2006. According to Statistics Canada, the two largest periods for foreign acquisitions in Canada were 2000 and 2006, of which both have been explained away as unprecedented short periods of global acquisition and consolidation,

attempting to claim that Canada's experience in these two years is not unusual, nor cause for alarm in the long run.

Part of the qualitative analysis rests upon the contention that the hollowing-out phenomenon is not just about FDI or the total number of corporate headquarters or headquarter employment, but rather, it includes more subjective, contextual or experiential arguments. For example, there is a wealth of experiential knowledge to be garnered from CEOs and other corporate leaders regarding the effects that hollowing-out has had upon corporate Canada. This sentiment is reflected by Marcel Cote, a founding partner of SECOR Consulting in Montreal:

> Losing ownership of global players has also significant dynamic effects across the country. While they do not like to admit it, international companies are first and foremost citizens of the country where they are headquartered. National borders have not disappeared in this era of globalization. Multinationals expand in well-known territory and are biased toward the country where they are headquartered, where proximity leads to familiarity. Experimentation, which is vital to innovation, can also be better observed when carried out near the head office, in the same country. The same is true for research and development. When downsizing, these companies tend to protect local operations, all other things being equal. In times of crisis, these enterprises are always more responsive to their national government's concerns (May 2008).

The table below provides an overview of cross-border takeover activity from 1995 to 2001.

Table 4: Crossborder Takeovers Involving Canadian Firms, 1995-2001

	Number of Transactions	Number of Transactions Where Values Were Reported	Total Reported Value	Average Size of Transaction[a]	Median Size of Transaction
				(US$ millions)	
			Canadian Takeovers of Foreign Firms		
1995	193	102	10,011.9	98.2	9.7
1996	254	132	10,926.2	82.8	9.5
1997	288	158	14,266.8	90.3	12..9
1998	340	178	33,430.4	187.8	16.5
1999	289	124	21,814.1	175.9	18.0
2000	345	207	32,845.8	158.7	14.0
2001	254	136	24,184.0	177.8	12.8
Total	1,963	1,037	147,480.1	142.2	13.5
			Foreign Takeovers of Canadian firms		
1995	181	101	9,675.8	95.8	16.2
1996	211	98	7,478.4	76.3	11.5
1997	230	102	9,733.0	95.4	21.6
1998	276	135	14,724.7	109.1	14.2
1999	257	112	27,703.0	247.3	18.8
2000	377	185	80,560.4	435.5	25.2
2001	229	118	22,169.7	187.9	18.0
Total	1,761	851	172,044.9	202.2	17.6
			Net Canadian Takeovers[b]		
1995	12		336.1		
1996	43		3,447.8		
1997	58		4,533.9		
1998	64		18,705.6		
1999	32		-5,889.0		
2000	-32		-47,714.6		
2001	25		2,015.3		
Total	202		-24,564.9		

[a] Calculated using only those transactions for which a value was reported.
[b] Net Canadian takeovers were calculated by subtracting transactions in which Canadian firms were targets from those in which Canadian firms were buyers.
Source: Thomson Financial, SDC Platinum.

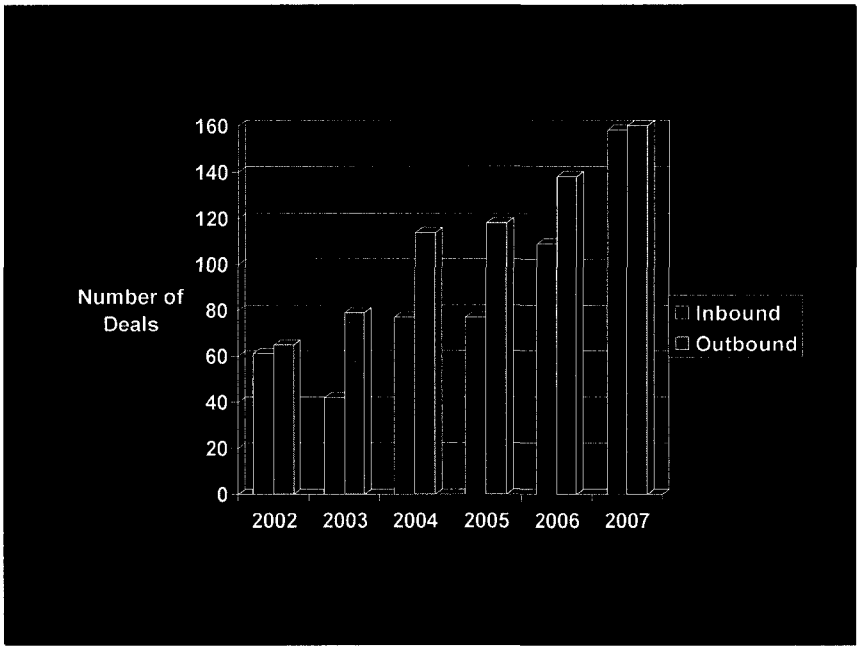
The chart above indicates a modestly negative balance for Canadian takeovers abroad in the majority of the years in consideration. However, there was a tremendous surge in foreign takeovers in 2000 (which many authorities attribute to the tech-bubble explosion). And in only one of the years in the study did Canada actually gain more firms than it lost (32 firms in 2000). For the most part, Canada's growth has been positive in both the number of acquisitions, and the value of the takeovers.

It would seem however, that the "tendency" of the Canadian condition is to experience small to medium positive growth in takeovers overseas for many years,

followed by a tremendous period of acquisition and consolidation, whereby Canada loses more than it has accumulated, in a short time.

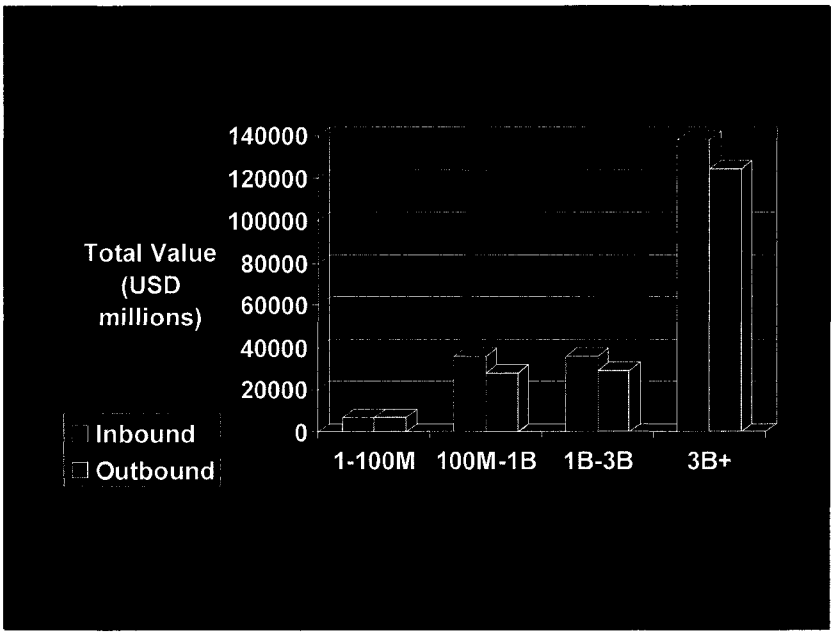
The next several graphs represent many of the qualitative aspects that Canada should be concerned about. These data sets were completed and presented recently at a conference on hollowing-out by a Montreal based company called SECOR Consulting.

Figure 15: Number of Inbound/Outbound Acquisitions, Canada (2002-2007)



During the past five years for which there is data available, the number of Canadian acquisitions overseas (outbound) is consistently higher than foreign acquisitions in Canada (inbound), and has been rising steadily, indicating quite a bit of change in control transactions. These acquisitions account reflect transactions for which there has been a change in control from one firm to another.

Figure 16: Value of Acquisitions by Size Bracket, Canada (2005-2007)



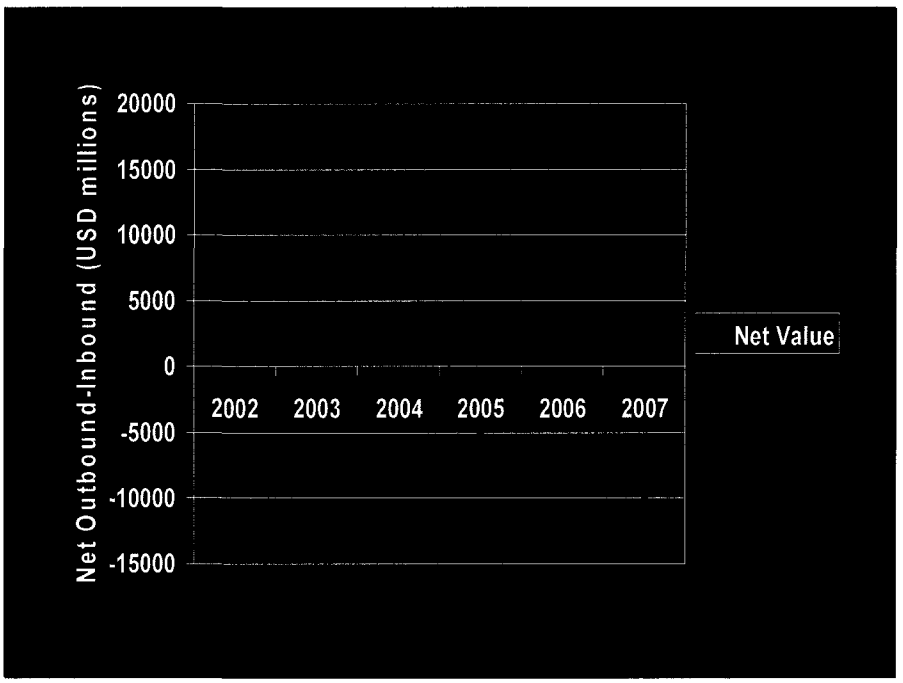
However, when looking at the value of the transactions from 2005-2007, the picture is entirely different: Canada has been losing its biggest companies, and buying smaller firms overseas. For each value group, from $1-100 million, to deals worth over $3 billion, the result is the same. According to SECOR Consulting, the situation is not attractive:

> The deficit of sales and acquisitions in Canada topped $24 billion between 2005 and 2007. The US, Great Britain and Canada are the only industrialized countries with a negative balance, measured by the value of the transactions. However, Canada's deficit is the largest, since it is equal to 7% of the market capitalization of Canadian companies and is three times the US deficit. The only bright spot is Canada's positive track record in terms of the number of transactions, since we primarily sell our large corporations. The deficit is particularly large in three critical sectors: resources, energy and technology, reaching $112 billion in three years (Cote, May 2008).

The graph below indicates how from 2003 onward, Canada has become a net seller in terms of value. The steepest increased in the value of inbound deals occurred from 2005 to 2007. Over this time period, the cumulative net deficit of outbound to inbound was

US$ 24.3 billion. This creates a trend which is very alarming. In 2003, Canada descended from a net buyer into a net seller position.

Figure 17: Net Value of Acquisitions, Canada (2002-2007)



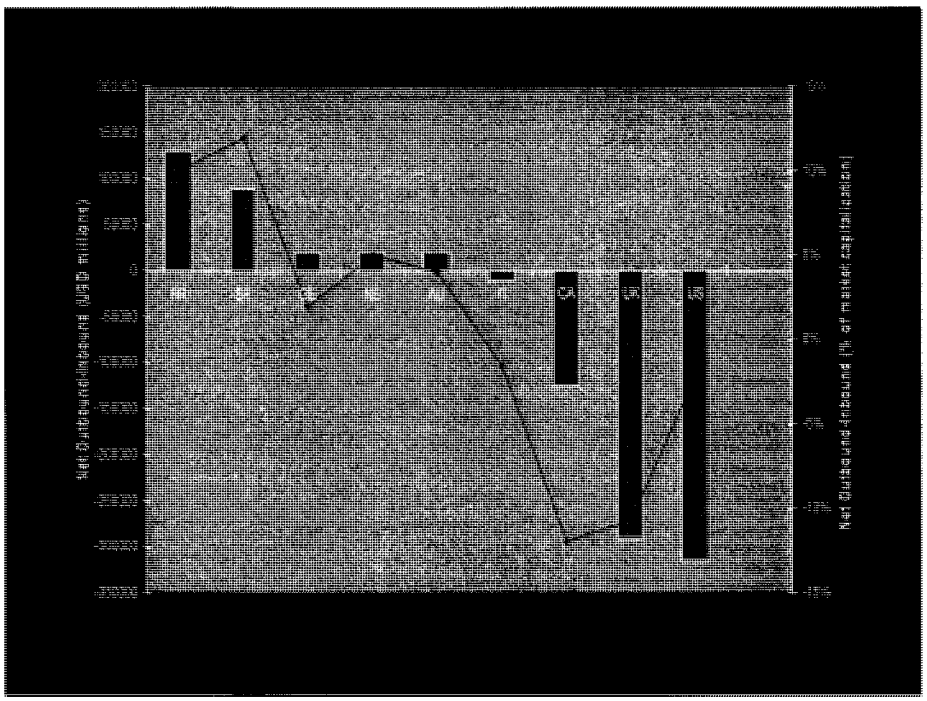
Two categories of industries emerge in terms of their performance in the market for corporate control: net buyers, and net sellers.

Significant net sellers included basic materials, energy, and technology sectors. Together, these firms resulted in a cumulated net deficit of $112 billion between 2005 and 2007. On overage, inbound deals were significantly larger than outbound deals.

On the other hand, significant net buyers were the communications, financial services, manufacturing and utilities sectors. In this respect, Canada has been successful, with a cumulated surplus of $86 billion. Three of these four factors are largely protected by FDI restrictions (financial services and communications) and crown corporations (utilities) in Canada. Overall, excluding protected industries, the net deficit is $80 billion.

Another disconcerting statistic that is used to sound the alarm about hollowing-out of corporate Canada is that relative to market capitalization, Canada is the biggest net seller. According to SECOR Consulting, when comparing internationally for big deals, this is not a small country phenomenon. Countries smaller than Canada have maneuvered themselves into net buyer positions (for example, Australia, which has taken the situation more seriously to become a net buyer).

Figure 18: Value of Completed Acquisitions, Canada (2000-2007)



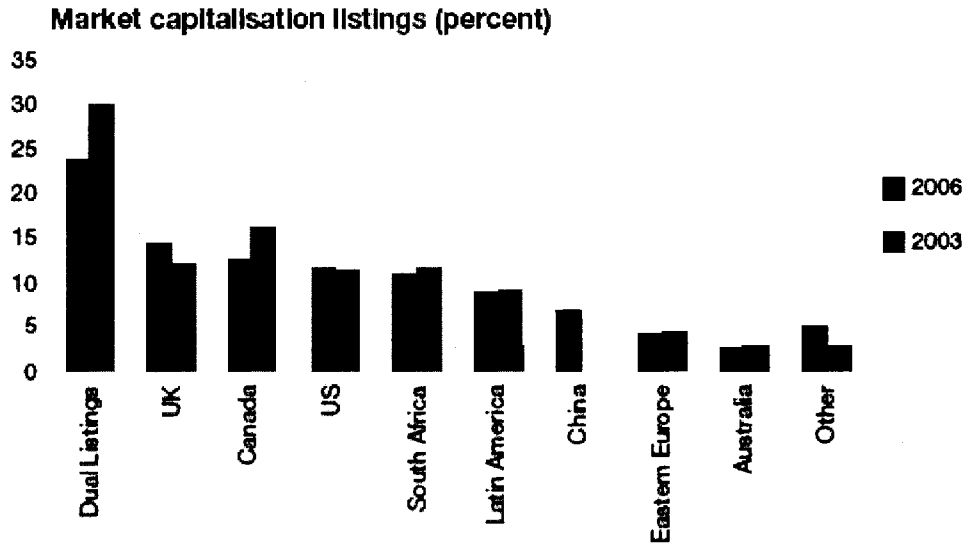
The chart indicates that when illustrating the net outbound-inbound transactions as of 2007, (as a % of market capitalization), Italy (-1.6%), Canada (-12%), the UK (-10.7%) and the United States (-2.1%), are net-sellers in this respect. Market capitalization is the market value of a company's stock, which gives a picture of the company's size. It is calculated by multiplying the price of shares by the number of shares outstanding (in the hands of the public).

However, Canada's situation is considered to be more tenuous, given that although the United States values are largest in absolute terms in millions of dollars, their sale position is insignificant compared to their overall market capitalization.

Similarly, the United Kingdom's situation is considered less fragile than that of Canada's because their sale of utilities included some veto power for the location of head offices, helping to retain head office jobs, and decision-making powers. Additionally, London is still considered to be one of the most desirable cities for a global headquarters in the world. Analysis by PriceWaterhouseCoopers shows that London was the "sixth largest city economy in the world by estimated GDP at purchasing power parities (PPPs) in 2005, but should rise to fourth place by 2020, overtaking Paris and Chicago. Tokyo, New York and Los Angeles are expected to be ahead of London in 2020, but London's economy is projected to grow faster than any of these cities, driven in particular by strong growth in business and financial services" (PWC, March 2007). Therefore, of the sample group of countries selected in this study, Canada is considered to have the world's largest net deficit.

If the "global game" is for corporate control, then Canada has slipped recently in terms of market capitalization available for its mining operations, as the next graph illustrates.

Figure 19: Market Capitalization Listings (percent)

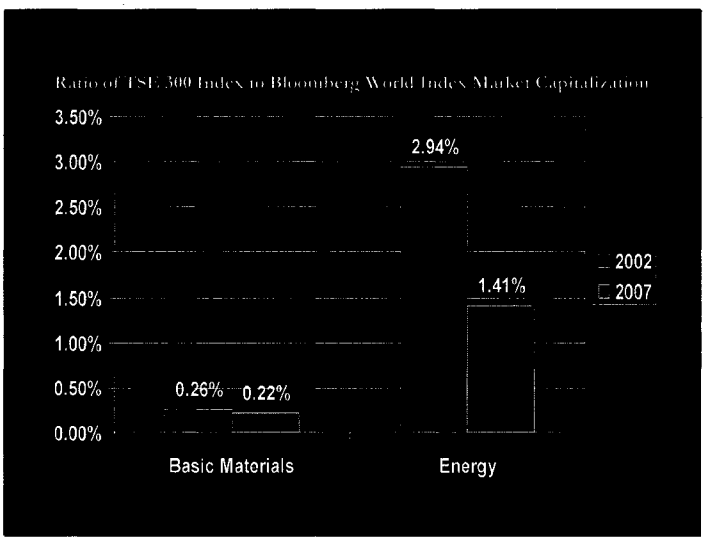


Source: Datastream and Top 40 analysis

According to PriceWaterhouseCooper's report, *Riding the Wave 2006*, Canada has slipped, "even after excluding the dual listed entities (Rio Tinto and BHP Billiton), the United Kingdom has now surpassed Canada as the Top 40's primary access point for capital" (PWC, 2007:37). The Top 40 refer to the world's largest mining corporations as ranked by market capitalization.

Flowing from the preceding diagram, the graph below gives a small snap-shot of the share of Canadian clusters in the global economy, of years 2002, and 2007.

Figure 20: Share of Canadian Clusters in the Global Economy



The sale of companies in basic materials resulted in a loss of share globally of 15% (from .026% to .022%). There was a greater decline in Canada's position globally of energy companies: a loss 52% (from 2.94% to 1.41%). In a global economy of nations competing with each other for fewer and fewer resources to fuel expanding growth, it could become potentially problematic should Canada not have a stronger hold on world energy resources.

Head Office Control

The hollowing-out debate has also focused on corporate headquarters (HQ) in Canada in several ways: total number of HQs, levels of employment, decision-making capabilities, boards of directors, professional services they employ, their role in the community, and also the intangible benefits of having global corporate champions owned and located within Canada. The rise in M&A activity has also fuelled a debate in Canada about the importance of domestically-controlled corporations and the benefits of the presence of company head offices. Harry Arthurs states the importance of corporate head

offices as: "thus tend to function as economic nuclei, around which cluster providers of advanced and specialized producer services – consultants, lawyers, accountants, software houses, designers, advertising agencies – whose physical proximity to head office facilitates efficient interaction" (1998:9).

These worries centre on the loss of head-office functions and the valued-added jobs, decision-making power, research and development activity and a commitment to building within Canada that accompany a corporate headquarters, as well as associated functions such as high value-added consulting, legal and accounting services, and financial and underwriting services: "While Canadian head offices tend to be small, employing on average fewer than 50 employees, they are a significant source of high-skilled, high-paying jobs. In 2005, average salaries at head offices in Canada were $74 900, well above the overall average salary of $37 800" (CRPR, 71:2008). Head offices are an obvious source of wealth and strength to Canada's economy.

However, these decision-making jobs are important not just for the salaries and tax revenue they generate directly, but for their impact on everything from growth opportunities for smaller businesses to the health of the voluntary sector in Canadian communities. Any successful strategy for maintaining Canada's economic sovereignty therefore must include a focus on attracting and retaining the decision-making jobs that accompany the head-office operations of globally competitive companies.

For the Canadian Council of Chief Executives (CCCE), head offices are understandably quite important, as they explain in their submission to the Competition Policy Review Panel:

> As centers for corporate decision-making, they create clusters of well-paid jobs both directly and in related service industries. They are drivers of innovation both

> within their companies and through business relationships and research partnerships. They provide a focus for business investment in communities, providing private-sector leadership for charitable causes, education, health care and cultural activities. They also play a crucial role in the growth of other companies, whether by spinning off operations, providing capital to new ventures or simply offering opportunities for local enterprises to move onto a larger stage at home and abroad. ("From Common Sense to Bold Ambition", 2008:5).

Given the significant role that HQs have within countries, it is no wonder that critics of foreign takeovers are highly concerned over the possible negative effects that the loss of some of Canada's largest firms.

The report released by the CRPR, of which the authors were mainly prominent corporate executives and of business-oriented mentalities, emphasized the argument of many of those supportive of the hollowing-out debate: "Our experience tells us that the head offices of large private companies and of public companies disproportionately provide the benefits that a head office provides to its host city and country. When a Canadian company is acquired by another Canadian company, Canada loses a head office but gains a stronger company. When the acquirer is foreign, Canada loses a head office and a company" (CRPR, 71:2008).

Harry Arthurs supports this claim, citing evidence indicating rises in the prevalence of "non-resident external directors" which increased from 9.36% in 1985 to 16.6% in 1995. Most notable is that while 92.5% of subsidiaries had a resident CEO in 1985, that number had declined to 86.6% in 1995 (Arthurs, 1998:15). Trends continue to show that Canadian directors are being replaced by their international (typically American) counterparts. But what supporters of hollowing-out see as the continued evidence of this phenomenon can actually be explained as the natural process of

transition in management, following a takeover, or even during a normal "changing of the guard" at the senior executive level.

More gas is thrown onto the "hollowing-out fire" when proponents consider that the Canadian government, in its 2006 *Advantage Canada* report, committed itself to the policy of, "Allowing Canadian financial institutions to add more foreign experts to their boards, as long as the majority of directors remain Canadian residents, to enhance their capacity to be competitive in foreign markets" (*Advantage Canada*, 2006:88).

Senior Management Functions

As of May 29, 2008, the Toronto Stock Exchange (TSX) is considering giving its top job to former Chicago Board of Trade president and CEO Bernard Dan to run the company, thereby passing over Ontario-born Luc Bertrand, widely viewed to be the top candidate for the job (Erman and Marotte, *The Globe and Mail,* May 29, 2008). Ideally, the position will be the given to the man most qualified to run the company. This will be done regardless of the candidate's nationality, and will serve to benefit those who truly have a lasting interest in the profitability and sustainability of company: the shareholders.

This has lead to the rise of nationalist (and in this case separatist) concerns. The TSX has purchased the Montreal Exchange (MX) recently, in a move to create a single national securities regulator. However, "many argue the MX shouldn't be sold outside the province because of concern Montreal would lose expertise in financial markets' (Erman and Marotte, *The Globe and Mail,* May 29, 2008).

So, then, does nationality even matter in an issue like this? Not likely. "Major Quebec shareholders could protest by selling shares of TSX or by directing trading away

from TSX, analysts said. However, the effect is not likely to be significant… A more likely consequence would be the departure of Mr. Bertrand…" (Erman and Marotte, *The Globe and Mail,* May 29, 2008).

A further issue of this arises when considering the question of living arrangements. Where is the CEO going to reside? Many American CEOs of Canadian public companies live north of the border, while their families remain in the U.S. Bill Downe, who became BMO's top executive last year, "spends most of his working time in Toronto, but his family remain in Chicago. Why does it matter? That Mr. Downe is a member of the Chicago Club and not, say, the Toronto Club isn't going to make BMO shareholders any poorer. But there is something symbolic here" (Erman and Marotte, *The Globe and Mail*, May 29, 2008).

However, the concerns over "hollowing out by the backdoor", whereby the power centre at Manulife will shift away from Toronto, are very real, if not necessarily legitimate. Manulife CEO Dominic D'Alessandro, a leading nationalist supporter of the hollowing-out critique, may be replaced by American John DesPrez (and is highly qualified for the post), who currently lives in Boston.

While there is no empirical data or studies linking a decline in stock value with a firm's CEO decision to live away from the company's headquarters, it would certainly ruffle many feathers, and create a lack of confidence amongst domestic shareholders themselves.

Arthurs sheds some insight into what a corporation is, by quoting Galbraith: "a large and complex organization [in which] individuals align themselves with its goals in

response to diverse motives." Arthurs then takes this definition, and expands it further into the context of the hollowing-out debate:

> a site of multiple intelligences and competing rationalities, of ongoing contestation and tenuous cooperation between holders of debt and equity, between shareholders and other stakeholders, such as workers, between management and directors, and amongst members of its technostructure with differing degrees of influence on the central direction o the company and differing mandates and technical skills (Arthurs, 1998:3).

This presents a picture of "organized chaos", with conflicting loyalties, motives, and ambitions. It is easy to see how the goal for a "greater national good" can become lost to conflicting desires of the many actors involved. "Consequently, the arrival or departure, expansion or contraction, of global and regional head offices – the specific and tangible consequences of reorganizing corporate governance – implicates a space economy which differs in important ways from that associated with, say, manufacturing or distribution operations" (Arthurs, 1998:9).

The concern arises as follows:

> First, changes in the governance of foreign-based (and especially American-based) transnationals have led to a corresponding decline in the autonomy, range of functions and actual numbers of their subsidiaries. Second, as predicted, these corporate changes may be affecting the market for producer services in cities where regional head offices tend to be located, such as Toronto, Montreal, Calgary and Vancouver (Arthurs, 1998:10).

Overall, Canadian CEOs tend to be highly divided on the prevalence of foreign takeovers, and hollowing-out. Gerald Schwartz of Onex Corp. said that "When a head office leaves Canada, so do all the support positions at accounting firms, law firms, recruiters and other key suppliers of head office intellectual capital" (May 5th, 2007). Several MPs have been vocal on the issue as well. For example, Judy Wasylycia-Leis, the federal NDP finance critic is quoted as saying, ""It has become apparent in the last few

months that we're facing a serious threat in terms of Canadian ownership and control. If your core is owned by foreign nationals, you lose the ability to shape your own destiny" (June 20th, 2007).

However, the most vocal proponent of the hollowing-out of corporate Canada has been Dominic D'Allessandro, CEO of Manulife, "What if we were to consider ... adopting ownership restrictions for certain sensitive sectors of our economy that would be similar to those that now apply to our financial institutions? I sometimes worry that we may all wake up one day and find that as a nation, we have lost control of our own affairs" (May 27th, 2007).

The hollowing-out phenomenon affects many senior management positions within the firm, one of which includes marketing positions: "When Kraft Foods announced in late 2005 that it was flattening its North Amercian marketing structure and in essence eliminating the 49th parallel when it came to its agency relationships, it was feared in ad circles to be the start of a fresh round of "hollowing out" of Canada's marketing space" (Brent, 2008).

From the perspective of Tony Chapman, CEO of Toronto agency Capital C, the threat is very alarming:

> One of [marketer's] responses for cost cutting is to centralize brand strategy and brand creativity," Chapman says. "So they are going to create the one-size-fits-all campaign and then the [other] countries will be responsible for activating in their local market." So, where brand strategy, brand creativity and creative platforms were once handled in Canada, more often now the multinationals are pulling it outside of Canada. "The danger is that these [Canadian] offices will eventually be primarily servicing sales forces and customer marketing initiatives. (Brent, 2008)

This has led several critics to claim that Canada is being hollowed-out, and many of the country's global headquarters are becoming "glorified sales offices", taking direction

from overseas locations, although this argument has been criticized for being too simplistic.

IBM's operations in Canada, for instance, have become home to a growing number of North American responsibilities, leading to transfers of top executive positions to Canada from the United States. Similarly, in companies as diverse as Nestle in food products and HSBC in banking, Canadian subsidiaries are their parents' global centre for product innovation and market testing. Microsoft has been building Canada into a major centre for research and development, and not just sales and service.

By the same token, companies that remain Canadian-owned do not always maintain their full range of head-office functions in Canada. Even prior to its takeover, Ipsco had transferred most of its senior executives from its legal head office in Saskatchewan to its "operational headquarters" in Chicago. Nova Chemicals went even further, transferring all of its top jobs from Calgary to Pittsburgh (although Alberta remains its major R&D centre). As early as 1999, John Roth of Nortel pointed out that only 28 of that company's top 400 executives were still living and working in Canada. However, David Stewart-Patterson, Executive Vice President of the CCCE, maintains that, "in my experience, foreign ownership is not a bar to the creation and maintenance of high-level decision-making jobs in Canada".

Identity/Sovereignty/Culture

One of the many qualitative arguments for the belief in the hollowing-out phenomenon is the negative effect foreign ownership would have on a Canada's identity, sovereignty and culture.

The Canadian Centre for Policy Alternatives (CCPA) produced a paper regarding the threat of foreign ownership in Canada's telecom sector, and its subsequent negative effect on Canadian culture: "Culture is in need of protection in the trade negotiations because unrestricted competition in this arena would replace local and national cultural expression with powerful international media conglomerate" (White, 2008:1). This would result in the displacement of the presence of Canadian broadcasting and telecom firms and content.

The usual definition of telecom services includes the network of communications, such as satellite, cable, wireless transmission and fiber optics, as well as telephones, fax machines and cell phones. Media or cultural services includes television, radio, news, music, as well as live performances and museums. Broadcasting services are the networks that specifically carry television and radio. The Broadcasting Act, section 3, sets out Canada's broadcasting policy as follows:

> the Canadian broadcasting system shall be effectively owned and controlled by Canadians; and the Canadian broadcasting system, operating primarily in the English and French languages and comprising public, private and community elements, makes use of radio frequencies that are public property and provides, through its programming, a public service essential to the maintenance and enhancement of national identity and cultural sovereignty (White, 2008:2).

Similar language is found in section 7 of the Telecommunications Act:

> It is hereby affirmed that telecommunications performs an essential role in the maintenance of Canada's identity and sovereignty and that the Canadian telecommunications policy has as its objectives: (a) to facilitate the orderly development throughout Canada of a telecommunications system that serves to safeguard, enrich and strengthen the social and economic fabric of Canada and its regions...(d) to promote the ownership and control of Canadian carriers by Canadians...(e) to promote the use of Canadian transmission facilities for telecommunications within Canada and between Canada and points outside Canada (White, 2008:2).

Since 1999, the Minister of Canadian Heritage has reviewed and approved 98 cultural investments, while disallowing three proposals (CPRP, 2008:29).

However, part of the recommendations made by the CPRP include: "allowing 49% foreign ownership of Canadian airlines on a reciprocal basis, and liberalization of foreign ownership limits in telecom and broadcasting. They contemplate more or less immediate approval of all new investments in the cultural sector, and higher thresholds for review of takeovers in the cultural sector. They want to strip the Minister of Canadian Heritage of any role in the process" (Jackson, June 26th, 2008).

The Council of Canadians echoes this concern of foreign investment in Canada's telecommunications sector: "If foreign companies are able to take control of Canadian broadcasters, cable companies or other firms involved in Canada's broadcasting system, these foreign companies would have access to the provisions of Chapter 11 of the North American Free Trade Agreement" (Neil, 2007:3).

Community Philanthropy

Supporters of hollowing-out maintain that local charities will experience a noticeable decline in the private funding from corporate entities once they are taken over. Additionally, the influx of new, foreign managers would have little comprehension for local social-problems and local community needs. The term *philanthropy* in this context refers to corporate giving, employee volunteerism and giving, and corporate participation on charitable boards.

A paper produced by the Canadian Centre for Social Entrepreneurship (CCSE) at the University of Alberta, "sought to assess the linkages between corporate Canada and

the charitable sector" (Azer, 2003:4). Statistics Canada cites up to 77,000 charities and 100,000 non-profit organizations registered in 2000. A 1997 survey completed by the Voluntary Sector Initiative illustrated a startling discrepancy between where the public thinks charities receive most of their funding, and where it actually comes from:

Figure 21: Where Charities get their Funding (1997)

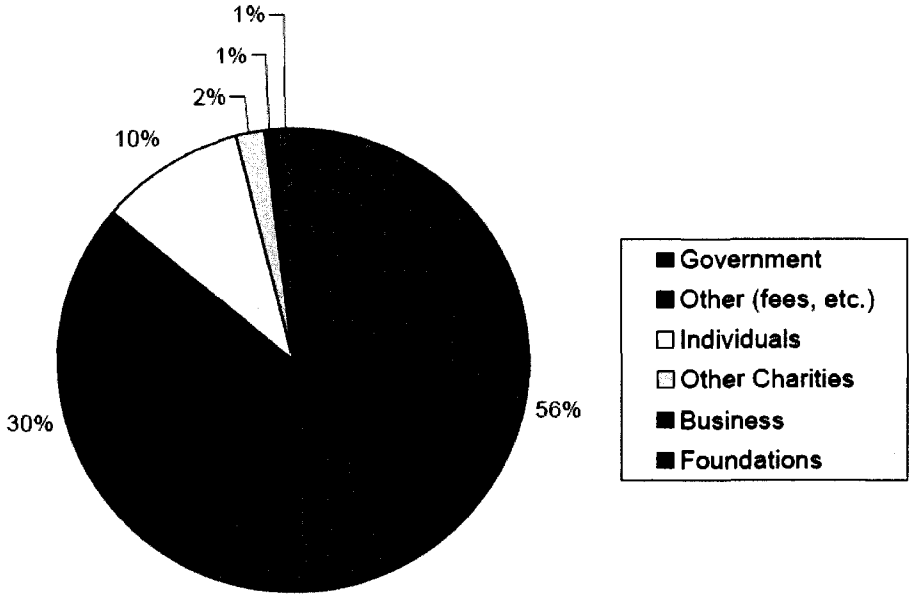
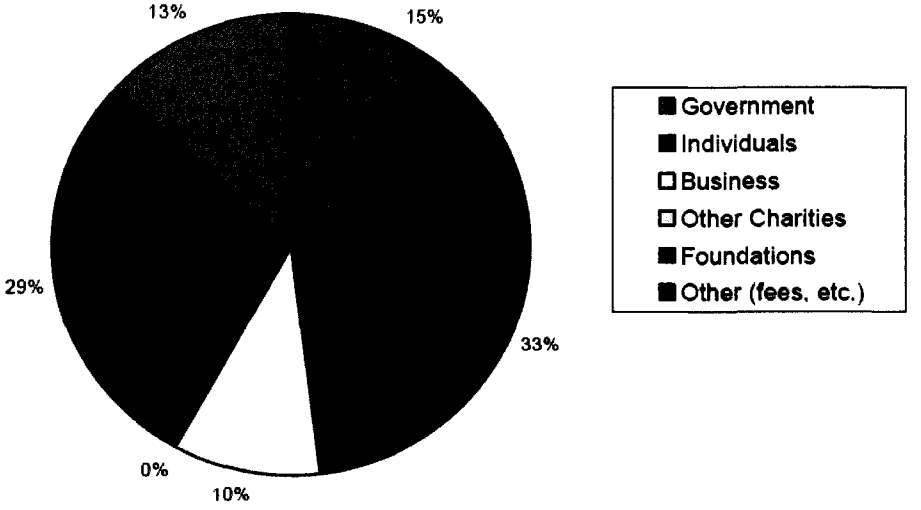


Figure 22: Where the Public Thinks Charities get their Funding (1997)



Using figures from 1997, charities received 56% of their funding from government sources, 30% from fees and other sources, 10% from individuals, 2% from other charities, and 1% from each of business and foundations.

The paper by the CCSE, which was a collection of responses from forty interviews with leaders from the public, private and non-profit sectors, found that, "the strongest determinant of philanthropy is the location of corporate decision-makers. However, if the acquired company becomes a branch plant with little decision-making authority, philanthropic decisions will be made elsewhere and support for local community initiatives will likely drop" (Azer, 2003:10).

Some other key highlights from the paper include:

> Foreign acquirers consistently honored charitable commitments made by Canadian companies prior to takeover… There is a growing gap between 'have' and 'have-not' charities that is linked to the giving preferences of foreign companies. Charities involved in youth, education, and health attracts easier than those working in the arts, amateur sports, and the environment and on addictions, homelessness, and domestic abuse… The value of corporate donations has declined due to the number of Canadian companies that have been acquired, merged, and relocated… (Azer, 2003:10).

While respondents from the charitable sector agreed that in most cases foreign acquirers honored charitable commitments made prior to takeover, "the charities chosen by the Canadian owners did not always fit the preferences of the foreign owners leaving many charities scrambling to find new funders in an increasingly competitive environment" (Azer, 2003:12). This is particularly disturbing given the rise of "strategic partnerships" that firms prefer to make with charities, by donating to organizations that are more in line with the firm's goals and values, or whereby the firm would get "the biggest bang for their buck".

Therefore, with respect to hollowing-out's effect on the charitable sector, the results are mixed: "Some charities, particularly those in the areas of health and education, are establishing mutually beneficial relationships with foreign firms while others, in the areas of social services and the arts, are finding themselves out of favour with many corporate funders" (Azer, 2003:17).

Environmental Concerns

Something else worth mentioning is the connection that proponents of the hollowing-out phenomenon try to make, between the studies of FDI/foreign ownership from the orthodox perspective, to much more global concerns. Critics such as Mel Watkins are concerned that increased foreign investment, not just within Canada, but globally, would mean an increase in global trade and transportation, which would increase carbon emissions and therefore hasten global warming, with disastrous consequences for the environment, and humanity.

This is certainly a much more difficult case to make, and although this issue is beyond the scope of this thesis, there is room enough here to consider it as a viable concern of those weighing-in on the hollowing-out debate.

Conclusion

The qualitative arguments expressed in this chapter have attempted to illustrate the point that quantitative analysis alone cannot fully account for what is happening to Canada, regarding the hollowing-out of the country's corporate headquarters. It should be clear from the arguments studied here that the concerns of hollowing-out go beyond

orthodox-economic analysis of the Canada's headquarters, to include the impact of foreign takeovers on communities, philanthropy, Canada's competitiveness globally, culture and identity, the environment, and public perceptions.

These arguments can be properly situated within the context of the political-economic theories outlined in chapter 2: the Schumpeterian Workfare State, and McBride's "paradigm shift". From that perspective, the hollowing-out arguments do hold more truth to them.

The last two chapters have attempted to examine and explore the arguments for and against the hollowing-out of corporate Canada. Many academics and policy makers have been quite divided on the validity of this phenomenon, as well as the proper policy recommendations to deal with the concerns that have been raised, and how best to move forward.

There has been considerable expansion and contraction of the presence of Canadian companies on the global scene, across many industries. This chapter is not attempting to say that Canada is losing on all fronts – but rather to show areas for which Canadians should be concerned about in the near future.

When the arguments for both sides of the debate are compared, while it is maintained in this thesis that there are seriously legitimate causes for concern which have been outlined above, the claim of this thesis still stands, which is that the hollowing-out of corporate Canada is not happening. Rather, the cyclical nature of foreign investment in Canada's experience would suggest that these concerns come and go over time, but it has not eroded the standard of living of the majority of Canadians over the past several decades.

The next chapter of this thesis deals with the risk-assessment question Canada is faced with in the context of foreign ownership and takeovers: are the benefits of FDI worth the risks of potentially being hollowed-out?

Chapter 5: Risk-Assessment

So far, this thesis has been dedicated to the arguments for and against the hollowing-out debate. The final chapter of this thesis summarizes these two sides in the form of a risk-assessment question that is very broad in scope: are the benefits of foreign direct investment (FDI) greater than the risks of potentially being hollowed out? To answer this question, it will be important to reference the expansive literature on the subject, most of which is rooted within business theory, which has been accustomed to performing risk-assessments.

However, the very nature of performing orthodox-economic risk-assessments will contain inherent biases, which must be considered. At the time of writing this thesis, there were no literature references or methodologies to be found, which attempted to categorize a nation's behaviour with respect to FDI, from a risk-assessment perspective.

Foreign ownership and foreign investment contain inherent risks to a nation's economy and society; however, in the context of a global economy, some serious questions need to be resolved. Fears regarding hollowing-out, branch-plant economies and "losing control of our economic destiny", need to be debated and controlled. From a business-manager perspective, risk is inevitable, and therefore needs to be managed appropriately. Therefore, it is up to the nation's leaders to view these dynamics, and make to the most informed decision possible, but also for the public be aware of their own fears with regards to foreign investment and ownership, and the responsibility they have to control those fears. Risk management planning is the process of deciding how to identify and manage possible risk events that might affect project goals. Good planning

prepares team members for even the most serious threats that occur during the project; it also prepares them to take advantage of any opportunities that arise. The main issue, in this case, is whether or not to view foreign ownership and investment positively (an opportunity), or negatively (a threat).

In the business literature, risk consists of three factors: 1) risk event; 2) probability, or likelihood, that the risk will occur; 3) impact on the project if the risk does occur. In the context of hollowing-out: 1) event of foreign-ownership, or a foreign takeover of a Canadian firm; 2) in a global economy, the likelihood of "risk" in this case, is highly probable; 3) the "project", in the context of hollowing-out, relates to the standard of living of Canadians, and to Canada's overall economic development.

Part of risk planning involves developing a set of strategies and specific actions that may be implemented to enhance specific opportunities and reduce significant threats to project objectives in the face of risk. The following is a list of risk management response strategies that addresses risk as a negative threat:

1) *Avoidance*: changing the project plan to eliminate the threat.
2) *Transfer*: shifts the impact of an adverse risk event to a third party.
3) *Mitigate*: seeks to reduce the probability or impact of adverse risk events to an acceptable threshold.
4) *Accept*: consists of simply dealing with consequences of an adverse risk it if happens, either actively (by developing a contingency plan) or passively (just dealing with the consequences of the risk if it happens).

There are also four broad strategies for responding to opportunities, or positive risk events:

1) *Exploit*: ensures that the opportunity is realized. It seeks to eliminate the uncertainty associated with a particular risk by making the opportunity happen.
2) *Share*: allocates ownership to a third party who is best able to capture the opportunity.

3) *Enhance*: seeks to increase the probability of an opportunity, by identifying and maximizing key drivers of these positive impact risks. It seeks to facilitate or strengthen the cause of the opportunity.
4) *Accept*: dealing with a risk's consequences either actively or passively.

How then, does this relate to the thesis of this thesis? How would we classify the Canadian states response to the recent levels of foreign ownership, and takeovers of domestic companies? Given the facts, evidence, claims and arguments, attempting to "quantify" this analysis might be unsuitable.

However, in a measureable sense, it can be observed that Canada (and any given government of the day) does enact a "risk assessment" of their own, by reviewing certain foreign investments into Canada under the Investment Canada Act (ICA), over a certain threshold; and by placing limitations on foreign ownership and investments in specific industries. Any foreign investment above the threshold is subject to review by the Minister of Industry (or Minster of Cultural Heritage, depending on the sector), and must be deemed to be a net benefit to Canada. This test is designed to supposedly ensure these foreign investments are a "net benefit" to Canada, the economy, and the populace.

The behaviour of the Canadian government, and its attitude towards foreign investment and ownership, can be tracked over time, and categorized, according to the strategies outlined above; from seeing foreign ownership as a threat in the 1960s and 1970s, to contemporary perspectives and actions from the mid-1980s and into the 21st century.

We can see from the academic literature and political rhetoric in the 1960s and 1970s that foreign investment was less than positively welcomed. Government panels and recommendations of the 60s, such as the famed Watkins Report, in turn led to the creation of the Foreign Investment Review Agency (FIRA) of the Trudeau era in 1975.

Over time, a combination of global economic pressures and shifts in domestic political objectives, led to the abolishment of FIRA, and the creation of the Investment Canada Act (ICA), which committed itself to openness and encouragement of foreign investment. "By 2000, foreign direct investment in Canada was over two-and-a half times as much as it was in 1990, and over four- and- a-half times as much as it was in 1980" (Hurtig, 2006:3).

Speaking quite generally, it can be seen that the government's strategy, according to the risk-assessment strategies outlined above, has shifted from seeing foreign ownership as a *threat*, (specifically, *mitigation* of the "risk"), to seeing it as an *opportunity*, which has included a combination of strategies: *exploitation*, *enhancement*, and *acceptance*. The notion of "sharing" these opportunities is unsuitable because, seen from a macro-level of nation states actively competing with each other in a global economy, it would not make sense to share the benefits of foreign ownership in Canada, with a 3rd party (in this case another nation state).

Granted, there are still elements of the "old strategy" to be found in Canada's foreign investment regulatory regime. There are several sectors of the Canadian economy that have restrictions regarding foreign investors or limitations on competitive intensity: uranium mining, telecommunications and broadcasting, financial services and air transportation. And there are continued calls for increased openness and deregulation of these sectors, as well as removing unnecessary laws and regulations which, many claim, encumber and hinder Canadian competitiveness.

However, as was illustrated in Chapter 2, Steven McBride states that there has been a "paradigm shift" in Canadian political economic policy and ideology, which

corresponds with the overall change in risk-assessment strategies. As stated in the final report of the Competition Policy Review Panel: "Our Competitiveness Agenda does not ask Canadians to give up anything, nor to settle for less. On the contrary, we are asking Canadians to raise their sights, and to recognize the challenges and *opportunities* of economic globalization. We are asking Canadians to take a global perspective. We do not believe Canadians have any other choice" (2008:103 [emphasis added]).

While the stance of the Conservative government is that hollowing-out is not happening, ironically, the Parliamentary Secretary to the Minister of Finance, during a Parliamentary debate on a private members motion on the importance of an exempt surplus regime to the competitiveness of Canadian companies (in response to a resolution that the Income Tax Regulations be amended so they do not override certain Canada-Barbados tax treaty provisions) said:

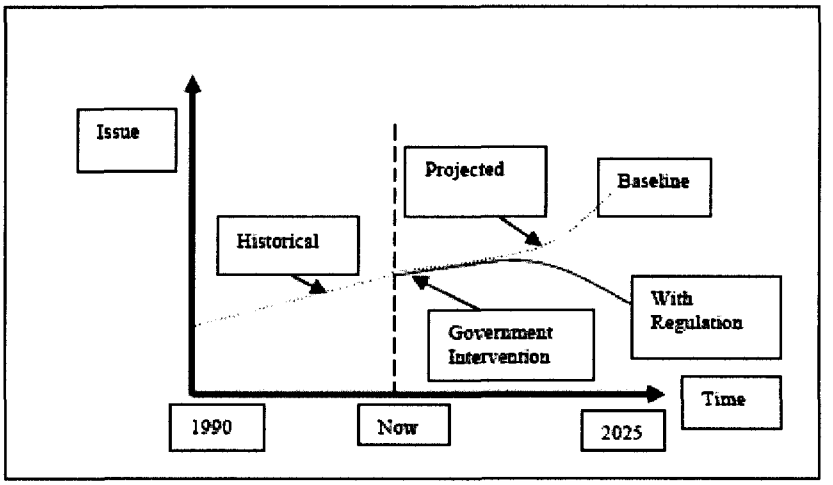
> "If [the resolution became law], we would essentially hollow out corporate Canada. Pretty well all the companies in Montreal, Ottawa, Toronto, Calgary or Quebec City that are of an international nature would simply alter their international arrangements. Then the exempt surplus that is generated by those companies for active businesses offshore would not at all ever arrive back in Canada in any form whatsoever" (KPMG, October 6th, 2005).

It would appear then, from the perspectives and strategies outlined above, that the Canadian government has deemed it to be worth the risk to accept foreign ownership of a substantial part of the economy, in order to ensure the overall competitiveness of the corporate Canada.

The Canadian government typically applies a cost-benefit analysis to many environmental, social and economic issues. "In April 2007, the *Cabinet Directive on Streamlining Regulation* replaced the 1999 *Government of Canada Regulatory Policy*. One of the key requirements of this new directive is that departments and agencies assess

regulatory and non-regulatory options to maximize net benefits to society as a whole" (Treasury Board, 2007:1). However, no such test has been applied to foreign investment and ownership in this way, other than through the review process within the mandate of the Investment Canada Act (ICA).

Figure 23: Comparison Between the Baseline and "With Regulation" Scenarios



The figure above is taken from an Environment Canada study to illustrate the effectiveness of government intervention into a given issue. The baseline represents the risks associated in the absence of government interview. The "with regulation" line represents the desired outcome the regulatory authority would like to achieve; the gap between the two lines indicates the stream of benefits accrued over time, due to government intervention (Treasury Board, 2007:5).

The point to be understood here is that with reduced government intervention, in the form of reduced regulation, the benefits experienced from a "risk" such as foreign ownership and investment would be diminished. However, trends in Canadian government regulations are moving in the opposite direction: "Any new regulations or review of existing regulations requires a proper assessment to ensure they will not impose excessive burdens on Canadian businesses that would reduce their international

competitiveness. While it is important to protect the environment and safeguard the health and safety of Canadians, regulatory actions need to be carried out in a way that allows for private-sector innovation to take place" (Treasury Board, 2007:3).

The original question of this chapter remains: are the benefits of foreign direct investment worth the risks of potentially being hollowed-out. Is it feasible, or even necessary, to attempt to quantify the answer to this question, from a paper which is based on comparing quantitative and qualitative arguments? The answer may have to be left to subjective criteria; by contrasting opposite arguments and perspectives on this risk-assessment question.

The question of who is at risk in a foreign takeover is central to the risk-assessment portion of the thesis. The Conference Board of Canada (CBofC) responded to this question by assessing and rating many of the actors who are affected during a change in control transaction out of a scale of +3 to -3, supporting the claim of this thesis, that there are positive, negative and neutral corporate takeover effects (CTEs) in the foreign acquisition of a Canadian firm: shareholders (2.3), governance (-2.7), management (-1.2), operations (0.5), capital (1.0), people (0.2) and community (0.1). The results change slightly when compared to a domestic takeover by another Canadian firm: shareholders (2.4), governance (-1.9), management (-1.7), operations (-0.3), capital (0.1), people (-0.4) and community (0.0) (Grant and Bloom, v.1 2007:62). A quick comparison of the results indicates that there are actually greater risks of "hollowing-out" indications from a domestic takeover, rather through foreign takeovers of domestic firms.

Who has the most to gain from foreign ownership and foreign takeovers? Surely, mainstream economics would hold that the efficiencies of the "trickle-down effect" would reach the broadest portions of society. Specifically, the company's shareholders would logically gain the most from a foreign takeover. Currently, it is the company's leader's responsibility to ensure the highest premiums are accrued by the firm's public owners.

How best then, to study the relationship between the benefits of FDI, received through "trickle-down economics" and the "project", referred to earlier: the standard of living of Canadians? Is it even possible, or fair, to place such a conception into a quantifiable paradigm, and compare it to many of the supposed benefits of FDI: the transfer of technology and ideas, shareholder premiums, increased capital inflows, etc.?

Several metrics, such as the "social discount rate of Canada", defined as the "minimum real rate of return that a public investment must earn if it is to be worth while undertaking... The economy's real income will increase only if the public investment yields a return in excess of the social opportunity cost of the resources withdrawn from the private sector" (Burgess, 1981:383), have come close to providing a quantifiable account in which investments in Canada can be realized. However, this concept does not sufficiently relate to an investment made by a foreign agent, but rather the reassignment of funds.

How have Canadians on the whole fared over the past two decades of increased foreign ownership and investment? Does a rising tide indeed lift all boats? The Canadian Center of Policy Alternatives (CCPA) does not agree: "Another way to compare the growth in prosperity of CCCE corporations, their CEOs and shareholders with that of

Canadians generally is to examine income growth by income group" (Campbell, 2007:4). How else do we generally recognize the rise and fall of living standards, other than through the rise and fall of incomes in Canada? "In contrast to the experience of average Canadian workers, the pay packages of the top Canadian CEOs have ballooned. According to the Globe and Mail's survey, the nation's top 100 CEOs earned an average of $9 million in 2005, 237 times the average Canadian wage. Ten years earlier, the gap was less than half that—104 times" (Campbell, 2007:4).

Citing data gathered by Statistics Canada, the CCPA claims that "only the incomes of the very richest of Canadian individuals (and families), the top 5%, have grown rapidly since 1982. And, only at the top 1% of the income heap were the increases really dramatic. What's more, this top 1% really pulled away from the rest of Canadian society in the 1990s" (Campbell, 2007:5). This of course paints an entirely different reality of the "benefits" of FDI.

This entire thesis has been based on quantitative arguments which must be qualified in some respects: "Hollowing-out is not happening, but there are causes for concern"; "the benefits of FDI are worth the risks, but not for everyone"; "people have benefited from FDI over the past several decades, but not equally". In the context of this thesis which claims that the hollowing-out of corporate Canada is indeed not happening (although this statement contains many stipulations), for the time-being the benefits seem to outweigh the risks.

Chapter 6: Overall Conclusion

Nationalist predispositions have been a major force behind the criticisms of hollowing-out supporters. When seen in the context of mainstream economic analysis regarding foreign direct investment (FDI), merger and acquisition (M&A) activity, total head office and head office employment figures, an assessment of the arguments of both sides of the debate reveals that concerns over hollowing-out are indeed unfounded. However, this is not to say that these criticisms are not without merit. On the contrary, it is important to recognize here the need for continued vigilance from careful observers across the political spectrum when Canada is again presented with pressing issues, and difficult decisions to make. Therefore, although a review of the facts and arguments points to the conclusion that the worrying "hollowing-out" of corporate Canada is not happening, there are still causes for concern.

Again, bearing in mind that there are many global economic and political factors to consider when studying M&A activity, particularly within the Canadian hollowing-out context, this thesis has attempted to emphasize the significance of Canada's own foreign investment regulatory regime, as a partial explanation for the large increase in the past several years of inbound takeovers.

During the more than twenty years that the Investment Canada Act (ICA) has existed, only one takeover bid has been prevented (at the time of writing this thesis), the attempted American purchase of MDA in 2008, which was blocked for "national security" concerns, although this may have simply been an attempt for the Conservative government to win support away from hollowing-out enthusiasts, and to be seen as actually protecting corporate Canada. However, we have not, as some NDP party MPs

have claimed, lost control of our own affairs through the loss of some of Canada's largest corporate entities. The state's regulatory role (such as controlling the money supply), has not disappeared, even with neoliberalism.

Although the Competitiveness Policy Review Panel (CRPR), led by former BCE chief-executive officer, Red Wilson, has recently come out with their list of policy recommendations for the government to improve Canadian competitiveness in the global game for corporate control, in the words of one reporter, "Wilson's panel has not been successful in designing an effective policy on foreign takeovers that balances Canada's commitment to an open economy with the need for a stronger business sector headquartered in Canada" (Crane, July 24th 2008).

The concern still remains that, by not enacting any stronger national policies on foreign takeovers in Canada, "even if we do a better job of creating new companies, the best of them could also become foreign takeover targets. So we would be growing seed corn for foreign multinationals or, as it has been put, "growing guppies to feed the sharks" (Crane, July 24th 2008).

However, this is indeed balanced by the CRPR's recommendation to strengthen the role/power of the boards of directors of Canadian companies, to more stalwartly resist the temptation to acquiesce to a foreign takeover bid. A stronger defense by Canadian directors of firms against foreign takeovers should provide the protection necessary to retain domestic control of many of the country's firms. The tradeoff however is with more entrenched senior management; would Canadian shareholders truly be getting the best deal for their stock?

The majority of policy makers and the current government tend to agree that reinstituted protectionism is not a viable option in response to the so-called hollowing-out, and would instead like to bring Canada up-to-speed with the foreign investment regulations of other G8 and WTO nations, which would mean a higher threshold from which to review potential foreign investors, and instead strengthen the desire and boldness of Canadian firms and entrepreneurs.

This thesis has covered many extensive concepts and issues to arrive at this conclusion. The synthesizing and complementation of Jessop's Schumpeterian Workfare State (SWS), his revised Schumpeterian Workfare Post-National Regime (SWPR), along with McBride's "paradigm shift" create the theoretical context from which to study the hollowing-out debate. In chapter 2 it was necessary to borrow from, and synthesize these three concepts, to illustrate how Canada has shifted ideologies, from the days of the National Energy Program (NEP) to encourage indigenous capital development, to the Investment Canada Act (ICA) thereby promoting foreign capital development.

As part of the restructuring process from the Keynesian Welfare State (KWS) to the SWS conceptualizations, as this thesis has defined them, it was necessary for Canada to "advance the interests of home-based multinationals but also means creating conditions favourable to inward investment" (Jessop, 1993:14). Canada has certainly done this, by placing foreign ownership restrictions on certain sensitive sectors (financial, telecommunications, uranium, etc), but has also increased the speed and intensity with which foreign investment has penetrated, leading to concerns that corporate Canada is being hollowed-out.

By utilizing the SWS concept, it can be seen that Canada has followed the "cosmopolitan approach that welcomes internationalization of domestic economic space in the form of both outward and inward investment" (Jessop, 1993:29), in the form of foreign takeovers of domestic firms, and even majority foreign ownership of several domestic industries.

This is separate from the questions being raised by the hollowing-out supporters. Would, as Mel Watkins suggests, increased trade and transportation (probably through increased merger and acquisition activity) lead to increased carbon emissions and therefore global warming? Certainly this is outside of the context of this thesis's study of the hollowing-out of the corporate Canada, but the gravity of the question remains, and the stakes are too high to avoid open debate into these issues.

Incidentally, in the CPRP's final report, the panel recommended raising the ICA minimum threshold by which foreign investments are reviewed in Canada, from the current $295 million in gross assets, to $1 billion in enterprise value, for two reasons: "First, a higher threshold is consistent with the scope for intervention being narrower, and thus more exceptional, than under the current ICA. Second, a higher threshold would be aligned with Canada's underlying premise that foreign investment is, except in unique circumstances, beneficial to Canada" (2008:31).

While this thesis has tried to maintain a balanced opinion on the issue of foreign ownership, the changes recommended by the CPRP regarding the raising of the review threshold would do little to alleviate concerns over hollowing-out. Raising the level for which investments are to be reviewed could potentially allow for very large deals that would not be of "net benefit" to Canada, to go unnoticed or unchecked. At the very least,

the state's powers should allow for the possibility of the review of foreign investments, which does not necessarily mean revoking them, bearing in mind that in over two decades of the ICA's existence, only one foreign investment was reviewed and rescinded.

The arguments explored from the quantitative perspective have emphasized the level of inward and outward FDI over time, and authorities such as Statistics Canada have concluded that, over the long-term, Canada has become a net-exporter of investment, indicating, as some claim, that Canada is hollowing-out other countries. However, this statement needs to be qualified: "Canada's share of the world FDI stock has fallen from almost 16 percent in 1970 to just over 3 percent in 2006. In terms of FDI relative to gross domestic product, Canada over the past 25 years has experienced the greatest decline in the Organization for Economic Co-operation and Development (OECD)" (CPRP, 2008:16).

As expressed throughout this paper, much of the disagreement between supporters and critics of hollowing-out have circled around a conflict of definitions, whereby quantitative mainstream economic analysis cannot debate against the qualitative subjective, experiential arguments of the hollowing-out supports, and vice versa.

For the most part, Canadians have experienced the benefits of FDI; specifically through one of its many sub-components, merger and acquisitions by foreign firms. However, this thesis should not be taken as a ringing endorsement of such practices. There are still considerable levels of poverty and inequality that serve to blemish the promises of free trade, and social and economic integration, not just within socio-economic classes in Canada, but between developed and developing countries as well. Indeed, a rising tide has not lifted all boats.

This paper has presented arguments from both sides of the debate, to the best of this author's ability, and would continue to call upon further debate on this issue. Furthermore, it is important to recognize the unique ability of a multi-disciplinary approach to the study of these important issues which confront Canada daily.

Alternative schools of thought, such as within the field of political economy, present unique and valuable criticisms, arguments, theories and evidence, which should be taken seriously, and add considerable weight to a broad range of issues. They keep us constantly aware of factors which may normally exist outside the more conventional, orthodox streams of thought. They give a voice to those who have none, bring a perspective that would otherwise go unnoticed, and give a physical presence to the otherwise intangible.

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