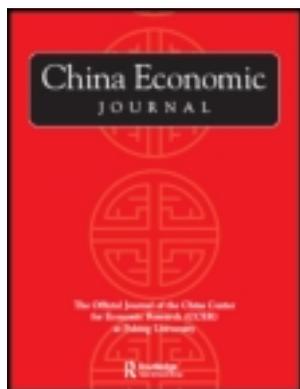


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Chinese lessons: state-owned enterprises and the regulation of foreign investment in Canada

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A recent influx of Asian investment is changing the character of the Canadian oil and gas industry and reviving old debates on the regulation of foreign investment. Particular attention has been placed on investment by state-owned enterprises (SOEs), driven in part by public suspicion about investment from China, which has been the largest source of SOE capital flows to Canada. Recent amendments to the *Investment Canada Act* have made SOE investment more difficult and have raised questions about the country's attractiveness as an investment destination. This paper makes the case for non-discrimination of SOEs in the investment review process. In the context of a policy framework that is fundamentally supportive of inward foreign direct investment (FDI), the Canadian government does not require a set of redundant measures to protect against the relatively low risk of undesirable investment.

Keywords: state-owned enterprises; China; FDI; regulation; Canada

JEL codes: K200; L500; F520

1. Chinese investment in Canada

The largest acquisition to date of a foreign firm by a Chinese company was completed in February 2013. Valued at US\$15 billion, the purchase of Calgary-based Nexen Inc. by China National Offshore Oil Corporation Limited (CNOOC) was important not only for its size but for the national debate it generated in Canada on the merits of investment from state-owned enterprises (SOEs). CNOOC–Nexen was by no means the first investment by a Chinese SOE in Canada, but it was by far the largest. It also coincided with another large proposed investment by a Malaysian SOE, Petroliam Nasional Berhad (Petronas), which was seeking to acquire Progress Energy of Calgary for US\$6 billion. The CNOOC and Petronas deals were the biggest test yet of SOE guidelines first released in 2007 as part of Canada's foreign investment review process.

Until 2008, Chinese investment in Canada was relatively insignificant. In 2007, the stock of Chinese foreign direct investment (FDI) in Canada was only C\$4.2 billion (DFATD 2013). As shown in [Figure 1](#), this amount rose to C\$12 billion in 2012. The official figures, however, under-report the actual amount of Chinese FDI in Canada because of domicile issues related to the investing entity, as well as issues to do with the location of the assets being purchased.¹

A detailed picture of Chinese investments in Canada is seen in [Table 1](#), which lists publicly available information on recent transactions. The overwhelming share of investments has been in the resource sector, which has until recently been on the ascending

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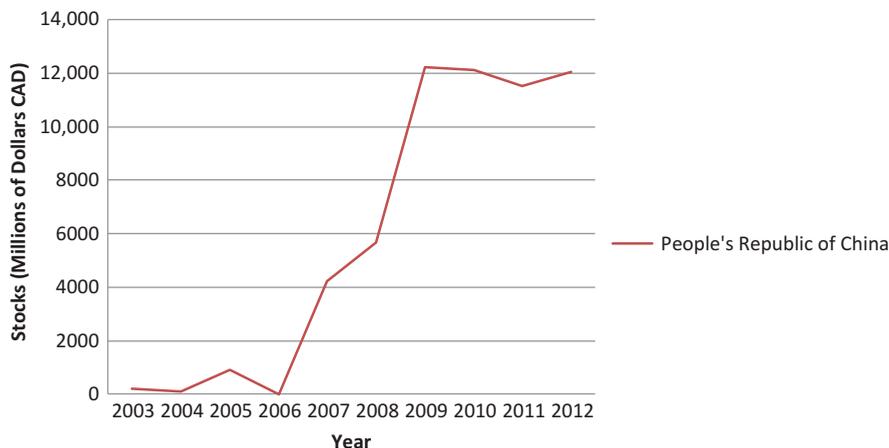


Figure 1. Foreign direct investment (stocks) in Canada from China, 2003–2012.

Source: Department of Foreign Affairs, Trade and Development Canada (DFATD 2013).

slope of a commodity price super-cycle led in large part by Chinese demand. Chinese investment interest in Canada has specifically focused on the oil and gas industry, including conventional oil and gas, as well as non-conventional assets such as oil sands, shale oil and gas, and tight oil. As a share of total FDI, the stock of Chinese investment in Canada is relatively small at around 2% according to official Canadian statistics (Table 2). Surveys of outward investment intentions, however, indicate that Canada is seen as an attractive destination for Chinese enterprises, suggesting that the volume and share of Chinese investment in Canada is poised for further increase in the years ahead (Asia Pacific Foundation of Canada 2010).

The debate around Chinese investment in Canada has been complicated by recent developments in the Canadian oil and gas sector, which is undergoing structural challenges related to the discovery of shale gas in the United States and limitations in North American energy transportation infrastructure. Virtually all Canadian exports of oil and gas go to the United States, which is reflected in the predominantly North–South network of pipelines linking Canada to its major market. While there are pipelines from oil and gas fields in Saskatchewan, Alberta, and British Columbia to Canada’s Pacific coast, virtually all of the current westward flow is intended for domestic consumption or is exported as crude oil to the United States for refining, and re-imported into the country (Asia Pacific Foundation of Canada 2012). There is also limited pipeline capacity in Central and Eastern Canada, with much of the existing flow entering the country as imports of crude oil that are refined in New Brunswick and subsequently distributed to markets in Ontario and Quebec (see Figure 2).

The glut of natural gas in North America and tapering energy demand in the United States has driven down the price of natural gas and clouded the prospects of oil sands development in Canada. US resistance² to the building of a new pipeline (Keystone XL) to connect the abundant oil sands resource of Northern Alberta with markets in the American Midwest and South has added pressure on Canadian producers to seek markets outside North America, especially Asia. Lack of access to international markets is a principal reason for a discount on the price of Western Canadian Select (the benchmark for heavy crude oil, commonly known as bitumen), which has been as large as US\$25/barrel compared to the

Table 1. Recent Chinese investments in Canada, 2009–present (C\$).

Investor	Date	Size	Sector	Target	Location	Notes
Chihong Canada Mining Ltd	March 2013	\$50M	Mining	Selwyn Resources	British Columbia (BC)	Remaining 50% of Selwyn zinc and lead project in the Yukon Territory
China National Offshore Oil Corporation Ltd (CNOOC)	February 2013	\$15.1B	Oil & gas	Nexen	Alberta (AB)	Acquisition
PetroChina	February 2012	\$1B	Oil & gas	Royal Dutch Shell PLC	BC	20% stake in shale gas project
Yunnan Chihong Zinc & Germanium	February 2012	\$100M	Mining	Selwyn Resources	BC	50/50 joint venture
PetroChina	January 2012	\$680M	Oil & gas	Athabasca Oil Sands Corp	AB	100% controlling position of Mackay River and Dover oil sands
WISCO International Resources	November 2011	\$120M	Mining	Century Iron Mines	Quebec (QC)	40% interest in three projects
Sinopec	October 2011	\$2.2B	Oil & gas	Daylight Energy	AB	Acquisition
Sichuan Bohong Industry	September 2011	\$179M	Auto Parts	West Cast Industries	Ontario (ON)	Acquisition
Minmetals	September 2011	\$1.3B	Mining	Anvil Mining	QC	Acquisition
CNOOC	July 2011	\$2.1B	Oil & gas	Opti Canada	AB	Acquisition
China Longyuan Power	July 2011	\$260M	Energy	Farm Owned Power	ON	Right to develop 100-megawatt project
Sinopec	January 2011	\$100M	Oil & gas	Enbridge Inc	AB	Investment in pipeline project
China Investment Corp	May 2010	\$1.23B	Oil & gas	Penn West	AB	Joint venture for 45% of oil sands properties
State Grid International Development Ltd	May 2010	\$1.5B	Energy	Quadra Mining Ltd	BC	Purchase 10% in Quadra Mining Ltd and 50% in Sierra Gorda project
Sinopec	April 2010	\$4.56B	Oil & gas	Syncrude	AB	9% stake

(Continued)

Table 1. (Continued).

Investor	Date	Size	Sector	Target	Location	Notes
Jilin Jien Nickel and Goldbrook Ventures	January 2010	\$192M	Mining	Canadian Royalties Inc.	QC	Acquisition
Sinopec	June 2009	\$8.3B	Oil & gas	Addax Petroleum Corp	AB	Acquisition
PetroChina	2009	\$1.9B	Oil & gas	Athabasca Oil Sands Corp	AB	60% stake in two undeveloped oil sands properties
Sinopec	2009	N/A	Oil & gas	Total S.A.	AB	10% stake (50% total)
China Investment Corp	2009	\$1.5B	Extractive	Teck Resources Ltd	BC	17.2% stake

Source: Asia Pacific Foundation of Canada (2013).

Table 2. Foreign direct investment positions in Canada at year-end.

	2009	2010	2011	2012
	Billions of dollars (C\$)			
Foreign direct investment in Canada	573.9	592.4	599.3	633.9
United States	299.3	317.7	310.9	326.5
Netherlands	56.3	53.6	59.9	61.4
United Kingdom	47.1	42.4	47.3	54.6
Luxembourg	13.9	20.9	22.2	24.6
Switzerland	23.5	19.7	20.3	21.4
Japan	14.5	12.7	15.4	17.5
Brazil	13.2	17.3	14.5	15.8
France	17.6	17.4	13.2	14.8
China	12.2	12.1	11.5	12.0
Germany	9.4	8.2	11.0	11.7
All other countries	67.0	70.6	73.1	73.4

Source: Statistics Canada (2013).



Figure 2. Existing and proposed LNG pipelines through Canada.

Source: Canadian Energy Pipeline Association (2013).

West Texas Intermediate (WTI) benchmark that is the standard price index for oil in North America. In recent years, WTI has in turn been trading at a discount of as much as US\$20/barrel relative to Brent Crude³ (Janzen and Nye 2013). This differential has narrowed

significantly in 2013, but the gap is expected to persist as long as infrastructure bottlenecks are not resolved.

In the case of natural gas, pricing in Canada and the United States is unconnected to international prices because of the insulated North American market. The Henry Hub benchmark is a market-based measure that reflects supply and demand on the continent and it is generally unaffected by market conditions outside of North America. The shale gas revolution in Canada and the United States has resulted in a massive expansion of natural gas production and has driven down the Henry Hub price to as low as US\$2/mmBTU in April 2012 compared to an average price of US\$8.9/mmBTU in 2008. By contrast, natural gas pricing in Asia is linked to oil prices and natural gas is generally traded through long-term contracts at substantial premiums over the Henry Hub price. For example, in the aftermath of the 2011 Tohoku disaster and nuclear shutdown in Japan, the contract price for liquefied natural gas was as much as US\$16/mmBTU.

The significant price discounts faced by Canadian oil and gas producers are behind the impetus to build infrastructure (pipelines, terminals, liquefaction plants) that will allow for access to new markets. Pipeline projects have been proposed both westward to the Pacific Ocean and eastward to the Atlantic, with the objective of reaching ‘tidewater’ as the jump-off point for markets outside of North America. Given the energy deficit in most Asian countries and expectations of continued high demand for fossil fuels across the region, the principal focus of Canadian efforts to diversify its energy exports is Northeast Asia.

The opportunity to access one of the few remaining large untapped reserves of oil and to take advantage of price differentials between North American and international oil and gas markets has not been lost on Asian investors. In addition to investment in the Canadian market from Chinese entities, there has been substantial participation by Japanese, Korean, Malaysian, and Thai oil and gas companies – mostly involving SOEs (see Table 3). The influx of Asian investment is gradually changing the character of the Canadian industry, which has hitherto been dominated by the super-majors⁴ and by a small group of domestic firms.

The structural challenges facing the Canadian oil and gas industry, and its quest for new markets in Asia, are an essential part of the backdrop to debates around investment by Chinese SOEs. A lesser, but not unimportant, context is the larger discussion around climate policy in Canada and the characterization of the oil sands by many environmentalists as an especially ‘dirty’ source of energy because of the higher emissions associated

Table 3. Recent non-Chinese SOE investments in Canada (C\$).

Investor	Origin	Date	Size	Target
Japan Oil, Gas and Metals National Corporation (JOGMEC)	Japan	August 2012	\$1.95B	Cutbank Dawson Gas Resources Ltd
Petronas	Malaysia	June 2012	\$5.5B	Progress Energy
Korea National Oil Corporation (KNOC)	South Korea	December 2010	\$525M	Hunt Oil Company of Canada
Korea Gas Company (KOGAS)	South Korea	March 2010	\$565M	EnCana
PTTEP	Thailand	November 2010	\$2.4B	KKD Oil Sands Partnership
Statoil	Norway	April 2007	\$2.2B	North American Oil Sands Corporation

with the recovery of heavy oil. Opposition to oil sands development – and, to some extent, opposition to shale gas development – on environmental grounds has been non-discriminatory. There is, however, a sense in some circles that Asian investment (especially from China) in Canadian oil and gas development will only add to the problem of global emissions and retard the shift to cleaner fuels and renewable energy sources (Nikiforuk 2011).

2. The Investment Canada Act (ICA) and the net benefit test

The history of foreign investment regulation in Canada dates back to the early 1970s with the passing of the *Foreign Investment Review Act* (FIRA) of 1974. The FIRA was enacted in response to nationalist sentiment among Canadians, along with fears about the long-term negative repercussions of foreign ownership of Canadian industry (O’Sullivan 1980). At a time when one-third of business operations in Canada were controlled by foreign entities (mostly from the United States), there was strong public support for greater restrictions on inward investment as a way to protect and foster Canadian ownership. The FIRA, which was in force between 1974 and 1985 before being repealed, reflected a generally skeptical, if not hostile, attitude toward foreign investment. Under the Act, all new foreign acquisitions and establishments of business in Canada above a certain size were required to undergo review. This imposed additional legal and administrative costs on foreign investors, and created uncertainty for investment projects (Globerman and Shapiro 1999). The criterion for approval was based on an amorphous concept known as ‘significant benefit to Canada,’ which included measures related to job creation, productivity, and industrial efficiency.

In 1985, the Canadian government’s stance toward FDI shifted significantly with the repeal of the FIRA and the passing of the ICA. The ICA was also a mechanism to assess the benefits of foreign investment for Canada but, unlike its predecessor, was premised on foreign investment as a desirable policy objective (Grover 1985). In place of the significant benefits test, the ICA introduced a new ‘net benefit’ test, which added two additional criteria to the review process, namely the contribution of the investment to Canada’s global market competitiveness and its compatibility with federal and provincial cultural policies (*Investment Canada Act* and RSC 1985 (1st Supp), c 28, s 20). A summary of how the ICA’s ‘net benefit’ test operates can be found in Appendix 1.

The advent of the ICA reflected a broader relaxation of restrictions on foreign investment and a departure from nationalistic impulses, most notably in the energy sector. Even apart from the FIRA, the energy industry was subject to a variety of regulations designed to limit foreign participation. The most notable of these efforts was the National Energy Program (NEP), which was set up in 1980 to encourage Canadian ownership and control of the petroleum industry, resulting in much resentment in the oil-producing province of Alberta. The NEP facilitated the expansion of Petro-Canada, a SOE (known in Canada as a Crown corporation) that was created in 1975 as part of the government’s effort to increase Canadian ownership and control of oil and gas assets.

With a change of government in 1984, the NEP came to an end along with the FIRA, even though the privatization of Petro-Canada did not commence until 1991.⁵ The saga of Canadian state involvement in the energy industry continues to haunt current debates about investment by foreign SOEs in the country, with the prime minister himself invoking the successful privatization of Petro-Canada as a reason not to allow rampant investment by foreign SOEs in the oil patch.⁶

Although the standards imposed by the FIRA were relatively restrictive of foreign investment in general, SOEs were not given special consideration in the investment review process under that regime. The ICA likewise did not distinguish between SOE and private enterprises until July 2007, when a set of ‘special guidelines’ (henceforth referred to as the ‘2007 guidelines’) were issued by the Minister of Industry (Industry Canada 2012). The 2007 guidelines focus on the governance of SOEs and on the extent to which they operate as commercial entities. They also outline some factors that the government will use to assess the adherence of SOEs to Canadian standards of corporate governance and commercial practice, as well as listing examples of commitments that SOEs may be required to provide before a proposed transaction is allowed to proceed. The impetus for the 2007 guidelines with their focus on SOEs is obscure since there was no transaction involving an SOE in the public eye around that time⁷ and the government had already asked a blue-ribbon Competition Policy Review Panel to come up with recommendations on the treatment of SOEs under the ICA (Government of Canada 2008). In the event, the government pre-empted the panel by suddenly issuing the guidelines and hence removing that item from the panel’s mandate. Importantly, the guidelines effectively became the regulatory backdrop for investments by SOEs for the next five years.

The approval of the CNOOC–Nexen/Petronas–Progress deals in November 2012 marked the end of the first phase of scrutinizing SOEs under the ICA. The 2007 guidelines were spare and vague, but they provided a measure of guidance for prospective SOE investors. It is not clear what impact the guidelines had on the investment intentions of SOEs, but investment by SOEs (including Chinese firms) in Canada rose sharply during the 5-year period that the guidelines applied. The conventional wisdom of the time was that while investment by SOEs in non-controlling stakes of Canadian companies would be tolerated, regulators would resist any attempt at majority ownership or an outright acquisition of a prominent Canadian asset. This proviso was not found anywhere in the ICA or in the 2007 guidelines on SOEs, but it was widely believed to be a ‘red line.’ In the same way, the regulations did not single out investment by *Chinese* SOEs for special treatment, but it was also widely assumed that the barriers for investments from China would be much greater than for investments by SOEs of other countries (Mayeda 2012).

Both of these notional red lines were crossed when CNOOC made its offer of a friendly takeover of Nexen in 2012, notwithstanding the overall attractiveness of CNOOC’s proposal. CNOOC’s offer appeared to meet or exceed the standards of the 2007 guidelines. Not only was the acquisition attractive from a shareholder point of view (representing a 60% premium over Nexen’s share price at the time of offer), but it also included sweeteners that were clearly a response to Ottawa’s concerns around corporate governance and commercial practice. CNOOC agreed to keep in place the Nexen management team and the Calgary head office; expand Nexen’s Calgary head office responsibility to include the merged (CNOOC–Nexen) company’s North and Central American operations; list the new entity on the Toronto stock exchange; and ensure that Canadians accounted for at least half the members of the board of directors.

From a political standpoint, however, approval of the deal was never taken for granted. Public opinion was against the transaction, and there was fundamental opposition from senior officials to state ownership of any sort – foreign or Canadian. Rather than providing clarity on investment by SOEs in Canada, the 2007 guidelines were increasingly seen as inadequate to the task of properly screening such deals.

It was no surprise, therefore, that the approval of the CNOOC–Nexen and Petronas–Progress transactions came with a further elaboration from the Minister of Industry on the review of investment by SOEs in Canada. The minister’s statement, published on the

Industry Canada website, articulated a number of key suppositions about SOEs and their involvement in the Canadian economy:

- (1) Foreign SOEs are inherently susceptible to foreign government influence that may be inconsistent with Canadian national industrial and economic objectives.
- (2) SOE acquisitions of Canadian businesses may have adverse effects on the efficiency, productivity, and competitiveness of those companies, which may in turn have negative effects on the Canadian economy in the longer term.
- (3) The Canadian oil sands are of global importance and immense value to the future economic prosperity of all Canadians. While the vast majority of global energy deposits are state-controlled, Canada's oil sands are primarily owned by innovative private sector businesses. If the oil sands are to continue to develop to the benefit of all Canadians, the role of private sector companies must be reinforced (Government of Canada 2013).

As a guide to the review of future investment by SOEs in Canada, the minister's statement added a number of matters that the minister must be satisfied of prior to approving prospective investments:

- (1) ...the investor satisfies the minister of the investment's commercial orientation; freedom from political influence; adherence to Canadian laws, standards and practices that promote sound corporate governance and transparency; and positive contributions to the productivity and industrial efficiency of the Canadian business.
- (2) ...the Minister of Industry will closely examine the degree of control or influence an SOE would likely exert on the Canadian business that is being acquired; and the degree of control or influence an SOE would likely exert on the industry in which the Canadian business operates.
- (3) ...the Minister of Industry will closely examine the extent to which a foreign state is likely to exercise control or influence over the SOE acquiring the Canadian business. Where due to a high concentration of ownership a small number of acquisitions of control by SOEs could undermine the private sector orientation of an industry, and consequently subject an industrial sector to an inordinate amount of foreign state influence, the government will act to safeguard Canadian interests (Government of Canada 2013).

The minister also took the unusual step of addressing any future proposed investment by an SOE in the oil sands:

Each case will be examined on its own merits; however, given the inherent risks posed by foreign SOE acquisitions in the Canadian oil sands the Minister of Industry will find the acquisition of control of a Canadian oil sands business by a foreign SOE to be a net benefit to Canada on an exceptional basis only. (Government of Canada 2013)

Most of the points raised in the minister's statement are simply a restatement of the net benefit test that is part of the ICA. For example, the attention to productivity, efficiency, and competition is integral to the net benefit test and would presumably apply to private companies as well as SOEs. What was unusual about the statement was the declaration that any future investment involving the acquisition of control of a Canadian oil sands

business by a foreign SOE would be approved on an exceptional basis only. It is not clear why oil sands investments were singled out (SOEs account for a small share of the assets of the oil sands) and what other industries might be subject to an exclusion of this sort in the future.⁸ It is noteworthy that while Canadian oil and gas majors generally came out in favor of the CNOOC–Nexen deal, they also expressed the need to maintain a strong Canadian presence in the oil sands, arguing that foreign investment in larger and more ‘strategic’ Canadian companies should be off limits (Mayeda 2012).

The underlying concern reflected in the minister’s statement has to do with ‘inherent risks posed by foreign SOE acquisitions’ and ‘foreign government influence that may be inconsistent with Canadian national industrial and economic objectives.’ These risks are not spelled out, but whatever they may be, they are at the crux of the ICA provisions that constitute a formidable (if ambiguous) barrier to investment from SOEs.

To underscore the focus on foreign state *ownership* as such rather than on the net benefits offered by the investing entity, the government issued a proposed further clarification of the definition of SOEs in April 2013 (Bill C-60 2013). Under these more stringent rules, SOEs could include not only entities but also individuals acting under the direction, or the direct or indirect influence, of a foreign government (s 136, cl 2). In the case of China, which is a nominally socialist economy with a Leninist political system, all enterprises could potentially fall under such a broad definition. The Bill also provides the Minister of Industry with sweeping powers to determine whether an entity is in fact controlled by an SOE and whether there has in fact been an acquisition of control of an entity by an SOE (s 143, cl 4). The minister also has the discretion to effectively characterize entities that ordinarily qualify as Canadian-controlled as SOEs, hence subjecting them to review under the ICA.

3. Canadian public opinion

Recent Canadian public opinion has been negative toward state-owned investment in Canada. According to a poll by the Asia Pacific Foundation of Canada (2013), 52% of Canadians oppose investment from SOEs, with 23% strongly against. By contrast, just 4% of Canadians ‘strongly support’ investment by SOEs, while 28% ‘moderately support’ it, and 16% ‘don’t know’ (Figure 3).

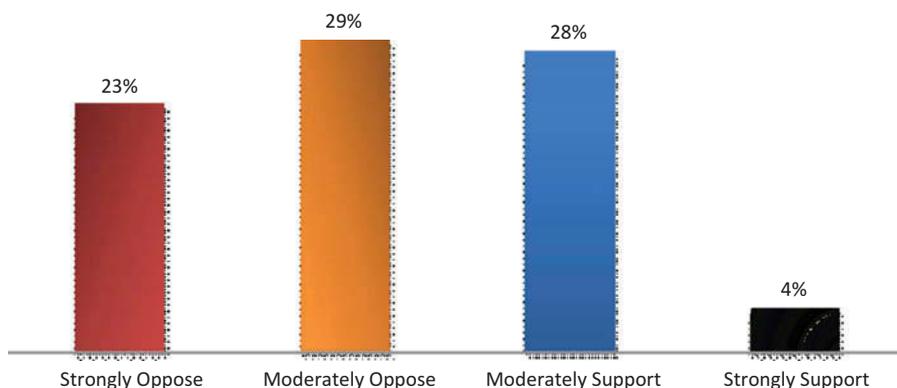


Figure 3. Canadian support for foreign direct investment in Canada by state-owned foreign companies, 2013. $N = 3474$, margin of error $\pm 1.7\%$.

Source: Asia Pacific Foundation of Canada (2013).

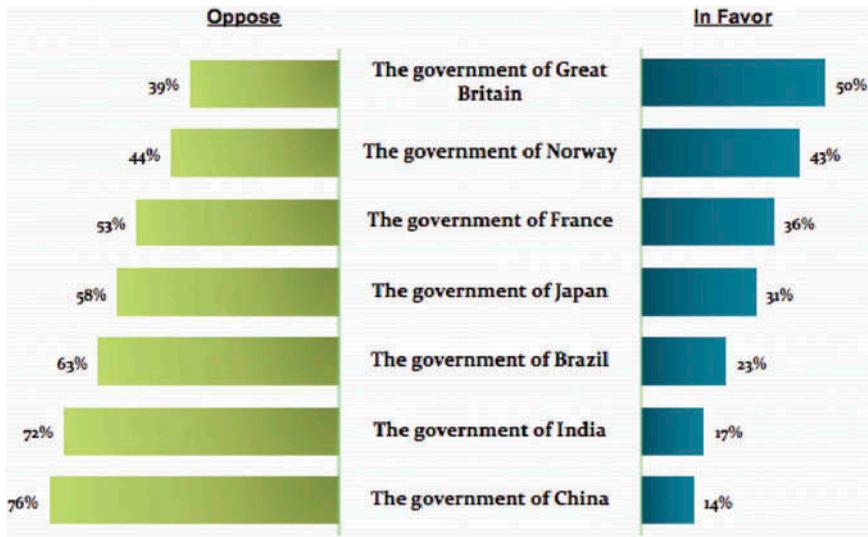


Figure 4. Degree of Canadian opposition to SOEs depends on country of origin. $N = 3474$, margin of error $\pm 1.7\%$.

Source: Asia Pacific Foundation of Canada (2013).

When asked about a majority stake investment from different national SOEs, Canadians were least supportive of Chinese enterprises, with 76% opposed compared to only 14% in favor. Respondents were twice as supportive of investment by SOEs from Japan or France, and more than three times more supportive of investment by SOEs from the United Kingdom (Figure 4).

Canadians have been particularly opposed to investment by Chinese SOEs, a trend that has seen little change since 2010 (Figure 5).

Setting aside investment by SOEs as such, Canadians are generally positive about investment from Asian countries, even though the level of support has fallen in the last six years (Figure 6).

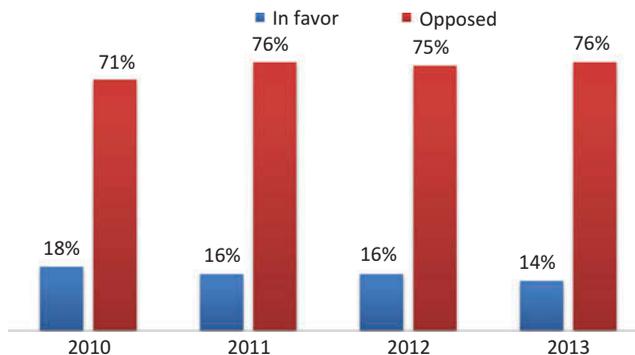


Figure 5. Canadian attitudes to foreign direct investment by Chinese SOEs. $N = 3474$, margin of error $\pm 1.7\%$. Some participants responded that they 'did not know.'

Source: Asia Pacific Foundation of Canada (2013).

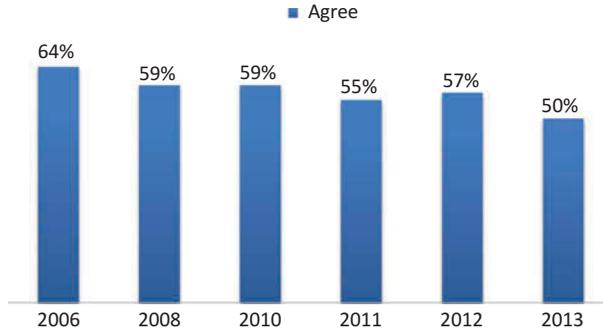


Figure 6. Canada would benefit from more Asian investment in the country. $N = 3474$, margin of error $\pm 1.7\%$.

Source: Asia Pacific Foundation of Canada (2013).

The extent of opposition to Chinese investment is a function of the degree of control by the acquiring company, as reflected in a Harris-Decima poll conducted at the time of the CNOOC–Nexen transaction (Figure 7).

4. Policy debates

While public opinion has clearly been against investment by SOEs in Canada and investment by Chinese SOEs in particular, views in the public policy community and among scholars/analysts are mixed. The CNOOC–Nexen deal precipitated a torrent of commentary in newspapers and research publications, arguing both sides of the issue.

In a throwback to the 1970s, a small group of opinion leaders voiced opposition to the deal on a strictly nationalist basis. An extreme version of this view could be found in the

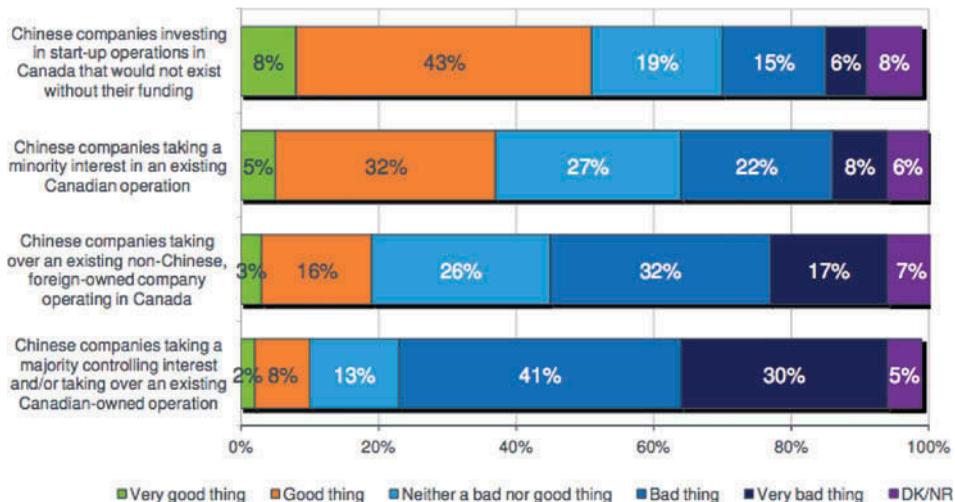


Figure 7. Canadian attitudes to varying degrees of Chinese investment control. Note: DK/NR stands for ‘don’t know/not relevant.’

Source: Harris-Decima (2012).

writings of business columnist Diane Francis (2012), who fears that Canada is a ‘colony waiting to be conquered again.’ She advocates a 10% limit on all foreign ownership of Canadian companies, with the exception of greenfield projects. While there were few takers for her draconian restrictions on foreign investment, she nevertheless echoed a lament that is increasingly heard across corporate Canada about the loss of Canadian majority ownership in iconic companies such as Alcan, Inco, and Viterra.

Whereas Francis would have applied her foreign ownership rule to both SOEs and private enterprises, other commentators singled out state ownership as the stumbling block in the Nexen deal. The general argument was that Beijing would dictate how CNOOC operates, leading to non-market decisions that are contrary to Canadian interests. This view, however, has not been expressed with respect to SOEs from countries other than China that have operations in Canada – for example, Malaysia’s Petronas, Korea’s KNOC and KOGAS, Norway’s Statoil, Japan’s JOGMEC, and Thailand’s PTTEP (Cattaneo 2013).

A different take on the SOE problem comes from Mintz (2012), who views foreign state investment as a form of ‘backdoor nationalization’ of Canadian industry. His objection to the CNOOC deal is based on the grounds of unfair competition (since the company is subsidized by the Chinese state) and the belief that SOEs perform less well than private companies in the long run. Mintz would place limits on all foreign investment by SOEs in Canada (excepting greenfield projects), including state-linked pension funds and sovereign wealth funds. This view has been given fuller expression in a recent paper by Chen (2013).

A relatively new and increasingly popular line of argument is to use Chinese investment interest in Canada as a bargaining chip in bilateral relations. Indeed, Martin (2012) has argued that the only standard for assessing the CNOOC deal is reciprocity from the Chinese government. In other words, Ottawa should approve the CNOOC deal only if Beijing would in principle allow a similar transaction involving a Canadian company looking to invest in China.

Proponents of the CNOOC–Nexen deal have emphasized the benefits of inward investment and downplayed the risks that a Chinese SOE would pose to Canada. Coyne (2012) and Woo do not see a problem with Chinese state subsidies that enable CNOOC to outbid the competition since the higher price offered for the acquisition of Nexen shares is to the benefit of stockholders and does not create a burden for Canadian taxpayers. Woo acknowledges that SOEs may in general underperform private companies, but points to the dominant role of SOEs in the global oil and gas sector as a reason to not exclude them from involvement in the Canadian industry. He also challenges the use of relative performance as an appropriate criterion for government to apply in the net benefit calculation: rejecting investment from a company that performs below its peer group average is an extreme form of intrusion on shareholder rights. If applied to SOEs, the same principle would presumably hold for investment from private firms as well. He argues that the decision to accept a bid from a prospective investor (and the implicit judgment about the capabilities of the new management) should rest with shareholders of the target company (Woo 2012b).

Woo (2013) disputes the view that SOEs in the Canadian oil patch represent a form of stealth nationalization:

... no Canadian taxpayer funds are involved in a foreign SOE operating in Canada and, more importantly, there are no Canadian government preferences accorded to the foreign SOE, which has to operate within the market framework of the Canadian economy. To the extent that Chinese SOEs receive preferences in their home country, that problem is for Chinese taxpayers to protest.

In an industry where memories of, and ill feelings about, Canadian government interference are still fresh, the argument about ‘backdoor nationalization’ is both emotive and potent.

Schwanen and Bergevin (2011) and others have notably argued that it is impractical to link a specific transaction such as the CNOOC–Nexen deal to demands for broader reciprocity from the Chinese government. They also point out that demanding reciprocity at the expense of a deal that is already deemed to be of ‘net benefit’ runs contrary to Canadian interests. Woo (2012a) adds that ‘[i]f we believe that foreign investment is good for Canada, why would we impose a condition that works against our interest?’ Grant (2012) points out that China has been extremely successful in attracting foreign investment on its own terms, and there is no reason why Canada should harmonize its investment policies with those of China on the grounds of reciprocity.

5. The case for non-discrimination against SOEs

Singling out SOEs for special consideration under the ICA is a relatively recent development, and one that has been subject to ad hoc clarification – a sign that this policy approach is still evolving. A careful reading of the current provisions concerning SOEs suggests that they are more about the issue of ownership than about ‘net benefits.’ Indeed, the assessment criteria highlighted in both the 2007 guidelines and the 2012 clarification by the Minister of Industry are already contained in the ICA – importantly, they are criteria that already applied equally to private companies and SOEs. The amplified focus on SOEs therefore appears to be based on a more fundamental opposition to state ownership, and on the belief that there are ‘inherent risks’ to the country arising from foreign government control of Canadian-based companies.

These ‘inherent risks’ are not spelled out in the legislation, the 2007 guidelines, and the policy documents governing this area or in the various commentaries and research papers advocating special scrutiny of SOEs. Critics of SOE-led investment tend to be long on foreboding but short on specifics, and they almost always neglect to consider the ways in which Canada can (and does) protect itself against undesirable behavior on the part of corporations through domestic regulation. To the extent that there are concerns about workplace safety, environmental practices, labor rights, competition, transfer pricing, and so on, provincial and federal authorities have the ability to regulate these areas and to apply these regulations in a non-discriminatory fashion to SOEs and private firms alike – whether they are Canadian or foreign owned.

One likely reason why opponents of investment by SOEs downplay the role that existing domestic regulation can play in safeguarding Canada from the potentially adverse effects of foreign investment is that their opposition to Chinese SOEs is more fundamental. They appear to dislike the Chinese government, which is described in a recent scholarly publication as having a ‘distorted and often disreputable drive toward global hegemony’ (Chen 2013). Much of the popular commentary on investment by Chinese SOEs boils down to distrust of the Chinese regime, whether it is on account of human rights abuses, the lack of democracy in China, suppression of the media, or Beijing’s position on a given international issue. For example, former Canadian opposition leader Preston Manning described the CNOOC–Nexen transaction as emblematic of a ‘deadly serious political competition with China.’ According to Manning (2012):

[s]tate-owned enterprises, especially those owned by a government whose values are at fundamental variance with our own, should be opposed on principle, unless such takeovers can be structured so that, when Canadian values and those of the owners of the SOE conflict with respect to their Canadian-based operations, it is the Canadian perspective that will prevail.

There is much to dislike about the record of Chinese political and economic development since the founding of the People's Republic in 1949, but it is not obvious that blocking investment by SOEs in Canada will set Beijing on a better path. In any case, if one's objection to the Chinese government is that it stands for values at 'fundamental variance' to those of Canadians, it is hypocritical to accept some kinds of economic interaction with China (e.g., two-way trade) but not investment.

This is not to argue that there should be no scrutiny of SOEs or that there is no possibility that actions taken by state-controlled companies may be inimical to Canadian interests. But it is simply unclear that SOEs should be treated differently from private firms under the ICA, especially when the clarifications on the treatment of SOEs essentially boil down to a restatement of the net benefit test. Furthermore, the introduction of a vague new standard in Bill C-60 around the 'influence' of foreign governments creates more uncertainty for companies from China and is contrary to other recent actions of the Canadian government designed to attract more investment from the People's Republic.⁹ In extreme cases, the ICA already has a national security provision that can be used to block any foreign investment – private or state-owned. The Minister of Industry can invoke a national security review independent of the net benefit test and can request any information considered necessary for '...determining whether there are reasonable grounds to believe that an investment by a non-Canadian could be injurious to national security' (*Investment Canada Act*, Part IV.1 'Investments Injurious to National Security'). 'National security' is not defined, but the review is sweeping in its coverage and could involve as many as 20 different government agencies with responsibilities ranging from public health to heritage.

To the extent that the 'inherent risks' of SOEs boil down to security issues – however defined – the proper mechanism for assessing those risks is the national security provision of the ICA¹⁰ rather than a separate set of guidelines for SOEs that merely reiterate the net benefit test. This is not to argue for a more liberal use of the national security provision, which in some jurisdictions has been applied as a pretext for protectionism or as an excuse for jingoism. It is to recognize, however, that in the context of a policy framework that is fundamentally supportive of inward FDI, the Canadian government does not require a set of redundant measures to protect against the relatively low risk of undesirable investment. If Ottawa needs a 'trump card' to turn down a proposed investment where it poses a genuine risk to Canadian welfare, it has one in the form of the national security review. Further stacking the deck is unnecessary and counterproductive.

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Notes

1. Multinational firms often channel their investments through subsidiaries in tax havens such as Hong Kong, the British Virgin Islands, or Luxembourg. The 'home country' for these investments is recorded as the tax haven rather than the country of origin of the parent firm. For example, CNOOC acquired OPTI Canada Inc. and a 35% working interest in an oil sands project through its Luxembourg subsidiary for C\$2.1 billion on 20 July 2011.

2. US resistance stems ostensibly from environmental concerns relating to (a) impact on local communities and (b) the belief that the Canadian oil sands are an especially ‘dirty’ source of oil and contribute to carbon emissions.
3. The international price benchmark for globally traded oil.
4. For example, Shell, Exxon Mobil, and Chevron.
5. Petro-Canada was founded in 1975 by an Act of Parliament, as part of the NEP, to allow Canadians to benefit from Alberta’s substantial oil reserves and rising global oil prices. It was met with opposition from rival (mostly American) oil companies and became a symbol of Canadian nationalism. As part of a wave of privatization efforts in western industrialized economies, the Canadian government announced a plan to reduce its stake in the company and began to do so in 1991. It was not until 2004 that the government relinquished its remaining 19% stake in the company. On 1 August 2009 Petro-Canada and Suncor merged to achieve a combined market capitalization of C\$43.3 billion.
6. Prime Minister Stephen Harper has been quoted as saying ‘[t]o be blunt, Canadians have not spent years reducing the ownership of sectors of the economy by our own governments, only to see them bought and controlled by foreign governments instead. The government’s concern and discomfort for some time has been that very quickly, a series of large-scale controlling transactions by foreign state-owned companies could rapidly transform this [oil sands] industry from one that is essentially a free market to one that is effectively under control of a foreign government’ (*The Toronto Star*, 7 January 2013).
7. China Minmetals, an SOE, contemplated a takeover of Noranda in 2004 but abandoned the effort because of public and political resistance. The major foreign takeovers in 2007 of Canadian icons Alcan and Inco did not involve SOEs.
8. No such exclusion was made for the natural gas sector, which was the focus of the Petronas–Progress deal and likely an area of substantial SOE investment interest in years ahead.
9. After 18 years of negotiations, Beijing and Ottawa concluded the Canada-China Foreign Investment Protection and Promotion Agreement in November 2012.
10. It is beyond the scope of this paper to discuss the criteria for a national security review. There are clearly risks associated with a capricious and over-zealous use of the national security review process. Moran (2012) provides a useful starting point for consideration of this issue, including possible criteria for a national security test.

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Appendix 1. A summary of the *Investment Canada Act's* 'net benefit' test

The net benefit test

Under the *Investment Canada Act*, a non-Canadian investor seeking to acquire control of a Canadian business valued at more than certain financial thresholds must demonstrate that its transaction will result in a 'net benefit to Canada.' The thresholds are different for SOE and non-SOE investors. Proposed acquisitions by SOEs are reviewable if the book value of the transaction is greater than C\$344 million. Where non-SOEs from WTO member economies are looking to acquire non-cultural businesses, the current threshold for review is C\$600 million and will rise to C\$1 billion over a 4-year period. A more thorough interpretation of the *Investment Canada Act* is described by Lally et al. (2012). The criteria used in assessing net benefit are as follows:

- (a) the effect of the investment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada and on exports from Canada;
- (b) the degree and significance of participation by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada of which the Canadian business or new Canadian business forms or would form a part;
- (c) the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
- (d) the effect of the investment on competition within any industry or industries in Canada;
- (e) the compatibility of the investment with national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment; and
- (f) the contribution of the investment to Canada's ability to compete in world markets. (*Investment Canada Act*, RSC 1985 (1st Supp), c 28, s 20)