Inside Canada's FIRA Process

The what, why, and how of the Foreign Investment Review Agency; licensing plays important role

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I shall describe the "what", "why" and "how" of Canada's Foreign Investment Review Agency and explain why I believe that, through licensing, the more fundamental aims of that process can well be served.

What are:

1. The Foreign Investment Review Act.
2. The Foreign Investment Review Agency.
3. The Foreign Investment Review process?

THE ACT

This act of parliament was introduced by the government of Canada in two stages, in 1974 and in 1975. It established the means whereby the government could examine, and could decide whether to allow or to disallow two forms of direct foreign investment in Canada:

1. The acquisition of control, by a foreign investor, of an existing Canadian business enterprise; be it Canadian—or already foreign-controlled, and
2. The establishment by a foreign investor of a new business in Canada if the activities of that business do not relate to any Canadian business already controlled by that foreign investor.

THE AGENCY

To administer this act, an organization called the Foreign Investment Review Agency was established. Although called an "agency," it is like any other department of government except that, with a complement of 131 persons, it is one of the smallest. It is headed by a commissioner who reports to a Minister (in Canada, this means an elected person to whom the Prime Minister has assigned a portfolio of responsibility) who, in our case, is the Minister of Industry, Trade and Commerce.

THE PROCESS

Occasionally, we determine that a reviewable transaction of the two sorts I have described, has taken place for which no notice has been filed. When that occurs, we have to initiate the process. But that is rare. Notices in respect of almost all reviewable proposals are filed, voluntarily, and on their own initiative, by foreign investors or by counsel acting on their behalf. The subsequent steps are as follows:

1. A legal determination is made as to whether the transaction is, in fact, reviewable.
2. If it is found to be reviewable, an economic/policy judgment is made as to whether the transaction, in the words of the FIR Act, "is or is likely to be of significant benefit to Canada." To help investors submit proposals which are likely to meet this test, there is listed in the act five broad factors (comprising several more sub-factors) that are to be taken into account in the determination of significant benefit. All proposals are, therefore, assessed in terms of their effect on:

—The level and nature of economic activity in Canada.

—The degree and significance of participation by Canadians in the business.

—Productivity, industrial efficiency, technological development.

—Product innovation and product variety.

—Competition within the sector.

—Compatibility of the transaction with national and provincial policies.

Agency officials do not carry out this judgmental process in isolation. In almost all cases, contact is made with the investor or his counsel to clarify certain aspects of a proposal or to make suggestions as to how we think it could be improved. We also seek the views of the provinces in which investments are planned, and of federal departments that have responsibility for the product or service sectors involved. When we have received the provincial and federal inputs, and when the applicant has informed us that he has completed his representations, we complete our assessment and send it to the Minister along with our recommendation that the proposal be allowed or disallowed. The Minister, acting on our advice, which he may accept in whole or part or not at all, consults with his colleagues, following which he recommends to the Governor in Council that the proposal be allowed or disallowed.

The decision is rendered in the form of an Order in Council which, once issued, is a public document. I should stress that, throughout the process, all of those who are involved in the administration of the act are bound by its confidentiality provisions and they may not disclose to third parties any of the information provided by investors, in confidence, to the agency.

WHY

That describes the Foreign Investment Review Act, the agency and the way in which the act is ad-

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ministered, but it does not explain *why* Canada introduced this review mechanism. Beginning in the 1940s and 1950s, Canadian public attention began to focus on the fact that an extraordinarily high proportion of the Canadian economy was foreign controlled. A number of studies were conducted, ending in 1970 with one entitled "Foreign Direct Investment in Canada," or the "Gray Report," named after the chairman of the group that conducted the work, the Honorable Herb Gray. It pointed out that in 1967, exactly 100 years after Canada's founding, foreign investors controled 57% of our manufacturing industry (and for some subsectors of manufacturing, e.g. chemicals, transportation equipment, and rubber products, the levels were much higher—85%, 89% and 91%, respectively), 74% of the petroleum and natural gas sector, and 65% of all mining and smelting. And U.S. investors predominated.

For the three sectors I cited—manufacturing, petroleum and natural gas, and mining and smelting—U.S. investment accounted for 79%, 81% and 86%, respectively, of all foreign investment in the sectors. Faced with this situation, it is understandable that the Gray report focused not only on the *fact* of such high levels of foreign control over key sectors of our economy, but on the *effects* of such control.

Among other things, it drew attention to the structure of Canada's manufacturing sector, which had grown the way it had partly because of Canadian commercial policy, specifically tariff policy, and partly because of the high level of foreign ownership over the sector. The situation was (and still largely is) this:

Canadian customs duties on manufactured goods—relatively high and progressively higher the greater the level of value added—had been designed to foster manufacture in Canada of a wide range of goods, as opposed to their import into this country. And it worked. But, the problem was that investors—mostly, as we have seen, U.S. firms (in part because of our proximity, and in part because of the heritage shared by many in both countries) elected to enter the Canadian market rather than leave it to their competitors. They began to produce in Canada all or nearly all of the products that they produced in the U.S.A. But, naturally enough, not at the same scale.

They built plants in Canada not for reasons of inherent economic advantage but, rather, to "get around" our customs duties. These facilities were, therefore, almost invariably geared to the Canadian market, a market which for most products is one-tenth or less the size of the U.S. market. But it went beyond that.

There was less incentive to employ the newest technology, equipment and processes in these small-scale, Canadian-market oriented plants. For these reasons, they were not extraordinarily competitive and, therefore, were not export-oriented. Nor were they the sites where R&D facilities were located, or new technologies tried. All of this was natural enough and represented no more than investor response to existing conditions, but the effect from Canada's point of view was far from satisfactory. We ended up with a miniature, noninternationally-competitive, branch-plant structure geared to the Canadian market and controlled by investors whose primary interests were rooted in their own country where they had large-scale, more modern and efficient facilities.

THE FUTURE

That is the situation the government faced in the 1970s. That is, while recognizing that many benefits had accrued to Canada because of foreign investment, their attainment had not been without cost, at least opportunity costs, in that our economy was structured in such a way as to hinder its being able to compete internationally, just at a time when progressive rounds of tariff cuts were exposing inefficient facilities in all sectors, in all countries. It was concluded that, left by itself, new investment, much of it foreign, would not necessarily correct this situation. Hence, it was decided to institute a review mechanism—not one to block foreign investment but, rather, one that would ensure that only that investment that would likely be of benefit to Canada would be allowed.

For that reason, in our dealings with foreign investors we stress the need to address the following fundamental issues:

—That Canadian industry must become world competitive.

—That we must employ up-to-the-minute technology.

—That we, too, must innovate.

—That we must have full product cycle responsibility for many of the products we do produce, i.e. from the conceptual stages through research and development and prototype testing to production and marketing.

—That for some products, the center of excellence within the overall corporate structure must reside in Canada.

As you can see, a central purpose of the FIR Act is to bring about an increase of technology transfer into Canada. But, because the act brings under review only direct foreign investment, officials of the agency generally discuss with foreign investors only such issues as the establishment of Canadian R&D operations, direct technology transfer between parent and subsidiary, and the price to be paid by the Canadian company for that transfer. But it is clear that much of what we wish to achieve could be gained through licensing rather than through direct foreign investment. Let me turn, then, to licensing.

LICENSING

The Gray Report referred in several places to licensing. Two extracts that show how highly the authors thought of licensing as an alternative to direct foreign investment are as follows:

—In the chapter, "The Technological Impact of Direct Foreign Investment," the observation was made that as opposed to direct foreign investment, "in some cases it might have been more efficient to import it (meaning "technology") in the form of the final product *or to buy it on license*" (emphasis added).

—Later the report said, "The value of licensing arrangements involving use of foreign technology or know-how and joint ventures lies in the fact that they may impose fewer restrictions on the activities under-

taken in Canada and result in greater benefits to Canada. More generally, these techniques permit greater Canadian influence over the industrial activity involved while, at the same time, they give Canada the benefit of the superior foreign inputs." That's quite an endorsement.

I must tell you too, though, that thought was given to including licensing within the ambit of the review as proposed in the Gray Report. Under the section, "What Categories of Investment Could Be Reviewed," was included "new licensing and franchising arrangements."

But, rest assured. As I have already explained, only two categories of transactions, i.e. acquisitions and establishment of new, unrelated businesses, are reviewable under the FIR Act. Licensing arrangements per se are no reviewable nor is any consideration being given to making them so. Therefore, our paths will not likely cross, at least not on account of licensing. And, yet, I do not want to leave you with the impression that we are disinterested in the process. From a Canadian point of view, licensing can be a very attractive alternative to direct foreign investment, and we would encourage it.

As people involved in the licensing process, you could very well ask: "You say that the licensing of technology to Canadian firms may often be more beneficial to Canada than is direct foreign investment, but what does Canada have to offer to the potential foreign licensor of high technology to Canadian firms?" The answer is, "Quite a lot." I will end by elaborating on that just a little.

GOVERNMENT ASSIST TO TECHNOLOGY DEVELOPMENT

Last May, the Honorable Don Johnston, Minister of State for Science and Technology and for Economic Development, presented a Technology Policy to the House of Commons and, in so doing, said that the government had dedicated $700 million for technology development over the next two years and had made another $100 million available in the form of tax incentives. There is an array of means whereby the government can, in fact, help private industry enhance its technological capability.

There are tax incentives and special depreciation allowances. There are grants and loan guarantees for large companies, small companies and for firms in particular sectors. There is financial assistance available for defense industry projects and there are others that apply to industry generally. There is a program to promote the use, by industry, of government research. Another provides salary assistance for hiring technically qualified recent post-secondary graduates. Still another helps Canadian universities provide scientific services for industrial firms unable to do so on their own. And there are more.

My point is to make clear that the Government of Canada is committed, and here I quote from the Technology Policy, "to strengthen the Canadian economy through the development of new technologies for producing goods and services and the widespread adoption of new and existing technologies." So, in speaking to prospective licensors, I would hope that you not leave them with the impression that potential Canadian licensees are not likely to be able to adopt, utilize and otherwise exploit licensed technology. Far from it.

I would conclude by stating my belief that there is a mutuality of interest between those of us who are striving to help Canada become internationally competitive, those in other countries who own technology, and licensing executives such as yourselves who play a bridging role in bringing technology owners and users together.