Regulation of

FOREIGN DIRECT INVESTMENT

in Canada and the United States

Regulation of FOREIGN DIRECT INVESTMENT *in Canada and the United States*

Edited by
Earl H. Fry
Lee H. Radebaugh

Brigham Young University
David M. Kennedy International Center

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Acknowledgments

The BYU School of Management and the David M. Kennedy International Center were very pleased to co-host the conference on the Regulation of Foreign Direct Investment in Canada and the United States, which was organized by Lee Radebaugh and Earl Fry. We think that a conference such as this is a natural focus for our university with students who have language and cultural experience from around the world. With our International Executive of the Year Award, which has been a very profound and influential award, we are hopeful that more and more companies will see BYU as a center of activities in the international scene and a source for students who can be placed in international management.

It was especially significant that the conference could be held in the N. Eldon Tanner Building. President Tanner had a very successful life in government and business circles in Canada before becoming a General Authority in the Church of Jesus Christ of Latter-day Saints. He was elected to the Alberta legislature and became the provincial minister of lands and mines. He remained in government service until 1952, when he became president of Merrill Petroleums. Later, as head of TransCanada PipeLines, Limited, he directed the building of the Trans-Canadian pipeline.

We would like to express our deep gratitude to the Business Fund for Canadian Studies in the United States, Imasco Limited, Imperial Oil, TransCanada PipeLines, Turner Valley Financial, and the Canadian Consulate-General in San Francisco for providing funding for the conference. In addition, special thanks are extended to the Business Fund for Canadian Studies in the United States for helping to underwrite the costs of this volume. We also thank Deborah L. Coon and Michelle Moulton for their extensive production assistance.

We look forward to continued cooperation between the School of Management and the Kennedy International Center and to addition-

al conferences devoted to Canada-U.S. economic and business linkages.

William G. Dyer, Dean
School of Management
Brigham Young University

Stan A. Taylor, Director
David M. Kennedy International Center
Brigham Young University

Earl H. Fry and Lee H. Radebaugh
Editors

Preface

Direct investment activity worldwide is now at record levels and the United States and Canada rank number one and number two respectively as host nations for direct investment. The remainder of this century will likely be a period of unprecedented investment activity in these two North American nations, but government intervention in the business sector may also increase significantly.

This book will focus on the investment restriction and investment incentive policies of federal, state, provincial, and municipal governments in Canada and the United States. One-half of the provinces and almost two-thirds of the states have opened offices overseas for the purpose of attracting foreign investment and hundreds of millions of dollars are being dispensed annually in the form of incentives to overseas investors.

On the other hand, national and regional governments have also enacted significant business restrictions which may have a major impact on the profitability of business ventures. Foreign Investment Review Agency (FIRA) and National Energy Program (NEP) stipulations, performance requirements, content standards, reciprocity codes, extraterritoriality practices, antitrust rules, Buy American edicts, and securities and tax disclosure provisions are among the numerous government regulations in Canada and the United States which must be closely watched by prospective foreign investors.

This book is a compilation of papers which were presented at a Canada-U.S. Investment Conference held March 31-April 1, 1983 at Brigham Young University. The setting for foreign direct investment in the United States and Canada is featured in the first section of the book. The second part looks at the federal regulation of direct investment, followed by a section which examines the restriction and incentive policies of state, provincial, and municipal governments. The fourth part of the book delves into the extraterritoriality and antitrust dimensions of foreign direct investment, and the fifth major section discusses the intricacies of acquisition and merger strategies within the North American market. The final section looks at the changing environment for foreign investment and some of the challenges which individual investors and corporations will face in the future.

This is the second in a series of books to be published by the Canadian Studies Program in the David M. Kennedy International Center at Brigham Young University. The first book in the series is entitled *Energy Development in Canada: The Political, Economic, and Continental Dimensions* (1981) and future books will deal with issues of prime concern to the business communities and government institutions in both the United States and Canada.

Earl H. Fry
Lee H. Radebaugh
Provo, Utah
August 1983

Biographical Sketch of the Authors

Samuel R. Baker is a partner in the international law firm of Stitt, Baker & McKenzie. He works extensively with foreign corporations which desire to invest in Canada and has gained a reputation as one of Canada's leading legal experts on Foreign Investment Review Agency (FIRA) regulations and procedures.

Harvey E. Bale, Jr. is the Assistant United States Trade Representative for Investment Policy and has been a leading figure in the formulation of U.S. government policy towards inward direct investment.

Harold Crookell is Director of the Center for International Business Studies and Professor of International Business and General Management at the University of Western Ontario. He is a member of Canada's Export Trade Development Board and has authored numerous scholarly books and journal articles dealing with international trade and investment issues.

G. H. Dewhirst is the Director General for the Policy, Research, and Communications Branch of Canada's Foreign Investment Review Agency. He has played a significant role in the development of the Canadian government's policy towards foreign direct investment.

David Elton is President of the Canada West Foundation and Professor of Political Science at the University of Lethbridge. He is the author of numerous articles dealing with public opinion and with issues of special interest and concern to the residents of Western Canada.

C. Douglas Floyd is a Professor in the J. Reuben Clark Law School at Brigham Young University and a leading expert on antitrust policies.

W. Milton Folds is the Commissioner of the Georgia Department of Industry and Trade and has been a chief architect of Georgia's highly successful campaign to attract foreign direct investment.

Earl H. Fry is Coordinator of Canadian Studies and Associate Professor of Political Science at Brigham Young University. He is the author of *Financial Invasion of the U.S.A.* (McGraw-Hill, 1981), a book which deals with foreign direct investment in the United States, and of *The Politics of International Investment* (McGraw-Hill, 1983).

Robert J. Grenier has served since 1977 as the Industrial Commissioner for the Montreal Urban Community, an agglomeration of 28 municipalities with a population of 1.8 million. He has particular responsibility for the United States and Canada.

Lawson A. W. Hunter is a noted legal expert specializing in antitrust and extraterritoriality cases. He currently serves as Assistant Deputy Minister in the Bureau of Competition Policy and as Director of Investigation and Research, Combines Investigation Act, in Consumer and Corporate Affairs Canada.

Thomas H. Olson is an attorney associated with the law firm of Holme Roberts & Owen in Denver, Colorado, and is also a Barrister and Solicitor in the province of Alberta. He is an expert on securities and tax issues linked to foreign direct investment.

Nicholas J. Patterson is an Ottawa-based economic consultant with a background in investment securities, banking, and export finance. Some of his articles dealing with foreign direct investment have been featured in the *Financial Post*.

Lee H. Radebaugh is an Associate Professor in the School of Accountancy at Brigham Young University and is co-author of *International Business: Environment and Operations,* 3rd edition (Addison-Wesley, 1982).

David A. Ricks is Professor of International Business at the University of South Carolina. He has authored or co-authored five books and over thirty articles on such subjects as international financial management, foreign exchange risk management, capital budgeting, international business strategy, foreign investment in the United States, and international business blunders.

Table of Contents

Foreign Investment In The United States And Canada: The Setting

Earl H. Fry

Introduction

The United States and Canada rank number one and number two in the world as host nations for foreign direct investment, a type of investment which provides investors in one country with a controlling interest in a company located in another country. Foreign direct investment in the United States increased by more than 1,000 percent from 1965 to 1982 and in Canada by more than 350 percent during the same period. Tables 1 through 6 indicate the level of foreign direct investment in each country, as well as the source and distribution of the investment. It is anticipated that both the United States and Canada will continue to outdistance the rest of the world in attracting new overseas investment.

Thus, the remainder of this century will likely be a period of unprecedented investment activity in North America, but government intervention in the business sector may also increase significantly.[1]

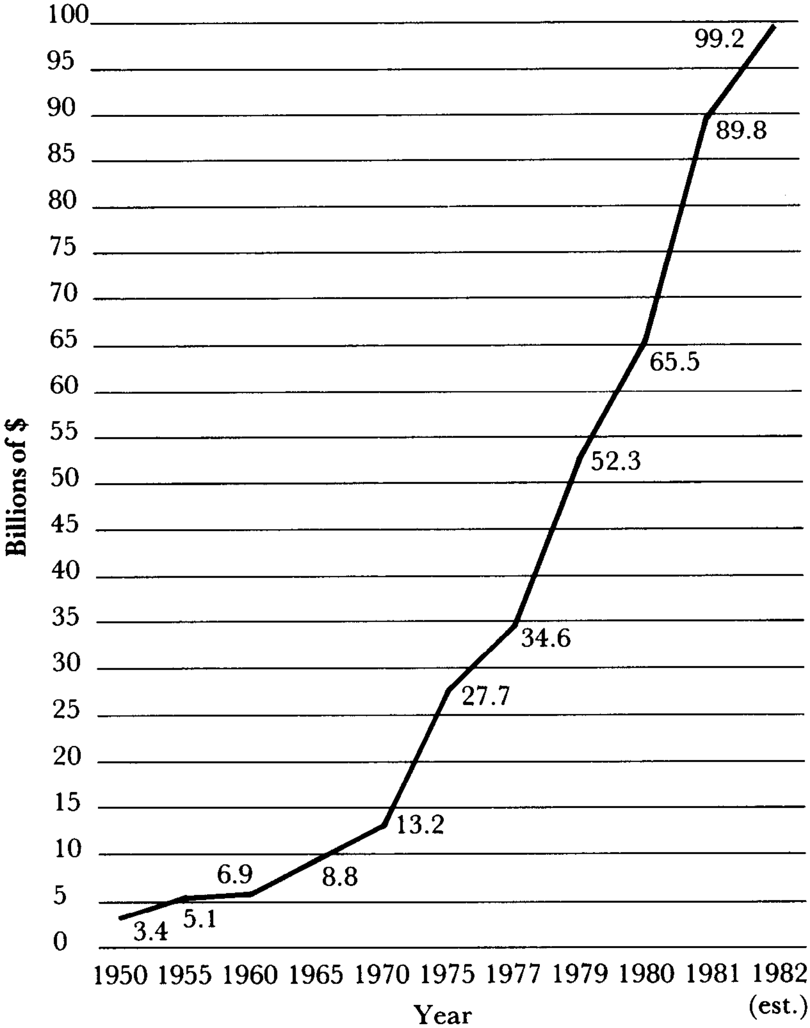
Why Invest in the United States and Canada?

The United States attracted 86 billion dollars in new foreign direct investment from 1970 until 1982, as compared to 13 billion dollars from 1789 to 1970. The emergence of the United States as the number one host nation in the world for foreign direct investment may be traced to a variety of factors. The United States has both the largest and the richest market in the world, and in an increasingly interdependent global setting it is to be expected that the giant foreign-based transnational corporations would want to acquire a sizable piece of the action. The stability of America's economic and political system is also extremely important to foreign investors and they appreciate the middle-of-the-road predictability of the U.S. governmental system. At a time when many regions of the world are suffering major political upheavals and uncertainty, the United States continues to be

Earl H. Fry is Coordinator of Canadian Studies and Associate Professor of Political Science at Brigham Young University.

Table 1

Foreign Direct Investment In The United States, 1950 to 1982



perceived by overseas residents as a safe, attractive, investment haven. Furthermore, foreign investors recognize that there is a minimum of red tape involved in making an investment in the United States, that their investments generally have the same legal status as domestic investments, and that they are not subjected to government-mandated performance requirements.

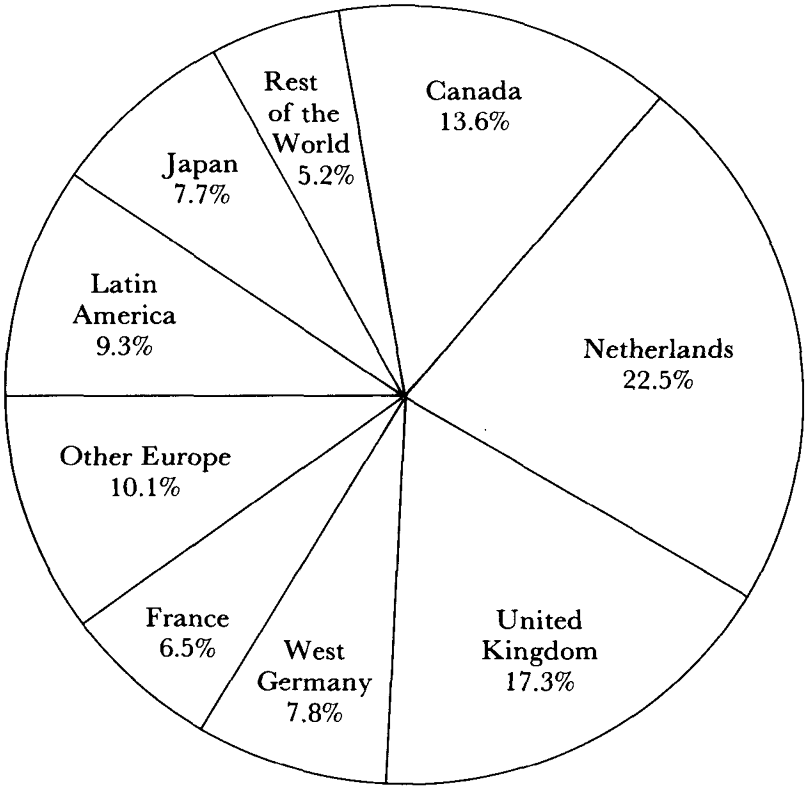
Direct investment in the United States also provides access to sophisticated technological, managerial, and marketing innovations. Tax rates in the United States are also among the lowest in the advanced industrial world and when one takes into account fringe benefits, U.S. wage rates are currently well below those of several other Western nations. Skilled labor is readily available in America and foreign firms have easy access to research and development facilities. Furthermore, many foreign firms have been prompted to establish operations in the United States because of the secure and abundant supply of relatively inexpensive natural resources and energy.

The depressed value of the U.S. dollar vis-à-vis many major currencies during the 1970s and the rather static performance of the stock market during that period also heightened the foreign interest in acquiring existing U.S. businesses. The Dow Jones industrial stock index stood at 809.20 on January 2, 1970, and at 824.57 exactly one decade later. When one takes into account inflation, the stock value of an average publicly-traded U.S. firm was actually cut in half during this 10-year period, whereas the value of the assets controlled by the firm increased dramatically simply because of inflationary tendencies. As a result, foreign investors rushed in to take advantage of the relative weakness of the stock market in order to acquire assets at what they considered to be bargain basement prices. In addition, by taking over an existing company, overseas investors benefit by having management in place and an established clientele.

The relative weakness of both the U.S. dollar and stock market, however, should in no way be construed as indications of the demise of American economic prosperity. Even though several nations currently have an average per capita income higher than that of the United States, American consumers still enjoy the most clout when it comes to purchasing power, a fact which has not been overlooked by astute overseas investors looking for an affluent market. In its survey to ascertain purchasing power in 45 major metropolitan areas in the non-communist world, the Union Bank of Switzerland determined that Chicago, San Francisco, and Los Angeles ranked number one, two, and three on the list, and New York, the only other American city included, ranked number six in terms of their citizens' purchasing power. A Purchasing Power Parity (PPP) Index developed by three University of Pennsylvania professors also indicates that the relative prosperity of citizens in the United States vis-à-vis nations in Western Europe actually changed very little from 1970 through 1980, even though there were major currency fluctuations during this period. For example, the PPP of West Germany was 78 percent of that of the United States in 1970, and had increased slightly to 81 percent by the end of the decade. By 1980, Sweden's PPP was 78 percent of that of the United

Table 2

Foreign Direct Investment in the U.S. by Country, 1981



Source: *Survey of Current Business,* August 1982, p. 37.

States, Belgium's 78 percent, the Netherlands' 70 percent, and Switzerland's 70 percent, to give just a few illustrations. Overall, on an annual basis, the average European has about 3,500 dollars less in real goods and services available for investment or consumption purposes than the average American, with per family differences being at least twice as great.

Although Canada has a population of only 24 million, about the same as California's, it ranks very close to the United States in many of the aforementioned categories. Canadians enjoy a very high standard of living and their Purchasing Power Parity is not appreciably different than that of Americans. The political and economic systems in Canada are very stable and its natural resource base is one of the richest and most diversified in the entire world. In addition, once the Tokyo Round agreements are fully implemented in 1987, virtual free trade in many product sectors will exist between Canada and the United States, providing many Canadian firms with nearly unimpeded access to the U.S. market featuring 230 million consumers.

Restriction and Incentive Policies of the U.S. Federal and State Governments

Federal Restriction and Incentive Policies

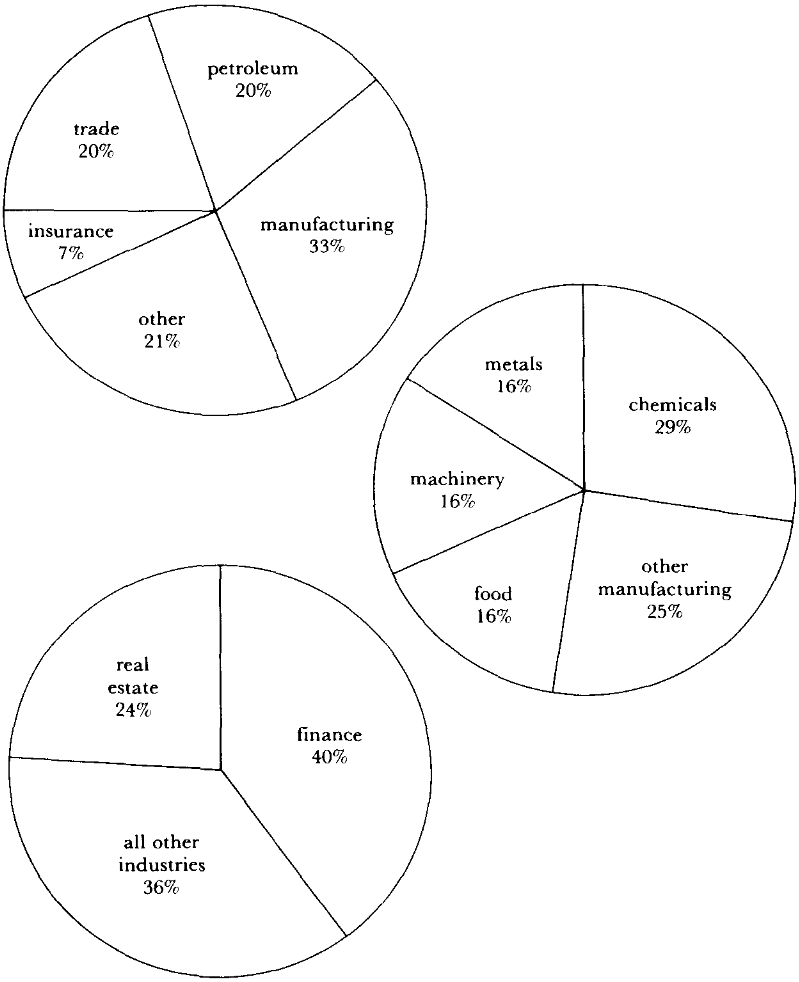
The U.S. federal government has steadfastly maintained that private direct investment should be allowed to play a pivotal role in modernizing and expanding national economies. Therefore, officials in Washington have often voiced support for the "national treatment" and "most-favored-nation" principles of international direct investment. The "national treatment" principle stipulates that foreign investors in the United States should be treated no less favorably than domestic investors in similar situations. The "most-favored-nation" principle further asserts that the investors of one foreign country should be treated no less favorably than the investors of other foreign countries. Both principles are designed to avoid instances of discrimination directed at foreign investment in the United States.

Although an arguable assumption, it may well be that the United States has fewer restrictions on foreign direct investment than any other advanced industrial nation. For national security reasons, overseas residents are prohibited from making direct investments in most industries linked to shipping, domestic airlines, hydroelectric power generation, atomic energy, and defense. For example, the Kuwait Petroleum Corporation was allowed to acquire most of the assets of California-based Santa Fe International, but one of Santa Fe's subsidiaries, C.F. Braun, was forced to terminate its government defense contracts and its files were purged by federal authorities. In addition, for monitoring and bookkeeping purposes, foreign investors who acquire 10 percent or more of a U.S. company or purchase 200 or more acres of U.S. land are required to report the transactions to the Commerce Department's Bureau of Economic Analysis. The U.S. Securities and Exchange Commission also mandates that any firm purchasing 5 percent or more of the stock in a publicly-listed U.S. corporation must disclose this acquisition and fill out forms providing some very sensitive information about the firm's operations.

Direct investments made in the United States might also subject foreign firms to the requirements of the U.S. Trading With the Enemy

Table 3

The Distribution of Foreign Direct Investment in the United States by Economic Sector, 1981



Source: *Survey of Current Business,* August 1982, pp. 36–38.

Act and to other related restrictions. The Trading With the Enemy Act allows the President of the United States to regulate and control transactions with countries considered to be hostile to the United States. This law certainly has extraterritorial implications and has