



COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON DC 20548

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SEPTEMBER 6, 1979

The Honorable Benjamin S. Rosenthal
Chairman, Subcommittee on Commerce,
Consumer, and Monetary Affairs
Committee on Government Operations
House of Representatives

HSE 01501



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Dear Mr. Chairman:

Subject: Should Canada's screening practices for
foreign investment be used by the United
States? (ID-79-45)

DLG-02698

This letter addresses questions you requested that GAO
answer concerning [Canada's Foreign Investment Review Agency]
(FIRA), as stated in your letter of March 8, 1979, and
modified in subsequent discussions with your office. Your
questions were intended to obtain information in considering
whether FIRA's screening practices should be used by the
United States.

Enclosure I provides an overview of why FIRA was estab-
lished and how it works to screen incoming foreign investment.
Enclosure II addresses your specific questions

We do not see the need at this time for establishing
a foreign investment screening agency in the United States.
Our reasons are explained in our answer to question 7,
enclosure II.

DLG-02705

From 1974 to 1978, total foreign direct investment in the
United States increased from \$26 billion to almost \$40 billion.
Because of the rapid increase, public concerns in specific
geographic or economic sectors were expressed and legisla-
tion was enacted to monitor and evaluate the effects of
foreign investments.

In a series of hearings, your Subcommittee has identi-
fied the need for improved data to assess the effects of
foreign direct investment. The scope of our work did not
include evaluating the adequacy of current efforts to monitor
and evaluate the effects of foreign investment. However,
we do not believe that the problems identified to date
warrant establishing a foreign investment screening agency
in the United States. Instead, the (1) effective implemen-
tation of existing legislation, (2) effective functioning

ID-Canada
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Monetary policies
Economic policies
Policy evaluation
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International economic relation
foreign investments in U.S. (481560)
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of the interagency Committee on Foreign Investment in the United States, and (3) continued congressional interest should alert agencies and the Congress to the need to further improve the monitoring and the regulation of foreign investment.

As requested by your office, we did not obtain formal comments from any agencies contacted during the course of this review. However, we informally discussed the subject with the Department of State and incorporated its comments where appropriate.

Copies of the report are being sent to officials who provided us with pertinent information; copies will also be made available to others upon request.

Sincerely yours

A handwritten signature in cursive script, appearing to read "James A. Heath".

Comptroller General
of the United States

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CANADA'S FOREIGN INVESTMENT REVIEW AGENCYWHY THE AGENCY WAS ESTABLISHED

Foreign dominance of Canada's economy has a long history and has resulted in a number of ad hoc government efforts over the years to protect certain key economic sectors from foreign intrusion. These sectors include domestic air, rail, and water transportation; finance and insurance; media-related enterprises; and natural resource development involving mining and oil and gas leasing of Crown lands.

The Canadian economy is heavily influenced by the magnitude of foreign direct investment, variously estimated at

- 60 percent of Canada's total manufacturing;
- 50 percent of mining and smelting;
- 75 percent of petroleum and natural gas;
- 86 percent of chemicals and pharmaceuticals;
- 90 percent of the rubber and electrical industries; and
- 96 percent of the automotive industry.

A 1976 study by Ontario's Ministry of Treasury, Economics and Intergovernmental Affairs examined foreign control over Ontario's industry between 1969-73. The study found that foreign-controlled corporations provided half the total nonfinancial corporate taxable income in Ontario and employed about 1.2 million people, about one-third of its labor force. It also noted that more than half of these employees were in high-technology industries and, thus, exposed to sophisticated managerial and productive techniques which could be spread to Canadian corporations as the employees changed jobs and moved around the economy.

Although Canada acknowledged the contributions of foreign investment to its economy, it believed many of the foreign-controlled enterprises were little more than branch plants established to penetrate tariff barriers and geared to production for the domestic market. These types of firms were considered to be too susceptible to decisions from the foreign parents and to contribute little to technological innovations and development of export markets.

As concerns grew, the Government commissioned a national study in 1970 to develop policy proposals. The resulting report from that study, commonly referred to as the "Gray Report," led to the Foreign Investment Review Act and establishment of the Foreign Investment Review Agency (FIRA) to

administer the provisions of the Act. The report identified the following issues associated with foreign-controlled investment.

1. Greater benefits of foreign investment may accrue to the foreign owner and may involve unnecessarily high costs to Canada.
2. Foreign-controlled firms may be influenced by the foreign environment or by foreign governments and, thus, are not sensitive enough to the demands of the local economy.
3. Foreign-controlled firms, especially multinational corporations, are more capable of frustrating Canadian policies than are domestic firms.
4. Foreign investment can be a vehicle for the extraterritorial application of foreign law.

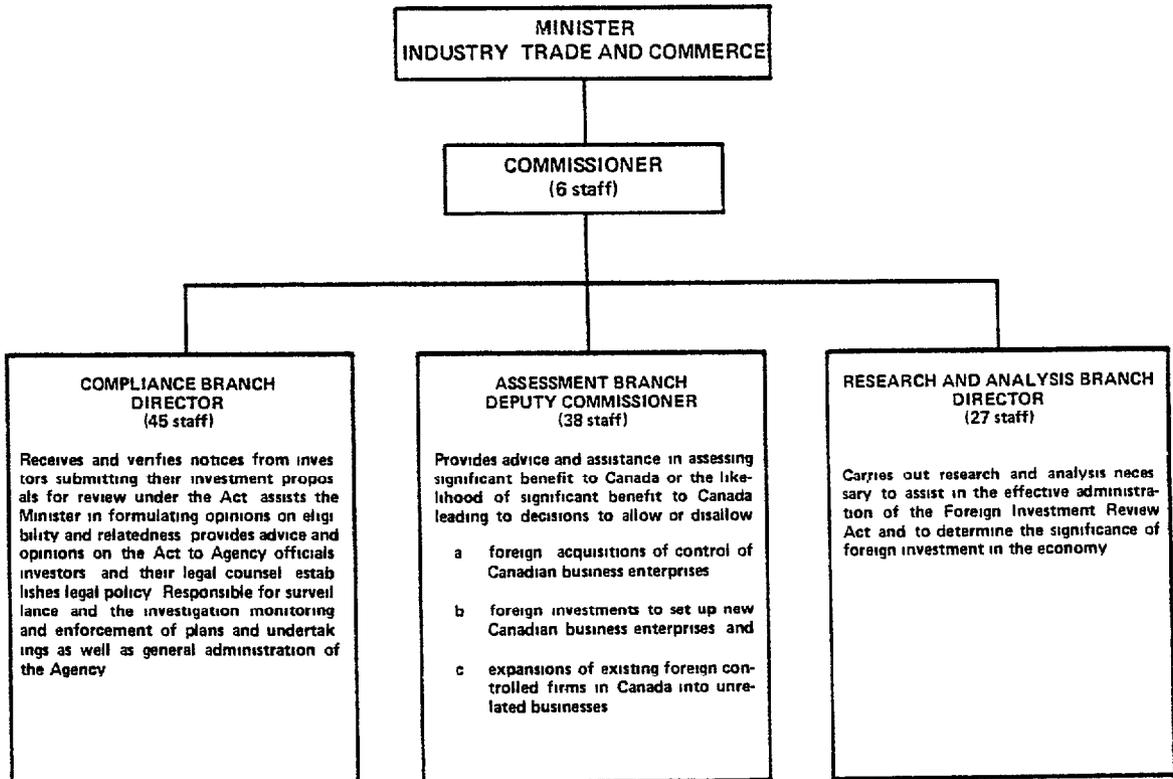
In late 1972, Canadians were provided with a broad analysis of three options for their future by the Secretary of State for External Affairs. The options were to:

1. Maintain the existing relationship with the United States with a minimum of policy changes.
2. Move toward closer integration with the United States.
3. Pursue a comprehensive long-term strategy for developing and strengthening the Canadian economy and other aspects of national life and, thereby, reduce Canadian vulnerability to outside influences.

In April 1974, FIRA, indicative of the government's selection of the third option, began screening foreign takeovers of Canadian firms. The second phase of the screening process, begun in October 1975, required FIRA to review proposed new investment by a foreign enterprise or any proposed expansion into a venture unrelated to a foreign investor's existing line of business in Canada.

HOW FIRA IS ORGANIZED

FIRA has a total staff of 116 and is divided into three branches--Compliance, Assessment, and Research and Analysis, as shown below.

HOW FIRA SCREENS INVESTMENTS

The Agency's screening or review process begins when the Compliance Branch receives a notice outlining an investment proposal. The Compliance Branch screens the application to determine whether the proposal is reviewable under the Foreign Investment Review Act and whether the notice is properly made out. If reviewable, the Act provides 60 days for the Government to accept or reject the application.

The proposal then passes to the Assessment Branch for evaluation. During this stage, additional information may be sought through contacts with the applicant and consultations with appropriate federal departments. The applicant is encouraged to talk with Agency officials; this gives him a chance to learn of deficiencies in the proposal and to strengthen it through modifications.

The notice is also circulated to the province or provinces significantly affected by the proposal. A province cannot overturn an Agency decision; however, in most cases an application would not be approved by the Agency if the affected province opposed the investment. Agency officials estimated that provinces probably disagreed with about 2 per cent of the Agency's decisions.

The Assessment Branch then prepares a document analyzing the proposed investment for the Minister of Industry, Trade and Commerce. If the Minister believes that the investment will result in significant benefit to Canada, he will recommend approval to the Cabinet. To obtain Cabinet approval, the Prime Minister and at least four Ministers must be present and approve the investment. The Cabinet presents the decision, or Order-in-Council, to the Governor General (who represents the Queen in signing), who signs the order as Governor-in-Council. According to FIRA officials, the Governor-in-Council's decision is final and conclusive because the assessment concerns economic factors, not points of law.

All decisions are made public, although the reasons for them are not. A checklist is periodically published with the announcement of benefits associated with the investment, including increased employment; resource processing; additional exports; use of Canadian parts and services; and Canadian participation as shareholders, directors, and managers. No details about these benefits are provided in the checklist, but FIRA does provide additional information through press releases.

When the Minister of Industry, Trade and Commerce believes that the benefits to Canada are not significant or that he needs additional information to make a decision, the investor is given 30 days to let FIRA know whether it will make further representations; if none are made, the Minister will base his decision on the information already submitted. When the investor agrees to make additional representations, it then has an unlimited amount of time to provide the representations and FIRA has no time limit for making its decision.

If an investor does not receive a FIRA decision accepting or rejecting the proposal within 60 days (unless asked to make further representations as described above) the Act considers the proposed investment to have been allowed; this has happened in only about 24 of the more than 1,200 cases. This 60-day requirement for a decision guards against any dilatory processing of an investment.

OUTCOME OF FIRA DECISIONS

FIRA presently handles about 800 cases a year, up sharply over previous years. Its decisions during the 4 years between April 1974 (when the first phase of the Act covering acquisition of control came into effect) and March 1978 are shown below.

Applications For Acquisitions

<u>Cases</u> <u>resolved</u>	<u>Allowed</u>	<u>Percent</u>	<u>Dis-</u> <u>allowed</u>	<u>Percent</u>	<u>With-</u> <u>drawn</u>	<u>Percent</u>
701	567	81	64	9	70	10

In 17 of the 64 cases that were disallowed, the original applicants submitted further applications offering additional benefits to Canada; 12 of these were allowed, 1 was disallowed, and 4 were still under consideration at March 31, 1978.

Applications For New Businesses October 15, 1975 to March 31, 1978

<u>Cases</u> <u>resolved</u>	<u>Allowed</u>	<u>Percent</u>	<u>Dis-</u> <u>allowed</u>	<u>Percent</u>	<u>With-</u> <u>drawn</u>	<u>Percent</u>
550	470	86	28	5	52	9

RESPONSE TO QUESTIONS ABOUT
CANADA'S FOREIGN INVESTMENT REVIEW AGENCY

1. WHAT GENERAL AND SPECIFIC CRITERIA HAS FIRA DEVELOPED TO EVALUATE THE DESIRABILITY (OR UNDESIRABILITY) OF FOREIGN INVESTMENTS? HOW ARE THESE APPLIED AND WHAT CONDITIONS ARE REQUIRED OF INVESTORS?

In deciding whether to approve a proposed investment, FIRA and, ultimately the Governor-in-Council, must determine whether the investment "is or is likely to be of significant benefit to Canada." The Foreign Investment Review Act sets out five criteria for making this decision.

1. Effect on the level and nature of economic activity in Canada, including employment; resource processing; utilization of parts, components, and services produced in Canada; and exports.
2. Degree and significance of participation by Canadians in the business enterprise and in the industry sector to which the enterprise belongs.
3. Effect on productivity, industrial efficiency, technological development, innovation, and product variety in Canada.
4. Effect on competition within any industry or industries in Canada.
5. Compatibility with national industrial and economic policies, taking into consideration industrial and economic policy objectives enunciated by a province likely to be significantly affected.

Agency officials stated that the above criteria are applied generally. The weight applied to each criterion varies with the investment proposal, the industry, and the region where the investment is being made. FIRA's review process has wide latitude under the many elements of these five criteria, but is bound to the range of the criteria.

Principles of international
business conduct

A further statement of what Canada wants from foreign investment is contained in the following 14 "Principles of

International Business Conduct" issued by the Canadian Government in July 1975.

1. Pursue a high degree of autonomy in the exercise of decisionmaking and risk-taking functions, including innovative activity and the marketing of any resulting new products.
2. Develop as an integral part of the Canadian operation an autonomous capability for technological innovation, including research, development, engineering, industrial design and preproduction activities; and for production, marketing, purchasing, and accounting.
3. Retain in Canada a sufficient share of earnings to give strong financial support to the growth and entrepreneurial potential of the Canadian operation, having in mind a fair return to shareholders on capital invested.
4. Strive for a full international mandate for innovation and market development, when it will enable the Canadian company to improve its efficiency by specialization of productive operations.
5. Aggressively pursue and develop market opportunities throughout international markets as well as in Canada.
6. Extend the processing in Canada of natural resource products to the maximum extent feasible on an economic basis.
7. Search out and develop economic sources of supply in Canada for domestically produced goods and for professional and other services.
8. Foster a Canadian outlook within management, as well as enlarged career opportunities within Canada, by promoting Canadians to senior and middle management positions, by assisting this process with an effective management training program, and by including a majority of Canadians on boards of directors of all Canadian companies, in accordance with the spirit of federal legislative initiatives.

9. Create a financial structure that provides opportunity for substantial equity participation in the Canadian enterprise by the Canadian public.
10. Pursue a pricing policy designed to assure a fair and reasonable return to the company and to Canada for all goods and services sold abroad, including sales to parent companies and other affiliates. In respect to purchases from parent companies and affiliates abroad, pursue a pricing policy designed to assure that the terms are at least as favorable as those offered by other suppliers.
11. Regularly publish information on the operations and financial position of the firm.
12. Give appropriate support to recognized national objectives and established government programs, while resisting any direct or indirect pressure from foreign governments or associated companies to act in a contrary manner.
13. Participate in Canadian social and cultural life and support those institutions that are concerned with the intellectual, social, and cultural advancement of the Canadian community.
14. Endeavour to ensure that access to foreign resources, including technology and know-how, is not associated with terms and conditions that restrain the firm from observing these principles.

Commitments or undertakings sought by FIRA

In addition to the benefits implicit in the investor's proposal, FIRA negotiates commitments or undertakings with the investor consistent with the above criteria. Although commitments are not mandatory, we were told that investors normally make them in order to obtain Agency approval.

Commitments might cover such things as making capital expenditures for plant expansion, purchasing materials and services based upon a "buy Canadian" preference, allocating a larger proportion of research and development expenditures

in Canada, appointing Canadians to the Board of Directors, and/or reinvesting earnings of the Canadian business in Canada.

Most commitments cover an investor's performance over a number of years and are monitored annually until FIRA is satisfied that the commitments have been met. The commitments are binding on the investor and enforceable in the courts, although to date no court action has been taken. An Agency official commented that, although most investors are fulfilling their commitments, changed economic circumstances have occasionally made it necessary to renegotiate undertakings. Data on how many commitments were renegotiated was not made available to us.

Business experience with FIRA

We talked with four U.S. companies who had applications disapproved by FIRA; one refiled and had its application approved, two still had their second applications pending, and one did not refile.

In no case was a company officially notified as to why the investment was disallowed. The applications refiled involved numerous meetings between FIRA and company officials, during which FIRA officials suggested modifications to the applications with the objective of increasing benefits to Canada. The U.S. companies would not give us written examples of their commitments to FIRA; but in our discussions some of the types of commitments were identified as follows.

- Purchase all goods and services in Canada, where competitively priced.
- Pay no dividends for 3 years, instead reinvesting that money in Canada.
- Export part of the company's Canadian production.
- Promote travel to Canada in one company's U.S. and European ad campaigns.

From our discussions with FIRA and company officials, it is apparent that FIRA places emphasis on negotiating additional commitments with the investor. Apparently it is unclear in advance of the negotiating process as to what specific concessions a firm will need to make to secure FIRA's approval.

Recently, United Technologies Corporation, a U.S. firm, filed its second application to acquire control of Otis Elevator Company Limited of Ontario. The Minister of Industry, Trade and Commerce explained that the first proposal had been disallowed because it failed to guarantee that declining employment at the Otis plant would be halted, lacked assurance on the future level of Canadian content in products sold by Otis in Canada, and did not show that significant research and development would be undertaken.

FIRA approved the second application after United Technologies agreed that:

1. Within any 5-year period, the annual value of Canadian content in Otis Canada's domestic sales would average not less than 85 percent; any excess of exports over imports would count toward the value of Canadian content.
2. Within 5 years, Otis Canada would increase its research and development expenditures to 1 percent per year of the company's sales of new equipment; the effort would be staffed by Canadians.

In another application, Brown Boveri (Canada) Limited, a wholly owned subsidiary of Brown Boveri Company Limited of Switzerland, proposed to acquire the Electrical Division of Canron Limited in Quebec. Both Brown Boveri (Canada) and Canron's Electrical Division manufactured power-generating equipment and, in fact, Canron manufactured some equipment under license from Brown Boveri. However, in recent years the Electrical Division had been adversely affected by competition from imports and from other domestic firms. Employment had decreased by almost 50 percent from 1966 to 1974.

The Brown Boveri acquisition proposal was allowed when Brown Boveri agreed to

1. expand the product range of electric motors;
2. make available the parent company's expertise and technology;
3. undertake research and development on traction equipment in Canada;

4. allow the Canadian plant to export and give the plant exclusive manufacturing rights to Brown Boveri traction and motors and controls in the North American market; and
5. make a 30-percent stock issue in Canada.

About \$1.75 million in equipment expenditures was expected over 3 years, and employment was expected to increase from 650 to about 1,000. Some months after the proposal was allowed, the Minister agreed to minor modifications in these undertakings due to changed market conditions.

2. WHAT OVERALL POLICY GOALS HAS FIRA DEVELOPED, AND WHAT TYPES OF INVESTMENTS HAVE CONTRIBUTED THE MOST TO CANADA'S NATIONAL OBJECTIVES?

Canada's policy toward foreign direct investment seeks to reconcile two needs. First, about 60 percent of Canadian manufacturing industry is foreign-owned, which raises concern over the need to protect national interests. Second, foreign investment is needed to supplement domestic financing of Canadian economic development. Therefore, Canadian policy welcomes foreign investment, provided that it is likely to yield benefits to Canada.

As discussed under question one, any foreign investment that meets the Foreign Investment Review Act's five criteria contributes to Canada's national objectives. FIRA may attempt to increase Canadian benefits by encouraging the investor to make commitments. Typical commitments are those that "Canadianize" investments and may include increased (1) exports, (2) processing of raw materials in Canada, (3) use of Canadian goods and services, (4) development of Canadian managerial and technical capabilities, (5) research and development, and (6) Canadian equity.

3. WHAT ARE FIRA'S CURRENT ADMINISTRATIVE, POLICY, ENFORCEMENT, POLITICAL, AND OTHER PROBLEMS?

Based on our talks with FIRA and Canadian provincial and industry officials we identified the following current problems.

Confidentiality of review process

FIRA's proceedings are closed and specific reasons for rejecting or approving an application are usually not made public. Beyond the general criteria discussed in question one, FIRA does not specify quantitatively what commitments

it seeks from investors. As a result, prospective investors have expressed confusion over the ground rules governing the review process but it is not known whether this discourages inward investment.

Agency officials defend their procedures on the basis of protecting the confidentiality of investor applications. The Minister of Industry, Trade and Commerce can disclose commitments made by investors, but only if he believes that disclosure is necessary for proper enforcement or administration of the Act and will not prejudicially affect the conduct of the investor's business. FIRA issues periodic press releases on particular decisions and also publishes a general "checklist" of benefits provided from each approved investment.

The news media has also speculated that the closed review process is susceptible to political manipulation, but provincial officials and businessmen we spoke with doubted whether FIRA evaluations were greatly affected by political pressure.

Agency officials admit they are involved in a subjective process and assert that each investment application must be evaluated individually. For this reason, comprehensive and quantitative criteria have not been developed. Investors speculate that this also allows FIRA the flexibility to negotiate additional concessions, regardless of the commitments in the original proposal.

Heavy administrative workload

The Foreign Investment Review Agency processed about 800 applications from April 1, 1977 to March 31, 1978. It claims that its staff of 116 is insufficient for the case-load and the indepth analysis needed for each investment.

In March 1977, new regulations were implemented to simplify and reduce the information that foreign investors were required to submit in their applications. The new regulations provided for an abbreviated form of notice and faster processing time for small businesses, (i.e., those involving the acquisition or establishment of a business with gross assets of less than \$2 million and fewer than 100 employees). Over 60 percent of the applications were processed in an average of 15 days under the new regulations in the first year. This did not completely alleviate FIRA's limited resources problem, but more people were available to handle the larger, more complex cases. Also, the new procedures reduced the administrative burden on small investors, a matter of concern to all applicants.

Most large investments currently take between 60 to 90 days to process. Agency officials stated that about 50 percent of large investment applications require modification to obtain approval. Sometimes processing can exceed 60 to 90 days when the Agency requests additional information. Such delays can adversely affect an investor's financial commitments.

Review of multinational acquisition
in another country

The Minister of Industry, Trade and Commerce may review the acquisition of one multinational by another even though the transaction takes place outside Canada. This occurs when the multinational being acquired has Canadian subsidiaries. Although the Minister's review authority extends only to the Canadian subsidiaries, a disapproval could require that the new foreign owner divest the subsidiaries if FIRA believes the purchase is not in Canada's best interest. According to Agency officials, this has occurred twice. No company has contested FIRA's right to review such transactions. However, since many U.S. firms have Canadian subsidiaries, a failure to recognize this authority can disrupt a company's acquisition plans.

Small business applications

According to FIRA officials, some investors apply as small businesses to circumvent the longer and more extensive review process for larger investments. When FIRA receives a small business application, it looks closely at the size of the business and its potential impact. If FIRA believes an investment does not qualify as a small business, it may require the investor to file additional information and subject the proposal to more extensive review and assessment. FIRA officials said that in about one-third of the small business cases the Minister requires the investor to file additional information, resulting in a longer, more extensive review and assessment of the proposed investment.

4. STATISTICS CANADA GATHERS DATA ON FOREIGN INVESTMENT.
WHAT TYPES OF DATA HAVE BEEN THE MOST USEFUL TO FIRA?
WHAT PROBLEMS HAVE BEEN ENCOUNTERED? TO WHAT EXTENT DO
THE DIVISIONS OF THE AGENCY SHARE DATA?

Statistics Canada, a federal department separate from the Foreign Investment Review Agency, is the only federal agency responsible for collecting data on foreign direct and portfolio investments. It collects, aggregates, and publishes the statistics for use by FIRA, university and private study groups, and others.

Statistics Canada officials told us they maintain a complete list of foreign investors in Canada. New investments are added by FIRA notifying the department each time a new investor files an application and by reviewing various business periodicals.

Statistics Canada sends out monthly, quarterly, and annual survey forms to all firms in Canada to gather economic and statistical data. No other Canadian department systematically surveys foreign investment. Statistics Canada conducts large-scale, census-type surveys on all companies in Canada having foreign ownership. The Balance of Payments Division of Statistics Canada collects data that shows Canada's balance-of-payments position, including information on trade, investment, and servicing flows. The Business Finance Division collects data on the firms' financial statements, including income account and balance sheet items. A FIRA official commented that to date FIRA has not made much use of the data but hopes to do so in the future.

The principal form for both direct and portfolio investment is the annual mandatory survey form, "Geographical Distribution of Ownership of Capital." Statistics Canada has the legal authority to force investors to complete the survey forms but has never found it necessary to take legal action, according to officials we spoke with. In the few cases where a foreign investor has not completed the survey forms, Statistics Canada has obtained the information from other sources, such as Canada's equivalent of the Internal Revenue Service. In most instances, however, officials consider business cooperation to be excellent.

Statistics Canada officials stated that they are prohibited by law from sharing data on individual investors with other federal agencies and with the public; data that is published is on an aggregate basis. However, the Balance of Payments, Census, and Business Finance Divisions within Statistics Canada freely share information on individual companies with each other.

The reporting burden on businesses in Canada is a problem just as it is in the United States. The Statistics Canada representative we met with would like to see smaller companies surveyed once every 5 years instead of annually.

The latest comprehensive data available is for 1974, the 1975 data is now being compiled. Information on key series, like foreign direct investment in Canada and Canadian direct investment abroad, is available through 1976. Statistics Canada issues current bulletins on foreign investment but they are on a less comprehensive basis.

5. WHAT KINDS OF INVESTIGATIONS DOES FIRA MAKE AND FOR WHAT GOALS? HOW MANY HAVE BEEN MADE AND WHAT HAVE BEEN THE RESULTS?

Besides gathering financial information on each new applicant, FIRA engages in two types of investigations: (1) determining whether all eligible foreign investors file applications and (2) monitoring investor compliance with commitments made during the approval process.

Filing applications

FIRA requires that an appropriate notice be filed whenever a non-Canadian proposes to make or has made an investment which is subject to review. To check whether foreign investors were complying with this requirement, FIRA in 1977 examined about 2,600 news items and received other unsolicited information from individuals and companies regarding acquisition of Canadian businesses, mergers of foreign companies, and establishment of new businesses in Canada. This led to 161 investigations resulting in the additional filing of 27 acquisition notices and 7 new business notices. In only one case was it necessary for the Minister to issue a formal demand under the Foreign Investment Review Act before the investor filed notice.

Because of the small number of reviewable cases uncovered, Agency officials doubt that many investors attempt to circumvent the Act. These officials believe that as the legal profession and business community become more familiar with the Act, it is unlikely that businesses, particularly larger ones, would fail to file notices.

Monitoring investor commitments

After an applicant's investment has been approved, FIRA's Compliance Branch continues to monitor commitments made by the investor during the review process. Because of the Compliance Branch's small staff, monitoring usually consists of reviewing information submitted by the investor. Monitoring continues until FIRA is satisfied that the investor's commitments are met.

The Agency selectively verifies annual statements submitted by investors concerning the status of their commitments. Verification may include obtaining affidavits and explanations from responsible officers, reviewing corporate records, and obtaining reports from chartered accountants, lawyers, architects, or other professionals.

Although commitments are legally enforceable, FIRA has yet to take legal action against an investor with unmet commitments, and officials told us no legal actions have been necessary. Unforeseen economic changes beyond the investors' control are, however, grounds for renegotiating commitments. No data was available on how often commitments are renegotiated, but officials indicated that such renegotiations occur.

6. WHAT IS CANADA'S CRITERIA FOR DETERMINING CONTROL OF CANADIAN FIRMS?

The Foreign Investment Review Act applies to two types of investments.

1. The acquisition of control of a Canadian business by foreign individuals, corporations, governments, or groups containing foreign members through acquiring shares or property used in carrying on the business.
2. The establishment of a new business in Canada by foreign persons who do not already have an existing business in Canada or by foreign persons who have an existing business in Canada if the new business or expansion is unrelated to the existing business.

The Act does not apply to businesses established or acquired by non-Canadians prior to December 12, 1973, and does not discriminate among investors on the basis of their country of origin. The Act applies generally and is not confined to particular sectors of the economy.

Canada does not use a single number or percentage to determine control in Canadian firms. Control can only be effected by acquiring the voting shares of a "Canadian business" or all or substantially all of the property used in carrying on the business in Canada.

Where a takeover involves the acquisition of voting shares, the Act creates the following presumptions as to whether control has been acquired.

- Where a non-eligible person (e.g., a non-citizen or a non-resident person or entity) acquires more than 50 percent of a corporation's voting shares, the acquisition is irreputably deemed to constitute the acquisition of control, unless

the person or group buying the shares already had control in fact of the corporation at the time the transaction in question occurred; and

- where a non-eligible person acquires, in the case of a corporation the shares of which are publicly traded, 5 percent or more of the voting shares or, in the case of a corporation the shares of which are not publicly traded, 20 percent or more of the voting shares, the non-eligible person is rebuttably presumed to have acquired control.

Where a non-eligible person acquires less than 50 percent of a corporation's voting shares, the principal consideration in determining whether control has in fact been acquired is whether the investor is acquiring de facto control of the corporation.

In establishing a new business, if a non-eligible person has not carried on any business in Canada immediately before the time the new business is proposed, then the establishment of a new business in Canada is reviewable.

With few exceptions, according to FIRA officials, real estate transactions do not involve the acquisition or establishment of a business and, therefore, are not subject to review under the Foreign Investment Review Act. The purchase of a hotel, apartment building, or commercial rental property would be reviewable if it met the basic test of acquiring control of a Canadian business. As a general rule, FIRA officials stated they do not look at any real property transactions involving less than \$10 million or 250,000 square feet. Additionally, the Act does not apply to

- investments to expand a foreign-controlled business in Canada;
- the establishment of a new business in Canada which is related to the investor's existing business in Canada; and
- the acquisition of control of a Canadian business whose gross assets do not exceed \$250,000 and whose gross revenues do not exceed \$3,000,000 by a person who is already carrying on in Canada a business related to the one being acquired.

7. IS THE FIRA REVIEW PROCESS NEEDED IN THE UNITED STATES?

We do not see the need at this time for establishing a foreign investment screening agency in the United States. First, a screening agency would be inconsistent with long-standing U.S. policy to encourage the free flow of trade and investment and to promote equal treatment of domestic and foreign investors.

Second, although the United States is the world's second largest foreign investment host, Canada's reasons for creating a screening agency, as discussed in enclosure I, are much less relevant to the United States. Whereas foreign investors control about 60 percent of the industrial firms in Canada, a 1976 Commerce study showed that foreign firms make up only about 2 percent of total U.S. manufacturing establishments. In areas of greatest concentration, the Commerce report showed that foreign-owned companies accounted for only about 10 percent of total sales in the chemical industry and from 2 to 3-1/2 percent in the fabricated metals, machinery, and food industries.

In addition, no single foreign country has a large concentration of investment in the United States. In contrast to Canada, where in 1974 U.S. investors made up 80 percent of all foreign investment (or about 50 percent of total industrial investment), the largest concentration of foreign investment in the United States, according to the Commerce study, comes from the Netherlands. Dutch investors make up about 21 percent of U.S. foreign investment, or less than 0.5 percent of total investment.

Third, the United States has already established methods to monitor and control some foreign investment. Like many countries, the United States limits or prohibits foreign direct investment in specific national interest sectors, such as aviation, coastal shipping, atomic energy, radio and television broadcasting, and mineral development on Federal lands. Other controls, such as antitrust legislation and the Securities and Exchange Commission cover the activities of U.S. as well as foreign firms in the United States. Exports of most commercially available commodities are regulated by the Secretary of Commerce under authority of the Export Administration Act of 1969, as amended, which states that controls may be used to (1) protect the national security, (2) further foreign policy, or (3) prevent excessive drain of scarce materials. Also, the Commerce Department reports that 25 States have some limitations on foreign ownership of land and 40 States limit foreign banking operations.

From 1974 to 1978, total foreign direct investment in the United States increased from \$26 billion to almost \$40 billion. Because of the rapid increase, public concerns were expressed in specific geographic or economic sectors and additional legislation resulted, including:

- The Foreign Investment Study Act of 1974 ✓
(Public Law 93-479), which directed the Secretary of Commerce and the Secretary of the Treasury to conduct a comprehensive, overall study of foreign direct and portfolio investment in the United States. This legislation resulted in the 1976 Commerce study on foreign direct investments (investments resulting in 10 percent or greater foreign ownership) and a Treasury study on portfolio investments (less than 10 percent foreign ownership).

- The International Investment Survey Act ✓
of 1976 (Public Law 94-472), which directed the President to set up a regular and comprehensive data collection program on foreign investment. The Commerce Department established the Office of Foreign Investment in the United States with responsibilities for developing a consistent and timely data collection and processing system on foreign investment activity in the United States; providing evaluations and reports on the impact of foreign investment; and preparing reports for publication. The Commerce Department's Bureau of Economic Analysis recently began surveying new foreign investments (Form BE-13) and existing foreign investments (Form BE-15). With certain exceptions, for relatively small investments effective January 1, 1979, the BE-13 must be filed in the event that a foreign person or his existing U.S. affiliate establishes or acquires certain voting interests in a U.S. business enterprise. The BE-15 will annually survey about 85 percent of the total value of existing foreign direct investments (about 2,000 firms). Commerce expects that results will be available later in 1979 from the first BE-15 mailing.

- The Domestic and Foreign Investment Improved Disclosure Act of 1977 (Public Law 95-213, title II), which requires expanded disclosure to the Securities and Exchange Commission of beneficial owners of more than 5 percent of specified kinds of securities. ✓
- The International Banking Act of 1978 (Public Law 95-369), which regulates some of the activities of foreign-controlled banking in the United States. ✓
- The Agricultural Foreign Investment Disclosure Act of 1978 (Public Law 95-460), which establishes a Nation-wide system for monitoring current landholdings and future U.S. farmland purchases by foreign persons and requires the study and analysis of the effects of these purchases on U.S. agriculture. ✓

To oversee monitoring of the effects of foreign investment and to coordinate the implementation of U.S. policy on such investment, the President established in 1975 an inter-agency Committee on Foreign Investment in the United States. The Committee's responsibilities are to (1) arrange for analyses of trends and significant developments of foreign investment, (2) arrange for advance consultation with foreign governments concerning their major investments in the United States, (3) review investments which might have major implications for U.S. national interests, (4) consider proposals for new legislation or regulations, (5) submit, as necessary, recommendations to the National Security Council and the Economic Policy Board, and (6) arrange for the preparation and publication of periodic reports.

In a series of hearings, the Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, is examining the adequacy of Federal efforts to monitor, evaluate, and formulate policy on the effects of foreign investments in the United States. The Subcommittee's concerns include:

- The duplication of monitoring efforts and the need for increased sharing of information on foreign investments, particularly between the Commerce Department's Bureau of the Census and Bureau of Economic Analysis.
- The gaps in Federal foreign investment data collection, such as the absence of foreign

ownership information on SEC Schedules 13D and 13G between 1970-78.

- The need for improved identification of beneficial ownership; i.e., identifying the ultimate controlling interest in an investment.
- The need for a more active role by the interagency Committee on Foreign Investment to identify significant issues resulting from foreign investments and to recommend solutions.
- The need for improved dissemination of the requirement to complete Form BE-13.

The scope of our work did not include evaluating the adequacy of current efforts to monitor and evaluate foreign investments. However, we do not believe that problems identified to date warrant establishing a foreign investment screening agency in the United States. Instead, the (1) effective implementation of existing legislation, (2) effective functioning of the interagency Committee on Foreign Investment in the United States, and (3) continued congressional interest should alert agencies and the Congress to the need to further improve the monitoring and the regulation of foreign investment.