

# Manufacturing Matters

## BUSINESS INVESTMENT AND FOREIGN TAKEOVERS

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*A Policy Brief: CAW-TCA Canada*

### The Problem

Canadian corporations are more profitable than they have ever been in history. Corporate profits are higher as a share of Canada's GDP than at any other time since Confederation. Expensive and unnecessary corporate tax cuts have further boosted bottom-line profits.

According to the logic of trickle-down economics, strong business profits are supposed to translate into strong business investment. That in turn creates jobs, improves productivity, and expands our economy.

But it hasn't happened that way. Real business investment – in things like factories, mines, and equipment – has grown very sluggishly in the current boom. For every dollar in new profits generated since 1999, businesses have reinvested barely half in real new projects. Resource developments (especially the mega-projects in Alberta's oil sands region) have done well, not surprising in light of the oil industry's incredible profits. But elsewhere in our economy business investment has hardly responded at all to the run-up in profits.

### **“Foreign investors have tried to get a piece of the action by taking over Canadian firms.”**

Instead, businesses and investors have reacted to the mega-profits in ways that undermine, rather than enhance, our long-term economic prospects. They have bid up the stock market value of Canadian companies to record highs. And foreign investors have tried to get a piece of the action by taking over Canadian firms. Some of Canada's most important and famous companies are now foreign owned. The federal government has rubber-stamped this sell-out.

Here's another painful side-effect of the many foreign takeovers: with tens of billions of dollars flowing into Canada to finance the takeovers, our loonie shoots even higher on international currency markets. This further undermines our manufacturing sector.

These are two sides of the same coin. Real business investment, so important to our economic performance, is weak. And more of our economy is falling under foreign control.

### The Takeover Binge

The combined value of takeovers involving Canadian companies almost doubled in 2006, to an awesome \$270 billion. Let's put that in perspective. A sum equivalent to one-fifth of our GDP was allocated last year to acquire and merge Canadian companies: building corporate empires. In contrast, Canadian business spent a mere \$170 billion on real capital investments: building the real economy.

Business investment spending is sorely inadequate, relative to our economic needs, and relative to record profits. Yet instead of build-

ing our real economic capacities, the titans of business have been building their own empires, instead. For each dollar they spent on real investment in 2006, businesses spent \$1.60 on mergers and acquisitions. This year's record will be even worse.

Every time a new deal is announced, the marrying executives boast about impressive “synergies,” savings, and efficiencies. These promises rarely amount to much. In reality, mergers and acquisitions are a corporate shell game, with few if any real economic effects. And sooner or later, most mergers backfire – and the pain is usually felt as soon as stock markets and/or commodity prices start coming back to earth.

In reality, the wave of takeovers reveals the bankrupt business leadership of uncreative executives who have way too much money to play with. Rather than inventing something new, expanding our capacity, or investing in real productivity, they pay outrageous prices for companies that others built. Bottom-line earnings appear to “grow,” and so might share prices (for a while, anyway, until the debt comes home to roost). Every marrying CEO – whether hunter or hunted – gets a golden parachute. And Bay Street, as usual, takes a juicy cut of every pointless deal.

But from the perspective of our real economic potential and productivity, at best this shell game is a sideshow. At worst, it's a portent of trouble ahead.

### The Hollowing Out of Corporate Canada

The biggest mergers have involved foreign takeovers of once-mighty Canadian companies: Alcan, Inco, Falconbridge, Molson, Fairmont, The Bay, Dofasco. These are just some of the leading Canadian companies that are now foreign-owned.

Foreign investment can be highly beneficial to an economy, and the CAW is not at all opposed to foreign investment in principle – so long as that investment results in new capital, new technology, new jobs, and new capacities for our real economy. Some of Canada's most important, dynamic, and socially beneficial businesses are foreign-owned.

But when foreign investment becomes a simple shell game – transferring ownership over an existing company from a Canadian to a foreigner, with no change in the real business – then it is clearly a net drain on our economy, and must be stopped. We lose control over the companies; we usually lose jobs in management, marketing, research, and other head office functions; and we end up paying many billions of dollars to foreigners in interest and profits on their investments.

Unfortunately, the federal government has been watering down controls on foreign takeovers since the 1980s, when Brian Mulroney abolished the Foreign Investment Review Agency. Today, major for-

eign takeovers are supposedly screened by Investment Canada. But their review takes place in secret, with no public input, and is mandated only vaguely to protect Canada's broad national interest. Not surprisingly, Investment Canada has never turned down a takeover.

Recently, the Harper government – responding to public concern about foreign takeovers – has announced it will review this Investment Canada process. The government has said it is especially concerned about takeovers that involve state-owned companies from other countries (like Chinese companies, which have been investing heavily in international properties in recent years).

This is a step in the right direction, but a very small one. And Canadians should have no more faith that a privately-owned foreign corporation should show any more respect for our national interests than a state-owned foreign corporation. Their actions, after all, are motivated solely by their bottom-line profits. They have no more commitment to Canadians than a state-owned Chinese firm.

There is real evidence that Canadian businesses, despite the many favours that have been granted to them over the past quarter-century, are failing miserably to build themselves a sustainable, valuable niche in global markets. Canadian business invests a paltry 1 percent of GDP in research and development. This badly hurts our ability to compete in world markets. And you'd never know from this weak effort that Canada's corporations received bigger tax breaks since 1999 than any other segment of our economy: the average effective corporate income tax rate fell from 35 to 25 percent in that time, worth fully \$20 billion per year in today's terms.

### What We Need (Part I): Policies to Regulate Foreign Investment

The entire Investment Canada foreign review process should be transformed, so that it has an explicit mandate to extract enhanced Canada benefits from potential foreign investors – and the explicit power to turn down foreign investments that simply transfer control outside of our country, rather than building our real economy.

- ◆ Foreign takeovers of resource-related companies must include commitments to retain and expand value-added processing and secondary facilities in Canada.
- ◆ All takeovers should make commitments to future investment in Canadian-based research and development facilities and activity, and targets for purchases of Canadian made supplies and services.
- ◆ Compulsory joint ventures could be mandated, to ensure that foreign companies work with Canadian partners – thus expanding our own capacities over time. Rapidly industrializing Asian economies (like China) have used these tools to great success.

In many cases, foreign takeovers should simply be forbidden, when they don't promise enough tangible benefits to justify the loss of control they imply. These measures will spark howls of outrage from business executives and investors – but their profits will remain at record highs. Better yet, they would lead to an immediate decline in the exchange rate, which would benefit our manufacturing industry.

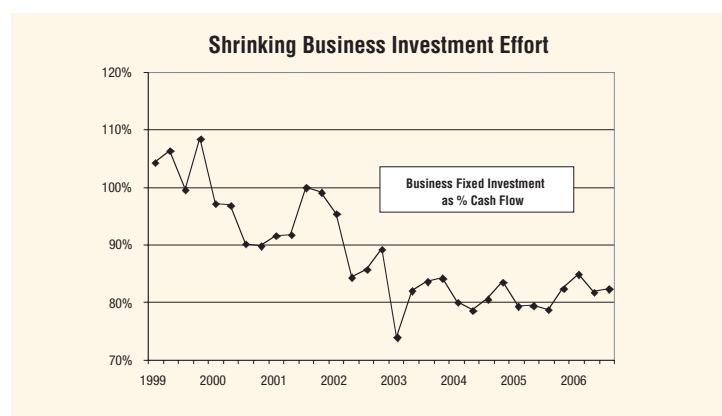
### What We Need (Part II): Policies to Promote Stronger Real Investment

Corporate tax cuts have been completely ineffective in motivating stronger business investment in real capital facilities and equipment – the buildings and tools that make our real economy tick. Those

across-the-board, no-strings-attached measures should be reversed. A portion of the resulting revenue savings (over \$20 billion per year) would be allocated to far more effective pro-investment measures:

- ◆ An investment tax credit which (similar to the existing R&D tax credit) offsets a portion of business investments in real facilities with reduced taxes.
- ◆ Restoring the lower business tax rate that was traditionally enjoyed by Canadian manufacturing companies, in order to promote more value-added industry in Canada. (This lower rate for manufacturing was eliminated as part of the steep reductions in overall business taxes earlier this decade.)
- ◆ More ambitious efforts through our universities and other public research facilities to expand Canadian scientific and engineering knowledge, including in the early commercialization of innovations.
- ◆ Targeted investment incentives, co-investments, and even public equity stakes to support strategic high-value industries (including auto, aerospace, and many others).

Major Canadian Takeovers Last 12 Months		
The Hunted	The Hunter	Value (\$ US)
Alcan	Rio Tinto (U.K.)	\$38 billion
Falconbridge	Xstrata (Swiss)	\$18 billion
Inco	CVRD (Brazil)	\$20 billion
Encana (upstream)	Conoco (U.S.)	\$7.5 billion
Fairmont	Kingdom Hotels(UAE)	\$3.9 billion
IPSCO	Svensk Stal (Sweden)	\$1.8 billion



Canadian companies are investing a shrinking share of cash flow into new Canadian projects. In a growing economy, businesses should invest over 100 percent of cash flow in new projects. That has fallen steadily to about 80 percent today – just as corporate tax cuts were further fattening the corporate bottom line. Those tax cuts have been utterly ineffective in motivating new investment. Remember, the graph above includes huge investments in Alberta's oil sands. Without that, the numbers would look even worse.