Investment in Canada by China's SOEs

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Last year, two unions, the International Union of Operating Engineers and the Construction and Specialized Worker's Union went to the Federal Court for a judicial review of the federal government's decision to allow HD Mining International, a Chinese owned company, to bring in 201 Chinese temporary workers to work at its underground coal mine in Tumbler Ridge, BC. These unions were supported by the powerful United Steelworkers Union which commissioned a study to investigate the background and ownership of the Chinese company at the centre of the dispute. Its report was ominously entitled "Who Owns Huiyong Holdings?

While the Federal Court dismissed the union's complaints that the company had not made sufficient efforts to recruit Canadian workers before applying for permission to bring in temporary workers from China, and that it was going to pay substandard wages to the Chinese workers, the damage was done. When the story hit the press the Human Resources and Social Development minister, Diane Finlay, ran for cover blaming her officials and putting the whole temporary foreign worker program under review. The provincial government was not much more help. A few Chinese miners arrived but were not allowed to work and the company soon sent them all home, at least for now.

Considering that at any given time there are about 400,000 TFW in Canada, and that in the past 5 years Tim Horton's has brought in over 14,000 temporary workers, 11,000 of them from the Philippines, it is hard to imagine that 200 Chinese miners posed a real threat to employment in Canada. However, while we don’t see protests about Filipino or Mexican workers coming to Canada, in the case of Tumbler Ridge the union and media focus was on ***Chinese*** workers, employed by ***Chinese*** companies that are controlled by the ***Chinese*** government which may result in the introduction of lax ***Chinese*** safety and environmental standards. British Columbia, where I am from and where I now live, has a long history of anti-Asiatic labour agitation, going back to the days of the infamous “head tax” and the Chinese Immigration Act of 1923 which resulted in the almost total exclusion of Chinese immigrants for a quarter of a century--during which time Canada took in over 1 million immigrants. In fact, between 1923 and 1947, when the Act was repealed, only 50 ethnic Chinese were admitted to Canada (one of whom was a future Governor-General, Adrienne Poy, aka Clarkson). But those were the bad old days, right? All that has changed. Apologies have been made. We live in a more enlightened era. China, India and the Philippines are now the no. 1, no. 2 and no. 3 sources of immigrants to Canada.

Well, the overt racism of the past has gone, but the fear of Chinese, or today of China, may not have gone. An irrational fear is called a ***phobia***, and there is evidence that elements of ***Sinophobia*** exist today, and this is relevant to the issue we are discussing tonight, Chinese SOEs. In the old days, there was a fear and dislike of Chinese workers (by workers and unions but perhaps not by employers) because they worked too hard for too little. Today there is a fear of China because it is big, powerful, getting richer, seems to have a long term plan. Not only that, it is perceived (by some) as a monolithic totalitarian state with a strategic vision of dominating the world.

That perception is relevant to tonight’s topic, Investment in Canada by Chinese SOEs. When the United Steel Workers was rolling out its big guns to discredit HD Mining, it set out to prove that the company was really a front for the Chinese government. Since it couldn’t prove so definitively it resorted to statements like “*Given Huiyong (Holdings) close ties with the Chinese government, and its (controlling) stake in HD Mining…does this mean that the Chinese government has* ***near total control*** *of the mining operations….at Tumbler Ridge*”? Or, “*The Chinese* *owned and operated mines in northeastern BC appear to be aimed at nothing more than creating profits for offshore companies with questionable links to the government of China*". The Government of China was the bogey man.

Actually I think it is quite likely that HD Mining has strong connections to, and may ultimately be owned by a provincial SOE, likely Shanxi where it is based. According to Dr. Chen Duanjie at the University of Calgary (I will come back to Dr. Chen later), even though the number of SOEs has been reduced substantially over the past decade, the number of non-financial SOEs in China numbers over 114,000. Only about a quarter of these are regulated at the national level and only 116 of the largest SOEs come under the administration of SASAC (State Owned Assets Supervision and Administration Commission of the State Council). But there are literally tens of thousands of SOEs in China, most of them involved in domestic trade with even many of the largest ones, such as China Telecom, essentially not doing any business outside China. Oil companies, however, especially oil companies whose specific mandate is to go offshore and explore (like CNOOC) obviously operate internationally.

These SOEs are the legacy of China's failed experiment with socialist central planning. As China moved from central planning to a more market oriented economy state monopolies were converted into state owned enterprises, operating on business principles (admittedly "with Chinese characteristics" as they say). As a number of these SOEs moved into the international sphere, they created international entities that were listed on stock exchanges in Hong Kong, New York and elsewhere. CNOOC International is one such company. What are the main characteristics today of these SOEs—the ones that are or may be interested in investing in Canada—and how should we deal with them? There are differing views.

According to Margaret Cornish, former Director of the CCBC in Beijing and now a representative in Beijing for the law firm Bennet Jones, "*Investments in Canadian resources by Chinese SOEs offer an opportunity to Canadian firms and governments to accelerate (the) adaptive process of augmenting existing supply* *chains, managerial networks an sources of technology. At the same time, Canada is in a position to assist Chinese resource SOEs in demonstrating that they are able to successfully operate in an OECD-level regulatory system…*". She goes on to say, with regard to the relationship between the major SOEs and SASAC (the arm of the Chinese government that governs them), "*SASAC's mandate is to ensure that state-owned assets are managed according to the rules to generate an appropriate return for its percentage share, and to control for agency and corruption problems"…."The focus of SASAC-supervised SOEs is on near and long term profitability as reflected by the predominance of financial criteria in assessing performance*". That doesn't sound too threatening. That is what all multinational companies also strive for—profitability.

However, Dr. Chen at the University of Calgary (whom I mentioned earlier), has a different take. She says, *"Chinese SOEs do not operate by the normal rules of commerce. They are, in fact, a very powerful tool of the Chinese government's industrial policy which is aimed at ruthless expansion (not just expansion, mind you, but ruthless expansion) of its global economic empire". "Party control of the top executives of central SOEs has ensured that those who are ambitious in climbing the government and party ladders must obey party orders more than ensuring the efficiency of the SOEs under their watch"*. That is certainly a more negative and ominous view. Ruthless expansion to create a global economic empire. Who is right?

These two studies could be considered the bookends of the debate. Ms. Cornish goes to some length to prove that the SOEs are largely governed by normal commercial motives and incentives, and act rationally, according to these standards. Dr. Chen clearly sees some sort of strategic plot, indeed a threat. It is interesting to note that the Canadian based in China takes a more relaxed view of the issue while the Chinese professor living and teaching in Canada is sounding alarm bells. I will leave it to you to discern you think there are any in-built cultural biases in these analyses.

Whatever you think of SOEs, it is clear that they are significantly different from Canadian Crown Corporations, one of the questions we are to consider tonight. Crown Corporations today at least are the residual tail of what was once a fairly active intervention of the state in various sectors of the economy, allegedly for special policy reasons. If we look back at some of the original CC's, such as the CNR, Trans-Canada Airlines/Air Canada, Alberta Government Telephone, Atomic Energy of Canada, Petrocan, they were somewhat more like today's Chinese SOEs. Those that remain, fewer in number year by year, are quite different (EDC, CCC, Via Rail, Royal Canadian Mint, CBC and some esoteric ones—the Atlantic Pilotage Authority, the Blue Water Bridge Corporation and the First Nations Statistical Institute) So let's admit that SOEs and CC's today are quite different, and move on. It is not relevant.

What is relevant is are the benefits that inward investment from offshore companies, including SOEs and specifically Chinese SOEs, can bring to Canada, and the question of how we should go about dealing with offshore SOEs? **That is really the key question tonight**. The immediate precipitator of course is the Investment Canada approval of two majority SOE investments in the oil and gas sector, the $5 billion acquisition of gas player Progress Energy by Malaysian SOE Petronas and the larger ($15 billion) acquisition of oil producer Nexen Inc. by CNOOC. As we know, those deals were eventually approved after a lengthy review process and several extensions with several caveats, the most notable of which is; **State-controlled investors will be allowed new takeovers in Canada's oil sands, (assuming they are found to be of net benefit to Canada) on "an exceptional basis only."** In other words, barring unspecified "exceptional circumstances", investments by SOEs involving majority control of oil and gas properties are off-limits.

This was supposedly meant to send the signal that while Canada remains open to foreign investment, SOE investment would be looked at differently. In the words of the Prime Minister, “When we say that Canada is open for business, we do not mean that Canada is for sale to foreign governments”. With the approval, the industry breathed a (temporary) sigh of relief, as a number of developments including the building of LNG terminals on the BC coast were at issue. The relief was short-lived.

It is not irrelevant to report a recent statement by former Minister of Industry Jim Prentice to the effect that, according to the National Post, investment by Chinese state owned enterprises in Canada which totaled $33 billion between 2005 and 2012, has “fallen off a cliff”. FDI in the oil industry has dropped 92% this year. M & A activity has dropped form $66 billion to $8 billion. That decline is a result of several factors. According to Mr. Prentice, it is because there are currently more sellers than buyers in the oil patch (and we have just ruled out an important set of prospective buyers), Canada has an infrastructure deficit (not enough facilities to get the product to the right markets—Keystone XL etc) AND **the impact of foreign investment rules.** So while the policy decision on CNOOC is not the only factor, it **is** an **important** factor.

According to Mr. Prentice, “**These companies (SOE investors) have their eyes on Canada but they don’t want to be rejected. They certainly don’t want an embarrassing confrontation with a western government. …Right now they are puzzled by Canada**”.

So that is the dilemma. Should we treat SOEs, especially Chinese SOEs, differently in an *a priori* basis, and is it in our interest to do so? Or should we be welcoming investment from all available sources, including Chinese SOEs.

Some, like the previously quoted Dr. Chen at the University of Calgary, are clearly not convinced. Others would argue that we should not open “sensitive” areas of our economy to companies controlled by a government that does not share democratic traditions as we interpret them. However if we are to limit commercial transactions (that are in our interest) only to countries who share all of our values, we will be cutting ourselves off from a good chunk of the international community. Who else should be put out of bounds? Russia? (hardly a poster child for democracy or good governance). Saudi Arabia?, the Gulf States? Cuba? South America in the old days? China yesterday and today?….the list could go on. Of course we do trade with such states (North Korea and Iran being the only exceptions these days) on the basis of **our own self-interest.** That is the key question; **is investment in Canada by Chinese SOEs in Canada's interest?**

I would answer with a strong YES….but. The "but" relates to the need to exercise due diligence and apply our laws and regulations in a fair and consistent manner to all players on a level playing field. These SOEs are not benign cuddly little panda bears. They are big muscular corporations pursuing their own interests as all large corporations do. According the Fortune 500 Ranking, Sinopec ranks 4th among global oil companies by revenue, following Shell (which is in partnership with SaudiAramco, a Saudi SOE) ExxonMobil and BP (formerly state owned I should add), and ahead of China National Oil Company, Chevron, Conoco Phillips, Total (formerly state owned) and Gazprom (effectively state owned). CNOOC is 25th on the list. The largest Canadian company is Suncor, no. 36. The Chinese companies are not bit players.

In Canada we have learned to deal with major corporations in not only the oil and gas sector but in the mining, agriculture, forestry and manufacturing sectors as well. If we can handle ExxonMobile or General Motors, we can arguably manage a relationship with CNOOC, Minmetals, Sinopec or other Chinese SOEs. Margaret Cornish, whom I have quoted earlier, makes the point that **"Foreign corporations (including of course SOEs) must all abide by Canadian laws, and all Canadian jurisdictions have the wherewithal to enforce vigourously their health and safety, labour and environmental protection laws. Canadian transfer pricing and administration is in place to address any concerns that SOEs might try to export**

to China at prices below market price". All companies in Canada are subject to Competition law, and in addition, those companies that have been required to submit to investment review through the Investment Canada Act "net benefit" process have made other undertakings that are legally enforceable. CNOOC for example, made a number of commitments with regard to maintaining its management and operations in Canada, CSR activities, transparency in reporting, listing on the TSX etc etc. The commitments are all on their website.

We in Canada have the tools to do the job. Canada is not the Sudan or other parts of Africa, where Chinese SOEs have not exactly covered themselves with glory with respect to their relationship to the locals. But then the record of the West in Africa, and even of some Canadian mining companies abroad today, is far from exemplary. If we allow ourselves to be exploited, that responsibility falls on us. On the other hand, if we structure an environment that will benefit Canada, that ensures that foreign companies play by the rules, and that attracts needed investment from sources that have the funds and motivation to invest, we should do so.

To close, I want to make the point that I believe that **it is in Canada's self-interest to continue to encourage Chinese SOEs to invest in Canada, according to transparent and fair criteria**. That is the key point. We have the means and experience to ensure that these investments bring mutual benefit to both China and Canada.

We should not, however, delude ourselves into thinking that these companies are not pursuing their own self-interest, a self-interest that has a connection to China's long term strategies to secure access to world markets and resources. While not the same, does anyone not think that the US government doesn't follow, influence, encourage and support the activities of its multinationals in areas considered of economic and strategic importance to the United States?

In closing, let me offer some specific recommendations:

The “net benefit” test, which is deliberately kept vague, needs to be further clarified to remove uncertainty and provide greater guidance as to what is expected from foreign investors.

The mixed signals that have been sent that Canada is open for business, except for certain types of companies in certain sectors, is not in our self-interest. The off-limits “except in exceptional circumstances” is not helpful.

The lower investment review threshold for SOEs should be re-examined.

The irrational fear of China, Sinophobia, whatever it is based on, should be removed from the equation.

Canada should continue to build trade, investment, cultural, diplomatic and strategic linkages with China, based on the efforts of the past 40 or more years of bilateral diplomatic relations. We can play a role in encouraging Chinese SOEs and companies to integrate more closely with the global economy, to adopt more market driven and transparent systems of governance and to recycle the wealth that China is accumulating through its current export led economic policies. **All to our benefit**.

Let us be rational, not emotional; respectful; confident and alert. Don’t close the door on Chinese SOEs and the significant investment they can bring to the oil sands and elsewhere. As the Chinese say, “let’s not drop a rock on our own foot”.

Thank you for your attention. I look forward to further discussion and questions.