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The Foreign Investment Review Process in Canada

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The Foreign Investment Review Process in Canada
(Background Paper)

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THE FOREIGN INVESTMENT REVIEW PROCESS IN CANADA

1 INTRODUCTION

There are strong arguments for and against foreign investment in Canada. Foreign investment can be highly beneficial for the Canadian economy. When a foreign firm purchases a Canadian company, innovative technology and new management ideas may be implemented by the foreign investor, which can lead to higher productivity and enhanced competitiveness. At the macroeconomic level, foreign investment can therefore translate into increased exports and employment, and, more generally, a faster-growing Canadian economy.

Foreign investment may also come at the cost of reductions in employment or in value-added activities. An example would be a foreign company that purchases a Canadian firm to gain ownership of natural resource assets while planning to shed all associated value-added activities – such as, for example, processing raw natural resources. Also, it is possible for national security and cultural sovereignty to be negatively affected by a foreign takeover of a Canadian firm, adding non-economic considerations to reviews of foreign investment.

For almost 40 years, the Government of Canada has reviewed possible takeovers of Canadian firms by non-Canadians. The reviews have occurred under different legislation, and different governments might see the balance between the benefits and costs of foreign investment differently.

This paper provides a descriptive and empirical overview of the current foreign acquisitions review process in Canada. The first section describes the *Investment Canada Act* and summarizes recent developments related to the Act. The second section presents data on foreign investment in Canada. The final section of the paper compares restrictions on foreign investment in Canada with those in other countries, with a particular emphasis on foreign investment in natural resource industries.

2 *INVESTMENT CANADA ACT*

2.1 DESCRIPTION

The *Investment Canada Act* (ICA) provides the framework for conducting reviews of acquisitions of control of existing Canadian businesses, as well as reviews of the establishment of new Canadian businesses,[1] by non-Canadians in Canada.[2] The ICA came into force on 30 June 1985, replacing the *Foreign Investment Review Act* (FIRA) that was introduced in 1973. Although the ICA contains many provisions that were also included in FIRA, the implicit objective of the ICA was to make Canada a more welcoming destination for foreign investors. Under FIRA, any takeover of a Canadian business by a foreign entity could be reviewed (meaning that it could be subject to approval by the Government of Canada); even transactions involving a small mom-and-pop business could be subject to review. Furthermore, for a foreign

acquisition to be approved, *significant* benefit to Canada resulting from the transaction had to be demonstrated.

The ICA narrowed both the range of foreign acquisitions that are reviewable and the scope of the "benefit to Canada" test to which these transactions must be submitted in order to receive approval from the federal government. The purpose of the ICA, as set out in section 2 of the Act, is:[3]

> to provide for the review of significant investments in Canada by non-Canadians in a manner that encourages investment, economic growth and employment opportunities in Canada and to provide for the review of investments in Canada by non-Canadians that could be injurious to national security.

Under the ICA, foreign investments are classified into two categories: investments that are subject to notification, and investments that are reviewable.

Foreign investments are deemed reviewable if at least one of the following five situations arises:

- **Situation 1**: The foreign investor is a state-owned enterprise[4] from a World Trade Organization (WTO) member country and the investment is made to acquire control of a non-cultural Canadian business that has gross assets, in 2014, of at least $354 million.[5]
- **Situation 2**: The foreign investor is not a state-owned enterprise but is from a WTO member country, and the investment is made to acquire control of a non-cultural Canadian business that has an enterprise value, in 2014, of at least $600 million.[6]
- **Situation 3**: The foreign investor is from a non-WTO country and the investment is made to acquire control of a non-cultural Canadian business with gross assets of $5 million or more, or to acquire indirect ownership of a non-cultural Canadian business with gross assets of $50 million or more.[7]
- **Situation 4**: The foreign investment is made to acquire direct control of a Canadian cultural business that has assets of at least $5 million or the Governor in Council considers that the investment in a cultural business should be reviewed in the public interest.[8]
- **Situation 5**: The Government of Canada considers that the foreign investment may be injurious to national security.

The authority to review a foreign investment in a non-cultural Canadian business under Situations 1, 2 and 3 rests with the minister of Industry. Such foreign investments can be approved only if the minister of Industry is satisfied that the transaction is likely to be of "net benefit" to Canada. Factors that are considered in the net benefit test as set out in the Act are:

> (*a*) the effect of the investment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada and on exports from Canada;

(*b*) the degree and significance of participation by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada of which the Canadian business or new Canadian business forms or would form a part;

(*c*) the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;

(*d*) the effect of the investment on competition within any industry or industries in Canada;

(*e*) the compatibility of the investment with national industrial, economic and cultural policies, taking into consideration industrial, economic and cultural policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the investment; and

(*f*) the contribution of the investment to Canada's ability to compete in world markets.[9]

In making a determination under Situations 1, 2 and 3, the minister consults with provincial governments, other federal departments, and the Competition Bureau. Also, the minister examines in detail the foreign investor's future plans for the Canadian business. The foreign investor may point to its legally binding undertakings (e.g., job creation, research and development activities, and new investments) to demonstrate a net benefit to Canada. The following box explores ways in which the minister of industry can ensure compliance with written undertakings and the Act in general.

Legally Binding Commitments

If a non-Canadian investor fails to live up to commitments (for example, by implementing an investment on terms that vary materially from the investor's application or by not abiding by written undertakings), the minister of Industry has a number of recourses. The minister may, according to section 39 of the *Investment Canada Act* (ICA), send a demand to the investor, requiring the investor to cease contravention of the Act, remedy the default, show cause why there is no contravention of the Act or regulation, or, in the case of undertakings, justify any non-compliance. The minister may accept a substitute undertaking in lieu of the undertaking the investor committed to at the review stage.

The minister's demand would also indicate the proceedings that could be undertaken under the Act if the investor failed to comply with a request contained in the demand. Legal proceedings could be initiated with the application for a court order to force compliance. A court order, if issued, could direct the investor to relinquish control of the Canadian business or to comply with agreed-upon undertakings, or it could impose a financial penalty.

The only time that the Government of Canada has applied for a court order to seek remedy for non-compliance under section 39 of the Act occurred when United States Steel Corporation (U.S. Steel) sought to acquire Canadian steelmaker Stelco in 2007. The Minister of Industry sent a letter to U.S. Steel in May 2009, demanding that the firm comply with the undertakings pledged to the Government of Canada at the time of the investment review. Unsatisfied with the response to the letter, the Minister filed an application with the Federal Court of Canada in July 2009 to seek appropriate measures to remedy the situation and force U.S. Steel to respect its commitments. In May 2011, the Federal Court of Appeal dismissed a challenge by U.S. Steel, allowing the government's case to proceed. On 12 December 2011, the Government of Canada agreed to discontinue proceedings as a result of what the Minister described in a statement as U.S Steel providing "significant new and enhanced undertakings under the Investment Canada Act."

After analyzing the investor's plan for the Canadian business and the undertakings, the minister makes a decision as to whether the proposed investment is likely to be of net benefit based on the factors included in the Act. The minister has 45 days to render his decision. An extension to 75 days can be unilaterally decided by the minister; further extensions are possible, subject to the investor's agreement.

If no decision is taken or no notice of extension is provided, the investment is deemed approved. In case of an initial rejection, the minister must provide an additional 30-day period to allow the investor to make further representations and make changes to his undertakings, which could strengthen the investor's case in demonstrating a net benefit to Canada. If, after these additional representations, the minister remains unsatisfied that the transaction is likely to be of net benefit to Canada, the investor is given notice that implementation of the investment is prohibited.

The authority to review a foreign investment in a cultural business under Situation 4 rests with the minister of Canadian Heritage. The net benefit test under this scenario consists of determining whether the investment is compatible with the strategic objectives of the Department of Canadian Heritage. These strategic objectives are:

- promoting Canadian content;
- cultural participation;
- active citizenship and civic participation;
- strengthening connections among Canadians.[10]

With regard to Situation 5, there is no definition of national security in the Act, or of the elements that can be considered injurious to national security. This provides the government with additional flexibility in making its determination under Situation 5. In this instance, a review is triggered by the Governor in Council on the Industry minister's recommendation. The minister consults with the minister of Public Safety to determine whether an investment could be injurious to national security before making a recommendation to the Governor in Council to proceed with a review.

If none of the five situations described previously applies, non-Canadians planning to acquire control of a Canadian business or to establish a new Canadian business need only give notice to the director of investments at Industry Canada and provide the required information.

2.2 Rejected Transactions Under the ICA

Only two transactions have been rejected under the ICA since it came into force in 1985.

In May 2008, the Government of Canada rejected the proposed takeover of the information system and geospatial businesses of MacDonald, Dettwiler and Associates Ltd. by a U.S.-based company on the grounds that the transaction was not likely to be of net benefit to Canada. This marked the first time that a transaction was rejected under the Act.

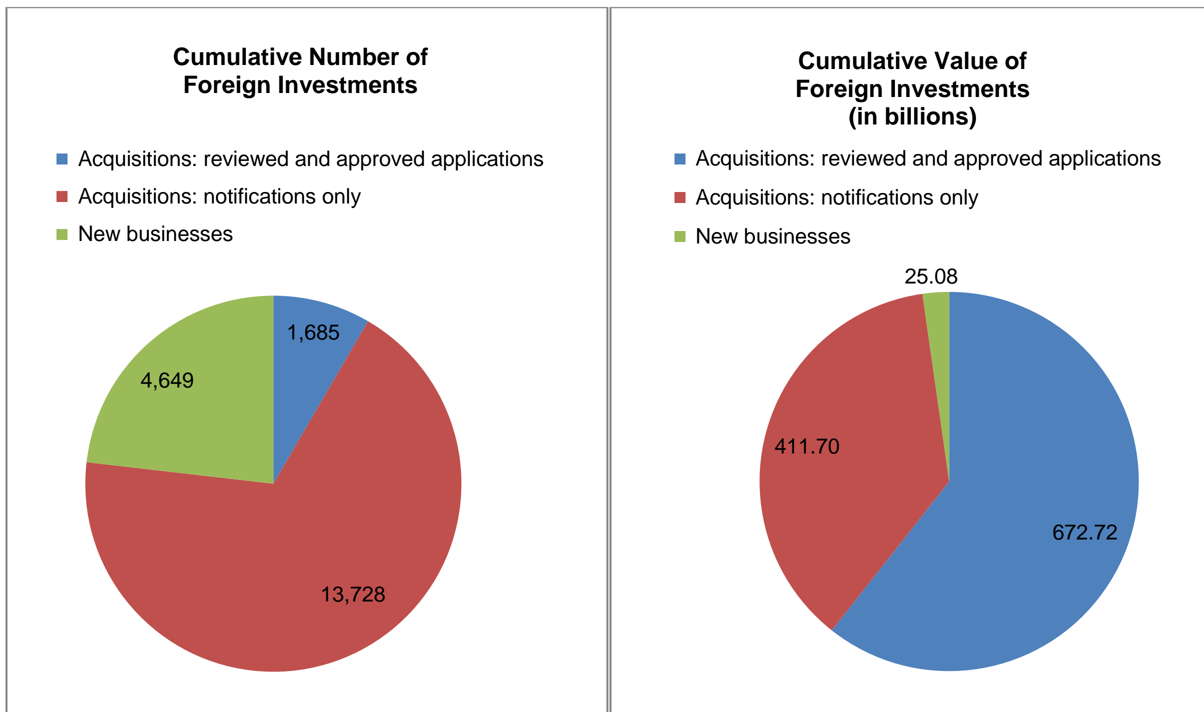
In October 2013, the Government of Canada rejected the proposed $520 million acquisition of the Allstream division of Manitoba Telecom Services Inc. by Accelero Capital Holdings. This was the first time that a transaction was rejected using the national security provisions under the Act.

In November 2010, the Government of Canada sent a notice indicating that it was not satisfied that the proposed takeover of Potash Corporation of Saskatchewan Inc. by BHP Billiton, whose headquarters are in Australia, was likely to be of net benefit to Canada. BHP Billiton subsequently withdrew its application for review under the Act. In this case, since it was the non-Canadian investor that decided to withdraw its offer, this transaction is not deemed to have been rejected under the Act.

3 DATA ON FOREIGN INVESTMENT IN CANADA

The twin pie charts in Figure 1 illustrate the share of foreign investment under the purview of the ICA from 1985 to 2013 that consisted of acquisitions that were reviewed and approved, acquisitions that were subject to notifications only, and, finally, new business endeavours on Canadian soil. In terms of number of investments, acquisitions subject to notification represented close to 70% of all foreign investment. However, in terms of value, acquisitions that were reviewed and approved represented the majority of foreign investment in Canada with 60% of the total value of foreign investment.

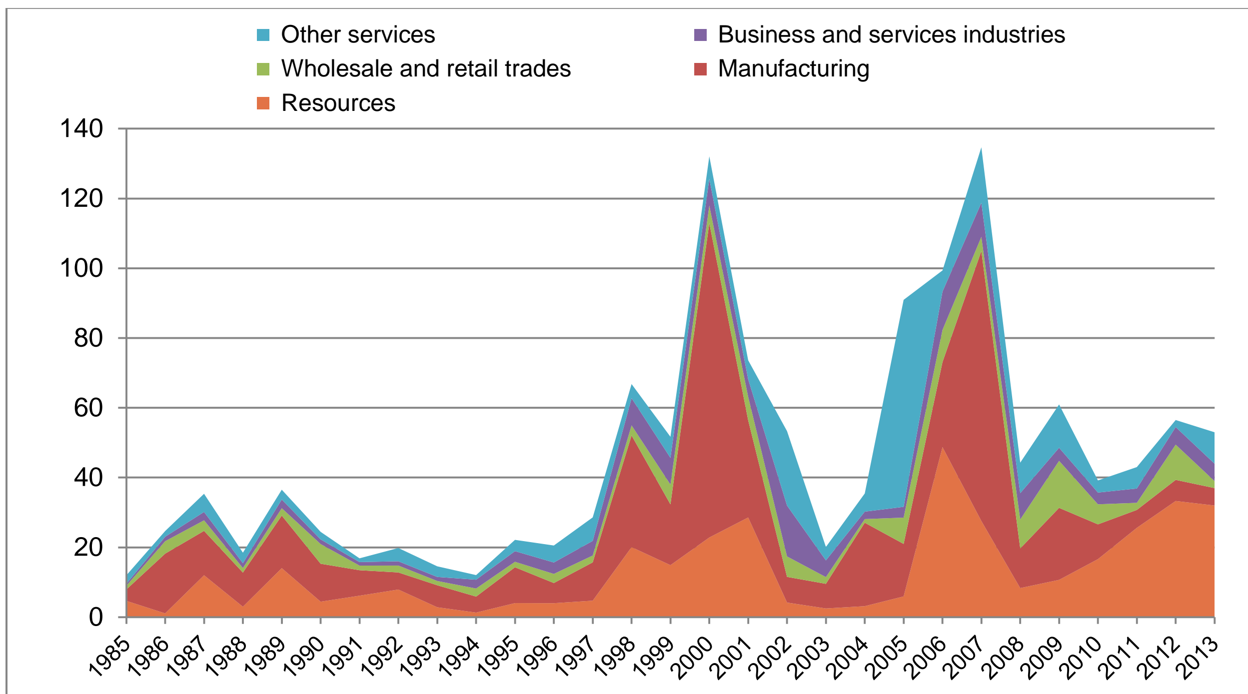
Figure 1 – Foreign Investment under the Purview of the *Investment Canada Act*, 1985–2013



Source: Figure prepared by the author using data obtained from Industry Canada, "Quarterly Statistics," *Investment Canada Act*.

Figure 2 shows the evolution of the value of foreign acquisitions of Canadian businesses in real terms (i.e., adjusted for inflation) and provides a breakdown by sector. The general trend is toward increased acquisitions of Canadian businesses by foreign investors. Volatility in the value of foreign takeovers has been very high, however, in the last 15 years, with two notable peaks. The 2000 peak was followed by a collapse year-over-year of 44%, 28% and 62% respectively in 2001, 2002 and 2003. The 2007 peak, which occurred on the eve of the 2008–2009 recession, was followed by a collapse of 67% in 2008. The acquisition of Canadian businesses by non-Canadians generally matches the business cycle, with the peak years for foreign acquisitions (1989, 2000 and 2007) corresponding roughly to the last year of an economic expansion period.

Figure 2 – Acquisitions of Canadian Businesses by Foreign Investors, 1985–2013 ($billions, adjusted for inflation [2013 dollars])



Note: The "Business and Services Industries" category includes business, education, health, social services, accommodation, food, beverage and other services industries. The "Other Services" category includes construction, transportation and storage, communication and other utilities, finance and insurance industries, and real estate businesses.

Source: Figure prepared by the author using data obtained from the Investment Review Division of Industry Canada.

4 COMPARING CANADA'S FOREIGN INVESTMENT RESTRICTIONS

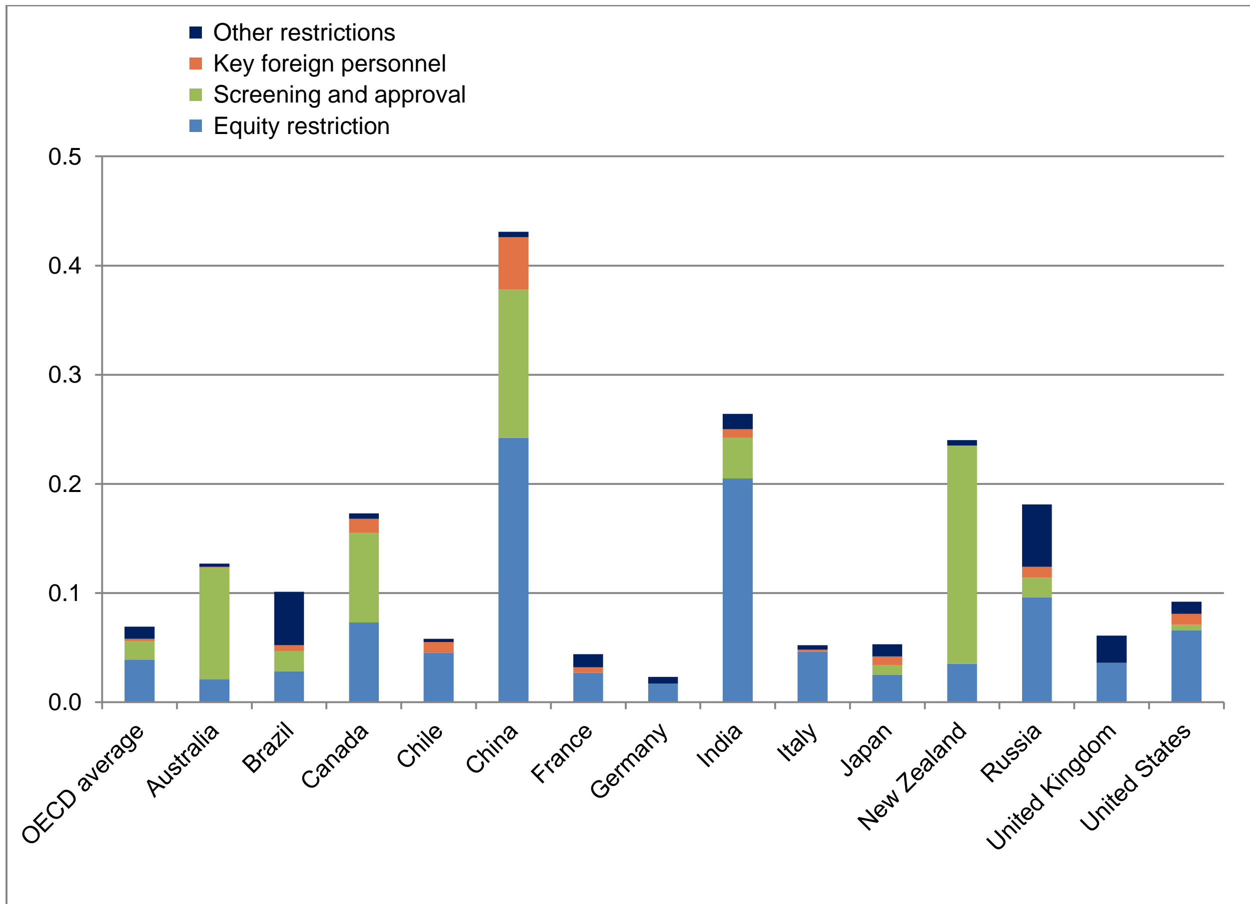
4.1 The Organisation for Economic Co-operation and Development Index

The Foreign Direct Investment (FDI) Restrictiveness Index of the Organisation for Economic Co-operation and Development (OECD) measures the extent to which a

country has restrictive rules in place regarding foreign direct investment.[11] The index ranges in value from zero to one. A value of zero means that no restrictions are imposed on foreign direct investment; conversely, a value of one means that no foreign ownership is permitted. The scoring system used by the OECD allows it to calculate a sub-index for four categories of foreign direct investment restrictions. The definitions of these four categories of restrictions are shown in the appendix to this paper. The overall FDI Restrictiveness Index is obtained by adding the value of the four sub-indices.

Figure 3 presents the OECD FDI Restrictiveness Index for various countries broken down by category of restrictions. Although Canada appears to be a restrictive country in terms of permitting foreign investment compared with countries such as France, Germany, Italy or the United States, caution should be used in interpreting the results of the OECD index. Indeed, any exercise that tries to assign a quantitative value to qualitative restrictions is bound to be subjective. The OECD index should probably be used more for the insights it provides on the type of restrictions on foreign direct investment imposed by each country than as a tool to judge the relative level of restrictions imposed by a particular country. In this regard, natural resources constitute an interesting case study.

Figure 3 – The Organisation for Economic Co-operation and Development (OECD) Foreign Direct Investment (FDI) Restrictiveness Index for Selected Countries, 2013



Source: Figure prepared by the author using data obtained from *OECD StatExtracts* (accessed in June 2014).

4.2 THE OECD FOREIGN DIRECT INVESTMENT RESTRICTIVENESS INDEX AND NATURAL RESOURCES

One feature that stands out in Figure 3 is that for countries whose economies are natural resource intensive, such as Australia, Canada and New Zealand, the most important restriction on foreign direct investment is screening and prior approval (such as the net benefit test in the case of Canada).

Screening and prior approval represent a convenient way of preventing a so-called "natural resources grab," whereby a foreign investor tries to acquire a company strictly for its natural resource assets while shedding all value-added activities associated with it. Indeed, screening and prior approval allow a government to examine the foreign investor's future plans for the business in terms of investment, employment and value-added activities – and to hold the foreign investor accountable. This approach can help discern a natural resources grab from foreign investment, which seeks to develop and advance the value-added activities associated with the natural resource. The following box explains the special place that natural resources have in the review process for foreign investment.

The Special Place of Natural Resources in Foreign Investment Review

Foreign investment in natural resources companies are often de facto treated differently than investments in other types of businesses in reviews of proposed foreign investment. The reasons for this include the following:

- Natural resources may be in limited supply, so it is often felt that decisions on the rate of depletion of a given resource should be made by the host country.
- Unlike other factors in production, such as capital goods (e.g., machinery and equipment), natural resources are country-specific. This gives bargaining clout to states endowed with them, allowing these states to accept foreign investment only on the best terms possible, particularly in times of booming commodity prices.
- Natural resource industries include two sets of activities: (1) the extraction or exploitation of the resource, and (2) the processing and transformation of the raw natural resource (value-added activities). Governments of countries with large stocks of natural resources are understandably concerned that, if natural resources are owned by foreigners, the resources may be extracted and shipped out of the country for processing and final consumption under exclusive supply agreements.

Note that no special treatment is provided under the ICA regarding the review of a foreign investment in a Canadian business involved in the extraction of natural resources. Moreover, nowhere are the words "strategic assets" or "strategic infrastructure" mentioned in the Act.[12] This stands in contrast to the situation in New Zealand, where foreign investments in non-urban land that exceeds five hectares have to be approved by the government.[13] In this case, the relevant ministers have to determine that the benefit "will be, or is likely to be, substantial and identifiable."[14] Furthermore, new regulations were implemented in 2008 in the midst of a boom in commodity prices to allow ministers to take into account "whether the overseas investment will, or is likely to, assist New Zealand to maintain New Zealand control of strategically important infrastructure on sensitive land."[15]

In Australia, foreign investment is regulated under the *Foreign Acquisitions and Takeovers Act* of 1975. As a general rule, foreign investments that are contrary to the national interest are disallowed.[16] What constitutes "national interest," however, is not defined in the Act and is evaluated on a case-by-case basis. This approach provides the government with considerable latitude in approving or disallowing a foreign takeover:

> The Government is making sure investments are not contrary to the national interest. If an investment is contrary to the national interest, the Government will intervene. This occurs infrequently.
>
> What is contrary to the national interest cannot be answered with hard and fast rules. Attempting to do so can prohibit beneficial investments and that is not the intention of our regime. Australia's case-by-case approach maximises investment flows while protecting Australia's national interest. […]
>
> The Government determines national interest concerns case-by-case. We look at a range of factors and the relative importance of these can vary depending upon the nature of the target enterprise. Investments in enterprises that are large employers or that have significant market share may raise more sensitivities than investments in smaller enterprises. However, investments in small enterprises with unique assets or in sensitive industries may also raise concerns.[17]

With respect to natural resources, only mineral rights, mining leases, mining tenements and production licences are expressly mentioned in the Australian policy document:

> Foreign persons need to apply to buy or take an interest in prospecting, exploration, mining or production tenements where:
>
> - they provide the right to occupy Australian urban land and the term of the lease or licence (including extensions) is likely to exceed 5 years; or
> - they provide an interest in an arrangement involving the sharing of profits or income from the use of, or dealings in, Australian urban land.[18]

A high-profile rejection in the Australian natural resource sector occurred in 2001, when the Australian government rejected Shell's bid to acquire Australian energy company Woodside Petroleum Ltd. The Government of Australia ruled that Shell's proposal was contrary to the national interest. The treasurer of Australia at the time stated that resource development and promotion was a key factor in his decision: "It is in the national interest for the operator of this project [the North West Shelf (NWS) project] to develop the resource to its maximum and for sales from the NWS to be promoted in preference to competing sales from projects in other parts of the world."[19]

5 CONCLUSION

Canadian businesses have experienced a relatively high level of foreign takeovers in the last 15 years – with notable peaks in 2000 and 2007 – relative to the average level for the previous 15 years. The extent of recent takeovers has given Canada's foreign investment review process a much higher public policy profile.

In Canada, the foreign investment review process, under the ICA, is based on six factors that make up the net-benefit-to-Canada test. Because these factors consist of broad evaluation criteria, the minister of Industry has considerable leeway in interpreting them, and hence in making a determination. Furthermore, even in a scenario in which net benefit to Canada could be objectively demonstrated on the basis of those six factors, national security provisions under the ICA provide the minister with significant additional leeway to reject an investment, since "national security" is not defined in the Act, nor are the elements that can be considered injurious to national security. Some observers have been critical of the Canadian foreign investment review process, arguing that too much discretion is given to the minister, creating an unpredictable foreign investment environment.

As noted in this paper, discretion is the rule rather than the exception in the case of other countries rich in natural resources, such as New Zealand and Australia. Like Canada, these countries rely on a screening and approval process that leaves room for considerable interpretation by their respective governments. In particular, the Government of Australia notes that the concept of a potential takeover's being "contrary to national interests" cannot be defined by a hard and fast rule; rather, it is determined on a case-by-case basis. New Zealand's 2008 regulations mention maintaining "New Zealand control of strategically important infrastructure on sensitive land" as a criterion for assessing benefit of overseas investment, without defining "strategically important infrastructure."

Replacing the ICA's six factors for the net-benefit-to-Canada test as well as the ICA's national security provisions with more transparent and rigid rules might replace much of the ministerial discretion permitted in the current approval process with a more standardized approach. Such an approach might also eliminate the possibility of judging foreign acquisitions on a case-by-case basis. The merits of such a change in policy depend on how much importance one attaches to ministerial discretion in the foreign investment review process.

NOTES

1. It is important to note that throughout this document, the term "foreign investment," when discussed in the context of the *Investment Canada Act*, refers to either the acquisition of control of a Canadian business by non-Canadians, or the establishment of a new business in Canada by non-Canadians.

2. Acquisition of control is generally defined as involving a majority of the voting interests in the company. For companies that are widely held, there is a rebuttable presumption that control may be acquired once one third or more of the voting shares are held. (Source: House of Commons, Standing Committee on Industry, Science and Technology, *Evidence*, 3rd Session, 40th Parliament, 17 February 2011, 1710 [Richard Saillant, Director General, Investment Review and Strategic planning Branch, Department of Industry]). In other words, in companies that have many shareholders, "acquisition of control" is presumed when the investor holds one third or more of the voting shares.

3. *Investment Canada Act* [ICA], R.S.C., 1985, c. 28 (1st Suppl.), s. 2.

4. In Section 3, the ICA defines a state-owned enterprise as:

> (*a*) the government of a foreign state, whether federal, state or local, or an agency of such a government;
>
> (*b*) an entity that is controlled or influenced, directly or indirectly, by a government or agency referred to in paragraph (*a*); or
>
> (*c*) an individual who is acting under the direction of a government or agency referred to in paragraph (*a*) or who is acting under the influence, directly or indirectly, of such a government or agency.

5. For foreign investors from a WTO member country, only direct acquisitions are subject to review. The threshold for review for such investments is updated annually. For more information, see Industry Canada, *Investment Canada Act*, "Thresholds for Review."

6. The threshold for review in relation to investments by foreign investors from a WTO member country will be adjusted incrementally to reach $1 billion over four years, and will subsequently be indexed to reflect annual inflation.

7. An indirect acquisition is a transaction involving the acquisition of the shares of a company incorporated outside of Canada, which owns subsidiaries in Canada. Source: Industry Canada, *Investment Canada Act*, "*Help with Forms*."

8. In the case of indirect acquisitions in cultural industries, the review threshold is $50 million.

9. ICA, s. 20.

10. Canadian Heritage, *Net Benefit Undertakings and Canadian Cultural Policy*.

11. The Organisation for Economic Co-operation and Development (OECD) defines foreign direct investment as follows:

> Foreign direct investment (FDI) is a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (*direct investor*) in an enterprise (*direct investment enterprise*) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship. Some compilers may argue that in some cases an ownership of as little as 10% of the voting power may not lead to the exercise of any significant influence while on the other hand, an investor may own less than 10% but have an effective voice in the management. Nevertheless, the recommended methodology does not allow any qualification of the 10% threshold and recommends its strict application to ensure statistical consistency across countries.

Source: OECD, Investment Division, Directorate for Financial and Enterprise Affairs, *OECD Benchmark Definition of Foreign Direct Investment*, 4th ed., Paris, April 2008, p. 234.

12. Guidelines were issued by the Minister of Industry for the acquisitions of Canadian oil and gas interests by non-Canadians. Guidelines do not, however, have force of law.

13. Overseas investments in New Zealand assets are screened only if they are defined as sensitive within the *Overseas Investment Act 2005*. Three broad classes of assets are currently defined as sensitive under the Act: acquisition of a 25% or greater ownership interest in business assets valued at over NZ$100 million, all fishing quota investments, and investment in sensitive land as defined in Schedule 1 of the Act. Examples of sensitive land include rural land over five hectares or land bordering on or containing foreshore, seabed, river, or the bed of a lake. Most urban land is not screened unless defined as sensitive for other reasons. (Source: New Zealand Treasury, "Foreign Investment Policy," *New Zealand Economic and Financial Overview 2010*.)

14. New Zealand, *Overseas Investment Act 2005*, Public Act 2005 No. 82 (as at 1 July 2014), s. 16(1)(e)(iii).

15. New Zealand, *Overseas Investment Regulations 2005* (SR 2005/220) (as at 1 July 2014), clause 28(h).

16. See Government of Australia, Treasurer, *Australia's Foreign Investment Policy*, 2013, pp. 2–3:

    > All foreign government investors must notify the Government and get prior approval before making a direct investment in Australia, regardless of the value of the investment. Foreign government investors also must notify the Government and get prior approval to start a new business or to acquire an interest in land, including any interest in a prospecting, exploration, mining or production tenement (except when buying land for diplomatic or consular requirements). […] Foreign persons should notify the Government and get prior approval before acquiring a substantial interest in a corporation or control of an Australian business that is valued above $248 million. They also need to notify for prior approval if they wish to acquire a substantial interest in an offshore company whose Australian subsidiaries or gross assets are valued above $248 million. The exception is for New Zealand investors and United States investors, where the $248 million threshold applies only for investments in prescribed sensitive sectors. A $1,078 million threshold applies to New Zealand and United States investment in other sectors.

17. Ibid., pp. 5 and 7.

18. Ibid, p. 12.

19. Government of Australia, Peter Costello, Treasurer, "Foreign Investment Proposal – Shell Australia Investments Limited's (Shell) Acquisition Of Woodside Petroleum Limited (Woodside)," News release, 23 April 2001 (accessed July 2011).

APPENDIX – THE FOUR CATEGORIES OF RESTRICTIONS IN THE FOREIGN DIRECT INVESTMENT (FDI) RESTRICTIVENESS INDEX OF THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD)

Equity restriction imposes quantitative limits on foreigners regarding their ownership of a domestic firm. For example, these limits could take the form of a maximum percentage of a corporation's voting shares that can be owned by foreign individuals or entities, either individually or collectively. A number of countries apply foreign equity limits, particularly in the service sector.[1]

Screening and approval restrictions that apply only to foreign investors fulfil a number of functions and vary widely in their scope. In some countries, the screening and prior approval restrictions may apply economic needs, net economic benefit or national interest tests before foreign investment is permitted, including in start-up companies and acquired firms.[2] In other countries, the screening process is only a formality, and the foreign investor is required only to notify the domestic authorities of his or her prior or intended investment.

Restrictions on key foreign personnel include economic needs tests for the employment of foreign managers, time-bound limits on the employment of foreign managers and nationality requirements for members of boards of directors.[3]

Other restrictions address value-added activities that must be undertaken within the host country and various other restrictive measures related to:

- the establishment of branch operations;
- the acquisition of land for business purposes, including situations where foreigners may not own property but may sign leases;
- reciprocity clauses in particular sectors;[4] and
- profit or capital repatriation.[5]

NOTES

1. Blanka Kalinova, Angel Palerm and Stephen Thomsen, "OECD's FDI Restrictiveness Index: 2010 Update," *OECD Working Papers on International Investment*, No. 2010/3, OECD Investment Division, June 2010, p. 10.
2. Ibid., p. 11.
3. Ibid., p. 12.
4. A reciprocity clause typically means that foreign companies are allowed to invest in a particular sector only if an agreement exists with the foreign company's host country.
5. Kalinova et al. (2010), p. 12.