



# From privatization to peaceful coexistence: dealing with SOEs in the world economy

Speaking Notes for Perrin Beatty

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I am honoured to have been asked to speak here today on an important policy issue facing the global economy: the rise, or perhaps more accurately, the return to prominence of state-owned enterprises, or SOEs.

I'm struck by how quickly things have changed. It feels like just a short time ago – although some of you would probably question my use of the word 'short' here – I was part of a government that spearheaded a wave of privatization and commercialization in the public sector.

In 10 years of governing, we privatized 23 companies worth over \$50 billion. In terms of economic policy, it was among our most significant achievements.

And it wasn't always about full-scale privatization. As Minister Responsible for Canada Post, I appointed an independent review commission to go over their plans and inject private sector expertise and guidance that would improve the efficiency and commercial viability of their services. The commission made far-reaching recommendations, most of which I'm happy to say were adopted.

As we all know, Canada wasn't alone. Across the West, governments were rejecting the blunt instruments of state control and planning in favour of market forces and price signals that allocate resources according to where they are most productive – not where they're most politically valuable.

The following decade saw the fall of communism and much of the developing world move in a similar direction. Sometimes it was unilateral; other times it was a condition for World Bank and IMF assistance.

However it happened, this rise of markets at home – and increased trade internationally – yielded an era of unprecedented growth.

But have free markets really triumphed? Sure, the overwhelming success of the BRICs and others can be partly attributed to their embrace of markets. But this embrace has been cautious: over half of the top 250 companies from these countries remain owned by the government.

It seems, then, that the spread of international markets has paradoxically stimulated the rise of state-led economies. And with slower long-term growth predicted in the rich world, the global balance between markets and states is swinging back.

But even at home, states are playing more of a role. The government's equity stakes in the automotive and financial services sectors during the recession represented the largest program of nationalisation in a generation.

In this case, it was only a short-term measure during a time of extreme need – as opposed to part of a broader industrial strategy – it nonetheless represented either the partial or total takeover of large and important companies.

Today, SOEs account for 10% of the sales of the world's top 2000 companies, and about 11% of international investment flows.

I want to speak for a few minutes about the policy implications of this trend, take a look at Canada's response, and talk about where we go from here.

First, let me start with some of the concerns we often hear about SOEs.

In Canada, the issue of SOE investment in Canada's resource sector gets most of the attention – including at this conference – so I feel I should start there.

You all know the story. Canada needs hundreds of billions of dollars to develop its oil and gas reserves, and the infrastructure to get them to international markets. And so we've been courting foreign investors – naturally going after the most eager and capital-flush.

But when this resulted in CNOOC's bid for Nexen – a company that was experiencing serious difficulties – Canadians responded with trepidation at the idea of a Chinese SOE "controlling" our oil.

While much of this opposition can be blamed on oversimplification or even xenophobia, some critics made points that needed to be considered.

There's national security. You've heard the argument: foreign governments could use their control over SOEs to hold our resources hostage. A sudden refusal to produce or attempt to otherwise disrupt the Canadian economy might leave us vulnerable to their demands. I have still some difficulty following this particular line of thought, given that the resource is in the ground and governments set the terms for whether it will be extracted and exported

The second concern is about the efficiency of their operations. SOEs may be directed by home governments to sell Canadian resources at sub-market prices to their domestic manufacturers or consumers – limiting the value of our exports and the level of tax revenue flowing to the public purse.

And then there's the view that we used to have while I was in government: that private ownership generally forces companies to stand on their own feet – providing strong incentives to lower costs and maximize revenues.

That is still my view, but to be frank, I'm more focused on that issue when Canadian taxpayer dollars are at stake, as opposed to those from other countries.

The issue of foreign SOE investment in the resource sector may be front and centre in today's Canada, but it's only part of a broader debate.

In other corners of the Canadian economy and abroad, the main problem is trade. SOEs are accused of competing unfairly with private companies because of advantages conferred on them by their home governments. This may be because of privileged financing arrangements, exemptions from key regulatory requirements, or other special treatment.

The trade problem is often considered separately from the investment problem. I think that's the wrong way to go about it. Both concern the potential threat that SOEs pose to the functioning of our market economy. When SOEs are seen to behave as commercial actors that compete on a level playing field – as opposed to agents of the state – concerns diminish.

That, to me, is the central issue, why we are focusing on ownership when we should be more concerned about behaviour.

Remember the case of Petro-Canada? When it first set up its Calgary headquarters in 1975, readers of the local business press could be forgiven for thinking it was owned by the Kremlin itself. But opposition eventually waned as it became clear that the company could co-exist with other market players.

Of course, the government eventually privatized Petro-Canada. There was no need for its continued existence as a Crown corporation.

But I could have used another example. Norway's Statoil, for instance. Or General Motors and Chrysler.

All these examples suggest that it's not state ownership that's the key issue – it's the implications of that ownership.

I'll allow that Chinese SOEs might be a different case than the examples I mentioned. Traditional links between management and the Communist Party, as well as the country's budding geopolitical ambitions, suggest that we should exercise perhaps a bit more caution.

But even then, managers of Chinese SOEs are often thinking more about the next dollar than about serving China's political interests. Many of them have taken to raising capital on global stock exchanges, and even their government shareholders expect to see competitive returns on their investments.

When it takes place, political meddling is often met by resistance from managers who increasingly measure themselves against the best of their international private sector peers.

These complexities make Canada's recent crack-down on SOEs in the Oil Patch rather – pardon the pun – crude. It may be a useful stop-gap measure until we determine how to fine-tune our policies, but it's not a long-term solution.

Much has been said recently about the drop in oil sands investment since the Prime Minister's announcement last year that Canada would effectively ban SOE acquisitions in the oil sands – not to mention tighten up the screening test across all other sectors.

All of the evidence I've seen over the last several months indicates that CNOOC's acquisition has brought significant benefits for Canada. It's hard to understand why it was a good idea last year – but would not be if it were taking place now.

Telling some of the world's largest pools of capital that they aren't welcome here certainly hasn't helped stimulate investment. In recent weeks, there has been quite a bit of discussion about whether the new policy has put a chill on figures from China.

There is both statistical and anecdotal evidence that these investors are looking elsewhere. However, I think the issue is more complex than that. Much of the drop in investment is the result of Canada's lack of export infrastructure, which is reducing the price we get per barrel and making projects less attractive. This is an enormous challenge we must overcome, with SOEs or without.

If investors saw clear evidence that Canada was doing what it takes to get our resources to world markets, I think we would see a dramatic increase in their interest.

Outside of resource extraction, SOEs and their owners are valuable partners for Canadian companies looking to do business in India and China – markets that just last month were identified by our Trade Minister as top priorities for Canada.

But India and China expect reciprocity. Blocking acquisitions by their companies is not going to win us any points.

Another problem with the current approach is how it distorts the allocation of capital across sectors and forms of investment. Takeovers of existing oil sands assets by SOEs are effectively prohibited, but greenfield projects aren't. And it doesn't apply to natural gas, where SOE investments are on the way up.

This isn't a sustainable model. It's time to think carefully about our next steps.

I'd like to suggest a middle path between the hawks and the doves.

This means, on one hand, being open to trade and investment with SOEs, just as we are with their private counterparts.

On the other, we can't be naïve. Canada will need to use existing policy levers and develop new ones to ensure that SOEs behave according to market principles: namely that they are commercial motivated and compete with private players on an even footing. But our focus needs to be on behaviour, not on ownership.

Let's start with what we have now.

First, it's important to remember that all SOE investments in Canada remain subject to Canadian laws and regulations.

Natural resources – regardless of who's extracting them – continue to be owned and controlled by the federal and provincial governments. On behalf of Canadians, they collect royalties, tax projects and apply and enforce Canadian environmental and health and safety regulations.

There are rules in place to prevent companies of all stripes from accumulating reserve rights without a corresponding increase in investment to explore or exploit of the asset.

SOEs are also subject to transfer pricing rules, which require that export values be based on market rates.

And we shouldn't ignore the role of our competition authorities, who are mandated to punish anti-competitive practices and prevent high levels of market concentration.

Full enforcement of these rules should already stem a number of the concerns we may have about SOEs.

And if that's not enough, there's the Investment Canada Act.

Most companies understand that countries will screen controversial acquisitions. In some cases, the screening agencies have names like Investment Canada; in others, they are called Parliament or Congress. Handled properly, our process can actually be less capricious than those of other countries that may not have a designated agency.

As many of you are intimately aware, in 2007, Canada put out fairly detailed guidelines for the screening of SOEs under the Act. In addition to the standard economic impact, they are assessed according to their independence from state influence and their commitment to transparency and commercial operations.

The Act's track record with SOEs is quite good. Let's go back to the Nexen case. CNOOC agreed to keep Nexen's head office in Calgary and to retain its senior staff. It also agreed to list CNOOC

itself on the TSX and to appoint a Canadian to its own board of directors. These commitments to Canadian corporate governance standards have been fully honoured.

As an aside, I want to point out that there's nothing in the Canada-China Foreign Investment Protection Agreement that would limit the applicability of Canadian law or the Investment Canada Act to SOEs as I've just described.

In 2010, the Canadian Chamber of Commerce released a report that called for the two countries to work towards the FIPA as the next step in our economic partnership. We have one on the table, but it's just sitting there.

Which is too bad, because Canadian small and medium-sized businesses in China, or considering China, repeatedly tell me they're worried about the risks to their investments and intellectual property.

My point is that the Canadian government has and will continue to have the tools needed to address SOE investment.

It's perhaps on the trade front where most of the new work is required. Here, policy tools to level the playing field are less developed.

Canada continues to maintain a robust trade remedy mechanism. This gives Canadian companies a means to raise duties on products that are competitive only due to special advantages granted by their home governments. It's also easier to secure rulings against China because of their non-market status.

But these measures are addressing the effects, not the cause. And only in the Canadian market.

A potentially more effective solution is under discussion at the Trans-Pacific Partnership talks. New disciplines in the agreement would seek to eliminate certain special advantages enjoyed by SOEs.

I want to be cautious about reading too much into last weekend's announcement, but if the recent Bali agreement signals the return of a more effective WTO, that would be another channel to put these issues on the agenda.

There are no silver bullets here. It will take a great deal of work and debate like you're undertaking here today to find the exact combination of tools – many of which already exist – that allow us to reap the benefits that come from working with SOEs from new markets, while protecting against the security and economic concerns that many Canadians have raised.

But one thing is clear. We need to make some difficult and important decisions about Canada's role in the world. We need a major infusion of new investment, both domestic and foreign, to help us bring our resources to market and to build a stronger economy.

We have every right to set groundrules for how we expect businesses to behave. But the opaque and confusing system we have today serves neither investors nor the companies that urgently need new capital. And until we see significant reforms, we will fall short of our economic potential.