

FOREIGN INVESTMENT REVIEW IN CANADA

Assessing Chinese Investment
Amid a Re-Evaluation of the
Investment Canada Act

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FOREWORD

The China Institute at the University of Alberta (CIUA) is pleased to publish this Occasional Paper, titled “Foreign Investment Review in Canada: Assessing Chinese Investment amid a Re-Evaluation of the Investment Canada Act.” As Canada confronts historic global and bilateral challenges, the question of how to best access and evaluate incoming Foreign Direct Investment (FDI) - with particular regard for China – is now in full view. This paper provides an in-depth analysis of the factors critical to the review of the Investment Canada Act (ICA) undertaken by the Standing Committee on Industry, Science and Technology (INDU) in 2020, in light of the COVID-19 pandemic. This paper specifically focuses on Chinese investment and the Canada-China relationship. It further incorporates data from the China Institute’s China-Canada Investment Tracker, allowing the CIUA to contribute an informed and data-oriented perspective regarding China’s investment activity in Canada to the current national investment review discussion.

China was the fourth largest source of global FDI outflows in 2019 and, including Hong Kong, is the sixth all time largest FDI source for Canada. Despite being outranked by other countries in terms of overall value, Chinese investment is the subject of considerable focus from Canadian legislators and policymakers. This reality was notable during my testimony to the Standing Committee on Industry,

Science and Technology (INDU) on June 18th, 2020. Unsurprisingly, the China-related factors pertinent to current discussions include China-Canada bilateral tensions and Chinese investor interest in Canadian resources.

Over the past ten years, Chinese investment flows to Canada have been particularly strong, first in the energy industry, which generated public debate in 2012, and now in the metals and minerals sector. However, Chinese investment in Canada touches a broad range of areas and warrants a nuanced analysis. Evan Oddleifson (Policy Research Assistant, CIUA) and Tom Alton (Policy Research Assistant, CIUA) discuss some of the guiding questions posed by the Standing Committee on Industry, Science and Technology (INDU) in its current study of the ICA. They highlight areas where the foreign investment review process may need to be constrained, and others where it could be expanded. The CIUA, by publishing this report, intends to provide relevant insight for Canadian policymakers and, additionally, foster understanding for members of the Canadian public. This research adds to a body of collaborative work from the CIUA pertaining to a range of topics, including Canada-China relations, trade, investment, and security. I wish to thank the authors their work on this paper, Deputy Director Jia Wang for her project oversight, and Vivian Chiew for her design and formatting contributions.



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INTRODUCTION

As a result of the global COVID-19 pandemic and its potential negative impacts on the valuations of Canadian businesses, the Canadian government took steps to enhance scrutiny of inbound foreign investment and is evaluating further potential changes to the foreign investment regulatory framework. On April 18, 2020, the Investment Review Division of Innovation, Science, and Economic Development Canada (ISED) released a Policy Statement on Foreign Investment Review and COVID-19.¹ The Standing Committee on Industry, Science, and Technology (INDU) also commenced a study of the Investment Canada Act in June 2020 to determine whether additional oversight should be applied to foreign investment transactions given the current global circumstances.

The review process surrounding inbound foreign investment, of course, is not aimed at any one country in particular. While the review thresholds outlined in the Investment Canada Act differ based on the source of investment (including WTO vs. non-WTO investors, trade agreement investors, and state-owned enterprises), the act makes no mention of specific countries or regions. There is, however, close Canadian public attention aimed at China, and by extension Chinese investment, given the current global political climate and ongoing Canada-China tensions. While the implications of the COVID-19 pandemic on investment will eventually fade, China-related topics will continue to attract a significant amount of public discussion and government consideration.

There remains a need to interpret and apply foreign investment regulations in a both a rigorous and timely manner. This is a balancing act. Foreign investment, to quote the April 18 Policy Statement, is “essential in ensuring that Canadian businesses

are able to invest in innovation and to compete in the global economy.” But we also must be aware of, and fairly judge, the potential risks of Chinese investment as we do with all foreign investment.

Given current government and public attention on foreign investment, the China Institute at the University of Alberta (CIUA), believes that there is a need to dispel myths, and to foster an objective and facts-based approach to Canada-China investment issues.

This report, using data from the CIUA China-Canada Investment Tracker, aims to equip readers with a broad understanding of the context, topics, and trends surrounding Chinese investment in Canada in order to provide a realistic perspective of the significance, benefits, and risks that arise from our investment relationship with China. It examines and challenges the socio-political context in which our investment relationship is typically discussed and provides an analysis of the characteristics of incoming Chinese investment in key Canadian industries. This report then compiles and contextualizes key areas of future consideration for the foreign investment regulatory framework in Canada. Through this, we aim to provide a balanced perspective of the realities surrounding incoming Chinese investment to academics, policymakers, industry stakeholders, and informed citizens.

This is not intended to be an exhaustive study of the subject of Chinese investment in Canada. The focus, instead, reflects recent trends in public attention in addition to the academic mandate of the China Institute, which aims to increase understanding of China and Canada-China relations in the 21st century.

INVESTMENT CANADA ACT: OVERVIEW

While there are well established international rules governing trade through the WTO and other multilateral agreements, the same is not true for foreign investment. Therefore, state level regulation of foreign investment is largely the arbiter of investment flows. A national foreign investment framework has existed in Canada since 1973 when the Foreign Investment Review Act (FIRA) was introduced. The Investment Canada Act (ICA) subsequently entered into force on June 30, 1985. The ICA, which replaced FIRA,² was intended to “make Canada a more welcoming destination for foreign investors” by “narrow[ing] 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 act is administered by Innovation, Science and Economic Development Canada (ISED) except in cases where an investment is deemed to be “cultural” under the act. These cases are instead reviewed by the Department of Canadian Heritage.

In the absence of a specific exception, the ICA requires non-Canadian investing entities to file a Notification or Application for Review. The filing of a notification is required for all investment transactions, while an Application for Review is required only when the value of the transaction exceeds the applicable threshold.³

There are four separate review thresholds under the act. These threshold levels are adjusted annually, although the process differs for each category. In 2020, they are as follows:

- Private sector, WTO investors: \$1.075 billion
- Private sector trade agreement investors: \$1.613 billion
- State-owned enterprise WTO investors: \$428 million
- Non-WTO investments and investments in cultural business: \$5 million dollars, \$50 million for indirect transactions.

For transactions that equal or exceed the relevant threshold, the Minister will undertake a review to determine if the deal is of “net benefit” to Canada. The investor is expected to address the following factors, as outlined by ISED, when applying for review:

- the effect on the level of economic activity in Canada, on: employment, resource processing, the utilization of parts and services produced in Canada, and exports from Canada;
- the degree and significance of participation by Canadians in the Canadian business or new Canadian business and in any industry or industries in Canada;
- the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;
- the effect of the investment on competition within any industry in Canada;
- the compatibility of the investment with national industrial, economic and cultural policies; and
- the contribution of the investment to Canada’s ability to compete in world markets.

With respect to the geographic origin of foreign investment deals covered under the act in 2018/19, the United States (58%) was far ahead of other countries. It was followed by the United Kingdom, France, Germany, and China.⁴

The vast majority of deals reviewed under the Investment Canada Act are approved. In the 2018-2019 fiscal year, there were 962 approved notifications under the Act. Only nine applications

were subjected to a net benefit review and all were subsequently approved.⁵ However, there will also be cases where a foreign investor declines to proceed with an investment – withdrawing from the investment review process – because of informal advice from ISED or a Canadian advisor that their investment faces significant barriers to approval. All investment transactions covered under the Act are subject to a national security review if the Minister has “reasonable grounds to believe that an investment by a non-Canadian could be injurious to national security.” Seven investments were subject to a formal national security review in 2018-2019. Of these, three were not subject to any further action, two withdrew after being notified of the review process, and two were ordered to divest.⁶

Figure 1:

GEOGRAPHIC ORIGIN OF INVESTMENT DEALS, BY COUNTRY/REGION

Country or Region of Origin	Number of Investment Deals
United States	564
European Union	156
France	54
Germany	39
Netherlands	12
Ireland	11
Italy	9
Rest of E.U.	31
United Kingdom	74
China	36
India	22
Iran	19
Switzerland	15
Japan	14
Australia	12
Other	50
Total	962

Source: Investment Canada Act Annual Report, 2018/2019

Figure 2:

NUMBER OF APPLICATIONS VS. NUMBER OF NOTIFICATIONS UNDER THE INVESTMENT CANADA ACT

Year	Number of Applications	Number of Notifications
2014-15	15	704
2015-16	15	659
2016-17	22	715
2017-18	9	742
2018-19	9	953

Source: Investment Canada Act Annual Report, 2018/2019

Recent Investment Canada Act Developments

On April 18, 2020, the Investment Review Division of Innovation, Science, and Economic Development Canada (ISED) released a Policy Statement on Foreign Investment Review and COVID-19.⁷ The Government noted that it would “scrutinize with particular attention under the [ICA] foreign direct investments of any value, controlling or non-controlling, in Canadian businesses that are related to public health or involved in the supply of critical goods and services to Canadians or to the Government.” Additionally, the Government would move to apply increased scrutiny to investments “by state-owned investors, regardless of their value, or private investors assessed as being closely tied to or subject to direction from foreign governments.” This directive was aimed at preventing “opportunistic investment behaviour” and will apply until the Canadian economy recovers from its pandemic-induced decline.

Given that the People’s Republic of China’s (PRC) investments come largely from state-owned enterprises, the effect of the April 18, 2020 policy adjustment may have greater impact on Chinese investors than is the case for US, European or other Asian investors.

On July 21, 2020, the Minister of Innovation, Science and Industry, Navdeep Bains, issued an order lengthening “the initial review period and the extended initial review period of the national security review timeline for any investments for which an application or notification has been certified as of

the date of the Ministerial Order, July 31, 2020, up to December 31, 2020.”⁸ The order also extends to investments that don’t require a filing under the ICA, a category which includes deals “that do not confer control over a Canadian business.”⁹

The Standing Committee on Industry, Science, and Technology (INDU) also commenced a study of the Investment Canada Act to determine whether additional oversight should be applied to foreign investment transactions given the current global circumstances. On June 1, 2020, the following motion was adopted:

“That, given the House motion made last week granted the committees power to study outside their usual scope, the Standing Committee on Industry, Science, and Technology conduct a study on Investment Canada Act; that this study determine the extent to which companies within strategic Canadian industries have been devalued as a result of the COVID-19 crisis; the extent to which foreign buyouts may occur; determine whether the current Investment Canada Act valuation thresholds is adequate to trigger a net benefit review given the potential extreme devaluation of companies within strategic Canadian industries; determine whether Canada should place a temporary moratorium on acquisitions from state owned enterprises of authoritarian countries; that this study consist of no less than four meetings; that this study be completed by June 21, 2020; that the Committee table its findings; and that the Government table a comprehensive response.”¹⁰

Before the prorogation of the Parliament in September, the committee convened five meetings on the subject and called on 25 expert witnesses to appear. At the time of writing, the committee has not yet tabled its findings in the form of a report.

CHINA-CANADA RELATIONS IN 2020

It would be remiss to discuss Chinese investment in Canada without mentioning the current state of the Canada-China bilateral relationship. The December 2018 arrest of Huawei CFO Meng Wanzhou and subsequent detention of Michael Kovrig and Michael Spavor, two Canadians living in China, has led to a sharp, and highly public, deterioration in relations between the two countries. Canada and China have further sparred on issues surrounding trade, 5G, COVID-19 vaccine collaboration and Chinese restrictions on certain Canadian exports, most notably canola. China-Canada friction in 2020 has been generated by a few key issues, the detention of Ms. Meng and Canadians Michael Spavor and Michael Kovrig, the controversial national security law in Hong Kong, human rights questions related to Xinjiang, and a failed COVID-19 vaccine development partnership. However, despite the poor state of bilateral relations trade between Canada and China, the impact to date on Canada-China trade relations has been rather modest, with the notable exception of Canadian canola exports in 2019.

In late May 2020, the U.S. extradition case involving Ms. Meng cleared a major hurdle after a B.C. judge confirmed that her alleged charges would, in fact,

be considered a crime had they occurred in Canada. Soon after, both Michael Kovrig and Michael Spavor were formally charged with spying and China's Ministry of Foreign Affairs Spokesperson, Zhao Lijian, referenced comments made by Vina Nadjibulla, Michael Kovrig's wife, that link the ability of the Canadian justice minister to end the extradition process and the situation of the two Canadians.¹¹ Prime Minister Justin Trudeau has rejected the premise that the Canadian government would intervene in the extradition process despite calls from a high-profile group of former diplomats and MPs.¹³ This sets the stage for further extradition proceedings that will run into mid-2021 – barring any sort of agreement between the U.S. Justice Department Meng/Huawei that would resolve the charges and halt the extradition request.¹⁴

Canada also moved to implement measures in response to a new Hong Kong national security law passed and implemented by Beijing. Prime Minister Trudeau announced that Canada would suspend its extradition treaty with the semi-autonomous region and bar the export of sensitive military items.¹⁵ This led China's Ambassador to Canada, Cong Peiwu, to state that China "reserved the right to further react"

and that Canada would “bear the consequences” of “interfering” in China’s internal affairs.¹⁶

A COVID-19 vaccine development partnership between a Chinese company and Canadian researchers also collapsed after unexpected issues emerged. Shipments from CanSino Biologics, based in China, to the Canadian Centre for Vaccinology at Dalhousie University were not approved for export by Chinese customs¹⁷ – effectively killing the project. Experts have theorized that the failed project is likely not just a “bureaucratic glitch” and could instead be linked to ongoing political tensions.¹⁸

These developments also fall against the backdrop of an ongoing great-power struggle between China and the United States. Canada, due to its deep geopolitical and economic ties with the U.S., is under unprecedented pressure to align with U.S. policy on China.

The Trump Administration had taken a profoundly hardline approach to China, its primary global strategic competitor and a country labeled “the greatest long-term threat”¹⁹ to the U.S. by FBI Director Christopher Wray. It has engaged in a full-scale trade war with China, imposed sanctions on high-ranking Chinese officials, banned Chinese students in certain subject areas from attending American graduate schools, passed legislation targeting Hong Kong with broad bipartisan support, and targeted popular Chinese apps. The American approach to Huawei and 5G, however, is the best example of a Washington-led influence campaign to draw allies into presenting a unified front towards China.

A broader discussion of the many factors impacting 5G policy around the world may be found in *Canada & 5G: Security, Diplomacy, and Policy*,²⁰ a China Institute occasional paper published in June 2020. Huawei has faced heavy scrutiny from Western nations, including the Five Eyes intelligence alliance.

The United States, Australia, New Zealand (in a de-facto sense) and most recently the United Kingdom have all moved to bar Huawei from participating in their respective 5G telecommunications networks. In the case of the U.K, an initial decision to allow Huawei equipment into its 5G network was overturned after Prime Minister Boris Johnson faced significant pressure from both external, namely via the Trump Administration, and internal parties. The U.S. decision in May to ban Huawei from using U.S. technology and software to produce semiconductors²¹ made it unviable or British regulators to properly assess concerns surrounding security.²²

Canada is now the only Five Eyes country not to have made a decision regarding Huawei and 5G - although it seems increasingly unlikely that it would diverge from precedent set by close allies and choose to allow Huawei “in”. Such a move would likely impact the established intelligence-sharing relationship between Canada and its allies, in particular the US.²³ Whereas Germany has chosen to take a more nuanced approach to Chinese involvement in 5G network development,²⁴ Canada is likely unable to commit to such a future. American attitudes and ideas – even under the new Biden Administration - are a key consideration in policy development and this case serves to illustrate the current reality of Canada’s bilateral relationship with China.

Contextualizing Chinese Investment in Canada

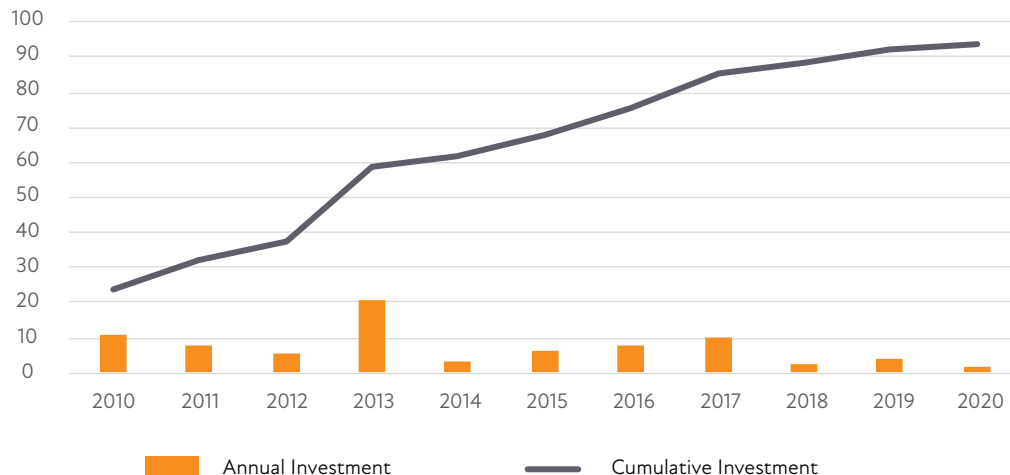
China is a driving force behind a significant portion of the world’s foreign investment flows. According to the 2020 United Nations Conference on Trade and Development (UNCTAD) World Investment Report,²⁵ China was the fourth largest source of FDI outflows in 2019 at US\$117 billion. Hong Kong was close behind in 7th place with US\$59 billion, although it is possible that some of the Hong Kong investment has mainland origins given the tightening economic integration between the two economies. The total value of Chinese overseas investment projects since 2005 stands at over US\$1.2 trillion according to data from the American Enterprise Institute China Global Investment Tracker.²⁶ 2019 did, however, mark the third consecutive year of declining outward investment from China. The 2020 UNCTAD report

attributed this to “continued restrictions on outward investment, geopolitical tensions and a challenging global trade and investment policy environment.”

Chinese investment in Canada has generally followed a similar trend to China’s global investment picture. As demonstrated in Figure 3, the China Institute at the University of Alberta Investment Tracker recorded C\$10 billion worth of investment in 2017, C\$2.6 billion in 2018, and C\$4.1 billion in 2019. This is down from an investment peak of \$19.5 billion in 2013, which was largely driven by the China National Offshore Oil Corporation (CNOOC)’s purchase of Nexen Inc. for C\$15.1 billion plus the assumption of C\$4.3 billion in debt.

Figure 3:

CUMULATIVE CHINESE INVESTMENT IN CANADA (BILLIONS CAD)



A list of the top 10 geographic sources of FDI stock in Canada can be found in Figure 4.²⁷ The United States, Netherlands, Luxembourg, United Kingdom, and Switzerland rank as the top five sources of FDI stock in Canada. China ranks as just the 7th largest source of foreign direct investment (FDI) stock in Canada. It moves to 6th on the list when combined with Hong Kong, which is categorized as a separate investing entity by Statistics Canada.

Figure 4:

**TOTAL FOREIGN DIRECT INVESTMENT
POSITIONS OF OTHER COUNTRIES
IN CANADA AT YEAR END
(BILLIONS OF CAD)**

Country of Origin	Year 2019
Total FDI in Canada	973.9
United States	455.1
Netherlands	123.9
United Kingdom	62.3
Luxembourg	56
Switzerland	51.7
Japan	33.6
China	21.2
Hong Kong	20.9
Germany	18.1
Brazil	15.4
France	14.8
Bermuda	13.3
Australia	11.2
Ireland	7.7
Cayman Islands	7.7
All other countries	60.9

Source: Statistics Canada

Canada and China have developed extensive economic ties while simultaneously clashing on political and geo-strategic issues, especially since the December 2018 detention of the Huawei CFO. China is Canada's second-largest trading partner, second-largest source of international students, and third-largest source of international tourists. In the age of COVID-19, Canada has also relied on China for access to personal protective equipment (PPE) and initially collaborated with a Chinese company in the race to develop a vaccine.²⁸ However, because of the factors discussed thus far, the benefits of collaboration are often intermixed with concerns surrounding engagement with China.

Canadian trade with China is illustrative of this practical dilemma. Bilateral trade has expanded rapidly over the past 20 years, entrenching China as a crucial market for many Canadian industries. But the current diplomatic deep freeze and ongoing threat of trade restrictions, such as those currently impacting Canada's canola producers, has shown that China is willing to engage in "economic retribution" for political ends. Canada's condemnation of China's alleged abuses in Hong Kong and Xinjiang²⁹ has created additional tension and the possibility of further trade-based retaliation, although the current stability in bilateral trade may indicate that this tool may not always be in China's own net interest.^{30 31}

Canadian public opinion, likely reflecting the prolonged tensions, has shifted to a much less favourable stance on economic ties with China. Recent survey data from IPOS shows strong Canadian support (82%) for a reduction in trade reliance with China.³² A notable number of respondents (38%), according to Ipsos, would even support a complete severance of economic ties.

Chinese investment is surrounded by a similar public sentiment. There are clear benefits of Chinese foreign investment for Canada, as there is from any other nation. The APFC's 2019 National Opinion

Poll: Canadian Views on High-tech Investment from Asia found that Canadians associate high-tech FDI from China with job creation and access to capital and foreign markets.³³ However, there was also a strong association of China with risks - specifically those related to security (“i.e. national security, cyber security, and intellectual property infringement”). This suggests that Canadians simultaneously acknowledge both the benefits and risks involved with Chinese investment in Canada.

While the APFC 2019 survey dealt specifically with high-tech investment, this sentiment appears congruent with the attitudes expressed towards investment deals in other sectors - namely Energy and Mining. The APFC’s more recent 2020 National Opinion Poll: Canadian Views on Asia found that just 19% of Canadians support more foreign direct investment from China into the non-renewable energy sector.³⁴

There was a mixed, leaning towards negative, public opinion of Chinese investment in Canada dating back to even before the current diplomatic deep-freeze. The Asia Pacific Foundation of Canada (APFC)’s National Opinion Poll 2018: Canadian Views on Asia found that while Canadians recognize the importance of Asian trade and investment, many are still wary that too much Chinese investment is entering the Canadian market.³⁵ Of the respondents, 59% were concerned that there was too much Chinese control of Canadian companies, 57% believed there was too much investment in commercial real estate, and 53% believed there was too much investment in strategic resources (“e.g., energy, communications, transportation, water”).

A December 2019 Angus Reid poll reported that 77% of Canadians supported the banning of Chinese investment in “sensitive” industries, namely finance and telecommunications.³⁶ A further May 2020 Angus Reid poll found that just 14% of Canadians

held a “favourable” view of China, compared with 38% in 2018.³⁷ In the same poll, 76% of respondents also stated that upholding human rights and the rule of law should be considered more important to Canada’s relationship with China than trade and investment opportunities. This fact, combined with the 88% of respondents who agreed that China “can’t be trusted” to uphold proper human rights or the rule of law, demonstrates that Canadians are generally wary of engaging with China.

Further, a 2019 study led by Xiaojun Li, Associate Professor of Political Science at UBC, found that Canadians also vastly overestimate the amount of Chinese investment flowing into Canada. Respondents, on average, estimated that 30% of all incoming investment was Chinese when the actual number is around 3%.³⁸ This reality reflects the difficulty facing Canadian officials tasked with evaluating deals under the Investment Canada Act (ICA). Chinese investment projects continue to hold an outsized position in the Canadian public consciousness, especially those in sectors deemed sensitive and/or strategic. There is a fine line between ensuring that Canada is attractive to foreign investors (and the rules are applied fairly) and effectively placating the security and strategic concerns of the Canadian populace.

INSIGHTS FROM THE CHINA INSTITUTE CHINA CANADA INVESTMENT TRACKER

The China Institute at the University of Alberta's China-Canada Investment Tracker was created in response to the lack of good, accessible data on Chinese investment deals in Canada. It tracks Chinese investment made in Canada dating back as early as 1993 and is one of the most comprehensive and up-to-date databases of Chinese investment in Canada.

Since its inception, the Tracker has recorded over C\$93 billion of Chinese investment in Canada. This is broadly similar to the amount recorded by the Asia Pacific Foundation of Canada's Investment Monitor (C\$87 billion) and the American Enterprise Institute (US\$57.3 billion) but remains more comprehensive than either.

Despite reporting a high cumulative level of Chinese investment in Canada, the CIUA Investment Tracker employs a conservative verification methodology, necessitating a high degree of certainty regarding the value and other specifics of each deal. As such, it may report different per-deal values than other trackers due to differences between announced values, which are often reported on by investors, and closing values, which sometimes vary.

The CIUA Investment Tracker data usefully encompasses investment deals captured by, and reviewed under, the ICA, thus positioning us to comment not only on what is being reviewed, but on what is not. Through this, we aim to provide clarity and promote understanding regarding the

characteristics of Chinese investment in Canada and how it is, and perhaps should be, treated under the Canadian foreign investment review framework.

This section will discuss the trends of Chinese state-owned enterprise (SOE) and private investment in an array of Canadian industries. For the purposes of this analysis, deals have been grouped by sector into three broad categories: (1) resource extraction, (2) value adding, and (3) retailing goods and services. Each category includes an overview of the primary "type" of Chinese investor (state vs. private), the level of investment, potential benefits of investments, and potential risks. A subsection on high-tech and other broadly strategic economic areas is also included to address the most acute investment-related concerns in the public and policymaking community's focus. This subsection will further develop ideas discussed in the overview of the three broad categories and situate Canada's investment landscape in a global context.

Figures 5 and 6 illustrate the breakdown of cumulative Chinese investment by Canadian sector. Figure 6 excludes the energy, metals and minerals, and entertainment and real estate sectors to provide a better view of the sectors in which investment value is less significant.

Figure 5:

**CUMULATIVE CHINESE INVESTMENT BY MAJOR SECTOR SINCE 2010
(BILLIONS CAD)**

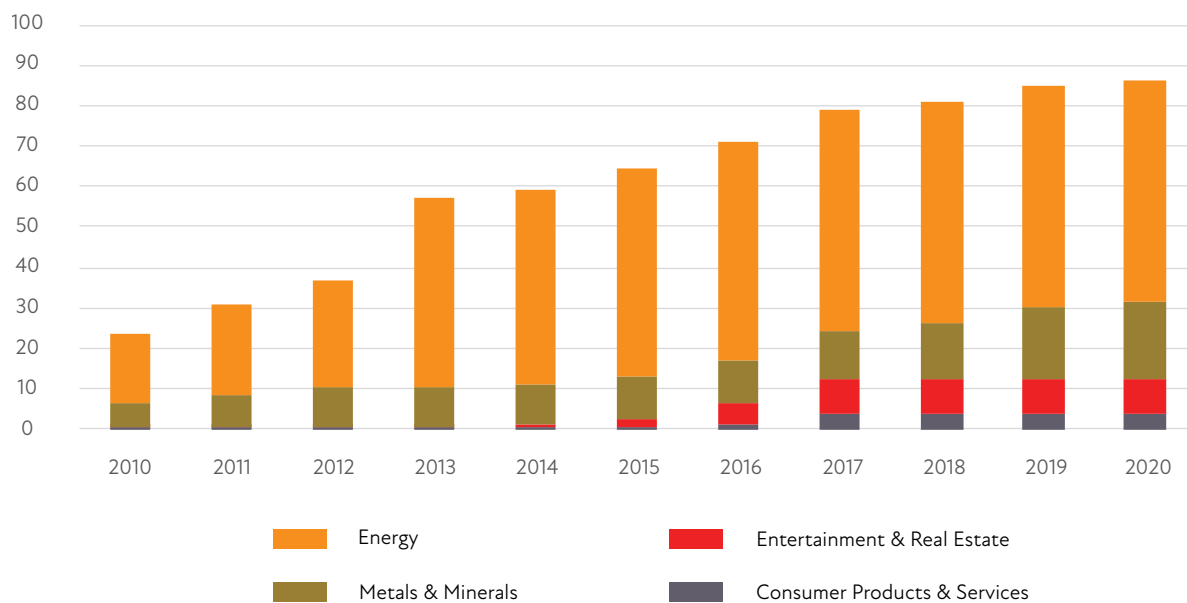
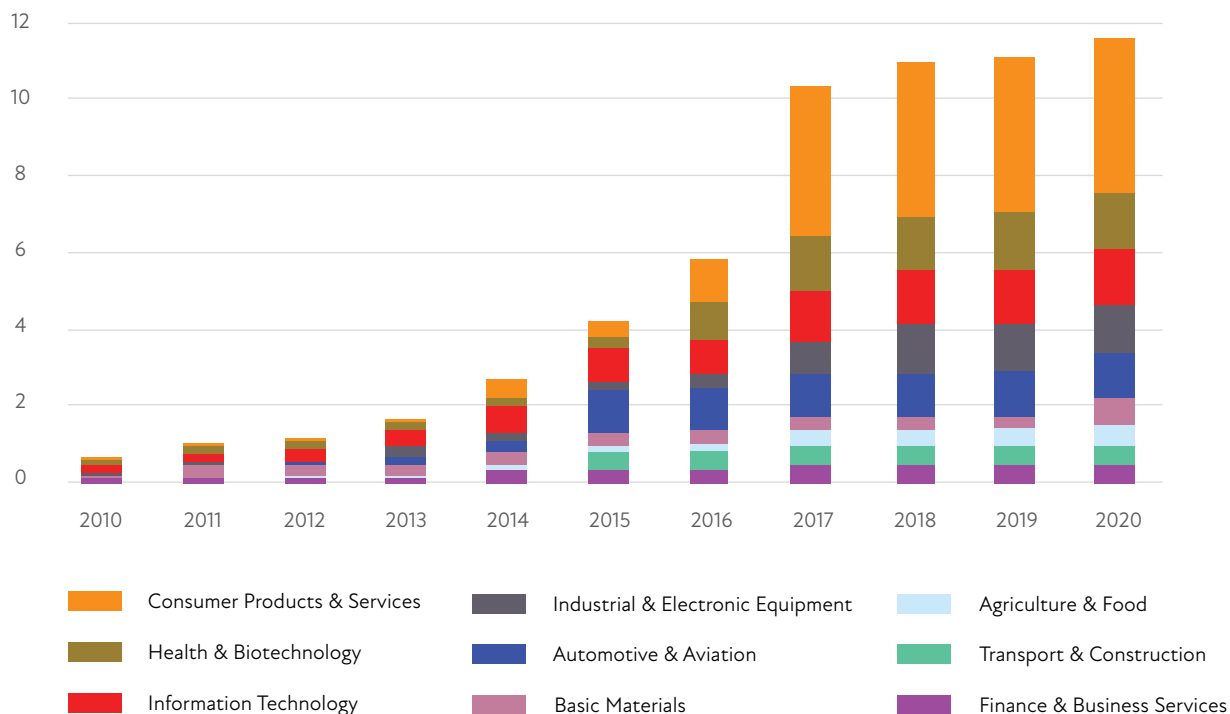


Figure 6:

**CUMULATIVE CHINESE INVESTMENT EXCLUDING TOP THREE SECTORS SINCE 2010
(BILLIONS CAD)**



Resource Extraction: Energy/Metals & Minerals

The Canadian energy sector has attracted, by far, the most Chinese investment by total deal value. Likewise, though cumulative investment in the Canadian metals and minerals sector is not even half that of energy, its total value also dwarfs that of other sectors. As significant outliers in terms of total value invested from China, it is no surprise that these sectors share several similarities.

First, the primary Chinese investors in these sectors are state-owned enterprises (SOEs) and the investments tend to be of ultra-high value, in the range of hundreds of millions or billions of Canadian dollars. Both sectors also primarily consist of export-based businesses that may sell natural resources to international markets. The periods in which each sector has attracted most of its investment from China do not align. As shown in Figure 7, Chinese investment in the energy sector primarily took place

from 2010 to 2016, while most investment into the mining sector has come since 2016. This highlights the fact that the big dollar appetite of Chinese SOEs has largely shifted from oil and gas to mining precious metals, such as gold, as shown in Figure 9.

It is important to note that the cumulative investment that the CIUA tracks differs from the stock of Chinese investment and refers to the total value paid by investors rather than the current market value of investments. For example, the largest deal in our database, the 2013 acquisition of Nexen by the China National Offshore Oil Corporation (CNOOC), had a transaction value of nearly C\$20 billion. Nexen's share price has depreciated greatly since the deal, leaving CNOOC with an estimated quarter of the transaction value in current market prices.

Figure 7:

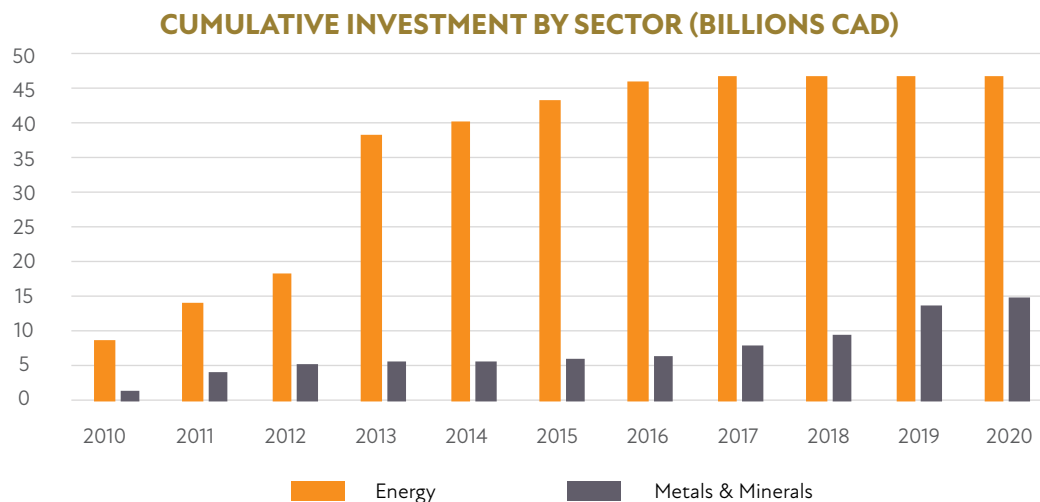


Figure 8:

**CUMULATIVE INVESTMENT BY SECTOR, EXCLUDING NEXEN DEAL
(BILLIONS CAD)**

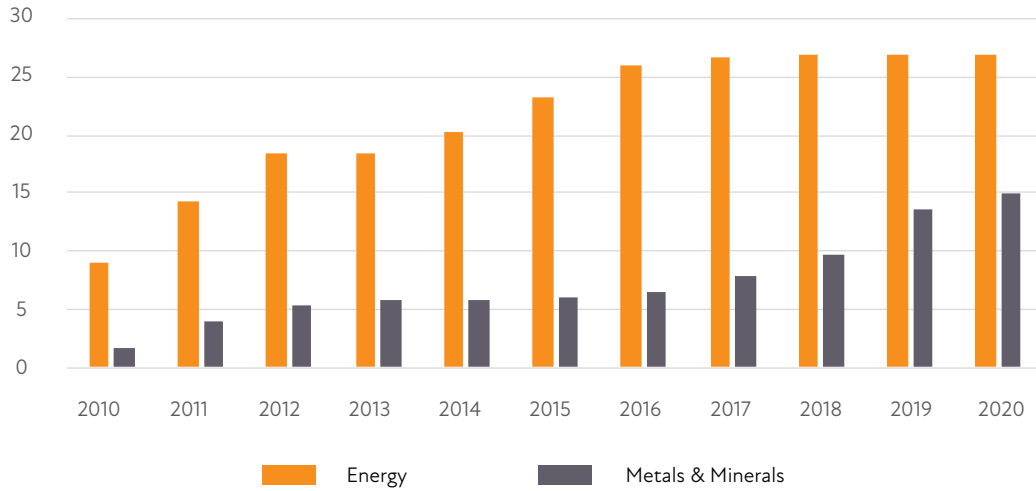


Figure 9:

**DISTRIBUTION OF INVESTMENT BETWEEN THE ENERGY AND
METALS /MINERALS SECTORS**

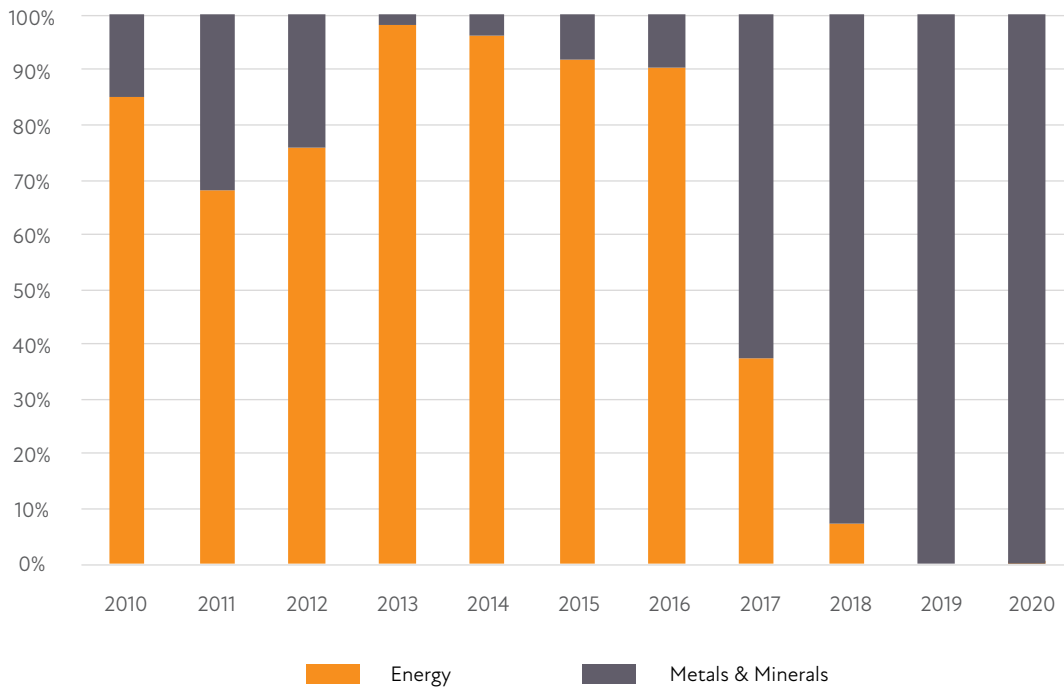


Figure 8 shows how the Energy and Metals & Minerals sectors compare when CNOOC's acquisition of Nexen in 2013 is excluded. Figure 9 shows the proportional distribution of investment in each sector by year.

During the expansionary period of Chinese investment into the Alberta oil and gas sector around the year 2012, and CNOOC's deal with Nexen in particular, the then Conservative government of Canada published a statement regarding their approach to SOE investment on December 7, 2012. The two primary concerns regarding this type of investment were that SOEs may be "inherently susceptible to foreign government influence that may be inconsistent with Canadian national industrial and economic objectives" and that "SOE acquisitions of Canadian businesses may also have adverse effects on the efficiency, productivity and competitiveness of those companies."³⁹ The statement goes on to summarize that "[e]ach case will be examined on its own merits; however, given the inherent risks posed by foreign SOE acquisitions in the Canadian oil sands the Minister of Industry will find the acquisition of control of a Canadian oil sands business by a foreign SOE to be of a net benefit to Canada on an exceptional basis only."⁴⁰

The significance of this statement is three-fold. First, it highlighted the will to protect the role of the private sector within the Canadian energy industry. Second, it provides a recent precedent for enhanced ministerial discretion relative to predefined threshold limits or other policy tools of investment regulation, akin to the recently enhanced scrutiny laid out by the new COVID-related ICA policy statement. Third, while China was not explicitly named to minimize any negative reaction from Beijing, it was obvious that China (and specifically Chinese SOEs) were the target.

Following the statement in 2012, the ICA was amended to further enhance ministerial discretion by "expand[ing] the definition of SOE to include individuals acting under the direction of a foreign government and individuals and entities directly or indirectly influenced by a foreign government."⁴¹ This move was widely seen as a response to the rapid influx of Chinese SOE capital into the Canadian oil and gas industry and was intended to enhance government influence therein. With the amended legislation, as well as the new Policy Statement on Foreign Investment Review and COVID-19, it is fair to say that the Canadian government has the tools and flexibility necessary to adequately intervene in foreign investments to protect national interests. However, when the 2013 amendment was implemented there was an ongoing discussion among legislators about the implications that Chinese SOE investment in Canadian energy projects had for Canada, the same conversations are not as prominent in the current context of the proliferation of metals and minerals investment.

That said, dialogue surrounding Chinese SOE capital flowing into metals and minerals projects, as well as comparisons to historically similar capital behavior in energy, may be gaining traction in Canada. The proposed takeover of a gold mine in the Canadian Arctic by Shandong Gold Co., a Chinese state-owned enterprise, is a recent case illustrating the balancing act between promoting investment (especially in Northern Canada, a region that has historically lacked economic development) and dutifully weighing the strategic and resource-based risks.

The aforementioned deal is currently being reviewed by Ottawa under the new investment review policy statement outlined by the Government of Canada in April. TMAC Resources, the sole owners of the Hope Bay property in Nunavut, have struggled financially and view the purchase as a financial lifeline.⁴² Jason Neal, CEO of TMAC, has stated

that the development costs associated with the project meant that “Shandong was the only bidder to emerge after TMAC contacted 76 companies about a possible deal.”⁴³

Some observers are, however, urging Ottawa to carefully consider the strategic implications of the investment transaction. Richard Fadden, a former director of the Canadian Security Intelligence Service (CSIS), has expressed concern that the transaction grants China strategic control over a key resource. Gold, Fadden notes, is “not only viewed as a safe-haven investment in turbulent economic times, but it is widely used in the control systems of nuclear-power plants and nuclear-weapons facilities.”⁴⁴ Whether gold, mined in many countries and acquired by individuals and governments as a store of value, is actually a critical and strategic commodity is open to debate.

There is further concern surrounding Hope Bay’s proximity to the Northwest Passage, a strategic shipping route. China is already an expansive and active investor in projects across Arctic states, mainly in the energy and minerals sector.⁴⁵ It has also developed plans to extend its Belt and Road Initiative to the Arctic.⁴⁶ Heather Conely, an analyst with the Center for Strategic and International Studies, told the Wall Street Journal that “[i]ndividual deals like the TMAC transaction may not seem troubling at first glance but become more questionable as part of a pattern of strengthening Chinese access to Arctic waters and establishing global dominance over industries like mining.”⁴⁷

On the other side of the argument, former Conservative federal Minister, TMAC Board Member, and Nunavut Inuk community leader Leona Aglukkaq has strongly advocated for the success of the deal, arguing that “the benefits are too great to pass up.”⁴⁸ Her statement echoes the perspective of many Canadians living in the North, who may see resource

extraction investment as one of the most important steps in creating jobs and developing their local economies, and whose views can contrast with those of southern Canadians who do not have a direct stake in the northern economy. This discrepancy in opinion highlights the difficulties faced when incorporating varying Canadian perspectives into an investment assessment.

In summary, the risks to Canada arising from this type of investment may not be as clear as the intellectual property theft that is frequently discussed in the media today. Instead, the risks mainly relate to China’s dominance in global supply chains. While analysts may suggest that these investments relate to broader Chinese strategic goals, they often fail to clearly indicate how these investments may be directly injurious to Canadian national security. Rather, they reference an ambiguous concern over China’s rise and ascension as a global superpower. Consequently, it could be argued that, generally, the most direct risk of SOE resource extraction investment is the threat to competition, which was specifically addressed in the aforementioned 2013 amendment to the ICA amid the influx of Chinese investment in the Alberta oil sands. Seen from that perspective, the investment risks in resource extraction industries may appear to be reasonably low and manageable.

Additionally, Leona Aglukkaq’s comments help illustrate the benefits. Investments that develop or keep open large-scale industrial projects, such as mines, tend to be big employers and contributors to local prosperity. Like Ms. Aglukkaq, many Albertans likely believe in the benefits of resource extraction, at least in the short term, through local employment, incomes, and government tax revenue. In part, these revenues helped Alberta build the “Alberta advantage”, and helped the province attain the highest per capita GDP in Canada. To many Canadians working and living in regional economies dominated by resource extraction, additional

investment, even from foreign sources, may be viewed as a both desirable and indispensable, and without the hazards of foreign investment in high-tech sectors.

Interestingly, Shandong's proposed acquisition of TMAC Resources has made headlines not just in local newspapers or industry-focused news publications such as the Canadian Mining Journal or Nunavut

News, but also in the Globe and Mail and the Wall Street Journal. This could signal the coming of a broader, more developed discourse regarding the current top target (by deal value) of Chinese SOE investors in Canada.

Value Adding: Industrial and Electrical Equipment/Manufacturing/Construction

The “value adding” economic area covers infrastructure, consumer goods, and industrial goods for export or domestic sale. As is the case with resource extraction, these operations tend to be large employers of varying skill levels at relatively decent wages. Chinese investments in manufacturing and construction sectors typically take the form of M&A deals, wherein the Chinese corporation is able to purchase a Canadian corporation. Chinese greenfield investments also occur, albeit with lower frequency. These deals result in the construction and operation of new manufacturing or production facilities in Canada.

Both types of investments may benefit Canadians by either maintaining or creating factory related jobs. However, some investments in these sectors involve high-tech, military, or other strategic area development which may risk the unauthorized transfer of intellectual property or carry other strategic considerations. Chinese investment stands

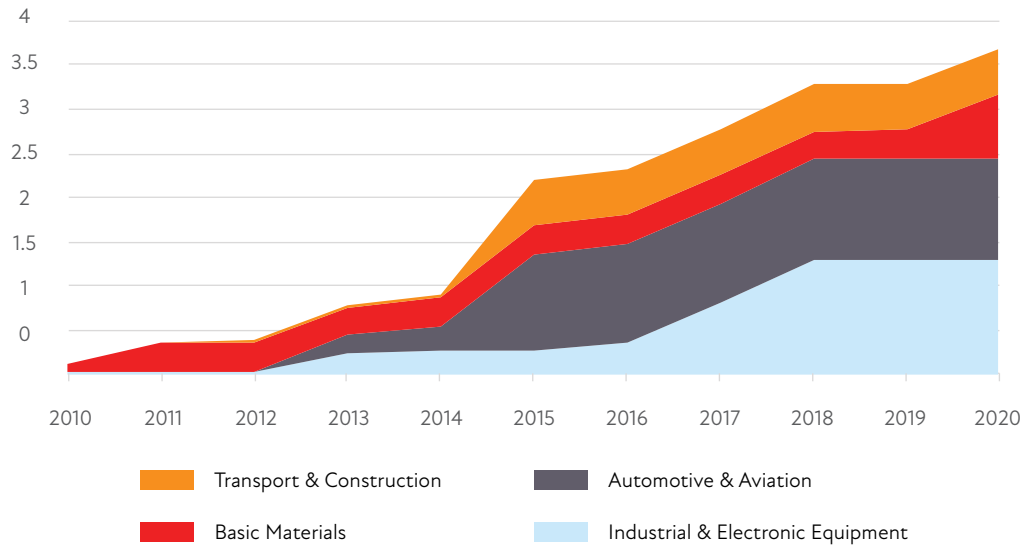
at roughly C\$4 billion in these sectors, as per the CIUA Investment Tracker.

One recent example of an investment in this area is a greenfield investment by a Chinese private enterprise, Xinyi Glass, to set up an automotive glass manufacturing centre in Ontario that could create up to 400 new jobs and boost local economic activity.⁴⁹ This deal has not escaped criticism – there are concerns surrounding its environmental impact, for example – but the fact that it is a greenfield investment in non-strategic or high-tech sector removes some level of concern.⁵⁰

One of the main concerns that observers may have regarding investments in these sectors is the potential for illegitimate technology transfer. However, based on the deals reviewed under the ICA in recent years, government orders of divestiture or withdrawal seem to be based on strategic concerns related to public infrastructure, such as decreased competition and control in sensitive public sectors

Figure 10:

CUMULATIVE INVESTMENT IN VALUE ADDING SECTORS (BILLIONS CAD)



such as utilities.⁵¹ These value adding sectors see, by far, the highest frequency of further action following review under the ICA. However, many of these orders are in high tech areas of electronic equipment manufacturing that are now considered sensitive, such as telecommunications, which is covered in a later section on high-tech and strategic economic areas. That said, many deals unrelated to these sensitive areas, but still in value adding sectors, also face further action after review.

A notable recent example that highlights both intellectual property and broader strategic concerns is the government’s blocking of AECON’s purchase for C\$1.5 billion by the China Communications Construction Company (CCCC) on national security grounds in mid 2018. AECON, a leading engineering and construction company in Canada, reportedly possessed valuable IP related to infrastructure construction, telecommunications, nuclear power generation project.⁵² Another prominent argument against the transaction was its potential to undermine the industry’s competitive business

environment in Canada. Conversely, many argued, including AECON stakeholders, that these concerns were being unequally levied against CCCC as a Chinese SOE compared to Korean and European SOEs.⁵³ Ultimately the deal was blocked as concerns regarding potential harms overshadowed the potential benefits in the view of the Canadian government.

This example highlights the fact that firms in value adding economic areas, such as construction or manufacturing, often possess valuable IP and may be involved in sensitive areas like utility provision or defense. Explicitly high-tech and strategic areas may overlap with value adding industries, although such areas would include the fields of biomedical research and financial services, which will be addressed in a later section. Many in the public and media, but also legislators, view Chinese SOEs more skeptically than SOEs of other countries and highlight the argument that “[Chinese SOEs] are companies that are using public funds to target strategic enterprises and control key resources, assets or technology.”⁵⁴ A

number of other China originating acquisitions have faced post-review action based on similar concerns. Of these deals, one was related to urban transit, one to ship building, and four to electronic equipment manufacturing.

Some commenters have raised concerns that investments in these areas are not being adequately scrutinized by the Canadian government and that government attention is overly focused on investment quantities and review thresholds, rather than the specific destination and parties involved in each deal.⁵⁵ While this is clearly not the case with relation to the AECON example, which was turned down, it may be valid in lower profile cases.

It is worth noting that the vast majority of Chinese investment in manufacturing comes from private enterprises, according to data from the CIUA Investment Tracker. In fact, the Tracker recorded only one SOE investment of known value in this sector since 2010 – Weichai Power’s investment in Ballard Power. With the ICA’s emphasis on SOE scrutiny, this further raises the question of whether or not the Canadian government is widely scrutinizing deals in these sectors, particularly when it comes to M&A investment in companies with valuable IP. Compared to the energy and metals and minerals sectors, which as mentioned above mainly receive Chinese investment from SOEs, the application of scrutiny in the industrial and electronic equipment and other manufacturing sectors may be less reliable due to the outsized focus on SOEs in the ICA. In short, one could argue that the higher review thresholds on private enterprise investment may cause more potential risks to be overlooked. However, this may be offset by the intent focus on China generated in the present political climate where any prominent investment from China tends to draw public and media suspicion.

Unlike in the resource extraction sectors, unauthorized IP transfer is a prominent concern for deals involving value adding industries. This

risk is more acute than those associated with resource extraction, because they can directly implicate Canadian information security. However, as discussed, concerns regarding China’s broader geopolitical and strategic goals and Canada’s non-security related interests still apply. Additionally, as most investment in these sectors originates from private enterprises, the Canadian government’s competition-related concerns articulated in the 2013 ICA amendment are less often applicable than in resource extraction areas. Conversely, the potential benefits of value adding industry investments from China or any other country remain high – from an economic perspective. For example, the construction and operation of the Xinyi Glass factory in Markham could significantly augment local prosperity. Therefore, as the government continues scrutinizing inbound Chinese investment, it is important to keep in mind that the opportunity cost of losing out on foreign investment is real.

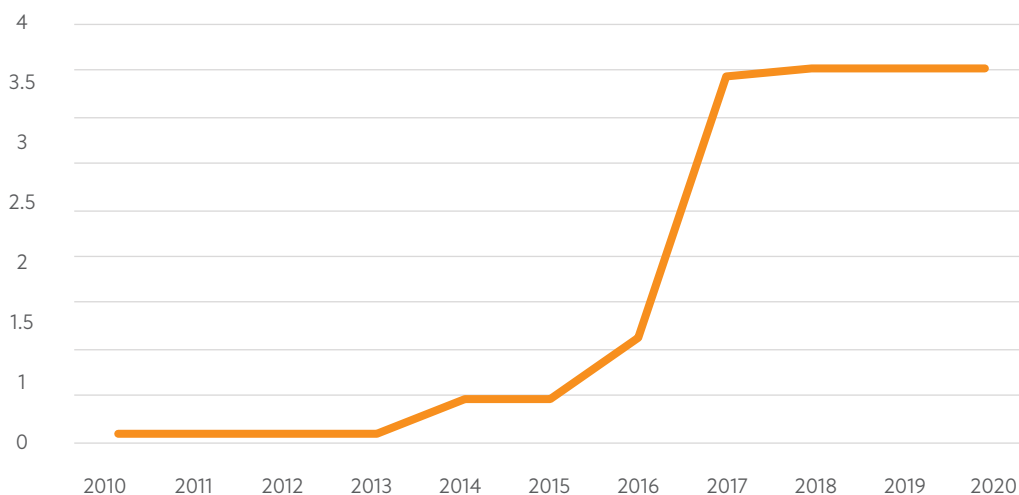
Retailing: Consumer Products and Services

Of the investment that Canada receives from China, those made in the consumer products and services sector(s) carry some of the most unique impacts. This sector serves as one of the most visible areas of societal linkage between China and Canada, and thus investments made here can have a great impact on public perceptions. Nearly everyone has become accustomed to the ubiquitous “Made in China” markings found on many consumer goods over past decades, but Chinese companies in this sector have only really been ramping up investment in Canada since 2016, with more deals, both acquisitions and greenfield investments, closing in 2019 than in any other year by more than double.

Likewise, there were as many investments made in this sector in 2016 and 2017 as there were from 1999 to 2015. This is significant, as it shows that despite the slowdown of Chinese investment flowing into other sectors, consumer products and services investment is thriving. While cumulative Chinese investment in the sector remains far below that of those previously discussed, its further development could provide great benefits for Canada by stimulating business engagement and furthering people-to-people and cultural ties.

Figure 11:

CUMULATIVE INVESTMENT IN CONSUMER PRODUCTS & SERVICES (BILLIONS CAD)

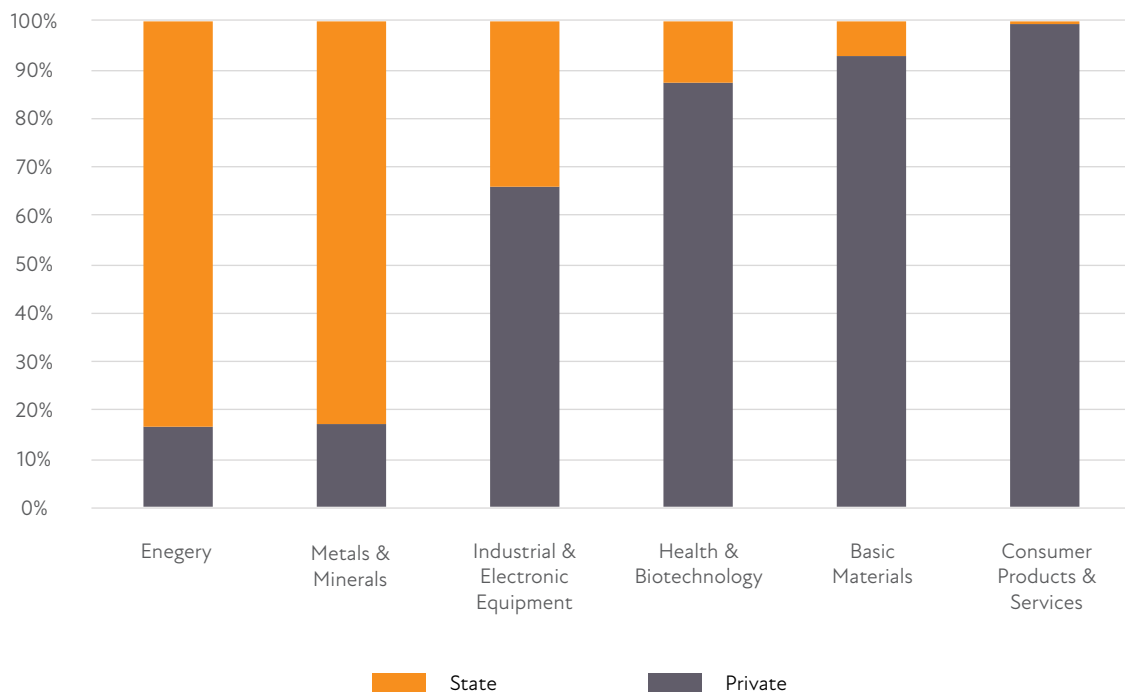


Many Canadians may have read news stories in recent years about the immense attention Canada Goose received in China when they first entered the Chinese market. News outlets in Canada used its success as an example of how Canada-China ties endured despite the tense political climate and related anti-Canadian sentiment in China.⁵⁶ While Canada has yet to see a Chinese company hit the Canadian domestic market with such a splash, the investments are still meaningful. A significant portion of China-Canada investment in consumer products and services currently contribute to English educational institutions, designed to help Chinese immigrants integrate with Canadian society. Another significant portion goes towards restaurants, retail outlets and product services. A notable example is the acquisition of Reliance LP, an air conditioner repair company, by CK Hutchison Group of Hong Kong.

The consumer products and services sector receives virtually no SOE investment. Furthermore, it is uncommon that investments in this sector will create any potential avenues for illicit IP transfer or relate to any sensitive economic areas. As such, this type of investment is typically low risk while still creating potential domestic employment opportunities, albeit less than in resource extraction and value adding sectors. As Canada looks to the future, this sector may emerge as beneficial for both sides.

Figure 12:

SHARE OF INVESTMENT SOURCE BY OWNERSHIP



Assessing Strategic Economic Areas and Addressing High-tech Investment

Though most new Chinese investment in Canada is now directed at the Canadian metals and minerals sector, public attention is also focused on high-tech sector(s). Moreover, many other countries are in the midst of rethinking and addressing the regulation of foreign investment in strategic areas of their economies.

Canada could, to this end, expand what it considers a strategic resource. Public commenters have argued that adding gold mining to the list may be warranted. However, what that would mean for the outcome of a deal such as Shandong's takeover of TMAC Resources is unclear.

Broadly speaking, it seems as though Canadian institutions, as well as the public, are becoming increasingly aware of the potential risks posed by some foreign investment. The Canadian Security Intelligence Service (CSIS) released the following statement on the matter in their 2019 annual public report:

“Economic espionage activities in Canada continue to increase in breadth, depth and potential economic impact. Hostile foreign intelligence services or people who are working with the tacit or explicit support of foreign states, attempt to gather political, economic, commercial, academic, scientific or military information through clandestine means in Canada... a number of state-owned enterprises and private firms with close ties to their government and or intelligence services can

pursue corporate acquisition bids in Canada or other economic activities... Corporate acquisitions by these entities pose potential risks related to vulnerabilities in critical infrastructure, control over strategic sectors, espionage and foreign influenced activities, and illegal transfer of technology and expertise.”⁵⁷

Canada has, through multiple articles and agreements, recognized several economic areas as strategic and incorporated additional considerations when reviewing these investments. Some of these relate to Canada's cultural heritage and national identity, which applies to many forms of media - from newspapers to film. Investments in these sectors are authorized by the Minister of Canadian Heritage and are subject to far lower review thresholds than other investments. Another example is the Canada-U.S. Joint Action Plan on Critical Minerals Collaboration, which “aims to facilitate development of secure supply chains for critical minerals that are key to strategic industries such as defence, aerospace and communications.”⁵⁸ Notably, Richard Fadden, the former CSIS Director, referred to this list when he expressed concern that gold was not included as a critical mineral.

It is difficult to parse out what is - and what is not - strategic. However, Canada does have the opportunity to look to other countries for guidance. For example, China's interest in Canadian metals and minerals is expected given that China has been

the largest importer of metals and minerals due to its immense manufacturing and construction industries. While China can service some of its demand through domestic supply, it still depends heavily on foreign mining operations to cover the difference. China has developed these operations extensively in Australia, Asia, South America, and Africa, and is only now beginning to better develop North American operations, in which Canada is playing a significant role.

Australia saw a strong, and larger, influx of Chinese SOE capital into its domestic mining sector earlier than Canada. It responded much like Canada did to Chinese investment in Alberta's oil sands. Australia declared that it would increase scrutiny on SOE investments as early as 2008 and, like Canada did in 2013, emphasized a desire to maintain private enterprise competitiveness and market-based processes.⁵⁹ Since these initial regulatory amendments, both Australia and Canada have continued working on their partnerships with China. The Government of Prime Minister Harper ratified a Foreign Investment Promotion and Protection Agreement (FIPA) with China, while Australia developed a more comprehensive free trade agreement that also established a robust bilateral investment regulation framework. In the Australia-China free trade agreement negotiations, China was particularly concerned with the powers granted to Australia's Foreign Investment Review board and sought to relax them. While some concessions were made, Australia ultimately resisted ceding regulatory autonomy with regards to SOEs and has since strengthened its foreign investment approval process by adding 38 new offences regarding areas such as covert activity, economic espionage, and political donations.⁶⁰ Canada, on the other hand, may have trouble implementing similar restrictions because of its FIPA with China. Even though Canada-China FTA talks are dead in the water, the potential to rework FIPA could help incentivize Canada to pursue them

again in the future.⁶¹ Australia Chose not to pursue a FIPA with China mainly because of the power it would grant large corporations to challenge social, environmental, and economic legislation.⁶²

On the high-tech front, Chinese investors appear to behave similarly in Canada as they do in the European Union, where a greater share of Chinese investment is directed to high-tech sectors when compared to investment from other countries. Dudas and Rajnoha highlighted that the acquisition of new technologies is one of the key motives of Chinese investment in the EU.⁶³ In both Canada and the EU, these investments tend to be mergers or acquisitions rather than greenfield investments. EU countries and the U.S. have also blocked acquisitions of high-tech and strategic firms, including the blocking of the proposed acquisition of 50 Hertz, a leading German electricity provider, by a Chinese SOE, State Grid.⁶⁴ In a general response, the EU and the US have tightened investment restrictions and increased scrutiny. This has taken several forms, from an insistence on increased transparency to reduced investment review thresholds.

AREAS OF CONSIDERATION INVESTMENT CANADA ACT

Given what we know about the current state of the Canada-China investment relationship, in addition to other global factors such as the COVID-19 pandemic, does the Investment Canada Act require re-evaluation? This section compiles a range of analysis and recommendations surrounding the Investment Canada Act, with a targeted emphasis on the China-related factors.

As mentioned above, the Standing Committee on Industry, Science and Technology (INDU) commenced a study of the Investment Canada Act in June 2020. The Committee adopted a motion to determine:

- “the extent to which companies within strategic Canadian industries have been devalued as a result of the COVID-19 crisis;
- the extent to which foreign buyouts may occur;
- whether the current Investment Canada Act valuation thresholds is adequate to trigger a net benefit review given the potential extreme devaluation of companies within strategic Canadian industries;
- whether Canada should place a temporary moratorium on acquisitions from state owned enterprises of authoritarian countries.”

The Standing Committee has yet to publish a final report from the study. It did, however, convene a number of government officials, lawyers, and other subject matter experts to discuss the aforementioned study questions. Gordon Houlden, Director of the China Institute at the University of Alberta, appeared as a witness in front of the Committee on June 18, 2020.

It is likely that devaluation has occurred, depending on where you look. And while foreign buyouts are possible, it’s not clear that any rush on Canadian assets is occurring. However, it remains relevant, not only with regards to COVID-19 but more broadly given global economic uncertainty and Canada’s relationship with China, to address the final two questions of whether the net benefit review process should be revised and, further, whether any moratoriums would be appropriate.

Net Benefit National Security Review Processes, Moratoriums, and a Negative List

Q: “Determine whether the current Investment Canada Act valuation thresholds is adequate to trigger a net benefit review given the potential extreme devaluation of companies within strategic Canadian industries”

The third guiding question of the Standing Committee’s review of the Investment Canada Act regards potentially lowering net benefit review thresholds in response to the devaluation of Canadian business amid the COVID-19 related economic downturn. While modifying threshold levels is indeed one approach, there are other potential areas where the ICA could be modified. Accordingly, lawyers from the Canadian Bar Association and Blake, Cassels and Graydon LLP both submitted documents in a personal capacity to the Standing Committee stating, broadly, that there is no practical need to modify the net benefit review process given the current circumstances.

The briefing prepared by lawyers from Blakes states that “a blanket prohibition [a moratorium] on investments by certain categories of investor or regarding certain industries is not warranted and a case-by-case approach to reviews under the ICA is appropriate.” Even with the extreme devaluation of Canadian firms in strategic sectors, the Act still grants immense power to scrutinize, remedy, or block any investment on national security grounds.

The April 18, 2020 Policy Statement on Foreign Investment Review and COVID-19 further notes that the government will increase scrutiny of investments in “public health or involved in the supply of critical goods and services.” In addition, the policy statement outlines that the government will subject all investments from state-owned firms, or private firms with close links to foreign governments, to increased scrutiny under the Act.

Given the ability of the government to, in essence, use the national security review process as a catch-all for deals that may ought to be reviewed but do not trigger a net benefit review, the question of whether Canada should raise net benefit review thresholds may be missing the mark. Instead, it may benefit the committee to shift its focus to the national security review processes and the security apparatus underpinning it. One example that might provide a good model for Canada is the recent investment regulation overhaul undertaken by Australia.

CASE STUDY: AUSTRALIA

Australia and Canada share many similar characteristics in the investment space. They receive similar level of foreign investment from China, are grappling with many of the same geopolitical tensions and pressures, and are both working to respond to perceived threats related to foreign investment - arising not only from China, but also the COVID-19 pandemic.

The system of foreign investment review in Australia is governed by the Foreign Acquisitions and Takeovers Act of 1975.⁶⁵ As it currently stands, “Foreign Government Investors (FGIs) already face a zero-dollar screening threshold, most private investments under \$275 million (or \$1,192 million for [Australia’s] Free Trade Agreement partners) are not screened.”⁶⁶ The current use of a threshold system means that some foreign investment transactions in sensitive Australian sectors, should they fall under the applicable threshold, “are not screened, even where an investment raises national security concerns.”⁶⁷

Like Canada, the Australian government implemented temporary changes to its foreign investment framework amid the coronavirus crisis. As of March 29, 2020, all proposed foreign investments subject to Foreign Acquisitions and Takeovers Act 1975 require approval from the Australian Foreign Investment Review Board, with the screening thresholds temporarily reduced to \$0. The Board will also “work with existing and new applicants to extend timeframes for reviewing applications from 30 days to up to six months.”⁶⁸

With these temporary changes only slated to remain in place for the duration of the coronavirus pandemic crisis, the Government also intends to implement permanent changes to enhance its foreign investment review framework. In June 2020, The Department of the Treasury introduced what it

considers to be “the most comprehensive reforms to Australia’s foreign investment review framework in more than 20 years.”⁶⁹

The extensive and complex reform package was grouped into three major areas by Josh Frydenberg, Treasurer of Australia, in a June 4, 2020 press conference.⁷⁰

First, it works to create a new national security test that “will enable the Treasurer to impose conditions or block any investment by a foreign person on national security grounds regardless of the value of investment.” It requires the filing of a notification for any foreign investment in a “sensitive national security business” and even allows for “any investment that would not ordinarily require notification to be ‘called in’ for screening on national security grounds.”

The list of sensitive businesses is still under consideration but is expected to include those related to critical infrastructure, telecommunications, national security goods/service/technology production, sensitive data, and those proximate to “defence or national security installations.”

Second, the changes move to create stronger penalties for regulatory breaches, increase the capabilities of regulators to “monitor investor compliance and/or investigate potential non-compliance,” and expand regulatory enforcement power.

Third, in an effort to attract foreign capital in non-sensitive sectors, the package “streamlin[es] the approval process for passive investments by foreign governments where they are partnering with private capital.”

Could Canada learn from this approach?

Though net-benefit review thresholds are lower in Australia than in Canada, Australia has not moved to modify its investment screening thresholds, and is instead working to overhaul and expand its national security review process. This approach indicates that screening thresholds – broadly- may not be an appropriate target area in the current global investment climate.

First, the ability for Canada to modify its threshold levels could be limited by its international trade agreement obligations. A submission to the Standing Committee made by the Canadian Bar Association notes that “[it] appears that at least some of the increases in the net benefit review thresholds cannot be reduced because they are enshrined in Canada’s free trade agreements” - including the USMCA, CETA, TPP, and WTO-GATS.⁷¹

Second, the current Canadian national security review process already possesses many of the powers outlined under the new Australian regulations. Canada is already equipped to review any investment governed by the ICA on national security grounds, potentially removing the need to modify investment review thresholds to protect strategic industries by acting as a catch-all. It does not, however, outline a specific list of areas deemed “sensitive” or “strategic.”

To follow suit and outline a list of “sensitive” economic areas could benefit both foreign investors and Canada. A well-defined list of sensitive business sectors and/or areas could serve to give foreign investors - including those from China - a more soundly based view of Canadian impartiality. Notably, amid the China-Canada tensions surrounding Meng Wanzhou’s extradition proceedings, Chinese officials and media have warned that uncertainty may dissuade investors, suggesting that Canada is

becoming discriminatory towards Chinese activity in and with Canadian entities.⁷² Defining a “sensitive” areas list, thereby signaling that an indiscriminate security review process will be levied regardless of an investors country of origin, could serve to bolster Chinese investor confidence that Canada will fairly judge foreign investment deals. Of course, if Chinese investor disinterest is instead driven by pressure from the Chinese government, such clarifications will do little to encourage investment flows. However, defining a “sensitive” areas list could, at the very least, undermine some rhetoric employed by Canada’s critics that casts Canada as unpredictable when working with Chinese partners.

While these political and rhetorical considerations may not apply to Canada’s dealings with its other partners, defining such a list would affect, at least in principle, all foreign investors. While this may only be consequential for a small number of investment transactions, there is potential that the regulatory clarity could provide further assurance to tentative investors. Moreover, if it helps to attract investment from China or elsewhere, Canada benefits both from the added assurance that each deal will satisfy Canada’s security and strategic interests and the gain of economic activity. A defined list - with yearly reviews to add/clarify business areas that become, or will become sensitive - could be beneficial, if only to increase clarity and reduce ambiguity in what is a broad, subjective process.

State Owned Enterprise Investment Regulation

Q: “Determine... whether Canada should place a temporary moratorium on acquisitions from state-owned enterprises of authoritarian countries.”

Notably, the wording of the Standing Committee’s guiding questions implicates not simply foreign SOEs, but specifically those from “authoritarian countries”. It follows, then, that the primary design of this question is not to determine whether to further scrutinize SOE investors, but to question the extent to which Canada opens itself to countries other than democratic, closely allied states. While “authoritarian countries” could apply to many locales, the country that could be classified as such and from whom Canada receives most “authoritarian” SOE investment is China. Therefore, China is a central focus of this question, making a China-specific analysis all the more relevant in this context.

In part, the question of whether to place a moratorium on acquisitions from SOEs is answered in this report’s earlier discussion of the net-benefit and security processes. A moratorium is unnecessary because the Investment Review Board has adequate authority and discretion to scrutinize and block certain investments using the national security review process, which is largely a subjective and broad process. However, questions regarding the regulation of SOE investment are likely to persist and while temporary measures, specifically the lowering of the net benefit review threshold for

SOE investment to zero, have been implemented to address COVID-19 related concerns there may yet be cause to evaluate permanent changes.

While the national security review process may be used in lieu of a net benefit review as a “catch-all” when necessary, the two are not the same. In their design, net benefit reviews specialize in assessing the balance of commercial considerations and protecting the economic interests of Canadian entities involved in or affected by foreign investments. Conversely, security reviews focus on broader strategic interests of the Canadian government. As such, if a “sensitive” areas list was defined under the Investment Canada Act, it may make sense to try and expand the applicability of net benefit reviews in non-sensitive areas on SOEs to maintain robust scrutiny across all areas.

Australia, for one, has done this by permanently implementing a net benefit review threshold on SOE investment of zero. If the government did define a “sensitive” areas list subject to automatic security review, it could still initiate discretionary reviews in other areas. However, if the list was robust, this should not often be necessary. Therefore, if the political will to closely scrutinize SOE investment in particular persists, it may be best to widely apply net benefit reviews rather than a security review process that may not be directly applicable in non-sensitive areas.

In sum, a moratorium on SOE investment is likely not warranted as the ICA allows for the review and, if necessary, blocking of any deal on security grounds - should there be an actual strategic and/or security-related element.

Likewise, lowering net benefit review thresholds across the board may also be unnecessary for the same reason. However, other potentially permanent changes to Canada's investment regulations, such as the introduction of a defined sensitive areas list subject to automatic security review and the lowering of net benefit review thresholds on SOE investors

may be warranted.

Accordingly, the Standing Committee could revise their guiding questions, asking not "whether... valuation thresholds [are] adequate to trigger a net benefit review given potential extreme devaluation" and if they "should place a temporary moratorium on acquisitions from state owned enterprises of authoritarian countries" but instead asking whether it would be beneficial to define a sensitive areas list to fortify the security review process and signal the ICA's impartiality, as well as evaluate whether permanent changes are warranted to the review threshold on SOE investors.

THE POLICY RESPONSE TIMELINE

The Standing Committee on Industry, Science and Technology commenced its review of the Investment Canada Act on June 8, 2020. As referenced in this report, the committee worked to address a number of questions relating directly to foreign investment and the ongoing COVID-19 pandemic. The motion also noted that the study was to be completed by June 21, after which the Committee would table its findings for Government review. At the time of publication (insert date), the Standing Committee has yet to publish

a final report on the matter.

The prorogation of Parliament on August 18, 2020, which halted all committee work, did disrupt this process. But while the committee will undoubtedly produce a productive report, there will have been a significant delay before a recommendation is made.

Has the ship already sailed on this matter? If the Standing Committee was to conclude that there is a need to modify elements of the Investment

Canada Act, it would be responding to concerns raised many months ago. The already robust Investment Canada Act, combined with the April 18 Policy Statement, are strong safeguards against predatory foreign investment. However, acknowledgment of the expert witness testimony and enhancing policy clarity may yet be beneficial for all parties involved - including foreign investors.

“IP Leakage” Issue

In April 2020, the Public Policy Forum released *New North Star II: A Challenge-Driven Industrial Strategy for Canada*. The paper theorizes that “[t]wo big geo-economic shifts—the rise of the intangibles economy and heightened geopolitical competition between the U.S. and China—require adjustments to Canada’s policy framework” and proposes a new “challenge driven” industrial strategy for the country.⁷³ It makes several policy recommendations, broadly aimed at leveraging human capital and facilitating an effective R&D and commercialization framework with the ultimate goal of overcoming Canadian shortcomings in the innovation/commercialization continuum.

One recommendation, with particular relevance to this paper, calls for Canadian policymakers to halt so-called “innovation leakage” – the process whereby intellectual property generated in Canada and supported by federal funding leaves the country and domestic benefits remain unrealized.⁷⁴ While the current net benefit review framework factors in “the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada,” there is no specific mention of the intangibles that are increasingly driving the global economy. The report, noting the fact that “current federal spending on R&D does not distinguish between Canadian and non-Canadian firms” and the current investment review regime “does not consider the extent to which Canadian companies bought by foreign firms have been supported with public investments,”

suggests that the ICA could be modified to require consideration of the data and intellectual property implications for a given deal.⁷⁵

Jim Balsillie, a Canadian businessman, former CEO of Research in Motion, and chair of the Council of Canadian Innovators prominently echoed this sentiment in an appearance in front of the aforementioned Standing Committee. Balsillie, testifying on June 15, 2020, stated that “Canada is on the sidelines in the global competition for IP and data, contributing to their creation but not contesting their ownership and ensuing benefits.”⁷⁶ He further criticized the federal government’s focus on valuation thresholds, state-owned enterprises, and jobs as being “inappropriate” and compared the current regulatory approach to an IP and data-driven economy as “akin to putting an additional bolt lock on the front door, while advertising that our screen door on the side is open.”

A joint report from the Mercator Institute for China Studies (MERICS) and Rhodium Group, published in April 2020, brings additional attention to this concept.⁷⁷ Although the report is an update on Chinese foreign direct investment in Europe, it notes that “[a]s acquisitions and other equity investment have become more difficult, Chinese firms are pursuing alternative ways to interact with European entities.”⁷⁸ It examines the increasing move towards research collaboration between Chinese and European firms, academic institutions, and government bodies. While this type of interaction is

often beneficial to both sides, military, security, and human rights concerns may arise from China gaining access to the technology/IP that grows from these R&D partnerships.

The report notes that “[w]hile Chinese equity investments in the EU-28 have dropped, non-equity types of activity have grown rapidly recently.” A 2018 collaboration between Xi’an Bright Laser Technology (BLT), Northwest Polytechnic University (located in Xi’an) and Airbus is noted as one example of sensitive research (metal additive manufacturing for aircraft parts) conducted between a European firm and Chinese partners with close links to the Chinese military and defence sectors. The report also notes the example of “China’s participation in the EU’s Galileo satellite system, which allowed the Chinese parties (including some of China’s largest military aerospace manufacturers) to retain ownership of resulting technologies and intellectual property after Beijing left the partnership.”

The EU has taken initial steps to regulate and/or block foreign entities from accessing the EU’s research programme - Horizon Europe - through the inclusion of a new provision granting the bloc enhanced power to “exclude the participation of legal entities established in the EU or in associated countries directly or indirectly controlled by non-associated third countries or by legal entities of non-associated third countries from individual calls.”⁷⁹

Academic institutions are also grappling with the implications of foreign partnerships in research areas. On October 15, 2020, Universities UK - a group representing 139 universities across the United Kingdom - published detailed guidance for “institutions on the considerations and measures they should take to guard against hostile interference and promote academic freedom.”⁸⁰ The report’s guidance relating to “international research and transnational education partnerships”⁸¹ outline

recommended measures to ensure best practices relating to research security, intellectual property, and export control compliance. There is no specific mention of China, but general “[s]crutiny of China, the UK’s third most important research partner, has grown in the past year.”⁸²

Looking beyond continental Europe and the United Kingdom, these critiques are relevant in the Canadian context - where prominent partnerships with China exist. Huawei is perhaps the most prominent example of a Chinese company funding academic research in Canada. A November 2019 CBC report found that while Huawei has provided over \$56 million in research funding to Canadian universities, “there are no federal guidelines around how these investments should be managed and disclosed, and that raises questions about who will own the findings of the research and the resulting patents.”⁸³

A further Globe and Mail investigative report, published in May 2018, found that Canadian professors and graduate students “have additionally obtained millions of dollars in government grants from the Natural Sciences and Engineering Research Council (NSERC) for their Huawei-related research.”⁸⁴ Huawei has received the exclusive intellectual property rights to work of Canadian academics in 40 cases, and further “licenses intellectual property from Canadian university researchers, often giving the company exclusive rights to their publicly funded research.” Huawei’s allegedly close relationship with the Chinese government⁸⁵ and links to Chinese military projects⁸⁶ underscore the lost opportunities and strategic implications arising from a system where research output isn’t properly contained, strictly managed, and/or domestically commercialized.

It is likely that, in some cases, a lack of Huawei funding would preclude some research from being conducted in the first place. Stephanie Carvin, an

assistant professor at Carleton University stated in the aforementioned CBC report that “[i]t’s either you’re denying these universities money or we’re making cheap IP [intellectual property] for the Chinese state. Pick your poison.”⁸⁷

And as mentioned in the MERICS/Rhodium Group report, research partnerships between Chinese and Canadian entities can, often, be beneficial for both sides. But if the Canadian system is inadequately equipped to properly scrutinize data and intellectual property, it is plausible that the same concerns

identified in the European Union could arise more frequently in Canada. And while research partnerships in the academic and/or public sector fall outside the scope of the Investment Canada Act, the same basic principles apply when considering the intellectual property and data-related implications arising from increased economic engagement with China. Therefore, it may be necessary to turn the increasingly scrutinous lens used to assess foreign investment transactions towards academic research engagement and implement rules to mitigate parallel concerns.

Increased Transparency

Another area worthy of consideration for Canadian policymakers could be attaching a greater level of transparency to both the investment review process outlined in the ICA and the extensive powers of the ICA itself. Both foreign investors and members of the public could potentially benefit from a more open and transparent system.

In their legal brief to INDU, lawyers from Blakes note that during the national security review process, “investors are told very little about the concerns and the steps that might be needed to address them.”⁸⁸ It states that because there is no legal obligation to confer the reason behind national security review orders under section 25.3 of the ICA, investors are sometimes left without a clear explanation of the relevant factors at play and that a process to address and respond to concerns “should be built into the

law and regulations.” This would allow for “parties to work together to develop solutions to allow the economy to realize the benefits of the investment while alleviating the security risk, or will provide an indication to the parties that the investment will not be permitted under any circumstance.”⁸⁹

To this end, the Canadian public could also be made more aware of the realities of the foreign investment environment, including the amount of Chinese foreign investment and the robust investment review process that exists in Canada, which may help temper negative attitudes.

The aforementioned 2019 study led by Xiaojun Li,, which builds on previous survey findings from the APFC’s 2015 National Opinion Poll: Canadian Views on Asian Investment, examines why Canadians

often view Chinese investment negatively. The study suggests that said public negativity surrounding Chinese foreign investment is, perhaps, attributable to misinformation and “innumeracy about the relative size of China’s FDI and misinformation about investment rules that govern FDI projects in Canada.”⁹⁰ The study found that Canadians overestimate the amount of foreign direct investment originating from China by almost ten times. It also found that Canadians “held incorrect beliefs about the regulation and approval procedures for foreign investments in the country” and that “these misperceptions constitute an important source of the public’s disapproval of Chinese FDI projects.” When respondents were provided with information correcting these misperceptions, the level of disapproval decreased.

In addition to overestimating the amount of Chinese investment in Canada, the average Canadian may not understand how the investment review process works. Li suggests that “Ottawa may want to find ways to dispel the misperceptions held by the public regarding Chinese investments, in order to prevent potential backlashes in the future.”⁹¹ This, says Li, could lead to the use of “short-term informational campaigns strategically launched at critical time points to rally support from a public that may be misinformed about the content or consequences of certain public and foreign policies.”

But clarity can also have downsides. The “black box” dimension of the Canadian review of foreign investments facilitates confidential and frank discussion within Government so that political and security issues can be examined without being made public. This can be especially relevant when Canadian intelligence, or classified information from our allies is employed in the examination of security dimensions of an investment review.

FINAL THOUGHTS

The politics of investment are complicated, divisive, and far-reaching. For each industry and/or sector there is a different slate of investors, varying amounts of capital, and unique concerns. This reality is sometimes forgotten when foreign investment (with a particular emphasis on China) is conceptualized as a singular entity. This underscores the importance of the Investment Canada Act review process, which is designed to apply the “rules” uniformly and fairly across all proposed deals yet at the same time affords the government the means to drill deeper in its assessment of the “net benefit” and potential national security risks of certain cases.

It is important to evaluate Chinese investment for net benefit and security purposes, but such judgements inevitably contend with the inflamed political environment of broader Canada-China tensions. It appears to be increasingly common, and perhaps politically popular, to broadly attack Chinese companies for their allegedly nefarious intentions whether or not these fears are actually founded. This approach is becoming increasingly common in Canada and appears to be creeping into public perceptions of economic engagement with China as a whole.

Canadians should instead focus on the merit of each individual deal and utilize the robust system that is already in place. Deals should, of course, be blocked if the net benefit test is not met or there is demonstrable threat to Canadian national security interests. But simply banning all deals from companies with ties to state-controlled firms ignores the possibility of benefits for Canada in the targeted sector and would likely discourage future investment flows when Canada badly needs new investment and where China is a rapidly growing source of innovation.

While it is important to view Chinese investment through an objective lens, it should also be recognized that some Chinese companies may well have strategic objectives that are contrary to the interests of Canada. We cannot ignore China’s arbitrary detention of Canadian citizens, alleged campaign of foreign influence in Canada, and other activities that are misaligned with the Canadian national interest – factors that are certain to be considered by Canadian government decision-makers.

It is important that Canadians and Canadian policymakers are aware of both the benefits and risks of Chinese investment so that they may appropriately evaluate whether or not a given investment is in Canada’s national interest. Moreover, there is also an information deficit surrounding foreign investment in Canada. These assessments may be difficult even for an informed public to make, and all relevant information may not be readily available to them. The potential risks associated with Chinese investment are widely discussed in Canada, often more so than the potential benefits. Therefore, it is important to promote a well-informed dialogue that will ultimately help equip Canada to properly weigh all dimensions of a proposed investment deal.

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