

Shifting Foreign Direct Investment (FDI) to High-Growth Sectors in Canada:

The Role of Investment Climate in FDI Diversification



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Preface

About ICTC

ICTC is a national center of expertise with the vision of strengthening Canada's digital advantage in the global economy. Through forward-looking research, evidence-based policy advice, and creative capacity building programs, ICTC fosters innovative and globally competitive Canadian industries, empowered by a talented and diverse workforce.

About this paper

Shifting Foreign Direct Investment (FDI) to High-Growth Sectors in Canada: The Role of Investment Climate in FDI Diversification is the first of a two-part series of white papers outlining potential new approaches to developing a national FDI strategy for Canada. This paper provides 1) a full picture of the status quo of inward FDI in Canada, 2) a comprehensive examination of the present investment climate in Canada, and 3) policy recommendations of fiscal instruments and FDI incentives that would diversify and attract inward FDI to Canada's strategically important and high growth sectors, such as information and communication technology (ICT). The second paper will focus on 1) providing national strategies on establishing investment promotion agencies (IPAs) abroad to attract high-quality inward FDI; 2) identifying Tier I and Tier II Canadian cities to attract horizontal FDI and export –platform FDI respectively; and 3) the development and provision of national FDI intelligence to facilitate investors' decision-making process.

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Executive Summary

Foreign direct investment (FDI) is recognized as a key driver of a country's economic and productivity growth. For investing countries, FDI is one of the most effective channels to expand influence on international markets, acting as a medium by which to promote homegrown products and services. FDI-receiving countries also benefit immensely from this type of investment, as the international capital can often act as a catalyst for job creation and economic growth. Additionally, it enables FDI-receiving countries to develop productive capacity, enhance skills of domestic talent through transfer of technology and managerial know-how, and help integrate the domestic economy with the global economy.

FDI has played a significant role in the Canadian economy. With the fourth highest inward FDI stock (the value of foreign investors' equity in and net loans to enterprises resident in the hosting economy) among OECD countries, this indicates the significant impact of foreign capital on Canada's economic growth and labour market. To quantify this, in 2017, Canada's inward FDI stock was 1.1 trillion USD, comparable to 65.2% of GDP. When it came to the impact of FDI on employment, approximately 1.9 million Canadians were employed by foreign majority-owned companies that year. This figure is nearly 12% of all employment in Canada. However, while FDI is a substantial form of capital and a job creation engine in Canada, it has actually decreased since 2014. A decline of 13 billion USD since 2016, Canada attracted the lowest level of inward FDI in 2017 since the financial crisis of 2008. Although a variety of factors have contributed to this decline, one key influencer is the energy slump. With 20%¹ of inward FDI in Canada attributed to the Mining and oil and gas extraction sector, global shifts like changes in energy prices and productivity can impact Canada immensely.

With Canadian FDI concentrated in the mining and oil and gas extraction sector, inward FDI to the sector reached 23% in 2014.² Totalling nearly one quarter of all foreign direct investment, it is no surprise that the downturn in the oil and gas sector has created a significant impact on inward FDI to Canada. With the oil price dropping from 112 USD per barrel³ (West Texas Intermediate, WTI) in June 2014 to 47 USD⁴ (WTI, June, 2017), Canada's inward FDI flow dropped from 59 billion USD⁵ to 25 billion USD during this period.⁶ Understanding that global shifts and economic uncertainties can create significant economic downturns in sectors like oil and gas, Canada must shift efforts to securing diversified FDI in high-growth sectors.

Some steps in this direction are already notable. The recently announced ministerial portfolio for International Trade Diversification is clear evidence that the federal government is making efforts to diversify and attract inward FDI. However, with what is currently the highest overall FDI regulatory restrictiveness among the G7 countries, Canada may be presenting an image of an investment climate that is not as open as it should be to attract potential investors. With the highest FDI sector regulatory restriction in sectors such as Telecommunication, Finance, Manufacturing and Primary sectors⁷, it can be challenging for investors in these sectors to break into the Canadian market. Some of these restrictions underpin important questions about topics like national security; however, these restrictions are not without consequences for the Canadian economy. Measures like these can act as impediments for Canada to fully realize its potential for greater productivity and economic growth by capitalizing on FDI spillovers. Additionally, these restrictions may also play a role in restricting the ability of home-grown small and medium businesses to seizing business opportunities in the global digital economy. For example, global investment in financial technology (Fintech) is estimated to reach 46 billion⁸ USD by 2020, the global 5G value chain could generate upwards of 3.5 trillion USD by 2035⁹;

¹ Statistics Canada. Table 36-10-0009-01 International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by North American Industry Classification System (NAICS) and region, annual (x 1,000,000). (Accessed on 13 September 2018)

² Ibid.

³ Crude Oil Prices - 70 Year Historical Chart <https://www.macrotrends.net/1369/crude-oil-price-history-chart>

⁴ Ibid.

⁵ OECD (2018), FDI flows (indicator). doi: 10.1787/99f6e393-en (Accessed on 24 August 2018)

⁶ Ibid.

⁷ the Primary sector of the economy refer industries where major economic activities involve direct use of natural resource. For instance, agriculture, forestry, fishing and mining industries all belong to the Primary sector)

⁸ Statista (2018) Total value of Fintech investments worldwide from 2008 to 2020 (in billion U.S. dollars)

⁹ HIS Economics & HIS Technology, The 5G economy: How 5G technology will contribute to the global economy <https://cdn.ihs.com/www/pdf/IHS-Technology-5G-Economic-Impact-Study.pdf>

and the global market of smart manufacturing is estimated to reach 395 billion¹⁰ USD by 2025. These are just a few examples of high-growth industries that Canada should be involved in.

Restrictions and regulations surrounding foreign direct investment are necessary. They are often essential in protecting national interest and safeguarding national security. They are also important in ensuring that incoming investment is utilized in a way that does not negatively harm domestic companies, or industries of cultural significance. Like with any form of investment, restrictions guided by practical policy considerations are a must. However, in some cases, a restrictive FDI regulatory environment can ultimately function to deter or derail the receipt of stable international capital in sectors with strong potential for economic growth. Moreover, a lack of FDI incentives to attract high-quality investment can make Canada a less competitive destination to multinational corporations. Fiscal instruments and FDI incentives should be formulated to encourage and diversify inward FDI to sectors that can spur and strengthen the Canadian economy. Whether in the form of corporate tax adjustments, repatriation policies or tax holiday allowances for example, shaping sound policies for foreign direct investment into high-growth sectors is a key lever in ensuring a strong and sustainable future for Canada.

Introduction

According to the Organisation of Economic Co-operation and Development (OECD), a foreign direct investment (FDI) enterprise is an incorporated or unincorporated enterprise in which a single foreign investor either: a) owns 10% or more of ordinary shares or, b) has voting power in another enterprise. Comparing this with foreign portfolio investment - colloquially referred to as “hot money” – that usually exists in the form of public stocks and bonds, FDI is a considerably more sustainable form of investment. In some ways, FDI can be considered to be something like “cold money”, in that its capital influence to a hosting country has the added capacity for greater stability and long-term growth.

FDI is a key driver of a country’s economic and productivity growth. For example, FDI can function to encourage the transfer of technology and expertise between economies; it can contribute to the spread of best practices in corporate governance and legal traditions; and it can even play a positive role in the development of international trade. For investing countries, FDI is one of the most effective channels to expand influence on international markets, acting as a medium by which to promote their homegrown products and services. Of course, FDI-receiving countries also benefit immensely from this type of investment. Here, the international capital can often act as a catalyst for job creation and economic growth; and competition from foreign institutions motivates domestic companies to invest in or develop innovative technology and utilize their existing resources more effectively. In turn, this can yield greater efficiency and profit.

Noting this, it is clear that FDI is and continues to be an important economic lever for Canada. In 2016 alone, Canada attracted more than \$ 974million USD in FDI.¹¹ This figure represented 3.4% of total global FDI that year. Similarly, the influence of FDI on employment in the country was also substantial. During the same period, approximately 1.9 million Canadians were employed by foreign majority-owned companies, a figure that is nearly 12% of all employment in Canada.¹²

With these growth prospects, it is no surprise that attracting this type of investment is a top priority for Canada. There are clear recent examples of efforts, both national and provincial, that have been undertaken with the goal of increasing Canada’s global presence and broadening our access to international markets. We need look no further than the development of the Investment Canada Act (ICA), last revised in 2013. This Act is a foundational building block when it comes to international investment in Canada. It is responsible for reviewing and assessing significant investments made by non-Canadians in Canada, with the ultimate aim of helping non-Canadian investors enter the Canadian market.¹³ This Act is key in setting the stage and moving the direction of FDI in Canada. Other prime examples include the recent ratification of the Comprehensive Economic and Trade Agreement (CETA) with the European Union in 2017, or the official launch of Invest in Canada, a new federal organization dedicated to attracting FDI.

¹⁰ Grand View Research, Inc Smart Manufacturing Market Size Worth \$395.2 Billion By 2025

¹¹ OECD (2018), FDI stocks (indicator). doi: 10.1787/80eca1f9-en (Accessed on 20 April 2018)

¹² Statistics Canada. Table 376-0153 - Activities of foreign majority-owned affiliates in Canada, employment at establishment level, by province and the North American Industry Classification System (NAICS), annual (persons) (2015) (accessed: April 20, 2018)

¹³ Government of Canada, Investment Canada Act, April 2018. <<https://www.ic.gc.ca/eic/site/ica-lic.nsf/eng/Home>>

However, while positive, these developments are not enough. To attract and diversify FDI to high growth sectors like Fintech, 5G, smart manufacturing among others, we need to improve Canada’s investment climate, and to formulate effective fiscal instruments and FDI incentives that position Canada as a competitive FDI destination. In so doing, we can work towards ensuring Canada’s place as not only a participant, but as a leader in the future economy.

This paper will underline the importance of FDI as a revenue-generating agent for the Canadian economy, and show-case Canada’s journey on the path to attracting and diversifying international capital to high-growth sectors.

Specifically, this paper will be comprised of the following sections:

Section I: Inward FDI in Canada and Key FDI Determinants. This section presents the current status quo of FDI in Canada and offers a descriptive analysis of key factors that affect FDI activities.

Section II: Investment Climate in Canada. This section provides an overview of Canada’s current investment climate. Taking into account rationales for restrictions in certain sectors, this section highlights the impact of FDI sector restrictions, corporate taxation and FDI incentives.

Section III: Conclusion. The last section provides a summary of key findings in the report.

Section IV: Recommendations: This section offers practical recommendations on how to improve Canada’s investment climate to attract FDI to high-growth and innovative sectors.

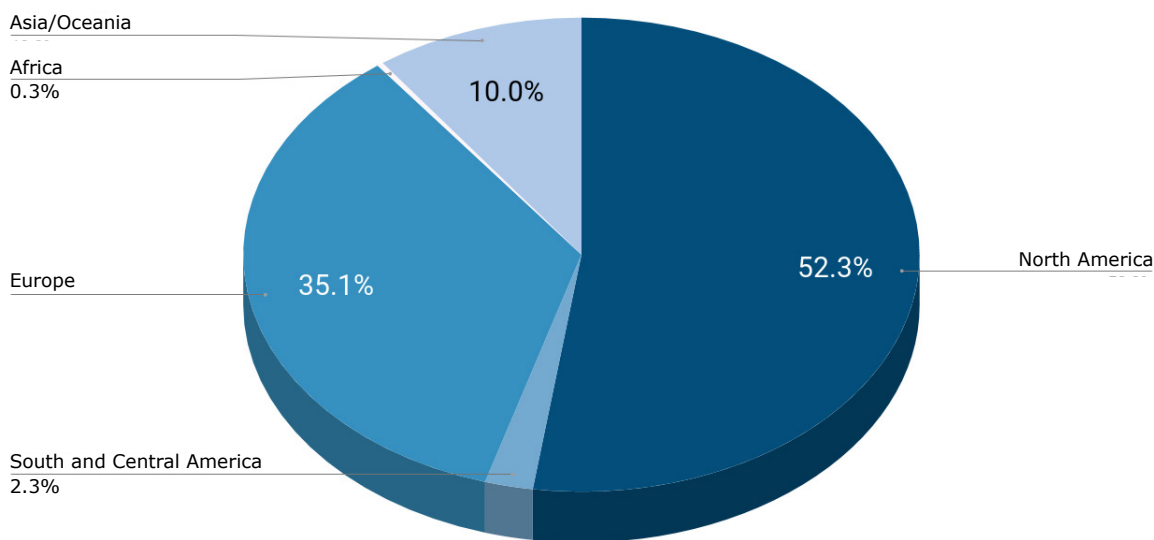
Section I: Inward FDI in Canada and Key FDI Determinants

FDI in Canada

Source and Type of FDI Investment in Canada

While FDI can come from all over the world, one key question for Canada is who our biggest contributors are. Where does the majority of Canada’s FDI come from and what sectors is it focused on? Currently, a large portion of our FDI investment comes from our next-door neighbour. The United States (US) is Canada’s largest FDI contributor, accounting for over 49% of Canada’s total stock of FDI.¹⁴

Fig 1. Foreign direct investment in Canada, by investing region, 2017

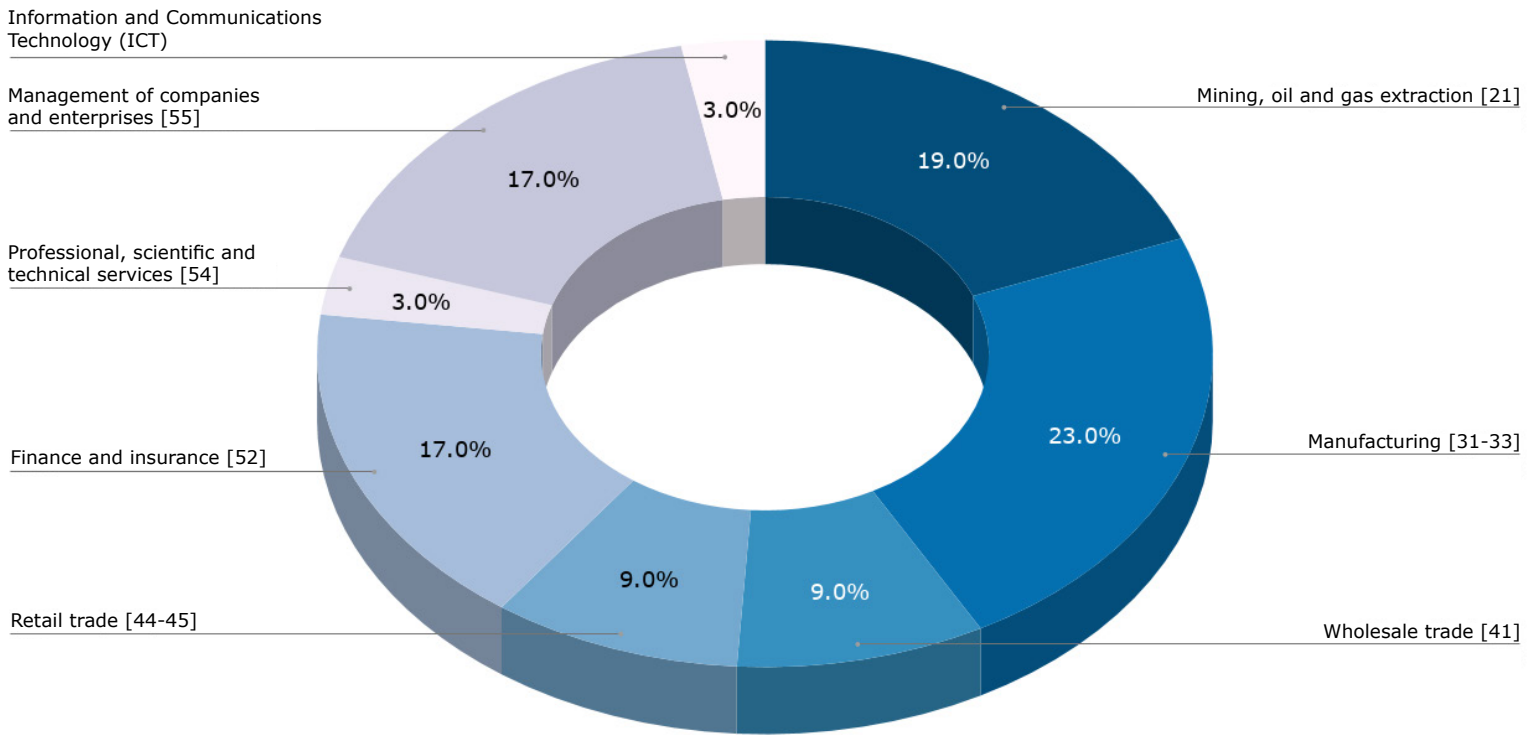


Data Source: Statistics Canada. Table 376-0051 International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by country

¹⁴ Table 36-10-0008-01 International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by country, annual (x 1,000,000) <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=3610000801>

When it comes to type of investment received in Canada, we see a notable difference among the countries providing investment, and outgoing investment from Canada. Here, FDI received from the US was primarily geared towards Canada’s traditional industries, such as Manufacturing (23%) and Mining and Oil and Gas Extraction (19%). Information and Communication Technologies industry only attracted 3% of the total inward FDI.¹⁵

Fig 2. Foreign direct investment from the US in Canada, by major industries



Data Source: Statistics Canada. Table 36-10-0009-01 International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by North American Industry Classification System (NAICS) and region, annual (x 1,000,000)

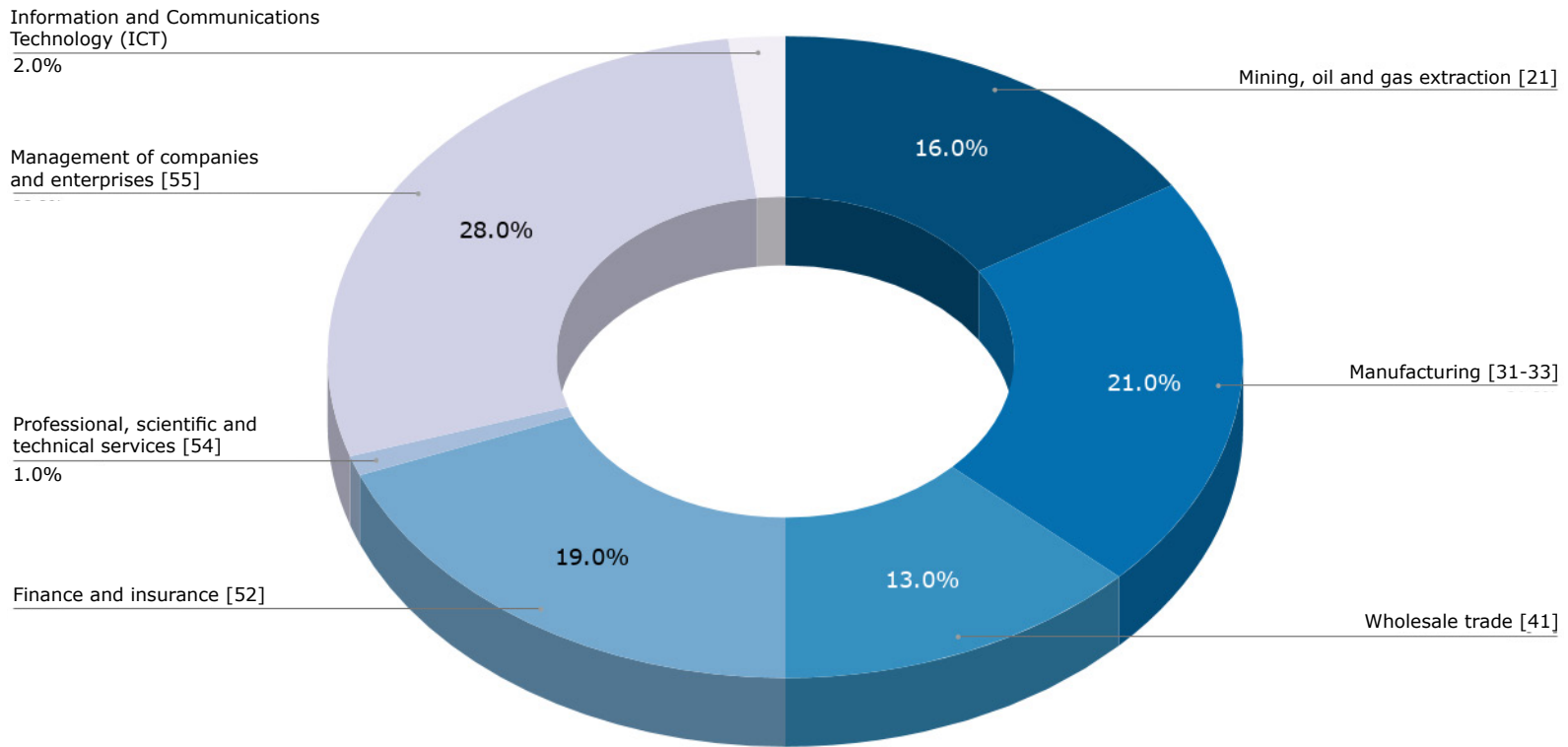
Europe was Canada’s second largest provider of FDI (35.1% of total FDI)¹⁶, with its investment is concentrated in Canada’s Management of Companies and Enterprises sector and manufacturing sector. Although Europe’s investment was more divided between the service and goods producing sectors than the US, investment was still not necessarily focused in high-growth sectors. For example, FDI to the Information and Communication Technologies (ICT) sector only accounts for 2% of Canada’s total inward FDI.¹⁷ However, with global consumer and technological trends that are paving the way for the accelerated adoption of technology across sectors, the importance of investing in strategically significant high-growth sectors like ICT is quickly becoming a clear reality.

¹⁵ Statistics Canada. Table 36-10-0009-01 International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by North American Industry Classification System (NAICS) and region, annual (x 1,000,000)

¹⁶ Statistics Canada. Table 376-0051 International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by country

¹⁷ Statistics Canada. Table 36-10-0009-01 International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by North American Industry Classification System (NAICS) and region, annual (x 1,000,000)

Fig 3. Foreign direct investment from Europe in Canada, by major industries

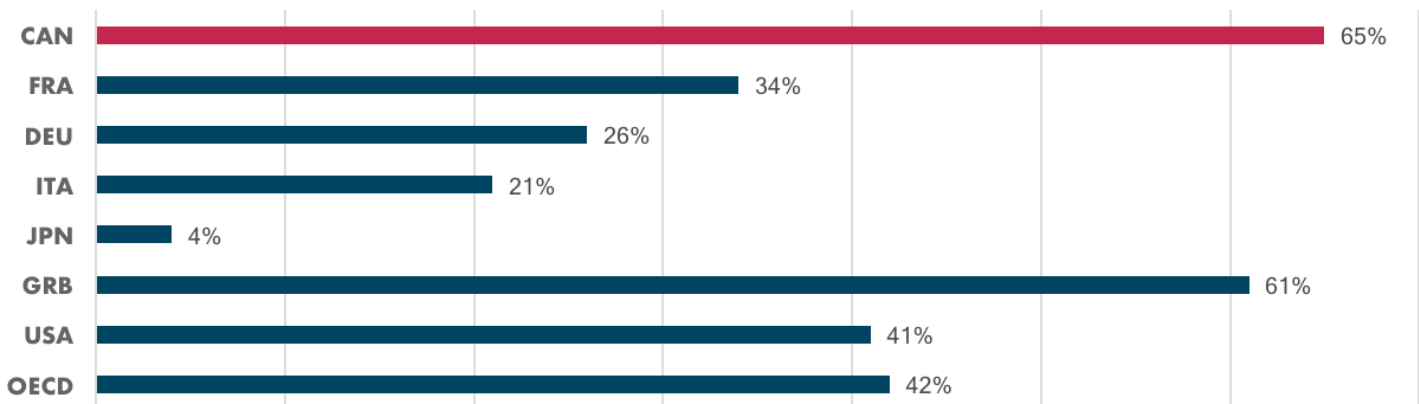


Data Source: Statistics Canada. Table 36-10-0009-01 International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by North American Industry Classification System (NAICS) and region, annual (x 1,000,000)

How Important is FDI for Canada?

Compared with other OECD countries, FDI is an especially important source of capital for Canadian businesses. In 2017, for example, Canada's inward FDI stock accounted for 65% of GDP. This figure is 23% higher than the OECD average that year, which totalled 42%.¹⁸ Comprising more than half of GDP, the importance of FDI to the Canadian economy cannot be understated. This means that an investment climate that continues to support foreign investment to key sectors of the economy these must be a priority.

Fig 4. FDI Stock, Percentage of GDP, 2017



Data source: OECD (2018), FDI stocks (indicator). doi: 10.1787/80eca1f9-en (Accessed on 29 August 2018)

Aside from pure economic benefit, a high percentage share of FDI in total GDP can indicate the significant effect of

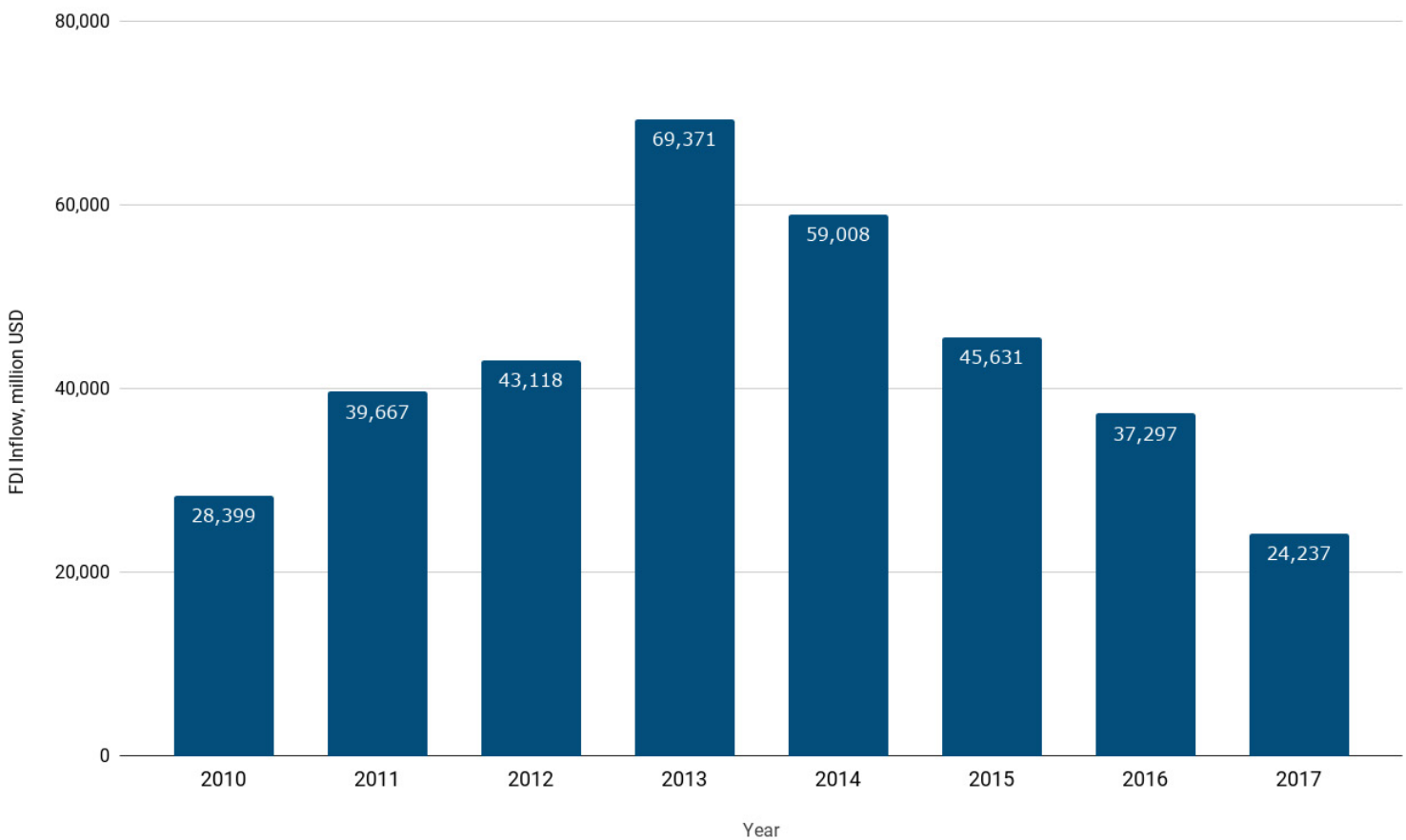
¹⁸ Data source: OECD (2018), FDI stocks (indicator). doi: 10.1787/80eca1f9-en (Accessed on 29 August 2018)

FDI on gross investment levels, labour productivity, tax revenue, and future output potential. This can be measured through by-products like technology diffusion, human capital development, and others. When it came to the impact of FDI on human capital, recent research found that, approximately 1.9 million Canadians were employed by foreign majority-owned companies in 2015 – that’s nearly 12% of all employment in Canada.¹⁹ A significant source of job-creation, concentrating FDI to high-growth sectors like technology would also function to create high-quality employment options for Canadians.

The Natural Resource Curse: Shifting FDI from Primary Sectors

While FDI is a substantial generator of revenue and job creation in Canada, in reality, it has experienced a significant decline in investment levels since 2014. In 2017, Canada attracted the lowest level of inward FDI since the financial crisis of 2008. With only \$24.2 billion USD attracted, this represented a decline of \$13 billion USD compared to 2016.²⁰ This sharp drop of inward FDI is a direct result of an exodus of capital from Canada’s oil and gas sector. Recently one of our nation’s leading economic sectors, global shifts in oil prices and trade uncertainties like those of the North American Free Trade Agreement (NAFTA), along with the US’ raising protectionism²¹ can cause roadblocks for the Canadian economy. This is one key reason that Canada should focus on diverting investment from goods-producing sectors like oil and gas to high-growth sectors such as Fintech or advanced manufacturing in the future.

Fig 5. Canada’s FDI inflow, 2010-2017



Data source: OECD (2018), FDI flows (indicator). doi: 10.1787/99f6e393-en (Accessed on 22 May 2018)

As touched on above, with the majority of inward FDI to Canada originating from the US under traditional sectors like natural resources, it is no surprise that the downturn in the oil and gas sector has created a significant impact on FDI receipt in Canada. To date, Canada’s FDI is still highly concentrated in the mining and oil and gas extraction sector, alone accounting for 20% of the total FDI to Canada in 2017.²² Compare this with FDI attraction to high-growth

¹⁹ Statistics Canada. Table 36-10-0451-01 Activities of foreign majority-owned affiliates in Canada, employment at establishment level, by province and industry (Year 2015)

²⁰ Data source: OECD (2018), FDI flows (indicator). doi: 10.1787/99f6e393-en (Accessed on 22 May 2018)

²¹ Financial Post: Foreign direct investment in Canada plunges to the lowest in eight years. <https://business.financialpost.com/news/economy/foreign-direct-investment-in-canada-plunges-on-oil-exodus-1>

²² Statistics Canada. Table 376-0052 - International investment position, Canadian direct investment abroad and foreign direct investment in Canada, by North American (accessed: May 13, 2018)

sectors like ICT, which only accounted for 2% that same year.²³

The primary sector (raw materials sector) has been the foundation of Canada's economy, with crude oil production ranking 7th in the world.²⁴ As a result, Canada has been a prevalent FDI destination for natural resource-based investment. However large natural resource endowments can also deter inward FDI into other sectors in Canada. Owing to what is known as the "natural resource curse" - the negative long-term impact that an abundance of natural resources has on a country's development – this "curse" has been known to affect prospects for economic growth, institutional quality, effective capital allocation, and the capacity to attract FDI in the future.²⁵ This theory is oftentimes compared to countries poor in natural resources that consistently obtain high levels of investment and strong economic performance. Take Israel as an example, whose economic stability and development has been attributed to its agricultural technology, strong R&D and advanced high-tech sectors, rather than its natural resources. Israel's Telecommunications, Computer Programming and Information Services sector attracted over 18% of the total inward FDI, followed by R&D sector's 12.9%.²⁶

While the effects of this "curse" are more evident in countries like Greece or Italy for example, Canada must not rely expressly on these resources. Instead, the focus should shift to attracting more sustainable investment in high-growth sectors like ICT. Furthermore, considering global shifts and economic uncertainties like the volatility in the commodity market as well as ambiguities surrounding key trade deals, the importance of securing and ensuring diversified FDI in Canada is clear.

Key Challenges of Inward FDI

While the benefits of attracting high-quality FDI may be evident, why do certain restrictions exist in this realm? What are the downsides of FDI attraction? Key considerations must be acknowledged when it comes to FDI restrictions in Canada.

The disadvantages of an FDI-intensive economy

Despite the fact that inward FDI can result in a considerable amount of capital inflow, the potential risks associated with being an economy that is overly dependent on inward FDI should not be overlooked. Ultimately profit-driven, multinational corporations (MNCs) seek for FDI receipt countries that provide the most competitive local advantages, such as market growth potential, high labour quality, stable exchange rate, low inflation, and compatible corporate rates, among others. This means that MNCs may leave the hosting country and move elsewhere if the investment climate should change to become less competitive. This can include changes like higher corporate tax rates, or even example rising wage levels of local workers.

Ireland for instance, was one of the first countries in the world to adopt an FDI-based development model. Ireland's high FDI intensity is one of the defining features of the economy, with inward FDI stock comparable of 270%²⁷ of its GDP. In addition to its competitive tax system, Ireland offers MNCs access to the EU single market through a competitive regulatory and commercial framework. These factors have made Ireland an attractive destination and many US multinationals like Google, Apple, Facebook, PayPal, Microsoft, and others have chosen Ireland to set up their subsidiaries. By 2014, the cumulative US investment alone amounted to more than 300 billion²⁸ USD, about a third more than Ireland's entire GDP. This over-reliance on FDI as a stimulator of economic growth has not been without its drawbacks²⁹. For instance, events like US tax reform, and the EU compelling Apple to pay 15.4 billion in back tax to Ireland, have challenged Ireland's FDI strategy of using low taxation to attract MNCs. Afilias for example, is a US MNC which operates one of the world's main registries for connecting internet users to online destinations, has left Dublin and relocated to Pennsylvania as a response to US tax reform.

This is just one example of the potential drawbacks of shaping an economic strategy whose growth is based on intensive foreign direct investment.

²³ *ibid.*

²⁴ OECD (2018), Crude oil production (indicator). doi: 10.1787/4747b431-en (Accessed on 09 August 2018)

²⁵ Asiedu, E., "Foreign direct investment, natural resources and institutions", IGC Working Papers, International Growth Centre, March 2013.

²⁶ Santander trade portal, Israel: Foreign Investment. <https://en.portal.santandertrade.com/establish-overseas/israel/foreign-investment>

²⁷ OECD (2018), FDI stocks (indicator). doi: 10.1787/80eca1f9-en (Accessed on 21 September 2018). Ireland (2017)

²⁸ <http://www.latimes.com/world/europe/la-fg-ireland-economy-2017-story.html>

²⁹ Ireland's Foreign Direct Investment Sector: the Impact of a hypothetical Irish Euro zone exit, <https://www.omicsonline.org/open-access/irelands-foreign-direct-investment-sector-the-impact-of-a-hypothetical-irish-euro-zone-exit-2151-6219-4-082.php?aid=21859>

“Low- cost Canadian labour” attracting low value-added FDI?

It has been highly debated that the main reason MNCs would choose Canada as an FDI recipient country is its low labour cost. Particularly when it comes to the attraction of US MNCs, lower Canadian wages have indeed acted as an incentive in the past. This is so much so that even recent strategies like Vancouver’s bid for the second North American headquarters of Amazon hinged on significantly lower wages in Vancouver vs. many US [and Canadian] cities.

However, international comparisons do not necessarily point to Canada as a top destination for low wages. First, Canada’s average wage is the second highest among G7 countries, ranking the 12th among 35 OECD countries³⁰, meaning that there are a great number of significantly lower-cost jurisdictions for MNCs to invest in, should wages be the main pull factor. Moreover, Statistics Canada’s most recent Survey of Intellectual Property Management indicates that 3.5% of issued patents are applied by Canadian companies, in comparison that of 0.6% are owned by their foreign head office³¹ - this suggests international investors do not necessarily curtail the development of Canadian-based IP.

There is no doubt that there are notable considerations to take account of in the debate surrounding the attraction of foreign direct investment to Canada. From the potential for increased economic volatility related to a high FDI-based economy, or the attractiveness of lower wages in Canada vs. the US; these concerns must be at the centre of rational and sustainable policies on investment. However, at the same time, the positive impact that MNCs have made in Canada should not be neglected. For instance, it is estimated that a 10% increase in annual labour productivity growth at manufacturing firms under foreign control is linked to a 5% increase at Canadian manufacturing firms³². The presence of MNCs can offer both horizontal (intra-industry) and vertical (inter-industry) spillovers to Canadian companies – something that in turn, helps to actually promote the growth and scale-up of domestic businesses. Whether via improvements to productivity, increased competition, skill transfer or access to new markets, in many cases foreign direct investment can actually pave the way for the acceleration of the local economy and the scale-up of Canadian businesses.

Key Inward FDI Determinants

One of the primary objectives of this paper is to understand key FDI determinants – that is, which factors help countries attract FDI. To answer this question, it is necessary to first understand the various investment motivations that drive firms to undertake investment projects abroad (USAID 2005).³³ These motivations may range, but typically centre on the following objectives:

- Natural resource-seeking FDI: to gain access to natural resources that are not available or cannot be produced efficiently in the company’s home country
- Market-seeking FDI: to gain access to new market (including export markets)
- Efficiency-seeking FDI: to reduce production costs by gaining access to new technologies or competitively priced inputs and labour
- Strategic-asset-seeking FDI: investors are interested in acquiring strategic assets, such as brands, human capital, distribution channels, among others in the FDI-receipt countries

Regardless of the motivation for investment, companies will always choose the investment location that possesses the highest expected profitability, i.e. either because it minimizes the cost of production (including reducing the riskiness of the investment) and/or because it maximizes the expected return. A number of host country advantages can be considered to either lower the cost of production or increase expected return. These include:

- Market size and growth potential
- Labour quality and cost

³⁰ OECD (2018), Average wages (indicator). doi: 10.1787/cc3e1387-en (Accessed on 21 September 2018)

³¹ Statistics Canada. Table 27-10-0031-01 Enterprises holding or using issued patents, by selected industry group, <https://www150.statcan.gc.ca/t1/tbl1/en/tv.action?pid=2710003101> Survey of Intellectual Property Management is a survey that sampled over 3,000 enterprises that use some type of intellectual property, specifically patents, copyrights and trademarks.

³² Baldwin, J. R. and W. Gu (2005). Global Links: Multinationals, Foreign Ownership and Productivity Growth in Canadian Manufacturing. Statistics Canada, Micro Economic Studies and Analysis Division.

³³ Kusi Hornberger, Joseph Battat, and Peter Kusek, “Attracting FDI: How Much does Investment Climate Matter?” <http://siteresources.worldbank.org/FINANCIAL-SECTOR/Resources/327-Attracting-FDI.pdf>

- Macroeconomic and political stability (such as a stable exchange rate, low inflation and low debt)
- Close geographical and cultural proximity
- Trade openness
- Tax benefits or a low tax rates
- FDI incentives
- High quality infrastructure
- Natural resource availability³⁴

Many factors are clearly important in attracting FDI. Examples include market size, being that the smaller and more concentrated the market, the less likely it will be as a location for investment. However, some previously mentioned-factors are also influenced and dictated at least in part by global shifts and economic trends. This could include trade relations, external policy decisions, and increasingly even factors like climate change which can impact the “attractiveness” of a given location for investment. Other drivers of FDI, such as labour productivity, and macro-economic and political stability, can be influenced only in the medium to long term, meaning that the results of these drivers take longer to come to fruition. Investment climate, including aspects such as corporate tax rates, FDI incentives and statutory openness to foreign investment that are directly controlled by the federal and provincial governments, can create substantial opportunities for near-term benefits to FDI at a low cost.

Section II: Investment Climate in Canada

Canadian Corporate Tax Rates & Recent International Developments

In Canada, the combined corporate tax rate is 26.5%.³⁵ While this is 3% higher than the OECD average (23.5%), historically Canada’s rates were significantly lower than many countries around the world.³⁶ This includes the US (Canada’s most significant investor) with a combined corporate rate of nearly 40% in 2017. Although reductions exist for Canadian-owned small businesses, allowing them to benefit from a 15% rate, recent legislative changes in the US present a challenge for Canada in this space, formerly a competitive advantage. As of January 2018, the US corporate tax rate decreased to 21%, offering US-owned companies the opportunity to capitalize on their growth more substantially via increased after-tax profits. Benefits of this change include the possibility to write off investments in equipment, and in some cases, to benefit from a lack of taxation on qualified dividends and capital gains.³⁷ While still fresh, these tax cuts have already produced some immediate effects. For example, less than one month after Congress approved the tax bill, Apple pledged to build a new corporate campus in the US and hire 20,000 American workers.³⁸ Of course, this is just one case; but this move is estimated to add \$245 billion to the US economy, and more importantly, will be generated completely by a US-based and owned company.³⁹

Other Recent US Corporate Tax Changes

The US’ tax bill also includes a one-time repatriation tax, which is designed to incentivize US-based companies that do business overseas to bring those profits back stateside – similar to the example of Apple. While the previously high corporate tax rates in the US encouraged many to set up “tax havens” in lower-cost tax jurisdictions like Ireland, the Netherlands or Canada, there is speculation that this one-time repatriation tax, combined with low tax rates, could lead to internationally-held cash flooding back into the US. The potential impact of this is substantial; Goldman Sachs

³⁴ See Antonakakis and Tondl (2010) for a detailed overview of the existing literature analysing the importance of all these host country characteristics.

³⁵ KPMG Corporate Tax Rates Table (2018) <<https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html>>

³⁶ *ibid.*

³⁷ The New York Law Journal, Corporate Tax Changes in New Tax Law, February 14, 2018. <<https://www.law.com/newyorklawjournal/2018/02/14/corporate-tax-changes-in-new-tax-law/?sreturn=20180420095743>>.

³⁸ U.S. News: Apple Banks on Tax Break to Build 2nd Campus, Hire 20,000 <<https://www.usnews.com/news/business/articles/2018-01-17/apple-to-build-2nd-campus-hire-20-000-in-350b-pledge>>

³⁹ *ibid.*

has recently estimated that a total of \$250 billion in untaxed overseas cash held by S&P 500 companies would be repatriated.⁴⁰ The impact of this move would impact Canada's ability to attract inward FDI from the US. In comparison, when a Canadian MNC's foreign operations are conducted through a subsidiary, the income earned by the subsidiary is generally not subject to taxation in Canada until profits are remitted to Canadian shareholders in the form of dividends or until the Canadian corporation disposes of its foreign subsidiary⁴¹. Such tax policy might have encouraged Canadian MNCs to set up subsidiaries in those low or no-tax jurisdictions (offshore tax haven). It is estimated that each year the Federal and provincial governments lose an estimated \$7.8 billion in tax revenues because of tax havens⁴². The development of repatriation schemes similar to the US – with the requirement that repatriated funds be again invested in local R&D and business development – can act a considerable economy booster for Canada as well.

FDI Pull Factors: Incentives

In Canada, there is currently no specific incentive program or policy (at the federal or provincial level) that is designed solely for the purpose of attracting or promoting FDI. In fact, the majority of the available incentives that are related to FDI attraction tend to be geared more towards advancing broader macroeconomic development goals, such as increasing R&D activities and the development of regional economic growth. For instance, the Scientific Research and Experimental Development (SR&ED) Program (which is the federal government's largest single program for R&D) provides support in the form of tax credits and/or refunds to corporations, partnerships or individuals who conduct scientific research or experimental development. Although SR&ED is extremely beneficial to homegrown companies, as it ensures that Canadian-controlled private corporations can qualify for a federal tax credit of up to 35% of qualified expenses, the development of a broader similar program may serve as an incentive for internationally-based companies to conduct research and development in Canada.

At the provincial level, some incentives are available to promote the development of certain sectors. For example, in British Columbia, targeted tax credits are offered to film production and digital media businesses, of up to 33% of eligible expenses⁴³ (up to 35% for eligible domestic productions⁴⁴); and a similar 20% credit for mining exploration companies.⁴⁵ In Ontario, the Film & Television Tax Credit allows Ontario-based production companies to receive credits on eligible expenditures incurred in the production of a film or television series.⁴⁶ While programs like these, and other initiatives like the recent development of Innovation Canada act as significant enablers to Canadian-businesses, there is currently no single incentive program targeted specifically at innovation sectors, such as ICT.⁴⁷

From 2016-2017, real gross domestic product (GDP) produced by Canada's ICT sector increased by nearly \$2.43 billion, totaling \$74.7 billion⁴⁸. This accounted for nearly 4.5% of total Canadian GDP in 2017.⁴⁹ This rapid growth, in combination with the development of world-class start-up ecosystems like Toronto and Vancouver, and the increasing permeation of technology across other sectors of the economy, it is expected that the strength of tech and innovation will only continue to grow.⁵⁰ Leveraging this growth and supporting it with strong policies that not only help Canadian companies scale, but attract FDI to high-growth sectors, is crucial.

Recent events that have been challenging the strength and sustainability of traditional sectors further support a shift of investment to high growth industries. For instance, with the uncertainty surrounding the development of NAFTA negotiations and resolutions on the Kinder Morgan pipeline, FDI in Canada's mining and oil and gas extraction sector has declined since 2016. According to Statistics Canada's Capital and Repair Expenditures Survey, the capital spending in the oil and gas extraction subsector is expected to continue contraction, with a fourth year of consecutive decline in

⁴⁰ Business Insider: Trump's tax plan could bring \$250 billion into the US — here are the companies set to benefit most <<http://www.businessinsider.com/trump-tax-reform-plan-repatriation-14-us-companies-with-most-cash-overseas-2017-9>>

⁴¹ <https://www.nrcan.gc.ca/mining-materials/taxation/8880>

⁴² How to Stop Canadian Multinationals from Dodging Their Taxes, <https://theyee.ca/Opinion/2014/07/29/Canadian-Multinationals-Dodging-Taxes/>

⁴³ Trade and Invest British Columbia: Competitive Supportive Tax Environment <<https://www.britishcolumbia.ca/TradeBCPortal/media/Marketing/bc-tax-mit.pdf>>

⁴⁴ Ibid.

⁴⁵ Ibid.

⁴⁶ Ontario Media Development Corporation, Ontario Film & Television Tax Cuts, 2017. <http://www.omdc.on.ca/film_and_tv/tax_credits/ofttc.htm>.

⁴⁷ Government of Canada, Innovation Canada <<https://www.ic.gc.ca/eic/site/080.nsf/eng/home>>.

⁴⁸ Ibid.

⁴⁹ Ibid.

⁵⁰ Tech Crunch, Canada is North America's up and coming startup center, April 20, 2017. <<https://techcrunch.com/2017/04/20/canada-is-north-americas-up-and-coming-startup-center/>>.

2018.⁵¹ Understanding this, it is clear that the diversification of FDI, including its steering towards innovative and high growth sectors is an important strategy.

Putting on the Brakes: Statutory Ownership Restrictions to FDI

When a multinational corporation considers investing options, narrowing down a list of potential investment destinations is the first step. During this process, a number of factors are included in the decision equation, such as market size and potential, talent availability, innovation networks, tax incentives, and operational cost. However, one of the foremost questions that need to be answered is to what extent the investing company would be able to receive national treatment in the hosting country. In short: to what extent can it be treated like a domestic company?

The OECD's Investing Across Sectors indexes measure statutory openness to foreign equity participation in 33 sectors (aggregated into 11 broader sector groups) and across 87 countries.⁵² The indexes take values from 0 to 100, where 100 denotes the absence of statutory ownership restrictions to FDI, and 0 means that foreign companies are not allowed to own equity in a sector or sector group. Among the 12 high-income OECD countries, Canada presents the most stringent restrictions on foreign equity ownership.⁵³ Imposing overt statutory ownership restrictions on a number of service sectors, Table 1 below highlights Canada's restrictiveness in comparison to its counterparts.

Table 1. Investing Across Borders - Statutory Ownership Restrictions Indicators

Sector Group (Canada)			Canada Country Score	High-Income OECD (12 countries average)	Global Average
Telecom			46.7	89.9	88
Sector	Greenfield	M&A			
Fixed-line Infrastructure	46.67	46.67			
Fixed-line Telephony Services	46.67	46.67			
Wireless/Mobile Infrastructure	46.67	46.67			
Wireless/Mobile Services	46.67	46.67			
Banking			65	97.1	91
Sector	Greenfield	M&A			
Banking	65	65			
Transport			79.6	69.2	78.5
Sector	Greenfield	M&A			
Domestic Air	49	49			
International Air	49	49			
Media			73.4	73.3	68
Sector	Greenfield	M&A			
Television Broadcasting	46.7	46.7			
Light Manufacturing			81.1	93.8	96.6
Sector	Greenfield	M&A			
Publishing	49	0			

Data source: Investing Across Borders, The World Bank Group <http://iab.worldbank.org/data/exploreconomies/canada#investing-across-sectors>

⁵¹ Statistics Canada: Non-residential capital and repair expenditures, 2016 (revised), 2017 (preliminary) and 2018 (intentions)

⁵² Investing Across Sectors Methodology <http://iab.worldbank.org/Methodology/investing-across-sectors>

⁵³ Investing Across Borders, The World Bank Group <http://iab.worldbank.org/data/exploreconomies/canada#investing-across-sectors>

Such statutory ownership restrictions towards FDI are imposed on a number of areas in Canada. Specifically, they are attributed to the following sector legislative schemes in Canada:

The Telecommunications Act

For telecommunications common carriers (i.e. the entities that own or operate facilities) with greater than a 10% share of national telecommunications, revenues must be Canadian-owned and controlled. An entity is Canadian-owned and controlled if

- a) in the case of a corporation, not less than 80% of the members of the board of directors are individual Canadians;
- b) Canadians beneficially own, directly or indirectly, in the aggregate and otherwise than by way of security only, not less than 80% of the entity's voting interests; and
- c) the entity is not otherwise controlled by persons that are not Canadians.

100% foreign ownership can happen when telecommunications entities only own transmission facilities or telecommunications carriers whose revenues account for less than 10% of total Canadian telecommunications revenues⁵⁴.

The Broadcasting Act

Under the Broadcasting Act, the broadcasting licenses may only be issued to companies that meet the following requirements:

- a) the corporation must be incorporated or continued under Canadian law;
- b) the CEO or equivalent and not less than 80 per cent of the Directors must be Canadian; and
- c) at least 80 per cent of the voting shares, and 80 per cent of the votes must be owned and controlled by Canadians.
- d) the corporation must not otherwise be controlled by non-Canadians (i.e., "control in fact").

The Bank Act.⁵⁵

Although there are no foreign ownership restrictions imposed under the Bank Act, but it prohibits any individual investor from holding more than 10% of the shares of a bank listed in Schedule 1 (i.e., a large bank) and the aggregate holdings of non-residents and their associates may not exceed 25% of all shares.⁵⁶ Canadian influence is also exerted through certain requirements of the Bank Act:

- a) the head office of a bank must be in Canada;
- b) shareholders' meetings are required to be held in Canada;
- c) two-thirds of the directors must be resident Canadians;
- d) the chief executive officer of the bank must ordinarily be resident in Canada;
- e) important corporate and transactional documents must be kept in Canada;
- f) certain administrative changes require ministerial approval.⁵⁷

⁵⁴ Telecommunications Act (S.C. 1993, c. 38) PART II Eligibility to Operate

⁵⁵ Canada: Broadcasting and Telecommunications Law Overview, Stikeman Elliott LLP <https://www.stikeman.com/en-ca/kh/guides/Canada-Broadcasting-and-Telecommunications-Law> (page Q3)

⁵⁶ Y. Beth Riley, Bennett Jones LLP, Foreign Direct Investment Restrictions in Canada (page 4)

⁵⁷ <https://www.export.gov/article?id=Canada-Openness-to-Foreign-Investment>

The Canada Transportation Act

With the Transportation Modernization Act (Bill C-49) receiving Royal Assent on May 23, 2018, the long-standing requirement that at least 75% of the voting interests be owned and controlled by Canadians (a.k.a. de jure control) is reduced to 51% where:

- (a) no more than 25% of the voting interest are owned directly or indirectly by any single non-Canadian, and
- (b) no more than 25% of the voting interests are owned by one or more non-Canadians authorized to provide an air service in any jurisdiction.

Although this change provides greater flexibility in structuring foreign investment in Canadian aviation companies, most of the challenges and complexities involved in establishing an ownership and governance structure to satisfy the definition of “Canadian” remain.⁵⁸

The Insurance Companies Act

The Insurance Companies Act limits foreign ownership in an existing Canadian owned life insurance company to 25% in the aggregate, and 10% for any individual non-resident; provincial legislation also places restrictions on foreign investment in the insurance industry.⁵⁹

The Purpose of Imposing Regulatory Restrictions to FDI in Canada

Protecting industries of cultural significance and preventing FDI that would undermine national security interests are the main rationales behind Canada’s restricted investment climate. Canada is one of the only two high-income OECD countries that have a formal investment review and approval process on foreign investment (Australia also has a similar review process)⁶⁰. Such review is governed by the Invest Canada Act (the “ICA”), wherein its objective is “...to provide for the review of significant investments in Canada by non-Canadians in a manner that encourages investment, economic growth and employment opportunities in Canada and to provide for the review of investments in Canada by non-Canadians that could be injurious to national security.”⁶¹ The ICA further indicates one of the rationales behind the presence of regulatory restrictions to FDI in Canada. That is that any investment made by a non-Canadian is subject to a national security review if the Minister of Industry considers that an investment could be “injurious to national security”.⁶² A recent example of this consideration is the Canadian government’s rejection to the takeover of Aecon Group Inc. by Chinese state-owned infrastructure company China Communications Construction Co. Ltd. Assessing national security concerns in the face of potential foreign direct investment is a critical step to insure that inward investment is not only economically beneficial, but sound from a national security perspective.

The rationale behind regulatory restrictions to FDI in Canada is also implied in the Broadcasting Act, which states that the Canadian broadcasting system should be effectively owned and controlled by Canadians, and that it should “safeguard, enrich and strengthen the cultural, political, social and economic fabric of Canada.”⁶³ This has led to regulations requiring that that all radio and television broadcasters must exhibit prescribed minimum percentages of Canadian content. A certification system is used to determine which programs or musical selections will be considered ‘Canadian’.⁶⁴ Similar to considerations of national security, the impact on Canadian cultural content must also be taken into account when assessing the value of foreign direct investment.

Herein lies the challenge for Canada: it is important to have effective regulations that would protect national industries of cultural significance, and to ensure national securities. However, the challenge is doing so in a way that such regulations do not discourage the inflow of international capital and technology that is not harmful and would otherwise benefit the economy.

⁵⁸ Foreign Ownership Restrictions Eased in the Canadian Aviation Sector https://www.cwilson.com/foreign-ownership-restrictions-eased-in-the-canadian-aviation-sector/?utm_source=Mondaq&utm_medium=syndication&utm_campaign=View-Original

⁵⁹ Government: Sectoral Limitations on Foreign Ownership of Canadian Businesses https://www.gov.mb.ca/jec/invest/busfacts/govt/f_ownership.html

⁶⁰ Y. Beth Riley (2011), Foreign Direct Investment Restrictions in Canada, Page 3

⁶¹ Investment Canada Act, R.S., 1985, c. 28 (1st Supp.), s. 2; 2009, c. 2, s. 445.

⁶² Y. Beth Riley (2011), Foreign Direct Investment Restrictions in Canada, Page 10

⁶³ Canada: Broadcasting and Telecommunications Law Overview, published by Stikeman Elliott LLP (2013), Page Q2

⁶⁴ Canada: Broadcasting and Telecommunications Law Overview, published by Stikeman Elliott LLP (2013), Page Q4

Zoom in: Canada's FDI Regulatory Restrictiveness among G7 Countries

Canada currently has the highest overall FDI regulatory restrictiveness among the G7 countries, measured by OECD's FDI restrictiveness index. This index quantifies the restrictiveness of a country's foreign direct investment (FDI) rules by examining four main types of restrictions: foreign equity restrictions; discriminatory screening or approval mechanisms; restrictions on key foreign personnel and operational restrictions. The index takes values between 0 for open and 1 for closed.⁶⁵ According to these indexes, we note that Canada also has the highest FDI sector regulatory restrictions in Communications, Fixed telecoms and Mobile telecommunications, Financial Services, Manufacturing, Primary sectors, among others. This is so much so that Canada's overall FDI restrictions is over 1.8 times higher than the US', with Financial Services and Telecommunications Sectors' FDI restrictions approximately 1.7 and 5 times higher than those of US counterparts.

Table 2. G7 FDI Regulatory Restrictiveness Index, By Industry, 2017

Industries	CAN	DEU	FRA	GBR	ITA	JPN	USA	OECD Average
Business Services	0.10	0.00	0.00	0.00	0.00	0.00	0.00	0.06
Financial Services	0.07	0.01	0.05	0.00	0.02	0.00	0.04	0.03
Manufacturing	0.10	0.00	0.00	0.00	0.00	0.00	0.00	0.02
Telecommunication	0.56	0.00	0.00	0.00	0.00	0.27	0.11	0.09
Total Sectors	0.16	0.02	0.05	0.04	0.05	0.05	0.09	0.07

Data source: OECD (2018), FDI flows (indicator). doi: 10.1787/99f6e393-en (Accessed on 22 May 2018)

Case Study: Regulatory Restrictiveness to FDI in Canada's Telecommunications Sector

While a variety of considerations were used to guide foreign entity restrictions in Canadian telecom – including the protection of cultural content and national security concerns – these restrictions are currently the highest in the OECD. Among 36 OECD countries, 17 of them do not have any foreign ownership restrictions for FDI in the telecommunication sector.⁶⁶ Additionally, if we compare to countries that do have foreign ownership restrictions, Canada's FDI restrictions in this sector are still substantially higher.⁶⁷ For example, in Mexico, the foreign ownership restriction is set at 49%, meaning that no more than 49% of the company can be foreign-owned.⁶⁸ At the same time, Mexico allows for an exemption to this rule in the case of cellular mobile operators.⁶⁹ Another OECD country that is considered to have high restrictions on foreign ownership is South Korea. However, even in South Korea, as long as the aggregate of foreign ownership does not exceed 49%, foreign companies are licensed to provide facilities-based services, with no other restrictions applied.⁷⁰

⁶⁵ OECD Definition of FDI restrictiveness. <https://data.oecd.org/fdi/fdi-restrictiveness.htm>

⁶⁶ OECD Communications Outlook 2013 Table 2.5 National treatment for foreign-controlled enterprises in telecommunications

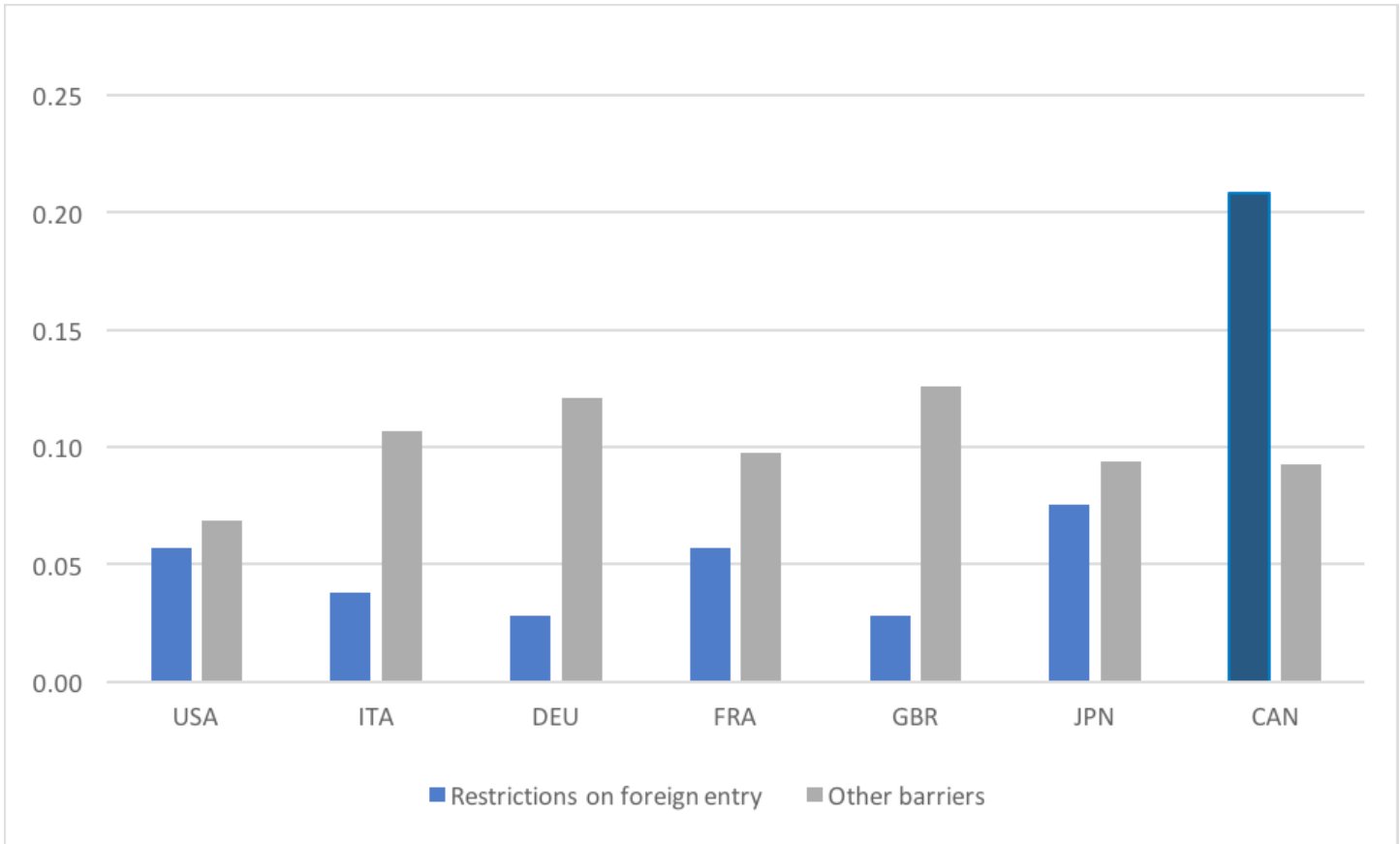
⁶⁷ Ibid.

⁶⁸ Ibid.

⁶⁹ Ibid.

⁷⁰ A telecommunications service provider owning, as opposed to leasing, networks used to provide telecommunications services. <https://stats.oecd.org/glossary/detail.asp?ID=4962>

Fig 6. Foreign entity restrictions in telecom among G7 countries



Note: Index from 0 (open) to 1 (closed)

Data Source: OECD, Services Trade Restrictiveness Index database.

Noting this, it can be argued that a high level of restrictiveness in FDI has created a siloed market in Canada, ultimately limiting purchasing options for Canadians in sectors like telecommunications. This is something that is evidenced when it comes to purchases of telecommunications products by Canadians. Compared to OECD countries, mobile broadband subscriptions in Canada are relatively low (ranked at 30th among 36 OECD countries), with 65.9 “data and voice” subscriptions (per 100 inhabitants). Compare this to the OECD average, which is 92.⁷¹

At the same time, the cost of telecommunications services such as mobile and broadband is relatively high, despite fixed broadband adoption rates that are above the OECD average.⁷² For instance, if we examine average monthly mobile baskets (300 calls+ 1 GB data), we note the average price among OECD countries is \$25.7 USD/month (\$18.01 USD/month in Korea and \$9.61 USD/month in Mexico).⁷³ By comparison, in Canada, the average price for these services is \$47.37 USD/month – that’s nearly two times higher than OECD average.⁷⁴ The same results are evident when we compare fixed broadband, which averaged \$33.17 USD/month among the OECD countries (\$17.8 USD/month in Korea and \$34.7 USD/month in Mexico), but totaled \$53.26 USD/month in Canada.⁷⁵

Another compounding factor for the Canadian telecommunications sector is its lower share of ICT goods and services exports. From 2010 to 2016, the share of Canadian ICT goods as a percentage of total export decreased by 2.3% totaling 2.1% in 2016 (down from 4.4% in 2010).⁷⁶ While in 2012, ownership restrictions were lifted for companies with a market share capped at 10%, no such entry has taken place to date.⁷⁷

⁷¹ *ibid.*

⁷² *ibid.*

⁷³ *ibid.*

⁷⁴ *ibid.*

⁷⁵ *ibid.*

⁷⁶ UNCTADSTAT. Share of ICT goods as percentage of total trade, annual, 2000-2016

⁷⁷ OECD Canada Economic Survey (2016) <http://www.oecd.org/eco/surveys/Canada-overview-OECD-economic-survey-2016.pdf>

The considerable opportunities and economic gains in high growth sectors like ICT, Banking and Transportation cannot be neglected. Canadian companies, especial small and medium-sized businesses that are involved in technological development and applications like 5G, Fintech, and smart manufacturing require significant amounts capital, technology transfer and access to new markets to truly expand and grow their businesses. FDI can be a key source of this growth-driving capital.

Section III: Conclusion

The Primary sector has served as a revenue engine for Canada, attracting natural resource-seeking FDI from all over the world. However, as many other natural resource rich countries, the Canadian economy can get trapped in a cycle of boom and bust, with an overdependence on one sector having significant consequences to economic stability. When an economy is over-reliant on one single sector, it may lead to risks of unbalanced government revenue and the creation of short-sighted policies. At the same time, this over-reliance can cause the primary sector itself can attract more domestic human capital, and thus crowd out resources for other sectors to grow and innovate. Taking these and other factors like global shifts and volatility in the commodity market into account, the importance of allocating domestic resources and attracting inward FDI to innovative and high-growth sectors in Canada is clear. The ICT industry, with over \$73 billion⁷⁸CAD in revenues, has experienced a significant growth of 2.3% in one year alone⁷⁹ - that is nearly twice as fast as the total Canadian economy (+1.2%). However, the current investment climate, with factors including a less competitive corporate tax environment and restrictive FDI regulations against foreign investors, have created challenges for even domestic ICT companies – especially small and medium – in their attempts to expand and grow. Canada should open up its innovative and high growth sectors to foreign investment. This kind of openness can not only assist domestic business scale-up, but it can facilitate the inflow of sustainable capital, technology know-how and healthy competition to the domestic market. While considerations like establishing regulations with the aim of protecting culturally-significant sectors, and safeguarding national security interests are crucial, there is a fine line between doing so and effectively limiting competition.

Innovative and timely policies must be considered in the interest of attracting high-quality foreign direct investment to Canada. Incentives like tax repatriation holidays may be effective fiscal instruments to convince Canadian MNCs to bring their overseas earnings back to Canada. This is something that, if invested back in local R&D and business development, can produce an extremely positive effect on the Canadian economy. Ensuring that the door for such Canadian companies, while also creating avenues for foreign investment that will boost economic growth in high-growth sectors can be a wise strategy for Canada.

The issues surrounding FDI are broad and wide-ranging. They can touch on topics like creating strategies to best attract it while simultaneously protecting national industries, or how to selectively attract FDI that can promote high R&D investment in Canada. With these strategies also come key considerations for not only the economy, but our national well-being. These range from considerations on economic growth, questions of national security, small business scale-up concerns and even cultural sovereignty. As a result, these topics are ones that will require extensive research and analysis beyond the scope of this paper. This paper was instead meant to act as a first steps to examine the status quo of inward FDI to Canada, its impact to the economy, and to spur discussion on revisiting ownership restrictions in high-growth sectors like ICT. These considerations are crucial to advancing the discussion and building a sustainable pathway with the potential of yielding significant tangible gains for consumers and businesses.

Section IV: Recommendations

With factors including a lack of FDI incentives for attracting and diversifying investment towards innovative and high growth sectors; restrictions and regulations on certain FDI-generating industries; and potentially unfavourable taxation circumstances, it is critical that Canada take action to create the basis for a strong investment climate. Doing so can attract and diversify FDI as well as help homegrown companies scale, grow and expand to new markets. Moreover, with the world becoming increasingly tied and connected by technology, creating a favorable investment climate is central to attract and diversify FDI to high growth sectors, like ICT which is one of the fastest growing sectors that play a productivity catalyst role across all industries. Improving the investment climate in Canada can offer immense benefits not only to the current economy, but it can also act as a key catalyst in helping Canadian companies grow,

⁷⁸ Canadian ICT sector profile https://www.ic.gc.ca/eic/site/ict-tic.nsf/eng/h_it07229.html

⁷⁹ *ibid.*

scale, and diversify their businesses across borders. The following recommendations are made in the interest of growing Canada's capacity to attract and diversify FDI to innovative and high growth sectors, and direct back capital from Canadian MNCs' earnings back into the Canadian economy:

1. Streamlined and effective tax policies should be leveraged in order to both help Canadian companies scale and grow, and attract non-natural resource FDI in high-growth sectors. Possible solutions may include: reducing the combined corporate tax rate to a more internationally competitive level (e.g. 23.5% of OECD average corporate rate);
2. Designing efficient tax incentives specifically to attract FDI, with a focus on international investors within the innovation space. Tax holidays that eliminate tax on net revenues from investment projects can be considered as a policy instrument to encourage MNCs to establish based in Canada. For instance, the government could grant a 100% tax holiday allowance for newly established MNCs in the innovative sector, for a period of two or three years, with a 50% tax holiday allowance for two additional years.
3. Revisiting restrictive FDI regulations would be helpful in designing relevant policies and procedures that meet the needs of current-day realities for the Canadian innovation sectors. Part of this may entail actions such as: alleviating or reducing the restrictions on foreign ownership in the Banking, Telecommunication and Transportation sectors. As a result, Canada may benefit from streamlining its policies on foreign ownership to be more in line with common practices of other OECD countries.
4. A repatriation tax break would effectively remove the need for Canadian MNCs to keep retained earnings overseas, and can be effective in bringing billions of capital back to the Canadian market. This tax break for repatriating companies, however, should be crafted to ensure that repatriated funds are steered back into the Canadian economy; such as via investment in R&D, business development, infrastructure build-out, mergers and other catalysts of domestic economic and labour growth. This new source of revenue would also help Canadian businesses, especially small and medium companies, expand and scale up with abundant capital.