46. Reduce Barriers to Foreign Direct Investment

Issue
An increasingly restrictive and burdensome regulatory and tax environment is making Canada a less competitive destination for foreign direct investment (FDI), which is critical to the country's innovation and diversification efforts.

Background
Deteriorating competitiveness**:**
The effects of globalization – such as reducing transportation and shipping costs and eliminating barriers to markets through trade agreements – have reduced the need for foreign investment into Canada to access the Canadian market. At the same time, recent policy shifts at the federal level have layered-on costs that cumulatively further threaten Canada's attractiveness as an investment destination.

According to Walid Hejazi of the Rotman School of Management, "The pace at which Canadian multinationals have expanded globally has far exceeded the pace at which foreign multinationals have expanded in Canada. Since 1997, Canada has had more Canadian direct investment abroad (CDIA) than there was foreign direct investment (FDI) in Canada."[1] According to various measures of openness to foreign investments, Canada does not rank favourably against many of its peers.[2]

The critical role of Foreign Direct Investment
Studies have repeatedly documented that business innovation in Canada lags behind other developed countries.[3] If Canada aims to increase its lagging productivity levels, significant new foreign capital will be required. Positive outcomes of FDI include a higher standard of living, higher levels of employment, higher paying jobs, more innovation, access to larger and more diverse markets, and increased levels of trade. Indeed, strong trading relationships provide exposure to the Canadian market for foreign investors and provide a critical entry point for FDI. Federal, provincial and territorial governments must carefully consider the policy decisions required to position Canada as the preferred destination to locate economic activity, and benchmark our attractiveness in this regard across sectors.

Putting our citizens first
In the current era of globalization, Canada needs to move past its existing economic structure, centred on the supply of raw product, into higher value added industrial and service sectors. This will require significant investment. It matters less where the money comes from than what is done with it. The critical metric is the country's ability to ensure that the operations of both foreign and domestic firms equally obey our laws and meet our standards and policy goals.

In negotiations relating to the Canada – EU trade agreement (CETA) and the Trans Pacific Partnership (TPP) agreement wording relating to foreign investments is along these lines; "Each Party shall accord to investors of the other Party and to covered investments, treatment no less favourable than the treatment it accords, in like situations to its own investors and to their investments with respect to the establishment, acquisition, expansion, conduct, operation, management, maintenance, use, enjoyment and sale or disposal of their investments in its territory."

Canada's foreign investment review framework:
Under the *Investment Canada Act*, before any foreign investment over a certain threshold is approved Canada imposes a test of its 'net benefit' to Canada. For private sector investments, the threshold is $600 million (based

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[1] https://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/vwapj/Hejazi.pdf/$FILE/Hejazi.pdf
[2] https://www.cdhowe.org/pdf/commentary_337.pdf
[3] http://www.ceocouncil.ca/wp-content/uploads/2015/02/Boothe-paper-March-2015-FINAL.pdf

on enterprise value[4]), while for state-owned enterprise investments the number is $375 million (based on asset value). The public position of the previous conservative government also limited approval of majority ownership of oil sands businesses by state owned enterprises – a large and growing source of global investment capital – to an "exceptional" basis only.[5]

To determine an investment's 'net benefit', the government looks to potential effects on employment, exports and productivity. The onus is on prospective investors to demonstrate how their investment would be of net benefit to Canada, but there is a lack of transparency in how government makes its determination. This arbitrary discrimination between foreign and Canadian investors discourages the development of foreign investment proposals, and creates extra costs and uncertainty if an investor does submit such a proposal for approval.

In 2007, in response to a growing national debate over foreign takeovers, the federal government established the Competition Policy Review Panel. Its mandate included a review of Canadian foreign investment policies with the goal of making Canada more competitive in an increasingly global marketplace. Some of its key recommendations included:

- Amending the *Investment Canada Act* to reduce barriers to foreign investment by increasing review thresholds; reversing the onus to require the government to demonstrate that an investment would be contrary to the national interest before disallowing a transaction; increasing transparency and predictability; and preserving a distinct approach for the cultural sector while also initiating a broad review of Canada's cultural policies;
- Liberalizing investment restrictions in the Canadian air transport, uranium mining, and telecommunications and broadcasting sectors, and removing the *de facto* ban on mergers in the financial services sector;
- Updating and modernizing the *Competition Act* in line with best practices internationally;
- Creating a Canadian Competitiveness Council to give voice to and advocate for competition in Canada, and ensure sustained attention by governments on national competitiveness.

Accelerated Capital Cost Allowance:
The Accelerated Capital Cost Allowance (ACCA) has been a successful feature of mining sector taxation in Canada for decades and more recently has encouraged investments in the manufacturing sector. Now more than ever, ACCA needs to be broadened and applied to all sectors as a key component of a strategy to attract new foreign investment in any capital intensive project regardless of industry. Capital cost allowance rules specify the rate at which capital assets can be expensed annually. ACCA allows the normal costs of capital to be deducted as fast as income from the project will allow rather than deferring the deductions over time. As corporations recover their initial investments sooner, ACCA reduces the investment risk associated with the mine or project, thus improving the overall economics of the project.

Recommendations
That the federal government:
1. Implement the recommendation of the 2008 federal Competition Policy Review Panel to improve Canada's competitiveness by reversing the onus to require the government to demonstrate that an investment would be contrary to the national interest before disallowing a transaction, as opposed to subjecting the foreign investor to the sometimes onerous task of having to demonstrate that the investment represents a net benefit to Canada as a condition of approval.[6]

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[4] Enterprise value is calculated as the market capitalization plus debt, minority interest and preferred shares, minus total cash and cash equivalents.
[5] https://www.osler.com/en/resources/cross-border/2012/new-rules-for-foreign-investment-by-state-owned-en
[6] http://www.ic.gc.ca/eic/site/cprp-gepmc.nsf/eng/home

2. Amend the *Income Tax Regulations* to provide generalized accelerated capital cost allowance (ACCA) treatment rather than targeting specific industries.
3. Work with provincial and territorial governments to:
   a. Pursue a more targeted and aggressive global trade policy and market development strategy, developed in partnership with the business community, to secure access for Canada's goods and services and secure a greater share of global foreign direct investment, which would stimulate economic growth, create jobs, and increase revenues for government.
   b. Identify the barriers to foreign direct investment in Canada and work to address them; and,
   c. Promote Canada as a destination for foreign investment by highlighting our competitive advantages, including an educated workforce, reliable legal system, and strong international transportation networks;
   d. Inform the Canadian public on the critical importance and value of foreign direct investment to Canada's economy, including investment by State-Owned Enterprises.