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Foreign Direct Investment in Canada – The Case for Further Openness and Transparency

by
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- Canada is seeking to attract foreign direct investment (FDI) to boost its economic competitiveness. At the same time, its performance in attracting FDI has been lackluster of late, both in historical terms and relative to competitors.
- In the 10 years since the Competition Policy Review Panel issued its report, Canada has liberalized its limits and made more transparent regulations that apply to foreign investments, while introducing a new mechanism for reviewing proposed foreign investments on national security grounds. Yet, it retains significant barriers to foreign investments in the form of screening mechanisms for foreign acquisitions above a certain threshold that require the investor to show a "net benefit" to Canada, and restrictions on equity investment in Canadian sectors or companies. These restrictions, for the most part, are not needed to preserve Canada's room to maneuver to achieve any policy goal it wishes, yet they deprive Canada from the potential benefits of additional FDI.
- I therefore recommend that Canada's remaining restrictions on share ownership in an industry or company be eliminated, retaining only those that are demonstrably necessary to preserve governments' ability to achieve clearly articulated public policy objectives, such as national security, fair competition, the promotion of Canadian content, or protection of the public. As well, Canada's "net benefit" test for investments above a certain threshold should be eliminated: Canada should certainly be able to reject proposed investments on the clear and principled grounds just mentioned, but the onus should be on the government to explain why a particular proposed investment is not in the national interest.

Canada is in a quest to attract more foreign direct investment (FDI).[1] In this, it faces serious economic headwinds. Yet, as we will see, it continues to maintain statutory provisions that often are significantly more restrictive toward FDI than those of its main competitors. I propose in this E-Brief that Canada continue on the road toward a more visibly open FDI regime, which it has by and large followed since the publication of the seminal 2008 report of the Competition Policy

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1 In March 2018, the Government of Canada launched "Invest in Canada," a federal organization promoting Canada to global investors and entrepreneurs and providing a single-window service to those interested in accessing opportunities in Canada.

Review Panel, chaired by L. R. Wilson (Canada 2008). I argue that this can be done while also retaining tools that can fully address any economic, cultural, or security concern posed by any particular proposed foreign investment.

Specifically, I propose, following the Wilson report's recommendations, that Canada replace its "net benefit" test, under which foreign investors seeking to acquire Canadian companies exceeding a certain value threshold must demonstrate net benefits to Canada, with a new framework. That framework would put the onus on the federal government to explain why it should reject any proposed FDI. In parallel, I recommend that Canadian governments remove any ownership limit in specific sectors or firms that could limit FDI, unless such restrictions can be shown to be the least burdensome way of achieving a broad policy purpose, such as ensuring Canada's economic or financial stability, its cultural vitality, or its national security.

Rationale for Welcoming Foreign Direct Investment

Foreign direct investment is defined as investment by a person or entity domiciled in one country ("the investor"), in a business domiciled in another country ("the investment"), in which the former has significant influence on the management of the latter. Statistics Canada, along with other statistical agencies, uses a threshold of 10 percent or more of voting equity in the target firm to determine whether the investor has significant influence, at which point the investment is classified as a direct rather than a portfolio investment.[2] FDI includes both equity and debt held by the investor in the enterprise (Statistics Canada 2017).

The importance of inward FDI relative to the size of a country's economy can be considered an indicator of how attractive an economy's prospects are, or how well operations on its territory complement the foreign investor's international operations, since the investor deems it worth the risk inherent in financing, owning and operating a business in a foreign country.

In turn, and by and large, inward FDI helps an economy make the best of its comparative advantages through more active participation in the global economy. Typically, for example, foreign-controlled manufacturing establishments in Canada will pay their employees significantly more than Canadian-controlled ones, since integration across borders makes them more productive (Statistics Canada 2011). The same is true of outward FDI – Canadian companies that own operations abroad do so because they cannot be as productive or expand as desired by remaining in Canada. Their foreign operations complement and make their Canadian operations more globally competitive (Rai, Suchanek and Bernier 2018), including through the work done in Canadian head offices.

This is not to say that FDI always and everywhere represents the best possible world for the receiving, or host, economy. Sometimes, firms will choose to produce in a foreign market via FDI, rather than trading across an international border, when trade barriers make the latter impractical. In that case, FDI may not be the most efficient way for the host economy, or the home economy of the investor for that matter, to benefit from integration with the global economy. And, seemingly without exceptions, governments prefer domestically owned multinational corporations, in which ultimate decisions are perceived to be made by those more likely to help

2 Note, however, that for policy purposes, governments, including the Canadian government when applying the *Investment Canada Act* and other relevant acts, will typically go beyond these statistical definitions and base their policies on who has ultimate control of an investment, regardless of where the entity is incorporated or established.

keep "good jobs" in the country, since, for example, they could be more aware of the country's advantages. Governments might also hope for a more direct line of engagement with the domestically owned firm than would be the case with foreign owners.

Regardless of this perception of the greater benefits of domestically owned versus foreign-owned multinationals,[3] it is hard to see why in a country like Canada, foreign ownership would constitute an impediment to growing successful domestic businesses.[4] That might be the case if for some reason the playing field – laws and regulations under which businesses must operate – was tilted in favour of a foreign-owned business, for example, in countries with corrupt governments. Other problems that compromise the domestic business environment can arise if the foreign investor acts in bad faith or seeks to politically favour its home country over its host country, or engages in anti-competitive behaviour, or is a threat to its host country's security. But absent such concerns, or assuming there are mechanisms to deal with them, restrictions that prevent Canadians from selling their businesses to whomever they might wish are unlikely to entice them to grow their businesses in Canada.

Canada also remains dependent on foreign capital to sustain growth in its standard of living.[5] As a net importer of capital, Canada can choose to incur debts and pay fixed interest on them regardless of the ups and downs in the economy. Or it can welcome foreign investors who want to take a long-term, patient stake in Canada's economy, one that will pay its foreign owners dividends commensurate with the success of their Canadian business. In turn, that success typically entails generating domestic employment, opportunities for Canadian suppliers, and taxes to pay for Canadian public services.

Even if the country did not have a current account deficit, domestic investment often cannot easily replace the specific know-how, technology and connections to foreign markets that a given foreign investor could bring to a particular company.[6]

In short, removing unnecessary barriers to FDI is a good policy direction for Canada.

Canada's Position and Prospects as a Destination for Foreign Direct Investment

Canada's share of the global stock of FDI has been on a generally downward trend over the past three decades or so (see Figure 1), save for a remarkable spike in inflows in 2000 due to major mergers involving Canadian

3 A perception often based on the assumption that key operations and headquarters of a Canadian company will expand or at least remain in Canada once it starts growing markets or merging with companies beyond Canada. But there are many examples showing that this is not necessarily the case.

4 Safarian (2011, especially Chapter 9 "Nationality of Ownership and Performance of the Firm") has reviewed in detail these concerns and concludes that they are not inherent features of FDI, which does not mean that governments should not guard against them.

5 Since the global financial and economic crisis of 2008, Canada has run deficits to its current account – receipts from abroad minus payments to entities abroad – of about 3 percent of GDP, and so requires net inward capital flows of the same size to finance them.

6 From that perspective, there is no distinction between an acquisition of an existing Canadian business by a foreign investor, and the starting of a new or "greenfield" business in Canada by a foreign investor. Certainly, the latter entails fresh fixed capital spending and new jobs in Canada, just as if a new or existing Canadian business expanded their activities in Canada. But acquisitions of existing Canadian businesses by foreigners also constitute a net infusion of productive, long-term capital in the Canadian economy from abroad, with Canadian owners free to reinvest the proceeds as they wish.

and foreign companies.[7] Many transactions that year involved Canadian and foreign shareholders taking share ownership in each other's businesses, and indeed Canada's outward FDI also shot up by a commensurate amount.

The downward trend since then is not surprising: a number of emerging economies and others transitioning away from planned economies, have since 1990, and particularly since the recovery from the 1997-98 Asian financial crisis, opened up and attracted an increasing share of the world's investments. By one measure, Canada has held its own despite this changing environment. Canada's share of global inward FDI stocks has remained well above its 2 percent or so share of global GDP.

But net flows of FDI into Canada are showing a worrisome trend, dropping sharply as a share of world FDI since 2014 and even, in 2017, falling behind net FDI flows into Australia, a smaller resource-based economy, and those into Mexico, another country affected by NAFTA uncertainty (see Figure 2). Furthermore, quarterly data show that FDI flows into Canada have shrunk markedly, while Canadian investors seem to find increasing opportunities outside of Canada (see Figure 3).

Global factors, such as the 2014-2015 collapse in oil prices,[8] feature prominently behind this decline, but oil and gas capital spending figures for 2017 suggest that Canada is falling behind its competitors in this area of traditional Canadian comparative advantage even at a time of relative stability in oil prices (Canadian Association of Petroleum Producers 2018).

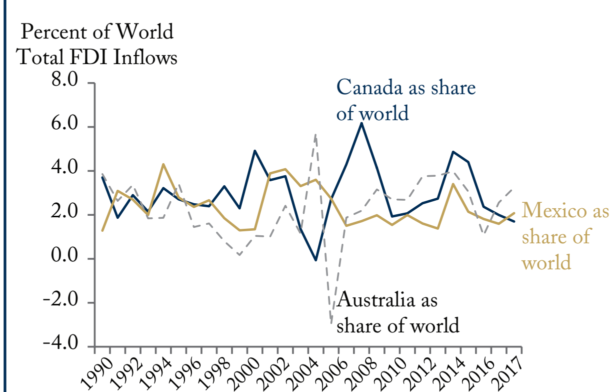
Uncertainty over the fate of NAFTA and access to the US market – and recently enacted US corporate tax reform – are weighing on otherwise strong

Figure 1: Share of World Total Inward FDI Stock, Going to Canada

Note: Canadian FDI stock is valued at constant 1992 USD/CAD exchange rate.

Source: UNCTAD, World Investment Report 2018, Annex Table 3 and Statistics Canada, Foreign Exchange Rates in Canada Dollars, Bank of Canada, daily.

Figure 2: Share of World Total FDI Inflows, by Country



Source: UNCTAD, World Investment Report 2018, Annex Table 1.

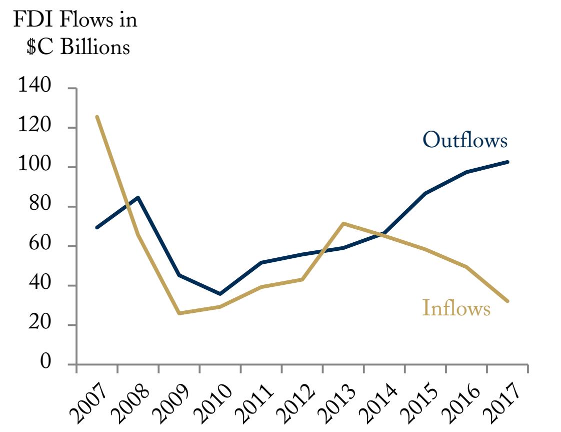
7 Such as, notably, the $50 billion merger between Seagram and Vivendi.

8 And perhaps also a stricture against foreign state-owned enterprises investing in Canada's oil sands, introduced in December 2012.

investment intentions in Canada generally for 2018 (Reuters 2018, citing Bank of Canada).[9]

There are a number of ways Canada could respond to this weakness, using tools entirely within its control, such as reforming its corporate tax regime to make fixed capital investment[10] more attractive and foster company growth in Canada (Boadway and Tremblay 2016). Canada could address costly regulatory delays affecting its oil and gas sector (Dachis 2018a) or, for that matter, address the high cost of key business inputs such as electricity in Ontario (Dachis 2018b). In short, it could respond by making Canada a location more conducive to capital spending by both domestic and foreign firms.

Figure 3: Total Canadian Inward and Outward Flows of Foreign Direct Investment



Source: Statistics Canada, Balance of International Payments, Flows of Canadian Direct Investment Abroad and Foreign.

Apart from these domestic policy factors that can make investing in Canada more or less attractive, an obvious avenue would be to specifically address the restrictions that exist against foreign direct investments. That is, in an environment in which we have recently struggled to attract FDI, and in which governments seem to be avidly seeking investors into Canada, we should also take a fresh look at the rationale behind policies that result in Canada refusing to accept some FDI outright.

One widely cited measure of the extent of barriers to FDI in any one country is the OECD's FDI restrictiveness index. The OECD compiles this index for 22 economic sectors, assessing for each: (1) the level of foreign equity ownership permitted; (2) screening and approval procedures applied to inward foreign direct investment; (3) restrictions on key foreign personnel; and (4) other restrictions such as on land ownership, corporate organization (e.g., branching) that specifically discriminate against foreign investors (OECD 2015).[11]

Canada ranks very low in terms of openness on this index relative to other countries (see Table 1). In turn, Canada's low ranking is mainly due to its scores for continued foreign equity restrictions across a number of sectors, and its screening and approval procedures for FDI.

9 Having said this, as the charts do show, FDI is volatile. Indeed, data for the first quarter of 2018 reverse recent trends, with inward FDI exceeding outward FDI for the first time since the third quarter of 2015. Further, senior global executives surveyed by management consultant A.T. Kearney in January 2018 report a stronger likelihood of making a direct investment in Canada over the next three years than in any other of 25 economies, except for the United States (A.T. Kearney 2018). However, these encouraging signs predate the US tariffs on Canadian steel and aluminum, as well as threatened tariffs on autos and uranium.

10 Fixed capital investment includes machinery and equipment, buildings and engineering structures, and intellectual property.

11 The overall FDI restrictiveness index is the total of the scores for each major type of barrier, adding up potentially to an overall FDI restrictiveness of 1, representing the maximum discriminatory barriers against FDI. In turn, the index for each major type of barrier is comprised of sub-indicators representing specific barriers, e.g., compulsory review for investments over a certain threshold. See Kalinova et al. (2010) for the detailed methodology.

To the credit of successive Canadian governments, Canada is generally more open to FDI than it was 10 years ago, when the seminal Wilson report, "Compete to Win," made a number of recommendations in that direction (see Box 1). The basis for the report's recommendations was the need it identified to remove barriers to competition, including foreign competition, in the interest of increasing Canada's economic productivity.

Unfortunately, while these initiatives have contributed to an improvement in Canada's score on the OECD's FDI restrictiveness index, Canada was so far behind most other countries that its ranking has not improved in recent years (Table 1).

Box 1: Key Changes to Canada's Foreign Direct Investment Policies Since the Wilson Repot

In 2008, the Competition Policy Review Panel, established by the Government of Canada and chaired by L.R. Wilson, released a report ("Compete to Win," also known as the Wilson Report) that examined various areas critical to Canada's economic success, including restrictions on foreign direct investment (FDI) in Canada under the *Investment Canada Act* (Canada 2008). The Panel was established specifically at the height of concerns about the "hollowing out" of well-known Canadian resource companies, following their takeover by foreign-owned competitors (Boothe 2015), which had been approved by the government under the "net benefit" test.

The Panel made a number of specific recommendations regarding FDI policy and the operations of the *Investment Canada Act* (ICA): raising the mandatory review threshold under the ICA from $295M of the gross assets to $1B of the enterprise value of the Canadian business whose control is being acquired (enterprise value being more closely related to the purchase price and more suitable for the valuation of tech companies, for example); Remove the mandatory notification of an inward FDI if it was below the threshold for review; changing the test that must be met during the review process from one requiring the investor to show "net benefits" to the Canadian economy to one where the government must demonstrate, if it rejects an investment, that it would have been contrary to the national interest if it had been permitted; and in general recommending much more transparency regarding reasons for which foreign investments can be turned down. The Panel also recommended a review of the ICA every five years, in order to ensure the restrictions have a minimal impact on competition in tune with continuously evolving economic circumstances.

The Panel also issued recommendations in the general direction of lowering the existing restrictions on foreign equity ownership in a number of sectors, focusing on air transportation, uranium mining, telecommunications and broadcasting, and financial services. For Canada to stay competitive in these highly regulated sectors, it made recommendations to increase the limits on foreign ownership to 49 percent in air transportation; to eventually broadly liberalize ownership of telecommunications and broadcasting companies after a transition period in which foreign-owned companies could occupy a market share of up to 10 percent; and, while maintaining the "widely held" rule limiting any one holder to 20 percent of voting shares (or 30 percent of non-voting shares) of large financial institutions, to implement a more permissive policy regarding mergers among them. The panel recommended that these restrictions be reviewed every five years also, and that the very low review threshold of $5M applying to financial services, transportation services (including pipelines), and uranium mining, be dropped. Finally, the panel anticipated the introduction of a new mechanism of reviewing investments where national security concerns may exist.

Box 1: continued

Since the report's publication, the Canadian government:

- Gradually raised the threshold for mandatory review across all sectors to reach $1B in 2017 for investors from other WTO members, except for state-owned enterprises for which review is triggered at a lower threshold, and changed the basis for measuring the threshold to the enterprise value.
- Following the Comprehensive Economic and Trade Agreement with the EU, which came into force in September 2017, further raised the threshold to $1.5B for all inward investments from countries with which Canada shares a free trade agreement that contains a most-favoured nation provision (this will include the CPTPP once it is in force).
- Eliminated the special thresholds for reviewing investments in transportation industries, non-regulated financial services and uranium mining (a special threshold and distinct notification requirements remain for cultural businesses).
- Removed the foreign ownership limit for telecommunications carriers with a 10 percent market share or less, liberalized non-resident ownership of uranium properties under certain trade agreements, and raised the limit on foreign ownership in air transportation to 49 percent.
- Has begun reporting annually to Parliament regarding the operations of the *Investment Canada Act*, now reports publicly on any disallowed transaction, and has published guidelines on the operations of the *Act*, including guidelines on how it applies to state-owned or state-influenced enterprises.
- The government also introduced a provision for national security reviews, with no limitation on the size of the proposed investment that may be scrutinized on those grounds.

Other key recommendations from the Panel have not been implemented, however. The government did not:

- Change the test for passing the review from one of "net benefit" that must be shown by the investor, to one of "contrary to the national interest" which would have to be argued by the government.
- Remove the mandatory notification of an inward FDI if it was below the threshold for review.
- Remove most restrictions on foreign ownership in telecommunications and broadcasting.

This can hurt Canada's reputation as a destination for investment.[12] Even in some sectors such as food, oil, metals and machinery, electronics, construction, wholesale, retail, architectural and engineering services, in which Canada's FDI restrictiveness index may appear low at under .1 (mostly due to the screening process for large investments), most other countries register zero – completely open – on the index.

12 Coppel (2013, 7) notes that "a significant number of international investors and policy makers decisions rely on indicators of the investment climate for analytical and decision-making purposes." Clearly, there is a wide list of factors affecting the receptivity to FDI and attractiveness of any country from an investors' standpoint (See, e.g., Coppel 2013, Box 1), but the OECD index is negatively correlated with the presence of FDI across countries surveyed by the OECD (See, e.g. Kalinova et al. p.7).

Table 1: Ranking of OECD Countries by Openness to Foreign Direct Investment

2017 Ranking	Country	2017 Index	2010 Index
1	Luxembourg	0.004	0.004
2	Portugal	0.007	0.007
3	Slovenia	0.007	0.007
4	Czech Republic	0.010	0.012
5	Netherlands	0.015	0.015
6	Estonia	0.018	0.031
7	Finland	0.019	0.019
8	Latvia	0.021	0.022
9	Spain	0.021	0.021
10	Germany	0.023	0.023
11	Hungary	0.029	0.029
12	Greece	0.032	0.032
13	Denmark	0.033	0.033
14	Belgium	0.040	0.040
15	United Kingdom	0.040	0.040
16	Ireland	0.043	0.043
17	France	0.045	0.045
18	Slovak Republic	0.049	0.049
19	Italy	0.052	0.052
20	Japan	0.052	0.052
21	Chile	0.057	0.057
22	Sweden	0.059	0.059
23	Turkey	0.059	0.082
24	Poland	0.072	0.072
25	Switzerland	0.083	0.083
26	Norway	0.085	0.085
27	United States	0.089	0.089
28	Austria	0.106	0.106
29	Israel	0.118	0.118
30	Korea	0.135	0.143
31	Australia	0.147	0.128
32	**Canada**	**0.162**	**0.175**
33	Iceland	0.167	0.167
34	Mexico	0.188	0.211
35	New Zealand	0.231	0.240
Memo: Non-OECD economies for comparison			
	Argentina	0.031	0.025
	South Africa	0.055	0.055
	Brazil	0.092	0.098
	Russia	0.182	0.174
	China	0.316	0.427

Note: Index of zero equals minimum restrictiveness and one equals maximum restrictiveness.

Source: OECD FDI Regulatory Restrictiveness Index, updated May 04 2018.

Table 2: FDI Restrictiveness Index by Type of Restriction, Canada Compared to Select Countries, 2017

	Total Restrictions	Equity Restriction	Screening & Approval	Key Foreign Personnel	Other Restrictions
Canada (absolute value)	**0.162**	**0.073**	**0.071**	**0.013**	**0.005**
Difference between Canada and:					
Australia	0.015	0.051	-0.048	0.012	0.001
Chile	0.105	0.028	0.071	0.003	0.002
Denmark	0.129	0.043	0.071	0.013	0.002
Finland	0.143	0.065	0.071	0.013	-0.005
France	0.117	0.046	0.071	0.008	-0.007
Germany	0.139	0.056	0.071	0.013	-0.001
Ireland	0.119	0.038	0.071	0.013	-0.003
Israel	0.044	0.011	0.053	0.007	-0.027
Italy	0.110	0.027	0.071	0.011	0.001
Japan	0.110	0.048	0.062	0.005	-0.006
Korea	0.027	-0.056	0.071	0.012	0.000
Mexico	-0.026	0.011	-0.029	0.013	-0.021
Netherlands	0.147	0.059	0.071	0.013	0.003
New Zealand	-0.069	0.038	-0.119	0.013	0.000
Norway	0.077	-0.001	0.071	0.007	0.000
Spain	0.141	0.052	0.071	0.013	0.005
Sweden	0.103	0.045	0.044	0.013	0.002
Switzerland	0.079	0.011	0.062	0.013	-0.006
United Kingdom	0.122	0.037	0.071	0.013	0.002
United States	0.073	0.007	0.066	0.003	-0.006
Argentina	0.131	0.048	0.071	0.013	-0.002
Brazil	0.061	0.045	0.052	0.008	-0.044
China	-0.154	-0.135	0.007	-0.035	0.000
Russia	-0.020	-0.025	0.055	0.003	-0.052
South Africa	0.107	0.037	0.071	0.011	-0.013

Note: A positive difference means Canada's restrictions are higher.

Source: OECD FDI Regulatory Restrictiveness Index, updated May 04 2018 and C.D. Howe calculations.

Of the four main types of restrictions on FDI recorded by the OECD, "equity restrictions" and "screening" are the two that cause most of the gap in FDI between Canada and comparator countries (Table 2). Restrictions on key foreign personnel and "other restrictions" are distant third and fourth contributing factors, for which Canada's scores are well within the OECD norm. As a result, the rest of the discussion will focus on the first two types of restrictions.

Equity Ownership Restrictions

Restrictions on FDI entry into a country typically result in a lower stock of FDI in that country than would otherwise be the case, and specifically have a negative impact on capital investments by firms operating in infrastructure sectors such as communications and transportation (OECD 2015, 2-3).[13] For this reason, policymakers would be wise to periodically review the rules that inhibit, or forbid altogether, foreign investment in specific sectors.

Notably, as Canada is seeking to foster investment in infrastructure writ large, including in the energy, transportation and communications networks that underlie its entire economy, it needs to open its doors to investments by institutional and other long-term, patient investors, because infrastructure investment is uniquely suited to these types of investors (Dachis 2017).

Canada's sector-specific restrictions on FDI are in general more extensive than those of other countries (see Table 2).[14] In most sectors, Canada's barriers are surpassed only by those of New Zealand, Mexico, China and Russia.[15] Particularly high restrictions exist in fixed and mobile telecoms, fisheries, air, radio and TV broadcasting (under review at the time of writing), and other media sectors. In fixed and mobile telecoms and other media, for example, Canada is more restrictive than all of its key competitors, except for China, according to the OECD.

As well, Canada maintains sector-specific and even company-specific barriers that prevent any investor, including foreign investors, from achieving majority ownership in certain companies.[16]

In some cases, such as banking, these restrictions on ownership have a well-established rationale – the prevention of self-dealing that would be contrary to the public interest, indeed potentially destabilizing for the financial system. They apply to all large banks in Canada, regardless of the nationality of shareholders. In other sectors such as electric utilities or rail, these types of restrictions on share ownership cover only certain companies (Hydro One and Canadian National Railway (CN)), even when, as in the case of CN, investment in comparable and direct competitors are not subject to such restrictions – meaning in effect that there is no policy rationale for the restriction. In contrast, comparator countries such as the UK, the US, France, Germany or Spain do not have similar ownership rules in place for rail (though in France and Germany the ownership of the largest railways is public). CN used to be owned by the federal government, and ownership restrictions on newly privatized companies are not infrequent as a way to help policymakers and management transition from a public to a private ownership structure. But other jurisdictions such as the EU have looked askance at the economic distortions arising from maintaining such restrictions over time (Driver 2013).

As mentioned, the trend in Canada has been toward liberalization. Since 2010, Canada has experienced a decrease in restrictions (of all types) in 23 of 30 economic sectors surveyed by the OECD, leaving the other five sectors without any improvement, three of which had relatively low FDI indexes to begin with (real estate,

13 See also Coppel 2013, Figure 4 showing the negative correlation between equity restrictions applying to foreign investors and the level of FDI in a given country.

14 Having said this, in agriculture, maritime transportation, insurance, and real estate investment, Canada is less restrictive with respect to FDI than 12 countries, 16 countries, 10 countries, and 13 countries, respectively.

15 However, in some other sectors Canada's barriers are lower than those in economies that are otherwise ranked as more generally open; namely Japan and the United States (in air transportation), or Chile and the United States (in fisheries).

16 These are not taken into account in the OECD FDI restrictiveness index because they are not barriers specifically against foreign investors. But they do restrict FDI.

agriculture and forestry). And Canada has recently raised its ownership limit in CN by any individual owner to 25 percent from 15 percent.

Yet, it is extremely difficult to justify most sectoral limits (unlike those applying to banking, for example) on any policy grounds: it has not been proven, for example, that the availability of Canadian content is better served by restrictions on foreign ownership in the cultural businesses, nor in fact is there a logical link between the two. Rather, the experience of other countries shows that in the cultural sectors, foreign capital can be beneficial, as long as competition is maintained, taxation neutral with respect to the mode of delivery, and space and support for Canadian content is maintained (Dachis and Schwanen 2016).

A similar test of fact and logic should apply to any sectoral (or even more so, company-specific) investment restrictions: is the restriction the least costly way to achieve broad, public policy objectives such as fair competition, or security and safety? If not, it should be removed.

Screening

Screening and approval mechanisms that apply to foreign investors fall close behind foreign equity limitations as the most significant reason for Canada's poor ranking on the OECD index. Canada's screening and approval barriers are more restrictive than 23 of the 26 countries we list in Table 2, with only Mexico, Australia and New Zealand being more restrictive. Furthermore, 14 of those 23 countries are registering zero for this sub-index, meaning that they have no formal mechanism for screening inbound FDI, other than for reasons of national security, which are not counted as a barrier under the OECD index.

The implicit assumption in these other countries' formal policies toward FDI is that it is welcome by default (except for sectors where FDI is formally restricted or for national security reasons), whereas formal restrictions, screening and tests in Canada for proposed acquisitions over a certain threshold assume that such investments are not necessarily advantageous for the country, and require the investor to show that they are.

Does this mean other countries do not have the tools to restrict foreign (or any) investment they would see as detrimental to their economy or security? Of course not. As noted in the Wilson report (pp. 29-30), most other countries' screening processes are simply not as up front as Canada's, not to mention the expansive ambit that can be given to the definition of "national security."

As described in Box 1, Canada's threshold for compulsory review of FDI other than by state-owned enterprises has increased, such that fewer proposed takeovers have to comply with the net benefit test (Rodal, Shuli et al. 2017). But, past a certain low level, the OECD index is not sensitive to further increases in the threshold, so Canada does not benefit from these recent moves in terms of its position on the index. For that matter, the OECD index is not sensitive at all to considerations of transparency and effectiveness in the application of any screening mechanism, so Canada's greater transparency over time (as had been recommended in the Wilson report), through the use of publicly available guidance documents, has also not benefited Canada in terms of this ranking.

There is no strong agreement about the actual economic costs of Canada's screening mechanism, but to the extent foreign investors must go through hoops and make commitments over and above those required of Canadian investors, or even to the extent that a state-owned company is scrutinized for anything other than the likelihood it would act on politically motivated, instead of commercially motivated considerations, Canada's screening mechanism imposes a cost to investors over and above the intrinsic value of the investment, and as a result risks deterring beneficial investments. (These arguments are developed in detail in Globerman 2015, Safarian 2015, Schwanen 2012 for the case of state-owned enterprises, and Bergevin and Schwanen 2011).

The "net benefits" for which Canada is screening are to some extent illusory. Undertakings that investors make to pass the test are by their nature temporary (3-5 years is the norm), since investors would be reluctant to invest otherwise. While governments seeking some assurance that a foreign investor would act as a good corporate citizen is reasonable (though presumably these considerations would be on the mind of the board of the willing Canadian seller), some other aspects of the undertakings required to obtain approval for investments over the review threshold (detailed in Facey and Krane 2017, 64-78) evoke, according to one expert (cited in Safarian 2015, footnote 14), a "shakedown culture" of seeking more from the foreign investor than would be expected from a Canadian or from the company being acquired itself.

Canada should therefore do away with the compulsory test and the threshold above which it applies, leaving the onus on government to reject any investment on clear, principled grounds, such as threats to national security, deleterious effects on competition or on fiscal and financial stability, or constraints to governments' regulatory room to maneuver, which would be contrary to the national interest.

Conclusion and Recommendations

Canada has both liberalized its policies toward FDI since the publication of the Wilson report, and refined them with respect to situations not covered by the report's specific recommendations; namely investments by foreign state-owned and influenced enterprises, and investments that may be injurious to national security (though the latter was anticipated in the report, for example in the discussion on relaxing uranium foreign ownership limits).

Even though in many cases Canada has reduced the gap in restrictiveness between it and other countries, this improvement has not been sufficient to improve Canada's overall ranking on the OECD's FDI restrictiveness score. This lack of improvement is no doubt due in large part to limitations in the index itself. But, it exposes Canada to a reputational risk. More fundamentally, it raises questions about the purpose of maintaining barriers to FDI, at a time when Canada's share of global foreign direct investment has been on a noticeable downward trend and has recently been buffeted by severe negative economic and political forces; this, while the Canadian government is openly seeking to attract FDI.

Canada can help itself by taking another critical look at policies that constrain FDI. It should in this respect continue to build on the thrust of the 2008 Wilson report, taking due account of developments in the global economy and of specific concerns that have emerged since then.

Any remaining barrier to foreign direct investment should rest on a principled, fact-based and transparent rationale, pertaining to the barrier being necessary for the government of Canada or provincial governments to achieve legitimate policy goals, including of course that of ensuring Canada's national security. Issues that may be raised in the context of certain types of investments should, where practicable, be addressed with other tools than those restricting the investment.

Thus, we recommend that:[17]

- Canada replace its net benefit test, by which prospective investors have to demonstrate net benefit to Canada, by a requirement that the government demonstrate that a prospective investment is contrary to the national interest if it wants to block it.

17 Analytical basis for recommendations along the same lines can further be explored in Bergevin and Schwanen (2011), Schwanen (2012) and Safarian (2015).

- Canada remove remaining restrictions on equity ownership of private enterprises, unless officials similarly demonstrate that lifting the restriction would be contrary to the national interest.
- As discussed above, the "contrary to national interest" demonstration would be based on the likely negative impact of any foreign investment (including by state-owned enterprises) on factors such as national security, competition, fiscal or financial stability, or ability of the government to regulate in matters ranging from safety and the environment to supporting Canadian content. It should thus encompass any issues with the investors' ownership or background that could suggest its unwillingness or inability to comply with Canadian laws or policies, or follow a commercial orientation.In the case of hostile takeovers of large Canadian companies, the government could require that the foreign acquirer includes with its FDI notification a statement of its intentions concerning continuity of business with competitive Canadian suppliers and of engagement with Canadian communities, as well as the target investment's senior management levels in Canada, compared to what might be expected of the current Canadian owner in the near term, giving it the ability to conclude that these intention are "contrary to the national interest" if they were to negatively affect certain industries or communities.
- In those cases where it refuses an investment, the Canadian government would explain clearly, to the extent allowed by commercial or security confidentiality requirements, the grounds on which it refuses the investment, providing clarity and guidance to Canadian and foreign investors alike.
- Investors could assume that they are automatically allowed to proceed with their proposed transaction if they have not heard otherwise within a short period, although that period could be longer for large investments, or investments in cultural businesses, or by state-owned enterprises.
- As proposed in the Wilson report, remaining restrictions to FDI be reviewed every five years to ensure their impact on competition is minimal.

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