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New Foreign Investment Policy

by Ronald Holloway, Toronto

The US accounts for about 75 p.c. of foreign direct investment in Canadian manufacturing. The structure of hitherto existing foreign investment has caused concern about negative effects on the economy. By a series of measures the Canadian administration tries to give foreign investment a form, that suits better the country's interests.

Canada offers a wide range of opportunities for foreign industrialists seeking a location with abundant natural resources, a rapidly growing and highly skilled labour force, well developed financial institutions, a large and prosperous market, and a basic commitment to constitutional government and free enterprise.

The gross national product (GNP) grew by 5.4 p.c. last year in real terms, slightly exceeding the average annual rate of growth over the past decade. 1972 GNP is likely to exceed US\$ 100,000 mn. Price performance has been relatively good.

Abundance of Resources

The population of 22 mn constitutes an ethnic mosaic, though mainly of North European descent, and there are few and rapidly eroding class distinctions. The labour force of 9 mn is growing at an annual rate of 3 p.c. — the fastest in any industrialized country — and this labour force is both relatively young and well educated — nearly half are under the age of 35 and two-thirds are under the age of 45 while one child in three can expect to proceed to post-secondary education. Unemployment, however, is high, averaging 6.4 p.c. last year, and Canada has a bad and worsening record for industrial disputes.

Although more than half the labour force is employed in the rapidly growing service sector, Canada's high standard of living is largely due to the wide range of manufacturing industries which employ nearly 2 mn and account for more than half the value added in goods production.

Expenditure on new construction and on new machinery and equipment for manufacturing is thought to have exceeded \$ 3,000 mn last year. Of this, over \$ 500 mn was for paper and allied manufacturing, nearly \$ 500 mn for primary metal production, about \$ 300 mn for food and beverage

processing, over \$ 250 mn for petroleum refining and petrochemicals, and about \$ 225 mn for other chemical production.

Table 1
Distribution of Foreign Direct Investment
in Manufacturing

Items	p.c. at end 1967
Vegetable products	10.5
Animal products	2.6
Textiles	1.9
Wood and paper products	18.8
Iron and products	28.7
Non-ferrous metals	15.9
Non-metallic minerals	3.7
Chemicals and allied products	16.0
Miscellaneous	1.9
TOTAL	100.0

Source: Statistics Canada.

Manufacturing in Canada is largely the result of foreign enterprise and an inflow of private capital together with associated management skills and production techniques. More than half the corporate assets in manufacturing are owned by foreign corporations, and US corporations account for about 75 p.c. of this foreign investment. The automobile industry, for instance, is almost entirely American owned and controlled, and it is entirely in the hands of foreign companies.

Change in Foreign Investment Policy

Canadians are concerned about this foreign domination of key industries, particularly since it seems to have resulted in price fixing to exploit the Canadian consumer or, where natural resources are exported to associated enterprises, to deprive the federal and provincial governments of tax revenue. Even greater concern has been expressed, however, over the export of natural resources without processing in Canada since this type of exploitation does not provide many jobs.

This widespread concern has led to a comprehensive review of federal policy towards inward direct investment, with the provincial governments also making their views known. Canada has never subjected foreign investment to exchange control, and guidelines to foreign companies investing in Canada, issued in 1966, are merely exhortatory. Certain activities such as banking and transport are protected from foreign ownership and control but these "key sectors" do not include manufacturing and, moreover, manufacturing has not been subject to *ad hoc* interventions to prevent foreign takeovers (as has happened in the natural resources field). Further, there are no requirements for Canadian participation in the ownership or management of a manufacturing enterprise except for the very minor requirement for a director resident in the province if incorporation is under the laws of British Columbia or Saskatchewan. However, large wholly-owned subsidiaries of foreign companies are required to publish financial information in the same way as public companies.

Promotion of Canadian Ownership

Corporations are subject to both federal and provincial taxes on their income, to provincial taxes on their capital, and to municipal taxes on their property. At the federal level the tax system is used to promote Canadian ownership and control. If a corporation has a required degree of Canadian ownership and at least 25 p.c. of its directors are resident in Canada, the rate of withholding tax on dividends paid to non-residents is 5 points lower than would otherwise be the case and it may also qualify for special capital write-offs. More importantly, Canadian equity participation is encouraged by tax credits to resident shareholders (who are able to deduct one-third of their dividends from taxable Canadian corporations in calculating their personal liability). Canadian-controlled private corporations pay a lower rate of tax while the branches of foreign-owned corporations are singled out for an additional tax on their profits. Both the branch profits tax and the withholding tax will be increased in 1976 unless otherwise provided by treaty. A further recently announced change is that interest deductibility for thinly-capitalized foreign-owned corporations is restricted as from this year.

Control of Foreign Takeovers

Legislation was introduced in May to subject foreign takeovers to federal review. With exemptions for very small companies, the federal government intends to authorize only those takeovers which will result in significant benefit to Canada. The criteria for this are five:

- the effect on the level of economic activity and employment,
- the degree and significance of Canadian participation,
- the effect on productivity, efficiency, technological development, product innovation and variety,
- the effect on competition,
- the compatibility with national economic and industrial policies currently under comprehensive review.

This last criterion seems to imply an undertaking to increase the degree of value added in Canada where possible. This interpretation is strengthened by the announcement of major tax concessions for processing and manufacturing in Canada. The general rate of corporation tax will be reduced on January 1, from 49 p.c. to 40, for profits derived from processing or manufacturing in Canada. Further, as from May 9, a two-year write-off for machinery and equipment bought for manufacturing or processing in Canada has been substituted for the general 20 p.c. annual rate. These tax cuts may only be intended to counter the adverse effects of the US DISC legislation, however.

Table 2
German Direct Investment in Canada since 1952

At end of year	DM mn	As p.c. of total direct investment abroad
1965	815	9.8
1966	858	8.6
1967	1 084	9.0
1968	1 212	8.4
1969	1 447	8.2
1970	1 677	7.9
1971	1 952	8.2

Source: Federal Ministry of Economics and Finance.

It may be many months before the new legislation is passed and promulgated but the lengthy official report leading to his legislation also advocated the screening of other forms of direct investment and further measures are not precluded. In particular, some of the provinces have advocated stronger measures and the federal government has invited them to adopt the measures they advocate. Ontario, the industrial hub of Canada, has already decided to discriminate in favour of Canadian-owned enterprises when making investments and loans, and further measures of economic nationalism seem likely to follow the report of a select committee of the Ontario legislature. In view of these considerations, immediate investigation of the prospects for production in Canada by an interested foreign enterprise would seem to be a wise decision.