Lawrence National Centre for Policy and Management

FDI by the Numbers

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"CANADA'S APPROACH TO ATTRACTING FOREIGN DIRECT INVESTMENT NEEDS TO BE REVIEWED AND ASSESSED AS TO ITS QUALITY AND PERFORMANCE INCLUDING THE DEGREE TO WHICH IT IS SUPPORTING GROWTH AND PROSPERITY ACROSS ALL MAJOR SECTORS OF THE ECONOMY AND THE COUNTRY. SUCH REVIEW AND ASSESSMENT WILL NEED TO INFORM SUBSEQUENT ACTION."

The views expressed in this study are our own and should not be attributed to any other individual or organization. We are grateful to our *Attracting Global Mandate* Project partners, Canadian Council of Chief Executives, Canadian Imperial Bank of Commerce, Industry Canada, IBM Canada and Ontario Ministry of Economic Development, Employment and Infrastructure for their support.

Introduction

Foreign Direct Investment (FDI) has played a central role in tectonic shifts in the global economic landscape in recent decades, and is increasingly understood as both a contributor to and measure of a country's economic performance and prospects.

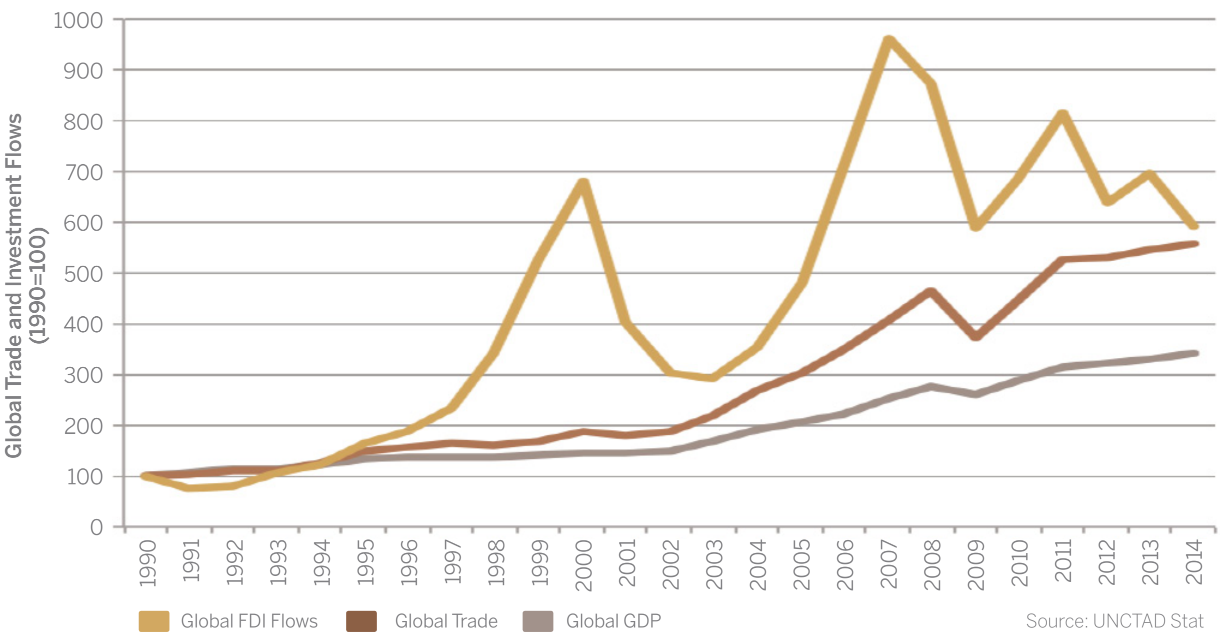
FDI also exhibits strong correlations with other aspects of competitiveness such as innovation, productivity, strength of the education sector, and industrial sector diversity. As a result, FDI attraction is among the top priorities for governments across the globe. Jurisdictions that have failed to organize themselves to compete effectively on this front have slowly but surely seen jobs, talent, investment dollars and intellectual capital move away to other more competitive jurisdictions.

This study is a scene-setter and companion piece to the other studies in the Lawrence National Centre's series on *The Future of Canadian Manufacturing: Attracting Global Mandates.* If Canada is to compete successfully for investment from the world's corporations and against every other potential location around the world for the economic activity that flows from investments in plant, equipment, technology and acquired skills, then we must first understand the trends and underlying dynamics of global FDI flows. This study provides a high-level portrait of those global flows. We then turn to an examination of Canada's performance in recent years in attracting FDI, as well as the activities and industrial sectors that have attracted those flows.

Global Landscape

Foreign direct investment (FDI) flows have grown phenomenally over the past quarter-century in both size and breadth.[1] Globally, annual FDI inflows grew by almost 500% between 1990 and 2014 (measured at current prices and in U.S. $). This translates into an annual average growth rate of 7.8%, over half-again faster than the 5.0% annual average increase in global GDP through that period. This long-running pattern of FDI growth that has outstripped economic growth held true for the

FIGURE 1 – GLOBAL FDI GROWTH OUTPACED GROWTH IN BOTH TRADE AND GDP OVER PAST QUARTER-CENTURY



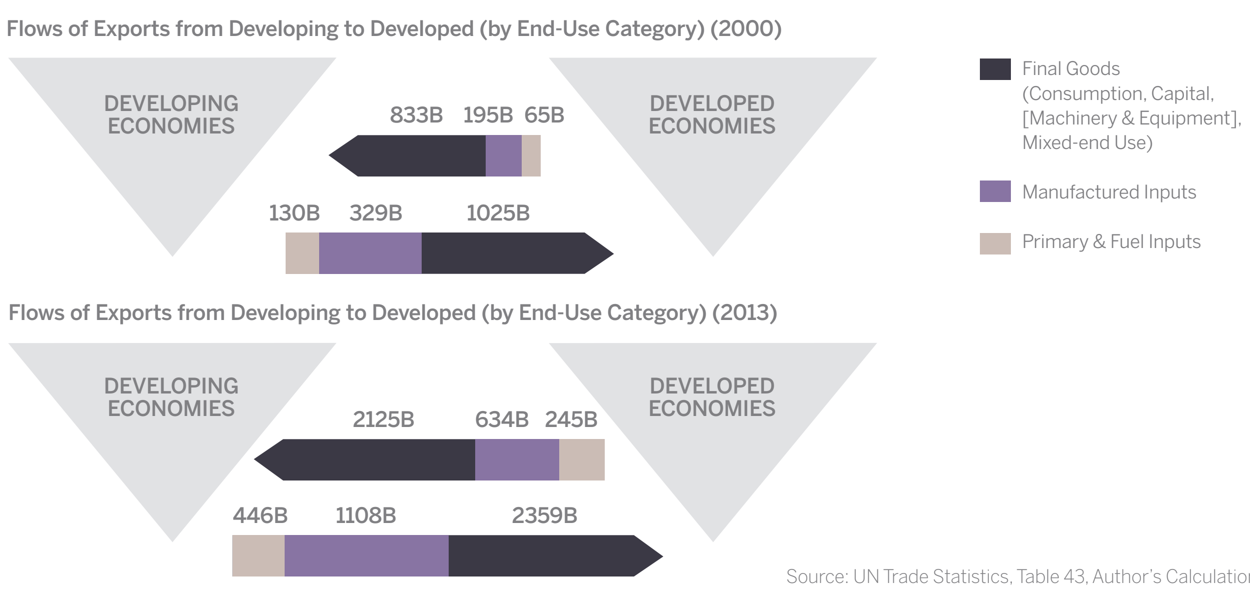
Source: UNCTAD Stat

1. **The United Nations Conference on Trade and Development (UNCTAD)** has published its World Investment Report annually since 1991 on official national data sources and multilateral definitions of Foreign Direct Investment. To note: UNCTAD total measures of FDI exclude "the financial centres in the Caribbean". UNCTAD relies on "definitions of FDI…contained in the Balance of Payments, based Manual: Fifth Edition (BPM5) (Washington, D.C., **International Monetary Fund**, 1993) and the Detailed Benchmark Definition of Foreign Direct Investment: Third Edition (BD3) (Paris, **Organisation for Economic Co-operation and Development**, 1996). According to the BPM5, FDI refers to an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor. Further, in cases of FDI, the investor´s purpose is to gain an effective voice in the management of the enterprise…Some degree of equity ownership is almost always considered to be associated with an effective voice in the management of an enterprise; the BPM5 suggests a threshold of 10 per cent of equity ownership to qualify an investor as a foreign direct investor…Since the main feature of FDI is taken to be the lasting interest of a direct investor in an enterprise, only capital that is provided by the direct investor either directly or through other enterprises related to the investor should be classified as FDI. The forms of investment by the direct investor which are classified as FDI are equity capital, the reinvestment of earnings and the provision of long-term and short-term intra-company loans (between parent and affiliate enterprises). According to the BD3 of the OECD, a direct investment enterprise is an incorporated or unincorporated enterprise in which a single foreign investor either owns 10 per cent or more of the ordinary shares or voting power of an enterprise (unless it can be proven that the 10 per cent ownership does not allow the investor an effective voice in the management) or owns less than 10 per cent of the ordinary shares or voting power of an enterprise, yet still maintains an effective voice in management. An effective voice in management only implies that direct investors are able to influence the management of an enterprise and does not imply that they have absolute control. The most important characteristic of FDI, which distinguishes it from foreign portfolio investment, is that it is undertaken with the intention of exercising control over an enterprise." (*http://unctad.org/en/Pages/DIAE/Foreign-Direct-Investment-(FDI).aspx*)

developed economies as a whole, although the margin was smaller, at 4.4% vs 3.9% respectively. The truly explosive difference between growth in FDI inflows and GDP growth took place in the emerging market and developing economies, where massive capital-deepening was the aggregate result of growth in FDI inflows of 12.7% on average over 25 years, versus annual average GDP growth of 7.8%.

These enormous movements of global capital in pursuit of productive opportunities are reshaping the global economy, as well as many national economies, in ways that have often caught local, national and global firms and policy-makers flat-footed, pursuing outdated strategies with outdated toolkits. An early example of this challenge to the status quo came in the rise of "global value chains" (GVCs) in an ever-broadening set of industries, well beyond their traditional presence in resource-based sectors. The fact that countries increasingly "build goods together", rather than trade final goods of national specialization, represents an ongoing shock to established tariff, taxation, and economic policies generally. The more recent advent of GVCs that extend beyond goods-producing industries to a range of service-sector industries is further driving new trade and investment flows and opportunities.

FIGURE 2 : GLOBAL VALUE CHAINS ARE LEADING GROWTH IN TWO-WAY GLOBAL TRADE FLOWS

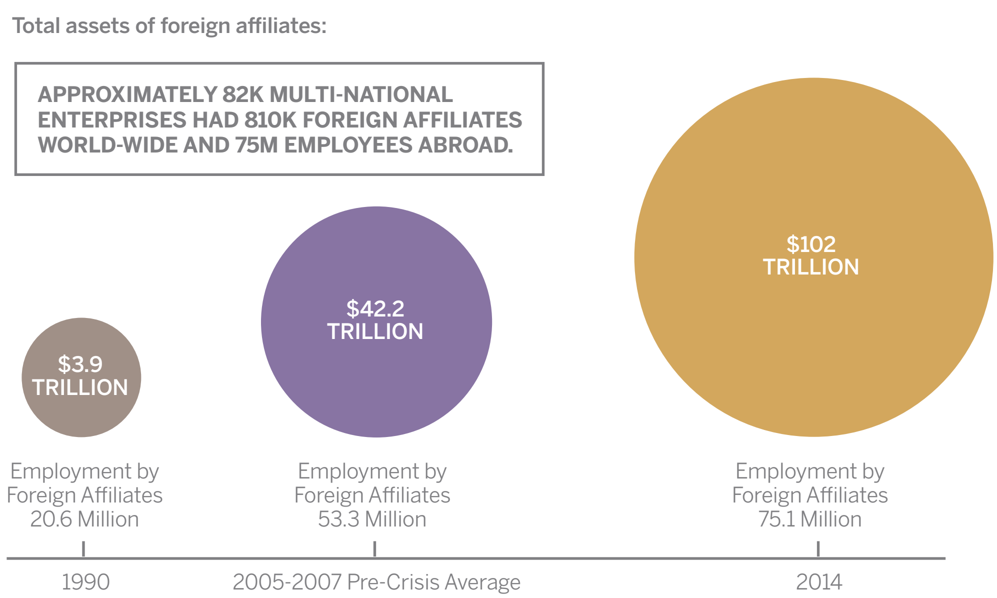


Source: UN Trade Statistics, Table 43, Author's Calculations

However, geography and dispersion of markets have not disappeared as a key consideration for business strategies around the world. Just as global sourcing is now standard across industries, so too are global calculations by firms of all sizes as to where best to situate each stage of their own production processes. Large flows and stocks of foreign direct investment enable both of the underlying business optimization strategies. As is often observed, "Trade Follows Investment" and this is at least partially reinforced through GVCs, but over time investment may also displace or divert trade in final products.

Consider that as of 2014, approximately 82,000 multi-national enterprises had 810,000 foreign affiliates employing 75 million people outside of an MNE's 'home' country. Over a 25-year period, the total value of assets held by these foreign affiliates rose more than 25-fold: from U.S.$3.9 trillion to $102 trillion (see Figure 3. All figures in this section are in U.S. dollars unless otherwise indicated.)

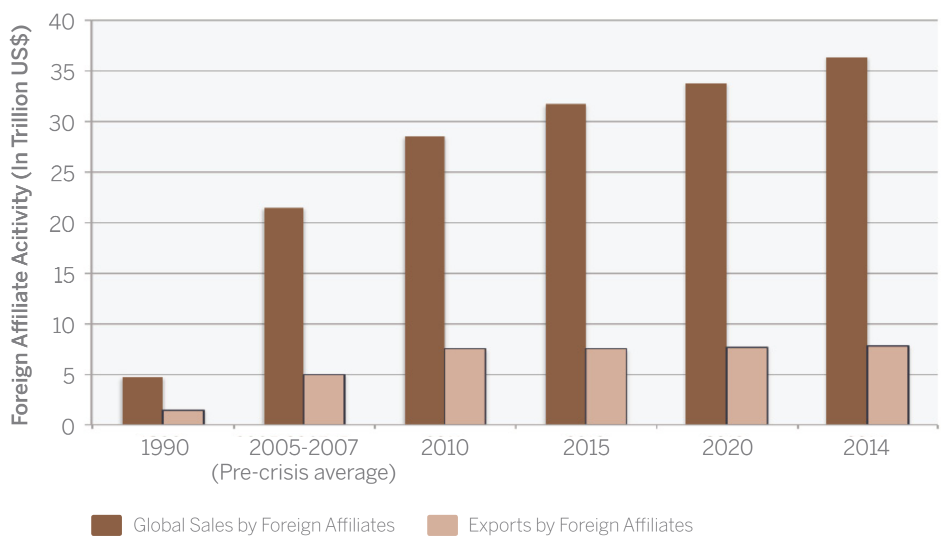
FIGURE 3 – ENORMOUS GROWTH IN GLOBAL ECONOMIC WEIGHT OF FOREIGN AFFILIATE FIRMS



Source: World Investment Report, 2014 and 2015

In 2014, foreign affiliates of MNEs recorded $36.4 trillion in global sales and accounted for almost one-third of the world economy's $23.7 trillion in global exports. However, while this demonstrates the growing importance of multinationals and FDI to global growth in output, jobs and trade, there is also clear evidence that many global companies are steering their FDI so as to produce for growing local markets at the point of investment. Against the $7.8 trillion of foreign affiliate sales that were exported, $28.6 trillion (or 79%) of foreign affiliate sales were made in their local economies (see Figure 4).

FIGURE 4 – FOREIGN AFFILIATES EXPORT ABOUT 20% OF THEIR TOTAL SALES

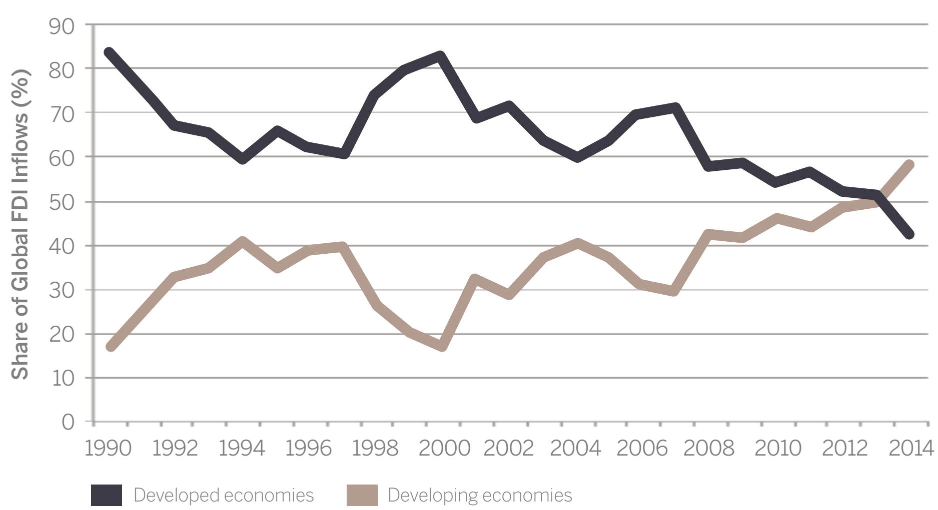


Source: World Investment Report, 2014 and 2015

Ascendance of Developing Countries

In 2014, for the first time ever, global FDI flows to developing economies in aggregate surpassed those destined for developed economies (Figure 5).

FIGURE 5 – DEVELOPING ECONOMIES ATTRACTED MAJORITY OF GLOBAL FDI FLOWS BY 2014

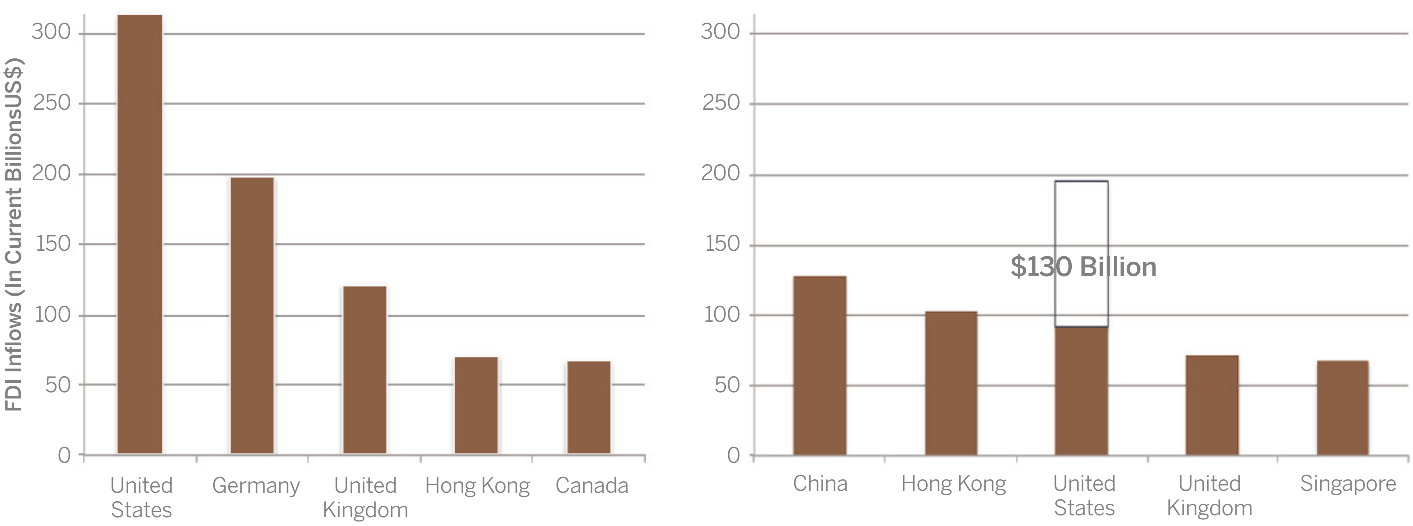


Source: World Investment Report, 2014 and 2015

This reversal in ranking is a landmark step along a path of enormous shifts in relative global economic weight. It is also relatively broad-based, moreso than is generally appreciated: developing countries made up 9 of the top 20 economies world-wide when ranked by FDI inflows in 2014. While this group is geographically-disparate (as we will see later in Figure 9), the shift is clearly led by a particularly sharp move in FDI flows towards Asia. Both China (#1) and Hong Kong (#2) moved ahead of the United States (#3) in 2014, with Singapore moving into fifth place (see Figure 6, and discussion on p.11 of a special factor that affected FDI into the U.S. in 2014). Canada has slipped to 7th place, albeit still above its global GDP rank, a point to which we return in the next section of this study.

The acceleration of FDI flows into developing country economies is driven by a growing wave of multinationals that are attracted not only to low wage levels but also to fast-growing education and skill levels and a corresponding expansion of the local consumer base. This factor is particularly evident as a growing set of countries move up from Least- to Low- to Middle-Income status. The resulting job opportunities in growing economies are creating a burgeoning middle class across emerging market economies world-wide, which in turn reinforces growth in new local markets for consumer products. Many developing economies have also opened up previously-protected industry sectors to foreign investors, one recent example being Mexico's oil & gas sector.

FIGURE 6 – ASIA CLIMBED INTO TOP FDI RANKS BETWEEN 2000 AND 2014

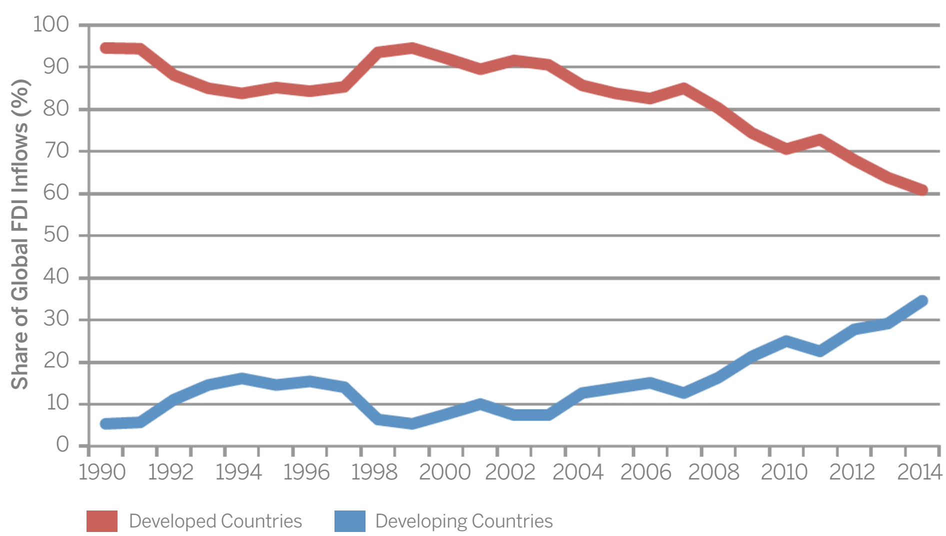


Source: World Investment Report, 2014 and 2015

In addition, as emerging market economies rapidly urbanize, investors from abroad are taking advantage of opportunities in infrastructure projects, including in the form of public-private partnerships. Emerging and developing economies have become a growth engine for global FDI flows in the service sector more generally, due to surging demand in construction, business services and finance. Multinational companies are also turning their attention to "new-growth", least-developed economies including those in Sub-Saharan Africa. While the extractive industry has traditionally been the largest recipient of FDI inflows in this region, as with others, recent data show that manufacturing and services are now growing in the share of total "greenfield" investments. Technology companies such as IBM, Microsoft, and Google are also establishing technology incubators in Africa in order to service innovative niches in the region.

The "BRIC" countries (Brazil, Russia, India and China), which led the growth success story in the developing world for some decades, are now facing diminishing returns from technological catch-up and their (initially) low domestic wages. Instead, they are now transitioning to higher value-added, upstream activities, as well as service sectors, and are forming regional value chains with other developing countries. As a reflection of industrial modernization, multinationals from developing countries are also investing in foreign assets, whether by acquiring foreign affiliates of multinational companies, entering into mergers, or directly investing in greenfield projects abroad. Outward FDI by multinationals from all developing countries surpassed 30% of global outflows as of 2014. The most common industry targets for these investors were construction, energy, telecommunications, and transportation.

FIGURE 7 – GLOBAL FDI OUTFLOWS –DEVELOPED VS DEVELOPING COUNTRIES' SHARES: 1990-2014



Emergence of "Mega-regional" Groups

The consolidation of markets through regional cooperation agreements and free trade treaties has also had significant impacts not only on the global scale but also on the regional distribution of FDI flows. The formation of Europe's Single Market, accession of central European economies to the EU, and the North American Free Trade Agreements were early catalysts of this trend, and played a strong role in securing FDI leadership for developed economies. More generally, a wide range of overlapping bilateral and issue-specific agreements ensued around the world: by the end of 2013, there were 3,240 International Investment Agreements (IIA)'s in place. These arrangements facilitated strong and widespread growth in both trade and investment flows. But these partial steps are now giving way increasingly to what has been termed "mega-regional" economic partnerships: deep integration partnerships between broad groups of countries or regions that entail the creation of trade and investment links that are typically also supported by regulatory harmonization.

To date, the formation of mega-regional agreements has advanced more rapidly in the developing than developed world. Proactive regional investment cooperation initiatives in East and South-East Asia have contributed to a rise in total and intraregional FDI in the region. FDI flows from "Regional Cooperation Economic Partnership" members now make up roughly 40 percent of FDI flows to ASEAN, up from 17 per cent in 2000.

There are currently three sets of negotiations underway, or moving to the stage of ratifications of draft agreements, that would create new mega-regional partnerships – the Trans-Pacific Partnership (TPP), Transatlantic Trade and Investment Partnership (TTIP), and Regional Cooperation Economic Partnership (RCEP). Each of these potential partnership groupings already accounts for 25% or more of global FDI flows and successful outcomes to negotiations and implementation would clearly play a significant role in shaping future FDI flows within and between each grouping.

Mergers & Acquisitions as a key driver of global FDI activity

Any analysis of trends and dynamics in FDI flows must take care to consider the distinct underlying patterns and drivers of its different components and the different business activities that are represented in these components. Official measures of FDI flows include:

- Equity capital flows
- Reinvested earnings
- Intra-company loans

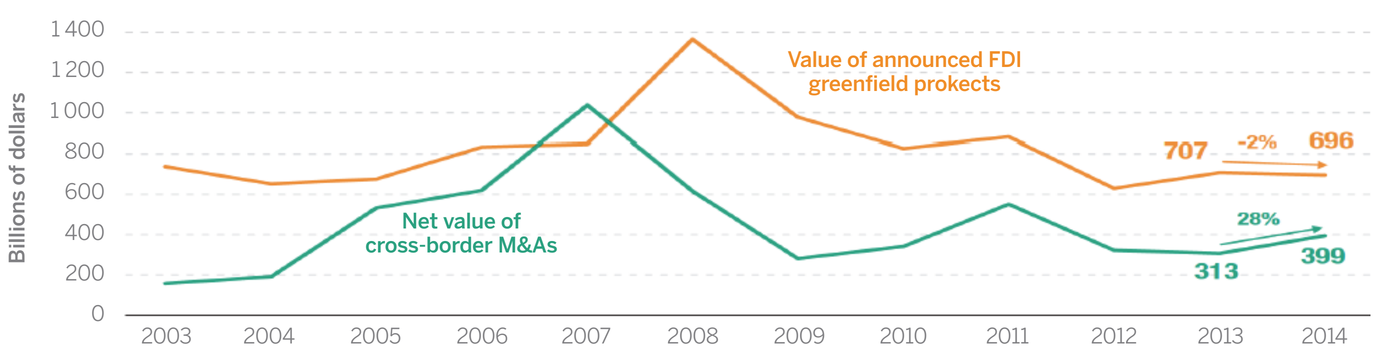
For the purposes of this study, the most important implication of these different flows is that the aggregate data lump together financing for two quite different business activities:

- Capital expenditures "projects" – creation/installation of new plant and equipment assets
- Net Mergers and Acquisitions (M&A) activity – acquisitions of interest in and control over existing assets minus divestments of same

From a corporate decision-making perspective, these activities represent alternative approaches to achieving a single strategic goal, that of entering into or expanding in a particular location for a specific business opportunity. The perspective of government policy-makers will be quite different, however, given the quite different implications in the short-run at least for economic activity and jobs.

Cross-border M&As also tend to drive a substantial portion of the volatility in overall FDI flows at a national level and even globally in some instances. Official data are not available on FDI flows for the purposes of capital investment projects – whether "greenfield" investments at new sites or "brownfield" expansions or upgrades at existing sites. However UNCTAD does publish data on both Cross-Border M&A activity and announced greenfield projects. These data show that cross-border M&As have accounted for a growing share of total FDI flows globally in recent years (see Figure 8). They were the key driver behind the 9% jump in the global stock of FDI inflows – to $26 trillion – in 2013, while annual global M&A deal volume surpassed $3 trillion in 2014 for the first time since 2007. National FDI rankings can be affected by such transactions, even at the top. For example, UNCTAD's *World Investment Report 2015* highlights the fact that a single transaction – the $130 billion divestment by U.K.-based Vodafone of its 45% stake in U.S.-based Verizon Wireless – more than accounted for a $92 billion drop in measured FDI flows into the U.S. That year-over-year drop more than accounts, in turn, for the slip from first to third place for the U.S. in the 2014 global FDI rankings (as depicted in Figure 6).

FIGURE 8 – CROSS-BORDER M&A'S ACCOUNT FOR A GROWING SHARE OF GLOBAL FDI FLOWS OVER PAST DECADE



Source: UNCTAD,cross-border M&A database for M&As (www.unctad.org/fdistatistics); Financial Times Ltd, fDi Markets (www.fDimarkets.com0 for greenfield projects.

Implications for Canada of the Internationalization of Production

With much of today's production of goods and services now organized into global value chains, most firms (and countries) now rely on foreign intermediaries for a significant share of total value-added in production. Most companies make use of foreign outsourcing opportunities not only as a way to focus their resources on their comparative advantage while delivering better products, but also to give them a better chance to access markets within the foreign contractor's surroundings.

These factors have led to several interesting implications for the global distribution of business locations. First, production sites are shifting towards clusters. This enables firms to outsource production of specific components to areas where specialized expertise for the production of that component is highest. Second, firms are consolidating their activities into fewer locations. Thus, firms require reliable, efficient international logistical capabilities that can sustain the myriad complexities of operating within the global value chain. Another key trend to highlight is the repatriation, or "re-shoring" of some types of production capacity back to developed economies, where competitiveness is innovation-driven (supported by high-skilled, well-educated workforce and R&D infrastructure) rather than cost-efficiency-driven (low cost structure).[2] This trend is especially strong in sectors where quality is key to the competitive position of products. At the same time, some emerging economy firms and affiliates will emphasize production for local consumers.

Given the strategic drivers outlined above, to win a firm's attention, the ideal site location should be able to demonstrate a globally-competitive cluster of relevant skills, comprising a strong combination of world-class universities, multinational presence (with globally-significant R&D), local companies with thriving export markets, successful startup culture, vibrant chambers of commerce, venture capital firms, and sophisticated customers that are receptive to new technologies.[3] Its industry clusters must also have meaningful interactions with each other and with firms and organizations overseas to maintain global relevancy. While market size and growth were traditionally the most important attractions for FDI, the quality of strategic assets, such as technology, knowledge, expertise, as well as presence of suppliers and competitors are important determinants in a company's choice to locate its high-value business activity.

Overall, in strategically positioning to attract FDI and business activity, policymakers have three main trends to contend with. First, what once appeared to be distinct national markets are now merging into a global marketplace. Second, the production of goods and services is now structured to source inputs from wherever there is specialized and cost-competitive expertise in producing them.

2. Güldner, F., Menze, T., de Leeuw, V. 2014. **The Future of Manufacturing: Scenarios for Investment in Manufacturing through 2050**. ARC Strategies Group. April 2014
3. DFAT Australia. 2008. **Paper on Trade & Investment Issues- Paper on Industry Development**. URL: *https://dfat.gov.au/trade/topics/review-of-export-policies-programs/Documents/LiteSteelTechnologiesPtyLtd.doc*.

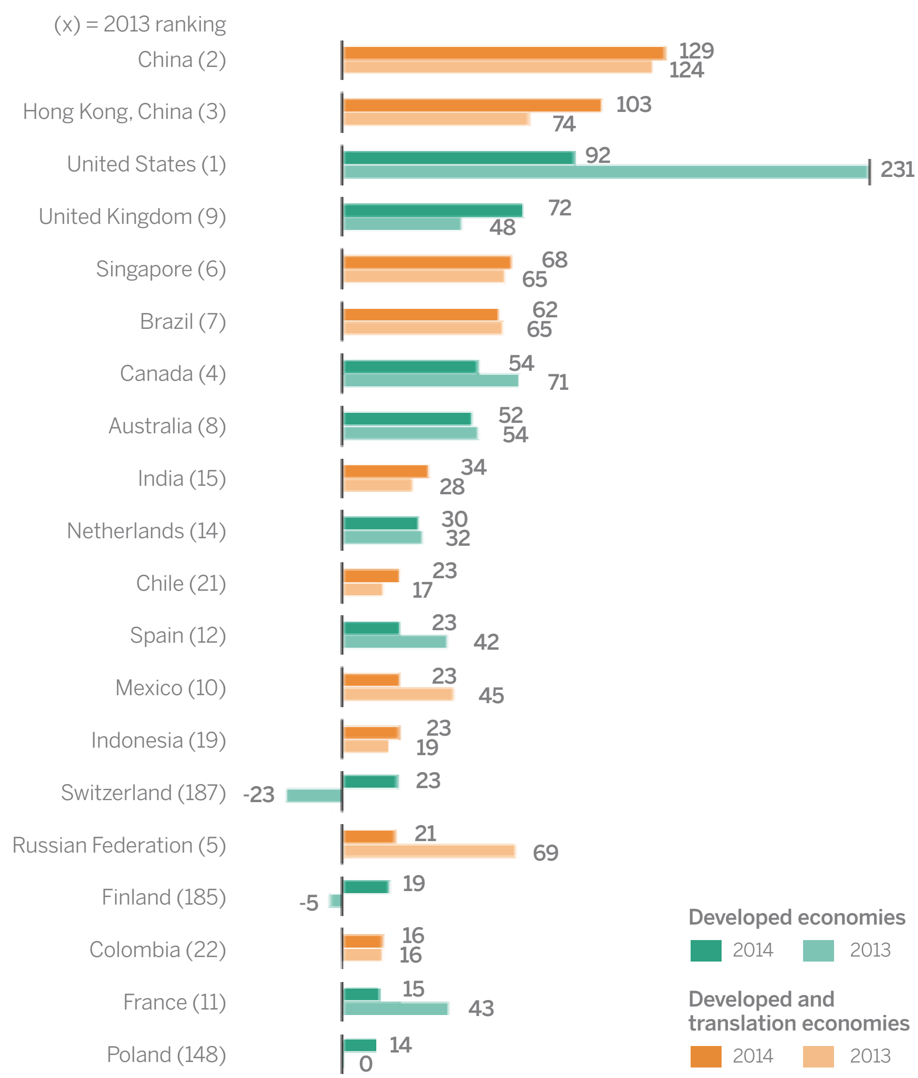
Third, the entry of disruptive technologies will continue to transform how companies make decisions on the location of production and service sites. This decision is a balancing act between addressing the need to be closer to markets, while being able to locate R&D and production bases in sufficient proximity with one another to facilitate information-sharing and joint efforts. Jurisdictions that are able to deliver strongly on each of these components are likely to win the attention of company executives. In sum, technological change has meant that the shifting concept of manufacturing is advancing far more rapidly than our understanding of the optimal target of investment dollars.[4]

4. Kotler, P & Kotler, M. 2014. **Winning Global Markets: How Businesses Invest and Prosper in the World's High-Growth Cities**. Wiley Publishing. August 2014

Canada's FDI Performance in Context

Canada's relative performance in attracting total FDI inflows has traditionally exceeded its overall economic weight globally and this remains the case, despite perceptions to the contrary. As depicted by the UN World Investment Report, Canada's ranking as an FDI destination has varied between 4th and 7th highest globally since 2000, compared to its GDP ranking of between 8th and 11th largest economy over that period (at current prices and market exchange rates).

FIGURE 9 – CANADA IS A TOP-TIER DESTINATION FOR GLOBAL FDI FLOWS

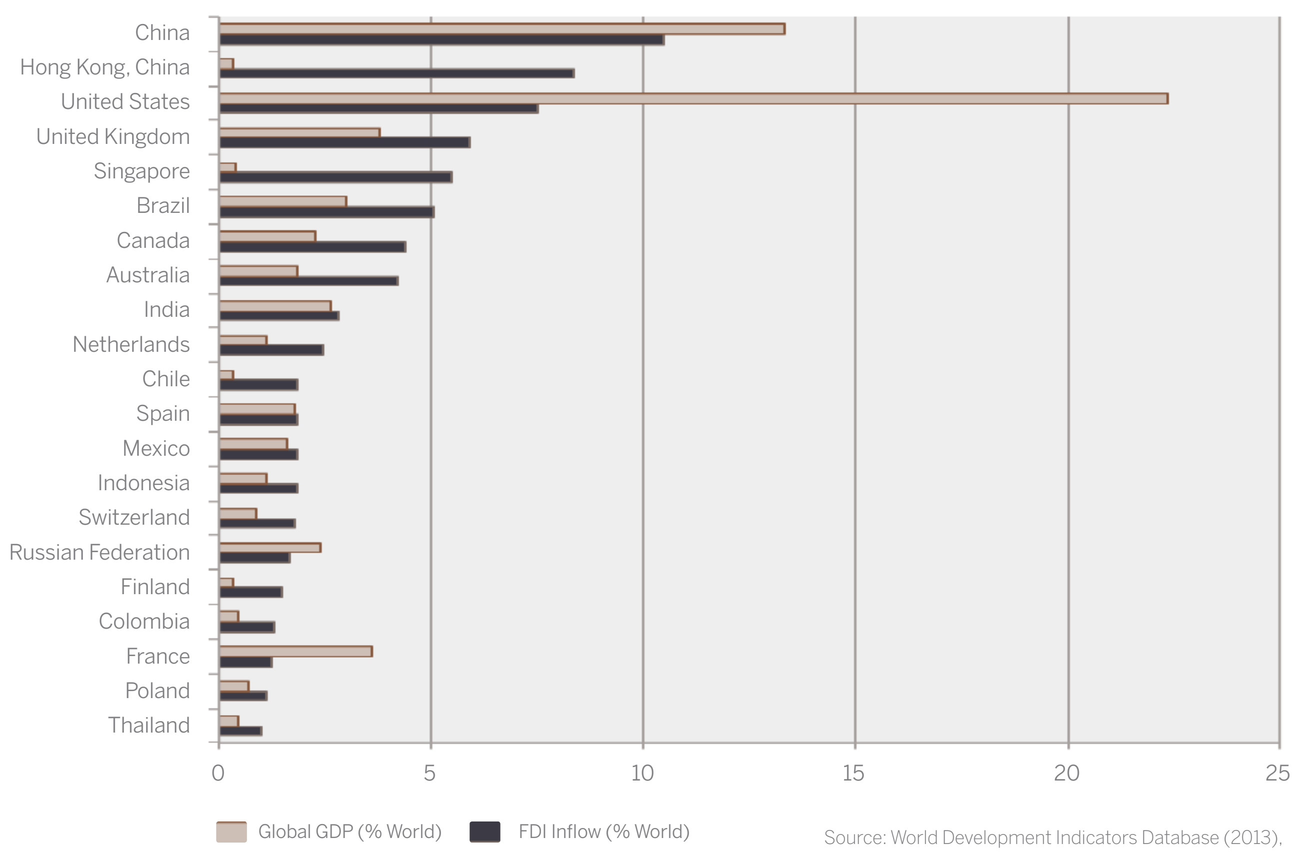


Source: World Investment Report, 2015

Similarly, Canada attracts a global FDI share that remains consistently well above its GDP share (Figure 10).

The volatility in FDI flows, shares and rankings reflects the interaction between their diverse components and a wide range of factors and circumstances related to domestic and global macroeconomic performance, exchange rate movements (including asset valuation effects), the industry mix of a national economy and of multinational enterprises that are resident there, as well as the full range of government policies and regulations both domestically and in parent countries.

FIGURE 10 – CANADA'S SHARE OF FDI FLOWS IS WELL ABOVE ITS GLOBAL GDP SHARE



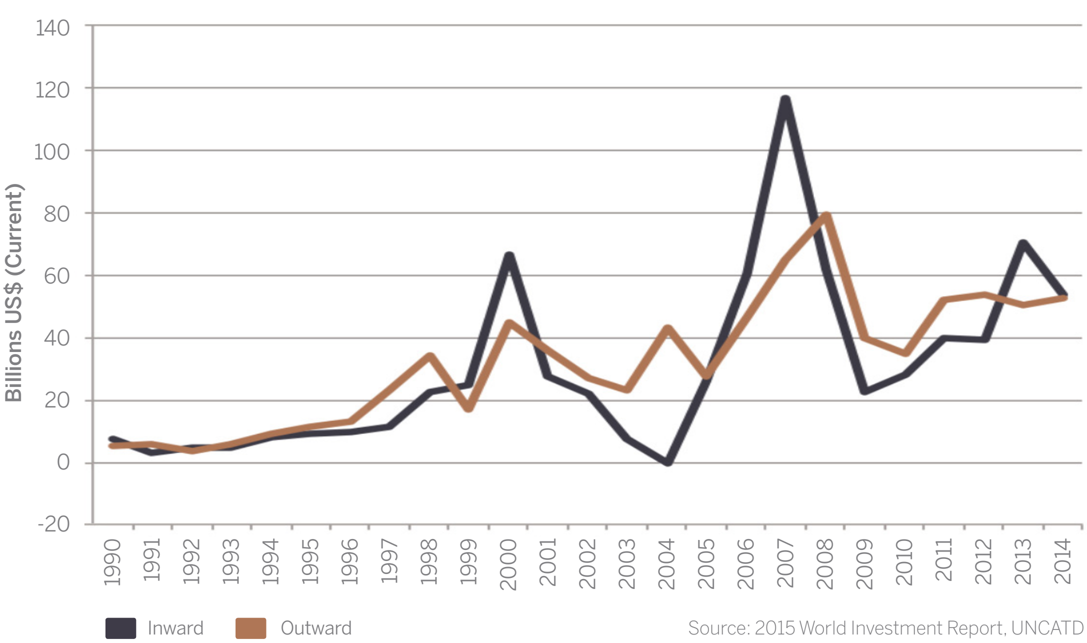
Source: World Development Indicators Database (2013), World Investment Report, 2015

Figure 11 demonstrates the resulting volatility in measured FDI flows for Canada over the past quarter-century, featuring order-of-magnitude shifts (both up and down) over the space of as few as three years.

Canada's Performance in Attracting Greenfield Investment

Given that the principal focus of this paper is on Foreign Direct Investment as a driver of productive capacity, jobs and growth, it is worth comparing Canada's performance to that of key economic partners and leading FDI destination countries on the metric of greenfield project announcements. Comparable country-level data on the number and value of "announced greenfield FDI projects" are published in the annual *World Investment Report*.

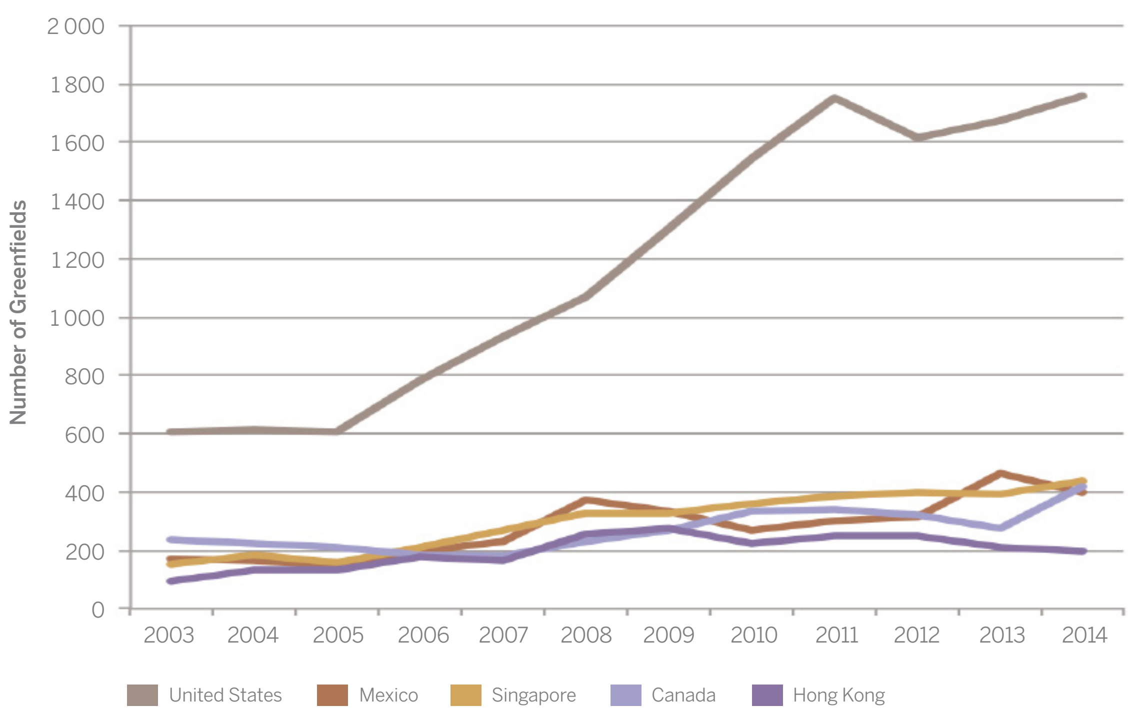
FIGURE 11 – ROBUST UPWARD TREND DESPITE SIGNIFICANT VOLATILITY IN CANADA'S FDI FLOWS OVER PAST 25 YEARS



Source: 2015 World Investment Report, UNCATD

We look first (Figure 12a) at the number of greenfield FDI projects announced over the period 2003-2014 for Canada as well as for the U.S., Hong Kong, Singapore and Mexico (the four comparator jurisdictions in our companion study on *Best Practice in Investment Attraction*).

FIGURE 12a – NUMBER OF ANNOUNCED GREENFIELD FDI PROJECTS DOUBLED IN CANADA YET SLIPPED FROM 1/3 TO 1/4 OF THOSE IN THE U.S.

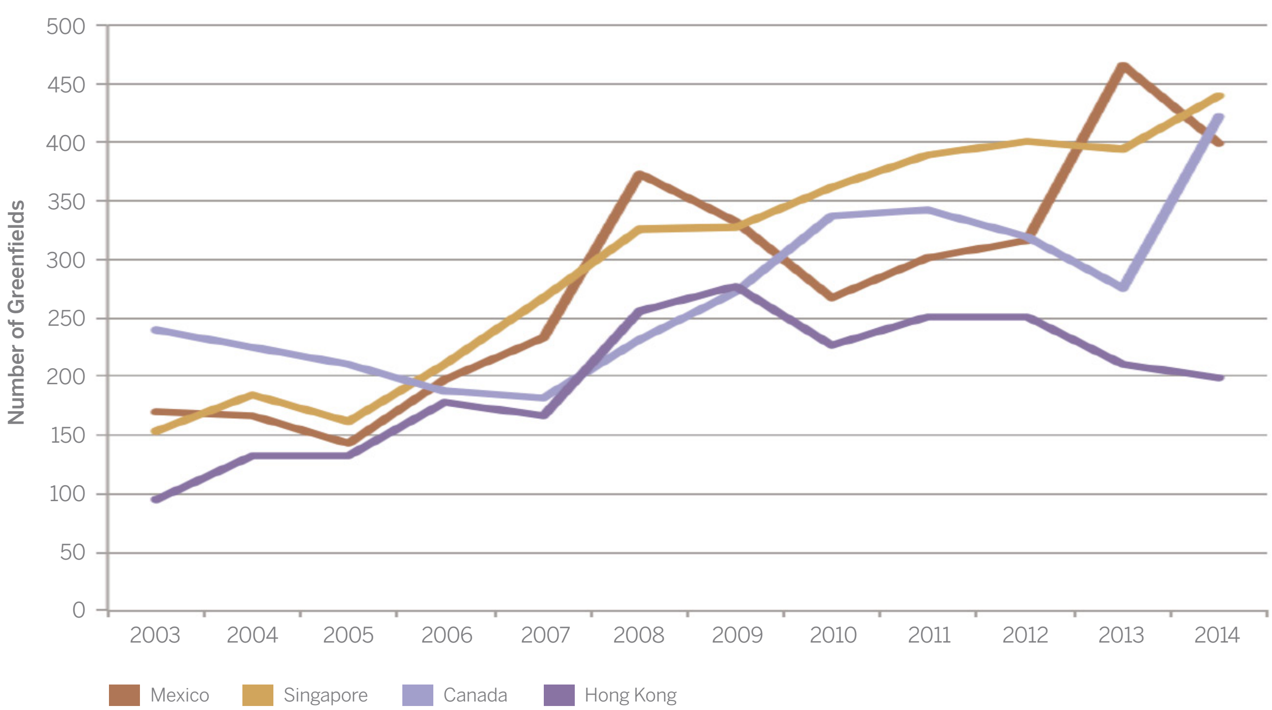


Source: UN World Investment Report, 2015

The most glaring feature of the overall comparison is the explosive growth in the number of projects announced for the U.S. beginning in 2006, far outstripping the otherwise-impressive growth in the other four countries. For example, despite a doubling in announced projects in Canada over a decade, U.S. projects soared from triple the original Canadian level to more than four times the Canadian level over that period.

Figure 12b removes the U.S. from the picture in order to facilitate comparison of Canada's performance vis-à-vis its other NAFTA competitor as well as Singapore and Hong Kong, both of which climbed in to the global Top Five as we saw in the previous section. This Figure shows more clearly and significantly that Canada's clear lead over projects announced in Mexico (+41%) and Singapore (+57%) as of 2003

FIGURE 12b – CANADA'S SIGNIFICANT LEAD IN THE NUMBER OF ANNOUNCED GREENFIELD FDI PROJECTS VS MEXICO (+41%) AND SINGAPORE (+57%) DISAPPEARED OVER A DECADE



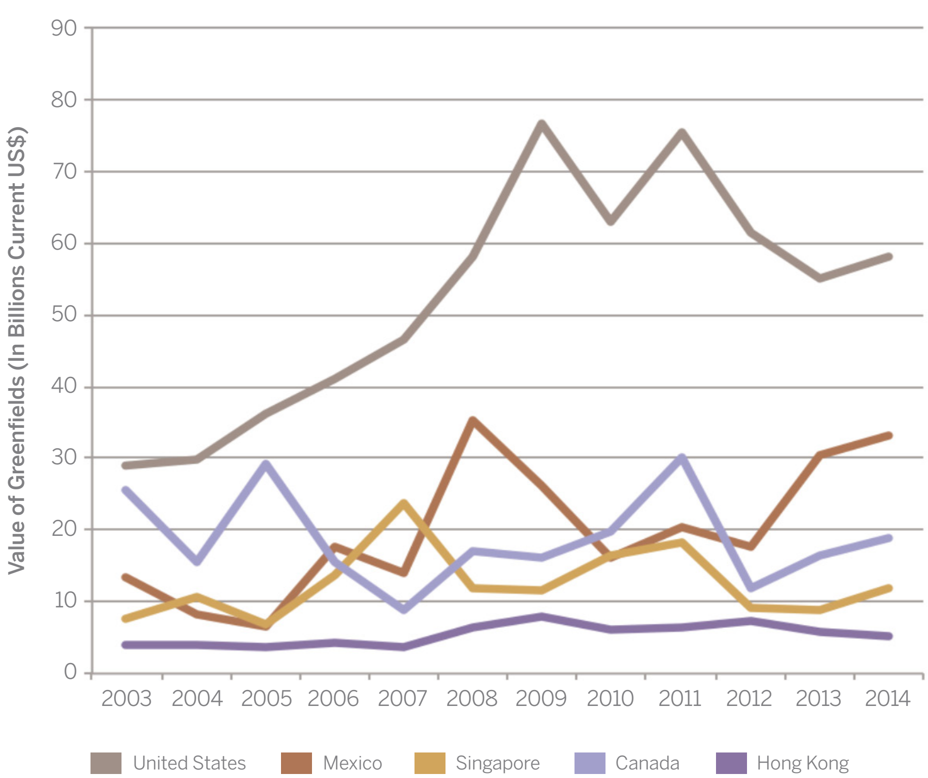
Source: UN World Investment Report, 2015

disappeared quickly and was not re-gained over the following decade.

While comparisons of the number of FDI project announcements will certainly jibe with anecdotal impressions based on media reports, the more important comparison from an economic impact perspective derives from the dollar value of the projects in question. It is important to repeat that the available data series in this respect are based on announced project values rather than actual investments that did or did not result, in the announced timeframes or at all, or in full or only in part.

With that caveat, the assessment of Canada's relative performance in terms of the value of greenfield FDI project announcements is still less rosy, on balance.

FIGURE 13 – CANADA'S RECENT PERFORMANCE IS BETTER IN TERMS OF THE VALUE OF GREENFIELD FDI PROJECTS VS. SINGAPORE AND HONG KONG BUT TRAILS WELL BEHIND THOSE OF THE U.S. AND MEXICO



Source: UN World Investment Report, 2015

Whereas the total value of U.S. announcements "only" doubled through the period from 2003 to 2014, the total announced value for Canada trended downwards through the period in U.S. dollar terms – and more so in Canadian dollar terms given the bilateral appreciation of the C$ of more than 20 per cent through this period. Comparison with Mexico is no more flattering: the value of greenfield FDI project announcements in Mexico tripled over this period, boosting its relative position from just over half of the corresponding value in Canada in 2003 to almost twice the value in Canada by the latest two years.

In contrast, Singapore's lead over Canada through most of this period in the number of announcements does not translate into higher announced greenfield FDI project values. Similarly, the value of greenfield FDI investment in Hong Kong is considerably further below that of Canada throughout the decade-plus period. Both of these observations are noteworthy given that Hong Kong's total reported FDI inflows have exceeded those into Canada for well over a decade and those of Singapore also did so in 2014, suggesting in turn that M&A activity may have played a larger role in the flows into these two countries.

Canada's FDI Performance By Industrial Sector

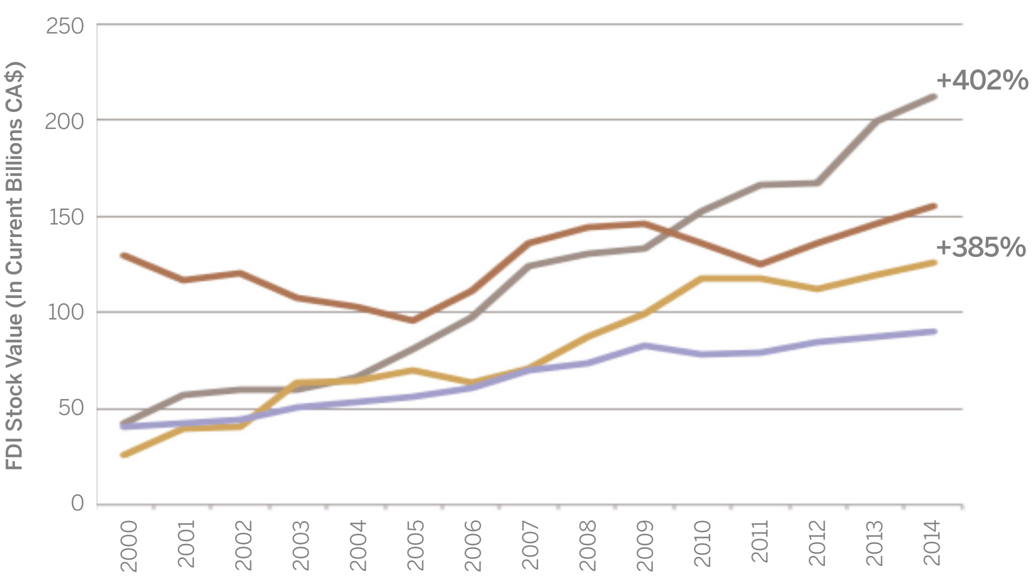
As a final screen against which to assess Canada's FDI performance we turn to an examination of the industrial sector composition of Foreign Direct Investment inflows over the past 15 years. In order to look through the annual volatility of flows at the sector level, we focus here on changes in the stock of Foreign Direct Investment, as published by Statistics Canada. These data are produced on a balance of payments basis (i.e. they align with data that are used in calculating GDP) and differ somewhat from those used by the UN, which focuses on the direction of financial flows. All figures in this section are compiled in Canadian dollars, at current year prices.

Total FDI stocks in Canada rose significantly from 2000 to 2014, increasing every year through a period that saw one major and one minor recession, for a cumulative increase of 130%. The corresponding FDI/GDP ratio rose from 29.1% to 37.1%, indicating a net capital-deepening across the economy as a whole.

This growth was spread quite unevenly across the economy however. The largest FDI capital stock by sector in 2000 was found in the manufacturing sector. As can be seen in Figure 14a, this dominance held true even if the "Petroleum and Coal Product Manufacturing" industry is excluded. Over the following 14 years, however, the non-petroleum portion of manufacturing only grew by 20%, dropping its share of economy-wide FDI stocks by almost half, from 41% to 21% (see Figure 14b).

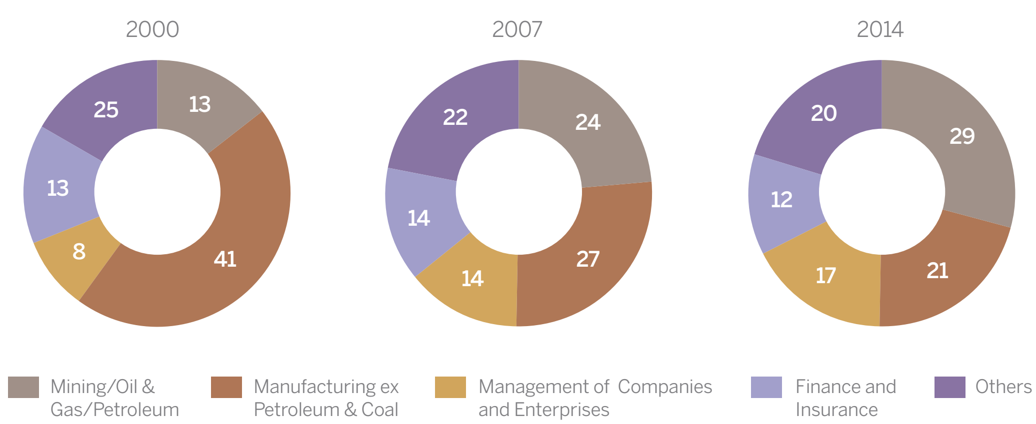
If the "Petroleum and Coal Product Manufacturing" industry, which notably includes refineries, is added to the "Mining, quarrying, and oil and gas extraction" sector (given the commonality of economic drivers), the resulting mining/petroleum construct is seen to have been the powerhouse of recent FDI flows, growing by a cumulative 402% between 2000 and 2014. This in turn more than doubled its economy-wide share of FDI stocks from 13% to 29%.

FIGURE 14a – GROWTH IN THE STOCK OF FDI HAS BEEN VERY UNEVEN ACROSS CANADIAN SECTORS OVER THE PAST 15 YEARS



Source: Statistics Canada, Table 376-0052

FIGURE 14b – MANUFACTURING'S SHARE OF FDI STOCKS FELL SHARPLY, PARTICULARLY OUTSIDE OF "PETROLEUM & COAL PRODUCTS" MANUFACTURING



Source: Statistics Canada, Table 376-0052

More surprisingly, given its low profile as a direct generator of GDP and employment, the "Management of Companies and Enterprises" sector (which includes holding companies and related service-producing firms) generated FDI stock growth of 385% cumulatively, nearly-matching that of Mining/ Petroleum and also more than doubling its economy-wide share from 8% to 17%. Given the functional nature of this sector, it might be reasonable to assume that its growing FDI stock reflects Merger and Acquisition activity, as opposed to "greenfield projects", but further investigation would be required to confirm any such conclusion.

The balance of the economy – ranging from transportation, financial services and retail trade to construction, utilities, forestry and agriculture, posted a 97% cumulative growth in FDI stocks, and a modest drop in its economy-wide share from 38% to 33%.

Overall, this sectoral perspective on the recent evolution of Canada's stock of FDI suggests that a strong performance by the economy as a whole over this period should not be mistaken as cause for complacency looking ahead, given the uneven distribution of the inflows over this latest period.

Canada's Prospects for Future FDI Inflows

Assessing Canada's likely FDI performance looking ahead is subject to the same myriad of conflicting factors as any backward-looking analysis, with the added complication of the need to assess the likely evolution of those underlying factors. One proximate guide that looks past such details can be found in ongoing surveys of private sector decision-makers. Since the relevant decision-makers will by definition be outside of Canada, any such survey must be broad-based and ideally global in nature. Surveys of global executives can of course be highly volatile in terms of their assessment of the attractiveness of specific countries around the world for FDI, broadly defined, and subject to a range of subjective influences. Nonetheless, UNCTAD and McKinsey have for some time conducted a biennial survey of 1000 business executives across 89 countries and they ask, inter alia, what is the top national target for each executive's FDI intentions over the coming three years. Canada's 11th place ranking among target markets in the 2015 survey (see Figure 15), is below its recent and historical rankings in total FDI inflows. But the 2015 result is nonetheless an improvement on the 2013 survey result, in which Canada failed to make the top 20 ranked 'prime target' countries as assessed by this group of executives. Aiming for 'top of mind' status with global decision-makers is a tall task but these latest survey results do otherwise bear a broad correlation with FDI flows. Such impressionistic evidence should not be ignored.

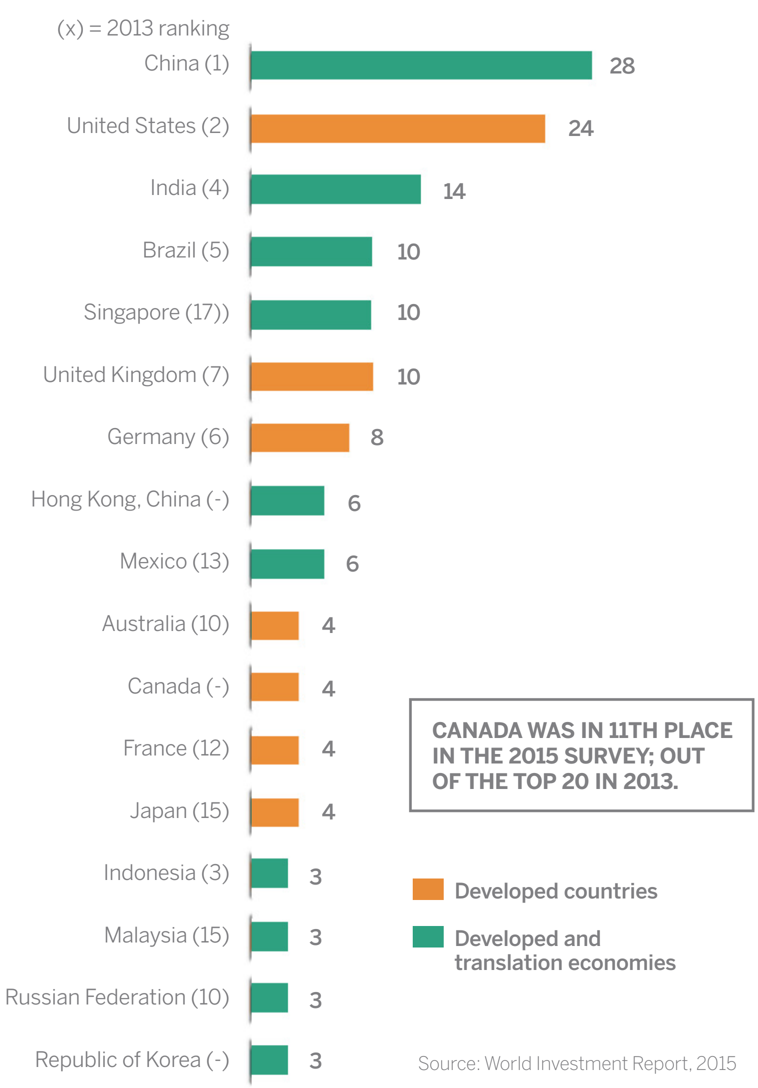
Assessment

Taken as a whole, the Canadian economy continues to attract its share, or more than its share, of Foreign Direct Investment, broadly defined.

However, Canada has not fared well over the past decade or so in terms of attracting greenfield FDI investment projects: we have in fact fallen behind key competitors and trading partners in this respect.

The FDI flows that Canada has managed to attract over the past 15 years have, by a very large margin, been disproportionately directed to a subset of resource-related industries – the mining and oil & gas extraction & refining industries – as well as to the "management of companies and enterprises" sector.

FIGURE 15 – FDI ATTRACTIVENESS RELATIVE TO PEERS



Source: World Investment Report, 2015

[Percentage of 1000 global corporate executives, surveyed by McKinsey in 2015, that view a given country as the single best investment location worldwide over 2015 to 2017.]

As well, a substantial portion of the measured FDI inflows to Canada over this period may represent M&A activity rather than investments in new, directly-productive assets. Outside of Petroleum and Coal Product Manufacturing, the balance of Canada's manufacturing sector has barely managed to grow its stock of Foreign Direct Investment over more than a decade.

This assessment supports the view that Canada's approach to attracting Foreign Direct Investment needs to be reviewed and assessed as to its quality and performance including the degree to which it is supporting growth and prosperity across all major sectors of the economy and the country. Such review and assessment will need to inform subsequent action.

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