

Summary

This study takes a close look at foreign direct investment (FDI) to and from Canada and concludes that fears about their adverse effects on the domestic economy are largely unfounded. The debate is too often framed around two misleading caricatures: that outward FDI is synonymous with exporting jobs, and that inward FDI is synonymous with excessive foreign control of Canada's economy.

A dispassionate analysis of the evidence shows that the benefits of foreign investment far outweigh any real or imagined drawbacks. Foreign firms operating in Canada are more innovative and productive than their Canadian counterparts, and they pay higher wages. More importantly, they import significant amounts of technology from their parent companies, and the benefits of these technologies spill over to domestic firms. In addition, though the stock of inward FDI did increase somewhat as a share of GDP in the late 1990s, it has held steady since then at just over 30 percent — the same share as in 1970.

Worries about corporate takeovers and the “hollowing out” of high-value head office functions in Canada are also misplaced. Foreign takeovers have actually increased head office activities in Canada in recent years, because foreign firms typically find it to their advantage to keep such activities geographically close to their Canadian operations.

Despite these benefits, Canada has been losing its attractiveness as a destination for foreign investment, particularly in the wake of continental free trade. Canada's share of global inward foreign investment has fallen since the mid-1980s, because firms are increasingly locating their production facilities in the United States or Mexico to serve the entire North American market.

The debate about foreign investment in Canada ignores the fact that Canadian multinationals have quietly become major players in the global marketplace. Canadian direct investment abroad has exploded in the past 30 years, and Canadian firms now own more foreign operations (in terms of dollar value) than foreign companies own in Canada. Far from exporting jobs, this investment abroad serves primarily as a beachhead for market expansion, stimulating domestically produced exports and high value added head office activities such as engineering and design.

Policies toward FDI should avoid counterproductive restrictions and focus on fostering a domestic economic environment that enhances the competitive posture of Canadian firms. As expected, domestic innovation and low corporate tax rates are shown to be important levers, but not in the ways that are commonly assumed. Domestic innovation and technology-oriented foreign investment are complements rather than substitutes (i.e., the former helps attract the latter). And low corporate tax rates in fact have little effect on the decision to invest in Canada, but they do help Canadian companies compete more effectively in foreign markets.