February 29, 2024

BRIEF FOR THE STANDING SENATE COMMITTEE ON BANKING, COMMERCE AND THE ECONOMY RE: BILL C-34, An Act to amend the Investment Canada Act

By Jim Balsillie

Honorable Chair, Members of the Committee,

At your request, I am pleased to provide some comments about the Investment Canada Act (C-34) in lieu of my oral presentation to the Committee.

Summary: Updating the Investment Canada Act (ICA) is a critical strategic step that can advance Canada's prosperity and security. While the current draft of ICA reflects some of the criticism heard in the House of Commons Industry Committee, proposed amendments and especially the strategy to leave the critical decisions to the discretion of the Minister are not sufficient to make ICA a useful tool to ensure a thriving domestic economy with robust security. In brief, ICA is still overwhelmingly designed to prevent investments from China, specifically their state-own enterprises. This framing misses the complete spectrum of threats to Canadian economy, security and society that are at play for small open economies like ours. Furthermore, the updated ICA gives the Minister powers to intervene in any transaction he/she deems damaging to national priorities as a catch-all guarantee, yet ISED has demonstrated no capacity to evaluate foreign investment for the economic and non-economic spillovers. For example, there has been zero analysis of the spillover effects for recent subsidies to electric battery manufacturers[1] which orient Canada's participation to low value-added activities (Figures 4 & 5). Prior, there has been zero analysis of spillover effects to foreign direct investment (FDI) such as Huawei partnerships inside Canadian universities; Google's Sidewalk Toronto project, Amazon HQ2 bid, etc. While the ICA is not a tool that can guarantee analytical policy capacity inside any Ministry, it's nevertheless an opportunity to use the updated Act as a catalyst to build that capacity so that the ICA can serve its intended legislative purpose.

New economy, new threats

In the modern, knowledge-based and data-driven economy, the sources of prosperity and the vectors of risk have changed. The changed nature of the economy was well captured in the excellent Senate report "*Needed: An Innovation Strategy for the Data-driven Economy*" published by your Committee.[2] Unfortunately, the understanding of foreign direct investment (FDI) that informs the updated ICA is mainly based on the tangible production economy even as it tries to overcome decades of changing economic landscape, contributing to Canada's weak

[1]Hinton, J. (2024, February 12). In giving billions to electric car makers, Canada is blinded by economic delusion. The Globe and Mail. https://www.theglobeandmail.com/business/commentary/article-canada-electric-vehicle-companies-subsidies/

[2] Senate of Canada. (2023, June). Needed: An Innovation Strategy for the Data-Driven Economy (BANC Senate Committee Report). Retrieved from https://sencanada.ca/content/sen/committee/441/BANC/Reports/Needed-Innov-Strat-Data-DrivenEcon_e.pdf

productivity performance (Figures 6 &7). As the economist Dan Ciuriak said[3], Canada is updating its investment strategy for digital economy 2.0 when the digital transformation is currently on 4.0 version.

Today's economy is knowledge-based, data-driven, and increasingly underpinned by the machine learning capital (Figure 1). In such an economy, FDI is *extractive* where technology, knowledge and data assets, senior executive personnel, tax base and wealth effects can easily flow out of countries that receive foreign investments. Prosperity and security risks do not scale with size and type of buyer but with the nature of economic and security spillovers. Economic and security risks should not be analyzed separately. Intellectual property (IP) and data have multi-sided features that interrelate giving rise to so-called "dual use" technology that has both economic and national security value. Any assessment of risk and net-benefit needs to include the economic and security value of assets as an integrated whole alongside the changed nature of spillovers for the economy of intangibles (Figures 2 & 3).

ICA needs to be regularly updated to properly guide an informed assessment of a given investment into Canada. IP and data have strong public good characteristics, so decisions made by businesses do not price the associated spillovers into contractual agreements. Data in particular has pervasive "dual use" characteristics with implications not just on the security of our nation's infrastructure (i.e. transportation, telecommunications, energy and finance) but also across all economic sectors and areas of human interaction – including democracy and child mental health.

Recommendations

While the updated ICA broadens the scope of review from a narrow financial threshold to wider net benefit review that includes IP and data, the focus is still clearly on State Owned Enterprises (SOEs) or entities in countries where Canada doesn't have trade agreements. I suggest a broader nature of the review that focuses on a more appropriate lens of critical, strategic technologies which would allow for the assessment of university partnerships, licenses and transactions of valuable IP and data. If assets are deemed critical to Canada's prosperity and security, then the ICA needs to ensure they remain in our control regardless of the type of foreign counterparty or nature of commercial relationship. **ICA should give legislative powers to the Federal Government, similar to those legislated in Australia, to unwind any prior investment, research partnership, joint venture or merger & acquisition.**

Changes to the Investment Canada Act will have little impact without changes in the capacity of government to identify, assess and act on acquisitions and partnerships that pose a threat to Canada's economic and national security. At the moment, the investment review process is very siloed, with ISED responsible for evaluating the economic implications of transactions, including whether the transaction passes the net benefit test, and national security agencies, led by Public

[3] Ciuriak, Dan. (May 9, 2023). The Implications of the Digital Transformation for the Governance of Foreign Direct Investment and Virtual Presence. Retrieved from https://ssrn.com/abstract=4444261

Safety, responsible for evaluating the security and defence implications. The reality is that it is often not possible to separate the economic aspects of a transaction from its national security aspects. This is especially true for transactions that involve cross-cutting technologies such as AI, quantum computing and robotics that are crucial for both economic success and national security. Canada needs to create a standalone agency that has the ability and expertise to examine all aspects of a transaction and provide a unified view of the costs and benefits to Ministers. Our major allies—the US, the UK and Australia—all have a single body responsible for reviewing foreign investment (CFIUS in the US, the Investment Security Unit in the UK, and the Foreign Investment Review Board in Australia), and Canada should adopt the same approach. **Creating a transparent, expert entity, akin to the American executive branch Committee on Foreign Investment in the United States (CFIUS), to implement and oversee all FDI regulations and strategies for the Federal Government is recommended.**

Recent FDI initiatives such as the Sidewalk Toronto project, university partnerships with Huawei, and Invest in Canada agency marketing strategies demonstrate that Canada's policymaking apparatus is not just rooted in the traditional, production economy of yesterday but is decades behind the realities of the contemporary economy. **It is critical that Canada builds capacity inside the Federal Government for governance of today's economy.** There is a real risk that the proposed Ministerial discretion might be abused or not effectively carried. The current Federal government has presided over 2/3rd of publicly funded research being transferred to foreign companies[4]. It has also produced no economic analyses for its FDI strategies. University research is central to the government's innovation strategy but remains outside the framework of scrutiny as to whether a foreign involvement provides a net benefit to Canada.

The strategic nature of IP and data have restructured the composition of markets by reconfiguring how an economy extracts benefits from technology and introduces new risks. This is why advanced economies and our allies have made significant steps to develop modern investment screening systems and continue to make dynamic updates, expanding the powers of foreign investment review necessary to defend valuable national assets. Canada must do the same if it wants to defend critical infrastructure and assets vital to our prosperity, security, and sovereignty.

[4] Hinton, J., Witzel, M., Wajda, J. (2023, April). An Economic Mirage How Canadian Universities Impact Freedom to Operate. CIGI Papers No. 274. Retrieved from https://www.cigionline.org/static/documents/no.274.pdf

Figure 1. Shift from Tangibles to Intangibles

Increase of the ratio of Intangible Stock Assets of the S&P 500, 1976-2019

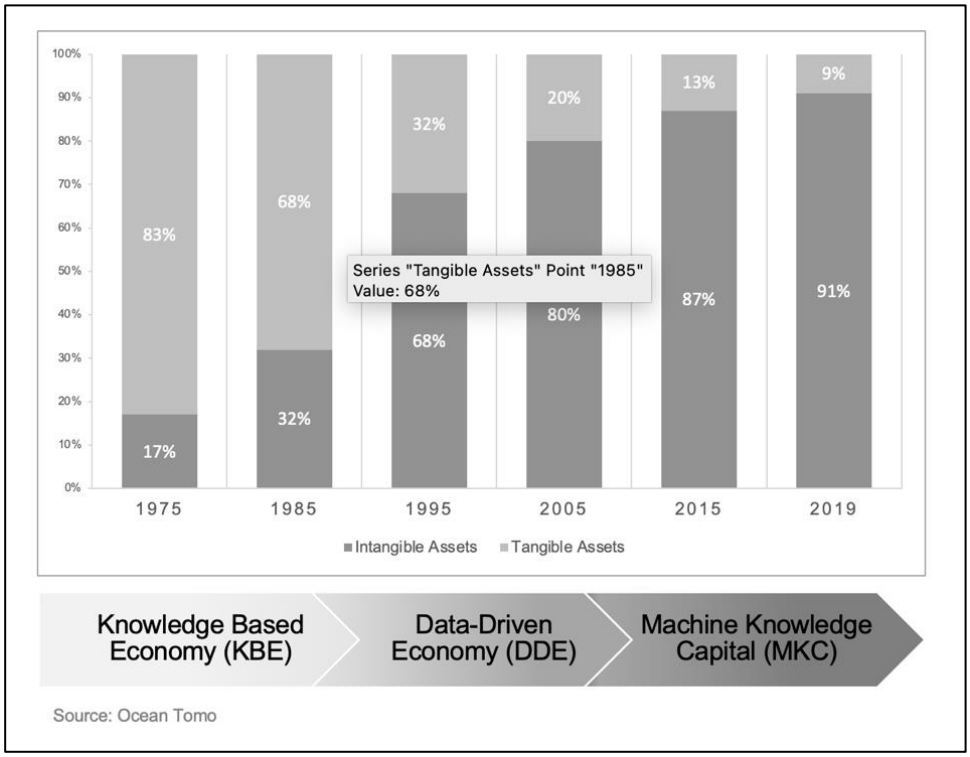


Figure 2. Foreign Investment Spillovers

Tangible v. Intangible Economies

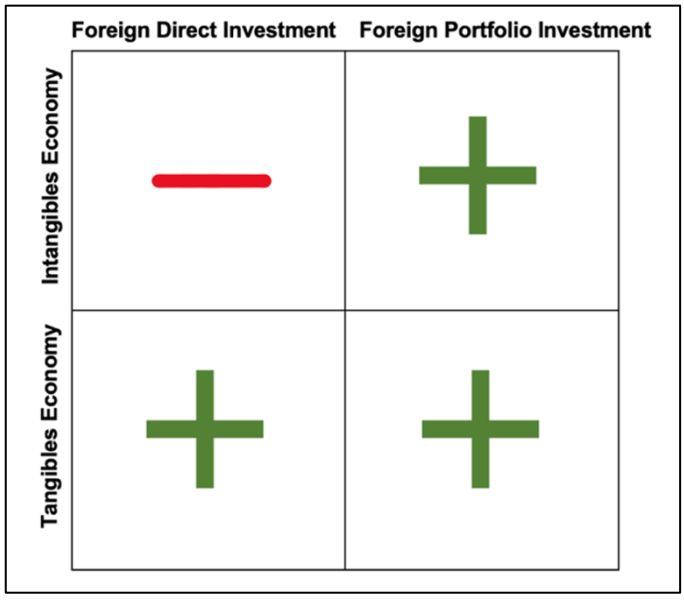


Figure 3. An Analytical Framework for Foreign Transactions Involving Canadian Intangible Stock Assets

Considerations for the Investment Canada Act

ECONOMIC PROSPERITY

1. Jobs Created (key skills such as computer engineering and data science have negative unemployment)
1. Wealth Effects (future benefits go to foreign owners)
2. Management Development
3. Top Talent Exfiltration
    a. Remote Direction/Supervision vs. Autonomous Branch Operation
    b. Expansiveness of Employee Non-Disclosure Agreements
    c. Comprehensiveness of Non-Competition Agreements
5. Data Exfiltration
6. Ecosystem Dynamism Effects
7. Erosion of Tax Base
8. Value Chain effects (particularly for high potential emerging firms)

NATIONAL SECURITY

1. Cyber Security Impacts
2. Critical Infrastructure Impacts
3. Public Health Impacts
4. Military/Defence Impacts
5. Social Good Impacts (democracy, values, cohesion, autonomy)
6. Geopolitical Considerations

Figure 4. Trade liberalization vs. FDI inward impact

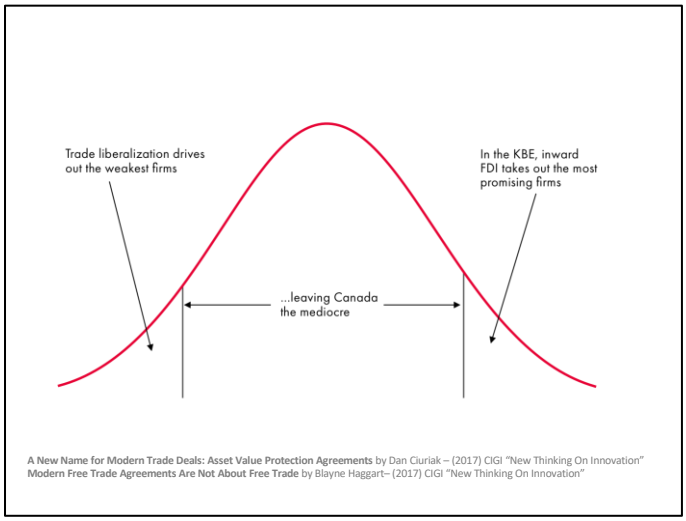


Figure 5. Strategic Positioning by Firms to Capture Rents

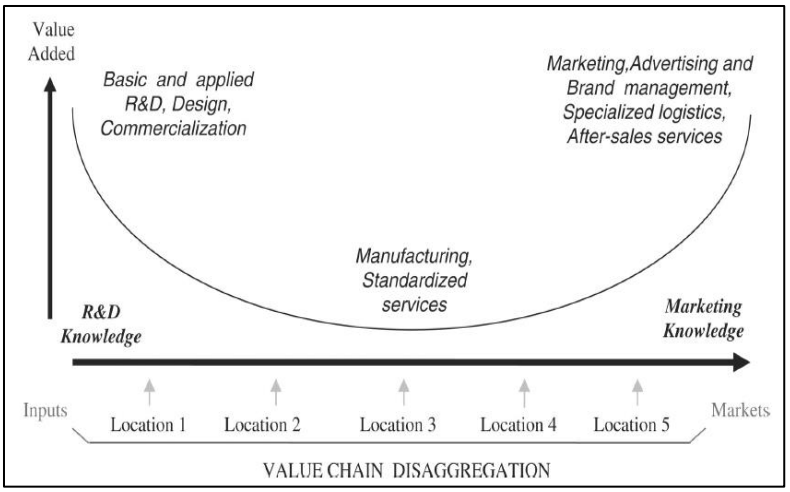
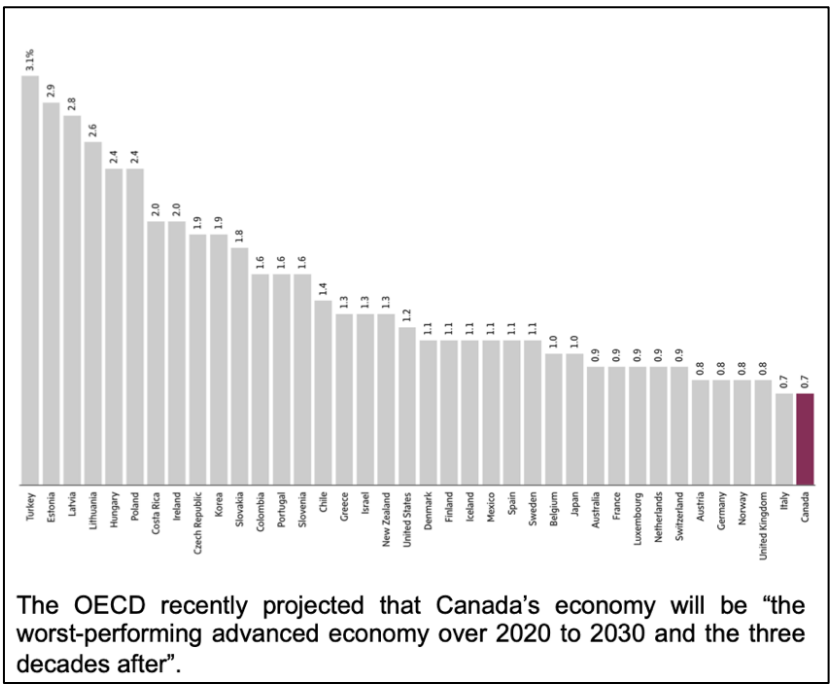


Figure 6. Canada to trail OECD in per-capita real GDP growth, Projected annual growth in real GDP per capita, 2020 to 2030



The OECD recently projected that Canada's economy will be "the worst-performing advanced economy over 2020 to 2030 and the three decades after".

Figure 7. Canada trailing the US in per-capita real GDP Growth Real GDP Per Capita

