1. <u>Investment</u>

(i) Background:

Investment policy cuts both ways. Canada needs to promote further domestic and foreign investment in Canada, while at the same time remaining open to the important benefits that flow from Canadian investments abroad.

Canada's overall effort to induce quality investment will have to increase significantly to meet a number of needs: incremental investment in machinery and equipment to capture accelerating technological advances and lower growth in labour supply, particularly skilled labour; additional capital expenditures to meet more stringent environmental standards; overdue public infrastructure renewal; and the infrastructural needs of an aging society. Moreover, Canada's geographic size, climate, limited population, and the capital-intensive nature of an economy still heavily defined by large resource-based industries indicate an on-going need for a greater investment effort than in most other industrialized countries.

Gross capital formation in Canada has not exceeded 24% of GDP since 1966-70. During the 1970s, it fell to 23.5%, declining further to just over 22% in the 1980s. With the domestic savings rate also declining from over 23% in the late 1960s to 21% twenty years later, foreign capital inflow has made an important incremental contribution to domestic capital formation (see Table 7). The contribution would appear even more important if we included re-invested earnings in Canada by foreign firms (80% of current foreign investment stock) as direct foreign investment inflow, rather than counting this funding as domestic savings.

On the basis of reasonable assumptions about labour productivity growth and the historical trend in the capital output ratio, one recent study has suggested that Canada's future gross investment requirements may be in the range of 26%-27% of GDP. Even higher levels could be required to meet incremental infrastructural and environment-related improvements.[26] Such an effort would push gross investment in Canada toward the record OECD performer in the 1980s: Japan (at 31% of GDP).

Whether or not we accept these specific projections, the need for a significant investment effort in Canada is apparent. It is not at all clear that this incremental effort can be met by significantly higher domestic savings in light of government dissaving caused by somewhat improved, but still persistent budget deficits. In this regard, many observers have suggested that the hunt for investment abroad in the

[26] Slater, "The Contribution of Investment", pp.59-74.