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Canada Is Missing Out On Global Capital Market Integration

Jack M. Mintz and Andrey Tarasov

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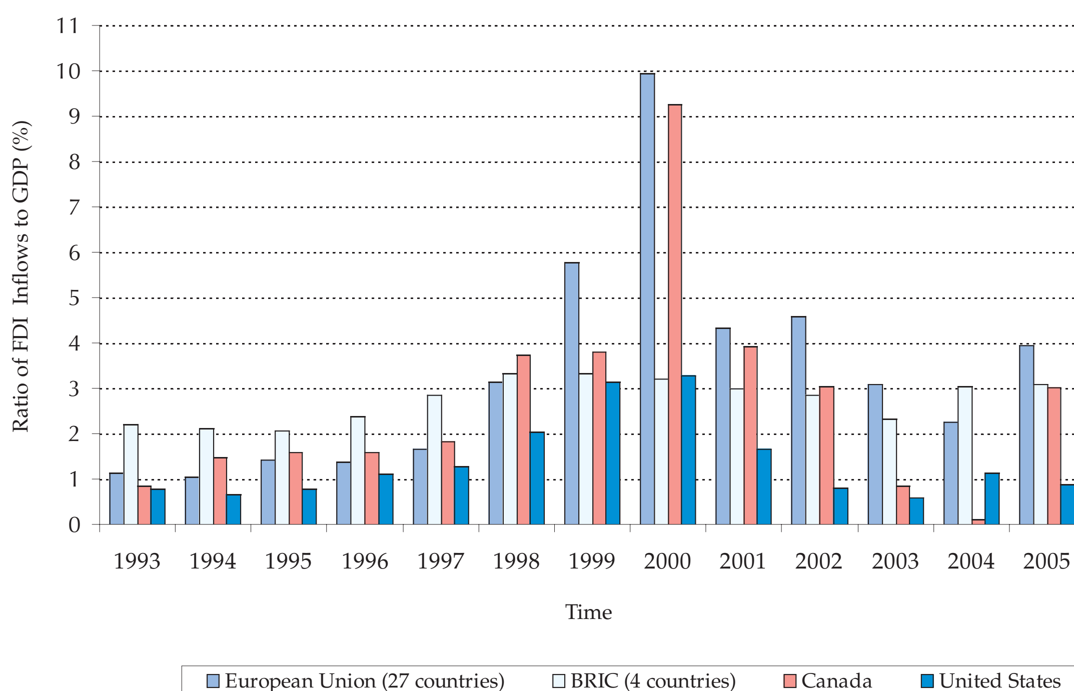
Recent foreign takeovers of significant companies, including Alcan, Falconbridge, Inco, and Four Seasons Hotels, have grabbed Canadians' attention, raising fresh worries over whether Canada is being "hollowed out." Does the pace of foreign direct investment threaten our economic independence?

Unlike portfolio investment, whereby stocks and other financial securities trade across national boundaries, foreign direct investment (FDI) places control and ownership of assets in the hands of multinational enterprises. Thus, a rise in FDI sometimes attracts questions about whether foreign businesses might make choices that are contrary to the host country's interests. Certainly, both outbound and inbound FDI flows have picked up in Canada since 2004. It is also true, however, that, since the mid-1990s, Canada has become a net investor abroad — in effect, a hollower-out of other countries.

Surprisingly, Canada's record as a host to global companies, whether Canadian or foreign controlled, is generally dismal. In international business, the trend is toward consolidation, with multinationals becoming more adept at creating and managing supply chains to improve their productivity and competitiveness. In 1993, net inflows of FDI, as measured by the International Monetary Fund (IMF), accounted for less than 1 percent of the gross domestic product (GDP) of 30 member countries of the Organisation for Economic Co-operation and Development, but rose to nearly 5 percent of GDP in 2000 before falling back to about 2 percent of GDP in 2005.[1] The trend in Canada has been similar to that in other countries, especially for EU member states, with FDI

1 Direct investment abroad (net outflows) and foreign direct investment (net inflows) in the reporting economy represent the change in the assets owned by investors in a country for cross-border investments. Direct investment includes equity capital, reinvested earnings, other capital, and financial derivatives associated with various transactions between affiliated enterprises that are at least 10 percent owned by the parent. Excluded are flows of direct investment capital for exceptional financing, such as debt-for-equity swaps. See IMF (1993, 2007).

Figure 1 *Ratio of FDI Inflows to GDP for Selected Countries and Country Groups*



Notes: The BRIC countries are Brazil, Russia, India, and China.

Sources: Authors' calculations based on data from IMF (2007) and United Nations (2007).

inflows rising to a peak in 2000 (owing mostly to the sale of Seagram Company Ltd.), then falling thereafter (Figure 1).[2]

Looking at the sum of FDI inflows and outflows as a share of GDP over the 2001-05 period, Canada ranks twenty-fifth among 73 industrialized and major developing countries (Table 1).[3] Over the same period, net inflows of FDI accounted for 2.2 percent of Canada's GDP, ranking the country forty-sixth. Just over a quarter of the assets of Canada's nonfinancial industries are controlled by foreigners, a proportion that has hardly budged since 2001 (Statistics Canada 2007). Net outflows of FDI over the same period, in contrast, equalled 3.8 percent of GDP, ranking Canada thirteenth among the 73 countries. Significantly, since the mid-1990s, Canada's historical role as a net capital importer has changed dramatically, to that of a net exporter of capital (Guillemette and Mintz 2004).

Major acquisitions by Manulife Financial (of John Hancock Financial Services) and Thomson Corporation (of Reuters Group) demonstrate that Canadian businesses can be significant global enterprises. During the 2001-05

2 In 2006, net FDI inflows were 2.5 percent of GDP and net outflows were 6.1 percent (Statistics Canada 2007).

3 We sum FDI inflows and outflows to evaluate the extent of an economy's openness to international direct investment flows. In the 1996-2000 period, net FDI inflows to Canada were 4.0 percent of GDP and net outflows were 4.1 percent, higher than in 2001-05. In 1991-95, net FDI inflows and outflows were 1.1 and 1.3 percent of GDP, respectively.

Table 1: *Ratio of FDI Net Inflow and Outflow as a Percentage of GDP, Country Rankings, 2001–05 Average*

Rank by FDI Sum	Country	FDI Inflow	Rank by FDI Inflow	FDI Outflow	Rank by FDI Outflow	Sum of Inflow and Outflow
		(% of GDP)		(% of GDP)		(% of GDP)
1	Luxembourg[a]	342.6	1	296.6	1	639.3
2	Hong Kong	14.0	2	13.5	3	27.5
3	Singapore	13.7	3	8.5	5	22.2
4	Iceland	5.5	14	15.1	2	20.6
5	Netherlands	5.9	12	11.0	4	16.9
6	Belgium[a]	9.8	5	6.8	7	16.6
7	Ireland	5.3	16	6.6	8	12.0
8	Lesotho	10.9	4	0.0	59	10.9
9	Switzerland	2.4	43	7.5	6	9.9
10	Bulgaria	9.1	6	0.1	45	9.3
11	Kazakhstan	8.7	7	0.4	72	8.2
12	Spain	3.6	28	4.6	10	8.1
13	Jamaica	7.1	10	1.0	27	8.1
14	Sweden	2.9	37	5.1	9	8.0
15	Czech Republic	7.3	8	0.5	33	7.8
16	United Kingdom	3.6	27	4.1	12	7.6
17	Chile	5.9	13	1.7	20	7.6
18	France	3.0	36	4.6	11	7.5
19	Congo	7.2	9	0.1	46	7.3
20	Botswana	4.4	22	2.2	18	6.6
21	Georgia	6.7	11	0.2	71	6.5
22	Croatia	5.4	15	1.0	26	6.5
23	Portugal	3.1	32	3.1	14	6.2
24	Hungary	5.1	18	1.1	25	6.1
25	**Canada**	**2.2**	**46**	**3.8**	**13**	**6.0**
26	Finland	3.0	33	2.6	16	5.6
27	Ecuador	5.1	17	0.0	61	5.1
28	Jordan	4.9	19	0.0	58	4.9
29	Romania	4.7	20	0.0	56	4.7
30	Austria	2.1	48	2.7	15	4.7
31	Tanzania	4.5	21	0.0	61	4.5
32	Malaysia	2.7	41	1.5	22	4.2
33	China	3.6	26	0.3	39	3.9
34	Ukraine	3.8	24	0.1	49	3.8
35	Costa Rica	3.7	25	0.1	48	3.8
36	Viet Nam	3.8	23	0.0	55	3.8
37	Latvia	3.3	30	0.5	36	3.8
38	Norway	1.3	58	2.2	17	3.6
39	Bolivia	3.5	29	0.0	53	3.5
40	Poland	3.2	31	0.3	38	3.5

Table 1 cont'd on next page

Table 1 (cont'd): *Ratio of FDI Net Inflow and Outflow as a Percentage of GDP, Country Rankings, 2001–05 Average*

Rank by FDI Sum	Country	FDI Inflow	Rank by FDI Inflow	FDI Outflow	Rank by FDI Outflow	Sum of Inflow and Outflow
41	Mexico	3.0	35	0.5	32	3.5
42	Denmark	1.5	55	2.0	19	3.4
43	Brazil	3.0	34	0.4	37	3.4
44	Russian Federation	1.7	54	1.6	21	3.3
45	Uganda	2.9	38	0.0	61	2.9
46	Peru	2.8	39	0.0	51	2.9
47	Australia	1.7	52	1.0	29	2.6
48	Italy	1.1	60	1.5	23	2.6
49	Sierra Leone	2.7	40	0.1	70	2.6
50	Tunisia	2.6	42	0.0	57	2.6
51	United States	1.0	62	1.3	24	2.3
52	New Zealand	2.4	44	0.1	69	2.2
53	Nigeria	2.2	45	0.0	61	2.2
54	Morocco	2.1	47	0.1	47	2.2
55	Germany	1.2	59	1.0	28	2.2
56	Argentina	1.9	50	0.2	44	2.1
57	Thailand	1.8	51	0.2	43	2.0
58	Egypt	1.7	53	0.1	50	1.7
59	Turkey	1.5	56	0.2	42	1.7
60	South Africa	2.0	49	0.4	73	1.6
61	Ghana	1.4	57	0.0	61	1.4
62	South Korea	0.7	64	0.6	31	1.3
63	Greece	0.7	65	0.5	35	1.2
64	Pakistan	1.1	61	0.0	52	1.1
65	Japan	0.2	72	0.8	30	1.0
66	India[b]	1.0	63	0.3	40	1.3
67	Madagascar	0.7	66	0.0	61	0.7
68	Mauritius	0.4	69	0.3	41	0.7
69	Indonesia	0.1	73	0.5	34	0.6
70	Ethiopia	0.6	67	0.0	61	0.6
71	Bangladesh	0.5	68	0.0	60	0.5
72	Rwanda	0.3	70	0.0	61	0.3
73	Kenya	0.2	71	0.0	54	0.3

Notes: [a] The averages for Luxembourg and Belgium are for the 2002-05 period. Prior to 2002, the two countries' FDI inflows and outflows were reported together. Over the 2001-05 period, their combined averages for FDI inflows, outflows, and sum of inflows and outflows were 342.6%, 296.6%, and 639.3% of GDP, respectively.

[b] India's averages are for the 2001-03 period.

Sources: FDI flows, IMF 2007; GDP, United Nations 2007.

period, Canadian companies acquired 23 foreign companies with assets in excess of $1 billion each, for a total of more than $60 billion in assets (UNCTAD, various years). This compares with the 25 foreign acquisitions of Canadian corporations worth more than $1 billion each, for a total of about $75 billion.

Nonetheless, Canada could be more open to international direct investment markets. During the 2001-05 period, the most open economies — as measured by the sum of FDI inflows and outflows as a share of GDP — were Luxembourg, Hong Kong, Singapore, Iceland, and the Netherlands. In contrast, among the Group-of-Seven major industrialized countries, Canada was less open than the United Kingdom or France, and received lower FDI inflows as a share of GDP than did major developing countries such as Brazil, China, or Mexico.[4]

Openness to international capital markets matters. Countries with healthily growing economies have encouraged both FDI inflows and outflows by easing regulatory burdens and reducing business taxes.[5] Direct investment abroad by Canadian-based companies (whether Canadian or foreign owned) provides numerous benefits: greater opportunities to expand business operations in international markets; greater market share for Canadian products; and better access to resources, technologies, know-how, and financing. Outbound FDI by Canadian-based multinationals also improves domestic company export performance (Hejazi 2007).

FDI inflows are also good for the Canadian economy. Under the threat of takeover by foreign competitors, less efficient managers are pressured to perform better or be replaced by stronger leadership, thereby increasing shareholder wealth. Foreign companies might also have better access to international technological and research and development markets, creating better opportunities for innovation and knowledge acquisition from outside Canada. And foreign-controlled companies in Canada often perform more efficiently than Canadian-controlled companies in terms of productivity (see Guillemette and Mintz 2004; Baldwin and Gu 2005).

Yet, Canadian governments protect domestic management through a variety of policies. Limitations on foreign ownership affect transportation, communications, and finance — particularly banking. Federal and provincial ownership of businesses creates barriers to competition from the private sector. Tax policies, such as high withholding taxes on dividend payments to nonresidents negotiated under bilateral treaties, make Canada less open to both outbound and inbound FDI.

True, not all foreign takeovers are good for the economy. Some mergers and acquisitions might reduce competition in product or supplier markets — although that would apply equally to foreign or domestic takeovers, and competition policy should protect Canadians from such harmful monopolistic practices, no matter what the source. Some foreign takeovers might also compromise Canada's national

4 Foreign ownership of the UK corporate sector (excluding unquoted companies) increased from 30 percent in 1995 to 50 percent in 2007 (United Kingdom 2007). The UK government expressly welcomes FDI through various regulatory and tax policies.

5 Foreign direct investment as a share of GDP rises with stronger economies but greater FDI could also contribute to higher growth rates. Although other factors affect growth rates, in an analysis of 68 countries we find that the real per capita growth rate increases by 0.2 percentage points with each percentage point increase in lagged FDI inflows as a share of GDP.

security, but policy responses should not become backdoor ways for governments to shield Canadian management from competition.

To improve its performance, therefore, the Canadian economy needs to become better integrated with world capital markets, and Canadian businesses need to be able to participate more fully in global supply chains. Canadians thus should pay little attention to those who call for more barriers to FDI, which serve mainly to shield domestic businesses from beneficial international competition, limit their access to international management and technology, and make it more difficult to achieve cost efficiency. Instead, given the significant economic benefits of FDI, Canada should pursue integration with world markets with relish.

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This *e-brief* is a publication of the C.D. Howe Institute. **Jack M. Mintz** Professor of Business Economics, J.L. Rotman School of Management, University of Toronto, and Fellow-in-Residence, C.D. Howe Institute. and **Andrey Tarasov** is an associate of the International Tax Program, Institute of International Business, J.L. Rotman School of Management, University of Toronto.

For more information contact **Finn Poschmann** at 416-865-1904, e-mail cdhowe@cdhowe.org. This *e-brief* is available at www.cdhowe.org.

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