

Going Global

International Finance in Canada

Foreign Liabilities

The capital account surplus and current account deficit that were once typical on Canada's balance-of-payments accounts demonstrate a key characteristic of the Canadian economy: foreigners own more financial assets in Canada than Canadians own in foreign markets. For the Canadian economy as a whole, the financial assets that Canadians hold in other nations, such as stocks and bonds, are considered "foreign assets," while those that foreigners hold in Canada are considered "foreign liabilities."

As Figure A shows, foreign assets equalled \$983.3 billion in contrast to foreign liabilities of \$1167.3 billion in 2002. Of financial assets that Canadians held in other countries, the majority (66.2 percent) were stocks held in foreign corporations. In contrast, the largest percentage of financial assets that foreigners held in Canada (40.2 percent) were various types of bonds. Another 36.2 percent of foreign liabilities took the form of corporate stocks.

Note that the two concepts—foreign assets and foreign liabilities—can be consolidated. "Net foreign assets" are foreign liabilities subtracted

from foreign assets to give a positive or negative figure. If foreign assets outweigh foreign liabilities, the number is positive; if the reverse is true, the number is negative. So, for Canada in 2002, net foreign assets were $-\$184$ billion ($\$983.3$ billion $-\$1167.3$ billion):

$$\begin{aligned} \text{Net foreign assets} &= \text{foreign assets} - \text{foreign liabilities} \\ -\$184 \text{ billion} &= \$983.3 \text{ billion} - \$1167.3 \text{ billion} \end{aligned}$$

Foreign Ownership

How does Canada compare with other countries? To answer this, we have to consider foreign ownership—summarized by net foreign assets—in the context of each country's economy. To do this, we use GDP. As Figure B shows, net foreign assets, expressed as a proportion of the country's GDP, range for seven countries from Japan's *positive* net foreign assets equalling just under 24 percent of its GDP to the U.S.'s *negative* net foreign assets equalling just under 26 percent. Italy, France, Japan, and Germany all have positive net foreign assets—in other words, residents of these countries own more assets internationally than they owe to foreigners. As a result, these four countries are net foreign lenders.

Many economists see Canada's foreign liabilities as a source of concern. The result of Canada's negative net foreign assets is twofold. While great amounts of foreign investment are made in the Canadian economy income from this investment leaves Canada.

Figure A Canada's Foreign Assets and Liabilities (2002)

Foreign Assets			Foreign Liabilities		
	\$ Billions	% Foreign Assets		\$ Billions	% Foreign Liabilities
Stocks	651.0	66.2	Stocks	423.1	36.2
Bonds	40.0	4.1	Bonds	468.9	40.2
Government reserves	56.2	5.7	Other	275.3	23.6
Other	236.1	24.0			
Total foreign assets	983.3	100.0	Total foreign liabilities	1167.3	100.0

Of the foreign assets owned by Canadians—split among stocks, bonds, government reserves and loans, and other short-term assets, such as bank accounts—stocks in corporations make up the majority (66.7 percent). In contrast, of the liabilities that Canadians owe to foreigners—in other words, the financial assets in Canada owned by foreigners—40.2 percent are bonds of various types.

Source: "Canada's Foreign Assets and Liabilities (2002)" adapted from the Statistics Canada publication "The Daily" Catalogue 11-001, September 25, 2003.

Figure B Net Foreign Assets as a Percentage of GDP (2001)

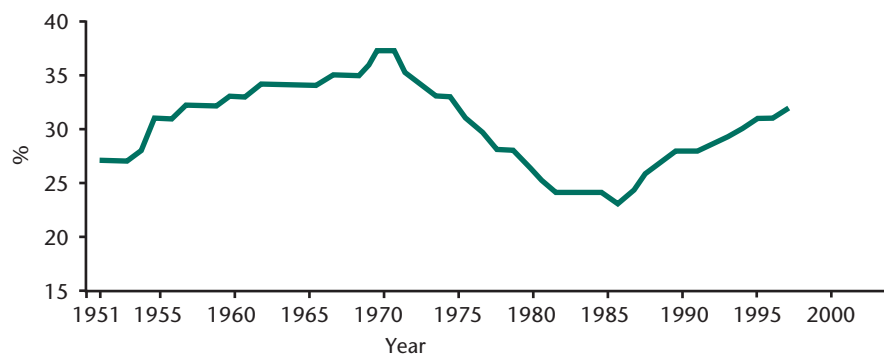
Comparing net foreign assets (foreign assets – foreign liabilities) as a percentage of a country's GDP demonstrates the degree to which foreign ownership in Canada exceeds that in many other nations. For example, while Canada's foreign assets are negative and account for over 11 percent of Canada's GDP, Japan's net foreign assets are positive and account for just under 24 percent of Japan's GDP.

Source: OECD Main Economic Indicators (Nov 2003), P. 243; IMF, International Financial Statistics (Dec 2002).

This large outflow of investment income from Canada each year means that funds that could have stayed in the country to produce and buy domestic products or that could have left the country to purchase foreign goods and services are instead being used to make payments to foreigners. Since this outflow is a loss of Canadian purchasing power, it represents a drain on the Canadian economy. This is especially true for the foreign debts of Canadian government, since annual outflows of interest payments on these debts are not tied to profitable capital assets, as with most corporate liabilities.

Foreign Control of the Canadian Economy

Much of the controversy surrounding Canada's foreign liabilities has focused on foreign direct investment, which involves controlling interests in Canadian companies. Because of past high rates of foreign direct investment in Canada, a relatively high percentage of the country's economy is controlled by outsiders. As depicted in Figure C, the percentage of nonfinancial industries dominated by foreigners rose during the 1950s and 1960s, reaching a high of 37 percent in the early

Figure C Share of Foreign Control of Capital Employed in Nonfinancial Industries in Canada

Source: Share of Foreign Control of Capital Employed in Nonfinancial Industries in Canada. From the Statistics Canada publication, 'Canadian Economic Observer', Catalogue 11-010, April 1993, pages 3 to 7 inclusive and 'Corporations Return Act', Catalogue 61-220, 2000 pg 38

1970s. After falling to 23 percent by 1986, the figure increased gradually, reaching 32 percent by 1997. Preliminary evidence suggests that it has fallen somewhat since then.

Direct investment by foreigners has been particularly significant in some sectors of the Canadian economy. Figure D shows that foreign control is most prevalent in such industries as manufacturing (45.2 percent) and oil and gas extraction and coal mining (42.5 percent). In contrast, foreign control is relatively insignificant in such areas as construction (4.6 percent) and utilities (3.1 percent).

The debate over foreign direct investment in the Canadian economy is closely tied to the role of so-called transnational corporations, such as General Motors and IBM, which have operations in many countries. The transnational corporations that play the largest role in the Canadian economy are listed in Figure E.

Benefits and Drawbacks

Benefits

Supporters of foreign ownership point to two potential benefits: overall benefits to the Canadian economy, and efficiency.

Overall Benefits to the Canadian Economy

Supporters argue that direct investment by foreign companies in Canada benefits the Canadian economy by increasing the stock of capital assets, thereby raising the productivity and living standards of Canadian workers.

Efficiency To the extent that transnational corporations concentrate particular types of production in countries where they can be carried out most efficiently, these businesses also help to cut production costs and prices not just for Canadians but for consumers in all countries.

Drawbacks

However, critics of direct foreign investment point to the drawbacks of increased foreign liabilities of the Canadian economy, loss of Canadian economic sovereignty, and low levels of research and development expenditures in Canada.

Increased Foreign Liabilities The first criticism is quite obvious: a high level of any foreign investment increases Canada's debt to foreigners.

Canadian Economic Sovereignty Canadian governments lose some of their power to govern when foreign-controlled companies are forced to comply with foreign legislation. The most publicized cases have involved laws of the United States that forbid American-owned companies—no matter where they operate—from trading with communist countries, such as Cuba.

Decreased Research and Development

Expenditures on research and development by Canadian businesses tend to be lower than in most other countries. Critics of foreign ownership claim that this is so because foreign-owned businesses conduct such activities at their international head offices rather than in Canada. The result is fewer jobs for Canadian scientists and

Figure D Foreign Control in Nonfinancial Industries (2000)

	Industry Assets That Are Foreign-Controlled (%)
Manufacturing	45.2
Oil and gas extraction and coal mining	42.5
Retail trade	18.2
Professional, scientific and technical services	18.2
Real estate and rental and leasing	15.6
Transportation and warehousing	14.7
Construction	4.6
Utilities	3.1
Total non-financial (excluding management of companies and enterprises)	25.5

Overall, 25.5 percent of the assets of nonfinancial industries in Canada are foreign-controlled. Of these industries, manufacturing and oil and gas extraction and coal mining have the highest proportions of foreign control, while construction and utilities have the lowest.

Source: Foreign Control in Nonfinancial Industries 1997. from the Statistics Canada, CANSIM database <http://cansim2.statcan.ca/cgi-win/CNSMCGI.EXE> Table 1790004.

Figure E Largest Foreign-Owned Companies in Canada, 2002

Company	Revenue (\$ millions)	% Foreign- Owned	Parent
General Motors of Canada Ltd.	37 000	100	General Motors
Ford Motor Co. of Canada Ltd.	23 329	100	Ford Motor Co.
DaimlerChrysler Canada Inc.	19 353	100	DaimlerChrysler
Imperial Oil Ltd.	16 890	70	Exxon-Mobil
Honda Canada Inc.	12 300	100	Honda Motor Co.
Costco Wholesale Canada Ltd.	7 318	100	Costco
Shell Canada Ltd.	7 232	78	Shell
Sears Canada Inc.	6 536	54	Sears, Roebuck and Co.
Canada Safeway Ltd.	5 481	100	Safeway
IBM Canada Ltd.	5 300	100	IBM

Source: Main Economic Indicators (Nov 2003). P. 243; IMF, International Financial Statistics (Dec 2002). The National Post Company

technicians as well as a lower rate of technological progress in the Canadian economy.

Whatever the benefits and drawbacks of foreign investment, most countries are facing higher levels of foreign investment than ever before.

Given Canada's history of high foreign ownership and the related policies that go with it, Canada's experience will provide lessons for the many countries that are "going global."

1. How will Canada's net foreign assets be affected by the following trends? In each case, explain your answer:
 - a. The decreasing attractiveness of Canada as a location for direct investment
 - b. A rise in borrowing by Canadian governments
 - c. A fall in Canadian interest rates relative to those in other countries
2. "The benefits of foreign direct investment in Canada outweigh the costs." Discuss using the concepts outlined in this article.