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Insights on the Canadian Economy

Changes in Foreign Control under Different Regulatory Climates: Multinationals in Canada

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Abstract

This paper examines the incidence of foreign control in Canadian non-financial industries. It focuses on changes in the share of assets and revenues under foreign control over a long-run period during which Canada’s regulatory climate shifted from being more restrictive to more liberal in its treatment of inward foreign direct investment. These regulatory changes coincided with a retrenchment and then a resurgence in the activities of foreign multinationals in Canadian industry. We report aggregate results for non-financial industries, along with specific tabulations for the energy sector. More detailed industry tabulations are presented for the 2000-2003 period.

1. Introduction

The economic performance of the Canadian economy depends on the efficiency of Canadian producers and the effectiveness of competitive market forces. The strength of these competitive forces depends on inherent characteristics like market structure, but also on the interaction of producers with the political system. Firms respond to economic incentives. And the operations of firms are often tempered by regulatory constraints that are imposed by the state.

The history of foreign multinational activity in the Canadian economy provides one example of how firms respond to different competitive environments. Foreign direct investment has been an important component of the Canadian economy since Confederation. Foreign firms have long responded to economic forces by locating their production activities in Canada. Throughout, the Canadian political system has attempted to influence the nature of these activities—first through tariffs and commercial policy, and more recently, through the direct regulation of foreign direct investment (FDI). The latter foray into regulation by the Canadian state offers a case study of the extent to which market forces can be shaped—how aggregate investment levels change when regulation is imposed and how these subsequently respond when regulatory barriers are relaxed.

In this paper, we report on long-run changes in foreign control, concentrating on years in which the regulatory climate shifted from being more restrictive to more liberal. We focus on aggregate changes in foreign control, along with those specific to the energy sector. Energy industries are examined separately because this is one area of the economy where tighter restrictions on foreign investment remained in place after more liberal policies had been phased in elsewhere.

Our data on the activities of foreign multinationals come from Statistics Canada’s Corporation and Labour Unions Returns Act (now the Corporations Returns Act). These data provide for a broad portrait of the importance of foreign-controlled corporations in different sectors of the Canadian economy. CALURA defines a foreign-controlled firm as one with 50%+ of its voting equity controlled by foreign residents or by a foreign corporation (there are exceptions to this majority equity rule in cases where the domestic company is effectively controlled from abroad). These data classify all equity, revenue and assets generated or held by foreign-controlled firms to the foreign-controlled sector. This readily allows us to estimate the share of domestic economic activity—in terms of assets, revenues or equity—that is under foreign control.
The organization of this paper is as follows. Section 2 provides a brief overview of the regulatory regime governing foreign capital in Canada. Section 3 reports on long-run changes in foreign control in non-financial industries. Section 4 discusses related research that places the importance of regulatory forces in context, by evaluating other factors that can be expected to engender changes in foreign control. Section 5 reports on foreign control in the energy sector and examines overall trends in non-financial industries after the energy sector has been excluded. Section 6 presents detailed industry tabulations for the 2000-2003 period. Section 7 concludes.

2. Changes in the investment regulatory regime—a brief synopsis

Both tariff reductions and regulatory factors have been posited to affect the level of foreign direct investment in Canada. While tariff reductions have gradually reduced barriers to the movement of goods, changes to the investment regulatory regime have first created, and then relaxed, barriers to the movement of capital. These shifts in regulatory policy were grounded in the prevailing intellectual currents of the time. In the late 1960s and early 1970s, much attention was focused on what was widely regarded as the negative consequences of increased foreign control. This culminated, by the mid 1970s, in the establishment of the Foreign Investment Review Agency (FIRA), the mandate of which was to monitor foreign investment in the Canadian economy and adjudicate proposed capital inflows. Inward FDI that involved the acquisition of Canadian businesses by foreign investors or the establishment of new foreign-owned startups was subject to FIRA approval. FIRA is perhaps the most visible example of a regulatory policy that was “primary and explicitly implemented to alter the environment for FDI in Canada;” under FIRA, foreign investors were required to demonstrate that FDI inflows would result in “significant benefit to Canadians” (Globerman and Shapiro, 1999: 515, 516).

From 1975 to 1985, FIRA established the broad regulatory framework governing the investment activities of foreign multinationals. Foreign capital came under greater scrutiny than in times past, and foreign investors bore an increased administrative and regulatory burden. While FIRA’s mandate was wide-reaching, Canada’s investment regulatory regime also included a sizable array of sector-specific policies that were tailored to the idiosyncrasies of different industries. Many of these centered on industries that are widely regarded as strategically important to the Canadian economy, such as financial services, telecommunications and oil and gas industries. The last of these, the energy sector, is examined herein. Levels of foreign investment in the energy sector have traditionally been high, with foreign-owned firms controlling a relatively large share of industry assets and revenues. The 1970s and 1980s saw regulatory initiatives put into place that were designed to limit the foreign presence in this sector. The National Energy Program, the most visible of these policies, was implemented in 1980 with multiple objectives, one of which was to encourage the Canadianization of the petroleum industry.

After a change in government in the 1980s, the broad regulatory climate towards foreign capital shifted from being more restrictive to more liberal. In 1985, FIRA was replaced with a new agency, Investment Canada, whose mandate was seen to be less restrictive—as facilitating and soliciting foreign direct investment rather than controlling it. At the same time, the foreign investment provisions of both the FTA and NAFTA relaxed the thresholds required for review
before the agency. The National Energy Program, with the exception of the continued state ownership of the national petroleum company (Petro-Canada), was allowed to lapse.

While a more liberal stance towards inward FDI came into effect in the mid-1980s, the tighter regulatory constraints of the 1970s were not relaxed equally across all industries, at least in the near term. In the energy sector, restrictions on foreign ownership continued—albeit attenuated from the earlier period. Restrictions that precluded foreign investors from acquiring “financially healthy” Canadian oil and gas companies remained in effect until the early 1990s (see Globerman, 1999). While some investment restrictions were loosened in the post-FIRA era, the federally-owned petroleum company (Petro-Canada) continued to exist and to be protected from foreign takeover.

In the following sections, we examine how the incidence of foreign control in Canadian industry varied under these different regulatory climates.

3. Decline and recovery: Aggregate trends in foreign control

The overall presence of foreign multinationals in the Canadian economy can be evaluated by examining the percentage of all corporate assets, or revenues, that is accounted for by foreign-controlled firms. Following the reporting conventions of the *Corporations Returns Act*, separate estimates are generally produced for non-financial industries and financial industries—with the former serving as the standard proxy for evaluating the magnitude of foreign control in the aggregate. Asset ratios are input-based, and focus on investment activities—purchases of machinery, equipment and structures that firms rely on to generate capital services. These asset ratios are one measure of the extent to which foreign multinationals influence the productive capacity of the domestic economy. Revenue ratios, in contrast, are output-based, and are more apt to reflect cyclical short-term fluctuations in economic activity if these affect foreign and domestic firms differently. Long-term trends in the shares of assets and output under foreign control may differ if foreign-controlled firms become more (or less) capital intensive than their domestic counterparts. The asset and revenue shares of foreign-controlled firms operating in non-financial industries are reported in Figure 1.5

Over the last four decades, foreign multinationals operating in Canada have experienced first a retrenchment and then a resurgence in their activities as evidenced by their share of both assets and revenues. As noted earlier, the late 1960s were witness to substantial consternation in academic and policy circles over what many regarded as the deleterious effects of foreign direct investment on the Canadian economy. This was also a period in which foreign multinationals, via FDI, were increasing their presence in Canada’s non-financial industries. By 1971, some 35% of non-financial assets and 37% of non-financial revenues were under foreign control. Beginning in the early 1970s, the overall presence of foreign multinationals in the Canadian economy began to decline, commensurate with the onset of a more restrictive regulatory climate. This retrenchment in foreign control continued in earnest after FIRA came into full effect in 1975. In that year, some 30% of assets in non-financial industries were controlled by foreign-owned firms; a decade later, at the conclusion of the FIRA era, only 22% of assets were under foreign control. The revenues of foreign-controlled firms, 35% of all revenue in non-financial industries in 1975, stood at 29% in 1985.
The post-FIRA era saw many of the restrictions on inward FDI relaxed, accompanied by a gradual resurgence in the share of economic activity accounted for by foreign-controlled firms. Both the share of foreign-controlled assets and revenues began to increase—asset shares gradually from the mid 1980s and revenue shares beginning in the 1990s. Throughout the 1990s, foreign firms were increasing their presence in non-financial industries—though the shares of assets and revenues under foreign control remained below those experienced during the peak years of the late 1960s and early 1970s. Conflicting incentives for multinational investment may help explain the relative modesty of the post-FIRA recovery. The fact that the increase in foreign control does not quite offset the previous decline is consistent with an interpretation that attributes changes in foreign control both to reductions in tariffs and to shifts in the regulatory regime. Tariffs declined more or less continuously during the 1965-2000 period. All things equal, both tariffs and the regulatory regime were working to reduce the incidence of foreign control during the 1970s and early 1980s. In subsequent years, these forces would be offsetting—with tariff reductions possibly operating to reduce foreign investment and post-FIRA regulatory changes serving to encourage foreign investment.

At first blush, the visual evidence presented in Figure 1 is compelling. Precipitous declines in the share of economic activity accounted for by foreign firms occurred during a period in which the investment regulatory regime was less open to FDI inflows. Once the regulatory regime began to shift from more restrictive to more liberal, this process of retrenchment begins to reverse itself, and the overall presence of foreign-controlled firms in the economy began to increase. This is certainly the case for assets, where the pattern of decline and recovery closely mirrors the transition from restrictive to liberal regulatory climate. Declines in the share of foreign-controlled assets occur more or less continuously from the early 1970s to the mid 1980s—during the lead up to, and for the duration of, the FIRA period. Shares of foreign-controlled revenues exhibited a slightly different decline and growth pattern, as the decline phase extended well into the late 1980s, followed by sharp recoveries during the early 1990s.
4. **The influence of other factors on changes in foreign control**

In this study, we draw attention to a set of regulatory forces that help to determine, in part, the attractiveness of the Canadian economy to foreign investors. In actuality, the foreign investment decisions of multinationals depend on a complex set of underlying factors, of which regulation is but one. Relative wage costs, the costs of raising investment capital, the dynamism of host economies, tariff policies, exchange rate differentials, hedging considerations—each of these can be expected to influence how multinational firms allocate their investment expenditures. Multinational investment strategies may be tailored to still other objectives, such as the need to obtain specialized assets (e.g., R&D capital) that are difficult to exploit via arms length transactions (Caves, 1982).

Disentangling these causal factors in a comprehensive fashion is beyond our scope here. Our interest is with the extent to which aggregate changes in foreign control are consistent with broad changes in the regulatory regime governing foreign investment. While ours is a straightforward look at the relationship between foreign control and regulation, some readers will require a more rigorous examination of causal influences—as a means of placing the importance of regulation in context. In an accompanying exercise (see Baldwin and Gellatly, 2005), we attempted to isolate the effects of changes in the regulatory regime from other factors that are posited to influence the magnitude of foreign capital inflows. These factors help to determine the attractiveness of the investment climate in Canada vis-à-vis the United States. In this exercise, we estimated how the share of assets under foreign control is related to relative GDP, relative unit labour costs, relative wage growth, and differences in the expected return to capital between Canada and the United States. This analysis included a time trend and binary variables that evaluated the transition from the more restrictive to the more liberal regulatory regime.

We found that relative unit labour costs and the relative growth in wage rates both have a negative and significant effect on foreign control. Accordingly, high relative labour costs in Canadian markets serve to reduce their attractiveness to foreign investors. The relative return on equity variable has a positive and significant effect, as relatively high (low) yields in Canadian markets serve to attract (deter) foreign capital.

It is noteworthy that when these proxies for the attractiveness of the economic climate are included, there is still evidence that the FIRA period was marked by a reduction in foreign control.

5. **Sectoral patterns of decline and recovery: energy versus non-energy industries**

In a related study, Baldwin and Gellatly (2005) found that the pattern of decline and recovery observed in Figure 1 was apparent in many sectors—which suggests that changes in foreign control were driven *inter alia* by general factors, such as changes to the regulatory regime.
The statistical exercise described in Section 4—which focused on the foreign share of assets in non-financial industries—corroborates this view. There is evidence of a statistical relationship between changes in the regulatory climate and changes in foreign control, once other factors that are expected to influence the magnitude of inward foreign direct investment are taken into account.

These aggregate patterns may, however, obscure more detailed industry-specific trends, as the transition from restrictive to liberal regulatory climates did not occur uniformly in all areas of the economy. As noted earlier, certain sectors, such as energy, maintained a variety of restrictive measures well into the post-FIRA period.

In this section, we focus on long-run changes in foreign control in Canada’s energy sector. This sector is comprised of two sub-sectors: (1) petroleum and coal manufacturing industries and (2) oil and gas extraction industries. Concerns over the activities of foreign multinationals in these sub-sectors have persisted well into the post-FIRA era. In Figure 2, we present the revenue shares of foreign-controlled firms operating in the energy sector. We report these separately for petroleum and coal industries and oil and gas industries, along with the energy sector average.

**Figure 2. Percentage of revenues under foreign control, energy industries**

![Figure 2](image)

Source: Special tabulations, Statistics Canada, Industrial Organization and Finance Division.

Foreign multinationals have long been a dominant force in Canada’s energy sector. During the early 1970s, foreign-controlled firms generated virtually all of the revenues in these industries. With the advent of FIRA, the revenue shares of foreign-controlled companies began to decline precipitously. By the early 1980s, the share of energy revenues generated by foreign-controlled firms had declined to about 70%. The reductions in foreign control that occurred under FIRA were similar in both sub-sectors.
The revenue estimates suggest that a progressive long-run decline in foreign control within the energy sector continued into the 1990s. In what follows, we examine how changes in foreign control in the energy sector influence the overall pattern of decline and recovery apparent during the FIRA and post-FIRA periods. We evaluate the impact of the energy sector in Figure 3 by excluding energy revenues from the tabulation of our non-financial totals. We are interested in the extent to which the post-FIRA recovery phase observed in the aggregate (Figure 1) becomes more pronounced once energy industries are excluded from the fold.\footnote{1}

Despite much higher foreign control shares in energy industries, the volume of revenues controlled by non-Canadian firms in energy industries is not large when viewed in relation to all foreign-controlled revenues across the economy. The exclusion of energy industries from our non-financial aggregate has only a small impact on the aggregate revenue shares presented in Figure 3. How does the exclusion of energy industries affect the aggregate trend? During the FIRA period, the declines in foreign control in energy industries had little qualitative impact on the pattern of aggregate decline apparent within the non-financial sector. In the post FIRA period, however, there is a slightly more accelerated recovery in foreign activity during the mid 1990s once energy industries are removed from the mix. And the progressive declines in foreign control during the 1970s and 1980s are reversed—foreign-controlled firms generated 32.4% of revenues in 1968 and 29.7% of revenues in 2000.\footnote{8}
6. Recent changes in foreign control, 2000 to 2003

This paper has examined long-run changes in the level of foreign control in Canada’s economy over the last three decades. We have concentrated on the non-financial sector—a comprehensive cross-section of different goods and service industries—as a means of evaluating the aggregate trend. We have also reported detailed foreign control tabulations for the energy sector, and subsequently examined how changes in foreign activity in this sector have affected the overall trend for non-financial industries. Our interest in the energy sector is driven by analytical considerations—as the liberalization of the regulatory regime that affected most sectors of the economy in the immediate post-FIRA period did not occur, at the same pace or to the same extent, in the energy sector.

As discussed in Baldwin and Gellatly (2005), periodic changes to the classification systems that are used to generate statistics on foreign control can hamper time-series analysis, especially at the detailed industry level. These periodic changes in classification are introduced with the aim of improving the accuracy and relevance of current statistics, as new classifications are designed to better reflect the evolving structure of the economy. One such shift occurred in 1999 with the adoption of the new North American Industry Classification System (NAICS). In this final section, we shift our focus from long-run trends to recent short-term movements in foreign control, using industry data for the 2000 to 2003 period that are defined on a consistent NAICS basis.

During recent years, there has been a sizable increase in the share of non-financial corporate assets controlled by foreign firms, up from 25.4% in 2000 to 29.3% in 2003. This represents a continuation of the upward trend in foreign control apparent since the mid 1980s. Foreign control of Canada’s non-financial assets has thus returned to levels witnessed in the mid 1960s.

Table 1 reports on the level of foreign control in specific industries in both 2000 and 2003, along with the corresponding percentage point change and the rate of growth (or decline). These growth or decline rates are calculated as the percentage point change in foreign control over the period divided by the level of foreign control in 2000. Both the share of assets and operating revenues under foreign control are examined. The industries in Table 1 are sorted by the share of industry assets under foreign control in 2000, from highest (manufacturing) to lowest (utilities).

Of the 16 industries for which data are available in both 2000 and 2003, nine experienced an increase in the share of assets under foreign control during this period. The two industries with high levels of foreign control in 2000 also experienced relatively large increases in multinational activity. Foreign control of manufacturing assets grew by 14% from 2000 to 2003 (from 45.0% of assets to 51.3%). Oil and gas extraction and support activities saw the asset holdings of foreign firms increase by 18.0%.

Several other industries experienced very large rates of growth in the share of assets controlled by foreign multinationals. Foreign control over mining assets (except oil and gas) grew by over 50% during this three-year period, as the share of industry assets accounted for by foreign firms rose from 22.5% to 34.5%. In transportation and warehousing, foreign control over industry assets grew by 83%.
Table 1. Assets and revenues under foreign control, by industry

<table>
<thead>
<tr>
<th>Industry</th>
<th>Percentage of assets under foreign control (2000)</th>
<th>Percentage of assets under foreign control (2003)</th>
<th>Percentage point change in asset share (%)</th>
<th>Rate of growth or decline (%)</th>
<th>Percentage of revenue under foreign control (2000)</th>
<th>Percentage of revenue under foreign control (2003)</th>
<th>Percentage point change in revenue share (%)</th>
<th>Rate of growth or decline (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturing</td>
<td>45.0</td>
<td>51.3</td>
<td>6.3</td>
<td>14.0</td>
<td>50.7</td>
<td>52.1</td>
<td>1.4</td>
<td>2.8</td>
</tr>
<tr>
<td>Oil and gas extraction and support activities</td>
<td>41.7</td>
<td>49.1</td>
<td>7.4</td>
<td>17.7</td>
<td>54.0</td>
<td>55.9</td>
<td>1.9</td>
<td>3.5</td>
</tr>
<tr>
<td>Wholesale trade</td>
<td>37.8</td>
<td>35.5</td>
<td>-2.3</td>
<td>-6.1</td>
<td>36.2</td>
<td>35.1</td>
<td>-1.1</td>
<td>-3.0</td>
</tr>
<tr>
<td>Administrative and support, waste management and remediation services</td>
<td>28.2</td>
<td>25.5</td>
<td>-2.7</td>
<td>-9.6</td>
<td>19.4</td>
<td>18.8</td>
<td>-0.6</td>
<td>-3.1</td>
</tr>
<tr>
<td>Mining (except oil and gas)</td>
<td>22.5</td>
<td>34.5</td>
<td>12.0</td>
<td>53.3</td>
<td>24.1</td>
<td>34.7</td>
<td>10.6</td>
<td>44.0</td>
</tr>
<tr>
<td>Professional, scientific and technical services</td>
<td>18.7</td>
<td>16.5</td>
<td>-2.2</td>
<td>-11.8</td>
<td>23.0</td>
<td>15.9</td>
<td>-7.1</td>
<td>-30.9</td>
</tr>
<tr>
<td>Retail trade</td>
<td>17.9</td>
<td>20.3</td>
<td>2.4</td>
<td>13.4</td>
<td>16.2</td>
<td>15.9</td>
<td>-0.3</td>
<td>-1.9</td>
</tr>
<tr>
<td>Transportation and warehousing</td>
<td>14.7</td>
<td>26.9</td>
<td>12.2</td>
<td>83.0</td>
<td>13.7</td>
<td>16.5</td>
<td>2.8</td>
<td>20.4</td>
</tr>
<tr>
<td>Accommodation and food services</td>
<td>14.7</td>
<td>16.4</td>
<td>1.7</td>
<td>11.6</td>
<td>10.1</td>
<td>11.2</td>
<td>1.1</td>
<td>10.9</td>
</tr>
<tr>
<td>Real estate and rental and leasing</td>
<td>14.0</td>
<td>13.7</td>
<td>-0.3</td>
<td>-2.1</td>
<td>14.7</td>
<td>11.5</td>
<td>-3.2</td>
<td>-21.8</td>
</tr>
<tr>
<td>Construction</td>
<td>4.6</td>
<td>5.0</td>
<td>0.4</td>
<td>8.7</td>
<td>5.4</td>
<td>4.9</td>
<td>-0.5</td>
<td>-9.3</td>
</tr>
<tr>
<td>Arts, entertainment and recreation</td>
<td>4.4</td>
<td>1.6</td>
<td>-2.8</td>
<td>-63.6</td>
<td>1.8</td>
<td>1.5</td>
<td>-0.3</td>
<td>-16.7</td>
</tr>
<tr>
<td>Information and cultural industries</td>
<td>4.3</td>
<td>5.7</td>
<td>1.4</td>
<td>32.6</td>
<td>8.8</td>
<td>7.8</td>
<td>-1.0</td>
<td>-11.4</td>
</tr>
<tr>
<td>Educational, healthcare and social assistance services</td>
<td>3.4</td>
<td>1.4</td>
<td>-2.0</td>
<td>-58.8</td>
<td>3.3</td>
<td>1.6</td>
<td>-1.7</td>
<td>-51.5</td>
</tr>
<tr>
<td>Agriculture, forestry, fishing and hunting</td>
<td>2.3</td>
<td>1.9</td>
<td>-0.4</td>
<td>-17.4</td>
<td>2.3</td>
<td>1.6</td>
<td>-0.7</td>
<td>-30.4</td>
</tr>
<tr>
<td>Utilities</td>
<td>2.2</td>
<td>6.7</td>
<td>4.5</td>
<td>204.5</td>
<td>33.3</td>
<td>31.1</td>
<td>-2.2</td>
<td>-6.6</td>
</tr>
<tr>
<td>All non-financial industries</td>
<td>25.4</td>
<td>29.3</td>
<td>3.9</td>
<td>15.4</td>
<td>31.1</td>
<td>30.2</td>
<td>-0.9</td>
<td>-2.9</td>
</tr>
</tbody>
</table>

Source: Statistics Canada, Industrial Organization and Finance Division.

The two industries with the third and fourth highest foreign control shares in 2000 saw modest declines in the share of assets under foreign control during the 2000-2003 period. Wholesale trade saw its foreign-asset share decline by 6%, from 37.8% in 2000 to 35.5% in 2003. Administrative and support, waste management and remediation services experienced a 10% decline in assets under foreign control.

While the overall share of non-financial assets under foreign control has increased in recent years, there has been no concomitant increase in the share of corporate revenues generated by foreign firms. In fact, foreign companies accounted for a slightly lower portion of non-financial revenues in 2003 (30.2%) than they did in 2000 (31.1%). Of industries with large increases in the share of assets under foreign control, only mining (except oil and gas) experienced large gains in the share of industry revenue under foreign control. Within manufacturing, the growth of foreign-controlled assets was accompanied by more modest gains in the foreign share of corporate revenues. This said, the share of manufacturing assets and manufacturing revenues controlled by foreign companies was virtually identical in 2003, both at slightly over 50%. In oil and gas extraction industries, the foreign asset share also increased more than the revenue share, but foreign-controlled revenues still remained slightly higher than foreign-controlled assets in 2003.

Changes in the share of non-financial assets under foreign control can result from both structural effects (changes in how assets are distributed across industries) and intensity effects (changes in the level of foreign activity within specific industries). We used a decomposition technique to
evaluate the relative importance of structural and intensity effects in generating the observed increase in the share of non-financial assets under foreign control. We found that virtually all the change over the 2000 to 2003 period was due to changes in foreign intensity—increases in the portion of industry assets accounted for by foreign-controlled firms after the impact of structural changes in the distribution of industry assets is taken into account.

The observed increase in the share of non-financial assets controlled by non-residents was led by a more visible multinational presence in industries with high levels of foreign control. As noted earlier, the two industries with the highest foreign control shares in 2000—manufacturing and oil and gas extraction and support activities—both experienced sizable increases in multinational activity over this short-run period, with foreign companies acquiring larger shares of manufacturing and oil and gas assets. These industries together accounted for about 65% of the stock of foreign non-financial assets in both 2000 and 2003.\(^\text{11}\)

7. Conclusion

Over the last four decades, foreign multinationals operating in Canada have experienced both a retrenchment and then a resurgence in their activities. This pattern of decline and recovery has mirrored underlying changes in the regulatory regime that first tightened and then relaxed the restrictions on inward foreign direct investment. In this paper, we examine the presence of foreign multinationals in Canadian industry, concentrating on the broad relationship between changes in foreign control and the regulatory regime.

We recognize that regulation is one of several factors that serve to influence the volume of multinational investment in Canada. Long-run reductions in tariffs may have been working to discourage multinational investment in Canadian markets during the period studied. Changes in the incentives for multinational investors may also have been occurring via underlying changes in the relative costs of Canadian labour and capital. These too would be expected to affect the size of FDI inflows. Accordingly, it becomes difficult to isolate the impact of regulatory changes from other causal factors.

This multidimensionality notwithstanding, the visual evidence on the relationship between the regulatory regime and foreign control is, at first blush, compelling. Our analysis here and in Baldwin and Gellatly (2005) suggests there are reasonable grounds to conclude that the major regulatory changes of recent decades—the implementation of FIRA and the subsequent replacement of FIRA by Investment Canada—had an appreciable impact on the aggregate share of economic activity under foreign control. As the regulatory climate became more restrictive under FIRA, there was a visible retrenchment in multinational activity. As restrictive regulations gave way to more liberal policies towards FDI in the post-FIRA era, the importance of foreign-controlled firms increased.

We looked for evidence of a relationship between the regulatory climate and foreign control in several ways (see Baldwin and Gellatly, 2005). First, we used regression analysis to account for different facets of the economic environment that are posited to influence the investment strategies of multinationals—and we still found the effect of regulatory change to be significant.
Second, we extended our descriptive analysis of foreign control to a broad cross section of industries, asking if the pattern of decline and recovery evident in the aggregate data is apparent in many different sectors, or localized to specific industries. We found that this growth and recovery pattern is generally widespread—which is also consistent with the view that a common regulatory effect was exerting an appreciable impact on the investment environment. In this paper, we extended this line of analysis by focusing on a specific area of the economy, the energy sector, where the pattern of regulatory change differed from the restrictive-to-liberal transition that in general characterized the end of the FIRA period. Here too there are grounds to conclude that regulation had an impact, as foreign control in mining and energy industries has now begun to trend upward, following the pattern seen in other sectors.

Statistics on the incidence of multinational activity often frame larger debates on the desirability of foreign multinationals and foreign direct investment. The central issue, beyond our scope here but well examined in many parallel studies, is how the presence of multinationals alters the competitive dynamics of domestic markets. This involves both the types of strategies and activities that foreign-controlled firms pursue in host economies, along with the impact that multinational operations have on domestic firms. The tighter investment restrictions of the 1960s and 1970s were predicated on a widely held view that multinationals truncate their activities in host markets, concentrating low-value activities abroad while locating high-value activities in home economies. On this view, multinationals were often portrayed as bringing little benefit to host markets, in that many of the economic rents associated with these foreign operations were transferred from affiliates to parent companies. Many recent studies, drawing from new business surveys and administrative data on economic performance, paint a decidedly different view of multinational operations, arguing that foreign-controlled businesses located in Canada tend to be well developed firms—productive and high paying relative to their domestic competitors, with relatively sophisticated innovation and technology activities. And there is some evidence that these foreign-controlled businesses transmit positive externalities, in the form of productivity gains, to domestic businesses.

These and other studies will continue to shape impressions of whether high incidences of foreign direct investment and foreign control are desirable or deleterious. In this paper and in Baldwin and Gellatly (2005), we draw attention to the fact that the multinational presence in Canada, while always sizable, is not invariant, in the short term, to the types of regulatory incentives under which foreign firms are expected to operate. While more restrictive investment regulations can perturb the economy from these levels in the short run, their impact is transitory once the barriers are removed.
References


Endnotes

1. A more extensive discussion of data issues is found in Baldwin and Gellatly (2005).
2. For examples, see The Watkins Report (1968) and The Gray Report (1972); for background, see Kurdle (1994).
3. See Globerman and Shapiro (1999) for a more extensive discussion of FIRA.
4. Globerman (1999) discusses many of these in detail.
5. See also Industrial Organization and Finance Division (2005, section 2).
6. Data descriptions for the two energy sub-sectors, petroleum and coal manufacturing industries and oil and gas manufacturing industries, are as follows. Data for petroleum and coal industries from 1968 to 1988 are based on two 1960 SIC-E industries, petroleum refineries (365) and other petroleum and coal products industries (369). Data for the 1988-1998 period correspond to the 1980 SIC-E industries, refined petroleum products (3611), lubricating oil (3612), and other petroleum and coal industries (369). Data for post 1998 years are based on NAICS 58424 petroleum and coal products manufacturing. In terms of oil and gas extraction industries, data for 1968 to 1988 are based on 1960 SIC-E industries, coal mines (061) and petroleum and gas wells (063). Data for the 1988-1998 period correspond to the 1980 SIC-E industries, coal mines (063), conventional crude oil and natural gas (0711) and non-conventional crude oil industries (0712). Data in subsequent years are based on NAICS oil and gas extraction (211) and coal mining (2121).
7. A minor note regarding data comparability: there is a very slight difference between the non-financial revenue estimates for the year 2000 presented in Figures 1 and 2. These reflect revisions to the non-financial series presented in Figure 1 that are not available for the sectoral estimates reported in Figure 3.
8. The same qualitative result is obtained if assets rather than revenues are used.
9. Note that the data for oil and gas and support activities are not directly comparable to the energy estimates reported in Section 5.
10. The increase in the foreign-controlled asset share relative to the foreign-controlled output share in manufacturing is compatible with an increase in the capital intensity of foreign-controlled manufacturing firms, which may explain recent increases in the relative labour productivity of foreign-controlled manufacturing firms (see Baldwin and Gu, 2005).
11. Manufacturing assets dominate this mix—the stock of foreign-controlled manufacturing assets amounted to 51% of all non-financial assets in 2000.
12. For discussion of these studies, see the multinationals section at http://www.statcan.ca/english/freepub/11-623-XIE/11-623-XIE2003001.htm