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THE AMERICAN CAPITAL IN CANADA AND
THE CANADIAN REACTION, 1950 - 1963

by

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B. A. University of Montana, 1963

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1966

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TO MY WIFE, RADKA

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A. Y.

Calgary, Alberta

September, 1965

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The Economist, like everyone else,
must concern himself with the
ultimate aims of man.

Alfred Marshall

INTRODUCTION AND PURPOSE

It has been said of Canada and the United States that they live in a kind of symbiosis--two organisms separate and distinct, each with its own ends and laws, but highly interdependent, indissolubly sharing the same continental environment and, in spite of a great disproportion in wealth and economic power, each necessary to the other.

This "symbiosistic" theory has been challenged in Canada, and in recent years a distinctive attitude--an attitude of concern, uneasiness, suspicion, resentment, and even hostility--has been developing towards the United States. Its origins on the surface appear to be mainly economic, but reflection on the issue shows that the real sources of discontentment lie at a deeper level. Mr. Hutchison has stated the issue in proper perspective:

The Canadian people are concerned with the specific, calculable frictions between the two neighbouring states only as they touch on a nonspecific, incalculable and seldom articulated thing which, for a lack of a better word, we call Canadianism. Can a nation like ours, absolutely dependent upon its neighbour for defence, for markets and for capital, long endure? This is the real question on Canada's mind today, though seldom on its inarticulate tongue.¹

¹ Bruce Hutchison, "Why Americans Can't Hear Canada's Hopes and Fears," The Financial Post (September 26, 1959).

The basis for Canadian anxieties is the conflict between two national aspirations: the desire for rapid economic development and the desire for cultural and political autonomy. There is nothing novel about these aspirations; each of them is characteristic of all the major nations today. What is relatively novel about the contemporary situation is that Canada now finds itself so placed that the two aspirations are in conflict. Rapid economic development can be achieved only at the cost of a surrender, or what is thought--felt--to be surrender, of some degree of her political and cultural autonomy. This conflict comes to its sharpest focus in connection with United States economic ties, more particularly with United States investment, since it is the inflow of United States capital that provides much of the impetus for Canadian economic development. On the other hand, it is this very capital that constitutes the greatest political threat to Canada via the policies and practices of United States subsidiaries in Canada.

The flow of capital investment from the United States to Canada has increased greatly since World War II as a result of important new discoveries of raw materials in Canada requiring for their exploitation an increased need for foreign capital. Also the supply of raw materials in United States is depleting at a faster rate, and the hazards involved in resource development elsewhere in the world coupled with a surplus of capital in United States are contributing factors to this flow. In an economic sense this process has undoubtedly benefited Canada as well as the United States.

It is the purpose of this study then to describe and analyze the flow of United States private direct investments into Canada from 1950 to 1963 and the threat it constitutes to Canadian independence via United States subsidiaries' policies and practices. The major emphasis will be on the "costs and benefits" it has brought to the capital-receiving country, in this case Canada.

In the last few years the debate as to benefits versus costs has picked up momentum and has become one of the hottest issues in Canadian life. The most outspoken Canadian critics of United States investment in Canada argue that such investment is nothing but United States exploitation of Canadian resources and indirect approach to economic control of Canada, which will eventually lead to political loss of sovereignty. These same critics condemn any Canadian policy that promotes such investment. On the other hand, other equally outspoken observers, citing only benefits, deny that any ill effects result from the inflow of such nonresident investments and argue that Canada should encourage more, not less, of it.

In order to provide a better understanding of the inflows and the effects of recent private United States direct investment in Canada, it is the intention of this research:

- 1) to present and analyze the extent of United States investment in Canada since 1950, the reasons for it, and Canadian reaction.
- 2) to examine the effects of the policies and practices of foreign enterprises in Canada upon the Canadian economy and independence.

3) to describe the costs and benefits of foreign investment, specifically with reference to the capital-receiving country--Canada--, in particular the relationship between capital formation and economic growth.

4) to present a theoretical analysis of the costs and benefits of foreign investment to the host country.

5) to determine the applicability of the existing theory of capital movements and to draw conclusions as to the fears of Canadians of American investment, as well as to suggest ways to keep the relationship as unique as it always has been.

The focus of this research is on the period of 1950 - 1963. However, this does not in any way restrict us from considering other years before and after this period when they are relevant and data are available. Particularly when it is necessary to point out trends and make comparisons with earlier periods of such capital movements.

In focusing our attention on capital flows, this study will not consider other economic relations between Canada and the United States, although some of these relations, as in the case of trade and balance-of-payments relations, have been affected by these capital flows. These relations will be brought out whenever relevant to our research.

CHAPTER I

CANADA-UNITED STATES RELATIONSHIPS

AND CANADIAN FEARS

In general the relationship between Canada and the United States has been a unique one unparalleled by any other relationship between any two other countries in the history of the world. This unique relationship has been compared to the Siamese twins of whom it is said that they cannot separate and still live. Thus J. B. Brebner refers to Canada and the United States as the "Siamese Twins of North America who cannot separate and live."²

This description at least is an oversimplification of the Canadian-American relationship and at best it is useful for general comparative purposes with other such relationships. The oversimplification lies in the fact that the Siamese twins in reality are twins of unequal size--one a very small twin and one a very large twin. This is evident in practically all fields with the exception of the physical size of the two countries which is approximately equal.

²John Sloan Dickey (ed.), The United States and Canada, The American Assembly, Columbia University (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1964), p. 30.

The equality of the physical size implies another close equality, namely, the endowment of natural resources in the two countries. It goes without saying that both Canada and the United States are blessed with lands that are both fertile and rich with natural resources. The development of these resources has led the two countries to an interdependent economic relationship which is unprecedented in the entire history of mankind.

The uniqueness of the relationship stems from many factors that are unique in themselves. It is unique in the length of the border, the multiplicity of crisscrossing of people, the volume of trade going to and from each country, the close and complementary nature of the two economies, the common historical and social background that the two countries have shared, and the sharing of the same continent that made them neighbours since their beginnings.

These factors not only caused and increased the unique relationship but also rendered it boring and critical at times. Boring because of numerous issues involved in the relationship, including many which are not of great importance when judged in the light of maintaining a workable relationship between the two countries, or which were of greater significance to one country and of little significance to the other.

Canadians usually are offended because some claim that the United States takes them for granted. In some cases there is probably

a justification for their resentment but in most there is no such justification. The misinterpretation of United States attitudes arises to some extent due to the uniqueness of the relationship itself. The United States has many world-wide problems that are more imminent and pressing, such as maintaining world peace and looking after its internal problems. However, it hardly seems logical that the United States has taken Canada for granted because it was the United States' Ambassador, Mr. Livingston Merchant, who proclaimed that "Canada is more important to the United States than any other single country" in the world. The problems that arise out of the unique relationship can be best illustrated by the statement made by the President of the United States, Lyndon B. Johnson, with the best of intentions and with a compliment to Canada as well: "Canada is such a close neighbour and such a good neighbour that we always have plenty of problems there. They are kind of like problems in the hometown."³ They are "kind of" not like that at all. They are the problems of a friendly foreign power first, and then of a good neighbour. And a friendly foreign power implies the fact that it is an independent state, which means not just a political expression but an identifiable and distinctive way of life, its people possessing a culture of their own and a historical character of national existence.

³As quoted by James Eayers, "Sharing a Continent: The Hard Issues" in The United States and Canada, ed. John S. Dickey (The American Assembly, Englewood Cliffs, N. J.: Prentice-Hall, Inc., 1964), p. 93.

Thus we can easily see how such good-intentioned remarks or statements which emphasize "good-neighbourliness" can be interpreted, and in some cases correctly, as de-emphasizing Canada's national identity, of which Canadians in recent years have become very much aware. Canada is only recently aware of this because she has had a full national independence for only a few decades and has not had the opportunity to consolidate her internal problems, such as solving the controversy over the relations between the British and the French nationals. A great deal of her time has been occupied by international events. She responded to world demands to contribute her share in preserving the peace. She joined the Western democracies in both the Second World War and the Korean Conflict to protect common interests and promote freedom.

In fact, Canada's search for identity and a solution to the internal strife between her two dominant races is not a new one. It has been going on since the Confederation in 1867. Now the conflict has been accelerated and has become the main issue for two reasons. First, Canada today is not involved in any kind of world conflict and therefore can concentrate on her domestic problems. Secondly, there exists a world-wide drive for complete independence by all the dependent nations. This drive for independence has increased both Canadian and Quebec national frustrations for independence. Canada as well as Quebec seeks not only full independence but at the same time is striving to preserve and protect the independence already acquired.

There is common fear in both cultures that their already acquired independence is being sapped by larger cultures--by the United States in the case of Canada, and by Canada in the case of Quebec. That fear is widespread throughout Canada, and it should not be dismissed lightly. As Professor Eayers observes: "newly independent nations that enter the world arena tend to regard themselves as being above and beyond the struggle for power."⁴ If Canadian fear of domination, both political and economical, is not taken seriously there is a danger that the cynical maxim of Kantilyas may yet prove to be true--that your enemy is that state which is on your border.

Canada's fear of domination is not of domination by the old America, but by America in its new role as the world's leading power. And as such she might be compelled at some future time to occupy Canada and thus negate Canada's independence. Professor Morton, a Canadian historian and the author of The Canadian Identity, states it thus:

It [Canada] fears that America in seeking to maintain its world power will make demand after demand on Canada, each reasonable in itself, until the substance of independence is modified out of existence. More than that, it fears that the United States, in some sudden convulsion of the world balance, will simply occupy Canada. Circumstances may easily arise in which the United States would have no more choice than Canada. They fear also, out of their knowledge of the American temperament in action, that such an occupation could be made needlessly, or that once made, would not be unmade. For the government and people of

⁴Dickey, op. cit., p. 55.

the United States, while they have come to accept Canadian nationhood, do not understand it and therefore do not value it.

Canadian concern with this fact arises from a mature awareness that while Americans in their friendly way accept Canada as a neighbour, they are not in their heart of hearts convinced that Canadian nationhood is possessed of a moral significance comparable with that of their own great nation.⁵

The fear of economic domination is even more strongly expressed even though there is not sufficient evidence to justify such strong contentions. The editor of the Victoria Times, Mr. Bruce Hutchison, put it this way:

It is easy and proper for the American Ambassador to Canada, Mr. Livingston Merchant, and for Canadian economists to argue that massive American investment, at this stage, is essential to Canada's growth. So it may be--but the undeniable human fact is that Canadians fear it, even while they seek and need it.⁶

It is the sheer size of the total American investment in Canada reinforced with the future expectations for economic self-sufficiency that worries many Canadians and their political leaders.

Total nonresidents' capital invested in Canada at the end of 1961 was \$23.6 billion, of which close to \$18 billion came from the United States. And \$11.3 billion of the United States' total entered Canada in the form of a "direct investment," which carries with it ownership and control. Furthermore this investment is concentrated

⁵W. L. Morton, The Canadian Identity (Toronto: The University of Toronto Press, 1961), p. 84.

⁶Bruce Hutchison, "Why Canadians Are Turning ANTI-AMERICAN," Harper's Magazine (May, 1958), p. 47.

heavily in the "dynamic" sectors of the Canadian economy, that is, the manufacturing and resource-extractive industries. The latest available official figures indicate that foreign ownership and control of these industries has increased. In 1954, according to the Dominion Bureau of Statistics,⁷ foreign ownership of the manufacturing and extractive resource industries--mining, petroleum, and natural gas--was 51 percent, and the relative figure for foreign control stood at 55 percent. The corresponding figures for 1961 indicate a substantial increase in both ownership and control. Ownership at the end of 1961 stood at 56 percent and control at 62 percent, an increase of 10 percent for ownership and about 13 percent for control for the seven-year period.

If the United States investment is taken separately, the relevant figures do not show such a marked increase. In fact, the United States figures indicate only a slight increase for United States ownership and a minute decrease for control. United States ownership for the same period increased from 47 percent to 49 percent, an increase of about 4 percent. The figures for control decreased from 52.7 percent to 52.3 percent, a decrease of about 0.8 percent. These figures are rather misleading because of wide fluctuations in the

⁷Canada, Dominion Bureau of Statistics, The Canadian Balance of International Payments, 1961 and 1962 and International Investment Position (Ottawa: Dominion Bureau of Statistics, 1961-1962), p. 83. Hereafter referred to as The Canadian Balance.

ownership of different industries by both residents and nonresidents in Canada, and only the "dynamic" industries are cited.

The trend is more alarming if we look only at certain individual industries. According to the Dominion Bureau of Statistics⁸ foreign control of the Canadian automobile and automobile parts industry is practically complete. In 1954 it stood at 95 percent and by 1961 it had increased to 97 percent. For the rubber industry it is even higher; foreign control increased from 93 percent to 99 percent, an increase of about 6.5 percent for the same period. The agricultural machinery industry experienced an increase of over 50 percent, from 35 percent to 54 percent for the same period. The transportation equipment industry saw an even larger percentage increase, a striking 97 percent increase from 36 percent to 71 percent. But the largest increase took place in the primary iron and steel industry: foreign control increased from 6 percent to 23 percent, an increase of 283 percent or 2.8 times for the same period.

While foreign control did not increase substantially in the electrical apparatus and chemicals industries, it is nonetheless very high. It was 77 percent in 1954 and reached 78 percent in 1961 in the former industry, and for the latter industry 75 percent and 79 percent. The electric apparatus industry, however, reached its peak of foreign control in 1959 at 81 percent. As far as the petroleum and natural gas

⁸The Canadian Balance, op. cit., p. 83.

industry is concerned there has been no increase in foreign control-- it was and still is 69 percent. However, in 1957 it reached 76 percent, which was its peak year. The same holds true for the smelting and refining of nonferrous metals industry; there has been no increase in the seven-year period and is at 55 percent, but its peak years were in 1957 and 1959, both at 66 percent.

The evidence, it is further charged, shows that somewhere between 80 and 95 percent of the foreign control of the above industries lies in the hands of United States investors. According to Mr. Fowler, American control for 1962 of the above industries is the following:

The latest available figures indicate that Americans control 95 percent of the Canadian automobile and automobile parts industry, 89 percent of rubber products, 64 percent of electrical apparatus, over 50 percent of the chemical industry, 43 percent of pulp and paper, 70 percent of the petroleum and natural gas industry and 52 percent of mining and smelting; and for all the manufacturing industry in Canada, nearly 50 percent.⁹

Further, Mr. Fowler concludes:

Such a concentration of foreign investment has never been equalled in any other country except where there was a colonial relationship or some dependency status. . . . It is not surprising that some Canadians began to feel like "colonials" and to believe that something should be done to resist the friendly pressure from the United States that seems likely to engulf us.¹⁰

⁹Robert M. Fowler, "The Impact of American Business," Atlantic (November, 1964), p. 120.

¹⁰Ibid., p. 121.

These statistical data, coupled with the impact of economic thought on contemporary nationalistic thinking,¹¹ have resulted in a call by the former Prime Minister of Canada, John Diefenbaker, to reduce Canadian-United States trade by 15 percent and the charge in 1957 that if the Liberals are re-elected "Canada will become a virtual forty-ninth state in the American Union."¹² In Mr. Diefenbaker's first speech to an American audience as the Prime Minister of Canada, he stated the political implications of the large United States control of the Canadian industries:

The heavy influx of American investment has resulted in some 60 percent of our main manufacturing industries, and the larger portion of our mine and oil production, being owned and controlled by United States interests. . . . There is an intangible sense of disquiet in Canada over the political implications of large-scale and continuing external ownership and control of Canadian industries.¹³

¹¹Dickey, *op. cit.*, p. 161. Professor Douglas V. LePan explains that for nearly thirty years Keynesian economists have been explaining how national governments through monetary and fiscal measures can maintain full employment and provide economic stability and growth. This doctrine has provided the nationalists with a new justification for independence and a new incentive for economic promise. The nationalists tend to think that once they take control of the government all they need to do is apply monetary and fiscal policies and the result will be economic self-sufficiency and abundance in economic wealth for all. Thus we have a newly-added meaning to the national independence concept; it is no longer only a political concept but an economic concept as well. The drive in Canada is not only for full political independence but for full economic independence as well.

¹²James Eayers, "Sharing a Continent: The Hard Issues," *The United States and Canada*, ed. J. S. Dickey (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1964), p. 74.

¹³*Ibid.*, p. 74.

Further, as an opposition leader he stated:

I believe that Canadians should declare their economic independence of the United States. I believe that political and economic independence go hand in hand.¹⁴

There are two very different if not opposite courses that the Canadian Government can follow in its commercial policy with the United States. It can either tolerate and encourage the unfavorable balance of trade between the two countries, correcting the imbalance by allowing capital inflows from United States investors, or it can discourage trade and impose restrictive measures on the movements of goods and capital from the United States into Canada with the hope that these protectionistic measures will stimulate the Canadian economy to self-sufficiency and thus become less dependent on United States capital.

The Canadian Government, until the election of John Diefenbaker as Prime Minister of Canada in 1957, has followed a course of tolerance and nonrestriction in its United States-Canadian commercial policies. Mr. Diefenbaker, as it turned out, could not turn the economic tide of events and managed only to shift the investment climate from encouragement to next to hostile. United States investors rejoiced in the return of the Liberal Government led by Lester B. Pearson, but contrary to Mr. Diefenbaker's charges and the rejoicings of the United States investors, the Liberal Government swung even further towards

¹⁴Ibid., p. 76.

a protectionist commercial policy against the United States. It announced an unprecedented discriminatory budget against United States investment in Canada.

The central theme of the Minister of Finance, Mr. Walter L. Gordon, in his budget to remedy the economic ills of the country, was "tighten your belts and live within your means."¹⁵ And the centerpiece of the discriminatory budget against United States investors includes: first, a measure allowing tax benefits to Canadian companies to enable them to increase their component of Canadian ownership; second, effective on the budget night, a tax of 30 percent on sales by Canadians of shares of Canadian companies to foreigners in excess of \$50,000. This was immediately withdrawn due to an immediate (almost overnight) flight of foreign funds out of Canada, which in turn created an even stronger demand for foreign capital.

The proposals of the Kennedy Administration aimed at improving the American international balance-of-payments position were of significant importance. These proposals threatened to dry up the outflow of capital to Canada more effectively than any Canadian could have imagined! As it turned out, Canada was excluded from President Kennedy's proposal on a preferential basis. However, it is interesting to speculate on whether President Kennedy's 1963 announcement was intended as a retaliation to the inhospitability of the Canadian budget

¹⁵ Ibid., p. 75.

or was just a coincidence. Also it is interesting to speculate on why the sudden retraction of the 30 percent tax by Mr. Gordon. Did he get a hint of President Kennedy's intention to dry up the flow of United States capital to Canada as a retaliatory measure or was it simply a realization on Mr. Gordon's part that such a tax is unworkable. If the latter, why was such a logical conclusion not reached before the tax announcement?

In addition to Canadian fears of United States domination of their economy, there exists a bill of grievances against the policies and practices of United States subsidiaries and branch plants in Canada. First, foreign subsidiaries, especially United States subsidiaries, are criticized for the alleged ill effects on the Canadian way of life. The Royal Commission on Canada's Economic Prospects¹⁶ recognizes such grievances in its study, and they are well summarized by Professor James Eayers. American subsidiaries and branch plants are charged with:

. . . keeping their common stock from prospective Canadian investors; excluding Canadians from high managerial positions; withholding information from Canadian Governments; failing, at the instigation of their head offices, to compete in the American market; buying American, instead of Canadian; providing little benefit to the host economy in the way of research; being laggards and sluggards in contributing towards Canadian charities and philanthropies.¹⁷

¹⁶Royal Commission, On Canada's Economic Prospects: Final Report (Ottawa, 1957), pp. 387-396. Hereafter referred to as The Final Report.

¹⁷Eayers, op. cit., p. 77.

We should mention here also the fact that the two countries have different attitudes on trade as an instrument of political policy which causes some misunderstandings between the two nations, as far as the Communist countries are concerned. The United States, in general, tends toward a more conservative restrictive policy, especially toward countries like Communist China and Cuba. Canada, on the other hand, due to the fact that she depends more on "world trade" than the United States, tends toward a liberal trade policy toward China and Cuba. In 1963 the total trade for Canada amounted to \$12.4 billion and that for United States amounted to \$38.2 billion.

The Minister of Canadian Foreign Affairs, Mr. Paul Martin, stated at the NATO Council meeting in Paris in November, 1963, that, "... isolation of the communist world is not in the interest of the detente as it is now developing."¹⁸ Mr. Martin was not announcing a new policy for Canada but merely reaffirming the already existing one for many years of the previous Canadian governments.

The source of irritation lies in the export policies of United States-controlled corporations in Canada. The parent firms in the United States, it is feared, will impose regulations conforming to United States foreign policy upon their subsidiaries in Canada. Thus

¹⁸John W. Holmes, "The Relationship in Alliance and in World Affairs," The United States and Canada, ed. John Sloan Dickey (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1964), p. 118.

the United States Government is extending its foreign policy into Canada. There are existing cases to render this fear valid.¹⁹

In addition there is a fear that the United States parent firm may even impose total restrictions on its subsidiary in Canada concerning the subsidiary's exports when they are in direct competition with the parent firm.

The President of the Canadian Institute of International Affairs, Mr. John W. Holmes, referring to Canadian exports to Cuba stated:

These matters of commerce, however, touched political issues on which Americans felt deeply, and they have caused more ill will between the two countries than most issues of world politics. In American eyes it may be excusable for Canadians to play the normal game of commercial advantage but not when it looks like aiding the enemies of the United States and taking advantage of American self-denial. In the Canadian view, however, these embargoes are unwise and unilateral. Canadians have been less inclined than Americans to see the overthrow of communist regimes as a feasible aim and have been more disposed, therefore, to hope that the beneficent influence of commerce would eventually erode barriers and create on both sides vested interests in peaceful relations.²⁰

This brings us to a much more fundamental reason for Canadian fears of the increasing domination of the Canadian industries by the United States investors. The Royal Commission on Canada's Economic Prospects stated it clearly in 1957 in its Final Report. The Commission stated:

¹⁹Dickey, op. cit., p. 118.

²⁰Holmes, op. cit., pp. 118-119.

At the root of Canadian concern about foreign investments is undoubtedly a basic traditional sense of insecurity vis-a-vis our friendly and more powerful neighbour, the United States. There is concern that as the position of American capital in the dynamic resources and manufacturing sectors becomes even more dominant, our economy will inevitably become more and more integrated with that of the United States. Behind this is the fear that continuing integration might lead to economic domination by the United States and eventually to the loss of political independence.²¹

These fears, genuine or not, have led to many problems that are currently facing both Canada and the United States. These problems are many and various, difficult and growing, some inaginary, others genuine, and demand immediate attention by both Canada and the United States.

It is beyond the scope of this research as well as the ability of this writer to state and analyze Canadian fears affecting other areas which have lead to misunderstandings and problems between the two countries. However, it is important to keep in mind that

. . . these two complicated urban industrial countries are part of a common system, that each is deeply dependent upon the other, and that they are bound by kinship, economy, organization, tastes, standard of living, and many common problems. One cannot describe either country without taking the other into account.²²

Also it should be remembered that any economy, open or closed, dependent or independent, cannot hope to develop without capital from

²¹The Final Report, op. cit., p. 390.

²²Everett C. Hughes, "A Sociologist's View," The United States and Canada, ed. John Sloan Dickey (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1964), p. 29.

somewhere--domestic or foreign, and that capital from almost anywhere is relatively scarce and thus relatively expensive.

The impression should not be left here that the two countries, due to expressed fears and the resulting problems, have become firm antagonists and are incapable of finding the proper as well as beneficial solutions to their common problems. The uniqueness of the relationship between Canada and the United States lies not in their failure to solve their common problems but in the fact that they always have been able to rise above all other nations and apply reason to their search for a common solution to their numerous problems. Such reason, needless to say, has led the two countries to logical and beneficial results and will continue to do so as long as it continues to prevail over passion and confidence prevails over suspicion. "Because of that confidence," asserts Professor James Eayers,

. . . any dispute which might arise between the two countries ought to be settled bilaterally, as befitting good neighbours, without the intrusion of alien international institutions. Like the British Commonwealth, Canada and the United States developed their own version of an inter se doctrine according to which their quarrels should be quelled in the privacy of the family circle.²³

Even in the trying sphere of trade and commerce, the special relationship between Canada and United States has prevailed. The United States charge' d' affaires in Ottawa wrote to the Secretary of State in 1933 the following letter:

²³Eayers, op. cit., pp. 57-59.

I submit that our relationships with Canada are and should continue to be exceptional. . . . Our trade relations with Canada often described as our "best customer," economically our most powerful neighbour, indissolubly an immediate part of the economic system of this hemisphere, are and must be considered on a different footing from our trade relations with distant nations or with all nations.²⁴

The uniqueness of the Canadian-American relationship has had many trials in the past and, no doubt, faces many new ones in the future. But it has been able to withstand them all, and it is this ability that has made it the envy of the entire world. It will continue to be the envy in the future provided reason continues to guide it as in the past.

The ability of the two countries to reason out their problems and reach common, beneficial solutions consists of two propositions, according to Professor Eayers:

First, that there exists between the two countries a community of interests and an equation of identity which render nullatory and unnecessary external mechanisms for the settlement of their disputes. Second, that insofar as they have been left alone by the twentieth century to settle their disputes, they have succeeded to a degree which other nations have not experienced and which must be their constant envy. This ideology persists today, in the face of all evidence to the contrary. A distinguished American wrote in 1961: "No difference has arisen that has not yielded to amicable solution; no instance has arisen in which one tried to outmaneuver the other; no hard bargains have been sought and no sharp practices have fettered the sense of fairness that has prevailed. The principle of reasonableness and of friendly cooperation has been the guiding star." The same year a still more distinguished American remarked, incontrovertably enough: "Geography has made us neighbours." But, President Kennedy (for it was he) added, "history has made us friends." History in fact made the two neighbours enemies. If they are friends today, it is in spite of history, not because of it.²⁵

²⁴Ibid., p. 59.

²⁵Ibid., pp. 59-60.

CHAPTER II

UNITED STATES CAPITAL IN CANADA: THE STATISTICAL EVIDENCE

Economic relations between Canada and the United States constitute a unique and interesting problem for study, since nowhere else in the world are there two major nations with separate economies that so nearly constitute a single economic system. To fully explain how the two countries came to approximate a single economic system would require the writing of an economic history of North America. This is not our aim. Our interest is only in one of the processes that has contributed to this situation: namely, the investment of American capital in Canada. This process, although one of many, is probably the most fundamental because it is the free flow of capital that has done more towards the integration of the two economies than any other single factor with the exception of geography.²⁶

It comes as no surprise that the two countries are bound by strong economic ties since it is geography that made them complementary in their economic demands (Canada needs and imports mainly

²⁶Hugh G. J. Aitken, American Capital and Canadian Resources (Cambridge, Mass.: Harvard University Press, 1961), p. 19.

what the United States is able to produce and the United States needs and imports mainly what Canada has to offer) by placing them one next to the other. It is not unnatural for two countries which have similar cultures, political traditions, a common language and a long unguarded border, to become influenced by and dependent upon each other.

It is interesting to speculate whether the two economies will grow more dependent on each other and more integrated as they continue to develop, or whether each will attain economic self-sufficiency, thus becoming less dependent on the other. The evidence until now and for the near future, especially for Canada, shows that the two countries will continue to increase their dependence on each other. However, my belief is that this dependence, measured in per capita trade, will decrease substantially within thirty to forty years' time as the two economies (especially Canada) reach fuller development.

The evidence for the United States already shows a substantial decrease in per capita trade with other nations. It is clear that, relatively speaking, United States' per capita trade is very small even though its absolute size has been increasing and is the largest in the world. As the Canadian economy reaches closer approximation to the present level of American economic development (in per capita Gross National Product terms), it is difficult not to expect a similar decrease in dependence on foreign trade.

Many contend that it is absurd even to suggest, much less to state, that Canada, one-tenth the size of the United States in population, could ever come close to catching up to its giant neighbour in its economic development. However, I venture the prediction that the twenty-first century will be Canada's century, as the nineteenth century belonged to the United States. It was Sir Wilfred Laurier who predicted that the twentieth century was to be Canada's century. Now it is obvious that his prediction was not totally correct.

There are three factors upon which I am basing this prediction. First, the United States as the most developed nation has begun to increase its rate of growth at a slower rate. Second, Canada on the other hand is developing and probably will increase its economic rate of growth at a faster rate. Third, and most important, the trend clearly shows that Canada is slowly closing the colossal gap between the two economies. United States' Gross National Product in 1929 was 18 times that of Canada's (United States' Gross National Product was \$159 billion while that of Canada was only \$8.8 billion). By 1955 the gap was decreased to 16 times (United States' Gross National Product stood at \$344 billion and that of Canada was \$22 billion in 1949 prices).²⁷ And by the end of 1963 the gap was decreased to only 15.3 times (United States' Gross National Product that year was \$585 billion and

²⁷Irving Brecher and S. S. Reisman, Canada-United States Economic Relations (Ottawa: Queen's Printer, 1957), p. 333.

that of Canada reached \$38 billion).²⁸ If this trend continues it is not an exaggeration to suggest that by the year 2000 Canada's Gross National Product probably will be only one-third as large as that of the United States. If we take the population increases into consideration we find that the per capita gap between the two countries has not changed considerably over the last three decades. This is because Canada's rate of population growth has been greater than that of the United States. However, even though the per capita income gap has not been reduced, I still believe that the twenty-first century will be Canada's century because as the Canadian economy grows its population rate of growth should decline, and thus the standard of living in Canada should increase.

The largest growth in the amount of foreign capital invested in Canada took place in the twentieth century. This growth has been quite irregular during the period and the principal sources and kinds of investments have undergone considerable change as well. Table 1 gives the amounts of the foreign investments in Canada and their place of origin.

In the long run Canadian dependence on the United States has not grown in correspondence to its economic development. However,

²⁸John S. Dickey (ed.), The United States and Canada (The American Assembly, Englewood Cliffs, New Jersey: Prentice Hall, Inc., 1964), p. 170, Table I.

TABLE 1

ESTIMATES OF FOREIGN CAPITAL INVESTED IN
CANADA, SELECTED YEAR ENDS 1900-1961

Year	Total Nonresident Investment			Percentage of Nonresident Investment		
	Direct	Portfolio	Total	United States	United Kingdom	Other Countries
	(in \$ millions)			(percentages)		
1900	..	..	1,232	14	85	1
1914	..	..	3,837	23	72	5
1918	..	..	4,536	36	60	4
1926	1,782	4,221	6,003	53	44	3
1930	2,427	5,187	7,614	61	36	3
1933	2,352	5,013	7,365	61	36	3
1939	2,296	4,617	6,913	60	36	4
1945	2,713	4,379	7,092	70	25	5
1946	2,826	4,355	7,181	72	23	5
1948	3,270	4,239	7,509	74	22	4
1950	3,975	4,689	8,664	76	20	4
1951	4,520	4,957	9,477	76	19	5
1952	5,218	5,167	10,385	77	18	5
1953	6,003	5,458	11,461	77	18	5
1954	6,764	5,780	12,544	77	17	6
1955	7,728	5,745	13,473	76	18	6
1956	8,868	6,701	15,569	76	17	7
1957	10,129	7,335	17,464	76	17	7
1958	10,880	8,130	19,010	76	16	8
1959	11,906	8,951	20,857	76	15	9
1960	12,872	9,342	22,214	75	15	10
1961	13,737	9,833	23,570	76	14	10

Source: DBS, The Canadian Balance of Payments, 1961 and 1962 and International Investment Position (Ottawa: Queen's Printer, August 1964), p. 133, Table XIII.

Canadian dependence on foreign economies has been commensurable to its economic development.

It was not until the mid-1920's that the United States became the leading supplier of capital to Canada. And it was not until the end of the Second World War that the economic ties between the two countries became sizable and significant. Since the beginning of the twentieth century there have been three periods--the 1900-1915 period, the period of 1920's, and the period of 1945 to the present--in which were experienced not only the most pronounced economic growth in Canada but also the heaviest influx of foreign investments. It was in the period since the 1945 that United States' capital outflows to Canada showed the largest increase in absolute terms.

At the end of 1963 total United States private investment abroad (to all countries) reached an all-time peak of \$66,366 million, of which \$40,645 million or 61 percent was in the form of direct investment. Canada received more than any other single country or area. Her share of the total United States private investments abroad amounted to \$21,568 million of the total, of which \$13,016 million was in direct form.²⁹ However, even though Canada received the largest share of United States' private investment abroad, she came second to Western Europe in her total assets and investment position with the

²⁹U. S. Department of Commerce, Office of the Business Economics, Survey of Current Business (Washington: U. S. Government Printing Office, August, 1964), pp. 9-10, 24.

United States. At the end of 1963 Canada's total liabilities to the United States amounted to \$21,574 million and that of Western Europe amounted to \$24,818 million. The situation is reversed when we include United States liabilities to Canada and Western Europe, thus getting the net balance position for these two regions with the United States. The total United States liabilities to Canada amounted to \$7,767 million. Thus we get a net liability for Canada to the United States of \$13,807 million. And the total United States liability to Western Europe amounted to \$29,879 million; thus there was a net liability for the United States to Western Europe of \$5,058 million.³⁰

In order to understand better the nature and the amounts of United States investment in Canada it is important that we examine them in the light of three perspectives. First is the historical growth of the United States investment in Canada and its growth in relation to England's investment. Second is the significant shift in the type of foreign investments represented primarily by the change from portfolio investments to direct investments. Third is the share of United States investment relative to the total investment in each of the several major industries in Canada. In short, what percentage does United States direct investment represent in terms of ownership and control of the Canadian economy?

³⁰Ibid., p. 24.

The main sources of foreign capital to Canada, as Table 1 shows, have always been the United Kingdom and the United States. Limited amounts have also come from other countries such as Western European countries. In 1914 the United Kingdom accounted for about three-quarters of the entire foreign capital in Canada. It increased little in the 1920's but declined sharply during the Second World War with the repatriation of British investments in Canada. At the end of 1961 the United Kingdom's investment in Canada accounted for only about 14 percent of total foreign investment in Canada and was less than her total investment in Canada at the end of 1914.

By contrast United States investments in Canada have been increasing steadily since the beginning of the century to the present, except for the depression decade of the 1930's. The United States took the leading position in supplying capital to Canada in the mid-1920's, becoming the main source of foreign capital for Canada since then. By the end of the Second World War the United States accounted for 71 percent of total foreign investment in Canada. By the end of 1961 its share had increased to about 76 percent of the total. All other countries contributed about 1 percent in 1900 and about 10 percent at the end of 1961 to the formation of foreign capital in Canada.

In order to grasp the data to be presented it is important to understand the terms foreign investment or capital inflows, direct and portfolio investments, and their significant characteristics as

associated with the terms control and ownership.

Foreign investment or capital flows are nothing else but the transfer of resources from the investing country to the host country. Such transfers of resources are usually classified into two main categories--portfolio investments and direct investments. The distinction is chiefly in the nature of the special characteristic of ownership. Essentially the distinction appears to be whether the investment carries with it a control over the enterprise in which the investment is made. Direct investments are those in which control (management) is in the hands of the foreign investors. According to the Dominion Bureau of Statistics direct investments are

. . . those investments in business enterprises which are sufficiently concentrated to constitute control of the concerns. The nature of the classification is such that potential control is implied rather than an actual exercise of control over business policy, although the latter may be present as is usually the case. Direct investments are usually in the form of equity ownership.³¹

The clearest example of direct investment is the establishment of a branch plant by a foreign country or foreign corporation that retains complete ownership and control of the plant.

Portfolio investments, on the other hand, are typically scattered minority holdings of stocks and bonds which do not carry with them control. The Dominion Bureau of Statistics defines

³¹ Dominion Bureau of Statistics, Canada's International Investment Position, 1926-1954 (Ottawa: Queen's Printer, 1956), p. 21.

portfolio investments as:

. . . typically scattered minority holdings of securities which do not carry with them control of the enterprises in which the investments occur. Usually the securities are public issues such as bonds and debentures of governments, municipalities, and corporations and the stock of companies listed on stock exchanges . . .³²

This is clear--until we raise the issue of what constitutes control. Difficult issues are involved here. The Dominion Bureau of Statistics solves these issues by using as the criterion of control the percentage of common stocks owned. They classify as direct investments all concerns in Canada which are known to have 50 percent or more of their voting stock held in one country outside Canada.

The Dominion Bureau of Statistics states:

The category of direct investments shown here generally includes all concerns in Canada which are known to have 50 percent or more of their voting stock held in one country outside Canada. In addition, a few instances of concerns are included where it is known that effective control is held by a parent firm with less than 50 percent of the stock. In effect, this category includes all known cases of unincorporated branches of foreign companies in Canada and all wholly-owned subsidiaries, together with a number of concerns with a parent company outside Canada which holds less than all of the capital stock. In addition there are a relatively small number of Canadian companies included in cases where more than one-half of their capital stock is owned in a single country outside of Canada where there is no parent concern. These exceptional cases are confined to instances where control is believed to rest with nonresidents.³³

This is not a clear definition; it is purely formal and control in this sense is consistent with considerable autonomy in management.

³²Ibid., p. 21-22.

³³Ibid., p. 24.

It should be pointed out that the largest part of direct investments is in the wholly-owned subsidiaries of foreign companies. Nonetheless, it should be remembered that for some specific industries, direct-investment companies in Canada range from companies whose stock is wholly-owned by a parent company abroad to Canadian public companies where there is no parent concern but where more than half the voting stock is held by investors in foreign countries.

Investments by the United States and the United Kingdom differ not only in volume but also in form. In the first quarter of this century the United Kingdom was the main supplier of capital to Canada; its investments were mainly in portfolio form and primarily directed into the railway and governmental sectors of the Canadian economy.

On the basis of Professor Viner's estimates,³⁴ total foreign capital in Canada at the end of 1913 was \$3,745 million. This was three times the total of 1900. Of this total, \$2,790 million, or almost three-quarters, represented the accumulated value of United Kingdom investment. It was primarily in portfolio form and was directed mainly into railways and the governmental sectors. In 1926 portfolio investments reached an amount of \$4,221 million. This was then about two-thirds of the entire foreign capital in Canada. The United Kingdom supplied the major portion, an amount of \$2,300 million; the

³⁴Jacob Viner, Canada's Balance, pp. 126, 134, 138. Also see: Penelope Hartland, Studies in Income and Wealth, Vol. 24 (Princeton: Princeton University Press, 1960), pp. 717-753.

United States was the second largest supplier and accounted for about \$1,800 million. The balance was supplied by Western European countries. At the end of 1930 the United States not only took the lead from the United Kingdom in supplying the largest amount of capital to Canada but also in supplying the largest portion of investments in both direct and portfolio forms. United States portfolio investments reached an amount of \$2,374 million. Total foreign capital at the end of that period was \$7,614 million.

By the end of the Second World War United States portfolio investments in Canada had increased to \$3,877 million, far outdistancing the United Kingdom which held only \$1,418 million, or a decrease of about \$956 million since the end of 1930. At the end of 1961 the trend still continued. United States portfolio investments increased to \$6,682 million, while that of the United Kingdom increased by about \$360 million, remaining small in relation to that of United States--about 26.5 percent.

The explanation for the predominance of portfolio foreign investments in Canada up to 1952, the year in which direct investments began to exceed portfolio investments, is twofold: first, Canadian industry was young and mostly in the early stages of development; second, most of the United Kingdom's holdings and a good portion of the United States' holdings were in railway and governmental securities--both federal and provincial. The Dominion Bureau of Statistics gives this

explanation:

The predominance of nonresident holdings in railway securities and in government and municipal debt in earlier periods was a reason for this early pattern. Typical financing was through floating new issues of securities of Canadian governments and railways or other utilities abroad. As Canadian industry was still in the early stages of development, there were relatively limited opportunities for investing in corporate securities outside of the utilities field. And much of the industrial development that did occur was through the establishment of branch plants by nonresident concerns, and therefore was financed through direct investment channels. Portfolio investments in the securities of Canadian industrial concerns mainly arose in the earlier period through floatation of whole or parts of issues of securities in the United States or London. These were supplemented by some holdings acquired by nonresident investors through purchasing outstanding stocks or bonds in Canadian security markets.³⁵

During the 1950-1963 period inflows of portfolio investments were large in absolute value terms, and for some years exceeded the amount of direct investments. Net capital inflows to purchase new and outstanding Canadian securities in the 1950-1960 period amounted to \$5,456 million. However, due to retirement of Canadian securities, Canadian portfolio outflows were exceptionally large for the same period, totalling close to \$2,200 million. Therefore the net inflow of portfolio capital purchases of new and outstanding Canadian securities over retirements was a little over \$3,200 million. Canadian sales and purchases of nonresident securities for the same period were very small and of no great significance. Portfolio investments in other countries are still small in comparison with those of the United

³⁵The Dominion Bureau of Statistics, op. cit., p. 21.

States and the United Kingdom. However, such investment has been growing rapidly, especially in the last decade, and at the end of 1961 reached an amount that is very close to that of the United Kingdom's. The sources were mainly from Western European countries.

At the end of 1961 portfolio investment accounted for a little over 40 percent of total foreign investment in Canada or \$9,833 million. The United States supplied \$6,682 million or 70 percent, the United Kingdom supplied \$1,772 million or 17 percent, and other countries accounted for \$1,379 million or 13 percent. Total foreign investment at the end of 1961 was \$23,570 million; portfolio investments as a percentage of this total for the above countries were: United States, 28 percent; United Kingdom, 7 percent; and other countries, 5.5 percent.

Direct investments in Canada by nonresidents have provided Canada with a substantial portion of its long-term investment and have increased rapidly since the end of World War II, especially in the last decade. At the end of 1961 direct investment accounted for a little less than 60 percent of total foreign investments. It was \$13,737 million. United States direct investments were \$11,284 million or 82 percent of the total. The United Kingdom held second place with an amount of \$1,613 million or 11 percent. Western European countries accounted for the remaining \$840 million or 7 percent. Corresponding percentages of direct investments as a percentage of total foreign investment for the above countries were: United States, 47 percent; United Kingdom, 9 percent; and other countries, 4 percent.

There are no complete data available for such investments from the beginning of the century to 1926, the year in which the Dominion Bureau of Statistics started its annual publications. However, there have been some studies made by scholars that we shall utilize. Professor Aitken points out:

. . . the evidence indicates clearly the preponderance of direct investment in the capital inflows from the United States as contrasted with security sales in the inflow from Great Britain.³⁶

Direct investments, according to Mr. Field's study,³⁷ accounted for almost 55 percent of United States investments in Canada in the first thirteen years of this century; the corresponding figure for the United Kingdom was only 11 percent. However, for the entire period United States investment was only \$780 million--little over one-fifth of the total of \$3,745 million. The United Kingdom supplied almost all of the remaining 80 percent.

Even though United States investment in absolute amounts was much smaller than that of the British, it grew at a faster rate. The volume of United States investments between 1900 and 1913 increased by four and one-half times and that of Great Britain increased only by two and one-half times.

³⁶Aitken, op. cit., p. 35.

³⁷F. W. Field, Capital Investments in Canada (Toronto, 1911 and 1914).

Statistics show that the largest amount of United States investments in 1914 went to Canada, followed closely by Mexico.³⁸ For Canada this trend still continues. Unlike the British with their portfolio investments, United States direct investments in 1914 were invested in the production of industrial materials such as pulp and paper--25 percent of the total or \$618 million; development of other manufacturing goods absorbed about 20 percent; mining and smelting absorbed another 20 percent; agriculture absorbed about 16 percent; and railroads and public utilities absorbed the remaining 19 percent.

There is a gap between Professor Viner's estimates for the above period (1900-1914) and the start of the official Dominion Bureau of Statistics series in 1926. For the abridgment of this gap we go to direct estimates by Professor A. Knox.³⁹ Total foreign capital inflows to Canada, according to his estimates, increased from \$3,837 million at the end of 1914 to \$5,714 million at the end of 1925, an increase of 50 percent. United States investors accounted for almost all of the increase. Their investments increased by 265 percent, from \$881 million to \$3,219 million. British investments actually declined by about \$430 million, from \$2,778 million to \$2,345 million. That of other countries declined as well, from \$177 million to \$149 million.

³⁸Cleona Lewis, International Investments, p. 606, Tables II and III.

³⁹Frank A. Knox, Dominion Monetary Policy (Ottawa, 1939), p. 89.

For the first time in Canadian history United States investors became more important to Canada as capital suppliers than the investors from Great Britain. This change of relative importance was no short-term phenomenon, holding true even today and likely to continue for at least another decade. World War I was the main reason for this change.

The value of British investments fell as a result of repatriation of capital needed to finance the war and liquidation of debt by Canada. The diversion of Canadian governmental and business borrowing from London to New York after the outbreak of the war was also partially responsible.

At the end of the period, Professor Knox estimates that 25 percent of total foreign investment was invested in government securities; 36.5 percent in public utilities (railroads included); 28.4 percent in industry; and the remaining 10.1 percent in merchandising, insurance, finance, agriculture and other services.

The sectoral distribution of United States investment for the same period reveals the familiar present-day pattern--the concentration of United States investments in manufacturing and extractive industries. These two sectors absorbed more than 70 percent of total United States investments at the end of 1924.⁴⁰ This compares with a little over 50 percent in 1914 and slightly less than 80 percent in 1961.

⁴⁰Lewis, op. cit., p. 578.

According to Table 1, total foreign capital inflows in Canada increased from \$6,003 million in 1926 to \$7,614 million in 1930 and then declined to \$7,365 million in 1933, and again decreased to \$6,913 million in 1939. British investment fell during this period from 44 percent of the total to 36 percent, while that of the United States rose to 60 percent from 53 percent. Reasons for the decrease in British investment were the same as before only now it was the Second World War. In 1933 Canada became a capital exporting nation and remained so until the beginning of 1950. Even though British investment showed a market decline in dollar value it increased its share in the manufacturing, mining, smelting, and financial institutions within the Canadian economy. During the period (1926-1939) United States investments showed the most marked increases in Canadian government bonds which grew steadily. The total increase of all the foreign capital inflows amounted only to \$795 million. This was because Canada was exporting capital seven out of thirteen years during the period. Net movements of capital into Canada were only \$60 million during the period 1926-1939. The Dominion Bureau of Statistics conducted a survey for 1932 as to the concentration for distribution of foreign investment in the Canadian economy. It was found that United States investment was again concentrated in manufacturing and the extractive industries. The survey pointed out that United States direct investment was widespread and that a substantial fraction of Canadian output was

from United States subsidiaries. Their output amounted to almost one-quarter of manufacturing output and more than two-fifths of mining output in Canada (by gross value of the product). United States capital had already established itself firmly, at least in the manufacturing sector of the Canadian economy, by 1932.

By 1958 the United States portion of Canadian foreign investments increased to 76 percent of total nonresident investments in Canada. In dollar terms it increased to \$14,600 million and the total increased to \$19,000 million. Total direct investments increased to \$10,880 million from \$2,296 million in 1939 over the nineteen-year period. In 1939 the United States supplied over 80 percent of total foreign direct investment in Canada, and by 1958 United States' share increased slightly to 82 percent, in dollar value increasing from \$1,881 million in 1939 to \$9,045 million by the end of 1958--an increase of 378 percent. On the other hand, British direct investments declined from 16 percent of total direct investments to 12 percent during the nineteen-year period. In absolute dollar value British direct investment increased from \$366 million in 1939 to \$1,296 in 1958--an increase of 251 percent.

At the end of 1961 the United States still accounted for about 82 percent of total foreign direct investments in Canada. Her total reached an amount of \$11,284 million out of the total of \$13,737 million. The United Kingdom held its own at a little less than 12 percent; however,

her total amount increased by 24 percent from \$1,296 million to \$1,613 million for the three-year period. The remaining 6 percent was supplied by Western European countries. Their amounts increased from \$539 million to \$840 million, an increase of 55 percent for the three-year period, while their relative share remained unchanged.

As was pointed out earlier, Canada was not always a capital importing nation but has been a capital exporting nation as well. Canada was a capital exporter for sixteen years from 1933 to 1949. Her total net capital outflows for this period were \$7,500 million. This includes changes in official holdings of gold, sterling and United States dollars. In 1950 Canada resumed her historic role as a capital importer and imported foreign capital every single year with the exception of 1952 in which she exported \$164 million.

The explanation of why Canada became an exporter of capital during the sixteen-year period is found not in the sudden Canadian ability to generate enough home savings for its required investments but from Second World War efforts. Canada, as an ally of the United States and Great Britain, "undertook to supply a major share of the resources necessary for the war efforts and for the reconstruction of Europe that followed."⁴¹ Professor Aitken explains that:

Primarily responsible for the massive exports of capital during the war years were Canadian contributions to mutual aid to the allied powers and a special contribution of \$1,000 million

⁴¹Aitken, op. cit., p. 52.

made to the U. K. for the purchase of war supplies in Canada in 1942. Extensive repatriations of Canadian securities owned in the U. K. also reflected the pressures of war finance and added to the capital outflow.⁴²

Continuing, Professor Aitken has this praise for the Canadian economy:

That such large capital exports could be generated when called for reflected the strength of the Canadian economy and the maturity of its fiscal and monetary institutions.⁴³

He further points out that:

The resumption of heavy capital imports in the early 1950's reflected a return to the historical pattern of Canadian development: growth achieved by the application of sophisticated technology to virgin resources, with the aid of capital borrowed from more advanced areas.⁴⁴

Total foreign investment in Canada increased by 242 percent or \$16,657 million during the 1939-1961 period, from \$6,913 million in 1939 to \$23,570 million in 1961. Of this increase the United States contributed 82 percent or \$13,815 million; the United Kingdom's contribution was very small, only 6.6 percent or \$1,109 million; and the contribution of all the other countries was a little over 11 percent, or \$1,933 million. Of total United States investment in Canada, direct investment accounted for 75 percent or \$10,403 million at the end of 1961. The remaining 25 percent was mainly in portfolio and some in real estate and mortgages.

⁴²Ibid., pp. 51-52.

⁴³Ibid., p. 53.

⁴⁴Ibid.

By the end of 1963, according to the United States Department of Commerce,⁴⁵ total United States private investment outside the United States was \$66,366 million. Geographical distribution shows that Canada received more than any other single country or "geographical area," \$21,568 million or 32.5 percent of the total.

The latest Canadian data available, according to Dr. A. E. Safarian,⁴⁶ shows that the book value of all foreign long-term investment in Canada amounted to \$25,000 million at the end of 1963. About 40 percent or \$10,000 million was in portfolio investment and the remaining 60 percent or \$15,000 million represented direct investment. Of this \$15,000 million United States investors supplied around four-fifths, or \$12,000 million.

Recently in Canada great concern has been shown relative to direct foreign investment for three related reasons: first, the size, absolute as well as relative, has increased enormously since the end of the Second World War, accounting for 60 percent of all foreign investment in Canada, "playing a most dynamic role in the recent period of accelerated Canadian development";⁴⁷ second, because of its

⁴⁵U. S. Department of Commerce, op. cit., pp. 9-11.

⁴⁶A. E. Safarian, "Foreign Ownership and Control of Canadian Industry," The Prospect of Change: Proposals for Canada's Future, ed. Abraham Rotstein (Toronto: McGraw-Hill Co., of Canada Ltd., 1965), p. 223.

⁴⁷Dominion Bureau of Statistics, 1924-1954, op. cit., p. 23.

dynamic role "it has become a leading focal point for observing the impact of investment of external capital in Canada"; third, and the most important for our research, is the single source of supply--the United States. Added to these factors is the unique characteristic of direct investment--ownership and control of industries and corporations in Canada. This has created an atmosphere in Canada of uncertainty, criticisms and fears of American economic domination through the control of Canadian industries.

It is important, therefore, that a full consideration be given to the special characteristics of direct investment--the extent of foreign ownership and control of Canadian industries and the available evidence respecting the economic consequences of such investments.

But before we turn our attention to these factor-problems we must examine the reasons why such investment takes place. Evidence shows that capital inflows to Canada during the 1950-1963 period originated from two sources: direct investments largely from the United States and net new issues of Canadian securities sold mostly in the United States. (Table 2 provides a full source summary.)

There are many reasons or motives why people invest abroad. The empirical studies show that the profit-directed motive is not all inclusive. Other motives are important too. According to an Oregon study,

Although increased profit was the avowed objective of 20 of the 72 companies, it was the single reported motive for only 8 companies.

Nearly half of these reporting stated that their motives were dual or encompassed several objectives; one-fifth gave a single motive other than increased profits.⁴⁸

The table below summarizes The Oregon Study findings:

TABLE 2

DISTRIBUTION OF MOTIVES TO INVEST ABROAD,
REPORTED BY 72 COMPANIES, 1959

Motives	Number of Companies
Increased profits	20
Expand foreign demand or market	19
Nationalism and foreign restrictions	14
To obtain raw materials.	12
Lower costs abroad (labor and better technology)	7
Diversification.	5
Shortage of dollars for imports in the host country.	4
Maintain supplier relation with customer	4
Poor performance of local distributors	3
Necessity to adopt product to foreign demands	3
To protect patents by working them.	2
To develop private enterprise abroad	2
To raise living standards abroad.	1
To protect the U. S. market	1

Source: University of Oregon Foreign Investment Questionnaire

Another survey conducted during 1960-1961⁴⁹ shows that 48 percent of the respondents cited "new markets" as the most important factor in their decision to invest abroad, higher profits were cited by

⁴⁸Raymond F. Mikesell (ed.), U. S. Private and Government Investment Abroad (Eugene: University of Oregon Press, 1962), p. 88. Hereafter referred to as The Oregon Study.

⁴⁹Overseas Operations of U. S. Industrial Companies, 1960-61 (New York: McGraw-Hill Co., 1960).

20 percent of the respondents, trade restrictions were cited by 16 percent of the respondents, and only 6 percent mentioned low-cost foreign labour as the primary inducement to invest abroad.

Professors Barlow and Wender, in their study entitled Foreign Investment and Taxation,⁵⁰ cited six important reasons for investing abroad:

. . . (1) maintenance of markets for companies in the manufacturing field; (2) availability of raw materials for companies in the extractive field; (3) expansion of existing operations with a particular country to meet greater need; (4) development of foreign markets for present product lines; (5) instigation for others desiring the company to operate within a particular country; (6) possibilities for unusually large profits.⁵¹

Professor Mikesell, however, holds that "corporations usually decide to invest abroad as a natural consequence of some phase of their current operations."⁵²

These motives, however numerous, do not explain fully why United States investors invest in Canada. There are some special factors which enter the minds of the board of directors of an investing corporation to invest in Canada, factors that make Canada a more attractive place for investments than any other country in the world. Among these special factors are the geographical proximity of Canada

⁵⁰E. R. Barlow and Ira T. Wender, Foreign Investment and Taxation (Englewood Cliffs: Prentice-Hall, Inc., 1955).

⁵¹Ibid., p. 146.

⁵²Raymond Mikesell, Promoting U.S. Private Investment Abroad (Washington D. C.: National Planning Assoc., 1957), p. 28.

to the United States and the fact that both countries have experienced very similar economic, political and social developments. It is claimed that political stability in Canada has been the dominant factor in the decisions of United States investors to invest in Canada. The authors of Canadian-American Industry,⁵³ claimed in 1936 that:

Geography and history have made it inevitable that the economic structures of Canada and the United States should become closely intertwined.⁵⁴

In 1957 the Royal Commission's Study on Canada-United States Economic Relations⁵⁵ stated the reasons for foreign investors wanting to invest in Canada as follows:

. . . Canada has had a long tradition of freedom for the flow of capital and income across its border. Canada has also had a long history of stable and orderly government. In addition, a skilled labor force and a highly developed educational system, an adequate transportation network and other social-capital facilities, reasonably stable economic and social conditions, a strong desire for material advancement, and positive encouragement by all levels of government . . .⁵⁶

Professor M. K. Inman adds another very important reason for United States investment in Canada. It is to by-pass the Commonwealth preferential tariff wall and sell from Canada to the other

⁵³ Frank Southard et al., Canadian-American Industry (New Haven: Yale University Press, 1936).

⁵⁴ Ibid., p. 1 and Chapter I.

⁵⁵ Irving Brecher and S. S. Reisman, Canada-United States Economic Relations (Ottawa: Queen's Printer, 1957, The Royal Commission on Canada's Economic Prospects).

⁵⁶ Ibid., p. 114.

commonwealth countries. He writes, "American branch plants are established as the means of taking advantage of the British Commonwealth preferential tariff."⁵⁷

Professor H. G. Johnson explains it in this way:

. . . the tariff creates a profit incentive for foreign firms to establish branch plants and subsidiaries in Canada in order to produce in Canada inside the tariff wall instead of exporting to Canada over the tariff wall. . . .⁵⁸

Assuming, as we do, the availability of capital in the United States, the above reasons with the following two explain pretty well why United States investors and others invest capital in the Canadian economy. The Royal Commission explains the two additional motives as follows:

The motives for the "resource" type of investment usually revolve about the desire to develop and guarantee sources of supply for materials in which United States and world needs are, or promise to be, greater than can be supplied from existing sources. In most instances, cost considerations have been dominant.

The second broad motive for direct investments is that of bringing a commodity or service into the Canadian market as an extension of the parent company's United States operations. This is typically the case for more highly fabricated products. Export markets may also be involved for this category of enterprise.⁵⁹

⁵⁷Mark K. Inman, Economics in Canadian Setting (Toronto: The Copp Clark Publishing Co., Ltd., 1959), p. 712.

⁵⁸Harry G. Johnson, The Canadian Quandary: Economic Problems and Policies (Toronto: McGraw-Hill Company of Canada, 1963), p. xi.

⁵⁹Brecher and Reisman, op. cit., p. 117.

In addition, The Oregon Study suggests that once there has been an investment in a foreign country by a firm, then it follows that the company or companies that supply the parent firm with the necessary goods and services will follow the parent's subsidiary abroad to accord it or them the same services. It is something of a snowballing reaction theory. States the study:

The fact that there is a rise in foreign operations by many United States companies has provided an incentive to foreign investment by United States firms which normally supply United States industries that have become established abroad.⁶⁰

It is true no doubt that all these motives are valid reasons for foreign investors to invest in Canada; however, economically we must conclude that it is mainly the profit motive that in the end encourages not only foreigners to invest in Canada but all investors to invest anywhere.

It has been suggested that perhaps there has been too much emphasis placed on tariffs and the low cost of production as an inducement to United States direct investment. It can be argued that since World War II tariffs in Canada and special Commonwealth preferential treatment have become less important, and that tariffs have become less influential in United States foreign investment in Canada. Professor Radford, in his study on Canada's postwar capital inflows up to 1953, states that "it is doubtful . . . whether the postwar capital

⁶⁰The Oregon Study, *op. cit.*, p. 90.

influx has been much affected by the tariff. " He also feels that Canadian tariff policy as a stimulant for "foreign investment is perhaps debatable." ⁶¹

This is admitted by the Royal Commission. However, the present level of the Canadian tariff is still too high and therefore still an important stimulant for foreign investors to invest in Canada. Thus the Commission accords more importance to the tariff than Dr. Radford does. The Commission states why:

The Canadian tariff has probably been of less importance in the postwar period than in the interwar period in attracting investment to Canada. . . . Nevertheless, given Canadian tariffs, the nonresident often finds direct investment in Canada a convenient and more profitable alternative to serving the Canadian market through exports. ⁶²

Recently lower production costs have been increasingly suggested as the most common motive for investment abroad by United States

. . . businessmen, labour leaders, politicians, economists, especially anyone of these with a proclivity for protection. ⁶³

⁶¹R. A. Radford, "Canada's Capital Inflows, 1946-53," International Monetary Fund Staff Papers, Vol. IV (February, 1957), p. 114.

⁶²Brecher and Reisman, op. cit., p. 117. For further discussions of the motives see pp. 116-119 in this reference.

⁶³Robert Whelan Knapp, United States Direct Investment in Canada, 1950-1960, Ph. D. dissertation, School of Economics, Commerce-Business, University of Michigan (Ann Arbor: University Microfilms, Inc., 1963), p. 18.

The evidence with respect to Canada, however, indicates that such suggestions are incorrect, and in fact Canada is generally a higher-cost producer than the United States. A survey conducted by the National Industrial Conference Board on large American manufacturing firms located in industrialized countries and producing the same or similar goods as in the United States compared the relative costs of producing these goods in United States and industrialized countries. The findings of this study are given in Table 3, which confirms that Canada on the aggregate is a higher-cost producer than the United States, although in Canada labour costs are lower than in the United States. Labour costs are more than offset by higher costs of materials. As Table 3 shows, Canadian cost of production is about 10 percent higher than that of the United States.⁶⁴

The explanation for higher Canadian costs of production according to the survey is:

Companies operating there can seldom achieve a comparable scale of production or rely on a comparable network of outside, specialized suppliers.⁶⁵

Thus we may conclude on the basis of this survey that the cost of production in Canada, at least, would act as a deterrent rather than an inducement to United States investment in Canada.

⁶⁴Theodore Gates and Fabian Linden, Costs and Competition, American Experience Abroad (New York: National Industrial Conference Board, 1961), pp. 85-90.

⁶⁵Ibid., p. 90.

TABLE 3

RELATIVE COSTS OF PRODUCTION, CANADA
AND THE UNITED STATES, 1960
(All figures are in percentages)

	Plant			Sub- total	Sales	Other	Total Unit Cost
	Material	Labour	Overhead				
Canada	47	17	19	83	20	7	110
United States	36	18	19	73	20	7	100
Difference	+11	-1	0	+10	0	0	+10

Source: National Industrial Conference Board, Costs and Competition, p. 84.

In conclusion it should be kept in mind that the overriding factor that provides the basic motive for United States investors to invest in Canada is the prospect of higher profits. The secondary motives are a favorable investment climate, both economical and political, and the proximity and similarity of economic as well as social and political institutions of the two countries.

Next we must consider a neglected but important issue: why do foreigners desire control through direct investment instead of maintaining portfolio holdings? Simply, why has there been a shift from portfolio investment to direct investment, which carries such ownership and control? It is important that a reasonable answer be provided.

Recent debate in Canada has centered around foreign control of Canadian industries rather than foreign capital investment per se.

The most satisfactory economic answer is provided by Dr. S. Hymer in his doctoral dissertation.⁶⁶ His theory of direct investment goes something like this: direct investment involves the international operation not of financial but of entrepreneurial talent. It is competitive advantage that decides whether a firm will establish a branch or subsidiary abroad. Direct investment will take place when the firm has an advantage over the local (national) competitors. The advantage may be based on superior access to capital or markets, greater command over patents or technology, or superior efficiency in decision-making. Control is maintained (retained) so as to exploit the full economic return--or economic rent--of the special competitive advantage, and 100 percent ownership provides the greatest possible control and, therefore, is preferred.⁶⁷ This analysis, of course, is based on the economist's assumption that firms do seek to maximize profits, and it follows that capital recognizes no political (national) boundaries. On the same question--foreign desire for 100 percent ownership--the Royal Commission gave four reasons:

First, there is the obvious reluctance by companies--which have taken capital risks, built a profitable operation and do not need outside capital--to share their profits with other investors.

⁶⁶Stephen Hymer, The Theory of Direct Investment (Doctoral dissertation, Massachusetts Institute of Technology, 1960).

⁶⁷Ibid., p. 50.

This reluctance is by no means unique to foreign companies investing in Canada. Secondly, there is the possibility that the parent company may lose some freedom of action in its relation with the subsidiary when the structure of the latter is revised to permit minority participation--even where the foreign corporation continues to hold voting control; the same limitations on freedom of action may apply to the subsidiary's management as well. Such limitations may arise because of conflicts of interest between the majority and minority shareholders on such share policy issues as dividend distributions, scale of operations, plant location and other important areas of corporate decision-making. Thirdly, there are a number of technical problems to be considered. For example, in many cases costs for such activities as research and training programmes are not allocated precisely between parent and subsidiary; similarly for ownership and valuation of particular assets. A public issue of equity stock would presumably require a more elaborate and precise accounting system to record transactions between parent and subsidiary. Fourthly, public equity participation entails the publication of financial statements revealing some aspects of the company's Canadian operations which it might prefer to keep confidential. Finally, Canadian tax law has had the effect of imposing a withholding tax penalty on foreign-owned companies in which the foreign equity is less than 95 percent; this tax disincentive to extending Canadian equity participation was recently removed.⁶⁸

Returning to the definition of foreign direct investment, the International Monetary Fund defines it as follows:

. . . investment made to create or expand some kind of permanent interest in an investment; it implies a degree of control over its management. In the case of portfolio investment, on the other hand, the investor has no intention of playing a major role in the direction of policies of the enterprise; he is influenced by such considerations as market ability, income yield, possibilities for capital appreciation, tax advantages, exchange rate prospects, and safety of principal. Borderline cases exist between direct and portfolio investment, but a larger part of all investment can in practice be distinguished as belonging to one or the other category. . . .⁶⁹

⁶⁸Brecher and Reisman, op. cit., pp. 125-126.

⁶⁹International Monetary Fund, Balance of Payments Manual (3rd ed., July, 1961).

The Dominion Bureau of Statistics explains that:

Most direct investment is made to expand an enterprise beyond the national boundaries of its home country, either by establishing factories and sales organizations abroad or by producing, or producing goods abroad for import for the home country or export to third countries. It is characteristic of direct investment that the investor possesses managerial control over the enterprise in which the investment is made and that he also makes available to it his technical knowledge (know-how).⁷⁰

Direct private investment, according to The Oregon Study, is described:

. . . as a flow of funds from a parent company to an affiliate abroad. However, it is more than a flow of money capital; it includes contributions of tangible and intangible assets in a variety of forms. Some of the resources are generated abroad from retained earnings, depreciation reserves and local borrowings. Nonmonetary transfers to the foreign affiliates include the shipment of equipment, the transfer of personnel, the provision of managerial and technical assistance, and the permission to use intangible assets of the parent company, such as trademarks and patents.⁷¹

It should be noted that the concept of control, as explained previously, is necessarily a formal one which indicates the existence of potential control of the firm by nonresidents, rather than the true extent to which management does in fact exercise it. Professor Safarian explains why:

There is a difference between the legal position of effective control of voting stock and the question of extent to which that

⁷⁰Dominion Bureau of Statistics, The Canadian Balance of Payments, 1961 and 1962 and International Investment Position (Ottawa: Queen's Printer, 1964), p. 95.

⁷¹The Oregon Study, op. cit., p. 77.

control is in fact exercised. When we consider data on foreign ownership and control of Canadian industry we are considering the former point only. The word "control" is a convenient short way to refer to this legal position, but it should always be remembered that the data alone tell us nothing about the extent to which the officers of the major or the sole shareholder abroad do, in fact, exercise their influence. In fact we know very little on this matter except that there is a wide range of situations from a high degree of centralization to virtually complete autonomy.⁷²

It is also important to keep in mind when interpreting the data to be presented that for some specific industries the direct-investment companies in Canada range from companies whose stock is wholly owned by a parent company abroad to companies which are Canadian in essence but where more than half of the stock is owned by nonresidents.

The Dominion Bureau of Statistics recognizes four distinct categories of such foreign ownership:

- (a) Branches of foreign enterprises, incorporated or unincorporated, i. e., including branches of foreign sole proprietorship and partnerships.
- (b) Other unincorporated enterprises operating separately in the compiling country but owned by nonresidents, or in which nonresidents are controlling partners.
- (c) Incorporated enterprises (such as subsidiaries) operating in the compiling country, in whose policies nonresidents exercise an important voice. In the absence of other information, the representation of specific groups of nonresidents on the board of directors, or the ownership of 25 percent of the voting stock by the closely organized group of nonresidents, may be taken as evidence of direct control. When there is

⁷²Safarian, op. cit., p. 224. Also see Brecher and Reisman, op. cit., pp. 131-137.

no evidence of direct control in local hands, ownership of 50 percent of the voting stock by residents of one foreign country or of 75 percent by all nonresidents may be taken as evidence of direct foreign control. . . .

- (d) Commercial real estate owned by nonresidents, if this category of direct investment enterprises does not take any of the forms mentioned above.⁷³

Further the Dominion Bureau of Statistics explains the concept of control:

In general an enterprise is considered to be foreign controlled if 50 percent or more of its voting stock is known to be held in one country outside Canada. The group is modified by the addition or deletion, as appropriate, of concerns where it is believed that because of the distribution of the stock effective control is held with less than 50 percent of the voting stock. (Since complete knowledge of share owners may not be available the classification of borderline cases involves a measure of judgement based upon all the known factors which could be relevant.) The enterprise includes all the corporations over which the group itself is in a position to exercise control. The concept of control which has been adopted is, therefore, one of potential control through stock ownership, and the degree, if any, of local autonomy permitted in practice by the owners is not relevant.⁷⁴

Now, with these warnings and meanings of the term control, we are ready to examine the official data on United States, private-direct investment in Canada. However, first it must be emphasized that we are dealing only with a "small" portion of the private and public wealth in Canada. Second, the relative importance of foreign capital has decreased with the growth of Canadian economy--the domestic supply of capital. Canadians have one of the highest rates of

⁷³DBS, 1961 and 1962, op. cit., p. 96.

⁷⁴DBS, 1961 and 1962, op. cit., p. 96. See also DBS, 1926-1954, op. cit., p. 24.

private savings, and it has been constant--about 18 to 20 percent of the Gross National Product--since 1926.

Professor Aitken states that "one million dollars of imported capital does not exert the same leverage on the Canadian economy today as it did fifty years ago."⁷⁵ The first point can be illustrated by the estimated total gross value of the capital stock. In 1955 the total estimated value of the capital stock in Canada valued in 1949 prices was \$77,892 million,⁷⁶ according to Table 4. The first section of the table gives the stock of "industrial capital" (plant, equipment, etc.). The latter section records the nation's stock of housing and the capital of governments and public institutions. The stock of industrial capital in 1955 amounted to more than \$40 billion or 52.8 percent of the total. About three-fifths of this was in the form of buildings and other construction works such as dams, land improvements, railway roadbeds, etc.; the remaining two-fifths was in machinery and equipment. Since, as it was pointed out, foreign direct investment has been concentrated in the dynamic industries, i. e., manufacturing and the extractive industries, and has thus created the greatest economic concern--the fear of foreign control of Canada's economy--we should exclude

⁷⁵Aitken, op. cit., p. 60.

⁷⁶H. Scott Gordon, "Planning for Economic Progress: Resource Development and Capital Investment," Social Purpose for Canada, ed. Michael Oliver (Canada: University of Toronto Press, 1961), p. 273.

TABLE 4
GROSS CAPITAL STOCK IN CANADA, 1955
(\$ million at 1949 prices)

	Plant, Buildings and Construction Works	Machinery and Equipment	Total	
			Dollars	Percentage ^a
INDUSTRIAL CAPITAL				
Agriculture	1,237.2	3,316.0	4,553.2	5.8
Resource industries	5,082.6	2,176.6	7,259.2	9.3
Primary manufacturing	1,728.5	2,056.6	3,785.1	4.9
Secondary manufacturing	3,790.8	3,868.6	7,659.4	9.8
Transport, storage and communication	7,625.8	3,506.5	11,132.3	14.3
Trade services and construction	4,362.2	2,385.8	6,748.0	8.7
Total Industrial Capital	23,827.1	17,310.1	41,137.2	52.8
SOCIAL CAPITAL AND HOUSING				
Government	9,608.2	1,334.2	10,942.4	14.0
Institutions	3,804.4	266.3	4,070.7	5.2
Housing	21,742.1		21,742.1	27.9
TOTAL	58,981.8	18,910.6	77,892.4	100.0

Source: William Hood and Anthony Scott, Output, Labour and Capital in the Canadian Economy, (Ottawa: Royal Commission on Canada's Economic Prospects, Queen's Printer, 1957), Tables 6B.2 and 6B.5.

^aFigures in this column do not total 100 percent due to rounding.

agriculture, transportation, trade, storage and communications capital stock, which in the table form the industrial sector of the economy, in order to get a somewhat more realistic picture of the relative size of United States direct investment to the gross capital stock in Canada. We are left with a total of \$18,693 million or one-quarter of the gross capital stock into which most of United States direct investment goes and, therefore, is only a portion of that total, since many Canadians invest in these sectors of the economy.

Professor Safarian supports this contention with the use of net figures of the stock of capital in Canada. He claims that:

. . . the major portion of private and public wealth in Canada is not covered by the data on foreign ownership and control of selected Canadian industries.⁷⁷

He continues:

An estimate of the net stock of fixed capital in industry in 1955, valued at 1949 prices, placed the total at \$25 billion. The net stock of social capital in government, housing, and institutions (i. e., schools, universities, churches, and hospitals) in 1955, again valued in 1949 prices, was placed at \$22 billion. The DBS ratios for foreign ownership and control of selected industries which are noted below refer to the relevant portions of the total of about \$20 billion of the former figure; the major part of the remaining \$5 billion is the net stock of capital in agriculture, an industry which is very largely owned by residents. Canadians own most of the debt underlying the social capital of \$22 billion (in 1949 prices) noted above.⁷⁸

Much the same conclusion can be drawn from the estimated book values of the ownership and control of capital employed in selected

⁷⁷Safarian, op. cit., p. 225.

⁷⁸Ibid., pp. 225-226.

Canadian industries. In 1955, according to the Dominion Bureau of Statistics, total capital employed in the selected industries--i. e. , manufacturing, petroleum and natural gas, other mining and smelting, railways, other utilities, merchandising and construction--was \$28.2 billion. Out of this total, Canadian residents owned \$19.1 billion or 68 percent and the remaining \$9.1 billion or 32 percent was owned by all nonresidents. The United States' share amounted to \$7.0 billion or 25 percent of that total, which was equal to 77 percent of the total non-resident share. The corresponding figures for 1961 saw a substantial increase in absolute terms but the relative shares of all remained practically unchanged. At the end of 1961 the total capital employed in the above mentioned industries reached \$48.2 billion. Of this total the Canadian residents owned \$31.7 billion or 66 percent--two percentage points less than in 1955. Thus the corresponding figure for the nonresident ownership increased by two relative percentage points to \$16.5 billion or 34 percent of the total. The United States' share, during this six-year period, increased by two relative percentage points, to \$12.9 billion or 27 percent of the total employed capital, which was 78 percent of total nonresident capital in the above selected industries.

As Table 5 clearly shows, foreign ownership of these selected industries has been about a third of the total since 1954, and the United States' share has increased only slightly for the six-year period.

TABLE 5

ESTIMATED BOOK VALUE, OWNERSHIP OF CAPITAL
EMPLOYED IN SELECTED CANADIAN INDUSTRIES

Industry	Total Capital Employed (1)	Resident Owned Capital (2)	Nonresident Owned Capital (3)	U. S. Owned Investments (4)	2/1	3/1	4/1	4/3
	(in \$ billions)				(percentages)			
END OF 1954								
Manufacturing	8.3	4.4	3.9	3.1	54	47	37	80
Petroleum and natural gas	2.5	1.0	1.5	1.4	40	60	56	93
Other mining and smelting	1.9	0.9	1.0	0.9	47	53	47	90
Railways	4.1	2.7	1.4	0.6	66	34	15	43
Other utilities	5.3	4.6	0.7	0.6	87	13	11	86
Merchandising & construction	6.1	5.5	0.6	0.4	90	9.8	6.6	62
Totals	28.2	19.1	9.1	7.0	68	32	25	77

TABLE 5--Continued

	Total Capital Employed (1)	Resident Owned Capital (2)	Nonresident Owned Capital (3)	U. S. Owned Investments (4)	2/1	3/1	4/1	4/3
	(in \$ billions)				(percentages)			
END OF 1961								
Manufacturing	12.7	5.9	6.8	5.4	46	54	43	80
Petroleum and natural gas	6.7	2.7	4.0	3.4	40	60	51	85
Other mining and smelting	3.4	1.3	2.1	1.8	38	62	53	86
Railways	5.4	4.0	1.4	0.5	74	26	9.3	36
Other utilities	10.3	9.0	1.3	1.1	87	13	11	85
Merchandising & construction	9.8	8.9	0.9	0.6	91	9.2	6.1	67
Totals	48.2	31.7	16.5	12.9	66	34	27	78

65

Source: Dominion Bureau of Statistics, The Canadian Balance of International Payments, 1961 and 1962 and International Investment Position (Ottawa: Queen's Printer, August, 1964), p. 136.

In order to indicate that the relative influence--contribution, if you will--has been decreasing at least since 1957, it is necessary to examine the contribution brought by foreign capital to the financing of the Canadian economy. In short, what portion of the total domestic investment expenditures did foreign capital contribute since 1957?

Two approaches are of interest in this regard. The first is concerned with the extent to which Canada on balance has drawn on foreign resources to finance its economic development. This may be measured by the surplus or deficit in Canada's international current account,⁷⁹ plus the retained earnings on foreign direct investments available for use in Canada, minus retained Canadian direct investments abroad. On the basis of this approach (see Table 6) it is clear

⁷⁹The current account includes payments and receipts for the import and export of commodities, transactions and other commercial services, immigrant's remittances and the expenditures of tourists, and interest and dividends due to nonresidents. Receipts (claims to payment) are given a positive sign (+) and payments a negative one (-). Receipts and payments may cancel out or show a negative or positive net balance. The capital account items, on the other hand, relate to changes in the country's assets and liabilities. They include sale of new securities abroad; redemptions, loans, and repayments; receipts and payments from the purchase and sale of outstanding securities, branch plant capital transactions; and changes in monetary, gold and externally held cash balances. An addition to external assets is given a negative (-) sign and an addition to liabilities a positive (+) one. The capital account also can reach a balance or show a negative or positive net balance. If it is positive net balance, it means that the country is accumulating more liabilities abroad than assets; that is to say, it is borrowing abroad on balance or "importing capital." In the end the current and capital account balances must be equal but of opposite sign. If a country is paying out on current account more than it is receiving this means that it is getting into debt to other countries or it is accumulating liabilities abroad. A deficit on current account must be offset by a surplus on capital account, or vice versa.

TABLE 6
FOREIGN AND DOMESTIC FINANCING OF ALL CANADIAN INVESTMENT, 1926-1962

Measure	1926-30	1946-49	1950-55	1956-60	1961-62
	(percentages)				
A					
Use of domestic resources					
as percentage of:					
1. gross capital formation	na	99	83	72	76
2. net capital formation	75	111	81	64	71
Use of foreign resources as					
percentage of:					
1. gross capital formation	na	1	17	28	24
2. net capital formation	25	-11	19	36	29
B					
Direct domestic financing of:					
1. gross capital formation	na	81	75	67	68
2. net capital formation	50	76	67	55	54
Direct foreign financing of:					
1. gross capital formation	na	19	25	33	32
2. net capital formation	50	24	33	45	46

Sources: DBS, 1961 and 1962, The Canadian Balance, op. cit., p. 72; Brecher and Reisman, op. cit., p. 96. For further information see: William C. Hood, Financing of Economic Activity in Canada (Ottawa: Queen's Printer, 1958), and A. E. Safarian and E. B. Carty, "Foreign Financing of Canadian Investment in the Post-War Period," Proceedings of the Business and Economic Statistics Section, American Statistical Association, 1954, pp. 72-79.

Notes: "na" indicates "not available."

Minus sign denotes net foreign investment by Canada.

that the contribution of foreign capital in capital formation has been substantial but decreasing since 1957. This is clearly shown in columns 3 and 4 of Table 6. In the period 1956 to 1960, foreign capital financed 28 percent of gross capital formation, and in the 1961-1962 period the percentage fell to 24 percent--a decrease of 14 percent.

This "short trend" is even more evident in Table 7. The net use of foreign resources reached its peak in 1957 at 29 percent and since then has decreased to 21.5 percent at the end of 1961, a decrease of 23 percent. Total capital formation from 1950 to 1962 was \$95.8 billion. The net use of domestic resources accounted for \$73.7 billion or 77 percent; the balance of \$22.1 billion was the net use of foreign resources or 23 percent of the total for the twelve-year period.

It is clear from Table 6 that domestic savings were adequate in the 1950-1955 period to finance 83 percent of gross capital formation, 72 percent during the 1956-1960 period, and 76 percent during the 1961-1962 period. However, not all Canadian savings were invested within Canada; some went abroad.

The second approach takes this point into account and is concerned with the extent to which nonresidents have directly financed Canadian investment. It refers to the new capital generated in the non-Canadian companies, inside or outside Canada, which is supplied to Canadian enterprises and governments--both federal and provincial.

Here the ratios are somewhat higher than the ratios for the total use of foreign resources. Nonetheless it is interesting to note

TABLE 7

USE OF FOREIGN AND DOMESTIC RESOURCES IN GROSS
CAPITAL FORMATION IN CANADA, 1950-1962

Year	Gross Capital Formation (1)	Net Use of Domestic Resources (2)	Net Use of Foreign Resources (3)	Ratio 2:1	Ratio 3:1
	(in \$ billions)			(percentages)	
1950	4.5	3.8	.6	87	13
1951	5.7	4.8	.9	84	16
1952	6.0	5.5	.5	92	8
1953	6.6	5.4	1.1	83	17
1954	5.6	4.4	1.2	78	22
1955	6.6	4.9	1.6	76	24
1956	9.1	6.6	2.5	72.5	27.5
1957	8.9	6.4	2.6	71	29
1958	8.0	6.0	2.1	74	26
1959	8.9	6.3	2.6	71	29
1960	8.6	6.3	2.3	73	27
1961	8.0	6.0	2.1	75	25
1962	9.3	7.3	2.0	78.5	21.5
1950-62 totals	95.8	73.7	22.1	77	23

Source: DBS, 1961 and 1962, The Canadian Balance, op. cit., p. 72, statement 20. See also: 1964, Report of the Royal Commission on Banking and Finance (Ottawa: Queen's Printer, 1964), p. 85.

that in spite of this, gross capital formation financed directly by foreigners has declined by 3.1 percent between the period of 1956-1960 and 1961-1962, from 33 percent to 32 percent. Net capital formation, however, increased by 2 percent from 45 percent to 46 percent.

The over-all significance of foreign financing in Canada since 1950 has been large and increasing up to 1957 and since then it has been declining. The point to keep in mind here is that the importance of foreign financing has been declining in relation to the growth of the Canadian economy--her ability to generate her own capital investment, since the beginning of the twentieth century.

As the study by the Royal Commission points out:

The over-all place of foreign financing in Canada's investment expansion since the war has been considerably less than in previous periods of heavy investment. The net use of foreign resources was about one-quarter in 1926-30, compared to 6 percent in 1946-54; and direct foreign financing fell from about one-half to one-quarter between the two periods. While comparable estimates for the period 1900-13 are not available, it would appear that the extent of foreign financing in that period was even greater than that in 1926-30. In effect, there has been a very considerable increase since the turn of the century in the capacity of the country to generate the savings required to finance its investment programme.⁸⁰

Professor Aitken professes much the same contention:

Comparisons with earlier periods in Canadian history are hazardous but essential for interpretation. In the period 1926-30, it has been estimated that the use of foreign resources as percentage of net capital formation was about 25 percent; direct foreign financing of net capital formation was about 50 percent. In the period 1900-13, these ratios were probably even higher. Canada's

⁸⁰Brecher and Reisman, op. cit., p. 97.

reliance on foreign capital in recent years has been great; but, to the best of our knowledge, it has not been greater than in previous periods of rapid growth.⁸¹

Then Professor Aitken adds:

Such a conclusion would be inescapable if there were some way of including in our calculation estimates of the capital imported by Canada in the form of adults, trained adults.⁸²

Furthermore, contrary to so-called "public opinion," Canada's ability to carry her external debt has been increasing even though the increased amounts of foreign capital in Canada have correspondingly increased Canada's interest and dividend payments to nonresidents. This is because both merchandise exports and Gross National Product have grown at a faster rate than the servicing of Canada's foreign obligations. In short, the post-war prosperity has reduced the burden of foreign payments to nonresidents. Also due to the shift from portfolio to direct investment, the servicing of Canada's foreign obligations has been directly tied to the prosperity of the Canadian economy--the business conditions of that country.

Dividends received by nonresidents on their direct investments vary according to business conditions; "hence, since no fixed charges are involved, the annual burden of fixed payments to outsiders has become relatively lighter."⁸³

⁸¹Aitken, op. cit., p. 62.

⁸²Ibid., p. 208.

⁸³Inman, op. cit., p. 712.

The evidence, according to Table 8 and Figures 1 and 2, indicates that the share of export receipts and the Gross National Product paid for the use of foreign capital has decreased substantially since the 1920's. The respective percentages are 6.7 percent and 1.4 percent in 1956-1960 period, compared to 16.2 percent and 4.7 percent in 1920-1930 period. These percentages were even higher in the 1930's, but much lower for 1963, 7 percent and 1.2 percent respectively.

Professor Aitken explains:

Both ratios were relatively low at the end of 1958. By these tests, Canada's productivity and international earnings have more than kept pace with the rising cost of servicing the external debt. The fact that much of this debt is now in the form of equity holdings rather than fixed-interest obligations is further element of strength, for dividends on equity investments can be remitted only when dividends are earned. It would take a depression of the utmost severity, accompanied by a catastrophic drop in export earnings, to raise the ratios to levels comparable to those reached in the 1920's and 1930's.⁸⁴

Professor Safarian supports this contention and uses it to support the productivity of borrowed capital which has been criticized as unproductive and wasteful. He explains:

The impression has been created by some persons, notably the former Governor of the Bank of Canada, that Canada has borrowed capital excessively and spent the proceeds unwisely. It is impossible to say precisely the extent to which the borrowed capital has been productively invested; such a conclusion depends in part on future results, and in any case is difficult to measure directly. One check which can be made however, is the measurement of the burden of the foreign obligations acquired by Canada.

⁸⁴Aitken, op. cit., pp. 63-64.

TABLE 8

CANADA: RATIOS OF NET INTEREST AND DIVIDEND
 PAYMENTS TO NONRESIDENTS TO GROSS NATIONAL
 PRODUCT AND RECEIPTS ON CURRENT ACCOUNT,
 SELECTED YEARS, 1900-1963

Period	Net Interest and Dividend Payments (1)	Gross National Product (2)	Current Receipts (3)	Ratio 1:2	Ratio 1:3
	(in \$ millions)			(percentages)	
1900	36	1,044	210	3.5	17.1
1910	92	2,186	389	4.2	23.7
1920	213	5,536	1,581	3.8	13.5
1926-29 ^a	272	5,720	1,683	4.7	16.2
1930-38 ^a	300	4,583	1,161	6.5	25.9
1939-45 ^a	279	9,401	3,189	3.0	8.8
1946	242	11,863	3,365	2.0	7.3
1948	255	15,350	4,147	1.6	6.1
1950	384	18,006	4,240	2.1	9.1
1951	335	21,170	5,166	1.6	6.5
1952	268	23,995	5,658	1.1	4.7
1953	239	25,020	5,491	0.8	4.3
1954	276	24,871	5,236	1.1	5.3
1955	323	27,132	5,850	1.2	5.5
1956	381	30,585	6,464	1.2	5.9

TABLE 8--Continued

Period	Net Interest and Dividend Payments (1)	Gross National Product (2)	Current Receipts (3)	Ratio 1:2	Ratio 1:3
	(in \$ millions)			(percentages)	
1957	435	31,909	6,515	1.4	6.7
1958	444	32,867	6,437	1.4	7.0
1959	489	34,857	6,792	1.4	7.0
1960	480	35,959	7,110	1.4	6.8
1961	561	37,421	7,734	1.5	7.0
1962	592	40,401	8,348	1.45	7.0
1963	646	43,500	9,226	1.24	7.0
1964	687	47,000	10,414	1.46	6.6

Sources: GNP estimates for 1900, 1910, and 1920 from O. J. Firestone, Canadian Economic Development 1867-1953 (London, 1958), p. 65, Table 9. Other GNP figures from DBS, National Accounts, Income and Expenditures, 1926-56, pp. 32-33, Table 1, and subsequent publications; Bernard Goodman, Two Dependent Economies: Canada and Australia (Lindsay, Ontario John Deyell Limited, 1964), pp. 94-95; and Economic Council of Canada, First Annual Review: Economic Goals for Canada to 1970 (Ottawa, Canada: Queen's Printer, 1964), pp. 12-15, 57. Interest and dividend payments and current receipts from J. A. Stovel, Canada, pp. 338-345, Table 27; DBS, The Canadian Balance, 1961 and 1962, p. 20; Quarterly Estimates of the Canadian Balance, Third Quarter, p. 7; and Brecher and Reisman, op. cit., p. 94, Table 21.

^aAnnual averages.

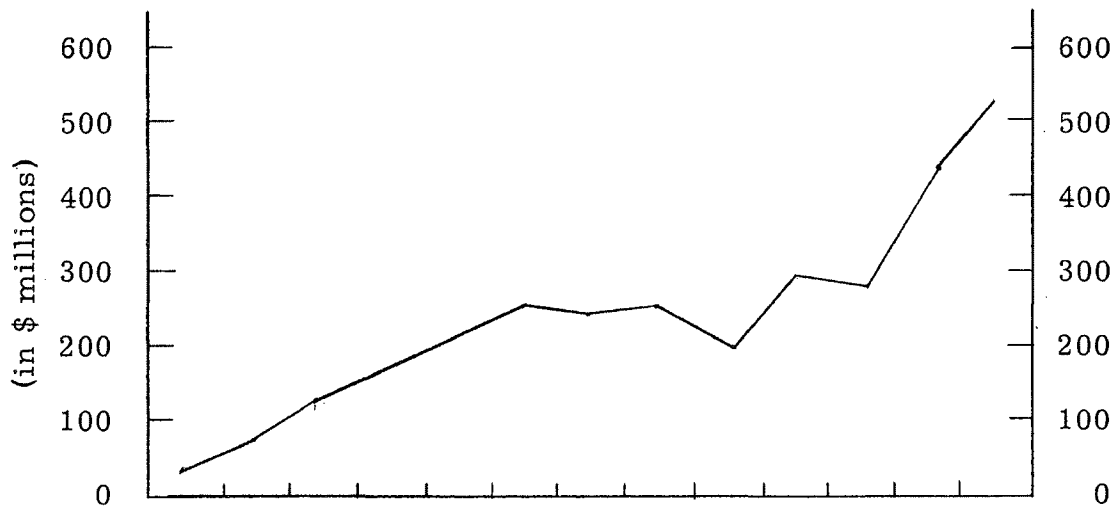


Fig. 1. --Net interest and dividend payments (five-year averages, 1901-05 to 1956-64).

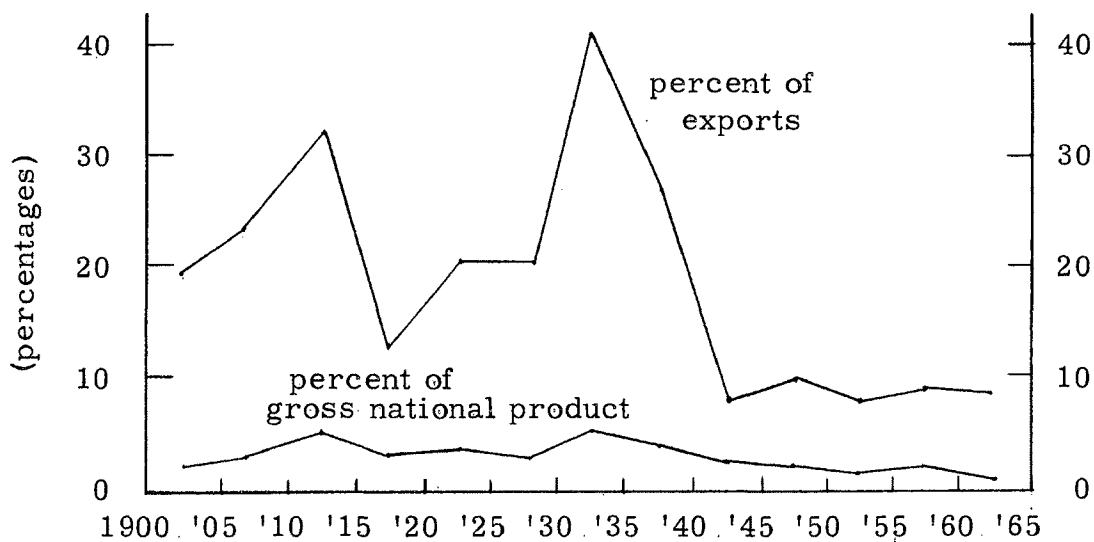


Fig. 2. --Net interest and dividend payments in relation to exports and Gross National Product (five-year averages).

Sources: 1964 Report of the Royal Commission on Banking and Finance (Ottawa: Queen's Printer, 1964), p. 84, for 1900 to 1958.

My own estimates for 1958 to 1964 based on the Quarterly Estimates of the Canadian Balance of International Payments published by the DBS Catalogue No. 67-001 (Ottawa: Queen's Printer, 1963, 1964, and 1965).

The evidence here does not suggest that we have been profligate, at least by historical standards. Interest and dividends paid abroad as a percentage of gross national product have fallen sharply from 2.9% of gross national product in the late twenties and 6.4% in the thirties, to 1.9% in the late fifties and early sixties. As a percentage of our foreign earnings from the sale of goods and services (earnings which are available to finance payments abroad), the payments of interest and dividends have declined sharply from 16% in the late twenties and 25% in the thirties to 9% in the late fifties and early sixties. It will be noted that Canada is in a much better position to avoid a sharp rise in these ratios in the event of a period of economic decline since, unlike the thirties, more of such payments are in relatively flexible dividends than in fixed payments for interest. It is true that dividends paid abroad will rise as the earnings of firms involved rise. . . . However, foreign owned industry includes substantial exporting and import-competing sectors, thus helping to supply or save foreign exchange as well as to use it.⁸⁵

Since the end of World War II foreign investment has increasingly contributed to the financing of the Canadian economy. The main sources of this capital have been and still are the United States and Western Europe (including Great Britain). Thus the United States is by no means the only supplier of capital to Canada. The focus of current Canadian attention and criticism is, nonetheless, on United States direct investment. This is due to the fact that an extraordinarily high proportion of the last decade's increase in the supply of foreign direct investment in Canada has come from United States investors and that most of it has been invested in the "dynamic sectors of the Canadian economy" (see Table 9). However, here it should be remembered that we are talking in absolute terms only. Relatively speaking, United

⁸⁵Safarian, op. cit., pp. 229-230.

TABLE 9
SOURCES AND ESTIMATES OF DIRECT FOREIGN
INVESTMENT IN CANADA, 1950-1962

Year	Total Direct Investment (in \$ millions)	United States		United Kingdom		Other Countries	
		Share of Total (in \$ millions)	Percentage of Total	Share of Total (in \$ millions)	Percentage of Total	Share of Total (in \$ millions)	Percentage of Total
1950	3,975	3,426	86.4	468	11.8	81	2.0
1951	4,520	3,896	86.2	497	10.8	127	2.8
1952	5,218	4,530	87.2	544	10.4	144	2.8
1953	6,003	5,206	87.0	612	10.2	185	3.0
1954	6,764	5,787	85.5	759	11.2	218	3.2
1955	7,728	6,513	84.5	890	11.5	325	4.2
1956	8,868	7,392	83.4	1,042	11.8	428	4.8
1957	10,129	8,472	83.8	1,163	11.5	494	4.9
1958	10,880	9,045	83.0	1,296	11.9	539	4.9
1959	11,906	9,912	83.2	1,384	11.6	610	5.1
1960	12,872	10,549	81.4	1,535	11.9	788	6.1
1961	13,737	11,284	82.5	1,612	11.7	840	6.1

Source: DBS, The Canadian Balance of Payments, 1961 and 1962 and International Investment Position (Ottawa: Queen's Printer, August, 1964), p. 134, Table XIII.

States investment in Canada has not changed at all. At the end of 1950 United States investors accounted for 76 percent of total foreign capital in Canada and at the end of 1961 the percentage was still the same--76 percent.

The relative importance of United States direct investment in relation to the total foreign direct investment has declined since 1950 from 86.4 percent to 82.5 percent, a decline of 5 percent. However, the absolute increase which caused concern tells a different story entirely. From 1950 to 1961 total United States investment increased from \$6,549 million to \$17,966 million, an increase of \$11,417 million or 174 percent--an average of \$1,038 million a year. Of this total increase, United States direct investment accounted for about \$7,858 million or 70 percent. Total United States direct investment at the end of 1961 reached \$11,284 million, which is equivalent to about 48 percent of total nonresident investment in Canada. This compares to a little less than 40 percent of the total at the end of 1950, an increase of 20 percent in the eleven-year period.

This increase has caused a corresponding increase in United States ownership and control of Canadian industries. Most of the recent increases, according to the Dominion Bureau of Statistics data:

. . . have been due to the expansion of direct investment in business enterprises which are controlled abroad. Totalling \$13.7 billion these make up nearly three-fifths of the total and have been growing more rapidly over the period than portfolio investment. The increase in direct investments are distributed among primary and secondary industries with gains in manufacturing being almost

as large as in the petroleum and mining industries.

Investment owned in the United States accounted for most of the increase in the total, rising to \$18.0 billion at the end of 1961 from \$16.7 billion in 1960. The direct investment group with a book value of \$11.3 billion was again the main source of the rise, with other substantial gains in United States holdings of Canadian government and municipal bonds, other portfolio holdings and miscellaneous investments. Investments owned in the United Kingdom rose only moderately in 1961 to a total of \$3.4 billion, and investments owned in other countries showed a somewhat larger gain to a total of \$2.2 billion.⁸⁶

Before we examine the official estimates of foreign ownership and control of Canadian industries, it would be useful to keep in mind the relative sizes of the concerned industries. As Table 5 shows, total estimated book value of the capital employed in the selected industries at the end of 1961 was \$48.2 billion, of which \$12.7 billion was in manufacturing, \$6.7 billion in petroleum and natural gas, \$3.4 billion in other mining and smelting, \$5.4 billion in railways, \$10.3 billion in other utilities, and \$9.8 billion in merchandising and construction.

Table 5 also shows that \$31.7 billion or 66 percent of the total capital employed in the above selected industries was resident owned. Canadians owned 47 percent or \$5.9 billion of the total in manufacturing, 40 percent or \$2.7 billion in petroleum and natural gas, 40 percent or \$1.3 billion in other mining and smelting, 74 percent or \$4.0 billion in railways, 87 percent or \$9.0 billion in other utilities, and 91 percent or \$8.9 billion in merchandising and construction.

⁸⁶The Canadian Balance, 1961 and 1962, op. cit., p. 71.

The nonresident ownership and control of the selected industries as a percent of the total capital invested in these industries is given in Table 10. It can be seen that the long term increase in foreign ownership and control is confined to the first three industries--manufacturing, petroleum and natural gas, and other mining and smelting. In the remaining three industries--railways, other utilities, merchandising and construction--such ownership and control has in fact sharply decreased, as in the case of railways and other utilities, or remained unchanged, as in the case of merchandising and construction. The ratios for all of these industries together demonstrate that there has been no change in the foreign ownership over the period of 35 years (1926-1961) which remains at one-third of the total. In the control ratios, however, there has been a substantial rise from 17 percent in 1926 to 33 percent in 1961, an increase of 94 percent. This increase was entirely due to the increase in control in the first three industries noted. However, since 1957 there has been no increase in either ownership or control; both remained at one-third of the total.

United States ownership and control of the selected industries as a percentage of the total capital invested in these industries is given in Table 11. It can be seen that the long term increase in both ownership and control is confined to the first three industries; for the other three industries the ratios of both ownership and control have decreased substantially. The ratios for all of the selected industries for United

TABLE 10

NONRESIDENT OWNERSHIP AND CONTROL AS A PERCENTAGE OF
CAPITAL INVESTED IN SELECTED CANADIAN INDUSTRIES,
SELECTED YEAR-ENDS, 1926-1961

Industry							
Percentage of Total Capital Owned or Controlled by All Nonresidents							
Year	Manufac- turing	Petroleum and Natural Gas	Mining and Smelting	Railways	Other Utilities	Merchandising and Construction	Totals
NONRESIDENT OWNERSHIP							
1926	38	..	37	55	32	..	37
1948	42	..	39	45	20	..	32
1951	44	51	51	40	18	..	32
1957	50	63	56	30	14	..	34
1959	51	62	58	27	14	9	34
1961	54	60	62	25	13	9	34
NONRESIDENT CONTROL							
1926	35	..	38	3	20	..	17
1948	43	..	40	3	24	9	25
1951	47	53	53	3	22	..	27
1957	56	76	61	2	5	..	32
1959	57	73	61	2	5	9	32
1961	59	69	59	2	5	11	33

Sources: The Canadian Balance, op. cit., pp. 133-134; Safarian, op. cit., p. 227, Table 1.

TABLE 11

UNITED STATES OWNERSHIP AND CONTROL AS A PERCENTAGE OF
CAPITAL INVESTED IN SELECTED CANADIAN INDUSTRIES,
SELECTED YEAR-ENDS, 1926-1961

Industry							
Percentage of Total Capital Owned or Controlled by United States Residents							
Year	Manufac- turing	Petroleum and Natural Gas	Mining and Smelting	Railways	Other Utilities	Merchandising and Construction	Totals
UNITED STATES RESIDENT OWNERSHIP							
1926	30	..	28	15	23	15	19
1948	35	..	32	21	16	..	23
1951	36	45	45	18	16	..	24
1957	39	57	46	11	11	..	26
1959	41	55	49	9	12	6	26
1961	43	51	54	9	11	6	27
UNITED STATES RESIDENT CONTROL							
1926	30	..	32	3	20	..	15
1948	39	..	37	3	24	6	22
1951	40	51	51	2	21	..	24
1957	43	70	52	2	4	..	27
1959	44	67	53	2	4	6	26
1961	45	60	52	2	4	6	26

Sources: The Canadian Balance, op. cit., pp. 133-134 (1961 and 1962); Safarian, op. cit., p. 227, Table 1; Quarterly Estimates of the Canadian Balance of International Payments, Third Quarter 1963, p. 13.

States ownership since the end of 1951 have not increased by much; they increased from 24 percent in 1951 to 27 percent in 1961, an increase of 12 percent for the ten-year period. The ratios for control show an even smaller increase; they increased from 24 percent in 1951 to 26 percent in 1961, an increase of 8.3 percent for the ten-year period. Actually they decreased since 1957 from 27 percent to 26 percent at the end of 1961, a decrease of 3.7 percent.

When the above industries are taken as a group, United States ownership ratios exceed its control ratios. The difference lies in the fact that the two ratios are composites of two different factors. Professor Safarian explains it this way:

The foreign ownership ratios measure equity and debt capital owned by nonresidents as a percentage of total capital employed in the industries. The foreign control ratios measure equity and debt capital invested by residents as well as nonresidents in those companies whose voting stock is controlled by nonresidents, all of which is taken as a percentage of the total capital employed in the industries.⁸⁷

For example, United States control of the above selected industries at the end of 1961 was less than its ownership in these industries. This means that other nonresidents or mainly Canadians controlled one percentage point of United States investment. If we take the first three industries only, we see that at the end of 1961 the United States controlled about \$819 million of Canadian capital and \$391 million was controlled by other nonresidents--a total of \$1,208 million.

⁸⁷Safarian, op. cit., p. 226, footnote 10.

This, however, is offset by the nonresident minority shareholders in the last three Canadian controlled industries--railways, other utilities, and merchandising and construction. It is clear from Table 10 that, on the average, for the above selected industries, Canadians are controlling one percentage point of the foreign ownership for the said industries. All nonresident ownership of total capital employed in the selected industries at the end of 1961 was 34 percent and the corresponding figure for control was 33 percent. Exactly the same thing is true with respect to United States investments; United States ownership was 27 percent and the corresponding figure for control was 26 percent.

In summary, we quote the Dominion Bureau of Statistics:

In some large Canadian companies controlled abroad there are substantial minority holdings of securities owned in Canada or in some other countries than the country of control. This type of situation gives rise to the instances where investments controlled abroad are greater than investments owned in the country of control. The petroleum and nonferrous smelting and refining industries and some fields of manufacturing like chemicals provide examples where this has been the case. In contrast in some other areas of manufacturing as beverages and pulp and paper there are enough foreign-owned portfolio investments in Canadian controlled companies to give rise to the opposite type of relationship.⁸⁸

Table 12 shows that even in the industries where foreign ownership and control is the highest and has increased the most in recent years, there is no evidence that the pattern has been even or that it

⁸⁸The Canadian Balance, 1961 and 1962, op. cit., p. 97.

TABLE 13

FOREIGN OWNERSHIP AND CONTROL OF SELECTED CANADIAN INDUSTRIES, SELECTED YEAR-ENDS, 1954-1961

Enterprise Classification	Foreign Ownership				Foreign Control			
	1954	1957	1959	1961	1954	1957	1959	1961
	(percentages)							
Manufacturing:								
Beverages	29	28	26	26	20	13	13	14
Rubber	78	84	86	88	93	97	98	99
Textiles	21	21	22	24	18	19	23	23
Pulp and paper	51	53	52	51	56	55	49	46
Agricultural machinery ^a	37	37	43	47	35	38	55	54
Automobiles and parts	78	78	89	90	95	95	97	97
Transportation equipment nop.	34	47	58	58	36	67	73	71
Primary iron & steel	16	24	25	..	6	26	23	..
Iron & steel mills	..	..	..	30	..	..	..	25
Electrical apparatus	70	70	74	73	77	77	81	78
Chemicals	64	62	61	65	75	75	77	79
Other manufacturing	46	50	52	55	52	57	61	66
Subtotals	47	50	51	54	51	56	57	59
Petroleum & Natural Gas:	60	63	62	60	69	76	73	69
Mining:								
Smelting & refining of nonferrous native ores	59	54	56	55	55	66	66	55
Other mining	55	56	59	64	49	59	59	60
Subtotals	56	56	58	62	51	61	61	59
Totals of above industries	51	54	55	56	55	61	62	62

Source: The Canadian Balance, 1961 and 1962, p. 83, statement 32.

^aIncludes enterprises also engaged in the manufacturing of other heavy equipment which tends to overstate foreign owned and controlled proportion of capital actually engaged in the manufacture of agricultural implements only.

would continue evenly in the future. Much depends on the years one chooses to compare, and small changes (increases or decreases) such as seen in Table 12 should not be overemphasized. This is important to keep in mind since

. . . an impression has been created by some users of the series not only that the ratios have risen over time but that they have also risen in recent years, even though general economic growth has slowed and even that they will inevitably continue to rise.⁸⁹

A close examination of Table 12 discloses that since 1954 some of the foreign owned and controlled enterprises have either declined or remained constant as to their degree of foreign ownership and control. The rest have increased their ownership and control content but at different periods and at different rates. However, the total foreign ownership and control of these industries has increased since 1954. Foreign ownership increased by 10 percent from 51 percent in 1954 to 56 percent in 1961, while foreign control increased by about 13 percent from 55 percent in 1954 to 62 percent in 1961.

The breakdown of the United States' share is not available until the end of 1959. Table 13 gives the United States' share for 1959, 1960 and 1961. At the end of 1961, according to the table, the United States' share of ownership and control stood at 47 and 50 percent respectively. Thus it is evident that even in these highly nonresident owned and controlled industries, United States ownership and control

⁸⁹Safarian, op cit., p. 228. See, for example, the quotation on page 21 (footnote 21) in this paper.

TABLE 13

UNITED STATES OWNERSHIP AND CONTROL
OF SELECTED CANADIAN INDUSTRIES,
SELECTED YEAR-ENDS, 1959-1961

Enterprise Classification	Ownership			Control		
	1959	1960	1961	1959	1960	1961
	(percentages)					
Manufacturing:						
Beverages	23	23	23	12	14	13
Rubber	79	80	81	90	90	91
Textiles	13	14	15	14	13	14
Pulp and paper	44	43	43	38	37	35
Agricultural machinery	43	43	45	55	49	52
Automobiles and parts	89	90	90	96	96	97
Transportation equipment nop.	27	26	25	27	27	27
Primary iron & steel	15	20	19	9	14	13
Electrical apparatus	65	62	64	67	66	66
Chemicals	44	44	47	52	51	54
Other	41	41	43	48	48	50
Subtotals	41	41	43	44	44	45
Petroleum & Natural Gas:	55	53	51	67	64	60
Mining:						
Smelting & refining of nonferrous native ores	42	41	44	66	64	55
Other mining	53	56	58	47	49	51
Subtotals	49	52	54	53	53	52
Totals of above industries	46	46	47	51	51	50

Source: The Canadian Balance, 1961 and 1962, op. cit., p. 135,
Table XV.

are only 47 and 50 percent, respectively, of the total capital employed in these industries.

When the above enterprises are broken down into subcategories or industries it becomes evident that United States capital has the controlling interests in nine out of the fourteen subcategories for 1961.

This is equivalent to 50 percent of total control and 47 percent of ownership. In two of these industries United States ownership and control were virtually complete--rubber and automobiles and parts. At the end of 1961 American ownership stood at 81 and 90 percent of the total respectively; American control was even higher at 91 and 97 percent of the total. In all remaining industries control by United States residents was less than 66 percent. The table also reveals that in five of these industries United States control has increased since 1959, decreased in five, and in the remaining four there was no change. In the area of decreasing United States control, the most marked change took place in smelting and refining of nonferrous native ores. It dropped from 66 percent in 1959 to 55 percent in 1961--a 20 percent decrease. The most significant change, however, in the area of United States decreasing control was the petroleum and natural gas industries, decreasing from 67 percent in 1959 to 60 percent in 1961, a decrease of 12 percent. This is important because the petroleum and natural gas industries are the largest industries that are completely controlled by United States investors.

Summarizing the foregoing statistical analysis in the words of Professor Safarian:

Foreign ownership and control are therefore high in three industry groups which accounts for half of the capital employed in the selected industries for which DBS has prepared ratios, and low in the remaining three industry groups. In the industry groups where it is high, it is not uniformly so, of course. In manufacturing, for example, the extreme cases are automobiles and parts and rubber, where foreign ownership was close to 90 percent and control close to 100 percent in 1959. The ratios are much lower in industries such as pulp and paper and agricultural machinery, which are roughly evenly divided between resident and nonresident ownership and control, and lower still in primary iron and steel and in beverages, for example, which are largely resident-owned and controlled.

It is well known . . . that residents of the United States account for most of the foreign investment in Canadian industry. Trends broadly similar to those in the overall ratios are evident if one considers ownership and control ratios by residents of the United States. . . . The data for residents of the United States are worth emphasizing, for presumably they are the ones which are relevant to any discussion of the political threat from foreign investment. It is the concentration of ownership of such investment in one country which is usually taken to constitute a threat. All too often, those who speak of threats to Canada's independence refer to the higher ownership and control ratios for all nonresidents, which are not particularly relevant in this context.⁹⁰

It has been charged that much of this concentration of foreign ownership and control has resulted from the retained earnings in foreign owned subsidiaries within Canada. Dr. O. J. Firestone refers to this as:

. . . The skill of American management in obtaining increased control of Canadian resources and industries while at the same

⁹⁰Safarian, op. cit., pp. 228-229.

time supplying only a small portion of the capital required for the development of these industries.⁹¹

The Royal Commission on Banking and Finance has this to say:

This trend to increased nonresident control of certain of our major industries has given rise to a feeling of disquiet among many Canadians, in part because it is believed such control will tend to perpetuate itself because of earnings retained in Canada. In the 1946-60 period, undistributed earnings on foreign direct investments in Canada amounted to \$4,150 million, compared to net capital inflows for direct investment of \$5,090 million. If depreciation and depletion allowances generated in Canada by these firms are added, total retained cash after dividend payments amounted to \$9.8 billion. . . . These internally generated funds were equal to 10.9% of gross domestic capital formation in Canada from 1946 to 1960, compared to 8.9% for net capital inflows of all kinds, some of which were in portfolio or other forms.⁹²

This particular form of analysis is irrelevant since the retained earnings are and should be considered as part of foreign investments. It would hardly make any difference if these undistributed earnings were repatriated to the United States parent concern and then brought back to Canada as capital inflows, since foreign ownership and control would be the same in both situations. As to the allegation of the snowballing effect of retained earnings, the same thing applies to Canadian or any other retained earnings for that matter, wherever they may take place.

⁹¹O. J. Firestone, "Canada's Growth Projects and Role of United States of America's Investment," Commercial and Financial Chronicle (July 2, 1959), p. 6.

⁹²1964 Report of the Royal Commission on Banking and Finance (Ottawa: Queen's Printer, 1964), p. 85.

The summary statement of United States direct investment since 1946 is provided by the Dominion Bureau of Statistics:

The sixteen years of the postwar period from 1946 to 1961 have seen gross inflows from the United States for direct investment aggregating \$5,658 million; 60 percent of it to the petroleum, natural gas and mining industries. During the same period some \$1,391 million of United States direct investment in Canada was repatriated, but this was almost offset by the inflows of \$1,359 million in other forms which added to the value of United States owned and controlled investment, making a total movement of United States capital of \$5,626 million. Undistributed earnings, reclassifications, etc., led to a further rise of \$3,354 million in the period, bringing the total book value of United States direct investments in Canada from \$2,304 million at the end of 1945 to \$11,284 million at the end of 1961.⁹³

The present extent of nonresident ownership and control, especially by United States investors, is not "particularly worrisome" because Canada has always used foreign capital in its quest for economic development; thus a part of Canadian economy has always been in the hands of nonresidents. "The fact that alarms the Canadians," according to Dr. Knapp, "is that such foreign influence has been increasing over the years of Canadian development, rather than diminishing, as was the case with other nations which borrowed portfolio capital from abroad."⁹⁴

The Dominion Bureau of Statistics puts it this way:

Perhaps the most striking feature of these series, viewed in the perspective of a third of a century, embracing depression and

⁹³The Canadian Balance 1961 and 1962, op. cit., pp. 47-48.

⁹⁴Knapp, op. cit., p. 124.

boom, war and peace, is the consistency of the direction of the change.⁹⁵

The impression is given here that portfolio investments are better in the sense that Canadian dependence on foreign capital would have been less or at least that Canada would be in a better position to diminish her reliance on foreign investment in the future. This is questionable since there is no acceptable theory, as yet, as to how we can measure precisely the benefits of portfolio and direct investments. Furthermore, Japan, which relied on foreign portfolio capital to develop and modernize her industry and economy, was not immune to economic ills. At present Japan faces a crisis, a shortage of foreign investments!⁹⁶

It is true in an absolute sense that foreign ownership and control have been moving in one direction--increasing. However, it is also true but conveniently forgotten by some students of the field that growth of the Canadian economy has also been moving in the same direction--increasing. What is relevant here is that the relative increases of both foreign investment and Canadian economic growth have been moving in the same direction and, more significantly, that the Canadian economic rate of growth has been the faster rate. This is so because otherwise the Canadian economy could not have decreased

⁹⁵The Canadian Balance, 1960, op. cit., p. 58.

⁹⁶U.S. News and World Report (July 26, 1965), p. 80.

its debt servicing as a percentage of its gross national product, as shown above. Furthermore, as shown above, the Canadian economy since 1957 has been decreasing its reliance on foreign capital to finance its economic activities. The investment in the industries examined does not constitute the total of the Canadian wealth. "Not covered are large sectors of Canadian wealth which are predominantly Canadian owned and controlled, such as investments in agriculture and social capital, other kinds of personal property and Canadian investments outside Canada."⁹⁷ These sectors of the Canadian economy with no foreign influence are estimated to have a stock of social capital nearly equal to the stock of industrial capital. In addition to this stock of capital ". . . there are still other important areas of Canadian wealth such as Canada's external investments, not to mention the significant savings represented by ownership of automobiles and other durables, nonindustrial land and such intangible social investment as education."⁹⁸

It is the disparity in the population size between Canada and United States, and not any abnormal propensity or grand design of Americans to invest in Canada, that accounts for a relatively large proportion of Canadian productive activities being owned by United States citizens. In comparing per capita investments in both countries,

⁹⁷The Canadian Balance, 1960, op. cit., p. 62.

⁹⁸Ibid., p. 63.

Professor Harry G. Johnson explains:

In 1959, the latest year for which comparable data are available to me, official United States sources showed total United States investments in Canada of \$15,779 million, and total Canadian financial assets and investments in the United States of \$5,796 million. On per capita basis, United States investment in Canada was \$89.08 and Canadian investment in the United States was \$331.52. The (statistically) average Canadian, in other words, has about 3 3/4 times as much invested in the United States as the (statistically) average American has invested in Canada, a disparity whose significance is increased by the relatively lower per capita income and wealth of Canadians. In the same year, the total United States direct investment in Canada was \$10,171 million, or \$57.42 per capita, whereas the total Canadian direct investment in the United States was \$1,688 million, or \$96.44 per capita, 1 2/3 times the per capita United States investment in Canada.⁹⁹

Thus, "Canadians have a markedly higher average propensity to invest in the United States than Americans have to invest in Canada."¹⁰⁰

There is a trend, according to Professor Johnson, toward "a substantial minority Canadian participation and a trend towards increasing Canadian participation in United States direct investment in Canada."¹⁰¹ He explains:

There has been a continuous though moderate shift towards lower participations of United States equity participation in the newer enterprises. A comparison of direct enterprises established in the period 1951-57 with direct enterprises established before 1951 shows that the proportion of such enterprises (by value) in which the percentage of United States ownership is

⁹⁹U.S. Department of Commerce, Office of Business Economics, Survey of Current Business, Vol. 40, No. 9 (September 1960), p. 24, Table 7.

¹⁰⁰Johnson, op. cit., pp. xii-xiii.

¹⁰¹Ibid., p. xiii.

95 percent or more has fallen from 63 percent to 57 percent, and the proportion in which the percentage of United States ownership is between 50 and 95 percent has fallen from 29 to 28 percent, while the proportion in which the percentage of United States ownership is less than 50 percent has risen from 8 percent to 15 percent.¹⁰²

We must conclude, therefore, that no empirical-statistical evidence exists to support the contention that the Canadian economic independence is threatened by the inflows of the United States investment.¹⁰³

¹⁰²Ibid., p. xiii.

¹⁰³This conclusion is based on the assumption that over 50 percent ownership and control of the Canadian industrial and social capital by nonresidents would constitute a definite threat to the Canadian economic independence.

CHAPTER III

EFFECTS OF THE POLICIES AND PRACTICES
OF FOREIGN COMPANIES

Since there is no statistical evidence to support the critics' contention that United States direct investment is a threat to Canadian economic independence, they have turned their attention to another field, less economical in nature but more political and sentimental in substance. Their new criticism is that United States direct investment in Canada has been the result of parent corporations whose aim through their policies and practices of subsidiaries in Canada is to exploit and use the Canadian market and its resources. "We know," states Mr. Clarence L. Barber,

that many United States controlled plants were set up mainly to exploit the Canadian market. These plants are seldom allowed to export to the United States and may often be denied access to other foreign markets. . . . A significant part of our present heavy dependence on United States imports may be a direct result of this United States control over many of our manufacturing firms.¹⁰⁴

According to C. D. Blyth and E. B. Carty, some of the economic aspects and consequences of control are fairly clear-cut. They

¹⁰⁴Clarence L. Barber, "Austerity 1962," Economics: Canada, ed. M. H. Watkins and D. F. Forster (Toronto: McGraw-Hill Company of Canada Ltd., 1963), pp. 157-158.

state:

Most of the direct investments. . . are owned by parent companies located outside Canada. This fact in itself will often determine the degree to which decisions affecting the policy of the subsidiary will rest with the owners. And no one could deny that the power, which ultimately rests with parent companies, to decide on investment and on productive processes, can have far-reaching effects upon the course of Canadian life and development. The rate and direction of much of our technological growth has been influenced in this manner. Likewise the sales campaigns and methods of distribution of the Canadian branches or subsidiaries will usually be modelled on those of the parent company and may have penetrating influences upon fashions in Canadian consumption.¹⁰⁵

More specifically, the criticism centers on United States subsidiaries' policies and practices within Canada. It is claimed that these subsidiaries do not hire enough Canadian personnel, do not publish financial reports, do not contribute enough to charitable institution, are not politically independent of the United States parent and the United States government, and many of them do not offer shares of stock in their subsidiaries for sale to Canadians. On the economic side the impact is that ". . . policies are formulated and actions taken which are inimical to the best economic interest of Canada."¹⁰⁶ These include marketing and purchasing policies pursued by United States subsidiaries in Canada at the command of the parent firms. The allegation

¹⁰⁵C. D. Blyth and E. B. Carty, "Nonresident Ownership of Canadian Industry," The Canadian Economy: Selected Readings, ed. John J. Deutsch et al. (Toronto: The Macmillan Company of Canada Ltd., 1962), p. 477.

¹⁰⁶Irving Brecher, "The Flow of United States Investment Funds Into Canada Since World War II," in Aitken et al., The American Economic Impact on Canada (London: Cambridge University Press, 1959), p. 107.

here is that the parent firms restrict the export of their subsidiaries in order to prevent direct competition with the parent firm. Also subsidiaries are forced to purchase high-cost materials from United States companies, thus raising costs and restricting Canadian sales. The effect of research operations has been to:

. . . limit opportunities for the employment of technical and professional skills in Canada, and to deprive Canada of that initiative and resourcefulness so vital to industrial progress.¹⁰⁷

Further, other objections to the policies and practices of United States subsidiaries in Canada include:

. . . decisions of firms to locate and expand with priority for the interests of the United States parent firms, thus providing a slower rate of economic development for Canada; pricing export products with regard for interest groups in the United States; curtailing Canadian operations first when there is a slack in world demand; and finally, decisions made abroad that determine the rate of exploitation of Canada's natural resources.¹⁰⁸

It is often alleged that the policies and practices of nonresident subsidiaries may not be in the best and sole interest of the Canadian economy, but to the interests of their parent corporations and their home countries. "To the Canadians, this is essentially foreign control over domestic matters, a problem that to them is growing."¹⁰⁹

The implication throughout the stated objections to the non-resident subsidiaries' policies and practices in Canada is that if these

¹⁰⁷Ibid., p. 107.

¹⁰⁸Knapp, op. cit., p. 23.

¹⁰⁹Ibid., p. 24.

companies were Canadian owned and controlled there would be no such objections because they would consider it their sole duty to take into account the interests of the Canadian economy and then, and only then, the interests of their own parent corporation. Such a proposition cannot be accepted even as an assumption. It goes contrary to the economist's assumption that firms engage in business to maximize profits. It follows necessarily that any capital, and the policies and practices that go with it, will be allocated by the firm regardless of national interests and national boundaries. It was Adam Smith who first recognized that the interests of the men (governing body of the corporation) or the individual are never exactly the same as those of the public, and he was not writing about foreign subsidiaries.

Professor Viner explains it this way:

It seems to me somewhat improbable that the management of large domestic corporations, whether American or Canadian, are typically besieging offices of state, or using large staffs of economists, to discover what they can do for their country regardless of their profits. It is also unlikely that governments, not waiting to be asked, make it a practice to tell individual corporate managements what precisely they should do for their country. The charge that Canadian officers of an American subsidiary would be less loyal than American officers to the head office needs convincing support by evidence and should not have been made without such evidence.¹¹⁰

There is not much point in condemning the particular practices which might be considered as unfavorable to the Canadian economy if

¹¹⁰Jacob Viner, "The Outlook for the Relationship: An American View," The United States and Canada, ed. John S. Dickey (Engle-Cliffs, New Jersey: Prentice-Hall Inc., 1964), p. 143.

the same practices are also found to be prevalent in the corresponding Canadian owned companies. For concrete evidence we must consult the empirical studies that were completed in 1957 and 1960. Each study covers a portion of foreign owned industry and each comes to the same conclusion on the economic effects of foreign direct investment in Canada.

The first study was undertaken by the Royal Commission and its findings were published in 1957. In discussing United States-Canadian economic relations the study admits that there is a further need for "examination of the behaviour of nonresident controlled companies and its effects on the Canadian economy." The study continues:

A paramount consideration in this regard centers on the basic objectives of all business enterprise--the maximization of profits. An international company, like any domestic firm, can be expected to allocate plant, production, markets and purchases primarily in response to profit motives. In the normal course of events, therefore, an international company would behave essentially in the same way as a domestic firm. Yet even where their behaviour is similar, economic disadvantages to Canada are sometimes attributed to the fact of foreign control. To reason along these lines is to confuse the effects of foreign control with the influence of other economic forces, such as relative economic advantage, the tariff and restrictive business practices.¹¹¹

The main conclusion of the quoted study was that adverse economic effects were small compared with the benefits which direct investment provided by way of capital, technology, skills, and markets--referred to as "an indivisible package" which performed "vital tasks which

¹¹¹Brecher and Reisman, op. cit., p. 157.

Canadians alone could do either less efficiently, more slowly or in some cases perhaps not for a very long time to come."¹¹² "In many cases," contends Professor Viner, "I am sure (and have some supporting evidence at my command) the choice is between an American branch plant and no plant at all."¹¹³

On the purely economic side, the Commission in its Final Report, concluded:

It would be unfair to overstress these unfavorable operating patterns. There are so many real advantages to Canada arising from the activities of foreign controlled companies in this country that conflicts or potential conflicts between the interests of Canada and those of the foreign owners seems somewhat small and unimportant by comparison. Moreover, these conflicts of interests would be more the exception than the rule.¹¹⁴

In regard to the charge that foreign owned firms do not employ Canadians in senior management positions and technical positions and the charge that these firms do not purchase from the Canadian markets, the Commission said:

By and large, Canadian subsidiaries of foreign companies do employ Canadians in senior management and technical positions whenever they can find qualified men to fill them. In fact, in recent years a number of the better known foreign controlled companies have appointed Canadians to their top executive positions. Furthermore, . . . it is also true that a great many of these concerns do, in fact, purchase their requirements in Canada whenever it is economically possible for them to do so. We believe such policies are desirable in themselves. They encourage the

¹¹²Ibid., p. 121.

¹¹³Viner, op. cit., p. 143.

¹¹⁴The Final Report, op. cit., pp. 391-392.

development of Canadian management and technical talent, they stimulate employment, and they are good for the economy as a whole.¹¹⁵

The second study was undertaken by the Canadian-American Committee and was published in 1960. The Committee examined six aspects of the behaviour against United States subsidiaries in Canada. They were: the sale of equity shares; Canadianization of senior personnel; publication of company data; commercial policies--sales, purchases and degree of manufacturing; research; and contribution to charity and education. The Committee's conclusion on these six aspects was:

As the detailed chapters in Part II will show, the staff found that none of the six points of criticism of United States subsidiary operations in Canada could stand up as a generalized indictment. In some cases the evidence collected in the course of this study clearly does not support the implications of the criticism. In other cases, where the record of performance is mixed, there are sound reasons why some companies do not adopt the practice which Canadians expect of them. In still other cases it would appear that responsibility for remedial action would rest with the Canadian authorities, and not with business management.¹¹⁶

The third study, the most comprehensive of official data on American direct investment in Canada in 1957, was undertaken by the United States Department of Commerce's Office of Business Economics. Among the more significant findings regarding United States direct

¹¹⁵Ibid., p. 393.

¹¹⁶John Lindeman and Donald Armstrong, Policies and Practices of United States Subsidiaries in Canada (Montreal: Canadian-American Committee, January 1961), pp. 7-11 and Chapter IX.

investment companies in Canada were the following:

Exports from Canada originating with the direct-investment companies accounted for some 40 percent of all Canadian exports in 1957. For manufacturing (including pulp and paper) the proportion was about 50 percent, and for petroleum and other minerals and metals combined the proportion was over 85 percent.¹¹⁷

And

Exports to countries other than United States were about half as large as exports to the United States, for all industries and for manufacturing.¹¹⁸

This is in direct opposition to the charges leveled by C. L. Barber and others that United States subsidiaries "were set up mainly to exploit the Canadian market. These plants are seldom allowed to export to the United States. . . ."¹¹⁹ According to the United States Department of Commerce Study, Tables 3 and 4, only one employee out of thirty-five in the supervisory, personnel, and technical grades was sent from the United States, and only one out of 241 among other grades was sent from the United States.¹²⁰ The study adds:

The number of persons employed by the companies reported on a partial bases was 440 thousand, and the total of all direct

¹¹⁷U.S. Department of Commerce, Office of Business Economics, U.S. Business Investments in Countries, A Supplement to the Survey of Current Business (Washington: United States Government Printing Office, 1960), pp. 11, 68, and Tables 34 and 35.

¹¹⁸Johnson, op. cit., p. xiv.

¹¹⁹M. H. Watkins and D. F. Forster (eds.), Economics: Canada (Toronto: McGraw-Hill Company of Canada Ltd., 1963), p. 157.

¹²⁰U.S. Department of Commerce, 1960, op. cit., p. 122.

investment companies is estimated at 670 thousand. Wage payments in Canada were nearly 40 percent of the total of all countries. . . . totalled \$2.7 billion, mainly in manufacturing and mining (including petroleum) where the companies accounted for about 40 percent of all such payments in comparable industries in Canada.¹²¹

United States companies with direct investment in Canada paid \$800 million in taxes to the Federal Government in 1957, \$582 million were income taxes and \$218 million other taxes. "Direct corporate income tax payments represented over one-third of total revenues from this source in Canada."¹²² Total tax payments by the United States direct investment companies to the Federal Government represented about 16 percent of overall government revenue in Canada. As will become evident from the theoretical analysis in the next chapter, these tax payments are the most definite and directly measurable of the benefits to Canada from American investment in Canada. Moreover, as Professor Johnson has stated, "United States tax law allows taxes paid to foreign governments to be offset against income taxes due the United States Government up to the limit set by the United States tax liability; much of these tax receipts accrued to the Canadian Government at the direct expense of the United States Treasury."¹²³

Professor Johnson explains how United States direct investment has helped Canada reduce her dependence on United States imports:

¹²¹Ibid., p. 12.

¹²²Ibid., p. 2.

¹²³Johnson, op. cit., p. xiv.

For chemicals, rubber products, primary and fabricated metals, electrical and other machinery, and transportation equipment, production by United States direct investments in Canada was more than twice as great as United States exports to Canada. This figure . . . indicates something of the extent to which United States direct investment in Canada has reduced Canadian dependence on imports from the United States, and in so doing has contributed to the United States balance-of-payments problem.¹²⁴

"The evidence of the above studies," according to Professor Safarian, "points to the following conclusions":

First, there is a deplorable lack of data on many aspects of the operations of foreign controlled companies, even though sweeping statements have been made about effects of such operations on Canada and legislation has been passed to correct alleged adverse effects. What evidence we do have suggests there are large net economic gains from direct investment and that adverse effects are few and scattered in nature. The evidence also suggests that faults ascribed to foreign ownership may often be due not to foreign ownership as such, but to the economic setting in which both foreign owned and resident owned firms operate. As such, the faults may reflect in part the limitations of our environment, in part the effects of some kinds of Canadian and foreign legislation, such as that on tariffs, and the absence or inadequacy of other kinds, such as legislation designed to increase efficiency or to spur development. Tariffs, for example, have played an important role in bringing some kinds of direct investment firms to Canada and in limiting the market horizons and raising the cost of many Canadian firms, whatever their ownership. The remedy, if we want it, lies partly in our own hands.¹²⁵

Professor Viner's position is that whatever the facts may be the United States has never forced Canada into accepting investment funds and never will. Canada is the sole authority as to what foreign capital should or should not enter her territory and no one else can

¹²⁴Johnson, op. cit., p. xv.

¹²⁵Safarian, op. cit., pp. 234-235.

force her to choose one way or the other. It is up to Canada to decide whether foreign capital is to her benefit or not and to legislate accordingly. "This is in fact primarily a domestic Canadian issue."¹²⁶ However, Canada has at least a moral obligation to permit the investment already in Canada to remain there if so desired by the respective owners. He believes further that:

It is evident that support comes to the campaign in Canada against American branch plants and subsidiaries from some groups of Canadian businessmen as a manifestation of their entrepreneurial protectionism in areas in which they would be the direct beneficiaries.¹²⁷

He concludes:

Whether the scale and the manner of American business operations in Canada creates for Canada a genuine and substantial economic problem, and if so what remedial action it is expedient for Canada to take, should receive serious consideration only after extensive and objective research. Since such research has not yet taken place, it seems that the answers to these questions widely circulated in Canada are at least premature.¹²⁸

In regard to the charge that United States direct investment subsidiaries in Canada refuse to offer stock shares for sale to Canadians, the Royal Commission in its Final Report made the following recommendation: ". . . they should sell an appreciable interest in their equity stock to Canadians." In the footnote the Commission adds, "We have in mind something of the order of 20 percent to 25 percent."¹²⁹

¹²⁶Viner, op. cit., p. 144.

¹²⁷Ibid., p. 144.

¹²⁸Ibid.

¹²⁹Final Report, op. cit., p. 393.

Almost all Canadian critics and observers stand together on this sensitive issue. Almost every Canadian statesman dealing with the issue of foreign investment in Canada strongly recommends that American companies, in the words of Prime Minister John G. Diefenbaker, ". . . should be incorporated as Canadian companies making available equity stock to Canadians."¹³⁰ This is one area in which the two major parties in Canada are in agreement. The above proposal was implemented by the Liberal Party (discussed previously) and then immediately withdrawn. However, the proposed changes in the withholding tax on dividends paid abroad were passed. The tax was reduced from 15 percent to 10 percent for companies in which Canadians owned at least 25 percent of the voting stock or where the parent company owned less than 75 percent of the voting shares. In addition, 25 percent of the directors of such companies must be residents of Canada. The

¹³⁰ John G. Diefenbaker, quoted by O. J. Firestone, "Canada's Growth Prospects and Role of United States of America's Investment," Commercial and Financial Chronicle (July 2, 1959), p. 18. For further information of the Canadian demand for joint participation in the shares of United States subsidiaries see Gordon Huston, "How a Foreign Subsidiary Can Win Friends in Canada," The Business Quarterly, Vol. XXIII (Spring 1958), pp. 34-36; Edward Ernest, "Problems of United States Investment in Canada," Second Seminar on Canadian-American Relations (Windsor, Ontario: Assumption University, 1960), p. 54; Willis Armstrong, "Thoughts on Canadian Subsidiaries," Second Seminar on Canadian-American Relations (Windsor, Ontario: Assumption University, 1960), p. 59; Lynn A. Townsend, "Doing Business Abroad--A Top Businessman's View," U.S. News & World Report (February 1, 1965), pp. 94-95; Ernst Wolf Mommsen, "Some Advice for Americans Who Do Business in Europe; Interview With a Leading West German Industrialist," U.S. News & World Report (July 5, 1965), pp. 76-77.

Minister of Finance, the Honorable Walter L. Gordon, justified these tax changes on the ground that they would gradually encourage a switch away from foreign equity financing, thus reducing the growth of foreign ownership of Canadian industries. He also believed that if there were at least 25 percent of Canadian minority participation in the foreign dominated industries, then that would be enough to ensure that the practices of these subsidiaries would conform to the best of Canadian economic interests.

The Royal Commission provided much the same justifications.

It stated:

Sales of equity stock to Canadians would be advantageous in itself because it would provide greater opportunities for Canadians to invest their savings in growing sectors of economic activity in their country. Moreover, it would make Canadians more aware of the important role of these companies in our economy and at the same time it would encourage these companies to take into account the wishes of their Canadian stockholders.¹³¹

The purpose behind these recommendations, legislation, and justifications is to achieve what has become known as the "Canadianization" of foreign owned and controlled enterprises in Canada. The obvious question is, "What is 'Canadianization'?" One of the better known economists in Canada defined it in the following general terms:

In my mind, Canadianization involves as an essential prerequisite that the management of the Canadian subsidiary should have a high degree of autonomy in making decisions of substantive interest to Canadians and the Canadian economy. They should be

¹³¹ Final Report, op. cit., p. 394.

subject to a minimum of centralized control by the parent; or, within the framework of centralized management philosophy, well-informed attention should be given to the Canadian operation by a senior official in the parent company who has power to act. It is not good enough for the United States parent company to operate a subsidiary in Toronto as though it were a branch plant in Toledo (and it is not surprising that the term "branch plant" as applied to United States operations in Canada has come to be a term of at least moderate contempt).

I call autonomy a prerequisite because only a relatively autonomous management can in fact Canadianize its operations. A subsidiary can sell stock to Canadians, can have Canadian personnel throughout, can give generously to charity, and so on, but if most of the decisions are made back in the home office by people whose interest in Canadian operation is not greater than (and often less than) their interest in a dozen or more similar operations in the United States and elsewhere in the world, then that subsidiary is not Canadianized.

What we fear most of all from foreign firms here which lack autonomy is that our interests will be overlooked--not maliciously, but simply because the men who made the decisions are too busy with other things to give our interests the attention that would be given to them by a purely Canadian firm without foreign connections. We also fear that companies whose decisions are made for them by the management of the parent company in the United States will bring with them into Canada a set of policies and practices which might be suitable in the United States, but which are alien and sometimes destructive in Canada.

But autonomy alone is not enough. There must be a management philosophy which requires management to make decisions with full awareness and sympathy for the commonly known interests of the country in which the firm operates. This is the essence of what I mean by "Canadianization." A United States firm operating in Canada must in any event adopt itself to Canadian laws, the Canadian tax structure, various regulations, municipal ordinances and so forth. One could then go on logically to suggest that any company that really wishes to be successful must go a good deal further than it has to by law and regulations to adopt itself to the environment in which it lives. This means that a United States company operating in Canada must go to some lengths to discover what are the broad objectives of Canadian policies, and what are the basic aspirations of the Canadian people, and seek not only to identify itself with these but also to work in the direction of furthering them. I think it should be emphasized that this course should be adopted in the essential interests of the corporate enterprises themselves and not as a reluctant adaptation to things that Canadians

wish to see them doing. Indeed, the self-interest motive in adaptation is one that is constantly overlooked by some United States companies. We welcome them if they are Canadianized. Our instinctive fear of foreign domination makes us suspicious of them if they are not, and this is bound to work against them in the end.¹³²

This is indeed a general and exacting definition which can be fulfilled only by at least 51 percent Canadian ownership and control of the voting stock in the foreign controlled subsidiaries, at which point they become Canadian owned and controlled and then there is hardly any need for such an elaborate definition since supposedly all of the Canadian enterprises are aware and conform to Canadian economic interests. At any rate, the present legislation in Canada falls short of the "Canadianization" definition.

Consider again the discussion of the desired 25 percent Canadian participation in United States subsidiaries' voting stock. Such participation is undesirable, as far as we can see, because it will not bring the desired objectives--to compel United States subsidiaries to take Canadian economic interests into account--and instead could lead to greater foreign control of Canadian capital. Rather, Canadian capital should be invested in new Canadian enterprises. In a separate study¹³³ the Royal Commission supports the above recommendations but recognizes that the objectives may not be achieved.

¹³² Quoted by Lindeman and Armstrong, op. cit., p. 5-7.

¹³³ 1964 Report of the Royal Commission on Banking and Finance (Ottawa: Queen's Printer, 1964).

They state:

At the same time, however, we recognize that the existence of a body of Canadian shareholders is not likely to lead to major changes in company (subsidiary) policy.¹³⁴

Professor Safarian is in full agreement with the recognition, and explains the confusion that encompasses this sensitive issue and why it will not be to Canadian economic interests to have 25 percent participation in foreign owned subsidiaries:

These measures (withholding tax measures) display much of the confusion and irrationality which surrounds discussion of foreign investment in Canada. To the extent the measures are successful and some firms issue shares in Canada, there is a tendency to forego future economic growth simply to buy existing assets. No new assets are being created directly by this process, but simply a use of scarce Canadian equity capital (which could be used to help create new assets and income and employment) to replace present foreign equity ownership in existing assets. Since there is nothing in this process to make Canada a more attractive place for foreign investment, much of capital freed by minority Canadian ownership may be exported to affiliates abroad. Indeed, in spite of protestations that the measure does not mean foreign capital is not welcome, some potential direct investment inflows might well be lost because of the terms and tone of the legislation. We could borrow more capital from abroad to offset any anti-expansionary effects, but this defeats the purpose of the exercise except in the special cases where bond capital from abroad can replace equity capital, with no changes in the package of technology, management skills, and market contacts which goes with the latter. It may be that foreign equity capital freed by the share issues will be reinvested in Canada rather than exported; in this case we shall have more firms with minority shareholders but also more firms in which more foreign capital is invested. The measure, if it is effective, will tend to reduce the potential for this nation's economic growth, but it might have the unexpected effect of spreading direct investment capital even more widely in Canadian industry. . . .

¹³⁴Ibid., p. 86.

A more fundamental point is that the tax changes are based on assumptions about foreign owned companies which need to be challenged. First, there is the assumption that a minority Canadian ownership of at least 25 percent, and resident directors in proportion, will tend to lead to a different set of corporate policies "more in keeping with Canada's interests." There is no significant evidence, however, that there is a difference in the behavioural pattern of the wholly-owned and partly-owned subsidiaries. The Final Report is unusually reticent on this key point, merely stating an "impression" but offering no real proof. The report prepared for the Canadian-American Committee argued that "good corporate citizens" among the subsidiaries were those where the locus of decision-making was with the Canadian management, but added that these cases were not necessarily associated with Canadian participation in ownership nor with Canadianization of senior personnel. There is considerable doubt whether minority shareholders and resident directors would in fact represent "the Canadian interest." Even assuming their views would be the determining ones on any particular issue (a large assumption in many cases), why should this necessarily be in the Canadian interest? What is good for the minority shareholders may or may not be good for Canada. . . .

Finally, and most important, one must ask whether the basic assumption of the legislation has been demonstrated. Where is the evidence that a significant number of foreign owned companies, because they are foreign owned, are acting in a way which is detrimental to Canadian interests? We have cited the evidence earlier in this essay, and it does not add up to a general indictment sufficient to warrant corrective legislation applied to the foreign owned sector. The basic flaw in such positions can be judged by the fact that Ministers of the Government, when discussing the alleged adverse practices, are reduced to referring to "some" companies in order to make the most of limited examples, or to hedging their statements to the point of meaninglessness, or to using reasoning which strains one's credulity, such as that on the influence supposed to be exerted by scattered minority shareholders and resident directors. The Final Report itself, as we have seen, believed such practices to be the exception rather than the rule, and, as noted above, had to resort to the presumed threat to political independence and the agitated frame of mind of Canadians to justify its recommendations.¹³⁵

¹³⁵Safarian, op. cit., pp. 236-39.

Professor Johnson holds much the same view and provides us with an additional argument why the proposed tax measures of 30 per cent are unworkable and why the take-overs, which its aim is to prevent, are beneficial to the Canadian economy. He explains it in this way:

The proposal to tax transfers of capital assets to nonresidents (tax of 30 percent) was so administratively unworkable that it was immediately and with considerable embarrassment withdrawn; but it nevertheless deserves a comment, both because many people seem to approve of its objective--the prevention of take-over bids by foreigners--and because a cleverer scheme for achieving that objective by discriminatory taxation may yet be devised and presented to Parliament. What the opponents of foreign take-overs seem completely unable to appreciate are the facts, first, that take-overs are one of the ways by which productive efficiency is improved and wealth and income increased in a market economy, and second, that preventing or impeding take-overs by foreigners may or may not damage the economic interests of the foreigners in question, it is practically certain to damage both the Canadian owners of real assets or equities and the Canadian economy as a whole. A take-over bid for the assets of a business or for a controlling interest in its stock is motivated by the conviction of the bidder that he can reorganize the management or operations of the business in such a way as to increase its earnings, and therefore its capital value, enough to yield him a profit on the price he has to pay to acquire it. It is successful if the owners conclude that the price they are being offered is higher than the business or its stock is worth to them.¹⁶ [¹⁶ Much popular discussion of foreign take-overs completely overlooks the elementary truth that it takes two sides to make a bargain, and conveniently ignores the fact that the Canadian seller receives the value of the assets sold to the foreigner.] Thus a successful take-over bid must make the previous owners better off than they were before. Correspondingly, governmental restrictions on the freedom to make or accept take-over bids are likely to make owners of assets worse off than they otherwise would be, by narrowing the market for their assets. In particular, discriminatory taxation designed to prevent take-over bids by foreigners is certain on balance to reduce the wealth of Canadians, since its effect can only be to force Canadian asset-holders to sell at lower prices to Canadians than they could have obtained from foreigners. . . . From the national point of view, discrimination against foreign take-overs is likely to make the country worse off than it otherwise would be,

by denying foreigners who believe that they can run existing business in Canada more efficiently than the present management the opportunity to try, and so denying the country the benefits of the improvement in productivity that might result.¹³⁶

Furthermore, it is interesting to point out that Canadian businessmen and investors are the last ones to have any resentments against foreign direct investments. "Despite the public furor," states Fortune Magazine, "real resentment of American capital per se is particularly non-existent among Canadian businessmen."¹³⁷

The principal demand for greater opportunity for Canadian equity participation is predominantly nationalistic and political in its outlook and is aimed at controlling and orienting foreign subsidiaries in a way which officials feel would be "more Canadian in outlook." This way the Commission's purpose "was to urge lines of action leading towards 'Canadianization' of management and management decisions."¹³⁸

It is claimed that there is one economic advantage to Canada that would result from larger Canadian participation in United States controlled subsidiaries that has been overlooked. If there is a larger amount of Canadian capital in United States subsidiaries, it follows that there would be more interest and premiums paid to the Canadians, thus reducing the burden of debt payments. This, however, would be

¹³⁶Johnson, op. cit., pp. xvii-xviii.

¹³⁷"The Canadian Troubles of U. S. Business," Fortune, LVI (July, 1957), p. 167.

¹³⁸Lindeman and Armstrong, op. cit., p. 22.

true if no additional foreign investments replace Canadian investments that were freed by Canadians in foreign subsidiaries. This can only be achieved by an increase in Canadian savings.

But since there would be an increase in the Canadian savings, would not it be more profitable to invest these new savings in some new enterprises or use it to acquire 50 percent or more of foreign subsidiaries? Canadian savings hopefully would be invested in some of the desired "dynamic sectors of the economy" and the control would be in Canadian hands. Or increased Canadian savings could be used to purchase 50 percent or more, just enough, to acquire control of the enterprise of foreign subsidiaries. In this way Canada will not only gain some increases in interest and premiums, but new business enterprises with full Canadian control as well as ownership. This process could either be applied on a piecemeal basis or on an industry-wide basis, depending on the availability of new savings for investment. The aim of the Canadians should be to extend their control over as large an area of the economy as possible by acquiring control of as many foreign controlled subsidiaries as possible. It is a mere waste of capital and time to seek minority control in foreign subsidiaries. This process only spreads the limited amount of Canadian savings across the entire economic field. Thus more industry comes under foreign control. Minority shareholding by Canadians either in foreign subsidiaries or their parents is not desirable and not in the Canadian interest. It will

not alter the policies and practices of foreign owned enterprises and will surely place more Canadian capital under the control of the non-residents. Such results are contrary to the recently adopted Canadian legislation. The legislation, if there ever was any need for it, should have aimed at giving Canadians the opportunity to invest in their economy and retain control over their investments. Once Canadians have acquired control of most present foreign subsidiaries there need be no fear of a foreign economic threat to the Canadian economy. This argument is only valid under the assumption that Canadians can provide enough savings to buy out the foreign subsidiaries. That assumption is an unrealistic one at the present time.

There are three ways in which Canadians can improve, substantially, their capital position. This is not in accordance with the profit maximization principle nor the allocation of scarce resources to their most productive uses, but merely will serve to pacify nationalistic feelings with the least amount of injury to the foreign investors and the Canadian economy. First, domestic savings--personal as well as corporate--should be encouraged by the government of Canada. This can be done by tax reductions. Second, Canadians should be encouraged to withdraw their capital in all foreign controlled enterprises and invest it in new Canadian enterprises. This would be effectively achieved if foreign enterprises were encouraged to retain 100 percent ownership or invest as minority shareholders in Canadian companies. This would

reverse the present trend where nonresidents have control over a large amount of Canadian capital. Third, Canadians who invest abroad should be encouraged to stop and bring back their capital to Canada. If this is accomplished it will be the beginning of the end of Canadian dependence on nonresidents to finance their economic activities. Total Canadian capital under the control of nonresidents amounted to \$1,208 million at the end of 1961;¹³⁹ Canadian long-term investment abroad reached \$5,463 million at the end of 1961;¹⁴⁰ and, in recent years Canadians' savings have been increasing by \$700 to \$800 million a year.

In regard to the charge that foreign owned enterprises determine "the rate of exploitation of Canada's natural resources,"¹⁴¹ it is important to point out that such a charge has been brought about by the fact that the United States relies upon Canada for many industrial raw materials, such as newsprint, asbestos, nickel, iron ore, aluminum, uranium, petroleum, other chemical elements and others. These raw materials and minerals exist only in limited amounts. Once American firms "exploit" these resources, there will be nothing left but empty mines and dry wells. Therefore no mineral wealth or its residue will remain for Canadian posterity.

¹³⁹The Canadian Balance, 1961 and 1962, op. cit., p. 135.

¹⁴⁰Ibid., p. 127.

¹⁴¹Knapp, op. cit., p. 23.

This view is shortsighted. It looks at currently known resources as being limited, scarce and irreplaceable. Mr. Eugene Holman, a geologist, explains why:

For many years, . . . people have tended to think of natural resources as so many stacks of raw materials piled up in a storehouse. A person with this sort of picture in his mind logically assumes that the more you use of any natural resources, the sooner you get to the bottom of the pile. Now I think we are beginning to discover that the idea of a storehouse--or, at least, a single room--does not correspond with reality. Instead, the fact seems to be that the first storehouse in which man found himself was only one of a series. As he used up what was piled in that first room, he found he could fashion a key to open a door into a much larger room, and as he used the contents of this larger room, he discovered there was another room beyond, larger still.¹⁴²

Man has advanced not by conserving his resources but by developing and putting them into use. In applying new techniques and developing available resources man has been able to discover and use, in turn, greater quantities and even better resources and skills. As Holman points out:

Nonuse results only in hobbling progress. It will not result in more material resources for men to use but less, because it retards the march of scientific progress.¹⁴³

To illustrate his point Mr. Holman uses the United States petroleum industry as an example. He points out that one discovery led to a refinement of techniques which produced further advances in

¹⁴²Eugene Holman, "Our Inexhaustible Resources," Atlantic Monthly, Vol. 189 (June, 1952), p. 32.

¹⁴³Ibid., p. 30.

discoveries and refinement in the oil industry. The discovery of ever new and richer minerals and raw materials in Canada since the war--largely by United States firms--has advanced in a similar way. The exploitation of natural resources should not be judged in the short-run because even the particular effects of the capitalistic economy (enterprises and processes) can not be judged in such a short time. In understanding the Canadian economy and thus its resource exploitation one should heed the warning of Professor Schumpeter. He has cautioned:

First, since we are dealing with the process whose every element takes considerable time in revealing its true features and ultimate effects, there is no point in appraising the performance of that process ex visu of a given point of time; we must judge its performance over time. . . . Second, since we are dealing with an organic process, analysis of what happens in any particular part of it--say, in an individual concern or industry--may indeed clarify details of mechanism but is inconclusive beyond that. . . . In other words, the problem that is usually being visualized is how capitalism administers existing structures, whereas the relevant problem is how it creates and destroys them. As long as this is not recognized, the investigator does a meaningless job.¹⁴⁴

It might be that when United States subsidiaries' policies and practices are examined in the long-run, their presumed ill effects will be less serious and less permanent.

It can also be argued that the charges levied against United States subsidiaries are imaginary and illogical on the ground that a profitable position for the subsidiary requires a sound and growing Canadian economy. Dividends (on direct investments) are not fixed as

¹⁴⁴Joseph Schumpeter, Capitalism, Socialism and Democracy (3rd ed.; New York: Harper and Brothers, 1950), pp. 83-84.

are those of portfolio investments, but vary according to business conditions in Canada. This is particularly true for nonresident enterprises in Canada producing only for the Canadian market. Economically no foreign or domestic firm will engage in any policies or practices that will have detrimental effects on the Canadian economy as their profit position is directly tied to the performance of the Canadian economy. If the Canadian economy slackens foreign profit earnings will slacken. For example, during the slackening of the Canadian economy in 1957, foreign earnings fell substantially for 1958 (Table 14).

TABLE 14

TOTAL EARNINGS ON FOREIGN DIRECT INVESTMENTS
IN CANADA, 1955-1960

Year	Total Earnings	Increase or Decrease	Percentage of Increase or Decrease
	(in \$ millions)		
1955	673	...	...
1956	805	132	20
1957	819	14	1.7
1958	620	-199	-24
1959	759	139	22

Source: The Canadian Balance, 1961 and 1962, op. cit., p. 22.

In conclusion, we do not deny that from time to time there will be specific problems arising from specific firms or industries, both Canadian and foreign. These problems arising out of the institutional and economic setting as firms attempt to improve their economic position. In such situations the Canadian Government should try to identify and preserve the Canadian national interest, directing remedies to the harmful practices themselves and not against foreign investment as such. We should remember always that the problems created are partly due to our own shortsightedness, as Professor Johnson has properly observed:

. . . insofar as there is a problem, it is largely one that Canada has created for itself by its policy of protection of manufacturing: the tariff creates a profit incentive to foreign firms to establish branch plants and subsidiaries in Canada in order to produce in Canada inside the tariff wall instead of exporting to Canada over the tariff wall, and it is inconsistent to say the least to defend protection yet complain of its effects in stimulating foreign investment in the country.¹⁴⁵

¹⁴⁵Johnson, op. cit., p. xi.

CHAPTER IV

COSTS AND BENEFITS OF BORROWING ABROAD

Apart from statistical analysis we must consider analytically the economic principles of the costs and benefits to the host country of international investment. This subject has resulted in considerable academic discussion in recent years as a consequence of two related problems. First is the question of how much foreign investment should be allowed in the host country. Second is the concern within the United States about the extent to which its private investment overseas has been contributing to the United States' serious balance-of-payments problem. The most important references on the subject are an elaborate theoretical analysis of the economic effects of foreign investment on the Australian economy by Sir Donald Macdougall,¹⁴⁶ and two chapters surveying the economic effects of private foreign investment from the point of view of the host and the exporting country contained in the massive study of United States private and government investment abroad prepared at the University of Oregon under the direction of

¹⁴⁶Donald Macdougall, "The Benefits and Costs of the Private Investment from Abroad; A Theoretical Approach," The Economic Record, Vol. XXXVI, No. 73 (March, 1960), pp. 13-36.

Raymond Mikesell.¹⁴⁷ Sir Donald Macdougall's analysis is of greater importance for our purposes since Australia's experience closely parallels that of Canada.

But before we discuss these questions of analogies it is important to examine first the Canadian "need" for foreign investments. Canada's "need" for foreign investment is best viewed in the context of both domestic and world development. The three rapid growth periods in Canada--1900-1914, the 1920's, 1945-1963--parallel and reflect economic expansion throughout the world. In these periods the world demand for Canadian goods and services was high and increasing. There was a climate favorable to long period exports. These factors, coupled with rapid internal growth, necessitated investment demands within the Canadian economy far beyond Canada's ability to provide them (especially in the export industries).

The exploitation of resources over wide areas, and the ancillary activities to which this gave rise, required vast amounts of both business and government capital. The increase in domestic investment was far more rapid than that of other major components of Gross National Expenditure. Indeed, in the period after World War II, Canadian capital formation in relation to total output has stood among the highest in the world.¹⁴⁸

At the same time Canadian savings were increasing at the same rate as GNP has been increasing, as can be seen in the tables following. Gross

¹⁴⁷Raymond Mikesell (ed.), U. S. Private and Government Investment Abroad (Eugene: University of Oregon Press, 1962). In this study referred to as The Oregon Study.

¹⁴⁸Brecher and Reisman, op. cit., p. 112.

private savings as a percentage of GNP has been very steady at 19 to 19.7 percent (Table 17).

TABLE 15
FIXED INVESTMENT (EXCLUDING HOUSING)
AS A PERCENTAGE OF TOTAL OUTPUT
(in 1958 prices)

	1955	1956	1957	1958	1959	1960	1961	1962
Canada	17.6	20.5	22.1	19.8	19.8	18.5	17.8	17.2
United States	12.7	13.3	13.1	11.8	11.6	12.0	11.6	11.7
U. K.	11.3	11.9	12.6	12.6	12.9	13.5	14.3	13.8
E. E. C.	14.8	15.3	15.2	15.3	15.7	16.5	17.3	17.6

Source: Organization of Economic Cooperation and Development.

TABLE 16
CAPITAL INVESTMENT IN CANADA, 1956-1959
(in \$ millions)

	1956	1957	1958	1959	1963
Business capital	5,004	5,654	4,869	4,720	5,800
Housing	1,547	1,430	1,782	1,759	1,700
Institutional services	402	455	515	531	. .
Government departments and waterworks	1,083	1,178	1,198	1,401	. .
Total	8,036	8,717	8,364	8,411	9,300
Total as percentage of GNP	26.3	27.4	25.7	24.3	21.6

Source: Dept. of Trade and Commerce, Private and Public Investment in Canada, Outlook 1960, pp. 5, 7.

TABLE 17

RATES OF GROSS PRIVATE SAVING OVER
BUSINESS CYCLE PERIODS, 1926-1963

Business Cycle Period	Gross Private Savings as Percentage of GNP
1926-29	18.89
1946-48	19.69
1949-53	18.96
1954-57	18.88
1958-60	18.98
1961-63 (preliminary)	19.69

Source: Based on data from Dominion Bureau of Statistics and estimated by the Economic Council of Canada.

The demand for investment in Canada was (in these three periods) higher than gross private savings within Canada, hence the need for foreign capital by Canada. Reasons for importing foreign capital are simple to state but hard for some to comprehend and thus accept. Aside from access to foreign capital, a country's capacity (in real terms) to invest is essentially a function of the level of income and amount of current output not consumed at that level, i. e., amount of savings. Productivity--"techniques of greater production"--depends upon saving, that is, upon the postponement of consumption."¹⁴⁹ For

¹⁴⁹Barbara Ward, "The Economic Revolution," Adventures of the Mind, ed. Richard Thruelson and John Kobler (New York: Vintage Books, A Division of Random House, 1961), p. 219.

a country (especially with a small population such as Canada has) with a small stock of capital and whose current consumption is high, where exists a strong determination to enjoy a high standard of living, severe limits are thereby set upon its capacity to finance the necessary growth from its current income. There are two ways such countries can adopt to achieve a faster economic development than what limited domestic savings provide. First, they can lower the level of consumption, thus generating more savings internally for investment. This clearly can not be done in Canada without government planning and control. But Canada adheres to the principles of private enterprise which tolerate no direct restrictions on the balance between consumption and private savings except under the emergency conditions of war. Canadians have become accustomed to a high standard of living which they would be very reluctant to sacrifice for political determination. In addition, such a sacrifice is not necessary. The second way requires no such sacrifice. The alternative left is to draw on foreign resources. That is exactly what Canada has been doing. In real terms the inflow of foreign capital is in part a measure of the Canadian desire for rapid economic development together with a high standard of living from current income.

Another reason for the insufficiency of domestic savings in Canada has been the lower population density and the long distances between population centres, resulting in relatively high overhead costs

in the utilities such as railways, highways, communication (radio and television), electricity, and the transportation of oil and gas. Perhaps the most significant reason for the Canadian insufficiency of domestic savings is her northern location which renders her economy as capital intensive. Canada requires more capital to develop at the same rate than a country of more southern location. Stated economically, in Canada it takes \$5 of additional capital investment to add \$1 per year to her Gross National Product.¹⁵⁰ For the more developed countries this ratio is usually 3:1, "and unless the discoveries of new and rich natural resources continue at their present pace it is almost bound to decrease [become worse]."¹⁵¹

Professor Hill, in his study on Growth and Investment, According to International Comparisons,¹⁵² found that:

Northern countries with severe climates and very low densities of population are to be found in the group with comparatively slow growth relative to their investment. This suggests that the heavy capital requirements associated with the infra-structure of these economies, especially for the development of some of their more remote regions, may be largely responsible for the apparently slow growth of measured output achieved.¹⁵³

¹⁵⁰Jacob Viner, Canada and Its Giant Neighbour, Alan B. Plaunt Memorial Lectures, Carleton University, Ottawa (January 30 and February 1, 1958).

¹⁵¹Ibid., p. 60.

¹⁵²T. P. Hill, "Growth and Investment, According to International Comparisons," The Economic Journal, Vol. LXXIV, No. 294 (June, 1964).

¹⁵³Ibid., pp. 290-95.

Professor Inman is in agreement with Professor Hill and explains that the northern part of Canada which contains "a vast amount of natural resources . . . is for all practical purposes uninhabited due to a frigid climate. The majority of the Canadians live within 300 miles of the American border." This, however, does not alleviate the problem since:

Even in the great industrial areas of southern Canada, the low winter temperatures necessitate the erection of buildings designed to withstand the rigours of the climate. Building and maintaining these expensive structures have the effect of raising production costs.¹⁵⁴

The Royal Commission explains the Canadian need for foreign capital in its study on Canada-United States Economic Relations as follows:

When assessing the capacity of a young and growing country to finance its investment requirements, it is not enough to focus on the dollar value of the savings it is able to generate. Capital is not a simple or uniform product; it embraces a number of complex properties both quantitative and qualitative in nature.

Of the utmost significance in this context, is the fact many investment projects undertaken in a modern industrial economy require enormous pools of venture capital concentrated in the hands of a single enterprise. In order to appreciate the significance of this fact, one needs only reflect on the kinds of resource development projects recently undertaken in Canada's petroleum, iron ore, and aluminum industries. As already noted, Canada, relative to its size, has accumulated impressive and increasing amounts of savings during the past few decades. But for the most part, Canadian savings have simply not been available in sufficiently large concentrations to finance these massive undertakings; and to the extent that they have been available, the policies of the financial institutions curtailing them have militated against their use for venture purposes.

¹⁵⁴Inman, op. cit., p. 701.

No less important is the fact that the investment dollar is not a homogeneous product. Many Canadian investment undertakings require not only substantial outlays of venture capital, but also an advanced technology, specialized entrepreneurial and managerial skills, an assured export market for a large part of the output, and the efficiency and security associated with vertically integrated enterprises. Here again Canada has, in recent years, made significant progress in meeting these requirements out of its own resources. The fact is, however, that foreign enterprises, particularly from the United States, have much more of all of these facilities at their command.

In effect, then, what Canada has required, especially in the course of her recent economic development, is an indivisible package of money, technology, skills and markets. It is this kind of package which nonresidents have provided, thereby performing vital tasks which Canadians alone could do either less efficiently, more slowly, or in some cases perhaps not for a very long time to come.¹⁵⁵

The study concludes:

It is clear then, that in the early stages of economic development, or where economic development is proceeding at a very rapid pace, a country may borrow heavily from abroad. This has been characteristic of the economic history of most western countries. The need for foreign capital is likely to be especially great where a country's growing industries are capital-intensive. In the case of Canada, size, sparseness of population, the discovery of natural resources in remote regions, and the nature of its basic industries have meant that capital requirements have been especially heavy.¹⁵⁶

In its separate Final Report, the Commission came to this conclusion:

Canada has never been able to provide enough capital from its own resources to finance the growth and development of the country. Indeed, one of the first and most important problems facing Sir John A. MacDonald and his colleagues was the raising

¹⁵⁵Brecher and Reisman, op. cit., p. 121.

¹⁵⁶Ibid., p. 114.

of funds abroad to build the Canadian Pacific Railway. The growth of the country at any stage in its history would have been much slower without large supplies of capital from foreign countries, principally from the United Kingdom and the United States. All our periods of great economic activity and expansion in peacetime have been characterized by heavy inflows of capital from abroad; in periods of economic stagnation, we have been importing very little capital.¹⁵⁷

Dr. Knapp, in examining the statistics on the Canadian economy and Canadian capital formation from the end of World War II to 1960, concludes that:

. . . first, Canada experienced a strong and steady economic expansion; second, this expansion seems to have been primarily stimulated by a tremendous surge in capital formation, especially in Canada's basic resource industries; . . . fourth, large amounts of foreign financing were increasingly necessary to compensate for the growing inadequacy of domestic Canadian savings.¹⁵⁸

According to Mr. J. W. Popkin, personal savings in Canada in life insurance companies totalled \$3 billion over the decade of the 1950's, of which \$2 billion was in mortgages, thus leaving only \$1 billion for all other kinds of investments by life insurance companies. Over the same period the net inflow of foreign capital was \$15 billion. Mr. Popkin concludes, "if the life insurance companies had invested the entire amount in ways that displaced foreign capital, it would have made but a small dent in the overall problem."¹⁵⁹ Other nonofficial

¹⁵⁷The Final Report, op. cit., p. 380.

¹⁵⁸Knapp, op. cit., pp. 108-109.

¹⁵⁹J. W. Popkin, "Canadian Business Outlook," Commercial and Financial Chronicle (March 30, 1961), p. 39.

studies similarly testify to the inadequacy of Canadian resources to meet postwar investment demands.¹⁶⁰

The need for external capital in Canada is evidenced in the Canadian balance-of-payments position as well. It is well known that Canada, in order to continue enjoying a high standard of living, must import many products from the rest of the world. In the long run she must pay for these products in exports. Canada has had current account deficits since 1950. Capital inflows have provided Canada with the needed foreign exchange to balance out its current account deficits.

Professor Inman and Dr. Anton explain it this way:

A country with an unfavorable balance of payments on current account must meet its net international financial obligations by exporting monetary gold, by tendering other acceptable currency, e. g., U. S. dollars, or by borrowing abroad. If a country does not have enough gold (and/or acceptable currency) to meet its adverse balance, or prefers not to exhaust its official reserves, the only way the country can settle its net debt on current account is by borrowing from other countries, i. e., by importing capital.

Despite the imbalance of Canadian-American trade, the adjustments in Canada's balance of payments has taken place quite smoothly mainly because Americans have been willing to invest in Canada.¹⁶¹

¹⁶⁰See, for example, Ronald Shearer, International Investment, Economic Growth and the Case of Canada (Ph. D. Dissertation, Department of Economics, Ohio State University, 1959), Chapters VIII and IX. In reference to the balance of payments impact of economic growth in Canada, Shearer concludes that without any foreign investment foreign exchange requirements would have exceeded foreign exchange receipts by an amount of \$3.7 billion to \$7.4 billion, depending on certain assumptions about export capacity.

¹⁶¹Mark K. Inman and Frank R. Anton, Economics in Canadian Setting (2nd ed.; Toronto: The Copp Clark Publishing Co. Ltd., 1965), pp. 567 and 707.

Stated in reverse, capital inflows permit a country to maintain a level of desired imports without paying for them out of current earnings or exchange reserves. In short, the country is enabled (through capital inflows) to run a current account deficit in its balance of payments. "To this extent, current account deficits and economic growth are but the opposite disks of the same coin."¹⁶²

This may be so with some exceptions of course, but the exact relationship between the two sides is difficult to determine. To be sure, there does exist some kind of a relationship since almost all of the references point out that foreign financing has stimulated Canadian economic growth. However, reasonably exact conclusions as to the causation between capital formation (including foreign capital) and economic growth are difficult to draw. There is even some disagreement as to the direction of the causation. Dr. Fullerton and Dr. Hampson hold that "while it is easy to list some of the main determinants of growth, it is less easy to establish which is cause and which effect, or to determine the precise relationship between them."¹⁶³ The Royal Commission on Banking and Finance expressed the same idea and concluded that both forces are at work.

It is obviously very difficult to separate cause and effect in this as in other aspects of economic life. One can never be sure

¹⁶²Brecher and Reisman, op. cit., p. 124.

¹⁶³Fullerton and Hampson, Canadian Secondary Manufacturing Industry, p. 34.

to what extent domestic forces govern the amount and composition of capital inflows and to what extent the inflows influence the size and shape of Canadian economic activity. Clearly both forces are at work, although with varying strength at different times.¹⁶⁴

Professor C. E. Ayers in his book, The Theory of Economic Progress, comes out completely against the contribution of foreign capital to the economic growth of the host country. He states:

I have tried to show in the chapters that follow that we have traditionally conceived capital both as industrial plant and as accumulated funds, and in both cases have supposed it to be indispensable to economic growth. Consequently both of these conceptions have seemed quite plausible when applied to the development of the less industrialized peoples.

Thus it seems to stand to reason that lack of funds is the decisive impediment to economic growth, and vast efforts have been made to supply a flow of funds to regions in which such development is being fostered. This presumption is based in part on what is quite generally taken to be the actual experience of countries such as the United States, in which very considerable and very rapid growth has indeed taken place. It is commonly assumed that such development was made by advancement of funds by older and wealthier countries. But in a paper entitled "The Contribution of Foreign Investments: A Case Study of United States Foreign Investment History," published in the spring, 1961 issue of Inter-American Economic Affairs, my colleague Professor Wendell Gordon has shown conclusively that such was not the case. Using figures most carefully compiled by the National Bureau of Economic Research he shows ". . . that for the period 1790 to 1900 (or 1914) net earnings on foreign investments in the United States substantially exceeded net increase in United States indebtedness. And this relation prevailed generally throughout the whole 125-year period." In short the hardy bands of men and women who first landed on these shores were quite capable of instituting a viable economy from the very start, and of paying for whatever imports they required with their own exports.

¹⁶⁴1964 Report of the Royal Commission on Banking and Finance, op. cit., p. 81.

This, and not a supply of funds from abroad, is the explanation of the growth of the American economy.¹⁶⁵

In Canada the former Governor of the Bank of Canada, James Coyne, has actually assumed away the possibility that foreign capital has helped the Canadian economy to develop at a faster rate. In referring to recent economic development in Canada, Mr. Coyne claims that:

A somewhat different kind of economic development with somewhat smaller but better balanced capital investment, and with a more continuing effect on employment, could have been carried on without large imports of capital every year, and could have provided at least as high an average standard of living, if not higher, with less fluctuation in employment and a high average level of employment.¹⁶⁶

However, Mr. Coyne does not say what different type of economic development should have been followed! It is up to Professor Clarence Barber of the University of Manitoba to provide the logic of Coyne's ideas. Referring to the rising rate of unemployment and the slowing down of the economic growth in the late 1950's, Professor Barber claims:

The dominant cause of this much sharper drop in the Canadian growth rate is the excessive volume of capital inflows that has plagued our economy in recent years.

¹⁶⁵C. E. Ayres, The Theory of Economic Progress: A Study of the Fundamentals of Economic Development and Cultural Change (2nd ed.; New York: Schocken Books, 1962), pp. xxi-xxii. See Douglass C. North, The Economic Growth of the United States, 1790-1860 (Englewood Cliffs, N.J.: Prentice-Hall, 1961), for an opposing view using the same data.

¹⁶⁶J. E. Coyne, "U.S. Trade, Capital Exports Don't Help Canada," Commercial and Financial Chronicle (March 30, 1961), p. 38.

I would say that Canada's high level of unemployment during the past few years has been primarily due to the government's failure to encourage a reduction in the capital inflow and in the size of the current account deficit.¹⁶⁷

It is not the foreign capital that retarded the Canadian economic growth, qualifies Professor Barber, but "its accompanying current account."

Professor Barber argues that if Canada had accepted less foreign capital, imports of goods and services would have correspondingly been less, forcing Canadians to spend more for domestic goods and services, causing a multiplier effect on domestic income levels and restoring the Canadian economy to a full employment level. Besides restoring a full employment income level, increased productivity, increased taxes, and balancing the budget would have also occurred, he argues.

If foreign investment really denied these benefits to the Canadian economy and the Canadian people, it was indeed a "plague" on the Canadian economy. But we may ask, has it been really so? Many Canadian economists do not agree! Coyne's economic ideas have been challenged by a number of economists in Canada, and one of the pressures brought to bear leading to his resignation as Governor of the Bank of Canada was a letter widely circulated and signed by

¹⁶⁷ Clarence Barber, "Canada's Unemployment Problem," Canadian Journal of Economics and Political Science, Vol. XXVIII (February, 1962), pp. 89 and 101.

twenty-nine Canadian academic economists, demanding Coyne's resignation as a Governor.¹⁶⁸

The most diametrically opposed views to Mr. Coyne's are those of Professor Viner and Professor Dales. Professor Viner asserts:

. . . try as best I can, I can either find little merit in the Canadian complaints against American business operating in Canada, or find them of minor economic significance, or find myself unable to appraise them because they never seem to be supported by careful, competent, and reasonably objective collection and analysis of what confirmatory evidence there may be.¹⁶⁹

Professor Dales of Toronto states:

In my view . . . the reaction in Canada has been emotional, political, sociological, and psychological. It has been intellectually dishonest, because there has been a strong tendency to mask emotional reactions, which westerners consider unmanly, by insisting that American investment in Canada poses economic problems. I believe that to be untrue. . . . My conclusion is that no economic problem exists. If Canadians want to be anti-American they should rest their case on a distaste for American policies, or, if they wish to be crude, for Americans; there is no need to corrupt the discussion of economic problems in Canada in the process.¹⁷⁰

¹⁶⁸H. Scott Gordon, The Economists Versus The Bank of Canada, 1961 (Toronto: Ryerson Press, 1961); J. W. O'Brien, Canadian Money and Banking (Toronto: McGraw-Hill Co. of Canada Ltd., 1964), pp. 197-201; David C. Smith and David W. Slater, "The Economic Policy Proposals of the Governor of the Bank of Canada," Queen's Quarterly, Vol. LXVIII (Spring, 1961), pp. 106-127. For discussion of the letter see "Is Canadian Money Too Tight?" Business Week (December 17, 1960), pp. 100-102.

¹⁶⁹Viner, op. cit., p. 55.

¹⁷⁰J. H. Dale, "Book Reviews, American Capital and Canadian Resources," Business History Review, Vol. XXXVI (Summer, 1962), p. 232.

Professor Barber's oversimplified arguments can be challenged for a variety of reasons. For example, his arguments overlook the fact that the multiplier applies to a net increase in spending, and it might well be that without the capital inflow total spending in Canada would have been lower. At issue here is the question whether foreign investment leads to spending the increased income, and hence specifically more employment in the capital importing country (Canada) or in the capital exporting country (United States). Professor Barber and Mr. Coyne, focussing their attention on the import surplus which "accompanies" the capital inflows, argue for the latter.

However, as shown before, this overlooks the fact that foreign investors also spend internally within the host country in the real sense, by building factories, buying machinery, hiring workers, and paying taxes. Such spending has as real a multiplier effect on income and employment as any other kind of spending. It is possible that part or all of this spending could be offset by the "attendant" current account deficits. But to hold that foreign inflows of capital have only depressive effects is only one side of the coin. Even Professor Barber hints at the possibility that foreign investment can stimulate domestic income and employment when he admits at the end of his article that policy-makers should not be too eager to accept his recommendations to curb capital inflows:

However, if our rapidly growing labour force is to be given productive employment Canada will continue to need a high level

of capital investment, and perhaps also a continued reliance on a moderate inflow of foreign capital. We should be careful, therefore, in developing measures to regulate requirements of the Canadian economy, not to take steps that will dry them up permanently.¹⁷¹

There has been a great intellectual activity in the "fallow" area since Dr. M. Abramovitz in 1952 made the remark that "the theory of growth is an underdeveloped area in economics."¹⁷² Still there is a lack of consensus among economists on what are the proper relationships among the factors that constitute economic growth. Recent empirical and theoretical studies of the causes of economic growth tend to show that technology and not the traditional factors of input (land, labour and capital), as commonly thought, contributes the most to the economic growth. Overwhelming evidence is offered by Professors Solow, Fabricant and Massell:

. . . to support (this) the view that technological change is of overriding importance in bringing about increased labour productivity over time and that there is need for economists to shift emphasis from the theory of capital to the theory of technical progress, as an explanation of the growth in aggregate output.¹⁷³

¹⁷¹ Barber, op. cit., p. 102.

¹⁷² Moses Abramovitz, "Economics of Growth," A Survey of Contemporary Economics, Vol. 11, ed. Bernard Haley (Homewood, Illinois: Richard Irwin, Inc., 1952), p. 133.

¹⁷³ Benton F. Massell, "Capital Formation and Technological Change in United States Manufacturing," Review of Economics and Statistics, Vol. XLII (May, 1960), p. 188. See also Robert Solow, "Technical Change and the Aggregate Production Function," Review of Economics and Statistics, Vol. XXXIX (August, 1957), pp. 312-320; Solomon Fabricant, Basic Facts on Productivity Changes, National Bureau of Economic Research, Occasional Paper 63 (New York: National Bureau of Economic Research, 1959).

Many other economists have reached the same conclusion.

Professor Kuznets defines that "the greatest factor in economic capacity to produce is the stock of knowledge--not measured by the commodities (or foreign claims) that enter our capital formation tables."¹⁷⁴

Dr. Cairncross expresses it more strongly: "Whatever may be true in the past, it is now technological innovation--the introduction of new and cheaper methods--that dominates economic progress."¹⁷⁵ Dr.

Abramovitz stresses that ". . . only the discovery and exploitation of new knowledge rivals capital formation as a cause of economic progress."¹⁷⁶ Professor Denison provides the analysis for the technology-growth theory. He claims that:

The results shown in Table 1 are rough estimates, and this derivation required some strong assumptions, but I think they provide correct perspective.¹⁷⁷

His results are the following:

I estimate that in the 1926-57 period, the earnings of labour (including the labour of proprietors) represented 73 percent of the national income; earnings of land, 4.5 percent; earnings of reproducible capital, 22.5 percent.¹⁷⁸

¹⁷⁴Simon Kuznets, Capital in the American Economy, A Study by the National Bureau of Economic Research (Princeton: Princeton University Press, 1961), p. 390.

¹⁷⁵Cairncross, International Social Science Bulletin, Vol. VI, No. 2, p. 233.

¹⁷⁶Abramovitz, A Survey of Contemporary Economics, Vol. II, p. 146.

¹⁷⁷Edward F. Denison, "United States Economic Growth," Economic Growth: An American Problem, ed. Peter M. Gutmann (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1964), p. 86.

¹⁷⁸Ibid.

Be that as it may, this is nothing new to the students of Schumpeter, who firmly argued that "innovation is the outstanding fact in the economic history of capitalistic society. . . ." He placed emphasis on the cause of economic progress as the entrepreneurial spirit of innovation or, as he ironically called it, "creative destruction." He explained the capitalistic process with these words, applicable within a nation as well as across national borders:

The fundamental impulse that sets and keeps the capitalistic engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise create. . . . The opening up of new markets, foreign or domestic, and the industrial development from the craft shop and factory to such concerns as United States Steel illustrates the same process of industrial mutation--if I may use that biological term--that is incessantly destroying the old one, incessantly creating the new one. This process of Creative Destruction is the essential fact about capitalism.¹⁷⁹

And the most powerful engine for Schumpeter's "driving and perpetuating the perennial gale of creative destruction" was the modern industrial large corporation. It is this large corporation that has exported its capital to Canada and other countries. It is important to keep in mind that foreign capital is an indivisible package of money, technology, skills and markets, and only when viewed in this context can we grasp the significant contribution that it has brought to Canadian economic growth.

¹⁷⁹Joseph Schumpeter, Capitalism, Socialism, and Democracy, (3rd ed.; New York: Harper and Brothers, 1950), p. 83.

Viewed in this context, there are certain effects of foreign capital on the economic growth in Canada. First, most of foreign investment since the war has been direct investment which has brought to Canada the kind of business experience (techniques and creative adaptability) most conducive to innovation and technological change. According to Professor Schumpeter there is a distinction between "entrepreneurial function" (pertaining to the creating and the carrying out of new combinations of productive factors) and the "capitalistic function" (pertaining only to the bearing of financial risk). These two functions are not of equal importance in stimulating economic growth. "It is leadership rather than ownership that matters," claims Schumpeter. Direct foreign investment, even though it bears financial risks, was much more effective as an economic stimulant in Canada because it was innovation oriented. Also, as Dr. Kendrick and others have argued,¹⁸⁰ the most important recent factor contributing to innovation and productivity within the United States economy has been the research and development undertaken by the large corporations. If this is so Canada has received a powerful impetus, since these same corporations have transferred operations and discoveries to their Canadian subsidiaries. It is indeed difficult to separate the determinants (the inputs)

¹⁸⁰See John Kendrick, Productivity Trends in the United States (Princeton: Princeton University Press, 1961); "Spotty Record of Progress," Business Week, Oct. 21, 1961, pp. 181-84; "The United States Invents a New Way to Grow," Business Week, Jan. 23, 1960, pp. 53-81.

of economic growth from one another and tell exactly how much each determinant contributes to economic growth. Nonetheless there has been recently a tendency to deemphasize the contribution of capital (investment) to economic progress, which, without a thorough examination and empirical evidence, should not have been. Professor C. L. Schultze points out:

One of the chief characteristics of industrial growth has been a sharp increase in the stock of capital per worker. The medieval artisan had, at best, a few rudimentary tools. In most parts of the world today the major investment of the typical farmer is still a mule or an ox. But the modern industrial worker in the United States has at his disposal an immense capital in machinery and equipment, not only directly in the tools he uses, but indirectly in the electric power he is furnished and the transportation system which delivers his finished product to the market. The same is true of the American farmer, or at least of those farmers who supply the bulk of our agricultural needs. The average value of capital invested in large Midwestern cash grain farms, for example, is over \$100,000.

Rising productivity involves an increase in our ability to harness the forces of nature for supplying power, transporting goods, and manipulating materials. This, in turn, requires not merely scientific and technical knowledge, but the provision of expensive plant and equipment. It requires, in other words, capital. And capital goods are not "free." They must be produced, using labour, materials, and machines which might otherwise have been utilized to turn out consumer goods. Providing the labor force with an increasing supply of machinery and equipment involves saving--the nation must refrain from consuming part of its output so that resources may be free to produce capital goods.¹⁸¹

Dr. McCracken explains the importance of capital to economic growth with the following words:

¹⁸¹ Charles L. Schultze, National Income Analysis (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., Foundations of Modern Economic Series, 1964), p. 118.

We need no learned expositions to persuade us about the contribution that capital makes to economic progress. The 8 percent of our labor force remaining on farms, equipped with \$18 billion worth of tractors and other complex equipment, pour out upon us an embarrassment of abundance. One man equipped with a power shovel or bulldozer can literally move a mountain. At my own university the balance sheet shows \$24,000 of investment per employee--with which a professor is occasionally helped to move a mind.

According to one estimate, the nation's total stock of reproducible wealth in 1958 was \$1,400 billion, about \$3 for each dollar of output produced. If roughly this same ratio has continued to prevail, the present figure must be about \$1,700 billion. And if the decade ahead is to be one of average economic progress, we shall have to add to this stock of wealth or capital another \$700 billion by 1973, in addition to that required for restoring the capital expired each year. If we fall short of this, the decade will also be one of disappointing gains in levels of living and job opportunities.¹⁸²

Dr. S. H. Cohn, in his statistical analysis of investment as a factor in economic growth, compares the growth rates for the seven leading industrial countries and concludes that the contribution of the other factors "should not be discounted, but the key to the explanation of productivity advances can be found in the role exerted by capital investment."¹⁸³ He concludes:

. . . there is a close correspondence between proportions of GNP allocated to investment and rates of expansion of national product.¹⁸⁴

¹⁸²P. W. McCracken, "The Basic Sources of Economic Progress," Proceedings of a Symposium on Economic Growth (The American Bankers Association, New York, N. Y., 1963), p. 26.

¹⁸³Stanley H. Cohn, "The Gross National Product in the Soviet Union: Comparative Growth Rates," Economic Growth: An American Problem (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1964), p. 71.

¹⁸⁴Ibid., p. 76.

This applies to all seven countries including U.S.S.R. Professor Gutmann agrees completely:

The growth rate in GNP is closely related to the growth rate in the stock of capital, which in turn directly depends on the proportion of national output devoted to investment. The higher a country's rate of investment, the higher will be its growth. However, increases in the rate of investment do not produce proportionate increases in the rate of growth since diminishing returns apply.¹⁸⁵

Dr. Barbara Ward, probably the most ardent supporter of the capital theory, states:

All of these techniques of greater production depend upon saving--that is, upon postponement of consumption.¹⁸⁶

In explaining the appeal of Communist Russia and its rapid economic growth she again emphasizes the role of savings-investment.

Communist Russia could not, any more than could capitalist Britain, avoid the iron necessity of beginning to save. There has to be capital--for the new source of energy, the new factories, new machines--and only the people at large could do the saving. But driven by his totalitarian demon, Stalin pushed the percentage of national income devoted to savings far above the Western figure. He compelled the Russians to save not 15 but 25 to 30 percent of the fruits of their labors.¹⁸⁷

The most conclusive official empirical evidence as to the significance of investment to economic growth is provided by the Council of Economic Advisers to the President of the United States.

¹⁸⁵Gutmann, op. cit., p. 26.

¹⁸⁶Barbara Ward, "The Economic Revolution," Adventures of the Mind, ed. John Kobler (New York: Vintage Books, A Division of Random House, 1961), p. 219.

¹⁸⁷Ibid., p. 222.

The importance of investment in the growth process is suggested by the parallel movement of the growth of potential output per man and the growth of capital per man. . . . Both ratios grew more rapidly after 1947 than before, and more rapidly between 1947 and 1954 than subsequently. In general, the experience since 1929 supports the belief that the more rapidly capital stock grows relative to the labor force, the greater will be the growth in potential output per worker, provided that other necessary conditions are met. . . .

Investment in new equipment serves as a vehicle for technological improvements. Without their embodiment in new equipment, many new ideas would lie fallow.

The slower rate of growth of the capital stock in recent years provides one explanation for the accompanying slower growth of labor productivity and potential output. During the period 1947-54, expenditures on business fixed investment averaged 11.0 percent of GNP and the stock grew at an annual rate of 4.2 percent (valued in 1961 prices). In the period 1955-60, 9.8 percent of GNP was invested and the capital stock grew at an annual rate of 3.2 percent.¹⁸⁸

After more serious reflection on the assumptions and conclusions, Professor Solow found himself in disagreement with his previous analysis and conclusions¹⁸⁹ relative to the unimportance of investment to economic growth. Subsequently he has changed his mind:

This downgrading of fixed investment as a source of growth had genuine policy implications. Calculations based on this idea suggested that substantial rates of growth were obtainable with little or no net investment, and that any visible acceleration of growth through the stimulation of capital formation would require fantastic amounts of investment--although people sometimes forget that with net investment only about half of gross, a 10 percent increase in the rate of gross investment means in the short run a 20 percent increase in the rate of net investment.

¹⁸⁸Council of Economic Advisers, "Economic Growth Policies," Economic Growth: An American Problem, ed. Peter M. Gutmann (Englewood Cliffs, New Jersey: Prentice-Hall, Inc., 1964), pp. 169-170.

¹⁸⁹See footnote number 173.

I finally came to think that this undervaluation, or downgrading, of the importance of capital investment was really a little implausible and that all reasoning like that, including my own, overlooked the fact that at least some technological progress requires being embodied in newly designed types of fixed capital before it becomes effective in production. Investment thus serves the purpose not only of adding to the stock of capital per worker, but also of improving its quality, of carrying new technology into operation.

You could easily devise numerical examples that would convince you that this could make a real difference in the story. When account is taken of "embodied" inventions, the kind of inventions that need new kinds of capital to become effective, then a surge in the rate of capital formation will have bigger effects on potential output than the simple notion of "residual" productivity increase would lead one to expect.¹⁹⁰

But perhaps the most ardent advocate and defender of American investment in Canada (thus defender of capital theory as well) is Dr. George Mowbray. In a somewhat philosophical way he explains why!

Of all the economic limitations which nature and human frailty have placed upon the progress of man from poverty to wealth, the shortage of real capital is perhaps the greatest. Over the vast area of the globe, whole peoples sweat out their short and dismal lives in economies with one hundred percent consumption, zero savings and zero capital investment. This is the vicious circle of the backward country. Of all the nations in the world, Canada is perhaps farthest removed from this cul de sac.

In the years before the first world war, our country was launched on the voyage to wealth by foreign investors, mostly British. Our capacity to make sizable savings beyond our current requirements came later, and by then we were on our way. The Americans, for quite selfish reasons, have helped us link our economy to the progressive, driving forces of their own great society. With money and talent they have enabled us, a small people in a large and often inhospitable territory, to achieve a standard of living second only to theirs in the modern world. In

¹⁹⁰Robert M. Solow, "Sources and Outlook for Growth," Readings in Economics, ed. Paul A. Samuelson, John R. Coleman, Robert L. Bishop and Phillip Saunders (4th ed.; New York: McGraw-Hill Book Co., 1964), pp. 116-117.

short, they have saved us from the restrictions on our own capacity to generate funds for capital investment and from the constraints of limited executive talent in a small population.¹⁹¹

Difficult as it may be to be precise as to the effects of foreign financed capital formation and the effects of the entrepreneurial skills accompanying it on the economic growth in Canada, there is much evidence relating to the causes of economic growth to suggest that these skills, especially those provided by the large corporations, can be expected to work mainly toward providing the technology and innovation on which strong and sustained economic growth depends.

In addition, surely one thing remains true--capital has been and still is an essential component of economic growth, however financed. It is, and has been, necessary in the advanced countries like the United States, and it appears to be even more important for the underdeveloped countries. In fact, the underdeveloped countries only can hope to develop their stagnant consumption economies through a rapid increase in their stock of capital, accomplished either by a rapid increase in the percentage of the national output devoted to investment or by imports of foreign capital. As the Council of Economic Advisers concludes:

There is substitution between the composition of output in the present and the level of output in the future. Just as a single individual can increase his consumption possibilities in the future

¹⁹¹George Mowbray, "'Little Canadianism' and American Capital: What Price Economic Nationalism?" Queen's Quarterly, Vol. LXV (Spring, 1958), pp. 19-20.

by present savings, so can a whole society provide more fully for its future by using present resources for acts of investments in the broadest sense. No absolute reduction in current consumption need occur; it is only necessary that consumption grow less rapidly than total output for a time. Indeed, future levels of consumption will be higher than they could otherwise be--the cost is primarily in postponement. Happily for an advanced society like ours, much of what is described from this point of view as investment can also be seen as present employment of some of the delights of civilization: widespread education, good health, and the search for knowledge.¹⁹²

Specifically then, foreign investments permit a country to invest domestically more than it currently saves, providing it imports more than it exports.

Thus in terms of Professor Kindleberger's equilibrium condition of national income for an open economy,¹⁹³ we have:

$$I_d + X = S + M : \text{transposed } S - I_d = X - M$$

where: I_d = domestic investment

S = savings

M = imports of goods and services

X = exports of goods and services

The greater the need for investment at home in excess of domestic savings, the greater the excess of imports over exports for the borrowing country. The alternative to borrowing abroad is an increase in the domestic savings which in most cases is difficult and

¹⁹²Council of Economic Advisers, op. cit., p. 174.

¹⁹³Charles P. Kindleberger, International Economics (Homewood, Illinois: Richard D. Irwin, 1958), pp. 172-195.

nonavailable, and would force the country to grow at a slower economic rate. So the most basic need and benefit of foreign borrowing is to accelerate economic growth by means of faster capital formation than otherwise would be the case.

There are other quantitative tangible as well as intangible benefits accruing from foreign investments to the host country as well. The tangible benefits include greater employment in the borrowing country, higher taxes generated for the government, encouragement of local suppliers, and in the case of manufacturing and production for local consumption, an increased supply of low-priced goods and services. The intangible benefits include, according to Professor Hunter, the following crucial factors:

Long-term direct investment is a "package deal," and the essential elements of the package are: an increment of foreign exchange, technical know-how, risk-bearing, and entrepreneurship.¹⁹⁴

There are, of course, other benefits derived from foreign capital to the host country, such as the introduction of new business concepts which help to revolutionize the thinking and the practice of the area, as Professor Mikesell has claimed.¹⁹⁵

¹⁹⁴John M. Hunter, "Long-Term Foreign Investment and Underdeveloped Countries," Journal of Political Economy, Vol. LXI (February, 1953), p. 17.

¹⁹⁵Raymond Mikesell, Promoting United States Private Investment Abroad (Washington, D. C.: National Planning Association, 1957), p. 8.

The authors of The Political Economy of American Foreign Policy have criticized the Randall Report for overemphasizing the "quantitative" benefits of foreign investment at the expense of the "qualitative" ones. They point out two distinct advantages from direct private investment:

First, direct private investment of the latter kind is capable of building relationships . . . which are organic and continuous. It usually involves relations between people, not governments; relations which become integral parts of the economic and social fabric of the recipient country. . . .

Second, direct, long-term, private investment fosters in various ways the growth . . . of a constructive middle class and habits of private, decentralized decision-making and enterprise.¹⁹⁶

Two other economists, Mr. Emilio Collado and Mr. Jack Bennett, recognize similar "direct" and "indirect" benefits as above. Among the direct benefits they include the income paid to the governments, the increased supplies of goods and energy for consumption and for use in other industries, and increased income; among the indirect benefits they include: encouragement of local suppliers, importing of technical skills, the introduction of new techniques, and the demonstration of efficient, voluminous mass production.¹⁹⁷

¹⁹⁶William Y. Elliott et al., The Political Economy of American Foreign Policy (New York: Henry Holt and Co., 1955), p. 328. For further discussion of the difference between portfolio and direct investments see: August Maffry, "Direct Versus Portfolio Investments in the Balance of Payments," American Economic Review, Vol. XLIV (May, 1954), pp. 614-623.

¹⁹⁷Emilio Collado and Jack Bennett, "Private Investment and Economic Development," Foreign Affairs, Vol. 35 (July, 1957), pp. 635-638.

Professor Nurkse sums up the special advantages of foreign direct investment in the host country as:

. . . being subject to private profit and business calculations, it is likely to be productively employed. It helps to promote the spread of modern technology and efficient management methods. It is free from the rigid interest and amortization requirements that affect international loans.¹⁹⁸

Professor Dunning in his recent three-year study¹⁹⁹ of the impact of United States direct investment in manufacturing on the British economy, found that the advantages described above do apply to Britain, even though she is not an underdeveloped country. Therefore his findings would certainly be applicable to the Canadian case as well. His five main benefits are: first, the availability of investment capital, which ". . . by providing a source of money capital which in turn creates a demand for real resources, has helped increase the pace of economic development." This corresponds to the first intangible benefit described above by Kindleberger's equilibrium equation. Second, the "general industrial development," that is, "the competitive and dynamic qualities of American economy . . ." and "American research, manufacturing and managerial enterprise." And the effects these have on the United Kingdom's economy are these:

¹⁹⁸Ragnar Nurkse, Problem of Capital Formation in Underdeveloped Countries (Oxford: Basil Blackwell, 1953), p. 82.

¹⁹⁹John Dunning, American Investment in British Manufacturing Industry (London: George Allen & Unwin Ltd., 1958).

The results have been in evidence both in the pioneering and development of new industries, and of new market structures more conducive to economic growth and efficiency. New skills have been introduced and an increased impetus given to the application of technologically superior methods of production and materials processing.²⁰⁰

When reference is made to the direction of the associations and contact of United States firms with both consumers as well as suppliers within United Kingdom, Dunning states that such association and contact has increased the British firms' receptiveness to new ideas,

. . . and has enabled this country to adopt herself to her changing economic environment more quickly and with less frictional disturbance than would otherwise have been the case. Productivity has been raised in many spheres of industry and commerce, American managerial practice has been both publicized and assimilated, and the general tempo of industrial development advanced.²⁰¹

These are, of course, the "qualitative" or "indirect" benefits, about which it is impossible to be exact since they can not be measured in any quantitative way even though they might be the most essential in promoting economic growth in the host countries.

The remaining three advantages according to Professor Dunning are: the effects on the external trade and balance of payments of the United Kingdom; the effects on reducing unemployment and locating industrial expansion in depressed areas; and the effects on strengthening strategic and political, as well as economic, ties with

²⁰⁰Ibid., p. 290.

²⁰¹Ibid., pp. 290-91.

the United States. Here it should be noted that this last advantage to Britain is considered perhaps the most crucial disadvantage in Canada. Some of these (the more important ones) will be examined in greater detail after we take a brief look at some of the disadvantages that foreign investments bring with them.

"Direct investment is not all beer and skittles," warns Kindleberger; it brings to the debtor nation costs, disadvantages and fears of economic domination, as well as benefits. Many of the costs and fears were discussed in the previous three chapters, where some of the unsupportable costs and illusory fears were repudiated. These included, for example, the charge that the foreign subsidiaries, especially those from the United States, may follow policies that are to the interests only of the parent corporations and thus to the United States Government, and not to the interest of the host country's economy, in our case to the interest of the Canadian economy. In fact, the charge deepens: their operations might be even detrimental to the growth of the Canadian economy. This and other similar charges have been examined and repudiated and therefore there is no need to repeat them here.

There are, however, two "main" disadvantages to the host country that are of significant importance. Putting aside ". . . the purely nationalistic argument that because an industry is mainly in the hands of a foreign country it is necessarily a bad thing," Professor

Dunning claims that:

(1) Whether or not, as a result of influence exerted by United States firms, British industrial development has been adversely affected or the consumer exploited, and (2) whether, if a situation arose which either necessitated the repatriation of United States capital or industrial development were noticeably retarded in the United States, the United Kingdom economy would find itself handicapped by the paucity of its own resources in the particular line of business which had previously relied heavily on American enterprise.²⁰²

Certain of the benefits that we have mentioned may instead turn into costs, under different economic conditions, in the host country. For example, the reduction of unemployment in the host country may turn into inflationary pressures on the host country's economy. It is true, as stated above, that spending by foreign subsidiaries leads to increased employment and more consumption goods for the locals, which leads to increased economic activity in the host country. However, just the opposite might happen if there are no unused resources available when the foreign corporation comes into the host country. If there is a full utilization of resources (full employment) in the host country, additional spending by foreign firms will be inflationary, will bid resources away from local firms, and, if more efficient, will displace them. This may be desirable in the long-run if the local firms are less efficient, thus less productive. Nonetheless, the construction of a new plant or other projects by means of imported machinery, engineers, and technicians is clearly an addition and a net benefit to capital

²⁰² Ibid., p. 308

formation and economic activity in the host country. Under these conditions the project would not have been constructed otherwise. As Professor Dunning pointed out, there could be adverse effects on the Canadian economy (its stability and growth) by a sudden withdrawal or large reduction of foreign capital in the host country, on which the economy of that country has come to depend. This is unlikely to happen because there will be adverse effects on the profit positions of foreign corporations and on United States' dependence on world markets and raw materials.

On the other hand, there could be adverse effects on the host country during tight money (inflationary) policy periods. Since foreign subsidiaries could borrow from their parent corporations, where it is assumed the inflationary pressures do not exist, at a lower rate of interest, expanding the funds, however, in the host country, thus worsening the inflationary pressures and thereby rendering the host country's monetary measures ineffective.

The final and most important tangible cost to the borrowing country is, of course, the debt servicing problem. This was discussed earlier and the conclusion was reached that Canada's ability to service its debt payments has increased and probably will continue to do so, depending on her rate of economic growth.

By now it is evident that there exist divergent views on the costs and benefits of borrowing abroad. Borrowing and lending among

nations inevitably involves heated discussions and disagreements over who benefits and how much, and who loses and how much. This is probably due to four factors. The first three are set forth by Dr. Knapp:

Perhaps this frequent debate is the result of the nation-state system in which no accepted international law or court has enforceable jurisdiction over sovereign nations, or perhaps it is the result of the widespread influence of the Marxist-Leninist dogma of capitalist exploitation and imperialism, or maybe it is the result of the bitter past experience of both international borrowers and lenders.²⁰³

The fourth factor is the failure of most economists to recognize the fact that both the lender as well as the borrower can benefit at the same time when such capital movements take place either across international boundaries or hometown streets. Conversely, both lender and borrower would lose much if there are restrictions placed on capital flows. The borrowing country will develop at a slower rate due to lack of sufficient investment, and the lending country will be faced with an excess of capital stock.

In this study, however, we are only interested in the costs and benefits to the host country (Canada) as a result of receiving foreign capital, and not in the costs and benefits as between lenders and borrowers, or lenders alone. Suffice it to say that on all three approaches there exists sufficient research and theoretical analysis. And there is not complete agreement on any of the three approaches as to the costs and benefits due to capital flows across international borders. It will

²⁰³Knapp, op. cit., pp. 36-37.

entail a thorough and enormous amount of research and weighing of all Marxist and anti-Marxist evidence to determine whether the lending or the borrowing nation gains more from capital flows. Lenin himself, a Marxist, admitted that "the export of capital greatly affects and accelerates the development of capitalism in those countries to which it is exported."²⁰⁴ On the other hand, there are some western, non-Marxist economists who would support the Marxist notion that inflow of capital is a capitalistic device for exploiting the host countries, which are usually the poorer countries. Dr. H. W. Singer, in attempting to show that "the process of traditional investment taken by itself seems to have been insufficient to initiate domestic development," concludes that "the purpose of foreign investment and foreign trade ought to be redefined."²⁰⁵ Professor John Knapp goes so far as to suggest that the way to promote economic growth abroad is to reduce United States private capital outflows abroad. He points out:

. . . the fact that capital exports are taking place cannot be interpreted as evidence that growth is being assisted in the borrowing countries. When what I have called excess borrowing is taking place, a decline in borrowing may increase the rate of growth in the erstwhile borrowing countries. A great deal of borrowing in the past may well have been of this excess borrowing type.²⁰⁶

²⁰⁴V. I. Lenin, Imperialism The Highest Stage of Capitalism (New York: International Publishers, 1939), p. 65.

²⁰⁵H. W. Singer, "The Distribution of Gains Between Investing and Borrowing Nations," American Economic Review, Vol. XL (May, 1950), pp. 476 and 484.

²⁰⁶John Knapp, "Capital Exports and Growth," Economic Journal, Vol. LXVII (September, 1957), p. 442.

Clearly these exceptional positions show the difficulty of coming to an agreement on the question of who benefits more, the lender or the borrower of capital funds.

But perhaps the following analysis of the effects on the host country of borrowing capital abroad will throw some additional and perhaps better light on the difficulties expressed above as to the costs and benefits to the host country of borrowing abroad. Here we shall depend exclusively on two theoretical studies mentioned before, The Oregon Study and the theoretical analysis by Sir Donald Macdougall.²⁰⁷

According to The Oregon Study, or more correctly Professor J. N. Behrman's analysis on the effects of foreign private investment on the host country, there are five major effects: (1) additions to the real resources of the economy; (2) the impact on output market structure and prices; (3) the shift in resource use and factor rewards; (4) the potential rise in the GNP and real income; and (5) changes in international trade and payments. The three additions to the real resources are personnel, techniques and capital.

In underdeveloped countries there is a lack of adequately trained managerial and technical personnel for which there is a great need, states Professor Behrman. This need is met by inflows of direct private foreign investment into the country. This is done through the actual transfer of officials, the training of local personnel by visits

²⁰⁷See footnotes 146 and 147.

of United States officials and technicians abroad, or by trips of foreign personnel to the parent company. An important contribution of foreign personnel is to improve the efficiency of local operations as well as to expand the technical or managerial forces.

The importance of the closer relations between the parent and the subsidiary is that "of minority participation, with the United States' partner providing temporary management; the long-run benefit of this relationship to the host country consists of training local nationals to take over entrepreneurial and technical functions, thus diversifying employment opportunities and upgrading the jobs available for local citizens."²⁰⁸

With the transfer of personnel goes various sorts of techniques which "are made available for increasing productivity in the foreign country." Foreign companies "not only benefit from the knowledge of well established processes and techniques, but also from the research continuously carried on by United States enterprises."

The importance of research is great because it "is the key-stone of growth providing both the new products and the new techniques which raise industrial productivity." Foreign firms get these benefits without paying too much for them. Professor Dunning estimates, for

²⁰⁸J. N. Behrman, "Economic Effects of Private Direct Investment," U. S. Private and Government Investment Abroad, ed. Raymond Mikesell (Eugene: University of Oregon Press, 1962), p. 138. Henceforth all quotations will be from this source unless otherwise noted.

example, that of the \$1,600 million American industry spent on private research in 1955, 25 to 30 percent was made available directly to British companies; this \$400 to \$500 million was more than twice the estimated sum spent by the whole of British industry on private research.²⁰⁹ Recently United States firms "have been establishing research facilities in many countries . . . where personnel are readily available [to the local firms] and ideas are as readily generated as in the United States." The inflow of foreign capital (reinvestments included) does not only add "to the productive capital resources of the recipient country . . . but there is a substantial mobilization of domestic capital as well. The transfer of personnel and new techniques from the parent firm also enhances the productivity of local capital."

The most significant point of direct investment "is to raise the potential for economic growth through the placing of additional real resources at the command of the host country."

The effects of such additional resources to the host country are threefold:

One effect of the addition of real resources is to alter types of products made and their costs in various industries. The market structure in the industry affected may also change; and, as a consequence of these changes, prices are likely to alter.

With the addition of new plants or companies in the host country, production will certainly increase in that country through "the addition of

²⁰⁹Dunning, op. cit., p. 167.

totally new products, or through a reduction of costs and a consequent increase in sales of existing items. Different production results occur, however, according to which of these is the stimulus to greater production."

The introduction of a new product may cause the local population to shift its demand to it from an old product. This will involve a change in cost factors and a change in the demand pattern. If such a shift takes place then, "... it is presumed that welfare is raised over the previous situation, but by how much cannot be determined."

The shift in demand will not take place if real output, due to the new product, is raised equally to the rise in disposable income. Assuming that other things remain constant, the increased income in consumers' hands will be spent for the purchase of the new product. "However, the introduction of new product provides a 'better' product-mix from which the consumer may choose, thus increasing his satisfaction."

In the market where the new product or products are sold, sellers of close substitutes or the same product will face severe competition.

"A move to competition would arise if the resources transferred were placed in an already established industry and were of the cost-reducing type." In measuring the competitive impact of the entrance of new companies, or new techniques and assets made

available to establish firms in the United Kingdom, Professor Dunning describes that:

. . . the evidence, such as it is, would strongly suggest that the United States firms are more efficient than their competitors-- and particularly so in the foodstuffs, tools and cutlery, and pharmaceutical industries. In only six cases out of fifty-five were there indications directly contrary to this hypothesis.²¹⁰

Due to the enhanced competition and the innovating responses of the British companies, Dunning concludes that there are certain advantages:

. . . the trans-Atlantic associations enjoyed by such firms have brought very considerable advantages in the form of technical and managerial knowledge. As far as can be judged, these benefits show themselves in terms of rising shares of the total market, favorable comparative productivity figures and higher income-asset ratios. We know, too, that such industries are among the most dynamic and productive of all within the United Kingdom economy; that their rate of productivity and capital growth are well above average; that they are amongst the most successful export industries; and that their attention is particularly directed to those variables making for rapid technological progress.²¹¹

An added benefit would likely be from the elimination of high-cost "marginal" producers with consequent benefits to the consumer.

The effect on prices of a cost-reducing or a product-introducing foreign investment cannot be determined in advance without advanced knowledge of the market structure where the product is sold. However, Dunning concluded after five years of study of the prices in Britain in the mid-1950's that there was not sufficient evidence to show that

²¹⁰Ibid., pp. 179-187.

²¹¹Ibid., p. 194.

United States financed companies were either "more price conscious or more scientific in their price fixing methods than United Kingdom competitors."²¹²

In summary Professor Behrman states:

. . . it may be stated that the transfer of real resources is likely to cause an increase in production and employment; it tends to cause an improvement in the quality of the commodities produced in the industry and by its suppliers; it is likely to disrupt existing market conditions, but in different ways, depending on the extension of exclusive rights and on previous market conditions; and it will probably reduce market prices. The distinct benefits to the consumer include the following:

1. He obtains a better adapted product, and market demands are given closer attention by the United States firm.
2. He obtains better servicing of the product.
3. He obtains new and different products, which, although available as imports, might not be known to him for lack of informative advertizing.
4. He obtains the products at a lower price--as a result of removal of transport costs which would otherwise raise the price from between 10 to 30 percent, a removal of tariff duties averaging between 10 and 20 percent, and in some cases a reduction in production costs under those in the United States.

Shifts in resources due to foreign investments have different impacts on factor prices and upon domestic industry depending on the utilizations of the factors of production, especially labour, and other structural conditions. There is an increase in the demand for factors of production when capital and technology move into a given industry in the host country; there is an additional demand for labour, materials, and land, as well as for domestic capital funds.

²¹²Ibid., p. 188.

If there is less than full employment of all the factors of production, especially labour, there will be no major shifts in the factors of production since unemployed resources and labour will move into the new industry. However, if there is full employment of all the factors of production there will be hardship for the competitors of the new industry of close or similar products, because the new firm will be in a better position to bid away the employed resources, since the new industry will be equipped with more and better capital and technological know-how. Competition will eventually become so intensive that "marginal" firms will be forced to vacate the business world, at least in this line of production. This is the inevitable result of economic progress since the desired result is the production of cheaper, better, and in larger quantities goods and services for the enjoyment of the consumer-king, brought about through a more efficient use of the factors of production.

However, host countries do not see it quite that way. They complain:

. . . domestic enterprise and initiative is being swamped by United States enterprises. Thus, when a domestic company enters a new field of production and opens the market, a United States company may enter with more efficient techniques and thereby lower costs. In bidding for domestic resources and cutting costs (and prices), foreign enterprise may edge the domestic producer out of business and stifle that very (domestic) initiative which foreign private enterprise is supposed to foster.

There will be an increase in the demand for raw materials and domestically-produced equipment due to the formation of the foreign

enterprise. if the demand of the foreign enterprise on the domestic raw materials and equipment is greater than the demand of the local industry that the affiliate displaced. The increase in the demand will be at its maximum when there is no displacement of local firms by the foreign affiliates.

There is no empirical evidence on the net increases in domestic demand by the formation of new foreign subsidiaries in host countries. So it is impossible to tell the exact impact of foreign affiliates on the domestic demand in the host country.

Theoretically it would seem that there would be a net increase in the demand for domestic raw materials and equipment because it usually takes a larger firm to drive another firm out of business. Also, foreign affiliates usually go into countries where they hope to expand their operations whereas local firms are unable to do so. The expansion in business operation implies increased demand for local raw materials and equipment.

Be that as it may, there is some empirical evidence on the purchase of United States affiliates in the host countries. The 1957 census of United States investments in all foreign countries showed purchases of domestic materials and services in the foreign countries of \$22 billion, of which \$11 billion was by manufacturing companies.

In Canada alone the purchases of domestic materials and services by United States affiliates amounted to \$7 billion, of which

\$4.7 billion was by manufacturing firms. The census concludes:

The full amount of production costs and other payments abroad cannot be taken as a measure of the net gain to foreign countries, since the foreign factors of production employed would have been utilized to some extent in any case, yet a substantial part of this total represents a net gain in production abroad. In the relatively underdeveloped countries where resources would have been only scantily utilized, a very large part of the output resulting from United States investment can be regarded as a net gain to local economies.²¹³

There is a substantial impact on the employment level by the creation of foreign affiliates in host countries, as stated before. The census shows that in 1957 United States affiliates abroad employed over three million persons. About 670,000 were employed in Canada, of which 35,000 held supervisory, professional or technical personnel jobs. The net impact here again is difficult to determine since, in any case, many of these people would have been employed by local firms.

Thus Professor Behrman concludes:

The added demand for resources, resulting in higher factor payments, has not always been welcomed--as in periods of overfull employment in Europe, but it has been eagerly received in most of the less developed countries.

The increased demand for these resources causes shifts in them and gradually increases their costs, including capital. It is usually argued that the inflow of capital will reduce the return to capital due to diminishing marginal returns to capital in the host

²¹³U. S. Department of Commerce, Office of Business Economics, U.S. Business Investment in Foreign Countries (Washington: United States Government Printing Office, 1960; A supplement to the Survey of Current Business), pp. 5-6, Table 29.

country. Professor Behrman argues that this may not be the case:

The fact that foreign investors increase the demand for domestic capital casts doubt on this conclusion. This is more readily seen when a joint venture is involved, but it is also true for those wholly owned subsidiaries which borrow on the domestic market for short-term and other capital needs. Thus there is no immediate reduction of returns to capital; rather there may be an increase. A partial offset to the increased demand for capital arises from the higher volume of savings generated by the new enterprises, and by the higher level of national income.

Also wages are likely to rise in the long-run due to an increase in the productivity of labour in the newly formed industries, caused in turn by the greater use of machinery and new technology. Also, in the host countries union demands supported by the government will give added weight to the wage increases. There is some empirical evidence which supports such analysis. American affiliated companies pay higher than average wages in foreign countries. This is particularly true for new companies that are wholly owned in the United States.

According to Dunning, United States affiliates do exert pressure to raise wages in time of labour shortage. Such labour shortage existed in Britain after World War II. Dunning observes:

Skilled labor of the kind required has been a very scarce commodity since the war, and the tendencies for many American subsidiaries to pay well above the current wage rates to attract the necessary numbers has caused certain older, established firms in the surrounding areas to have some misgivings about the desirability of such investment, particularly when comparative wage spirals develop to the detriment of the firms who can least afford to pay. However, this problem is, or should be, essentially short-term in character and can only be attributed in part to the presence of United States-financed companies, as the influx of new firms demanding unfamiliar production techniques and

types of labour has been a general feature of the postwar development of such areas.²¹⁴

Contrary to local complaints about the severe competition for a limited supply of labour, Dunning concludes that in the long run the required adjustments by local firms may benefit both workers and consumers. For example, Dunning explains how the jute industry, which lost labour to some of the new United States firms in one area, was required to increase wages and provide better working conditions in order to stay in business. This was accomplished through the use of new machinery and the implementation of modern managerial methods, with the end result of benefits to the workers as well as the consumers.

Increased production arising from introduction of a new product, expansion of sales of the existing products, and the increase in the factor payments, are all reflected in a larger gross national product for the host country.

For the theoretical analysis of the increase in real income by foreign capital in the host country, we must depend on the analysis by Sir G. D. A. MacDougall.

The aim of Sir MacDougall's analysis is "to assess the difference made to the real income of Australia at a given moment of time by the presence of more or less foreign-owned private capital in the

²¹⁴Dunning, op. cit., p. 300.

country, on the assumption that the economic forces involved have had time to work themselves out. . . ."²¹⁵ He begins his analysis with ten "drastic assumptions" which are relaxed as the analysis proceeds.

The assumptions are:

- (1) the government maintains "full employment without over-employment" or, more generally, a constant degree of employment of Australian resources;
- (2) no taxation;
- (3) the size of labour force is independent of the stock of foreign capital;
- (4) the stock of Australian owned capital is independent of the stock of foreign capital;
- (5) no external economies;
- (6) constant returns to scale;
- (7) perfect competition;
- (8) more or less investment from abroad has no effect on the terms of trade;
- (9) it creates no difficulties for the balance of payments which can be adjusted smoothly, and without cost, as required;
- (10) the increase in foreign capital considered does not require changes in Australian policy that themselves may involve a loss to Australia.

²¹⁵MacDougall, op. cit., p. 13. Hereafter all the quotations will be from this source unless otherwise noted.

In Figure 3 line GK represents the physical capital stock in Australia in relation to the physical marginal product of capital, "given the amount of other factors of production, which we shall call 'labour.' " At the beginning the capital stock is AC, which consists of AB owned by the Australians and BC owned by foreigners. Due to his assumptions, "profit per unit of capital equals the marginal product of capital," thus the total profits are FEBA on the Australian capital and EDCB on foreign capital. Labour's share of the total output is the remaining portion of GDF, therefore the total output is equal to GDCA.

Now suppose foreign capital increases from BC to BL; this will cause a change in profits to both the Australian capital owners as well as the foreign owners and change the share of labour. Foreign profits now become IKLB, the new foreign capital now earns JKLC, and the old foreign capital loses EDJI "because the marginal product of capital, and hence the profit rate, have fallen." Total foreign profits on balance are "almost certain to rise, because 'the elasticity of demand for foreign capital' (as we shall call the percentage increase in the stock of foreign capital associated with a one percent fall in its marginal product) almost certainly exceeds unity." Labour gains FDKH and Australian capital owners lose FEIH, therefore on the balance Australia gains EDKI, and since DKJ is relatively small, Australia's gain is approximately EDJI, which is equal to the old foreign

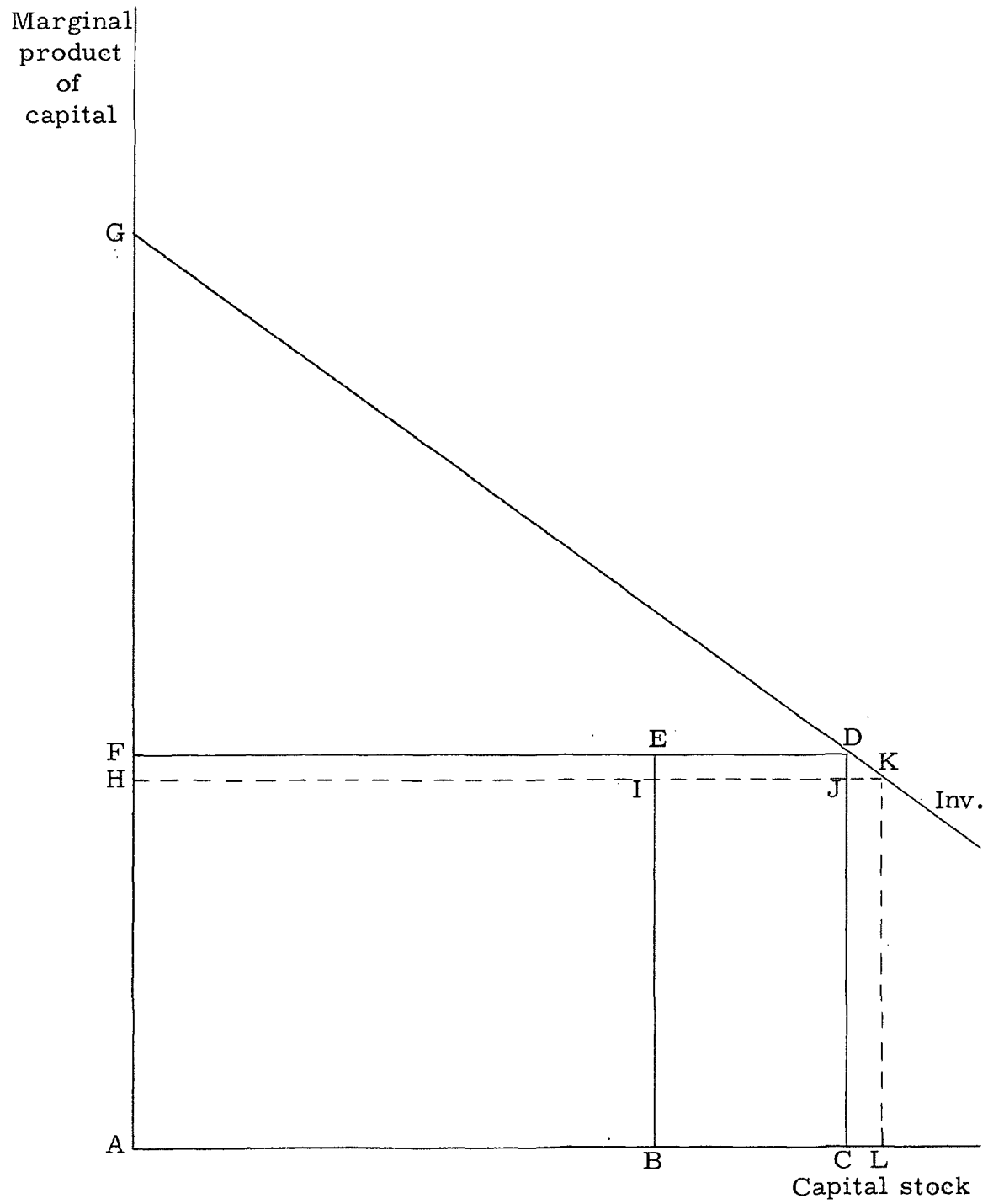


Figure 3

capital loss. Thus Australia gains what foreign investors lose--EDJI. "Australia does not, as is sometimes thought, gain the whole of FDJH, i. e., the whole of the increase in real wages resulting from labour's higher marginal productivity, but only a proportion corresponding to the ratio of foreign to total capital; the great bulk of labour's gain is merely a redistribution from Australian capitalists."

In Canada gains will be even greater since, as we have shown, the Canadian economy on the average is more capital intensive, i. e., the ratio of capital to output is greater than most other countries, especially those with a more southern location. Thus, the Canadian "elasticity of demand for foreign capital" will be less elastic than that of Australia. In Canada a bigger change in the capital stock causes a smaller change in the marginal product of capital than would be the case in Australia.

Assumption two is removed and allowance is provided for taxation. Let t represent the rate of tax on foreign profits. "This often approaches one-half where all profits are distributed, and we shall for simplicity use this fraction as an illustrative order of magnitude, though it should be borne in mind that it is on the high side." Australia now gains $t(JKLC)$ plus half of the previous gain, thus her total gain now is $t(JKLC) + (1-t)(EDJI)$. In Canada the tax gain from foreign enterprises brought to the Canadian Government about \$800 million in 1957, and at the present it is much more than that.

Next assumption three is removed and allowance is made to make the size of the Australian labour force dependent on the amount of foreign capital. "It is not unreasonable to suppose that immigration policy (and the supply of would-be immigrants) will be related in some way to the level of Australian incomes and these will be affected by the amount of foreign capital."

The above gains from more foreign capital will raise income per head if the labour force is not increased in Australia. Thus it will be possible for Australia to bring in new immigrants without having to sacrifice the present level of income to Australian labour. Importation of immigrants will not be in an exact proportion to the increase in the Australian gains from the foreign capital because, "if the criterion for immigration was that variations in foreign investment should not affect total income per head (and it may be worth repeating that this would not preclude a rising income per head over time), it would not then be possible to increase by as much as 1 percent. But some smaller increase would be possible since, if there were none, income per head would be raised by the extra foreign capital." (Sir MacDougall here supposes an increase by 1 percent in the total capital, which will result in an increase of 10 percent in foreign capital, 1 percent increase in the labour force and 1 percent increase in total output.)

Now remove assumption four, that the stock of Australian owned capital is independent of the amount of foreign capital.

The higher the foreign stock of capital at some future date, the higher must the inflow be between now and then, and the higher is the stock likely to be at most intervening dates. The higher, therefore, is Australian income likely to be in most intervening years, . . . if Australian owned capital is unaffected by the higher foreign investment.

The higher income suggests that Australian savings and investment probably will be higher, which will lead to higher stock ownership of the Australians in the future. However, this conclusion becomes less convincing when "account is taken of such factors as the redistribution of income between capital and labour resulting from increased foreign investment and from any consequent increase in immigration. . . ."

Now remove assumption five and allow for possible external economies from extra foreign capital investment in Australia, i. e., economies external to foreign enterprises investing the extra capital. If there is an excess of value added to output minus profits brought about by this capital after taxes, then this excess is a further gain to Australia.

However, this gain may be offset by the losses caused by the external economies elsewhere in the economy (mentioned earlier). The gain (which may be negative) according to MacDougall will be equal to:

. . . (a) the resulting change in the wage bill plus (b) the resulting change in profits of Australian capitalists plus (c) the tax on the resulting change in profits on the "old" foreign capital. If the benefit of the external economies spreads to both capital and

labour--and this seems a priori the most likely outcome--(a), (b), and (c) will all be positive, and there must be further gain to Australia.

Australia will still gain even if there are capital losses as long as labour in Australia gains, and labour will continue to gain since the external economies will "presumable" increase output, because labour's gain will be larger than the capital losses. And since Australia bears part of the capital's losses, then there is a net gain to Australia. Even if labour benefits nothing there will be a further gain to Australia, "provided there is no absolute reduction in the wage bill. But if there is an absolute reduction, Australia may lose."

Now remove assumption six and allow for economies of scale "in the sense that, if labour and capital were both increased by 1 percent, output would increase by more than 1 percent, whether the extra capital were foreign or Australian."

Economies of scale would bring further gain to Australia when foreign capital investment is increased. Economies of scale could be either internal or external to the firms. The former is only possible under monopolistic competition. There could be a loss but it is unlikely "since a mere increase in the scale seems less likely to cause drastic changes in the methods of production than the percentage of additional foreign capital, where the quantity of extra capital is the same in both cases."

Now remove assumption eight and allow for possible effects of investment from abroad on the terms of trade. Here MacDougall

further assumes that the balance of payments can be adjusted smoothly, that trade barriers are not raised and lowered to correct tendencies to international deficit and surplus respectively, and that the improvement in the balance of payments requires a worsening in the terms of trade and conversely. On these assumptions the terms of trade may be affected in three ways by the extra foreign investment:

First, the transfer of profits abroad will tend to require a worsening in the terms of trade to generate the necessary surplus in the other items of the balance of payments.

Secondly, the terms of trade may be affected by the increase in output and income in Australia resulting from the extra foreign investment and by any consequent changes abroad. . . .

Thirdly, the movement of capital across the exchanges will affect the terms of trade. An inflow will tend to improve them, by creating a tendency to surplus in the balance of payments . . . provided the capital does not reflect entirely additional imports of capital goods and remembering that the government is assumed to maintain a constant degree of employment. . . . Similarly, the terms of trade will tend to worsen if and when the foreign capital flows out again.

Now remove assumption nine and allow for the balance of payments problem that may arise if Australia runs into substantial deficit. The question is whether more foreign investment will contribute to these balance of payments problems.

Let us assume for the moment that there are no large and rapid fluctuations in the flow of new investment. If, then, with a given flow, the Australian balance of payments tends to improve over the years ahead with fixed exchange rates, an increase in foreign investment will not cause trouble by swelling the profits that have to be remitted across the exchanges, provided the increase is not too large. If on the other hand the balance tends to worsen with a given flow of investment, recurring crises will in

any case be likely. Extra foreign investment will not necessarily then aggravate them; it might alleviate them. The higher payments of profits might be offset, or more than offset, by the higher capital inflows and by favourable effects on the balance of payments resulting from the extra production; . . .

for this might result in what is called "import-saving" or "export-creating." The problem, on the other hand, might be aggravated by extra foreign investment when it has the effect of "import-creating" or "export-discouraging." This would lead to more serious and frequent crises, "and the resulting losses would have to be debited against the extra foreign investment described earlier."

Finally, remove assumption ten, "that the increase of foreign capital considered does not require changes in Australian policy that themselves might involve a loss," such as the encouragement by the Australian Government of foreign investments through a reduction in tax rates on foreign profits. Such loss of course would have to be subtracted from the gains so far described. This assumption, however, does not apply to Canada, since it is very doubtful that the Canadian Government would engage in any policy that would encourage foreign (especially United States) investment, much less pay for it!

MacDougall concludes his analysis with these paragraphs:

The main conclusions of this analysis are fairly straightforward and obvious. The most important direct gains to Australia from more rather than less private investment from abroad seem likely to come through higher tax revenue from foreign profits (at least if the higher investment is not induced by lower tax rates), through economies of scale and through external economies generally, especially where Australian owned firms acquire

"know-how" or are forced by foreign competition to adopt more efficient methods.

These gains may permit higher immigration, which will further increase Australian income, if the immigration policies are related in some way to the standard of living. They may also lead to higher domestically financed investment, which will later increase Australian income still further, but this is problematical and depends considerably on government policy; if domestically-financed investment were allowed to fall when more foreign capital came in, Australian income could actually be lower at some future date than otherwise would have been.

The effects of extra foreign investment on the terms of trade, which might be favourable or unfavourable, are unlikely to be large. The effects on balance of payments could be more important. They could be favourable, but the danger of future balance of payments crises might be increased; for there are inevitably fluctuations in the net inflow of private capital, and part at least of the foreigners' profits have to be transferred across the exchanges.²¹⁶

²¹⁶ This very short and dangerously abridged summary of MacDougall's excellent theoretical analysis is, of course, inadequate for the understanding of his article; however, here our purpose has been to present his main ideas as to the costs and benefits of borrowing abroad to the host country, in support of our research, and point out some changes that pertain to the Canadian case. For the understanding of his analysis the reader is referred to his article.

CHAPTER V

CONCLUSION

Our purposes in this study as stated in the "Introduction and Purpose" were the following: (1) to present and analyze the extent of United States investment in Canada since 1950, the reasons for it, and the Canadian reaction; (2) to examine the effects of the policies and practices of foreign enterprises in Canada on the Canadian economy and dependence; (3) to describe the costs and benefits of foreign investment, especially with reference to the capital-receiving country (Canada), in particular the relationship between capital formation and economic growth; and (4) to present the theoretical analysis of the costs and benefits of foreign investment to the host country.

These purposes, especially two and three, can be achieved only with some reservations. Number two is so interwoven with political issues it becomes impossible to separate the economic from the political factors. There is also insufficiency of quantitative data on this matter. Number three lacks an accepted theoretical framework having a reasonable amount of acceptance among economists.

The analysis of any economic problem is limited not only by lack of sufficient data but more so by theoretical concepts within which

such analysis can be interpreted. In most economic problems, theory has tended to lag behind the actual course of events; this is even more true in the field of international economics, especially where capital flows and their effects on the host countries are concerned. Professor Nurkse's observation is confirmed in this study. "Economic theory tends inevitably to lag behind the actual course of events. But in the field of international capital movements this lag has been unusually great."²¹⁷ Many of the theoretical concepts necessary for analyzing international capital flows are either unresolved or in conflict. First, the question of who benefits and who loses as between lender and investor is still an unresolved question in economic literature; some claim it only benefits the lender, others argue just the opposite. The question is also clouded by confusion of economic and political issues. However, as we have stated before, there are benefits accruing to both the lender and the borrower from international capital movements. Second, economic literature is not in agreement on the question as to whether foreign investment generates spending in the capital-exporting or capital-importing country. The answer depends not only on the country and its circumstances but also on the theory of capital movements. There is even less theoretical analysis as to the effects on the economy of the capital-receiving country from the policies and practices of foreign subsidiaries.

²¹⁷Nurkse, op. cit., p. 120.

In spite of these limitations of theoretical disagreements, this study does suggest some conclusions as to the costs and benefits to Canada from importing direct investment (with some accuracy) due to the availability of The Oregon Study and MacDougall's analysis. As we have pointed out in our chapter on the costs and benefits to Canada, there are two opposing views on this question. We believe that neither extreme position is correct, therefore this study concludes that the preponderance of evidence suggests that Canada has benefited considerably and that the offsetting costs have been largely overemphasized. Many of the Canadian objections are, at least, unprovable as far as the policies and practices of foreign subsidiaries are concerned, due to the nonavailability of economic data and a theory to support them. Such objections are clothed in and reflect noneconomic circumstances which reveal a shortsighted view of foreign investment.

The most important benefit to Canada of her foreign borrowing has been speedier capital formation which enhanced the country's productive capacity for speedier economic development. It performs the function of helping to bring international transactions into balance, enabling Canada to import more goods and services than she exports, thus enabling the Canadian people to have a higher standard of living. It provides quite a substantial portion of the Federal Government's revenues and some others mentioned before.

The principal costs include the debt servicing problem, which so far has been decreasing in relation to Canada's gross national

product. A further increase is in the loss of ownership and control to foreign investors, which, as we have pointed out, has not been proven to be a detriment to Canadian national aspirations.

By borrowing abroad Canada has been able to increase its investment ability. Canada has achieved the most marked economic growth during periods of the largest capital inflows. The industries which developed fastest and upon which Canadian economic growth largely depends were heavily financed by foreign investment. The fact that Canada has accepted foreign investment shows to some extent that such investments have been beneficial to her. Countries such as Brazil, who have rejected foreign direct investments before, are having a change of mind. U.S. News and World Report states: "Brazil hoped to get about 150 million dollars' worth of new private U. S. investments this year; may get 20 million."²¹⁸ Why? If this investment had occurred, it is doubtful that Canada would have the capital base, the employment, the technology and the living standard it now possesses.

The past experience of countries such as the United States, which managed to absorb their foreign indebtedness, gives some hope to Canadian experience that such a fate might be accorded to her as well. Mr. Henry Kearns points out correctly, "as Canada grows, it is reasonable to expect the increasing pool of native capital resources

²¹⁸U. S. News and World Report (August 30, 1965), p. 54.

will result in an increased ratio of Canadian equity participation.²¹⁹ As other underdeveloped countries reach the Canadian level of development they would offer a similar climate for investment to United States investors, thus United States investment will decline in Canada in the future. This is already happening in the manufacturing and petroleum industries. The major phases of the development of Canada's petroleum industry, which has attracted a substantial share of the United States investment, has been completed. For these reasons and others, the flow of the United States capital investment to Canada has declined in recent years. Professor Viner summarizes it well:

As American companies operating in Canada complete their pioneering, they will expand less rapidly and in less capital-using ways. They may even find elsewhere greener fields, or fields more saturated with oil, to which to apply their special talents. In consequence of these and other factors, it is a reasonable prospect for Canada that it will increasingly rely on its own generation of capital resources and will increasingly reduce its dependence on American capital, enterprise and skill in its pursuit for its people of a rich and larger national economy.²²⁰

In order for Canadians to achieve their aspiration to be the only masters of their economic destiny it is necessary that their business world become much more competitive in order to sell its products abroad and stop hiding behind a tariff wall which keeps them inefficient, attracting enterprises which eventually take control of Canadian

²¹⁹Henry Kearns, "How Canada Benefits from United States Capital Inflow," Commercial and Financial Chronicle (November 26, 1959), p. 13.

²²⁰Viner, op. cit., p. 60.

corporations. Canadians should strive to invest more of their savings and invest them in Canada and Canadian enterprises! The Canadian Government should implement more effective monetary and fiscal policies which will contribute to better performance of the Canadian economy. Canada should accept foreign investment as long as it is productive and useful to Canadian economic development, and does not endanger but, on the contrary, serves to promote the objectives of the Canadian people which are a greater, a richer, and an eternally Canadian Canada.

But above all, what Canadians need is a far more rational approach to the problem of Canada's dependence on foreign capital. Such a rational approach is indicated by W. Earle McLaughlin, President of the Royal Bank of Canada, in an address entitled "Maintaining Canada's Economic Independence":

There is a real problem associated with the large capital inflow of recent years, but it is not that of finding the means of repayment. The real problem is simply that Canadians are becoming increasingly concerned about the growing foreign control over their industry. This is basically a political problem; a problem of maintaining national sovereignty, of being master in our own house.

Because foreign capital is necessarily tied up, sometimes in a rather complicated way, with the trade balance and the exchange rate, capital inflow has become a victim of "guilt by association" and has had to bear the brunt of much obscure criticism, most of which completely misses the point.

Once we have cast out the fear of some imminent Day of Judgment when all our massive (and overstated) debt will become due and payable, the nature of the problem is not only changed but made vastly simpler. The solution is clearly not to "do something" about the trade balance or to frighten capital away, or

to hobble it in some manner. In part, of course, the solution is to encourage Canadian saving, and especially Canadian investment in the kind of risk enterprise that is dependent on foreign capital.

But, at least as important, if we are concerned about the behaviour of foreign owned subsidiaries (now or in the future), let us secure through moral persuasion or appropriate legislation the kind of behaviour we want. The foreign parents as well as their Canadian children would probably welcome a clarification of their position and a removal of the uncertainty which now arises from much Canadian grumbling but no clear-cut definition of where they stand and where we stand. . . .

Foreign owned subsidiaries are corporate Canadian citizens, subject to Canadian law. The government has the power to protect Canadian sovereignty by direct action. As in monetary policy, so in its policy towards international capital, the government, in ensuring a high degree of Canadian economic independence, need not result to any tinkering with exchange rates, trade balances or capital flows which, even if it achieved its immediate objective in the short-run (an extremely doubtful possibility), would do so only at the risk of incidental disaster to Canada's long-run economic development.²²¹

Canada can not otherwise escape the paradoxical situation that she is in at this time, the desire on the one hand to be less dependent on other countries and the equally strong desire on the other hand to achieve a full economic development. The two desires are driven by different forces that in some cases are opposite to one another. The first is driven by the worldwide drive for self-government--independence. The second is driven by the groupings of the people for more economic efficiency, such as the Common Market and the proposed Latin American Common Market. Canada alone cannot escape the economic forces that are bringing nations closer together and thus

²²¹See Annual Report, The Royal Bank of Canada, Montreal (January 12, 1961), pp. 10-16.

more interdependent. Canada, therefore, must decide whether to withdraw from the rest of the world in isolation or accept some sacrifices of its nationalistic aspirations.

If Canada is to embark on a new course in its economic relations with the rest of the world, that decision will be largely influenced by Canada's reaction to the effects of United States capital investments which she has received. Therefore, this study deems it necessary to suggest certain proposals that would be helpful to both countries for the continuation of their unique relationship.

The people of the United States must remember that Canada is an independent and sovereign nation first and only as such can she be a good neighbour. United States relations with Canada must conform with the first point. The United States should never take Canada and her people for granted (their proud national tradition and independence and Canada's intentions to remain such in the future). One of the most resented complaints of Canadians is that Americans take them for granted and treat them as residents of another state in the Union. This is probably due to the mass ignorance and indifference of the American people towards Canadian feeling and reactions. According to Professor Viner, there is "99.4 percent of the American people" who "have either no awareness of a Canadian-American problem or of an American-Canadian problem."²²² This in itself constitutes a

²²²Viner, The United States and Canada, op. cit., p. 145.

major reason for the existence of the Canadian-American problem or vice versa.

Americans must be aware of the recent upsurge of the Canadian search for national identity and take it into account in their dealings with Canada, since Canadian reactions have been largely non-economical and nationalistic in nature. What Canadians think determines what they do. To ignore these feelings because they are not economical is not to remove them.

Americans should be sympathetic with the Canadian concern over her indebtedness position and try to help Canada, because they themselves were once concerned with the same problem, as Cleona Lewis clearly explains:

For more than a century and a half America has been supplied with foreign funds--funds that were eagerly sought and brought in by many American borrowers in the prewar period, though in the postwar period they have come in without urging and have been accorded slight welcome. The body of foreign claims thus accumulated against the American economy was looked upon with suspicion and disfavor, even in early decades. The fear was ever present, and frequently expressed, that foreigners were acquiring too large a share in the control of American business, and an undue portion of the nation's income. Individual borrowers, finding their debt service a heavy burden, also complained against the onerous terms exacted by foreign lenders. At the same time, the lenders pointed out the losses they had suffered through lending to those "perfidious" United States.²²³

Canadians, on the other hand, when evaluating the effects of foreign investment, should keep a clear distinction between economic

²²³Cleona Lewis, America's Stake in International Investments (Washington, D. C.: The Brookings Institution), p. 151.

and noneconomic factors. Economic issues that pertain to the analysis of foreign investment are clouded with political and nationalistic feelings. The issue of benefits of foreign investment is an economic issue and the issue of the cost of Canadian dependence is a political issue; they should not be considered as one.

Canadians must be aware that the success of foreign enterprises depends on and is tied to the success of the Canadian economy! Therefore, it is not to their interest to implement policies and practices that will be detrimental to the Canadian economy as have been charged. The reasons for their detrimental actions must be sought somewhere else, for example, the monopolistic position they might acquire in Canada,²²⁴ but not in their policies and practices as such.

Canadians also should be charged with ignorance of what is good in the American culture and what benefits their economic associations bring to them, instead of being quick to criticize what is bad. The bad anybody knows, but very few people can distinguish the good from the bad. They are always concerned with the bad influences coming from the United States and never with the good ones. What we need in Canada is closer contact with the United States' finest expressions and seek out the evil influences and disregard them completely.

²²⁴See for example C. D. Blyth and E. B. Carty, op. cit., p. 474-76; Watkins and Forster, op. cit., p. 192; Michael Oliver, op. cit., p. 217; and Gabriel Kolco, Wealth and Power in America: An Analysis of Social Class and Income Distribution (New York: Frederick A. Praeger, Inc., 1962), p. 55.

Canadians are, I believe, mature enough to disregard the old belief that the way to become mature is to cut yourself off from the older people who are more mature than you are.

We live in an age where there is an irresistible trend towards greater economic as well as political and cultural interdependence among nations, thus at the same time the national differences are subdued. This trend may be the approach to the desired goal of World Utopia through a Parliament of all men.

The chief purpose animating this study is to maintain and strengthen the economic cooperation between the two neighbours as far as United States investment in Canada is concerned. Despite its many limitations it is hoped that this study may be of some relevance to both Canada and United States, and that it may provoke other students of economics to correct and improve it and explore other related aspects of the problem.

APPENDIX

The way to figure out the net gain or loss due to foreign investment in the host country is provided by Dr. Donald A. Wells on the assumption "that private and social value product are identical and that the foreign investment in question is designed to produce goods which are in accord with national economic objectives."²²⁵ The cost to the host country "is equal to the sum of the discounted values of: (1) future annual income transfers arising from original investment (P); (2) future annual income transfers arising from re-invested earnings (PR); and (3) future annual capital repatriation (CR)." The present benefit to the host country "is equal to the discounted value of annual net domestic product (Od) arising from the investment. The net domestic product is determined by subtracting from the total product (O) the import component (M) and the opportunity costs of local resources (C), including labor, capital, and natural resources, which entered into the production of total output. The present value of the discounted benefits from foreign investment also should include the indirect impact (x) of foreign investment on the

²²⁵Donald A. Wells, "Analysis of Attitudes of Host Countries Toward Direct Private Investment," The Oregon Study, *op. cit.*, p. 493.

domestic economy; this impact includes such diverse effects as external economies, the encouragement of local investment, and the training of supervisory personnel and the labour force. Thus:

$$\text{Costs} = P + PR + CR \sum_{t=1}^{t=n} \left(\frac{P_t}{(1+i)^t} \right) \quad \text{and} \quad (E = \sum)$$

$$\text{Benefits} = O + x - M - C \sum_{t=1}^{t=n} \left(\frac{Od_t + x_t}{(1+i)^t} \right)$$

where i equals the rate of discount and t the number of years. If benefits exceed costs there has been a net gain to the host country due to the foreign investment, because there has been a net addition to the host country's total resources and output.²²⁶

²²⁶ Ibid., p. 493.

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