The Conference Board of Canada
Insights You Can Count On

Briefing January 2011

# Direct Investment Abroad
## A Strategic Tool for Canada

**At a Glance**

- The best Canadian companies use direct investment abroad to access new markets, technologies, talents, and resources.
- Canadian companies that establish operations abroad are often assumed to be detracting from Canada's economy. In reality, direct investment abroad boosts Canadian productivity, trade, investments, jobs, and skills.
- Investments motivated by growth opportunities abroad or that take advantage of each location's relative strengths are more likely to benefit Canada than are investments motivated by the desire to escape conditions in Canada.

### DO OPERATIONS ABROAD DIMINISH ACTIVITIES AT HOME?

Companies that have set up operations abroad are commonly assumed to be doing what is best for them but not necessarily what is best for their country. Setting up operations abroad is known as direct investment abroad. (See box "What Is Canadian Direct Investment Abroad?")

In the U.S. in particular, high unemployment and the 2010 congressional elections fuelled rhetoric and policies aimed at penalizing those companies that invest abroad. For example, in his Labour Day speech, President Barack Obama said, "You know how we paid for [a bill to help states save jobs]? By closing one of these ridiculous tax loopholes that actually rewarded corporations for shipping

### What Is Canadian Direct Investment Abroad?

In simple terms, Canadian direct investment abroad (CDIA) occurs when a Canadian business owns all or part of a business in another country. The ownership has to be large enough to exert influence over the foreign company's management. The internationally agreed-upon threshold is ownership of more than 10 per cent. Some argue that 50 per cent plus one vote is a better marker, with a threshold below that level only if there is effective control (i.e., that the rest of ownership is widely distributed).

CDIA is distinct from Canadian portfolio investment, in which investors invest small amounts in companies abroad and can easily move their investments at any time.

We commonly think of investing abroad as setting up new operations. However, investments need not be new—or "greenfield"—investments. It is, in fact, more common to acquire or merge with existing companies.

Not all activities by Canadian companies abroad constitute direct investment. For example, Research In Motion outsources some production of its BlackBerry devices to partner companies in Hungary and Mexico. Other examples include alliances and joint ventures between Canadian companies and companies in other countries.

Direct investment abroad is sometimes referred to as "outward foreign direct investment." In this briefing, however, we use the term "Canadian direct investment abroad"—or CDIA—wherever possible. While "outward foreign direct investment" can be an accurate and often helpful description, the word "foreign" evokes negative connotations. Moreover, in today's globalized world, it no longer makes sense to focus on the "foreignness" of an investment. Direct investment abroad is a more neutral term, which allows us to evaluate its effects on their own merits instead of with a negative predisposition.

Source: The Conference Board of Canada.

jobs and profits overseas."[1] The underlying message seems to be that companies that invest abroad eliminate jobs at home and transfer jobs and profits abroad.

While the public discussion in Canada is not nearly as intense, the view that Canadian direct investment abroad (CDIA) detracts from activities in Canada is common in the media and among the public. Most politicians avoid openly promoting Canadian investment abroad, lest they be associated with "shipping jobs overseas." Traditionally, federal, provincial, and municipal policies have almost exclusively focused on encouraging growth in traditional exports, and on attracting global investment to Canada and its regions. These policies have typically ignored the "investment abroad" side of the equation—or, in some cases, have actively discouraged it. Academic and public policy research has similarly focused largely on the effects of cross-border trade and of attracting investment to Canada, rather than on the role of CDIA.

**While the public discussion in Canada is not nearly as intense, the view that CDIA detracts from activities in Canada is common in the media and among the public.**

By contrast, many Canadian business leaders—notably, those in financial services and mining—have long recognized that investing abroad can be an important strategic tool for growing their businesses and staying internationally competitive. In fact, growth in CDIA has outpaced growth in Canada's traditional exports over the past decade. For certain products and services, CDIA may be a better strategy than exporting. For example, while it may be difficult to sell certain services directly to a given market, a company can invest in that market by setting up a local affiliate and then sell to that market via the affiliate. By directly investing abroad, a company can gain access to new markets, resources, and technologies, thereby improving its performance. And direct investment can help companies to stay ahead of—or at least keep pace with—the competition.

There is also a growing recognition within some policy circles that while attracting investment to Canada and its regions has important benefits, investing abroad also carries benefits—not just for companies, but for Canada's cities, provinces, and the country as a whole. One concrete policy outcome of this recognition is that federal trade commissioners now have an explicit mandate to facilitate investment by Canadians abroad. Indeed, Canada's direct investment abroad experience can be considered a relative success story.

1 Obama, "Remarks by the President."

The aim of this briefing is to educate Canadians in general and decision-makers in particular about the effects CDIA has back in Canada itself. While policy and research has tended to focus on the effects of inward investment, this briefing puts investing abroad front and centre. The analysis cuts through common perceptions to examine what the existing empirical evidence actually tells us about the effects of investing abroad—not only for companies, but also for broader Canadian economic interests, including productivity, jobs, skills, trade, and investments in Canada. Since existing empirical evidence on this issue is very limited—both for Canada and globally—the briefing also considers what is likely to happen conceptually as a result of direct investment abroad.

**The aim of this briefing is to educate Canadians in general and decision-makers in particular about the effects Canadian direct investment abroad has in Canada.**

Moreover, while most of the limited work on the effects of direct investment abroad lumps all such investments together, it is not clear that all investments abroad have the same effects in Canada. The briefing therefore takes a more nuanced approach, asking the following questions:

- Does the motivation for investing abroad matter?
- Does the type of activity conducted abroad matter?
- Do the short-term effects differ from the longer-term effects?
- Does whether it is a new investment or an acquisition of an existing asset or organization make a difference?
- Do the effects on the company align with, or differ from, the effects on Canada and its regions?
- Does the performance of the company before it goes abroad matter to its success?
- Are increased risks of investing abroad sufficiently compensated for by increased rewards?

The answers are not always clear or straightforward, and more research is needed to answer many of these questions in depth. What does become clear is that the effects on Canada of Canadian companies investing abroad are multi-faceted and go far beyond simply shipping jobs and profits overseas. Policy-makers and business leaders need, at a minimum, to start asking these types of questions.

## CANADA'S PERFORMANCE: A RELATIVE SUCCESS STORY

In recent decades, global direct investment abroad has been growing rapidly—much more rapidly than trade flows or economic growth. From 2000 to 2009, global stocks of direct investment abroad grew at an average annual compounded rate of 10 per cent.[2] This growth partly reflects the acceleration of global and regional value chains. Multinationals today break down their business operations into tasks and locate each task where it can be done most efficiently. And the role played by emerging markets—as recipients of direct investment and as the home address for companies investing abroad—is also growing rapidly. The competition for direct investment abroad opportunities has intensified.

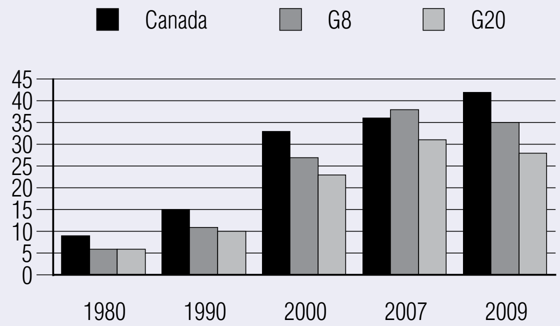
Where does Canada fit into this trend? At first glance, Canadian companies appear to be relatively active. Canada's stock of direct investment abroad has been growing in line with global trends—at an average of 10 per cent compounded annually over 2000–09.[3] CDIA stocks account for a rising and significant share of Canada's GDP—at between 35 and 40 per cent in the late 2000s. (See Chart 1.) This is generally higher than the G8 or G20 average. And Canada's stock of direct investment abroad ($640 billion in 2008) has been larger than the stock of foreign direct investment into Canada ($540 billion in 2008) over the past decade.[4] Canadian direct investment abroad is also growing more rapidly than direct investment into Canada.

2 Conference Board calculations, based on data from UNCTAD's interactive FDI statistics database.

3 Ibid.

4 Statistics Canada, "Canada's International Investment Position."

**Chart 1**
Direct Investment Abroad as Share of GDP
(per cent)




Source: UNCTAD, *World Investment Report 2010*.

Over the past decade, Canadian companies accounted for 3 per cent of global stocks of direct investment abroad.[5] This compares with Canada's 2 per cent share of global gross domestic product, suggesting that this country "over-performs" in its direct investment abroad. While Canada's share of global foreign direct investment has declined from its 1980 level of 5 per cent, this reflects the growing role played by emerging markets rather than any deterioration of Canada's position. The emerging markets' share of direct investment in other countries more than doubled from 1990 (7 per cent) to 2008 (15 per cent). So if CDIA benefits Canada (as this briefing concludes), then it is good news that Canada has managed to hold on to a relatively stable share of the rapidly growing pie of global direct investment abroad.

CDIA has been predominantly directed at traditional markets, such as the U.S. and Europe. Almost half of Canadian direct investment abroad in 2008 was in the United States. This represents a decline from roughly two-thirds two decades earlier.[6] The decline was due to the Canada–U.S. Free Trade Agreement, which made it no longer necessary for Canadian firms to set up affiliates in the U.S. to avoid export tariffs.[7] Europe—mainly the United Kingdom—accounted for one-quarter of Canadian direct investment abroad in 2008.

**While Canada's share of global foreign direct investment has declined from its 1980 level of 5 per cent, this reflects the growing role played by emerging markets rather than a deterioration in Canada's position.**

Investments in offshore financial centres or low-tax jurisdictions, such as Barbados, are next in line in reported CDIA, representing roughly one-fifth. Unfortunately, investments are recorded at their first destination rather than at their ultimate destination, so it is difficult to get a clear picture of where those investments ultimately end up. However, low-tax jurisdictions are generally used as conduits rather than destinations. Investments therefore tend to transit through these jurisdictions en route to other markets. Canadian companies appear to use these financial centres as conduits to access the global economy more efficiently than they otherwise could.[8] So while offshore financial centres are the recorded destination for a significant share of CDIA, this CDIA is really destined for investment in other markets, such as the U.S., Europe, Latin America, or Asia.

While CDIA has traditionally gone to the U.S and Europe, Canadian companies have in recent years been rapidly diversifying their direct investments away from traditional markets and toward markets in Asia and Latin America. (See Chart 2.) Asia now represents over 6 per cent of Canada's direct investment abroad, compared with 4 per cent in the early 2000s and 1 per cent in 1990. Still, Canada's investment presence in the developing world is relatively small compared with its presence elsewhere.

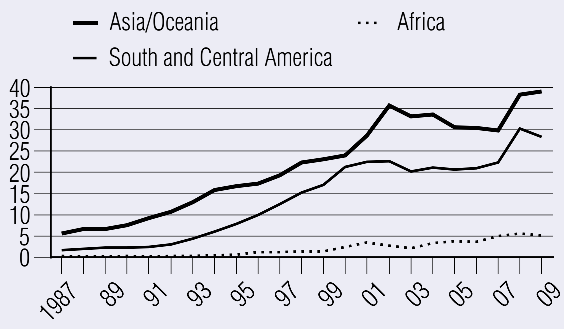
5 Conference Board calculations, based on data from UNCTAD's interactive FDI statistics database.

6 Conference Board calculations, based on Statistics Canada data.

7 Hejazi, *Dispelling Canadian Myths*, 16.

8 Ibid., 17.

**Chart 2**
Stock of Canadian Direct Investment Abroad, Non-Traditional Markets
($ billions)




Sources: The Conference Board of Canada; Statistics Canada.

In sum, Canadian businesses have actively used direct investment as a strategic tool in global markets and continue to rapidly increase their global presence. But competition and opportunities are intensifying. Canada may not be taking full advantage of the opportunities posed by large, rapidly growing emerging markets.

## WHAT MOTIVATES CANADIAN DIRECT INVESTMENT ABROAD?

Companies engage in direct investment abroad for a variety of reasons. And the different motivations can have different effects on both the company and the Canadian or regional economies.

Companies use direct investment abroad as a tool to achieve the following objectives:

- **Access new markets.** A Canadian company might establish a commercial presence abroad in order to sell directly in that market. (See box "Canada's Financial Services Companies: Accessing New Markets.") Some products and services might be more effectively sold via a local affiliate than as a cross-border export. This can be a particularly helpful strategy for Canadian companies entering distant or emerging markets, or for companies selling services that require a local presence. It may also become an increasingly preferred strategy as transport costs rise, making it more attractive to invest and make products abroad for sale directly to customers. This strategy also offers a way to access markets that are protected by import barriers—such as high tariffs or regulations.
- **Access natural resources.** Unlike people, technologies, or parts, natural resources cannot move. If Canadian companies want access to resources abroad, they need to invest directly. Canadian mining and oil and gas companies have applied expertise developed in Canada to resources acquired in other countries. Examples are mining investments in Chile by Canada's Barrick Gold and Teck Resources Ltd.
- **Access technologies.** Investing abroad is one way to gain access to superior technologies. (See box "Research In Motion Invests Abroad to Access Technologies and Talents.") One U.S. example is Apple Inc., which purchased German music production software company Emagic in order to use that company's software to develop Apple's Garage Band (a popular music production program).
- **Access skilled labour.** Companies may invest abroad to be able to gain access to workers with needed skill sets. In certain sectors, skilled workers are in short supply and are pursued fiercely. Setting up in global markets may allow better access to that talent. For example, America's Motorola accesses expertise globally via R&D centres in China, India, Australia, Canada, Singapore, the U.K., Argentina, and other countries. The company partners with major research institutes, such as the India Institutes of Technology, to be able to attract talent.[9]
- **Access cheaper labour.** Canadian companies may set up manufacturing plants or offices in emerging markets to take advantage of wages that are significantly lower than in Canada. (Companies have a choice here as to whether to invest directly or outsource. One reason they might prefer to invest directly is to maintain greater control over quality.)
- **Gain more control over supply.** If all suppliers are clustered in one location, or if it is difficult to consistently get high-quality inputs, companies may invest directly. Companies may wish to invest in multiple

9 Mazutis, White, and Beamish, *Research In Motion*, 11.

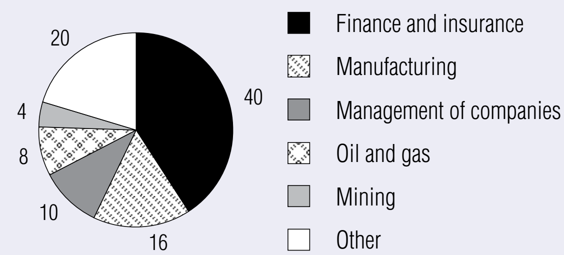
### Canada's Financial Services Companies: Accessing New Markets

Canada's financial services companies use direct investment abroad as a strategic tool to access new markets. In fact, Canada's financial services companies represented 40 per cent of Canadian direct investment abroad in 2009 (see chart)—a large increase from just over 30 per cent a decade earlier. The dominance of financial services in Canada's direct investment abroad is very different from the composition of Canada's measured cross-border exports, which are mostly products rather than services.

Five Canadian financial services companies were in the top 50 of the most globally oriented financial services companies in 2009, according to the United Nations Conference on Trade and Development—or UNCTAD. (See table.) Scotiabank is the most internationalized, with more than 100 affiliated offices in over 25 countries. Scotiabank is particularly active in Latin America, and has just expanded into Brazil. RBC is next, selling retail banking and wealth management services via affiliates in the U.S., Latin America, Europe, and Asia. Manulife Financial has been selling insurance in Asia for over 100 years, and continues to be particularly active there and in the United States. Even before the financial crisis struck, the relative positions of Canadian banks and insurance companies were strong, with Scotiabank, RBC, and Manulife all ranked in the top 50 among globally oriented financial services companies (as the table's 2006 rankings indicate).

The financial crisis strengthened the reputation of Canadian banks, and weakened the positions of banks elsewhere. As a result, Canadian banks CIBC and TD both moved into the list of the top 50 globally oriented financial institutions. The relative strength of Canadian banks, combined with the rise of the Canadian dollar, means that global acquisitions now look even more attractive to Canadian banks. In October 2010, for example, Royal Bank acquired the London-based wealth management company BlueBay. Scotiabank is also looking to acquire wealth management businesses abroad.[1] The global orientation of Canada's financial services companies seems likely to intensify further in the next few years.

Stocks of CDIA, by Major Activity
(per cent)




Sources: The Conference Board of Canada; Statistics Canada.

Global Orientation of Canadian Financial Services Companies, 2009 and 2006
(ranking; number)

| | Global Orientation Rank,* 2009 (2006) | Number of Foreign Affiliates, 2009 (2006) | Number of Countries, 2009 (2006) |
|---|---|---|---|
| Scotiabank | 17 (25) | 106 (60) | 25 (20) |
| RBC | 26 (26) | 100 (161) | 18 (16) |
| Manulife | 33 (40) | 43 (61) | 14 (9) |
| CIBC | 47 (Not top 50) | 18 (N/A) | 8 (N/A) |
| TD | 48 (Not top 50) | 39 (N/A) | 10 (N/A) |

*The global orientation rank is based on UNCTAD's geographical spread index. That index takes the square root of the number of foreign affiliates as a share of all affiliates, and multiplies it by the number of host countries.

Source: UNCTAD, *World Investment Report* (2010 and 2008)—Country Fact Sheet: Canada.

1 Alexander and Pasternak, "Scotiabank, Royal Bank Seek Money Managers."

Source: The Conference Board of Canada.

locations to diversify their supply sources in case of a problem with supply from one location. And if, for example, a company depends on agricultural inputs, it may make sense to invest in regions that have opposite seasons, thereby providing a stable year-round input supply.

- **Protect their competitive position.** Companies may directly invest in a particular market simply to keep pace with competitors rather than to expand their business. Staying out of a large and growing market while competitors move in might affect a Canadian

### Research In Motion Invests Abroad to Access Technologies and Talents

Canada's Research In Motion (RIM)—maker of the BlackBerry—has acquired several companies abroad in order to access new technologies and related skills. For example, in 2002, the company acquired the Israeli high-tech start-up Slangsoft.[1] That company was developing code that provided the ability to display Chinese characters. RIM relocated 11 of the company's engineers from Israel to Waterloo.[2] The acquisition gave RIM access to the technology, the skills of the engineers who developed it, and an improved ability to expand BlackBerry sales into Asian markets.

1 Mazutis, White, and Beamish, *Research In Motion*.

2 Ibid.

Source: The Conference Board of Canada.

multinational's ability to compete elsewhere.[10] In other words, there may be a large cost for *not* investing in a particular location.

- **Escape conditions at home.** A company might view conditions at home in a negative light—taxes are too high, research and development is limited, the regulatory environment is burdensome, or there is a scarcity of appropriately skilled labour. In that case, the company could be motivated to invest abroad to escape the conditions. Being motivated by the desire to escape conditions at home might at first appear to be equivalent to being motivated by access to better conditions (such as a greater pool of skilled labour) elsewhere. However, the psychology behind these two business motives is different,[11] and therefore the effects may turn out to be different as well.

These are not the only business motivations for Canadian companies to directly invest abroad. Nor are they mutually exclusive. Companies can have multiple motivations or goals for expanding abroad. Additionally, while the focus of this briefing is on motivations for legal investments abroad, some companies shift profits abroad illegally, in order to evade taxes. (See box "Shifting Profits Abroad to Evade Taxes.")

10 Beamish and Safarian, *North American Firms in East Asia*, 5.

11 Witt and Lewin, "Outward Foreign Direct Investment," 590.

### Shifting Profits Abroad to Evade Taxes

Some of the criticisms levelled at the practice of investing abroad are rooted in concerns that companies shift their profits abroad in order to evade taxes at home. This can be a legitimate concern. There is, however, an important distinction to be made. Some companies use offshore financial centres or low-tax jurisdictions simply to lower the cost at which they access the global economy. This is legal, relatively transparent, and may ultimately translate back into benefits for Canada. This is distinct from the practice by some companies of hiding their income and assets in opaque ways in other jurisdictions in order to evade taxes.

Offshore financial centres vary in the degree to which they make it possible for companies to hide income and assets. For example, the Organisation for Economic Co-operation and Development considers Barbados to have a high degree of transparency and information sharing with other countries. Because activities can be easily tracked, companies would find it difficult to use Barbados for tax-evasion purposes. (In 2009, about 7 per cent of CDIA stocks were in Barbados.) At the other extreme are those countries considered to be tax havens, where activities are much more opaque and there is little information sharing with other governments to determine whether tax evasion is taking place. As of 2009, the OECD no longer lists any country as a tax haven, though the organization does list a number of countries that still fail to meet OECD guidelines for transparency and information exchange.

While at first glance it might seem that the use of offshore financial centres would reduce Canadian tax revenues, the practice may actually boost tax revenues. How can that be? According to one study, Canadian companies' use of low-tax jurisdictions to invest in the global economy appears to generate more Canadian exports, investment, and employment than would be the case without the use of the low-tax conduits.[1] As a result, though the use of such conduits means lower tax revenues for Canada upfront, it can also lead to expanded economic activity in Canada—which raises tax revenues.

1 Hejazi, *Offshore Financial Centers*.

Source: The Conference Board of Canada.

Recent research confirms that CDIA is motivated both by positive factors (such as access to new opportunities in global markets) and by negative factors (such as unfavourable conditions in Canada).[12] The good news is that research also finds that CDIA motivated by positive factors dominates, compared with CDIA motivated by negative factors. Other research confirms that business motivations for CDIA are more likely to be positive than negative or defensive. For example, research shows that services-related direct investment abroad—which represents more than half of CDIA—is generally market-seeking.[13] Overall, the research shows that most CDIA is motivated by growth or efficiency reasons rather than by a desire to escape the home environment.

## WHAT ARE THE MAIN EFFECTS OF CDIA?

What are the main effects of CDIA on the companies pursuing such investment, and on Canada and its regions? What does it mean for Canadian productivity, trade, investments, jobs, and skills? And what does it mean for company performance and risk? Is what is good for the company necessarily good for Canada?

Table 1 provides a simplified overview of the likely key effects from direct investing abroad, broken down by the motivations for investing abroad introduced above, as well as the type of investment (i.e., greenfield versus merger or acquisition). The table is based on existing empirical evidence. Since that evidence is limited, the table is also based on thinking through the likely effects in concept or principle.

The table indicates that a particular factor increases or decreases if the balance of evidence or logic suggests it should. It does so *relative to a situation in which no direct investment abroad occurred*. The arrows summarize both direct and indirect effects. For example, if a company invests abroad, the company may generate trade directly by being on the ground and making connections, or indirectly by making the company stronger—which, in turn, generates more trade.

The briefing does not discuss the effects of CDIA on recipient countries (an important subject in itself, but one that merits a separate study—there is extensive literature on the impact of inward foreign direct investment that deals with that side of the equation).

### HIGHER PRODUCTIVITY IN CANADA

While there is limited empirical evidence on the effects of CDIA, one effect is clear—investing abroad increases productivity in Canada. Productivity improvements come from working smarter, not harder. Several studies show that companies that use direct investment abroad to specialize and to more efficiently allocate their activities globally, as well as to expose themselves more directly to intense global competition, tend to boost their productivity.[14] Access to new technologies and exposure to new business models as a result of direct investment abroad, for example, can raise workers' productivity at home.[15]

**Though there is limited empirical evidence on the effects of Canadian direct investment abroad, one effect is clear—investing abroad increases productivity in Canada.**

The productivity gains are not limited to those within the company itself. Productivity improvements are likely to spill over to other Canadian businesses and individuals that adopt these new processes and technologies. The evidence finds that as a result of investing abroad, productivity levels rise not only for the Canadian part of the multinational company, but also for Canada as a whole. This translates into a rise in Canadian living standards.

Does productivity only improve when investments abroad are in new operations? Though the public imagination tends to focus on setting up new operations abroad, productivity gains can also accrue from acquisitions. Companies acquire other companies in order to make the acquired resources more valuable.

12 Hejazi, *Dispelling Canadian Myths*, 27.

13 Francois and Hoekman, *Services Trade and Policy*, 14.

14 Rao, Souare, and Wang. "Canadian Inward and Outward Direct Investment," 332.

15 Ibid.

Does company motivation affect the degree to which Canadian productivity improves? There is no empirical evidence directly related to this question. In principle, however, it seems likely that companies that are primarily motivated by the desire to escape their home environment are not necessarily motivated by opportunities elsewhere. Therefore, they are less likely to seek and adopt new processes and technologies when they invest abroad. Such investments are thus less likely to produce significant spillovers that boost Canadian productivity. On the other hand, we assume that companies that are motivated by growth or efficiency opportunities abroad are more likely to pursue opportunities that will boost their productivity in all of their operations, ultimately spilling over to broader productivity improvements in Canada.

Though productivity on the whole increases as a result of CDIA, there may be some cases where innovation—and therefore productivity—suffers. For example, CDIA that breaks up a cluster of activities in Canada by moving high value-added activities abroad could reduce innovative activities in Canada.[16]

### EXPANDED CANADIAN TRADE

Does direct investment abroad substitute for trade, or complement it? On balance, the empirical evidence finds that direct investment abroad in general, and recent CDIA in particular, result in more exports.[17] A forthcoming study by Export Development Canada finds that, for every dollar increase in CDIA from 1992 to 2008, Canadian export volumes rose by six cents in the following year.[18] The cumulative effect of this over time could be substantial. When companies are on the ground, they make connections that translate back into strong demand for Canadian goods and services. This, in turn, boosts Canadian living standards.

Investing abroad boosts Canadian sales in another way, too. In certain sectors, due to trade barriers or because customers prefer to buy certain products and services locally, it may be difficult for companies to sell exports in a traditional cross-border sense. Instead, companies can sell their products and services by setting up an affiliate abroad and selling through that affiliate. Financial or engineering services are some examples. This is one way in which Canadian companies can export capabilities that they could not export directly.

**On balance, the empirical evidence suggests that direct investment abroad in general, and recent CDIA in particular, result in more exports.**

Again, if a company's direct investments abroad are motivated by the desire to escape conditions in Canada, we might speculate that the company's (and Canada's) exports are less likely to increase than if a company invested abroad to access new markets. If a company went abroad specifically to access skilled or unskilled labour, it might not increase its trade directly or immediately. But if the access to labour made the company stronger, that in turn could indirectly generate more trade over the medium term.

Is less trade created if the investment first transits through a low-tax jurisdiction? One empirical study shows that investing abroad boosts Canada's overall exports, regardless of whether the investments go through low-tax jurisdictions first or travel directly to their ultimate destination.[19] In fact, that study found that investments that transit through low-tax jurisdictions boost trade more than investments that go directly to their final destination. It appears that low-tax jurisdictions enable Canadian companies to access opportunities in the global economy at a lower cost of capital, which translates into greater Canadian exports.

In sum, for Canada as a whole, the evidence strongly suggests that direct investment abroad increases Canadian exports, but also that the company's motivation can matter.

16 Globerman, "Global Value Chains."

17 Rao, Souare, and Wang. "Canadian Inward and Outward Direct Investment"; Verno, *Canadian Outward Foreign Direct Investment and Exports*.

18 Verno, *Canadian Outward Foreign Direct Investment and Exports*.

19 Hejazi, *Offshore Financial Centers and the Canadian Economy*.

**Table 1**
Direct Investing Abroad: Key Likely Effects on Canada and Canadian Companies
("+" indicates positive effect; "–" indicates negative effect)

| | | Motivated By* | | | | | | | | Type of Investment | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Effects** | **On balance** | **Accessing markets** | **Accessing natural resources** | **Accessing technologies** | **Accessing talent** | **Accessing cheap labour** | **Securing supply** | **Protecting competitive position** | **Escaping Canadian environment** | **Merger and acquisition** | **Greenfield** |
| Productivity level in Canada | + | + | + | + | + | + | + | Same? | Same? | + | + |
| Canadian trade, including foreign affiliate sales | + | + | + | + | + | + | + | ? or + | Same? | + | + |
| Investment in Canada | + | + | + or same | + | Short-term: + or – Long-term: + | Short-term: + or – Long-term: + | + or same | Same | _ | Short-term; + or – Long-term; + or same | + |
| Number of jobs in Canada | Short-term: + or – (more likely to lose unskilled jobs) Long-term: + | + | + | + | Short-term: + or – Long-term: + | Short-term: + or – Long-term: + | Short-term: + or – Long-term: + | Short-term: same Long-term: ? | _ | Short-term; + or – Long-term: + | Short-term: + or – Long-term: + |
| Quality of jobs in Canada | + (though could reduce relative wages of unskilled workers) | + | ? | + | If complements home activities, +; if replaces them, – | If complements home activities, +; if replaces them, – | ? | ? | _ | ? | If complements home activities, +; if replaces them, – |
| Other | Associated with increased research and development in Canada | | | Increased knowledge transfer, technology adoption in Canada | Reduced labour shortages in Canada; Potentially reduced innovative capacity in Canada | Reduced labour shortages in Canada | | | | | |
| **Net long-term effect on Canada/regions** | **+** | **+** | **+** | **+** | **+** | **+** | **+** | **+ or same** | _ | **+** | **+** |
| Company performance | +, Assuming strong prior performance | + | + | + | + | + | + | + | + | ? | + |
| Company risk | + | + | + | ? | + | + | – | + | + | + | + |

*There can be multiple motivations for investing abroad; these categories are not mutually exclusive, nor complete.
Note: The sections that are shaded are effects limited to the company undertaking the direct investment itself, whereas the sections that are not shaded are the effects on Canada, its regions, and the company undertaking the direct investment.
Source: The Conference Board of Canada.

## EXPANDED INVESTMENT IN CANADA

There is little evidence that investment abroad depletes activities at home.[20] In fact, international experience suggests the opposite. One study shows that U.S. multinational activities abroad are strongly associated with investment in the United States.[21] And Italian multinational expansion abroad leads to greater investment in Italy.[22] In other words, a company that is expanding abroad tends to be expanding at home as well, and the relationship may be causal. One of the ways in which investments abroad translate into investment in Canada is via repatriated profits (See box "Profits Repatriated to Canada.")

In addition, as discussed in the previous section, CDIA boosts Canadian exports. Since it is well established that more exports lead to greater levels of domestic investment, investing abroad leads indirectly to increased investment at home. Again, this would be true whether or not investments go through low-tax jurisdictions en route to their investment destination or go directly to their destination.

### Profits Repatriated to Canada

Some Canadian and U.S. politicians criticize corporations for "shipping profits overseas." In reality, companies that invest abroad repatriate some of those profits. And those profits that are not repatriated tend to be reinvested abroad, generating profits that are, in turn, partly repatriated and partly reinvested. And the cycle continues.

Roughly $17 billion—or half—of the profits earned abroad by Canadian companies in 2008 were repatriated to Canada in the form of dividends. The other half was reinvested abroad. The repatriated profits in 2008 represented more than one-tenth of Canadian after-tax profits that year.

While the amount of repatriated profits appears to be significant, critics might still charge that they are not generally taxable in Canada—and therefore Canada derives no benefit from them. True, profits brought back to Canada that have already been taxed abroad are exempt from being taxed a second time in Canada (unless Canada does not have a tax treaty with the country in which the profit was earned). However, while Canada does not tax repatriated profits, it also does not give tax credits for taxes paid abroad. And even if repatriated profits are not taxed directly, this does not mean that they are not beneficial to Canada.

In fact, companies that repatriate profits can use them to make additional investments in Canadian operations, including adding head office jobs. This is true whether or not the profits were repatriated to Canada after being sent through offshore financial centres. This reinvestment then generates more profit, which is indeed taxable in Canada. Companies can also use repatriated profits to increase their dividend payouts. In turn, this increases personal income—and therefore income tax revenue. In other words, the repatriated profits are used for wealth-generating activities in Canada. One study finds that repatriated profits accounted for a not insignificant one-tenth of Canada's GDP growth over 2003–06.[1] So while profits brought home are not taxed directly, the wealth-creating activities that they generate increase taxable revenues in the end.

Overall, then, if a business is doing well abroad, it is not simply a case of shipping profits overseas never to be seen again. The beneficial effects of those profits are felt back in Canada as some of those profits are repatriated and invested at home. Profits reinvested abroad generate further profits, part of which are also repatriated and lead to wealth-creating activities in Canada.

Repatriated profits as a result of investments abroad are a gift that keeps on giving.

1 Trefler, "Canadian Policy Responses to Offshore Outsourcing."

Source: The Conference Board of Canada.

20 Navaretti and Castellani, "Does Investing Abroad Affect Performance at Home?"

21 Desai, Foley, and Hines Jr. "Domestic Effects of the Foreign Activities of U.S. Multinationals."

22 Navaretti and Castellani, "Does Investing Abroad Affect Performance at Home?"

If a company invests abroad in order to access cheaper labour or supplies, it seems likely that overall efficiency would increase. As a result, although the company may only maintain or even contract its activities at home in the short run, over the long run it is likely to be better able to expand its domestic activities. As well, access to new markets can mean that companies can make more investments at home, since they can spread their investment costs across a larger market.[23]

By contrast, it seems less likely—at least, in principle—that a company that is trying to escape conditions in Canada (or in a specific region of the country) will experience expanded investment in Canada as a result of its direct investment abroad. While the direct investment abroad still benefits the company (relative to not investing abroad), it seems less likely to benefit Canada and its regions.

A company that goes abroad to protect its competitive position—even without aiming for growth—may find it is better able to maintain its activities at home than it would if it had not invested abroad and activities at home had to be reduced or eliminated.

**The effects of Canadian direct investment abroad on jobs at home are far more positive and nuanced than the popular characterization of "shipping jobs abroad."**

There might be a difference in impact if the investment abroad was a merger or acquisition rather than a new investment. In particular, a merger or acquisition could mean that activities have to be rationalized between locations abroad and those at home, potentially reducing activities in Canada. One might therefore expect to see more positive impacts on investments at home if activities abroad are new investments rather than a merging of existing organizations or assets.

Are the benefits of increased investment at home, resulting from investment abroad, likely to be shared across Canada? Cities are the most likely to benefit disproportionately. This is because head offices and most economic activity are generally located in cities. In the case of Canada, most CDIA is in urban-centric industries (finance and insurance, manufacturing, and management), reinforcing the point that cities are most likely to benefit from increased investment at home as a result of investments abroad.

## MORE AND BETTER JOBS . . . FOR MOST

Rather than being a tool for job creation, the main benefits of CDIA come from increased specialization, which in turn boosts productivity. Still, concerns about job losses must be addressed. The good news is that the effects of CDIA on jobs at home are, by and large, far more positive and nuanced than the popular characterization of "shipping jobs abroad."

**There is little evidence that investment abroad depletes activities at home. In fact, international experience suggests the opposite.**

Most studies find that investment abroad causes, or is associated with, more and better jobs at home. For example, one study found that Italian companies that invest abroad created more jobs at home, relative to non-investing companies with similar characteristics.[24] Another found that investing abroad by U.S. companies is strongly associated with more U.S. jobs.[25] A third study surveyed the literature and concluded that any job losses that result from direct investment abroad are likely to be small.[26] A fourth study looked at U.S. companies outsourcing services offshore, and found that job losses are minimal and that workers find new jobs very quickly.[27] (While that study looked at offshore outsourcing, which is not technically the same as investing abroad, in the absence of a significant literature on investing abroad, it may provide insights into its

23 Trefler, "Canadian Policy Responses to Offshore Outsourcing."

24 Navaretti and Castellani, "Does Investing Abroad Affect Performance at Home?"

25 Desai, Foley, and Hines Jr. "Domestic Effects of the Foreign Activities of U.S. Multinationals."

26 Rao, Souare, and Wang. "Canadian Inward and Outward Direct Investment," 335–36.

27 Liu and Trefler, "Much Ado About Nothing."

likely effects.) In Canada's case, tight labour markets associated with an aging population might make it even easier for displaced workers to find new jobs.

Where we do observe job losses in Canada following Canadian investment abroad, we need to consider the effects relative to what would have happened otherwise. Would the job losses have been worse without direct investment abroad? (See box "Gildan: Did Investing Abroad Mean Fewer Job Losses at Home?") Sometimes investing abroad can, indeed, help to stem job losses.

But the motivation behind the direct investment abroad—and the time horizon—may make an important difference to the jobs outcome. CDIA that is complementary to activities at home can be expected to boost Canadian employment in both the short term and the long term.

### Gildan: Did Investing Abroad Mean Fewer Job Losses at Home?

In 2006, Montréal-based clothing company Gildan Activewear eliminated its manufacturing activities in Montréal and expanded its manufacturing activities in the Caribbean and Central America.[1] At first glance, this might seem to represent a bad outcome for Canada, since the company had to lay off Canadian workers. Obviously, it was terrible for the affected workers.

Another way of looking at the outcome, however, is to ask what would have happened had Gildan not invested abroad. The textile sector faces intense competition from imports made in countries with relatively cheap labour. Without investing abroad to access cheaper labour costs, Gildan might have been forced to shrink or might even have gone out of business. Job losses—including head office ones—might well have been even worse. Transferring some or all production to lower-cost countries might have been the only strategy to keep the company alive.

In this light, the outcome of the relocation strategy—a retained Montréal head office and a successful Canadian company—is far superior to the alternative of the company shrinking or going out of business entirely, which would have resulted in a much wider and deeper set of layoffs in Canada.

1 Gildan, *Gildan Activewear Announces Completion.*

Source: The Conference Board of Canada.

Studies have found that U.S. affiliate activity that is complementary to activities back home in the United States is associated with a rise in U.S. employment levels.[28] So, if a Canadian company started to access technologies and skills abroad that complemented those at home, this could boost Canadian employment.

**Most studies find that investment abroad causes, or is associated with, more and better jobs at home.**

By contrast, when a Canadian company moves high-skilled activities, which formerly were in Canada, abroad—and decides not to relocate some of its Canadian employees—we may see layoffs. The company might also lose some of the expertise associated with its innovative activities.[29] Over the long run, the company might still boost its performance—but the effects on Canadian jobs, innovation, skills, and productivity are likely to be more mixed. This same scenario could apply to the case of a merger or acquisition that results in activities being duplicated, requiring some rationalization between the company's operation in Canada and abroad—meaning job losses in Canada, at least in the short term.

Similarly, setting up operations in countries with cheaper labour can mean job losses in Canada if those activities were previously done in Canada. In fact, one study of U.S. offshoring from 1982 to 1999 found that if the move was motivated by access to cheap labour, it was associated with job loss in the United States.[30] In the case of Canada, however, tight labour markets due to an aging population suggests that any negative impact is likely to be short lived. Over the longer term, accessing cheaper labour could increase the company's global competitiveness, allowing the company to expand and offer more, and perhaps better, jobs in Canada.

28 Harrison and McMillan, "Offshoring Jobs?"

29 Trefler, "Canadian Policy Responses."

30 Harrison and McMillan, "Offshoring Jobs?"

Where there is a negative impact on jobs from CDIA, those workers with fewer skills are most likely to lose out. One study found that increases in U.S. direct investment abroad have a significantly negative impact on employment of unskilled workers.[31] By contrast, another study found that highly skilled U.S. service workers who lose their jobs when a U.S. company moves operations offshore are likely to find new jobs very quickly.[32]

**Where there is a negative impact on jobs from CDIA, those workers with fewer skills are most likely to lose out.**

While concerns about CDIA tend to focus on "exported jobs" and job losses, it is important to consider that Canada will be dealing with tight labour markets in the years to come—a situation that will constrain Canadian growth. Investing abroad may help mitigate the effect by going directly to available workers.

What is the effect of CDIA on the quality of jobs? Because this is a very underdeveloped area, we can only draw on limited evidence and consider likely effects. In principle, if investments abroad boost company performance, companies would be likely to invest more in Canadian training and development activities, and to boost wages at home. The limited evidence seems to bear this out. One study found that German direct investment abroad is strongly associated with upgraded German education levels.[33] Another found that investing abroad by U.S. multinationals is strongly associated with higher wages at home.[34]

Still, job quality is likely to depend on the nature of, and motivation for, the investment. It could, for example, depend on whether activities abroad complemented, or replaced, those at home. The former might lead to skill and wage increases at home, while the latter might not. A new study by the Government of Canada shows that only a small share of Canadian activities abroad are aimed at replacing activities at home.[35] Looking at Canadian companies with activities abroad over 2007–09, the study found that fewer than one-in-ten relocated business activities from Canada to another country during that period.[36] If CDIA tends primarily to complement activities at home rather than replace such activities, then it is likely to lead to an overall improvement in Canadian job and skill quality.

While overall job quality seems likely to improve as a result of CDIA, skilled workers are the likeliest to benefit. One analysis found that U.S. direct investment abroad does, in fact, reduce the relative wages of unskilled workers.[37]

**If CDIA tends to complement activities at home rather than replace them, then it is likely to lead to an overall improvement in Canadian job and skill quality.**

Overall, direct investment abroad could mean—in the worst case scenario—a small drop in employment at home. Unskilled workers are most likely to be negatively affected. At best, direct investment abroad tends to increase jobs and improve skills and wages at home over the longer term. The effects on Canadian jobs are likely to be more positive and require less adjustment in the short term when activity abroad focuses on activities that are complementary to those at home or when CDIA is aimed at growth opportunities, such as accessing new markets. Most (though not all) current CDIA builds on relative strengths at home and abroad, and tends to be aimed at positive opportunities abroad.

31 Yasin, "Trade Liberalization and Its Impact."

32 Liu and Trefler, "Much Ado About Nothing."

33 Becker, Ekholm, and Muendler, *Offshoring and the Onshore Composition*.

34 Desai, Foley, and Hines Jr., "Domestic Effects."

35 Industry Canada, Statistics Canada, and DFAIT, *Survey of Innovation and Business Strategy*.

36 Ibid.

37 Yasin, "Trade Liberalization and Its Impact."

### IMPROVED COMPANY PERFORMANCE

The evidence suggests that investing abroad improves company performance—but only if companies are doing well to begin. The best-performing companies tend to engage in direct investment abroad, further improving their performance. (See box "Does Investing Abroad Improve Performance?") This could show up in the form of greater sales, profits, and jobs in foreign affiliates, repatriated profits to Canada, and expanded activities in Canadian operations.

### INCREASED COMPANY RISK

If the evidence shows that investing abroad improves performance for companies that have something to offer, shouldn't all strong-performing companies invest abroad? Not necessarily, since investing abroad may be riskier than investing at home. For example, investing in markets with more unstable political regimes than Canada's can increase a company's overall risk. Companies may also be at increased risk of having their intellectual property pirated.

**Smaller or medium-sized companies may not be able to afford to wait several years for an investment in a particular country or region to become profitable.**

If risk increases, then performance improvements need to be sufficient to compensate for the extra risk. In the case of Canadian banks, the good news (according to a recent study) is that the significantly better performance of Canadian banks due to investments abroad appears to be sufficient to compensate for the extra risk they take on.[38]

On the other hand, smaller companies may not have an adequate financial cushion to compensate for the increased risk if their investment abroad turns sour—they could go out of business, a much worse outcome than they would have faced if they had not invested abroad. And unlike larger companies, smaller or medium-sized companies may not be able to afford to wait several years for an investment in a particular country or region to become profitable.

38 Hejazi and Santor, "Foreign Asset Risk Exposure."

### Does Investing Abroad Improve Performance (or Does Strong Performance Simply Reflect Better Companies Going Abroad)?

If a Canadian company establishes or acquires operations abroad and the company's performance improves, can we conclude that investing abroad caused the improvement in performance? Not necessarily. The most innovative and productive companies are the most likely to grow their businesses or seek efficiencies abroad. So it may simply be that the best companies go abroad.

To resolve this question, there have been studies that take into account company characteristics in order to isolate the true effects of investment abroad on company performance. One study compared the performance of Italian multinationals going abroad for the first time with what would likely have happened had they not gone abroad.[1] The authors found that going abroad led to significantly better performance—including higher productivity, employment, and sales growth—than the companies would have enjoyed had they stayed home. Another study looked at the performance of Canadian banks investing abroad, taking into account whether they were strong performers from the start.[2] That study found that the more sales, assets, income, and employees a bank had outside Canada, the more its profits and returns improved.

In short, both studies found that going abroad caused improved company performance relative to what would have been the case had the companies stayed home. So if we observe improved performance when companies go abroad, the evidence suggests it is because they were likely strong performers to start with and because going abroad improved their performance even further.

What about when we observe weak or unchanged performance after a company goes abroad? Should we conclude that, in these cases, the CDIA had no impact on (or actually weakened) company performance? No. We know that investing abroad improves company performance relative to what it would otherwise have been. In other words, the company's CDIA likely made the performance *less* weak. And it is possible that the company would have had to lay off even more workers had it not invested abroad.

All in all, investing abroad appears to improve performance—and the best-performing companies engage in direct investment abroad, thereby further improving their performance.

1 Navaretti and Castellani, *Does Investing Abroad Affect Performance at Home?* 16.

2 Hejazi and Santor, "Foreign Asset Risk Exposure."

Source: The Conference Board of Canada.

There may be other situations where risk does not increase, or where it even decreases. For example, if investing abroad provides a much more stable source of supplies, then the company's overall risk level may decline. In that case, any improvement in performance is beneficial, since it does not need to compensate for increased risk. And while investing abroad might increase a company's risk, not going abroad while competitors are establishing a foothold in markets abroad may carry with it even greater risk to the company's success.

**Evidence suggests that Canada benefits most when companies invest abroad to capitalize on growth opportunities, or when they pursue complementary activities at home.**

### OVERALL EFFECTS

Based on the evidence, investing abroad is likely to improve company performance—provided the company is already a strong performer. At the same time, it may also increase company risk, particularly for smaller companies. For Canada, nationally and regionally, the evidence shows that CDIA is likely to boost productivity, trade, investment, jobs, and skills at home. The number and quality of jobs is likely to increase over the long term. But in the short term, less-skilled workers, and those workers who have been replaced by activities abroad, are likely to have to adjust the most. Tight labour markets in Canada, however, should make adjusting easier. The evidence suggests that Canada and its regions benefit most when companies invest abroad to capitalize on growth opportunities, or when they pursue complementary activities at home. Canada and its regions benefit least from investments abroad when they are motivated by the desire to avoid a bad business-operating environment at home. These effects matter for business leaders considering their international strategies and for policy-makers wishing to maximize the benefits to Canada from investments abroad.

## ACTIONS AND IMPLICATIONS FOR BUSINESS

Canadian companies are responsible for making direct investments abroad and for the shape those investments take. Based on our analysis, companies should keep in mind the following guidelines when contemplating investing abroad:

- **Companies that are weak performers should stay home.** Investing abroad is not a panacea for what might be ailing a company. It is unlikely to improve the performance of weak Canadian companies.
- **Companies that are already doing well should consider going abroad.** Strong Canadian companies that are motivated by the desire for growth or by opportunities to be more efficient across their value chains are likely to be rewarded with improved performance.
- **Weigh increased risks.** Improved performance on its own is not sufficient to justify investing abroad. Investing abroad often carries increased risk relative to investments at home, so the rewards must be worth the increased risk. This is particularly true for smaller companies that may not have a solid financial cushion and may not be able to wait the number of years required for the rewards of investments abroad to exceed the costs associated with the risks.
- **Consider the intended and unintended impacts on Canadian operations.** In addition to thinking about what they wish to gain from their investments abroad, Canadian companies need to fully consider the impact of their investments on operations at home. If, for example, a company moves some high-skilled activities abroad, it may lose some of its innovative capacity at home. One partial remedy for this specific situation would be to invest in "excess capacity" in innovation-related workers at home, retaining engineers and scientists even after their projects have moved abroad.[39]
- **Consider emerging markets.** Opportunities in emerging markets are exploding, but Canadian companies are still invested primarily in traditional markets. Companies should look to see what advantages they can gain from investments in faster-growing, emerging markets.

39 Trefler, "Canadian Policy Responses."

## ACTIONS AND IMPLICATIONS FOR GOVERNMENTS

While businesses are responsible for their own strategic decisions, policy-makers have an important role to play in facilitating the most beneficial kinds of CDIA, and in mitigating any negative impacts on Canada and its regions. Based on our analysis, government—at the federal, provincial, and municipal level—should do the following:

- **Raise CDIA's profile.** Investment policies have traditionally focused almost exclusively on attracting investments to Canada and its regions. Government leaders should also focus on the opportunities provided by CDIA.
- **Recognize the kinds of investments abroad that are most beneficial for Canada.** Not all direct investments abroad are alike. Investments aimed at growth or efficiency opportunities, and investments that complement Canadian activities, are likely to be more beneficial than investments aimed at escaping suboptimal conditions in Canada. Investments that replace Canadian activities with activities abroad may require Canadians to adjust in the short term, and may reduce innovative activities at home.
- **Invest at home to promote the most beneficial investments abroad.** Creating a strong competitive environment in Canada is the best way for government and community leaders to discourage escape-driven direct investment abroad in favour of growth- or efficiency-driven investments. This includes transparent regulations, competitive tax policies, and smart investments in education and infrastructure.[40] These also happen to be the same types of policies that promote inward direct investment. A strong competitive environment in Canada will make companies less likely to leave for defensive reasons, and will strengthen Canadian companies, making it more likely that they will be able to pursue expansion opportunities abroad.
- **Do not penalize companies for going abroad.** U.S. policies appear to be leaning in the direction of penalizing U.S. multinationals for their foreign activities by, for example, taxing foreign affiliates at a higher rate than operations at home.[41] Canada should not follow suit. Similarly, taxing repatriated profits that have already been taxed in a foreign country would discourage Canadian companies from repatriating their profits. Canada would then lose out on all of the attendant benefits.
- **Remove barriers to investing abroad.** Given that CDIA is, on net, beneficial to Canada, not only should Ottawa not penalize it, it should make the removal of such barriers a central goal of Canada's free trade negotiations. Today, explicit and implicit policies block Canadian investments abroad in sectors such as finance, telecommunications, transportation, electricity, and legal services. When it comes to removing such barriers, priority sectors should be ones in which Canada has (or could have) relative strengths, where the greatest potential gains lie, and where progress is most likely to be made.
- **Mitigate negative CDIA effects via other policy tools.** CDIA can have intended or unintended negative consequences at home. Investments abroad might, for example, lead to short-term job loss or reduced job quality—particularly if activities abroad replace activities at home, and particularly for lower-skilled workers. Rather than trying to stop the CDIA, governments should invest in those areas that enhance workers' ability to adjust. This includes social safety nets for the short term, and education and skills development so that workers can invest in their future. To take another example, if companies move high-skilled activities abroad, they risk losing some of their innovative capacity at home. To counter this, government might consider providing incentives for companies to retain R&D-related employees.[42]
- **Provide information on (and, in some cases, financing for) CDIA.** There is a role for governments at all levels (perhaps coordinated by Ottawa) to fill information gaps and, in some cases, financing gaps. This is particularly true in the case of smaller, strong-performing companies that wish to go abroad. It might be particularly helpful for governments to share the experiences of front-runner companies that have invested in a particular location. This would help those that follow to avoid similar mistakes and to capitalize on similar opportunities. There are a number of existing vehicles

40 Globerman, *Best Policy Practices*.

41 Hufbauer and Moran, *Hobbling Exports and Destroying Jobs*.

42 Trefler, "Canadian Policy Responses."

to provide such assistance. These include Canada's Trade Commissioner Service, Export Development Canada, and the Business Development Bank of Canada. The first two already have mandates to facilitate CDIA, and they should be encouraged to expand their activities in this area. The latter should have its mandate expanded to include CDIA. Provincial, regional, and city investment agencies should also expand their mandates to include facilitating direct investment abroad.

- **Consider the repercussions of blocking investment into Canada.** Restricting direct investments into Canada could expose Canadian investments abroad to potential retaliation. In addition to limiting the benefits of inward direct investment, this action could also limit the benefits of CDIA.[43] (This action raises the much larger issue of whether Canada should provide and demand reciprocal treatment for and by its investment partners—a much larger topic of discussion that goes beyond this briefing.)
- **Continue to push for greater global tax transparency and information exchange.** Greater transparency in low-tax jurisdictions is critical to ensure that companies cannot hide their income and evade taxes. At the same time, it would allow Canadian companies to continue to transparently and legitimately access opportunities in the global economy via low-tax jurisdictions. Greater transparency could also reassure Canadians that activities abroad are primarily for the purpose of strengthening Canadian companies rather than simply a way to hide income and assets.

## CONCLUSIONS

Canadian companies that establish or acquire operations abroad are often assumed to be doing what is best for them but detracting from the economy at home. The evidence shows that the best Canadian companies do use direct investment abroad to improve their performance by accessing new markets, technologies, talents, supplies, and resources—and that Canadian companies have been relatively successful at investing globally to improve their performance.

But rather than detracting from Canada's economic activity, investments abroad translate into overall long-term benefits for Canada and its regions. The empirical evidence (though limited) points on balance to increases in productivity, trade, investments, jobs, tax revenues, and skill improvements in this country as the result of investments abroad, relative to what would otherwise have been the case. Investments abroad also offer a potential partial solution to the limits that tight labour markets will impose on Canadian growth.

While these are the likeliest overall effects, the analysis makes clear that not all investments are alike—nor are they equally beneficial to Canadian companies or to Canada as a whole. Governments, researchers, and business leaders need to nuance their assessments of CDIA to take into account factors such as company performance, motivations, and intended activities abroad.

**Most CDIA appears to be motivated by opportunities and complementary activities abroad, rather than by the desire to replace Canadian activities or to escape conditions in Canada.**

The research in this area is still emerging. Nevertheless, some tentative conclusions emerge from the analysis. On the one hand, investments that are motivated by growth opportunities or that take advantage of complementary strengths abroad and in Canada are likeliest to produce the greatest benefits for Canada. However, where activities abroad replace Canadian-based ones—including those mergers or acquisitions where some activities need to be rationalized—there may be some short-term costs for Canadians that must be weighed against potential longer-term benefits. And CDIA motivated by the desire to escape the Canadian policy or business environment presumably benefits the company, but is unlikely to yield significant benefits for Canada. The good news is that most CDIA appears to be motivated by opportunities and complementary activities abroad, rather than by the desire to replace Canadian activities or to escape conditions in Canada. This suggests that most CDIA results in minimal short-term adjustments, but yields important overall benefits for Canada.

43 Hejazi, *Dispelling Canadian Myths.*

The analysis also points to the need to disentangle the short- and long-term effects of direct investments abroad. It also highlights the need to assess any CDIA effects relative to what the alternatives might look like. Would, for example, any observed negative impacts from CDIA have been even worse if the company had not invested abroad? In such a case, while an observed impact might seem negative, CDIA might actually have preserved and grown the company, ultimately expanding investment in Canada and raising the skill profile of jobs in Canada over the long term.

**With a strong Canadian dollar anticipated for the foreseeable future, Canadian companies are well-positioned to take advantage of opportunities to invest abroad.**

While Canadian businesses have been relatively successful in the past using direct investment abroad as a strategic tool, the competitive environment has intensified, and new opportunities are emerging. Failure to protect and enhance their competitive positions, via direct investments abroad and other means, can mean companies could lose out—not only in new markets, but also in traditional markets, including in Canada itself.

With the Canadian dollar expected to remain strong for the foreseeable future, Canadian companies are well-positioned to take advantage of opportunities to invest abroad. On the other hand, while investing abroad may hold great promise of rewards, it typically comes with greater risk. Companies need to ensure that their rewards will more than compensate for this extra risk.

Policy-makers also have a key role to play in facilitating the most beneficial kinds of CDIA, and in mitigating any negative impacts it might have. Existing evidence suggests that creating a strong competitive environment in Canada is the best way for government leaders to discourage escape-driven direct investment abroad in favour of growth- or efficiency-driven investments. This includes transparent regulations, competitive tax policies, and smart investments in education and infrastructure. (These happen to be the same types of policies that promote inward direct investment as well.) A strong competitive environment in Canada will make companies less likely to leave for defensive reasons, and more likely that Canadian companies will become strong enough to pursue expansion opportunities abroad.

Since some investments abroad can have negative effects in Canada, governments need to find appropriate policy tools to mitigate any such effects. Negative effects could include job loss or reduced job quality for less-skilled workers, or some loss of innovative activities in Canada. Rather than trying to discourage CDIA and lose its associated long-term benefits, governments might consider providing incentives for companies to retain R&D-related employees. They should also invest in those areas that enhance workers' ability to adjust. This includes social safety nets for the short term, and education and skills development so that workers can invest in their future. Leaders need to help workers—particularly unskilled workers, who are the most likely to be hard hit—adjust in the short term. At the same time, leaders must always keep the long-term view in mind.

Canadian governments, at all levels, also have a key role to play as information brokers in facilitating CDIA, particularly for smaller companies. Government must avoid penalizing Canadian companies for going abroad, and must also make the removal of investment restrictions globally a central tenet of the country's trade negotiations. Ottawa needs to further consider that its policies on investments coming into Canada could have repercussions for how other countries treat CDIA. Finally, Canada should push for greater international transparency in offshore financial centres so as to ensure that activities abroad are legitimate rather than simply a way to hide income and evade Canadian taxes.

In an increasingly competitive global environment, Canadian acquisitions or expansions abroad are a critical strategic tool for Canadian businesses that yield, on balance, benefits for Canada, its provinces, and its cities.

## BIBLIOGRAPHY

Alexander, Doug, and Sean B. Pasternak. "Scotiabank, RBC Seek Money Managers Outside Canada." Bloomberg.com, September 15, 2010. http://noir.bloomberg.com/apps/news?pid=newsarchive&sid=adFAxuQM5MVo.

Beamish, Paul W., and A. E. Safarian. *North American Firms in East Asia.* Toronto: Institute for International Business (University of Toronto), 1999.

Becker, Sascha O., Karolina Ekholm, and Marc-Andreas Muendler. *Offshoring and the Onshore Composition of Tasks and Skills.* IAW Discussion Papers, 55. Tübingen, Germany: Institut für Angewandte Wirtschaftsforschung, 2009.

Desai, Mihir A., C. Fritz Foley, and James R. Hines Jr. "Domestic Effects of the Foreign Activities of U.S. Multinationals." *American Economic Journal: Economic Policy*, 1,1 (February 2009), 181–203.

Francois, Joseph, and Bernard Hoekman. *Services Trade and Policy.* Discussion Paper No. 7616, London, U.K.: Centre for Economic Policy Research, December 2009.

Gildan. *Gildan Activewear Announces Completion of Manufacturing Consolidation Into Offshore Hubs and Related Restructuring Charge.* News release. Montréal: Gildan Activewear Inc., March 27, 2007.

Globerman, Steven. "Global Value Chains: Economic and Policy Issues." Chapter in forthcoming book from Department of Foreign Affairs and International Trade. Ottawa: DFAIT.

———. *Best Policy Practices for Promoting Inward and Outward Foreign Direct Investment.* Ottawa: The Conference Board of Canada, 2010.

Harrison, Ann, and Margaret McMillan. "Offshoring Jobs? Multinationals and U.S. Manufacturing Employment." Working paper. Medford, MA: Tufts University (Economics Department), July 2009.

Hejazi, Walid. *Dispelling Canadian Myths About Foreign Direct Investment.* Montréal: Institute for Research in Public Policy, January 2010.

———. *Offshore Financial Centers and the Canadian Economy.* Toronto: Rotman School of Management (University of Toronto), 2007.

Hejazi, Walid, and Eric Santor. "Foreign Asset Risk Exposure, DOI, and Performance: An Analysis of Canadian Banks." *Journal of International Business Studies* (2010), 845–60.

Hufbauer, Gary Clyde, and Theodore Moran. *Hobbling Exports and Destroying Jobs*. Policy Brief 10–13. Washington, DC: Peterson Institute for International Economics, 2010.

Industry Canada, Statistics Canada, and Department of Foreign Affairs and International Trade. *Survey of Innovation and Business Strategy.* Ottawa: Industry Canada, 2009.

Liu, Runjuan, and Trefler, Daniel. "Much Ado About Nothing: American Jobs and the Rise of Service Outsourcing to China and India." Working Paper Series, w14061. Cambridge, MA: National Bureau of Economic Research, June 2008.

Mazutis, Daina, Roderick White, and Paul Beamish. *Research In Motion: Managing Explosive Growth.* Case Study. London, ON: Ivey Publishing, 2008.

Navaretti, Giorgio Barba, and Davide Castellani. "Does Investing Abroad Affect Performance At Home? Comparing Italian Multinational and National Enterprises." Presented at *The Final Conference of the TMR Network on "Foreign Direct Investment and the Multinational Corporation: New Theories and Evidence."* Conference held at Hydra, Greece, September 20–22, 2002.

Obama, Barack. "Remarks by the President at Laborfest." *Laborfest*. Held at Milwaukee, WI, September 6, 2010.

Rao, Someshwar, Malick Souare, and Weimin Wang. "Canadian Inward and Outward Direct Investment: Assessing the Impacts." In *Trade Policy Research 2010: Exporter Dynamics and Productivity*, edited by Dan Ciuriak. Ottawa: Department of Foreign Affairs and International Trade, 2010.

Statistics Canada. "Canada's International Investment Position." Statistics Canada. www40.statcan.ca/l01/cst01/econ08-eng.htm (accessed December 6, 2010).

Trefler, Daniel. "Canadian Policy Responses to Offshore Outsourcing." In *Offshore Outsourcing: Capitalizing on Lessons Learned*, edited by Daniel Trefler. Toronto: Rotman School of Management and Industry Canada , 2010, 1.1–1.30.

UNCTADSTAT. "Foreign Direct Investment Stocks." United Nations Conference on Trade and Development. http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx?sRF_ActivePath=P,5,27&sRF_Expanded=,P,5,27 (accessed December 6, 2010).

Verno, Claudia. *Canadian Outward Foreign Direct Investment and Exports: An Empirical Investigation Using the Hausman-Taylor Method for a Gravity Model.* Ottawa: Export Development Canada, April 2010.

Witt, Michael A., and Arie Y. Lewin. "Outward Foreign Direct Investment as Escape Response to Home Country Institutional Constraints." *Journal of International Business Studies* (2007), 579–94.

Yasin, Mesghena. "Trade Liberalization and Its Impact on the Relative Wage and Employment of Unskilled Workers in the United States." *Southwestern Economic Review*, 34, 1 (2007), 89–102.

# The International Trade and Investment Centre

The aim of the International Trade and Investment Centre is to help Canadian leaders better understand what global economic dynamics—such as global and regional supply chains, domestic barriers to trade, and tighter border security—could mean for public policies and business strategies.

## The Centre:

- Promotes informed dialogue on Canada's global economic role through independent, clearly communicated, evidence-based research
- Contributes to enhanced Canadian living standards by providing a sound basis for business and government decisions that enhance trade and investment outcomes
- Proposes solutions for improving Canada's future trade and investment performance, rooted in the Centre's original research findings, combined with other emerging analyses
- Brings together business and government leaders in an off-the-record forum to hear from top global thinkers and share successful trade and investment strategies

The International Trade and Investment Centre publishes evidence-based, accessible, and timely reports on key global trade and investment issues. Research is arranged under these five themes:

1. Trade and investment policy
2. Barriers to trade and investment
3. Tracking global value supply chains/ regional value chains
4. Internationalization of SMEs
5. Environment, trade, and investment

## Recent Reports

*Canada's "Missing" Trade With the European Union/ Le commerce « manquant » du Canada avec l'Union européenne*

*Some Plain Talk About Canada's International Trade/ Un regard franc sur le commerce extérieur au Canada*

*The Financial Crisis, Regulatory Reform, and International Coordination: What Remains to Be Done*

*Learning to Live With a Strong Canadian Dollar: Four Options for Business and Government*

**E-MAIL contactitic@conferenceboard.ca**

## Acknowledgements

The author would like to thank Ed Safarian, Louis Thériault, Glen Hodgson, Paul Ferley, and participants at the November 5, 2010, International Trade and Investment Centre meeting for their helpful comments on previous versions of this briefing. The author is also grateful to Keith Head, Walid Hejazi, Steven Globerman, and Daniel Trefler for discussions that helped shaped some of the arguments here.

### INTERNATIONAL TRADE AND INVESTMENT CENTRE MEMBERS

The Conference Board of Canada is grateful to the champion and lead members of the International Trade and Investment Centre that, through their membership, support the Centre's research program.[1]

**Champion Members**

Export Development Canada
Foreign Affairs and International Trade Canada

**Lead Members**

Business Development Bank of Canada
Canada Economic Development
Canada Mortgage and Housing Corporation
Farm Credit Canada
Forest Products Association of Canada
Industry Canada
Ministère du Développement économique, de l'Innovation et de l'Exportation du Québec
Natural Resources Canada
Ontario Ministry of Economic Development and Trade
RBC Financial Group
Sun Life Financial Inc.

### ABOUT THE INTERNATIONAL TRADE AND INVESTMENT CENTRE

The International Trade and Investment Centre aims to help Canadian leaders better understand what global economic dynamics—such as global and regional supply chains—mean for public policies and business strategies. The Centre brings together business and government leaders in an off-the-record forum to discuss successful trade and investment strategies. The Centre's independent, evidence-based reports propose effective policy and business solutions for improving Canada's trade and investment performance.

### FOR MORE INFORMATION

Please visit www.conferenceboard.ca/ITIC.

1 These organizations do not necessarily endorse the research conclusions of this paper.

Direct Investment Abroad: A Strategic Tool for Canada
by *Danielle Goldfarb*

**About The Conference Board of Canada**

**We are:**

- The foremost independent, not-for-profit, applied research organization in Canada.
- Objective and non-partisan. We do not lobby for specific interests.
- Funded exclusively through the fees we charge for services to the private and public sectors.
- Experts in running conferences but also at conducting, publishing, and disseminating research; helping people network; developing individual leadership skills; and building organizational capacity.
- Specialists in economic trends, as well as organizational performance and public policy issues.
- Not a government department or agency, although we are often hired to provide services for all levels of government.
- Independent from, but affiliated with, The Conference Board, Inc. of New York, which serves nearly 2,000 companies in 60 nations and has offices in Brussels and Hong Kong.

Publication 11-161
E-copy: Complimentary

The Conference Board of Canada
**Insights You Can Count On**

255 Smyth Road, Ottawa ON K1H 8M7 Canada
*Tel.* 613-526-3280 • *Fax* 613-526-4857 • *Inquiries* 1-866-711-2262

**The Conference Board, Inc.** 845 Third Avenue, New York NY 10022-6679 USA *Tel.* 212-759-0900 • *Fax* 212-980-7014 • www.conference-board.org
**The Conference Board Europe** Chaussée de La Hulpe 130, Box 11, B-1000 Brussels, Belgium *Tel.* +32 2 675 54 05 • *Fax* +32 2 675 03 95
**The Conference Board Asia-Pacific** 2802 Admiralty Centre, Tower 1, 18 Harcourt Road, Admiralty Hong Kong SAR *Tel.* +852 2511 1630 • *Fax* +852 2869 1403



**For more information,** please contact us at the numbers listed above or e-mail contactcboc@conferenceboard.ca. **This publication is available** on the Internet at www.e-library.ca.



conferenceboard.ca