WHITE PAPER

Foreign Footprints

How outbound foreign direct investment is strengthening Canada's economy.

Canada

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Realize a World of Opportunity

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Introduction: iPhones are Chinese?

Contrary to popular belief, Canada's international trade is remarkably diversified. While media headlines deride a perceived overdependence on the United States and Canada's inability to gain major footholds in overseas centres, Canadian companies have been charging headlong into emerging markets in Asia, Latin America, and Africa. In fact, Canadian companies, both large and small, have made sizeable foreign footprints and begun to tap into emerging market consumption growth and expanding South-South trade networks.

This reality has evaded popular discourse for one very simple reason—our understanding of international trade, and the metrics we use to measure it, is rooted in the 20th century, when production networks were largely confined to individual countries. Yet, since the late 1990s, the rise of global value chains, information technology, international trade and investment treaties, and consumption growth in emerging markets, among other factors, have reduced the significance of national borders and changed the way companies conduct international commerce. Simply stated, the idea that companies produce goods and services in one jurisdiction and export them to another is outdated, or as Stephen Poloz put it: "National economies today no longer fit inside the lines on the map. Companies are simply ignoring those geographical boundaries. This materially affects how we should look at trade and how we should interpret trade statistics."[1]

Yet, for the most part, trade analysis continues to emphasize traditional metrics such as customs derived statistics (i.e. merchandise trade data). This data is rich and timely, but it suffers from two important shortcomings. The first is its blunt nature. Merchandise goods export statistics, for instance, record the *gross value* of a particular country's exports. They do not measure its economic output—at least not with a high degree of precision.[2] Pascal Lamy, the previous head of the World Trade Organization, astutely pointed out that "by measuring trade in gross terms, we were effectively saying that the entire value of an export could be accounted for by the last country on the supply chain.[3] Using this logic, iPhones are Chinese.

The second shortcoming of customs data is its inability to account for massive, and ever rising, flows of cross-border investment. This creates a large blind spot. We now know that international investment has become a key tool that leading firms use to access and grow their business. According to a 2016 report by Koldyk, Quinn, and Evans, Canadian businesses rely heavily on investment to reach distant markets beyond North America.[4] In a nutshell, they argue that many Canadian companies employ an integrative trade model (see inset box on following page) whereby their domestic operations, or what they

1 Stephen S. Poloz, "Financial Intermediation Under the New Trade Paradigm: EDC and Integrative Trade," EDC Knowledge Centre, 5 January 2012 (available online at: http://www.edc.ca/EN/Knowledge-Centre/Economic-Analysis-and-Research/Pages/financial-intermediation-new-trade-paradigm.aspx (last accessed 2016-02-16)).

2 For a more comprehensive discussion of this issue, see Stephen Tapp, Ari Van Assche, and Robert Wolfe, ed., *The Art of the State: Redesigning Canadian Trade Policies for New Global Realities* (Montreal: Institute for Research on Public Policy, forthcoming June 2016).

3 Pascal Lamy, 'Foreword,' in *Global Value Chains in a Changing World*, ed. Deborah K. Elms and Patrick Low (Geneva: WTO Publications, 2013): xv.

4 Daniel Koldyk, Lewis Quinn, and Todd Evans, "Chasing the Chain: Canada's Pursuit of Global Value Chains," in *The Art of the State: Redesigning Canadian Trade Policies for New Global Realities*, ed. Stephen Tapp, Ari Van Assche, and Robert Wolfe (Montreal: Institute for Research on Public Policy, forthcoming June 2016). Available online at: http://irpp.org/research-studies/aots6-koldyk-et-al/

refer to as "onshore platforms", supply North American value chains and their foreign affiliate operations, or "international platforms", feed into overseas value chains in Asia, Latin America, and beyond. Koldyk, Quinn, and Evans' most striking finding, which inspired the research program behind this paper, was the extraordinary diversification of the international platforms since 2004. In the decade ending in 2013, Canadian foreign affiliate sales (i.e. the revenue generated by Canadian companies outside of Canada) increased 187 per cent in emerging markets while those in the United States grew by a mere 18 per cent.[5] At these growth rates, emerging markets will surpass the United States as the largest source of offshore revenue as early as 2018. As such, there are compelling reasons to consider a wider range of trade metrics, including foreign affiliate trade statistics, foreign direct investment data, and value-added trade statistics, in addition to merchandise goods and services exports.

By doing so, we can fine tune our understanding of a particular country's economic output and its integration into the global economy. Moreover, we can recalibrate our analyses to the way international trade is being conducted in the 21st century. These metrics will also steer us to toward more relevant questions. How well are Canadian firms adapting to the new ground rules? How well are the international platforms of Canadian firms performing relative to those of American, British, French, Australian, and Japanese firms (among other places)? And, perhaps most important of all, what does a shift toward an integrative trade model, and an increased reliance on international platforms in particular, mean for the Canadian economy?

In this paper, we will focus on the latter question by looking at the Canadian benefit implications of growing international platforms. In particular, we ask: what are the Canadian economic benefit implications, if any, of an increased reliance on international platforms? In order to answer this question, we will examine a ground breaking 2015 survey of 546 Canadian companies with foreign affiliate operations that was executed by Export Development Canada.

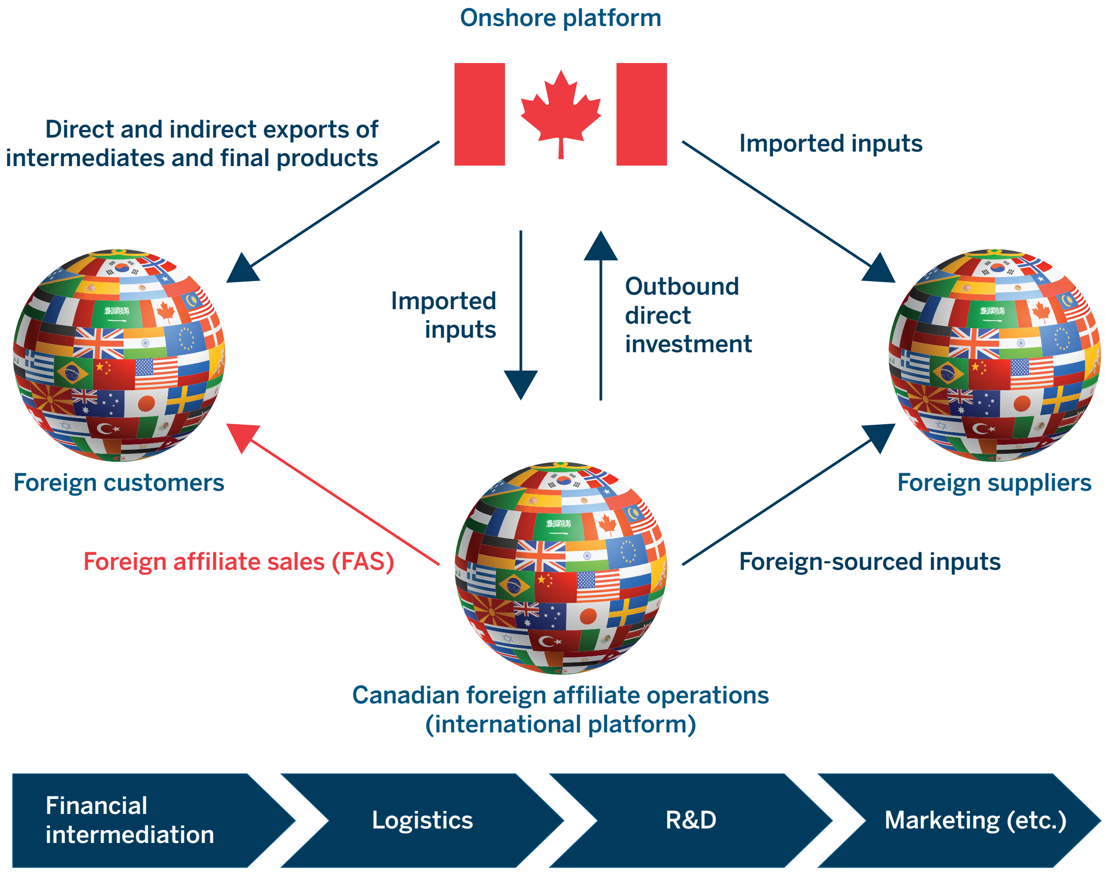
But before we do so, we need to take a step backward to briefly consider the rise of the international platform and the debate surrounding outbound investment.

The uprising: from international trade to foreign affiliate trade

One of the most underappreciated phenomena when it comes to Canada's international engagement is its foreign affiliate uprising, which began in 2003, and the impact this uprising is having on Canada's economy. This section will zero-in on three central features of this phenomenon: revenue generation, trade diversification, and services.

5 Daniel Koldyk, Lewis Quinn, and Todd Evans, "Chasing the Chain: Canada's Pursuit of Global Value Chains," in *The Art of the State: Redesigning Canadian Trade Policies for New Global Realities*, ed. Stephen Tapp, Ari Van Assche, and Robert Wolfe (Montreal: Institute for Research on Public Policy, forthcoming June 2016).

THE INTEGRATIVE TRADE MODEL



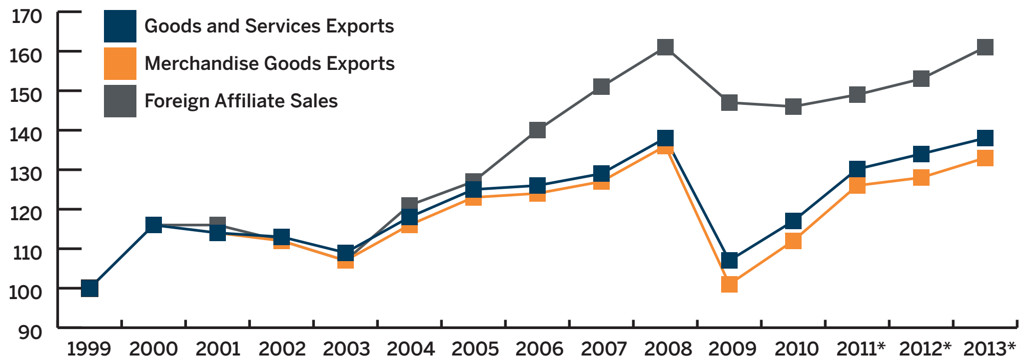
In simple terms, integrative trade is a business model that internationalizes a company by expanding its network to include foreign affiliate operations. This allows the company to source a wider range of inputs and more easily access offshore growth opportunities. This model is typically supported through an underlying infrastructure of support services, including financial intermediation, R&D, logistics, marketing, accounting, and legal, much of which tends to be located directly within the company's headquarters or elsewhere in the domestic jurisdiction.

While it remains unclear why foreign affiliate sales took off in 2003, the trend is obvious and it has continued through 2013 (latest available data). As illustrated in Figure 1, foreign affiliate sales grew by 61 per cent between 1999 (earliest available data) and 2013.[6] That is nearly double the speed of Canada's merchandise goods export growth, which came in at 33 per cent, and 1.6 times the pace of total exports (including services), which came in at 38 per cent.

One of the most important aspects of this growth is the revenue it has generated for Canadian firms. As illustrated in Figure 2, foreign affiliate sales eclipsed merchandise goods exports as the largest source of international revenue in 2006 and generated $510 billion in 2013 alone. By comparison, merchandise goods exports created $472 billion in international revenue and services brought in just $93 billion.

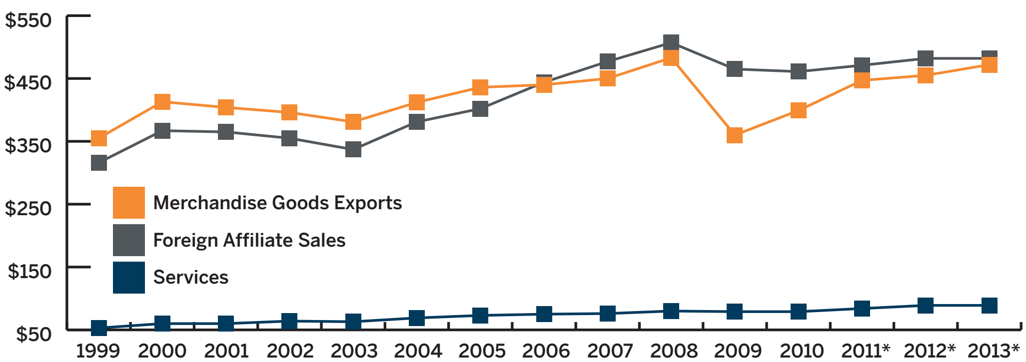
6 Years that are marked by an asterisk include data from CANSIM table 376-0065 or 376-0066. Years without an asterisk include 376-0060 or 376-0061 data.

Figure 1: Growth of Goods and Services Exports and Foreign Affiliate Sales (1999 = 100)



Sources: Industry Canada (Trade Data Online), Statistics Canada, and EDC Economics

Figure 2: Goods and Services Exports and Foreign Affiliate Sales (billions)

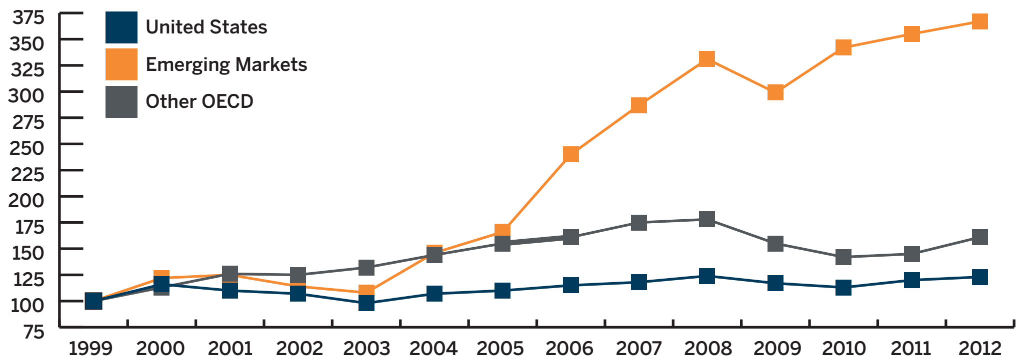


Sources: Statistics Canada, EDC Economics

On the trade diversification front, foreign affiliates have clearly been Canada's most important engine. This reality is especially evident in growth terms. As illustrated in Figure 3, Canadian foreign affiliate sales in emerging markets grew 267 per cent between 1999 and 2012.[7] By comparison, sales in the United States and "other OECD" (the OECD excluding the United States) grew by just 23 per cent and 61 per cent, respectively, over the same period.

7 In December 2015, Statistics Canada modified the geographical categories in its Foreign Affiliate Trade Statistics. The new data in CANSIM table 376-0065 only includes a three year time series (2011-2013). Since a longer time series was required for this paper, the early table (376-0061), which dates back to 1999, was used.

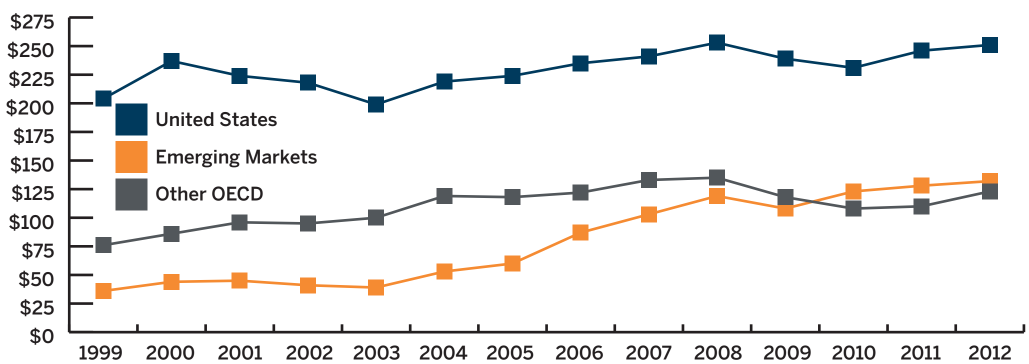
Figure 3: Canadian FAS Growth by Region
(2004 = 100)



Sources: Statistics Canada, EDC Economics

Moreover, as demonstrated by Figure 4, the emerging market growth figure sits on an already sizeable base. In 2010, for instance, emerging markets overtook the "other OECD" block to become the second largest source of foreign affiliate revenue. And in 2012, Canadian companies earned $132 billion in emerging markets, or 26 per cent of all global sales.

Figure 4: Canadian Foreign Affiliate Sales
(billions)



Sources: Statistics Canada, EDC Economics

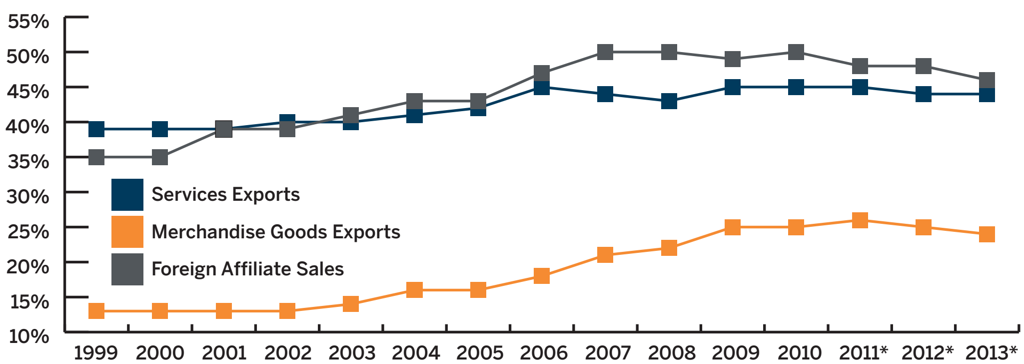
When we simplify the definition of trade diversity as "trade beyond the United States," the picture becomes even more obvious. The proportion of foreign affiliate sales generated outside the United States in 2012 was 46 per cent (Figure 5). In contrast, only 25 per cent of Canada's 2012 merchandise goods exports and 44 per cent of services exports escaped the United States' gravitational pull.

On a sectoral basis, we can see that the foreign affiliate uprising has been largely rooted in services. While foreign affiliate sales derived from goods production enjoyed a rapid increase in momentum between 2003 and 2008, they suffered a setback during the global financial crises and sales continued to fall through 2012, at which point they bottomed out at $245 billion (Figure 6). By comparison, foreign affiliate services revenue steadily increased in value since 2003, and as of 2013, the revenue generated from services was approximately equal in value to the revenue generated by goods production.[8]

The growth of foreign affiliate services revenue is especially noteworthy when we compare it to Canada's direct services exports. As illustrated by Figure 7, in 2013, Canadian companies earned $253 billion in services revenue from their foreign affiliates and just $93 billion from direct exports. In other words, the international platforms of Canadian companies generated 2.7 times more international services revenue than their domestic platforms did.

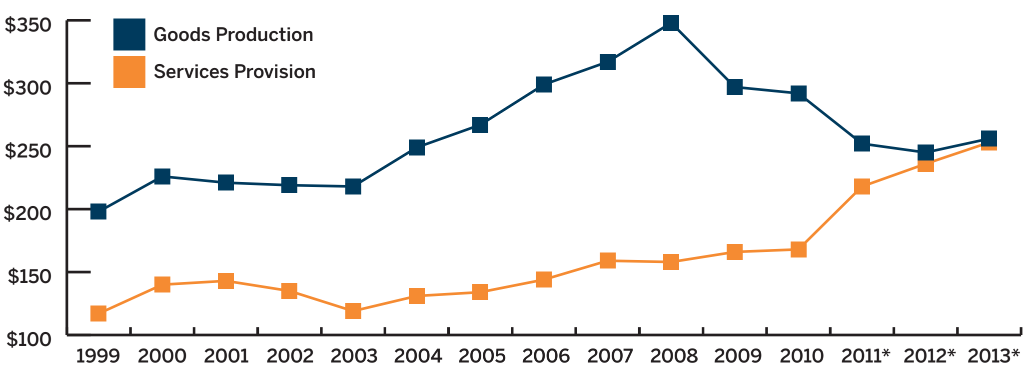
Integrative trade metrics thus demonstrate how Canadian companies have been busy augmenting their international platforms, growing their revenue base, and diversifying their businesses along geographical and sectoral lines.[9]

Figure 5: Non-US Share (Percentage of Total)



Sources: Industry Canada (Trade Data Online), Statistics Canada, and EDC Economics

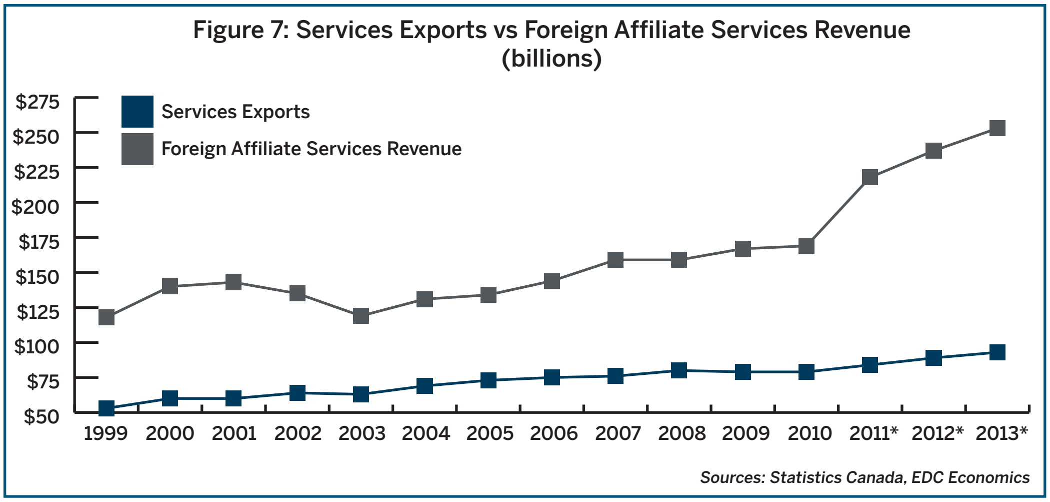
Figure 6: Foreign Affiliate Goods Production and Services Provision (billions)



Sources: Statistics Canada, EDC Economics

8 Statistics Canada began to include the foreign revenues of Canadian banks in its 2011 data. This change follows similar revisions in United States and European Union data. This helps to explain the significant increase in foreign affiliate services revenue between 2010 and 2011.

9 For a more in-depth discussion of the drivers behind the expansion of the international platforms, see Daniel Koldyk, Lewis Quinn, and Todd Evans, "Chasing the Chain: Canada's Pursuit of Global Value Chains," in *The Art of the State: Redesigning Canadian Trade Policies for New Global Realities*, ed. Stephen Tapp, Ari Van Assche, and Robert Wolfe (Montreal: Institute for Research on Public Policy, forthcoming June 2016) (available online at: http://irpp.org/research-studies/aots6-koldyk-et-al/); and Jacqueline Palladini, *Spotlight on Services in Canada's Global Commerce* (Ottawa: The Conference Board of Canada, 2015) (available online at: http://www.conferenceboard.ca/e-library/abstract.aspx?did=7255).



A zero-sum game?

When we look to the field of international economics to contextualize the uprising, we need to expand our scope of analysis to the wider issue of outbound foreign direct investment (OFDI) due to a paucity of research on foreign affiliates. This sub-field has a rich, albeit controversial, literature on the home country effects of OFDI, which is relevant to foreign affiliate activity.

The narrative that enjoys the most play in the popular media has a decidedly negative tone. For the most part, it assumes that a zero-sum scenario exists whereby an expansion of foreign affiliate activity leads to a concomitant contraction, or "hollowing out" of home country operations. As noted by Walid Hejazi, critics of outbound investment typically argue that it is "tantamount to the export of domestic jobs and investment."[10] In effect, when a Canadian multinational company establishes a new production facility in China, the United States, or another country, it inevitably scales back its Canadian footprint and creates downward pressure on employment, wages, and capital formation in Canada.

For the most part, specialists in international economics remain divided on this question. While Feldstein and Anderson and Hainaut, who published seminal papers on foreign direct investment, found evidence that OFDI produces negative consequence for the home economy using aggregate macro-level data,[11] Desai et al. and Stevens and Lipsey, among others, have found that OFDI has a net positive effect on the home country with firm-level data.[12] The foreign affiliate survey that was executed for this paper also uses firm-level data and produced equally compelling results that a positive correlation exists.

10 Walid Hejazi, "Dispelling Canadian myths about foreign direct investment," *IRPP Study*, 1(January 2010): 11.

11 See Palle S Andersen and Philippe Hainaut, "Foreign Direct Investment and Employment in the Industrial Countries", *BIS Working Papers No. 61*, (Basle: Bank for International Settlements, 1998); and Martin Feldstein, "The Effects of Outbound Foreign Direct Investment on the Domestic Capital Stock," in Feldstein et al. (eds), *The Effects of Taxation on Multinational Corporations* (Chicago: University of Chicago Press, 1995): 43-63.

12 Guy V. G. Stevens and Robert Lipsey, "Interactions between domestic and foreign investment," *Journal of International Money and Finance*, 11.1(1992): 40-62; and Mihir C. Desai, C. Fritz Foley, James R. Hines Jr., "Foreign Direct Investment and the Domestic Capital Stock," American Economic Review 95.2(2005): 33-38.

Hejazi, who investigated Canadian OFDI, added some clarity when he suggested that the impact of outbound investment on the home economy is ultimately rooted in the rationale behind the investment. When a firm is seeking to cut labour costs, for instance, the immediate impact on the home economy is negative, particularly when it comes to employment, capital formation, and wages (although the long run impact can become positive as resources are reallocated to higher-value ventures).[13]

However, when the rationale behind OFDI is offensive or strategic in nature (e.g. revenue growth via improved access to global value chains, new markets, and/or South-South trade networks) rather than defensive (e.g. cost cutting), it tends to have a positive impact on the sending economy. This is because "direct investment abroad serves as a beachhead for market access, thus stimulating domestically produced exports and high-value-added head office activities."[14]

The Canadian experience

In Canada, critics of Canadian Direct Investment Abroad (CDIA) often make the mistake of conflating offshoring with international outsourcing—the practice whereby a firm attempts to reduce costs by hiring a foreign company to supply a particular good or service rather than producing it internally. The practice of outsourcing is beyond the scope of this paper. Critics also cite job losses in Canada's manufacturing sector as evidence of the damage offshoring can cause to the domestic economy.

As illustrated by Figure 13, manufacturing employment did shrink by 25 per cent between 2005 and 2010. And since 2010, the total number of manufacturing employees has remained in the 1.7—1.75 million range, with no significant evidence of a recovery as of 2015. As such, it is hardly surprising that this storyline has been pervasive and resonated loudly within many circles. But was this contraction in employment the result of offshoring?

The field of labour economics has developed a rich literature that has isolated a wide range of variables that can impact employment, including: productivity, automation/technological progress, sticky wages, free trade agreements, comparative advantage, and recessions, to name just a few.[15] This literature is far too deep and complex for us to do it any justice here. Suffice it to say that any direct cause and effect relationship between manufacturing job loss and offshoring is at best problematic.

Nonetheless, if offshoring was a contributing factor to the reduction in Canadian manufacturing employment, we should logically expect there to be an augmentation in the number of manufacturing employees Canadian companies employed abroad. Yet, when we examine the employment registers of Canadian foreign affiliates, we find the exact opposite trend in place. Figure 14, for instance, demonstrates that

13 Walid Hejazi, "Dispelling Canadian myths about foreign direct investment," *IRPP Study*, 1(January 2010): 11.
14 Walid Hejazi, "Dispelling Canadian myths about foreign direct investment," *IRPP Study*, 1(January 2010): 11.
15 For a more comprehensive discussion, see: Daron Acemoglu and David Autor, "Skills, Tasks and Technologies: Implications for Employment and Earnings," *NBER Working Paper No. 16082* (June 2010): 1-96; David Autor, Lawrence Katz, and Melissa Kearney, "Measuring and Interpreting Trends in Economic Inequality - The Polarization of the U.S. Labor Market," *The American economic review* 96.2(2006): 189-194; Mark Bils, Yongsung Chang, Sun-Bin Kim, "How Sticky Wages in Existing Jobs Can Affect Hiring," *NBER Working Paper No. 19821* (January 2014): 1-30; Nir Jaimovich and Henry E. Siu, "The Trend is the Cycle: Job Polarization and Jobless Recoveries," *NBER Working Paper No. 18334* (August 2012): 1-53; and Willem Van Zandweghe, "Why Have the Dynamics of Labor Productivity Changed?," *Economic review* 95(2010): 5-30.

Canadian foreign affiliates also experienced a sharp reduction in their manufacturing workforce beginning in 2005. In fact, foreign affiliates let go nearly 23 per cent of their manufacturing employees between from 2005 and 2009. And since then, employment growth in this sector has been flat, hovering within a narrow range of 416,000 and 428,000. The foreign affiliate trend has thus mirrored what occurred in Canada and for this reason alone it seems doubtful that foreign affiliates have been absorbing Canada-based manufacturing tasks.

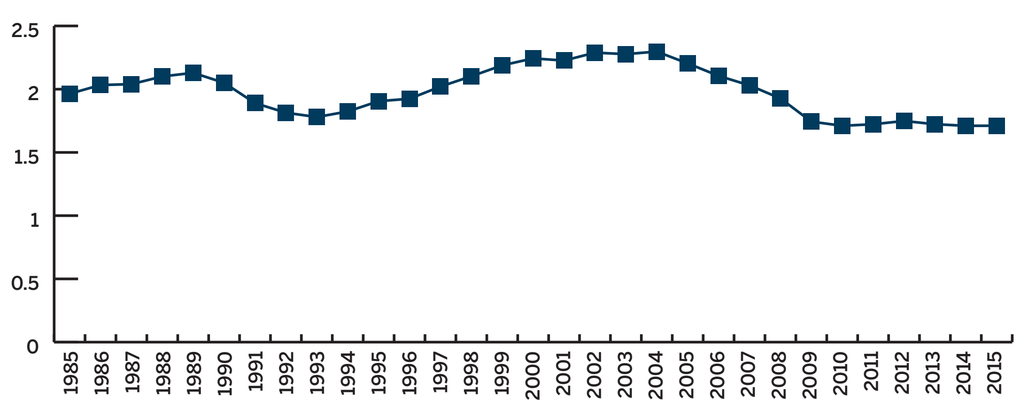
Figure 14 also illustrates a significant increase in foreign affiliate services employment, which can lead to questions regarding the offshoring of Canadian service sector jobs. However, Figure 15 demonstrates that Canada's service sector has also been growing rapidly since the 1980s. In addition, we know that many of the service positions being created in foreign affiliates are indigenous to the economy in which the affiliate is operating and could not have been offshored from Canada.

Table 1 (Statistics Canada, EDC Economics)

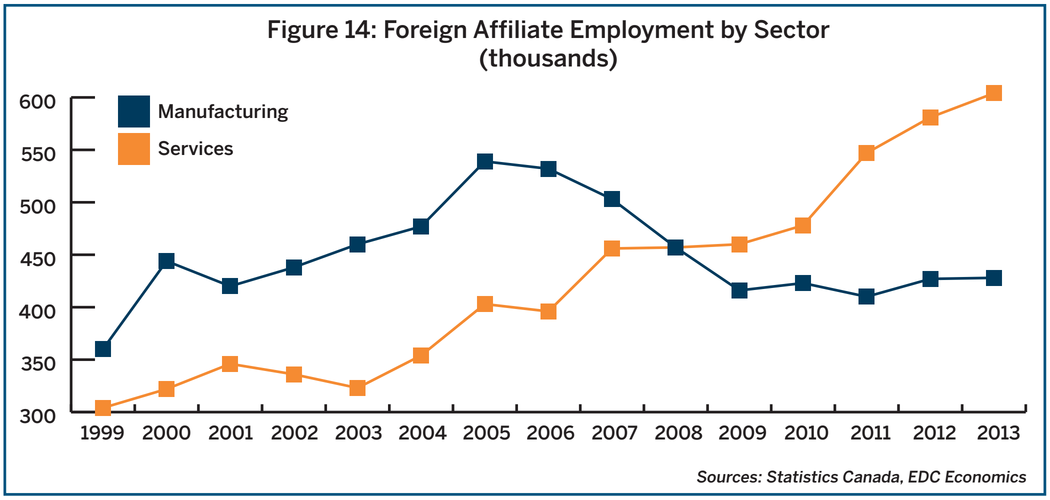
	Category (NAICS)	Employees
Canadian foreign affiliate services employment (2013)	Finance and insurance (52)	139,157
	Professional, scientific and technical services (54)	59,165
	Retail trade (44-45)	55,268
	Wholesale trade (41)	45,943
	Information and cultural industries (51)	39,106
	Transportation and warehousing (48-49)	26,530
	Management of companies and enterprises (55)	7,472
	Other services (56-91)	231,258

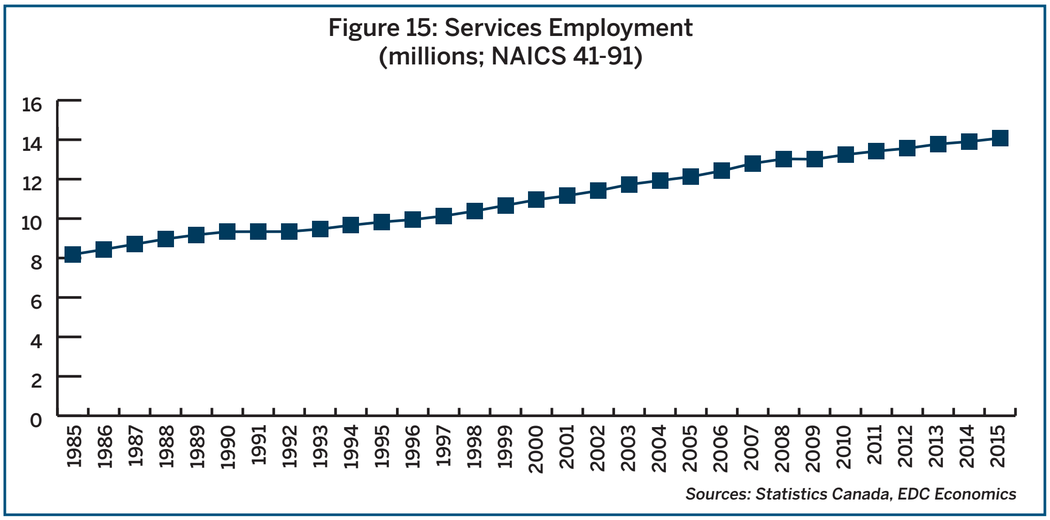
The latter point becomes readily apparent when we break services down into its various subsectors (Table 1). The "finance and insurance" subsector, for instance, serves residents within a particular foreign affiliate's jurisdiction and is thus external to the Canadian economy. This is equally true of the "retail sales" subsector, which employs individuals to sell, service, and install a foreign affiliate's products. Again, these positions are rooted in the foreign market that is being served and as such are unconnected to Canada's employment rhythms. Simply put, these services are allowing firms to grow internationally and increase the international reach of Canadian companies.

Figure 13: Manufacturing Employment (millions; NAICS 31-33)



Sources: Statistics Canada, EDC Economics





Global trends and inward investment

When we widen our perspective to include international trends, it becomes apparent that Canada's experience is not unique, but rather part of a gloomy global scenario. As illustrated by Figure 16, there has been a widespread and prolonged downward trend in manufacturing employment across developed economies. On a national scale, the contraction ranges between 14 per cent in the case of Japan to 35 per cent in the United Kingdom for the 2000-2015 period. Canada and the United States have had similar experiences while emerging market economies have fared somewhat better. However, even China's manufacturing employment peaked in 2012, despite ongoing stimulus spending by all levels of the Chinese government.[16] What has occurred in Canada is thus part of a much larger world-wide trend.

On a more upbeat note, investment flows in two directions—inward and outward—and it would be misleading to ignore the employment effects that inward foreign direct investment has had on Canada's manufacturing sector. This topic has not been adequately addressed until now due to a dearth of publicly available data. However, in September 2015, Statistics Canada released new CANSIM tables (376-0151 and 376-0152)

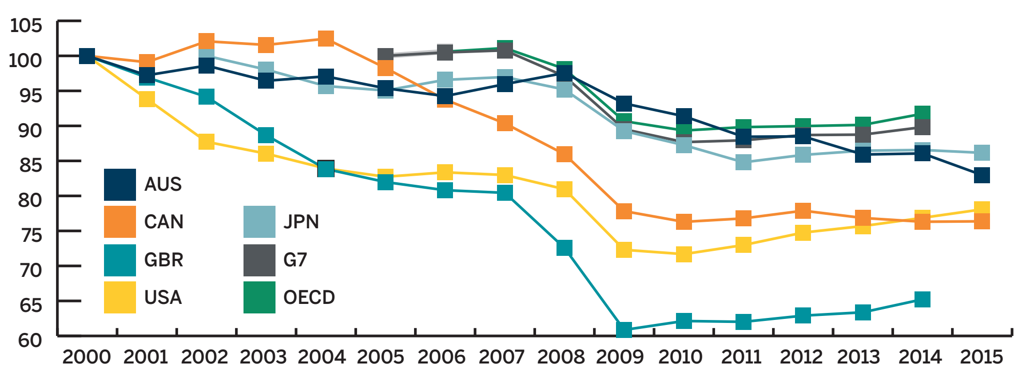
16 According to the National Bureau of Statistics of China, Chinese manufacturing employment topped out at 232.4 million in 2012. It has since fallen by 1.42 million.

that allow us to take a closer look at the activities of majority owned foreign affiliates in Canada—and the results are promising.

Foreign companies employed approximately 1.9 million Canadians in 2013, which "represented nearly one in eight jobs" and "one-third of the total employment in the [manufacturing] sector."[17] As illustrated in Figure 17, Canada was a net beneficiary in terms of manufacturing and service sector jobs. Even when we take a conservative approach by subtracting all retail sector positions that were created by foreign companies in Canada (some of which remunerate employees at minimum wage levels), foreign companies still generated 272 thousand more jobs in Canada than Canadian foreign affiliates created abroad. In total terms, Canada enjoyed a net benefit of 675 thousand jobs. The only industry that did not have a net inflow of positions was the mining, quarrying, and oil and gas extraction sector, for obvious reasons. As such, Canada has largely been a net beneficiary of global offshoring practices.

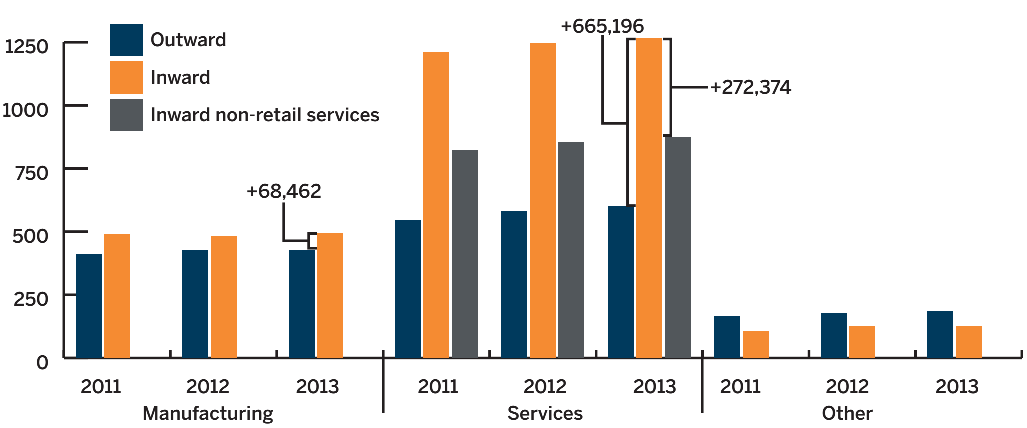
With this context in mind, we can now turn to the research methodology that guided the foreign affiliate survey and its key findings.

Figure 16: Manufacturing Employment Trends by Country/Region (1999=100)



Sources: OECD, EDC Economics

Figure 17: Inward and Outward Foreign Affiliate Employment by Sector (thousands)



Sources: Statistics Canada, EDC Economics

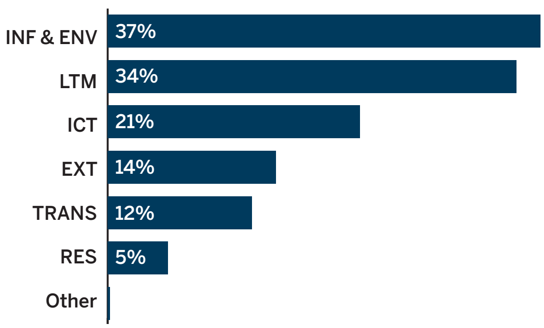
17 Statistics Canada, "Activities of foreign majority-owned affiliates in Canada, 2013," *The Daily* (2 December 2015). Available online at: http://www.statcan.gc.ca/daily-quotidien/151202/dq151202a-eng.pdf

Research methodology and findings

Survey Results

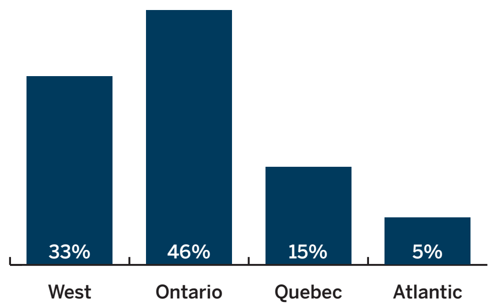
One of the greatest challenges that confront research on new and rapidly evolving topics is the availability of reliable data. Outside of Statistics Canada's foreign affiliate trade statistics tables (CANSIM tables 376-0060, 376-0061, 376-0065, 376-0066), which were revamped in 2015, and the tables of other jurisdictions like the United States and European Union, there is very little information beyond anecdotal accounts.[18]

Figure 8: Respondents by Sector



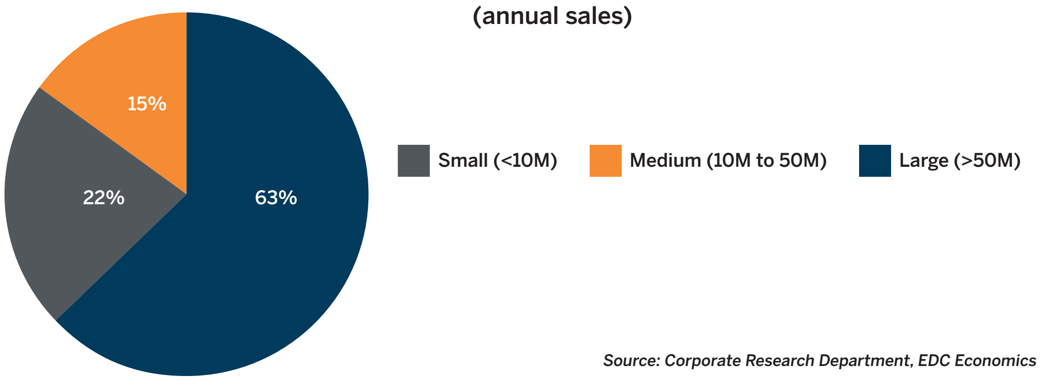
Source: Corporate Research Department, EDC Economics

Figure 9: Respondents by Region



Source: Corporate Research Department, EDC Economics

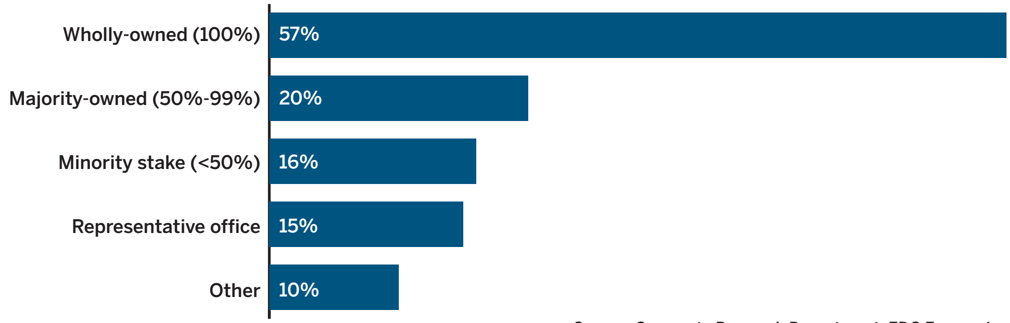
Figure 10: Respondents by Company Size (annual sales)



Source: Corporate Research Department, EDC Economics

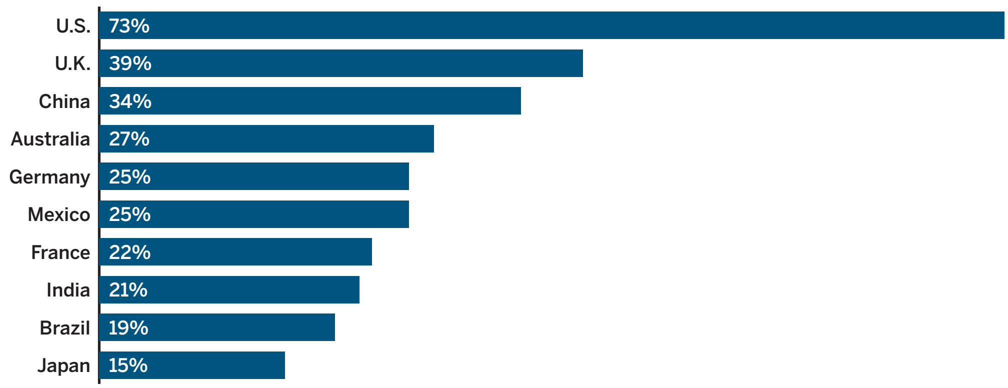
18 The revisions that were made to Statistics Canada's Foreign Affiliate Trade Statistics led to a discontinuation of CANSIM tables 376-0060 and 376-0061 and the creation of two new tables—376-0065 and 376-0066. The new tables include a data revision and a three year time series that ends in 2013. The earlier tables date back to 1999. In some cases, variable definitions were significantly modified. As already noted, the geographic categories changed considerably between 376-0061 and 376-0066, so much so that comparison between the two data sets was unfeasible. In table 376-0066, the definition for "finance and insurance" was modified to include the foreign revenues of Canadian banks. This explains the jump in service sector revenue between 2010 and 2011.

Figure 11: Ownership Structure of Foreign Affiliates



Source: Corporate Research Department, EDC Economics

Figure 12: International Distribution of Foreign Affiliates



Source: Corporate Research Department, EDC Economics

It was for this reason in July 2015 Export Development Canada executed a ground breaking anonymous web-based survey of 546 Canada-based companies with foreign affiliates provided by a leading Canadian online sample provider. This exploratory survey succeeded in capturing a large number of respondents across a diverse cross-section of sectors, including: infrastructure and environment (INF & ENV), light manufacturing (LTM), information and communication technology (ICT), extractives (EXT), transportation (TRANS), resources (RES), and "other" (Figure 8). The survey also managed to capture respondents from across the country (Figure 9). In fact, the geographic distribution of respondents is largely proportional to Canada's regional distribution of businesses.[19] However, due to the fact that most small businesses do not have the expertise and/or resources to open and operate foreign affiliates, the survey results are naturally weighted toward large enterprises with revenues of $50 million or more (Figure 10).[20] It is nonetheless significant that 37 per cent of respondents were employed by a small or medium-sized enterprise (SME). For these reasons, the survey produces important results that are allowing us to dig deeper into Canada's international investment trends.

19 According to Statistics Canada's Business Register (CANSIM 552-0003), as of December 2015, 33 per cent of Canada's business were based in the west, 36 per cent were in Ontario, 20 per cent were in Quebec, and 7 per cent were in the Atlantic region.

20 As the pool of Canadian companies with foreign affiliate operations remains undefined, we cannot claim that the survey's results are fully representative of the universe of Canadian companies with foreign affiliates.

In terms of foreign affiliate ownership structure, Figure 11 indicates that 57 per cent of respondents had foreign affiliates that were wholly owned by their firm. Just 16 per cent of respondents represented a minority partnership in a foreign affiliate venture. Figure 12, which provides the international distribution of Canadian foreign affliates, reveals that the majority of respondents (73 per cent) had at least one foreign affiliate in the United States. The United Kingdom ranked second, with 39 per cent, and China came in third place at 34 per cent.

Survey questionnaire

The questionnaire for the survey was made up of a combination of close- and open-ended questions that were designed to maximize response rates and capture as much information from respondents as possible. The questionnaire's development also benefitted from extensive qualititative research that included dozens of open-ended interviews of Canadian executives who had an intimate knowldege of their firms foreign affiliate operations.

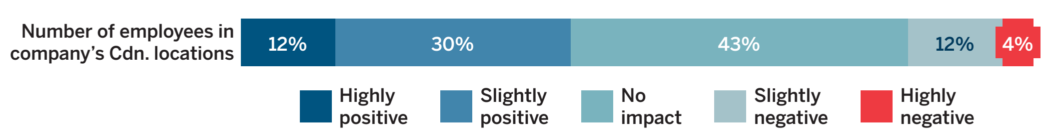
Five new findings

The foreign affiliate survey produced several important findings across a broad spectrum of categories that support the contention that OFDI has a positive impact on home economies.

I. Employment and operations—foreign affiliates boost Canada's workforce and augment domestic operations.

One of the most important findings of the survey is the impact foreign affiliates are having on Canada's workforce. As illustrated in Figure 23, 85 per cent of respondents stated that foreign affiliate activity had a positive or neutral impact on the number of people they employ in Canada. Of this 85 per cent, half noted that their foreign affiliates had a "highly positive" or "slightly positive" impact. Only 12 per cent of those surveyed indicated that their foreign affiliate activity had a "slightly negative" impact on their Canadian workforce, and just 4 per cent noted that they had a 'highly negative impact". The positive results thus outweigh the negative results by a factor or 2.6 to one.

Figure 23: Canadian employment effects of OFDI



Source: EDC Foreign Affiliate Survey, Corporate Research Department, EDC Economics

On a related point, 69 per cent of respondents said their domestic operation was either "very important" or "important" in supporting their foreign affiliate operations. Only seven per cent of those surveyed stated that their domestic operation did not have a significant role to play.

As illustrated by Figure 24, while home country operations provide a comprehensive range of products, the list is dominated by services. At the top of this list is: “business development, marketing, and market intelligence”. More than half of the companies surveyed (54 per cent) leaned on their domestic operation for this value-added service. Two more high-value-added services—“Research and development” and “Engineering and other technical services”—were tied for second place (43 per cent). In fact, of the 12 functions that home economy operations provide, 9 were value-added services. Only two tasks were goods related—finished products (35 per cent) and raw materials and intermediate goods (16 per cent). This result underlines our earlier conclusion that offshoring practices are not a major factor in Canada’s manufacturing job loss trends.

Figure 24: Foreign Affiliate Demands on Home Country Operations (percentage of respondents)

Source: EDC Foreign Affiliate Survey, Corporate Research Department, EDC Economics

In effect, these results suggest that foreign affiliates are an important source of demand for the products and services that are provided by a multinational’s home country operations. In other words, companies cannot grow foreign affiliate networks without a robust presence in Canada.

II. Wages—foreign affiliates allow firms to augment compensation for Canada-based employees

An equally important finding is the effect foreign affiliate activity is having on home country wages. According to the survey, 90 per cent of respondents indicated that their foreign affiliate activity had a positive or neutral impact on the compensation levels of their Canadian employees (Figure 25). While the majority of respondents indicated that their foreign affiliate operations did not affect their remuneration of their Canada-based employees, 20 per cent stated that they had a “highly positive” or “slightly positive” impact on wages. Only 11 per cent noted that their foreign affiliate operations had a “slightly negative” or “highly negative” impact. As such, the wage advantages of OFDI outweighed the disadvantages by a factor of nearly two-to-one.

Figure 25: Canadian Wage Effects of OFDI

Source: EDC Foreign Affiliate Survey, Corporate Research Department, EDC Economics

III. Competitiveness—foreign affiliate activity makes Canadian companies stronger.

In terms of competitiveness, the survey results clearly demonstrated that OFDI in the form of foreign affiliate networks makes Canadian companies stronger. In fact, 92 per cent of respondents believe their company is more competitive today because of their foreign affiliate network(s).

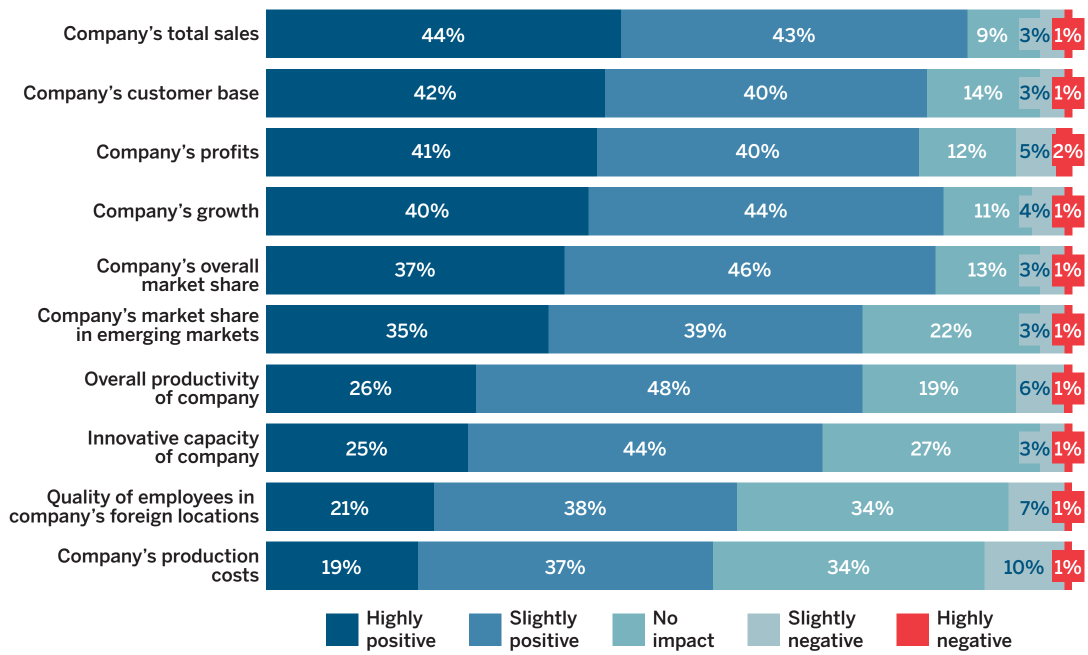
The rationale for this overwhelming response is illustrated in Figure 26. In almost every category, foreign affiliates provided a clear and definitive benefit. For instance, 87 per cent of respondents noted that their foreign affiliates had a positive impact on sales; 84 per cent agreed that they generated growth; 83 per cent said they improved their global market share; 82 per cent stated that they improved the customer base; and 81 per cent indicated that they augmented profits. It is also noteworthy that the number of negative responses was largely insignificant in all categories.

IV. Offensive growth—the main driver of foreign affiliate activity is revenue growth and improved access to global markets, not cost cutting.

The foreign affiliate survey also provides evidence that the offshoring that is occurring today is not about cost cutting and job losses, as the dominant narrative typically claims; it is about offensive growth that is allowing Canadian companies to more effectively access global value chain networks and new customers, consumption growth in emerging markets, and South-South trade flows.

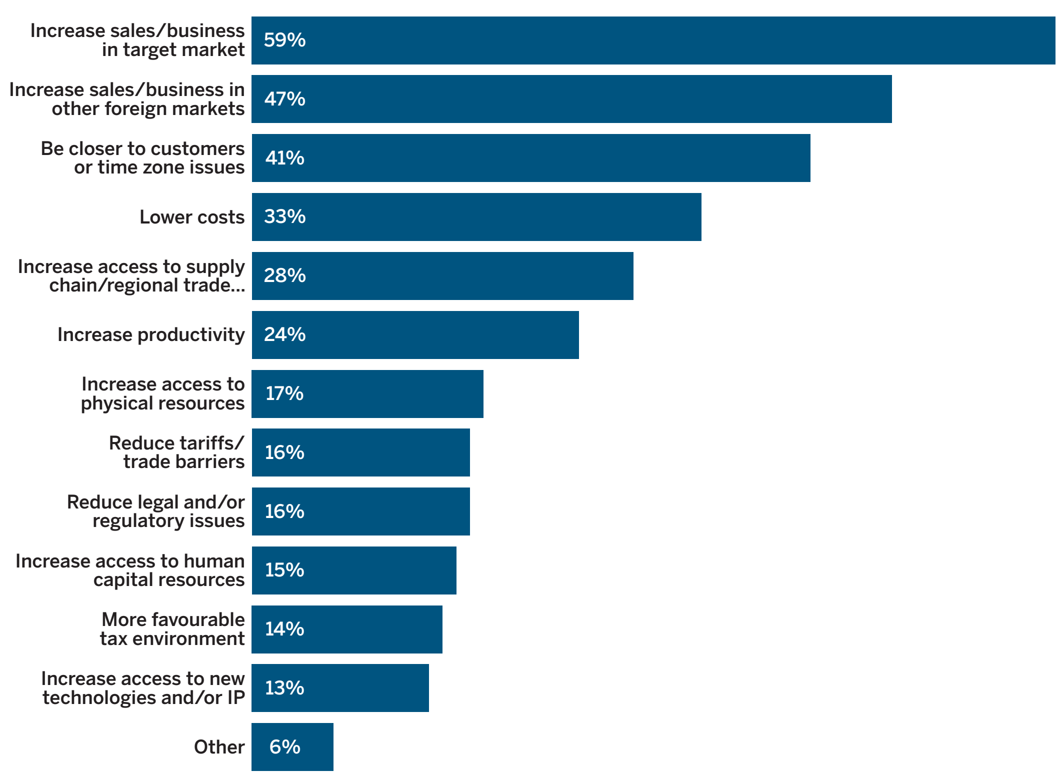
This conclusion is captured by Figure 27, which illustrates how the majority of respondents stated that their foreign affiliate networks were established for offensive or strategic reasons. The top two reasons were related to the generation of foreign revenue—59 percent of respondents were seeking to increase sales in the location where the foreign affiliate was established while 47 per cent were relying on their foreign affiliates to increase sales in third markets. Under the latter scenario, a Canadian firm is typically using a foreign affiliate as a beachhead to generate sales in the region in which the affiliate is located. For instance, a company may setup an affiliate in Hong Kong or Taiwan with the intention to generate sales in mainland China.

Figure 26: Competitiveness Effects of OFDI



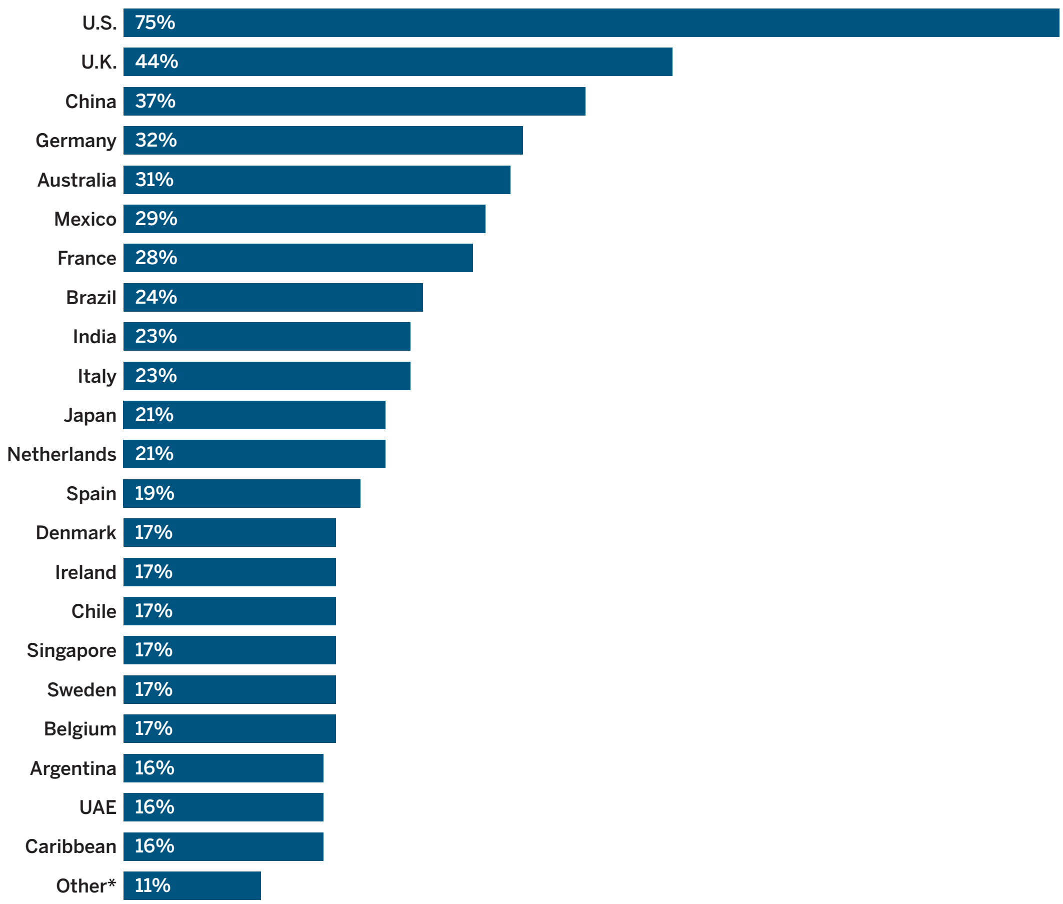
Source: EDC Foreign Affiliate Survey, Corporate Research Department, EDC Economics

Figure 27: Reasons Why Companies Establish Foreign Affiliates



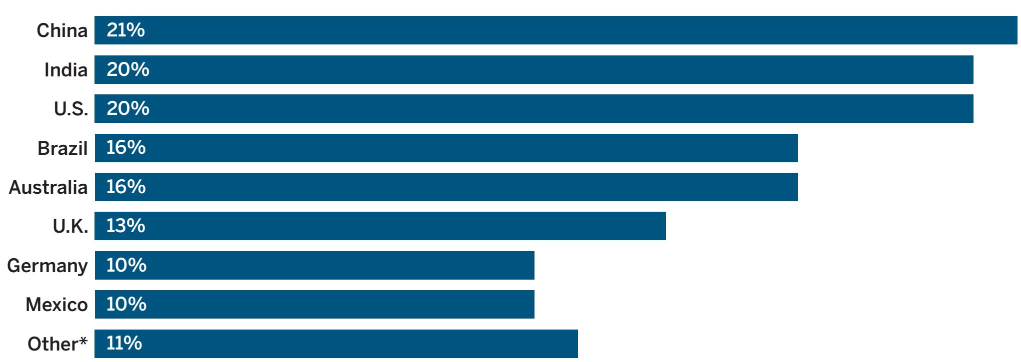
Source: EDC Foreign Affiliate Survey, Corporate Research Department, EDC Economics

Figure 28: Foreign Affiliate Sales by Country



Source: EDC Foreign Affiliate Survey, Corporate Research Department, EDC Economics

Figure 29: Countries Targeted for Expansion in the Next Five Years



Source: EDC Foreign Affiliate Survey, Corporate Research Department, EDC Economics

It is also noteworthy that only 33 per cent of respondents noted that they established a foreign affiliate to reduce production costs and just 16 per cent indicated that the reason was their rationale for creating a foreign affiliate network was to seek a more favourable tax environment.

V. The diversification dividend—foreign affiliates are diversifying Canada's trade flows

The final finding pertains to the diversification dividend and manner in which foreign affiliates are helping to diversify Canada's international trade patterns, especially as we look to the future.

While the United States is, and will remain, the most important market for Canadian foreign affiliate activity (Figure 28), growth is rooted in Asia and other emerging markets. As illustrated by Figure 29, the largest growth market for foreign affiliates in the next five year will be China and three of the top four are key emerging markets (China, India, and Brazil).

Moreover, when we exclude the United States, eight of the top 20 growth markets are in Asia, five are in Latin America, five are in Europe, and two are in the Middle East and Africa. This diversification is amplified by the fact that 50 per cent of survey respondents plan to expand their foreign affiliate networks within the next five years.

Conclusion: iPhones are not Chinese

The rise of global value chains, revolutions in information technology, and 21st century trade and investment agreements have dramatically altered the way international commerce is conducted around the globe. It goes without saying that the methods we use to track this business should evolve in tandem.

Traditional indicators such as gross merchandise goods exports are detailed and timely, but rooted in a simpler time when companies produced goods in one jurisdiction and exported them to another. In today's world, products such as the iPhone are manufactured in multiple locations across the world. Their components are made in the United States, Japan, South Korea, Taiwan, Germany, and Italy. Yet, according to merchandise goods export data, iPhones are Chinese since they are assembled and exported from Shenzhen.

By expanding our analysis to include value added trade data, foreign affiliate trade statistics, and other metrics, we can extend our reach into global value chains, disaggregate complex production networks, and assign production value where it is actually created. Even the iPhone's trucking costs that are incurred in South Korea when components are shipped to port for export to China, for instance, can be captured. These metrics also allows us to better understand how businesses are increasingly relying on outbound foreign direct investment to compete in the international marketplace, how these practices are affecting companies, and the effects these practices are having on home economies.

The foreign affiliate survey took aim at these questions by collecting firm-level data on the interrelationship between offshoring and domestic operations. The results were unambiguous and challenged the dominant narrative across a broad spectrum of categories by demonstrating that foreign affiliate networks produce important benefits for Canadian companies and the domestic economy. At the company-level, the survey showed how foreign affiliates allowed firms to compete more effectively by increasing sales, providing better access international customers, and allowing them to access lucrative global value chain networks. These networks also allowed companies diversify their client base and participate in the consumer revolutions that are taking place in fast growth emerging markets. At the national-level, the survey demonstrated how foreign affiliates can have a beneficial impact on employment and wages and provided evidence that OFDI can diversify Canada's international trade footprint. This latter benefit will only grow in significance as the centre of global economic activity continues to shift toward Asian behemoths like China and India.