WHY FOREIGN OWNERSHIP IS A PROBLEM — AND WHAT TO DO ABOUT IT

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In recent months, concern has been expressed in some surprising quarters about the possibly harmful effects of foreign investment on the Canadian economy. A major difficulty in making public policy regarding such corporations is that we know hardly anything about them: Wholly-owned subsidiaries are not obliged to file financial statements. Two modest policy changes are called for: Any corporation with sales greater than $1 million should be required to publish full financial statements, and Statistics Canada should publish separate data series for Canadian and foreign-owned corporations.

Des voix s'élèvent depuis quelques mois, dans des milieux où l'on s'y attendrait fort peu, pour dénoncer les dangers que les investissements étrangers feraient courir à l'économie canadienne. La définition de politiques publiques à l'égard des filiales qui sont propriétés exclusives d'entreprises étrangères se heurte à une difficulté de taille : ces filiales ne sont pas tenues de produire au Canada leurs états financiers. Deux changements mineurs sont demandés : premièrement, obliger toute entreprise dont les ventes dépassent un million de dollars à publier des états financiers complets; deuxièmement, obtenir de Statistique Canada deux séries de données distinctes — l'une pour les entreprises à propriété canadienne, l'autre pour les entreprises à propriété étrangère.

Over the last few months, Thomas d'Aquino of the Business Council on National Issues, William Thorsell of the *Globe and Mail*, William Dimma, a dean of Canadian business, and other leading figures of the Canadian business community have joined Mel Hurtig and Maude Barlow in expressing concern over the high and increasing rate at which US corporations are acquiring Canadian corporations. D'Aquino and Thorsell acknowledged that the attractive managerial and professional jobs at corporate headquarters go south with ownership, and they ask rhetorically: What future does a country have when the best of its young people must go abroad in order to find jobs commensurate with their talents?

Dimma raises an even more serious concern. Thirty-five years ago, Walter Gordon and Mel Watkins complained that foreign ownership was creating a "branch plant economy" in which Canadian subsidiaries did little more than assemble components manufactured abroad. Looking to the future, Dimma fears that all manufacturing activity is being eliminated: The branch plants are being reduced to "lobbying and selling" organizations. What little manufacturing that Canadian subsidiaries have been doing is expected to be eliminated by the worldwide rationalization of production encouraged by NAFTA and the WTO.

This paper will first present some comparative data on the manufacturing sectors of Canada and the US to establish quantitatively what has taken place and what can be expected in the future. Then two courses of action will be proposed to deal with the problem, one modest and the other more ambitious.

Statistical agencies of the Canadian and US governments collect and report annually for their manufacturing sectors data that includes: (1) the employment and compensation of production workers; (2) the employment and compensation of managerial and professional employees; and (3) value added, which is defined as sales minus the cost of materials and energy used in production. Value added is a better measure of production than sales since sales can be artificially inflated when input costs are high.

In 1949, managerial and professional employment (MPE) in Canada was 23.3 per cent of production employment, almost identical with the figure for the US (see Table 1). In 1971, the Canadian figure had climbed to 39.4 per

Table 1
Comparative "management and professional employment" (MPE) relative to production employment in the manufacturing sectors of Canada and the United States.

	1949	1971	1996
Production employment (000)			
Canada	*950*	*1,168*	*1,279*
US	*11,016*	*12,875*	*12,168*
Management and professional employment (000)			
Canada	221	460	425
US	2,551	4,551	6,498
MPE as per cent of production employment			
Canada	23.3	39.4	33.2
US	23.2	35.3	53.4

cent, somewhat higher than the 35.3 per cent for the US However, between 1971 and 1996, while production employment continued to rise in Canada, MPE actually fell, so that in 1996, it was just 33.2 per cent of production employment. By contrast, in the US, MPE continued its rise, reaching 53.4 per cent of production employment.

A number of factors explain the large decline in MPE relative to production employment in Canada by comparison with the US. The most important, I believe, is the rise in foreign ownership. Unfortunately, Statistics Canada does not publish the data that can establish whether or not I am right. The classification of the data according to whether plants are owned here or abroad could be done very easily. However, Statistics Canada provides only very limited data on foreign ownership, and that under very restrictive conditions. One would never know from the published data the high degree of foreign ownership of Canadian industry and the widespread public concern over the consequences it may give rise to.

At a conference of government and academic economists held in Ottawa in January on the growing Canada-US productivity gap in manufacturing, Andrew Sharpe of the Centre for the Study of Living Standards, the organizer of the conference, reported that Canadian productivity had fallen from about 90 per cent of the US level in the postwar years prior to 1977, to 72 per cent in 1998. This was especially disturbing because over these two decades considerable technology transfer from the US took place, which, it was believed, should have narrowed the gap. Other papers presented at the conference confirmed Sharpe's finding and tried to explain it. The chief reason offered was the exceptional growth and much higher productivity of US information technology industries. If these industries were excluded, it was reported, the productivity gap remained constant during these years. The one subject not mentioned in these papers was foreign ownership.

Table 2 presents comparative data for the two countries on the information technology industries. To fully appreciate this data, keep in mind that, excluding these industries, and assuming a Canadian dollar worth 73 cents US, value added in manufacturing in the US is 12.1 times the level in Canada. However, value added in the US information technology industries is 38 times the Canadian figure (which includes Nortel). The employment of production workers in these industries in the US is only 16.6 times that in Canada, but MPE in the US is 30.4 times as large. The ratio of value added to the wage bill for production labour — a measure of productivity and profitability — is twice as high for the US as for Canada.

Comparative compensation rates for production workers and MPE are also interesting. For production workers, the US wage rate is only

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Table 2
Comparative data for high-technology information industries in Canada and the United States, 1996*

	Canada	US	Ration: US to Canada
Value added (000,000)	$9.424	$261,886	37.9[1]
Production hours (000,000)	123.7	2,049.5	16.57
Managerial and professional employees (000)	30.2	919.0	30.43
Value added production wages	4.74	9.41	1.99
Hourly wage rate	$16.19	$13.58	1.144[1]
Annual salary rate, PME	$53,384	$53,876	1.377[1]

* The industries are the computer, communication, electronic and instrument manufacturing industries.
1 The ratio is based on a $0.733 Canadian dollar.

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14 per cent higher than the Canadian. For MPEs, the US salary rate is 38 per cent higher. Either US MPEs are substantially more able or the US provides higher-quality jobs.

We see that in the US the information technology industries are immensely larger, immensely more profitable, and have immensely more MPE than in Canada. Is this due to a Canadian-owned industry that has a much lower level of technology? Or is it because Canadian subsidiaries of multinationals are confined to low-technology activities? The government does not publish the data that might help us answer this question.

Another area in which government statistics are completely silent is on the extent to which transfer pricing is used to transfer profits out of Canada, thereby reducing reported productivity and profits. Foreign corporations with Canadian subsidiaries that want to recognize Canadian profits at home or in off-shore tax havens can do so quite easily. Those that buy raw materials from their subsidiaries in Canada can do so at depressed prices, while those that sell components or finished products to their subsidiaries in Canada can do so at inflated prices. To the extent that this takes place, taxable profits and reported productivity in Canada are reduced.

What should be done about foreign ownership of Canadian industry? Clearly, it cannot be eliminated, and it may not even be possible or desirable to reduce it. But we can get more information on its consequences, and with that information we may be able to make foreign corporations and their subsidiaries serve Canada better.

The difference between the information we have on the Canadian subsidiaries of foreign corporations and publicly owned Canadian corporations is like the difference between night and day. Corporations that are widely owned publish periodic reports with detailed financial statements and other information. They have to in order to inform their many current and prospective stockholders about the corporations they do or will own. By contrast, corporations with one or only a few shareholders are under no obligation to make such information public and usually do not.

Ford, Toyota, Merck, Microsoft, Siemens and other multinational corporations have very large operations or sales in Canada, but in each case they are the sole shareholder of their Canadian subsidiary, and no annual reports with financial statements and other information are published on the subsidiaries.

The assumption behind this practice is that the owners of a corporation are the only persons with an interest in its operation. That assumption is false. It is now widely recognized that a corporation's stockholders are not its only stakeholders. The latter also include its employees, customers, governments and all of the residents of the country in which it operates. If Canadian citizens are to provide their governments with informed advice on what policy they should follow with respect to corporations in Canada, both foreign and Canadian-owned, citizens should have the information needed to give informed advice.

The privileges foreign corporations enjoy here in Canada are quite remarkable. Real people face restrictions on entering Canada and operating here. Corporate persons can set up subsidiaries here, and then keep the operation of these subsidiaries secret. Furthermore, the treaty obligations Canada has undertaken under NAFTA and the WTO give these foreign corporations privileges that publicly-owned Canadian corporations do not have.

The simple course of action I propose is the provision of more information, in two ways. First, on the micro level, all corporations, regardless of ownership, which have sales or assets above $1,000,000 should be required to publish annual financial statements and related information. I see no reason why the privacy that real persons enjoy as a matter of right should be extended to corporations. The latter are creations of the state and only have the rights granted to them by the state. Second, on the macro level, data on business operations published by Statistics Canada and other government agencies should be classified according to whether or not the corporations are owned abroad.

I will not propose government policy with regard to foreign corporations in Canada, beyond noting what has taken place in the pharmaceutical drug industry. That industry is for the most part foreign-owned, and at one time, with few exceptions, consisted of Dimma-type corporations: They did little more than marketing and lobbying here. The lobbying was for patented drugs to remain free from competition from generic producers for a longer time. In return for a longer patent life, these firms agreed to do more R&D and production here. The government agreed to their proposal despite the objections of consumer groups and the provincial governments that were to be burdened with the higher cost of drugs. Whether or not the greater employment in the industry offsets the higher cost of prescription drugs is open to question. But quite aside from that, it is reasonable to believe that participation in the Canadian market should not be a privilege that is enjoyed with no reciprocal obligations. Participation in the Canadian market by large multinational corporations should be related to the level and quality of their production and employment here. Once that principle is accepted, ways to carry it out can be found. That, in effect, is what Vincent Bladen, a distinguished economist at the University of Toronto, said many years ago in a study for the Canadian government that eventually resulted in the *Auto Pact*.

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Costs vs. spending At a recent "summit" on health-care costs the Secretary of Health and Human Services, Donna Shalala, said that health care is the only industry in which technology increases, rather than decreases, costs. But the Secretary has it backward. New technology has the same effect on health care that it had on John D. Rockefeller's oil industry, on Henry Ford's Model T, and on today's cell phones: it decreases costs and expands markets. Until a decade or so ago gall-bladder surgery was an open-abdomen procedure, and many patients put up with chronic pain and discomfort rather than risk the operation. Now ... the surgeon makes four small incisions in the abdomen, inserts a tiny camera and a light, clips off the gall bladder with a mini-tool, and pulls it out through one of the incisions. The patient goes home the same day, and usually misses only a day or two of work. Arthur Leibowitz, the chief medical officer of Aetna US Healthcare, says that fees for gall-bladder surgery are about half what they used to be, and inpatient hospital costs have been virtually eliminated, but the company's total gall-bladder bill has risen, because surgeons are now more likely to recommend the procedure and patients are more willing to undergo it...

The difficult truth is that almost all improvements in health care increase spending over the long term. From the perspective of a cost-cutting reformer, the single greatest catastrophe of recent years has been the success of the drive against smoking. Smokers tend to die early and quickly. But someone who stops smoking in time can make it onto the Medicare rolls in good shape and burn up health-care dollars for decades...

Charles R. MORRIS, *Atlantic Monthly*, Dec. 1999

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