V. CAPITAL AND FINANCIAL ACCOUNTS

The capital and financial accounts consist of transactions in financial assets and liabilities. The capital account includes capital transfer such as migrants' assets and inheritances, and federal government superannuation. The financial account covers inflows and outflows of direct investment, portfolio investment and other investment.[18]

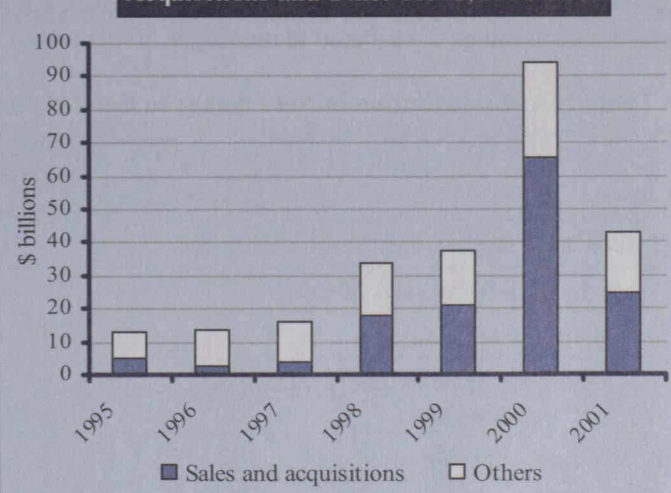
Direct Investment

FDI flows into Canada fell sharply in 2001, coinciding with a drop of 40 percent in FDI inflows for the world as a whole, the first decline since 1991 and the largest year-on-year global fall over the past three decades. The global decline was associated with the slump in the dollar value of cross-border mergers and acquisitions, in part because the prices paid for many companies have come down substantially from "overvalued" levels in 2000, especially for those in the technology sector. (The shocks such as September 11 and the Argentine default later in the year had marginal impact on global FDI flows in 2001.) Inflow of FDI into Canada remained at an historical high level of $42.8 billion in 2001, though it fell by about 55 percent, after surging by more than 150 percent in 2000 to a record level $94.1 billion. This drop in FDI in 2001 occurred as inflows from the EU collapsed from $72.1 billion in 2000 to just $0.13 billion in 2001, following the completion of takeovers of Seagram Co. by Vivendi SA of France and of Newbridge Networks Corp by Alcatel SA of France in 2000. In contrast, inward FDI flow from the United States jumped to a record high of $40 billion in 2001 from $17.3 billion in 2000, as a result of takeovers of several Canadian companies in the energy sector.

The outflow of direct investment (CDIA) in 2001stayed at a high level of $57.3 billion, despite a 12.5 percent drop. This drop in investment outflow was concentrated in markets in the U.S., the EU and Japan. CDIA into the United States fell to $38.9 billion in 2001, from $40.5 billion in 2000, representing 67.9 percent of total outflows. CDIA into the EU fell to $4.9 billion in 2001, from $9.7 billion in 2000. The movement in CDIA resulted from acquisitions of foreign companies in the United States and Europe, and was concentrated in the finance and insurance sector and in the traditional sectors such as energy and metallic industries.

Over the period 1993-1998, CDIA consistently exceeded FDI. In 1999 and 2000, the flow of FDI exceeded CDIA (Figure 14). In 2001, however, CDIA again exceeded FDI. The high level of two-way flows in 2000 and 2001 suggests that the main driving forces have been shifts in the underlying structure of industry and trade in response to globalization pressures, rather than transient factors such as exchange rate movements or cyclical fluctuations.

Figure 13: FDI in Canada: Sales, Acquisitions and Other Flows, 1995-2001



Source: Statistics Canada, *Canada's Balance of International Payments*, Catalogue no. 67-001-XP, 4th Quarter 2001

The stock figures represent values recorded in the balance sheets of the enterprises where the investment is made. They include not only the stream of past investment flows cumulated through time, but also capital gains/losses on existing assets, reinvested earnings, exchange rate revaluations and other adjustments (Table 16A). The exchange rate revaluation takes account for the change in the position of an asset or a liability, denominated in foreign currencies, due to changes in the value of the currency of issue versus the Canadian dollar from December 31 of the previous year to December 31 of the current year. Other revaluation changes take account of the difference between the price at which the transactions occurred and the value recorded in the balance sheet, as well as write-ups or write-downs of investment. Reinvested earnings are earnings that the enterprises do not distribute as dividends, which are treated as direct investment in the balance of payments investment position. Other changes include corporate reorganizations, which lead to reclassifying a portfolio investment to direct investment when ownership increases to 10 percent or more of that stock.

[18] Direct investment refers to investment that allows investors a significant influence in the management of an enterprise. For practical purpose, direct investment pertains to transaction in which the investor has ownership of at least 10 percent of an enterprise's voting equity. Recent data show that 88 percent of the outward investment stock went into Canadian subsidiaries with ownership of more than 50 percent. Portfolio investment includes transactions between non-residents and Canadian residents in bonds and stocks and Canadian money market papers, which are debt instruments with original maturities of one year or less. Other investment includes loans, deposits, official international reserves, and assets such as trade credits, deferred immigrants' funds and progress payments.