Strengthening Canada Abroad

EXPORT PROMOTION REVIEW COMMITTEE
COMITÉ D'EXAMEN DES SERVICES DE PROMOTION DES EXPORTATIONS

Chairman: Roger Hatch

STRENGTHENING CANADA ABROAD

Final Report of the Export Promotion Review Committee

November 30, 1979

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November 1, 1979

The Hon. Robert de Cotret
Minister of Industry, Trade
and Commerce and
Minister of State for Economic
Development
11th Floor East
235 Queen Street
Ottawa, Ontario
K1A 0H5

Dear Mr. de Cotret:

Attached is the final report of the Export Promotion Review Committee -- "Strengthening Canada Abroad" -- which contains our recommendations on ways in which Canadian exports might be increased.

We trust that the Government will find our recommendations helpful, and are very pleased to have had this opportunity to make our views known on this subject, which is of vital importance to the future of Canada.

Yours very sincerely,

Roger Hatch
Chairman

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Acknowledgement

I wish to thank the members of the Committee for the enthusiasm and diligence with which they approached this task. In particular, I would like to acknowledge the efforts of the chairmen of the sub-committees that did much of the detailed investigatory work: Camille Dagenais (Aid and Finance, and Quebec); Keith Hendrick (Ontario); D. A. S. Lanskail (Western Provinces); A. R. Lundrigan (Promotional Support); W. H. Morrow (Maritimes); and W. H. Rix (Overseas). The following also made significant contributions to the work of the Committee: Roger Blake, Doug Cooper, Dr. K. Dhawan, Rod Heath, Jean-Emile Denis and Dr. L. Kryzanowski.

Finally, I would like to especially thank Dr. Harold Crookell who so capably handled the writing of the final document.

Roger Hatch
Chairman

CONTENTS

INTRODUCTION

The Export Promotion Review Committee was established in December 1978 by the Minister of Industry, Trade and Commerce with a mandate to examine the effectiveness of existing government export promotion and support services and to recommend ways of improving them.

The members appointed to the Committee by the Minister are listed in Appendix 2, page 43 of this report and included a representative from the academic community and senior executives from a wide cross-section of private sector companies.

At its initial meeting the Committee established the following terms of reference:

(1) To assess the adequacy, accessibility and relevance of Government export development and support.

(2) To recommend ways to:
- (a) improve such export development and support;
- (b) ensure that the export potential identified in the reports of the sectoral task forces is optimized;
- (c) better co-ordinate export development and support by the federal and provincial governments to ensure a more concerted effort in world markets;
- (d) strengthen the consultative process between government, business, labour and the academic community as it pertains to Canada's export performance.

In order to fulfill its terms of reference the Committee solicited briefs from all interested parties by means of letters to provincial governments, associations and companies, and advertisements in national and local newspapers. Meetings were held with major national associations and with the federal government departments and agencies responsible for export promotion programs.

Four geographic sub-committees were formed to hold meetings with provincial governments and local associations, and functional sub-committees were established to enquire into government activities in the areas of aid and finance, promotional support, and overseas programs.

The level of response to the Committee's actions was excellent, indicative of strong and widespread interest in its subject. More than 170 briefs covering many export related topics were received from individuals, companies, associations and provincial governments. Following the receipt of these briefs, the full committee and the various subcommittees held meetings during the spring and early summer with selected respondents to obtain additional information on various topics.

The balance of the summer and early fall was devoted to analysis of the input, follow-up meetings with government organizations to explore key questions which had been identified, and preparation of this report to meet the publication date established when the Committee was formed.

SUMMARY AND RECOMMENDATIONS

If Canada's balance of trade is to improve significantly, a fundamental change is needed in the economic climate for Canadians doing business abroad. Export financing and taxation of export earnings in Canada are not competitive with those of other major trading nations; export promotion programs are impeded by regulatory procedures; and too few exportable products are designed and developed in Canada. The situation is aggravated by lack of co-ordination and consequent failure to ensure the sharper focus and more decisive thrust needed in foreign trade. Relative to other leading nations, not only is business-government co-ordination deficient, but also co-ordination between the various federal agencies that represent Canada abroad — and between federal and provincial governments.

These are some of the major problems that have surfaced from several months of field work carried out by the Export Promotion Review Committee. Submissions have been received from 170 firms and associations from Newfoundland to British Columbia. Interviews have been held with provincial governments, national associations and key agencies of the federal government. The excellent co-operation of so many organizations in submitting briefs and otherwise assisting the work of the Committee is evidence of a broad interest in improving Canada's export performance. If, therefore, the government acts quickly to improve the general framework for Canadian firms doing business abroad there is likely to be a swift and healthy response from Canadian managers.

It would come none too soon. Canada's international payments' position has been deteriorating throughout the 1970's, partly because of her economic growth which has exceeded that of many other countries, and partly because of her enormous reliance on technology from abroad and the consequent huge trade deficit in technology intensive manufactured goods. It seems we have coasted for years on our raw materials while imports of manufactured goods have climbed inexorably, reaching $30 billion in 1978 for a manufacturing deficit of $12 billion. The current account position began to get out of control in 1975 when the deficit jumped to $5 billion, a figure which has persisted each year since and which has been compensated by net external borrowing with annual interest commitments. The effect of this on the service account has been dramatic. By 1980, it is expected that a trade surplus of $10 billion will be needed to offset the ballooning service deficit if the current account is to be balanced.

What are the chances of so massive an increase in Canada's exports over the next five years or so? Not good at first glance. The medium-term outlook for the economies of our major trading partners is not encouraging. Such growth as there is appears to be in the Far East, the OPEC nations, and certain developing countries, and largely in the form of major turnkey capital projects. But, if the major economies are not growing and the arena of international trade is becoming more competitive, what are the chances of Canada increasing her exports by increasing her market share of world trade? Could Canadian exports grow at the expense of others? We believe so! In part because, for the last decade, others have been growing at our expense (Canada's share of the global export market for manufactured goods has slipped from 5.9 per cent in 1967 to 4.6 per cent in 1977). And also because the currency adjustments of the last two years have improved the international competitiveness of Canadian industry and made possible a reversal of this pattern.

The thrust of the Committee's recommendations, therefore, is to go for growth in exports and to do it by improving the competitiveness of export services and the innovativeness of Canadian industry to the point that Canadian-based firms have positive incentives equal to or better than the incentives other nations offer to their firms. Because our international payments position has deteriorated so much, we recommend that serious consideration also be given to selective, low-key programs to encourage Canadian-based firms to manufacture in Canada certain products that are now heavily imported. For many firms, a significant share of the domestic market is a necessary prerequisite to export activity. As it is, Canada imports more manufactured goods per capita than any other industrialized nation, and in many areas lacks the in-house technology needed to manufacture them at home. Perhaps this is a luxury we can no longer afford. The Committee endorses the efforts of the government to persuade other nations to reduce their non-tariff barriers to trade and open their markets more to competition from Canada. Pending success in this effort, Canada should reduce the openness of its own market, especially in the purchasing policies of its government and utilities.

The Committee also recommends a more liberal policy toward direct investment in Canada with a view to reducing foreign borrowing with fixed interest obligations. Foreign direct investment needs to feel welcome in this country. There is concern, of course, about the sheer magnitude of it, but policies to redress that should, in the view of the Committee, emphasize positive incentive for Canadian-owned firms to become internationally competitive, rather than negative measures to constrain the foreign multinationals. We touch on this subject because of the recently concluded Tokyo round of GATT negotiations. Some United States firms are reportedly questioning whether the resulting tariff cuts remove the economic viability of their Canadian branch plants. Their answer may well be yes if the branch plants produce the same product lines as the parents, but otherwise, no. The Committee notes that some subsidiaries have, in fact, developed unique products in Canada through which they have earned worldwide or regional marketing rights within their firms. This is a pattern which should be encouraged since it enables subsidiaries to contribute more actively to Canada's export effort.

At the same time Canadian-owned firms should be encouraged to innovate, and export support programs should favour those who do. It is the view of the Committee that the Canadian market, with its vast energy related projects, has been the basis for many foreign firms to develop skills and technologies that they have exploited around the world. While foreign technology has often been necessary and beneficial for Canada, the effective transfer of it to Canadian-owned firms for downstream exploitation has been notably lacking. In future, opportunities in the Canadian market should be used to build the capability of Canadian-owned firms, where possible, through joint venture or licence agreements with key foreign firms.

The remainder of this summary deals with the Committee's major policy recommendations to achieve export growth. The recommendations are influenced by widespread private sector support of the government's commitment to spending restraint, and a consequent rejection of adding new programs to old. They are also influenced by the dramatic changes in the world economic environment over the past few years and the consequent need for more active government-business co-ordination to keep Canada's export support services internationally competitive on an ongoing basis.

Recommendation 1 —
Fundamental Commitment to Exports

Canada needs a vigorous renewal of will on the part of corporate managements and labour to maintain international competitiveness and to get out and win export markets. That renewal of will needs a supportive federal government with co-ordinated and focussed export support services. The federal government should, therefore, make a high profile public commitment in support of Canadian exports. Active ministerial involvement is needed both in pursuit of contracts abroad and in emphasizing at home the enormous economic significance of international trade to the Canadian economy. Trade must become more important politically. Public statements by ministers of all departments must be examined more carefully for their potential impact on trade so that exports are not inadvertently harmed by political statements without due deliberation. In this connection, the appointment of a Minister of State for International Trade is viewed as a positive and favourable step.

For the past decade, Canada has been preoccupied with domestic issues. It is time to look outward. Public awareness of Canada's trade position with major nations must be sharply increased. With international trade close to 25 per cent of output, the need to maintain international competitiveness in our economy should be a pressing public priority. Renewed effort is needed in international education. Private sector firms active abroad should make sure their boards of directors contain some members with international skills or experience. And the overall public commitment for the long term must be to encourage more firms to invest in foreign markets and view them as an integral part of business activity.

Recommendation 2 —
Formation of an Export Trade Development Board

As part of that fundamental commitment, Canada's export support services need to be co-ordinated on an ongoing basis, and private sector involvement in the framing of priorities needs to be established. The Committee strongly recommends the formation of an Export Trade Development Board to supervise a more focussed and co-ordinated approach to export support services. The purpose of this recommendation is to provide an opportunity for responsible private sector participation in, (a) the development of international marketing strategies and priorities (including co-ordination of those activities of the Canadian Commercial Corporation (CCC), the Canadian International Development Agency (CIDA), the Export Development Corporation (EDC), Industry, Trade and Commerce (ITC), External Affairs, and others which have an impact on export trade), (b) the design and implementation of government support programs (principally within ITC), and (c) the monitoring of performance based on the policies agreed by the Board.

The majority of Board members would be private sector executives, diverse both in terms of industry sector and geographic region; others would be heads of the major governmental agencies, corporations and departments involved in export trade. The Board would be chaired by a private sector executive and would report to the Minister of Industry, Trade and Commerce through whom the funds for export services are voted. Provincial co-ordination would be achieved through the geographic diversity of private sector Board members, selected with provincial government consultation, and through meetings of the Board with appropriate provincial government officers.

The need for improved co-ordination of Canada's activities abroad is urgent, and this recommendation has the vigorous support of the Committee. The kinds of issues to which the Board should address itself include:

1. Determination of markets for concentration.
2. Determination of marketing strategies for priority markets.
3. Determination of allocation of ITC funds to the maximum benefit of the priorities agreed by the Board.
4. Examination of the programs of other countries to monitor the competitiveness of the Canadian export support package.
5. Consideration of new means of support for exports.

Table 5 (page 19) depicts a suggested organization structure for the proposed Export Trade Development Board.

Recommendation 3 —
Tax Incentives for Innovation and Exports

In the view of many respondents, Canadian exports could be stimulated enormously by tax incentives, not primarily to redress Canada's lack of international competitiveness, but to redress tax advantages other countries give to their firms. In this area Canada is lagging behind its major trading partners, and there seems ample room, in the light of what other nations are doing, for significant improvement in financial incentives for Canadian exporters. Exports have become a national priority, perhaps not so much by will as by economic circumstance and it is time, in the view of the Committee, to recognize the related downstream economic and employment benefits through systematic tax incentive as other countries have done.

The kinds of incentives envisaged include measures to reduce or defer the payment of income tax on export earnings, better carry-forward and carry-back provisions, and more liberal tax treatment of Canadians working abroad in the interests of Canadian trade. Because of the complex nature of this specialized area, the Committee recommends the formation of a government-industry task force to examine it further and makes a number of suggestions to guide its work in Appendix 1 (page 40).

In one area, however, the evidence seems overwhelming. This has to do with the lack of innovation in Canadian secondary industry which reflects not only a lack of research and development in Canada but, more significantly, a lack of in-house product design and engineering capability in Canadian firms. The Committee recommends that greater incentive be provided through the tax system for firms manufacturing in Canada to design, develop and market their own unique products. The intent in so recommending is to promote the development of more exportable products on the one hand, and on the other to build the technology needed domestically for effective import displacement.

Recommendation 4 — Export Marketing

There is widespread praise for Canada's Trade Commissioner Service, and the view of the Committee is that economic and trade considerations should be given greater weight in Canadian foreign policy and in the priorities of Canadian missions abroad. The Trade Commissioner Service has not grown appreciably over the past decade, and a greater proportion of government expenditures should be devoted to it. The Committee does not feel that Canadian exports would benefit from subsuming trade commissioner activities under the jurisdiction of External Affairs. The Committee endorses the development in recent years of greater trade and economic knowledge on the part of Canada's ambassadors. It urges that the process be encouraged further. One means to achieve this would be through greater exposure of officers of the Department of External Affairs to trade matters during their careers, perhaps through an enhanced interchange program. Ultimately, all ambassadors should be knowledgeable in Canadian trade policy and committed to trade support.

In the area of trade promotion, the Committee would like to see foreign posts opened faster in areas of sudden commercial significance to Canadian firms, even though diplomatic links may have to be deferred. Trade commissioners should receive longer postings, should specialize in a particular region of the world and should develop special knowledge of Canadian competence in the key industries of their regions during their recall periods. At home, simpler and faster procedures for frequent users of the PEMD program are strongly urged. Introduction of a "blanket authorization" for corporations with a well-defined and successful export strategy would eliminate the need for "case-by-case" application procedures. To assist less-experienced Canadian firms, all government support programs for export should be co-ordinated in single regional offices for "one-step shopping" by potential users.

Recommendation 5 — Export Financing and Insurance

Canadian firms voiced frequent concern about the lack of competitiveness of the Export Development Corporation, especially in relation to the shorter end of long-term financing (say five to 12 years). Meanwhile the EDC has been growing and making a profit while borrowing most of its capital abroad. As the Committee examined this area, it became clear that EDC was competing best in the very long-term area (12 to 20 years) by using the length of term to compensate for the interest rate, and that this approach was working best for large projects where adequate cash flow took many years to develop.

In order to compete in the five to 12 year area, EDC has been passing back part of the financing cost to the Canadian exporter, who has had to absorb it either through lower margins or through higher prices. This "cosmetic" change is becoming more prevalent with 12 to 20 year loans also as Canadian interest rates continue to climb. Thus, while EDC has been fairly successful in its chosen area in the past, Canadian exports have been largely impeded. The Committee's opinion is that the government should ensure that EDC has access to funds which permit the *effective* cost of its offers to finance to be internationally competitive, especially in five to 12 year term loans; and that when significant Canadian export business is at risk, EDC is able to match competitive financing by utilizing concessional rates. To make this possible, EDC should utilize its present profit margins and engage in linked parallel financing with CIDA. In addition, the Committee believes it would be useful if consideration were to be given to the issue of tax-exempt bonds in Canada to raise loan funds for EDC at rates which would enable them to compete more effectively.

A number of additional financing services are needed by Canadian exporters, and the Committee would like to see EDC offer them. These include: (a) one to five year term fixed rate export financing (could be handled through Canadian commercial banks with EDC guarantees); (b) more flexible and broader insurance coverage, including partial cost escalation and currency fluctuation insurance; and (c) earlier entry by EDC into the negotiating process with foreign customers. If government subsidy of EDC is necessary to achieve and maintain international competitiveness in financing services, such subsidy should be given.

The Committee also feels that business understanding of the activities of EDC would be improved if the board of EDC were composed in majority of private sector executives with a private sector chairman, and if EDC were represented on the proposed Export Trade Development Board.

Recommendation 6 — The Trade-Aid Interface

Canada's aid policy should be more closely related to what Canadian firms and institutions are able to deliver competitively. The Committee sees a serious lack of co-ordination between the Canadian International Development Agency and the private sector. Too much aid money is going through multilateral agencies for funding of projects in which Canadians seldom participate. And bilateral aid is diffused over too many countries.

The Committee strongly recommends a fundamental shift in the priorities of CIDA to do fewer things more thoroughly and with broader involvement of Canadian firms. The thrust of the present administration towards a better trade-aid interface is welcomed. Specifically, a smaller percentage of the aid budget should be multilateral and more Canadians should be placed in the multilateral agencies to insure Canada gets a reasonable share of the work. Bilateral aid should be more sharply focussed to fewer countries and should be tied to Canadian output using Canadian skills and technology wherever possible, or using the project to help develop them. CIDA staff should be deployed more extensively in the field (identifying projects) and in developing sectorial expertise in conjunction with ITC. This is not a recommendation for more staff.

The need for improved co-ordination is perhaps greatest between CIDA and EDC in the area of linked parallel financing. The Committee feels there is a strong likelihood that this type of financing will become more common in the future. Canada needs to move swiftly to ensure that Canadian firms are in a competitive position when faced with credit-mixte financing from their competitors. To avoid possible delays, the lead role in negotiating parallel financing arrangements should be taken by EDC. The creation of the Export Trade Development Board recommended earlier should help to avoid the past divergence between Canada's aid policies and her commercial capability.

Recommendation 7 — Capital Projects Abroad

If Canada is to share in the growing proportion of world trade arising in the form of major turnkey capital projects, there is need for consistent high level ministerial support of Canadian efforts. Prime ministers, presidents and monarchs of other countries have been used to support their firms. The stakes are high, and there is need for appropriate focus, but major turnkey projects have become politicized and Canadian political leaders must lend their weight too. The appointment of a minister responsible for international trade is seen as a very positive step in this connection.

The scale of some of these projects is so huge that often technically capable firms will not bid because of the possibility of unforeseen crippling risks for which insurance is difficult or impossible to obtain.

The Committee, therefore, finds merit in the creation of a public-private facility, on a joint ownership basis, for risk evaluation and assumption of major risks in procurement and delivery of large capital projects for export markets. It is recommended that a contingent liability fund be established by the federal government for the recommended new facility, and that it operate on the principle of cost recovery rather than subsidy. The new facility would report through the Export Trade Development Board to the Minister of Industry, Trade and Commerce.

Recommendation 8 — Export and Small Business

Many Canadian firms that are active abroad are small firms with limited managerial and capital resources. Several of the foregoing recommendations are designed indirectly to help them via the financing of exports on one to five year terms, the streamlining of PEMD which is used heavily by small firms, the "one-stop shopping" concept for export support services, and taxation incentives on export earnings.

However, many small firms which could be exporting are not. Many of them are unaware of Canadian export services and many are intimidated by unknown documentation procedures and currency risks. It is recommended that government export support services be skewed toward small firms, that simpler export credit insurance procedures be offered, that help be given with documentation, and that trading houses be encouraged to operate in areas beyond the major cities.

In general, the Committee feels that small Canadian firms that are internationally competitive should be given major economic incentive to overcome the cash flow impediments to growth and to exploit their competitiveness to Canada's advantage.

Conclusion

If Canada is to build on its strength as an exporter of raw products so as to include export of more differentiated manufactured goods, new skills must be learned and the climate for learning them must be made more attractive. It is the position of the Export Promotion Review Committee that a significant opportunity now exists to increase the volume and alter the mix of Canadian exports, and that the need to do so is pressing and urgent in terms of Canada's international payments. The recommendations put forth in this paper are aimed to seize this opportunity and, in the national interest, help to resolve an increasingly intractable problem. Implicit throughout is the view that Canada must lead out in a more determined way to capture a greater share of world markets in the face of tougher competition, and set aside the follower attitude that has characterized her international trade policies in the past.

Chapter 1

THE EXPORT CHALLENGE

The Committee's mandate to find ways of increasing exports from Canada has arisen at a rather critical time. Canada is in serious difficulty with her international payments. The Minister of Finance reportedly expects a record current account deficit of $7 billion for 1979, and has indicated that domestic interest rates cannot fall until exports are increased or imports reduced. A massive increase in exports, however, is going to require an improvement in Canada's international competitiveness. Other countries have current account problems too and the total world market is not growing appreciably. Competition for that market is tough. For Canada to win an increasing share of it will require bold and decisive action by both firms and government departments and agencies.

The Committee has found that Canadian export services are often not internationally competitive. This is true of export financing and insurance, of export marketing support, and of risk sharing programs for major capital projects. Canadian firms competitive on price and product quality lose business to foreign competitors in third countries because those competitors have access to less costly financing. The situation is aggravated by lack of co-ordination in Canada and consequent failure to ensure the sharper focus and more decisive thrust needed in foreign trade. Relative to other leading nations, not only is business-government co-ordination deficient, but also co-ordination between the various federal agencies that represent Canada abroad — and between federal and provincial governments. At the same time, too few Canadian firms are active in the export market; two-thirds of all Canadian exports are handled by only 178 firms according to Michael Wilson, Canada's Minister of State for International Trade. More Canadian firms need to get involved in foreign markets. There has to be a greater private sector response. The Committee is optimistic on this point. The enormous decline of the dollar against other major currencies over the past three years has helped turn North America into a much stronger cost competitive export base. The Canadian dollar, of course, has dropped significantly against the U.S. dollar as well. Canadian firms now are much more interested in export markets. The excellent co-operation of so many managers in submitting briefs and otherwise assisting the work of the Committee is evidence of this interest.

Hence, while the payments problem is critical, the opportunity to redress it is not out of reach. It is the view of the Committee that if the government acts quickly to improve the general framework for Canadian firms doing business abroad there is likely to be a swift and healthy response from Canadian managers. This chapter of the report deals with some of the causes of the payments problem in Canada, its magnitude, and the general direction that solutions need to take. Emphasized in this chapter is the need for a fundamental public commitment to export, the need to strengthen it by developing a more dynamic indigenous technology base, the need to focus it better through more effective public-private co-ordination and co-operation, and the need to fuel it through tax support. In subsequent chapters, the report deals in greater detail with the challenge of achieving international competitiveness in export financing, of improving the export marketing support system, of encouraging more Canadian firms to take on the risks of major capital projects abroad, and of fostering the redirection of aid policy toward Canada's industrial and professional capabilities.

Canada's International Competitiveness

Canada has been losing market share in the global competition for world markets in manufactured goods. We haven't been alone. The United States and the United Kingdom have also been losing market share in similar proportion. That does not make the loss less painful, however. As Table 1 (below) indicates, Canada's decline in market share moved from 5.9 per cent in 1967 to 4.2 per cent in 1975 and then reversed itself slightly to 4.6 per cent in 1977. The compensating growth has gone largely to the much more determined and committed Japanese. As a measure of rough magnitude, the global market for manufactured exports was estimated at $650 billion for 1977 (see "International Trade 1977-78", page 2). Thus a decline of one percentage point in market share means exports of around $6.5 billion less than might have been. In other words, if Canada had been able to hold on to her 6.0 per cent market share of 1970-71, with imports continuing at present levels, the forecast current account deficit of $7 billion for 1979 would be a healthy surplus.

Canada's international payments position has been deteriorating in step with her declining share of world exports. The situation became critical in 1975 when the current account deficit jumped by more than $3 billion in a single year to an unprecedented $5 billion. Part of the cause is that

TABLE 1

PERCENTAGE SHARE OF MAIN MANUFACTURING COUNTRIES' EXPORTS OF MANUFACTURED GOODS

	CANADA	UNITED STATES	UNITED KINGDOM	WEST GERMANY	FRANCE	ITALY	JAPAN	OTHERS
1967	5.9	20.4	12.2	19.6	8.5	7.0	9.8	16.6
1969	6.3	19.3	11.2	19.6	8.2	7.3	11.2	16.9
1971	6.0	17.0	10.9	20.1	8.8	7.3	13.0	16.8
1973	5.0	16.0	9.4	22.1	9.6	6.8	12.7	18.3
1975	4.2	17.7	9.3	20.3	10.2	7.4	13.6	17.3
1977	4.6	16.7	9.3	20.7	9.9	7.6	15.4	16.8

Source: British Overseas Trade Report 1978.

Canada survived the troubled 1970's somewhat better than other major countries in terms of economic growth. Our markets grew faster than the markets to which we traditionally exported, and this contributed to serious declines in our trade balance. In a number of product areas, such as farm equipment, the Canadian market has been more open to global imports than have foreign markets to Canadian exports. Non-tariff barriers to trade in other nations are used much more deliberately and skillfully than they are in Canada. The Committee urges the government to continue to press for a reduction in non-tariff barriers and more open international markets, but at the same time to provide some non-tariff insulation of the Canadian market until negotiations succeed.

A more critical cause of our deteriorating international payments position, however, was Canada's enormous reliance on technology from abroad and consequent huge deficit in technology intensive manufactured goods. Imports of end products reached $30 billion in 1978 for a manufacturing trade deficit of $12 billion. This reliance also caused increased outflows for royalties and management fees, largely from subsidiaries to parents. For years, Canada has coasted on her raw materials to balance the trade account. The Committee's view is that it is time to take direct aim at the manufacturing deficit, and that means tackling the problem of technological dependency.

Alongside the deterioration in Canada's current account, there has been a marked change in the capital account. Direct foreign investment into Canada turned negative during the '70s. Canada has had many current account deficits in the past, but they have seldom put pressure on the currency because they were offset by direct investment inflows, largely from U.S. firms. This is no longer the case. In 1978, outflows of direct investment exceeded inflows by more than $2 billion. The result is that the huge current account deficits since 1975 have had to be financed through external borrowing with fixed interest commitments. These interest charges are making the current account progressively more difficult to balance. The service section of the current account (interest, dividends, fees, royalties, tourism, freight and insurance) moved from a 1975 deficit of $4.7 billion to $8.7 billion in 1978. It is expected to reach $9 billion in 1979. To balance the current account this year will require, then, a trade surplus of $9 billion. If the Minister of Finance's forecast of a $7 billion current account deficit is accurate, we will have a trade surplus of about $2 billion; in 1978 it was $2.3 billion. Without a major corrective effort we face more external borrowing and a spiralling burden of debt servicing costs. If we don't take the corrective steps ourselves, we will ultimately have to accept the discipline of the international financial market, and the prospect of foreign exchange controls.

The Technology Problem

Canada's dependence on outsiders for technology is of long duration. It is evidenced by a persistent net outflow of technology royalties. Most royalty flows are between parent and subsidiary, but a number of Canadian-owned firms have also found it much more attractive to compete at home against multinational subsidiaries by licensing technology from abroad rather than doing their own design and product development work. A small market, protected from the full blast of international competition, tends to elicit this kind of corporate strategy from indigenous firms. One resulting problem is that most products manufactured in Canada are designed elsewhere, and component sourcing follows the locus of design. What then has Canada to export? If most of what is made here is a more expensive copy of what is made in the U.S., how can Canadian firms possibly compete in export markets?

The answer is that in manufactured goods — the embodiment of modern technology — Canada does not compete that well. As Table 2 (below) indicates, our deficit in end products has climbed steadily from $2.9 billion in 1970 to $12.2 billion in 1978. The trade surplus of $2.3 billion in 1978 was a result of a massive surplus of $14.5 billion in raw materials and primary products. The components of that surplus and of the end product deficit are graphically depicted in Table 3 (page 15).

Table 4 (page 16) shows the composition of Canada's exports and imports in end products. Of the $18.5 billion exported, $12.2 billion was in the form of automotive trade with the U.S. Undoubtedly, a significant share of the remaining $6.3 billion represents exports by subsidiaries to their parents (extensive in farm equipment and other industries). It is interesting to contemplate what proportion of Canadian manufactured exports are sold at the marketing initiative of Canadian producers. It is probably not large. And so while exports represent 25 per cent or so of the value of our goods and services, well above the 18 per cent average for other major trading nations, we are not very experienced exporters, and not very well known in industrial circles abroad, because so little of what we export in manufactured goods is at arms-length, and so little is original in design.

The traditional reaction to this state of affairs is to recommend more spending on R&D, but this is not the really expensive part of innovation, and if carried out in isolation from market intelligence seldom results in commercial innovation at all. The downstream costs of innovation, e.g., product design and engineering, production engineering, tooling, prototype production and market launch, are much more costly. In Canada, relatively few firms perform this full range of innovation activity in-house. What is needed therefore is

TABLE 2

MERCHANDISE TRADE SUMMARY 1979-78

($ millions)

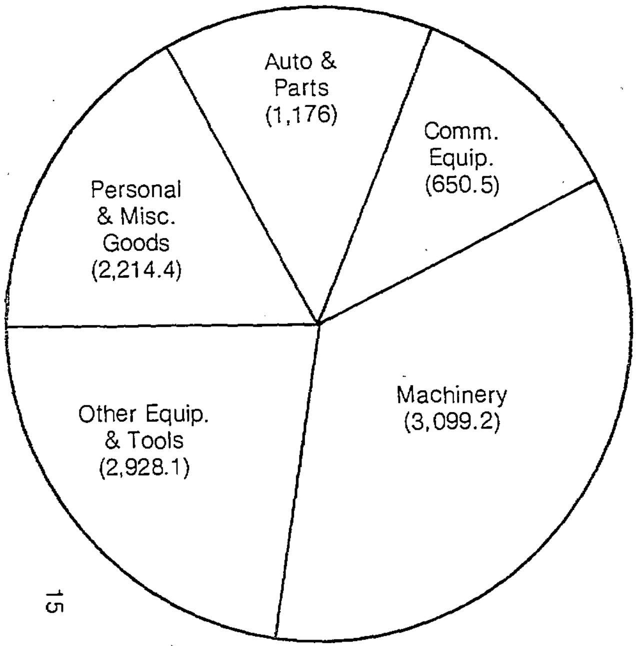
	SURPLUS IN PRIMARY PRODUCTS	DEFICIT END PRODUCTS	MERCHANDISE TRADE BALANCE
1970	5,626	(2,977)	2,552
1972	6,042	(4,801)	1,241
1974	9,403	(8,930)	473
1976	10,539	(10,068)	471
1978	14,577	(12,265)	2,312

Source: Statistics Canada

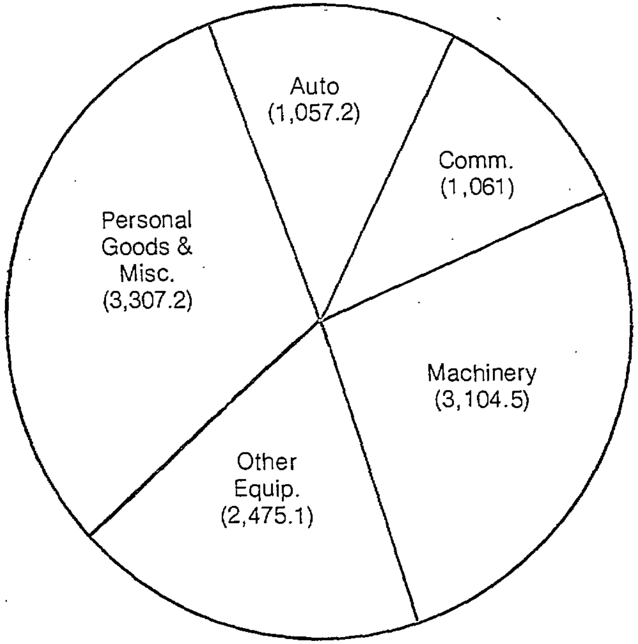
TABLE 3

TRADE DEFICIT IN INEDIBLE END PRODUCTS

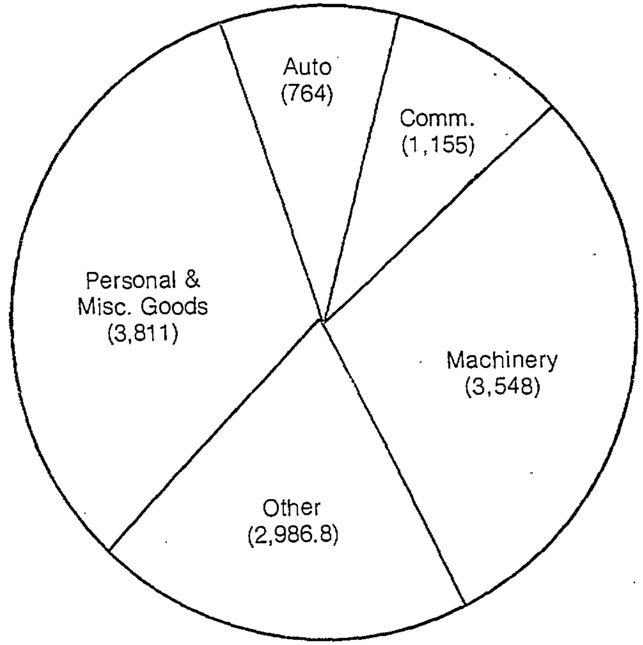
1976



1977

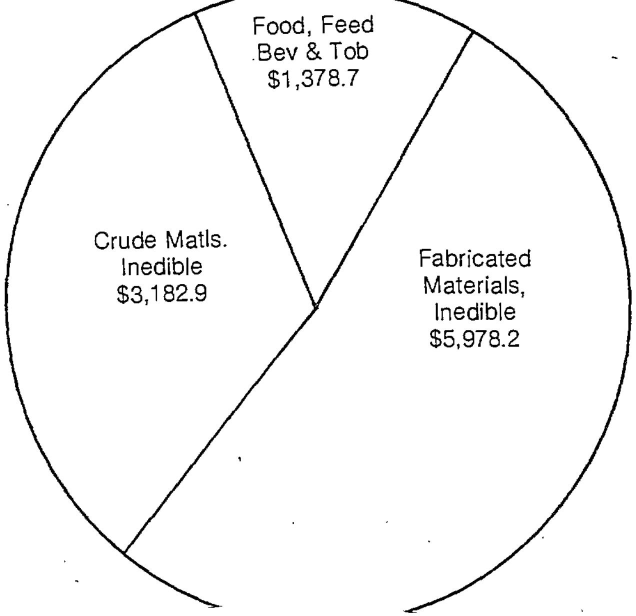


1978

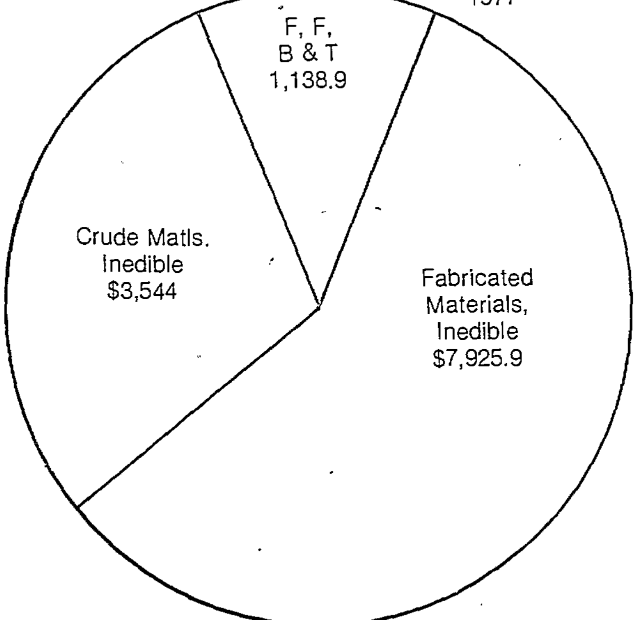


TRADE SURPLUS IN PRIMARY PRODUCTS

1976



1977



1978

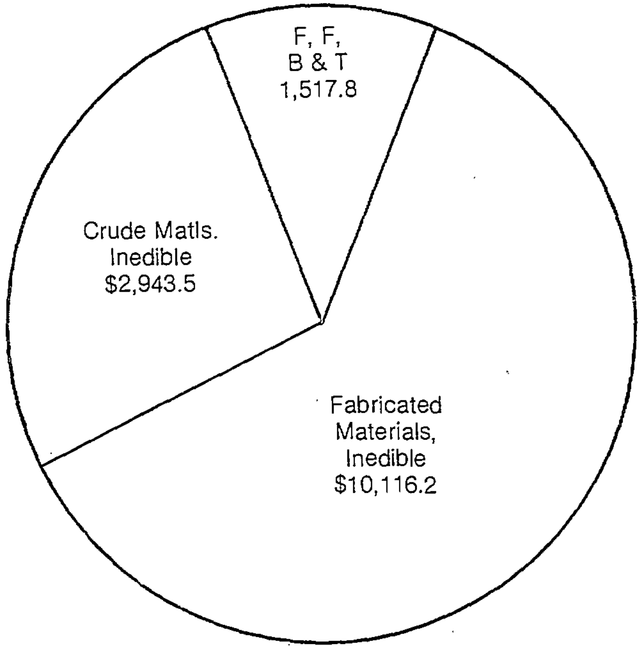
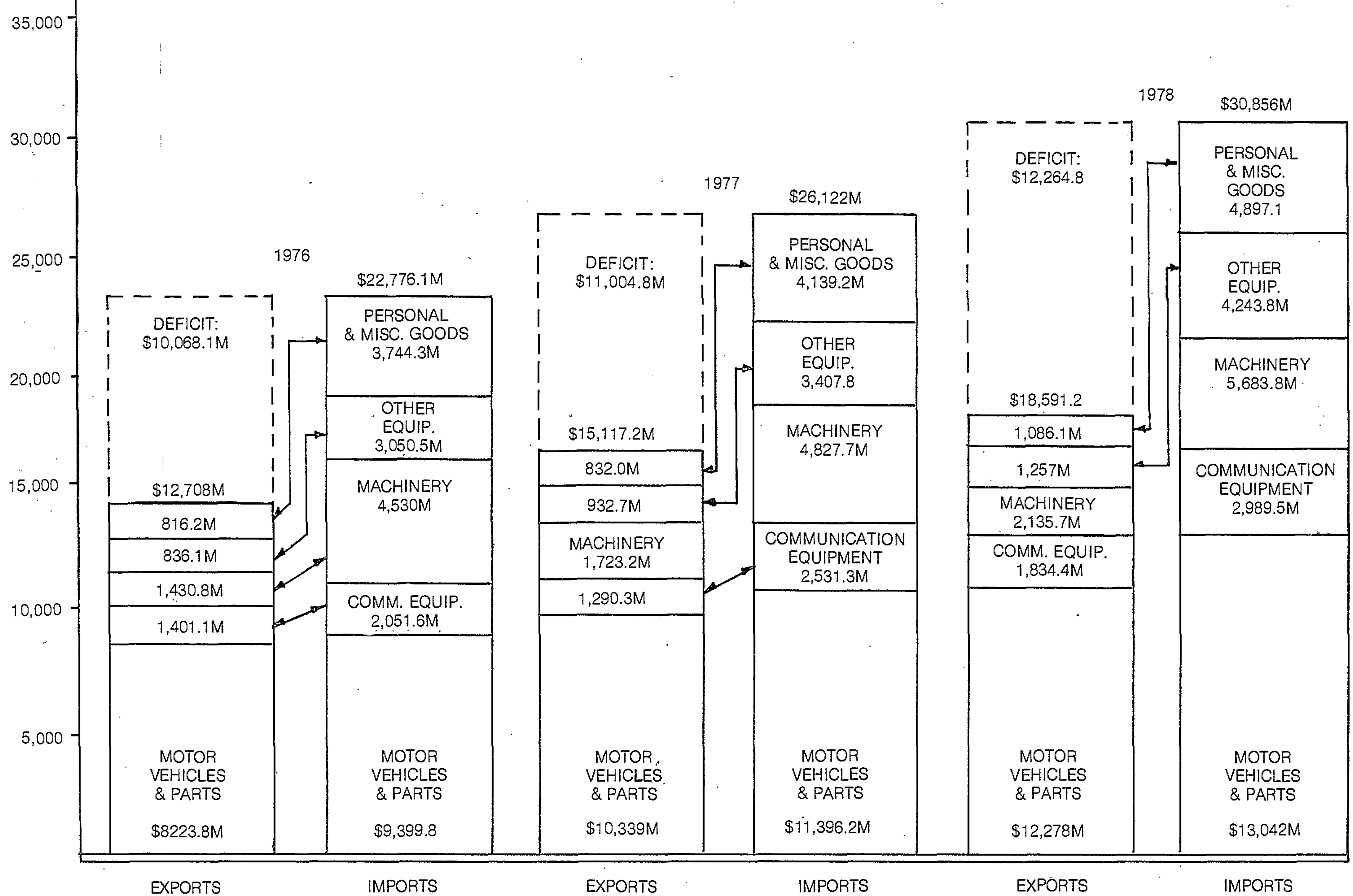


TABLE 4
END PRODUCTS, INEDIBLE



an approach to stimulating these downstream innovation activities. Once firms get involved in market-based innovation the demand for research will arise naturally from the problems they run into. This will result in more focussed research that is more related to market needs.

There is much resistance to overcome before any significant improvement can be expected in Canada's industrial technology base. The purchasing policies of Canadian governments and public utilities have not favoured Canadian technology but have often preferred to source abroad, even from countries that restrict access by Canadians to their own markets. Canada, on the other hand, has used foreign-based firms, sometimes pricing on a marginal basis, to handle many of the major capital projects at home (e.g., purchases by British Columbia hydro of turbines and generators from the U.S.S.R. and Japan, and by New Brunswick of turbines from the U.S.S.R.). Hence others have developed their technology and experience-base on Canadian markets, even where Canadian firms have had the capability to do the job competitively other than for foreign dumping practices.

Canada again faces huge opportunities in this area. Enormous energy-related projects need to be tackled. The question is with whose technology? Which firms will develop as a result of these projects? The questions are important because the successful firms will be strong potential exporters. The view of the Committee is that Canada should use its vast market opportunities to develop its own firms, and that when foreign technology is needed to get the project done it should be brought in on terms that permit Canadian firms to internalize it for future use.

The reason this matter is isolated so early in the report is because it cuts two ways and both are important. First, it makes little sense to expect a large increase in exports to flow from more competitive export support services if the real problem is a lack of exportable products. And second, it is doubtful, certainly in the short term, that Canada can balance her current account just by increasing exports. Reducing imports is also important and a brief glance at Table 3 (page 15) shows the product categories where the large deficits are. The point is that Canadian firms, by and large, do not have the technology base in-house to produce what is now imported. A program to stimulate indigenous technology will therefore contribute two ways. It will provide more exportable products and it will displace products now imported. It is the view of the Committee that selective, low-key programs to encourage Canadian-based firms to manufacture in Canada certain products that are now heavily imported should be pursued. For many firms, a significant share of the domestic market is a necessary prerequisite to export activity. As it is, Canada imports more manufactured goods per capita than any other industrialized nation. Perhaps this is a luxury we can no longer afford.

Foreign Ownership and Free Trade with the U.S.

Canada's technological dependency is normally linked, rightly or wrongly, to the enormous level of foreign ownership of our productive assets. Free trade with the U.S. is seen as the solution from this view. Access to a larger market, it is hoped, will encourage selective rationalization, and provide innovators with a market big enough to reward innovation handsomely. Of course, as the argument goes, there will be dislocation and retraining needs, but overall a net benefit and a persistent new stimulus. It is a beguiling point of view. It may be right in the long term. But if the short term isn't played right there may not be a long term. The position of the Committee in this is that if free trade were embarked upon, and it is not at all clear that it can be, the gains to trade would accrue to the locus of innovation. In other words, if Canada does not first take steps to redress the technology gap in selected areas, few of the benefits would be felt here but many of the problems.

The Committee also recommends a more liberal policy towards direct investment in Canada to reduce foreign borrowing with fixed interest obligations. Foreign direct investment needs to feel welcome in this country. There is concern, of course, about the sheer magnitude of it, but policies to redress that should, in the view of the Committee, emphasize positive incentives for Canadian-owned firms to become internationally competitive, rather than negative measures to constrain the multinationals. We touch on this subject because of the recently concluded Tokyo round of GATT negotiations. Some U.S. firms are reportedly questioning whether the resulting tariff cuts remove the economic viability of their Canadian branch plants. Their answer may well be yes if the branch plants produce the same product lines as the parents, but not otherwise. The Committee notes that some subsidiaries have, in fact, developed unique products in Canada through which they have earned world-wide or regional marketing rights within their firms. This is a pattern which should be encouraged since it enables subsidiaries to contribute more actively to Canada's export effort than they otherwise could, and it would be difficult to achieve the needed increase in exports if foreign-owned firms were excluded from the challenge.

The Committee wishes to add a note of concern here about the development of Canada's human resources. There is legitimacy in the view that foreign investment has done for Canada many of the things Canadians ought to have learned to do on their own but have not. This is a situation which, in the Committee's view, can be corrected without major impediments to foreign investment. There needs to be more insistence on obtaining a genuine transfer of technology into Canadian hands rather than merely the transfer through blueprints, specifications and standards of the output of that technology. Another impediment to greater national autonomy in technology is the shortage of Canadians skilled in design, development engineering, and trades in general. Already, while unemployment has hit Canada's youth particularly hard, there are skilled jobs that would go unfilled were it not for immigration. A deliberate attempt to stimulate indigenous technology would exacerbate these shortages. It is, however, something that must be done, in the view of the Committee, and training and apprenticeship systems must be streamlined for the task.

Small Business

Exporting is not an activity for large firms only. In a recent study* of 136 Canadian exporters of which 71 were small firms (sales less than $10 million), the small firms were found to be more heavily committed to foreign markets than the large firms: that is, they exported more as a proportion of total sales. Furthermore, the small firms had a tendency to compete more on product performance rather than price, indicating a more innovative posture, but leaned more to export or import agents for marketing purposes rather than in-house representatives.

Clearly, small firms face greater risks in their export efforts than large firms do. In framing the recommendations of this

*"International Marketing and Canadian Industrial Strategy", Crookell and Graham, Business Quarterly, Spring 1979.

study, the Committee has been conscious of the shortage of multinational firms based in Canada. There are not many. Conditions need to be set in place, therefore, that will help small firms that are internationally competitive (e.g., exporters) to grow more rapidly than their own resources would permit without loss of control. Some specific recommendations about loan guarantees and tax treatment of foreign income are contained in the body of the report. However, two general recommendations are included at this juncture. First, there is need for a tax incentive that encourages growth — the faster a firm grows the lower its rate of tax. And, second, there is need for marketing assistance for small firms selling abroad. Trading houses can assist of course and should be encouraged, but in addition some consideration should be given to the financing of overseas shipping and warehousing facilities which small firms could use to stock their products for faster delivery to foreign customers. Payment should be made for such a service but only after a sale is consummated.

Export Support and Spending Restraint

At various points in this report, specific recommendations may take the form of direct or indirect subsidization of export activity. At the same time, the Committee, and most of those submitting briefs to it, feel strongly about the importance of government spending restraint and the excess of red tape in some existing programs. This is an Export Promotion Committee and it is attempting to take the approach that exports should be promoted and restraint exercised somewhere else. This, however, would not quite capture correctly the Committee's view. That exports should be supported is not in doubt, of course. But the real feeling of the Committee is that support is necessary largely because other nations are supporting their firms. It is a competitive situation. Canadian exporters should not be continually disadvantaged. Canada's export support mechanism needs to be made internationally competitive and kept that way in a fast changing global environment.

In order to achieve this, exports must first become a national priority and international competitiveness a household term. The serious erosion of Canada's international payments position should supply both the supporting evidence and the needed sense of urgency.

Summary and Key Recommendations

In this chapter an attempt has been made to establish the magnitude of the international payments problem facing Canada and some of its root causes. Technological dependence and lack of skilled trades and professions were emphasized as major causes. Recommendations on particular issues have been made along the way. What follows now is a series of three recommendations that respond to problems voiced frequently in briefs and submissions made to the Committee and that the Committee regards as central to its proposed strategy. That strategy is to make a fundamental ongoing national commitment to export development, and to do it by improving the climate for innovation in Canada and matching other nations with the competitiveness of our export support services.

• Fundamental Commitment to Exports — Canada needs a vigorous renewal of will on the part of corporate managements and labour to maintain international competitiveness and to get out and win export markets. That renewal of will needs a supportive federal government with co-ordinated and focussed export support services. The federal government should, therefore, make a high profile public commitment in support of Canadian exports. Active ministerial involvement is needed both in pursuit of contracts abroad and in emphasizing at home the enormous economic significance of international trade to the Canadian economy. Trade must become more important politically. Public statements by ministers of all departments must be examined more carefully for their potential impact on trade so that exports are not inadvertently harmed by political statements without due deliberation. In this connection, the appointment of a Minister of State for International Trade is viewed as a positive and favourable step.

For the past decade, Canada has been preoccupied with domestic issues. It is time to look outward. Public awareness of Canada's trade position with major nations must be sharply increased. With international trade close to 25 per cent of output, the need to maintain international competitiveness in our economy should be a pressing public priority. Renewed effort is needed in international education. Private sector firms active abroad should make sure their boards of directors contain some members with international skills or experience. And the overall public commitment must be for the long term to encourage more firms to invest in foreign markets and view them as an integral part of business activity.

• The Export Trade Development Board — As part of that fundamental commitment, Canada's export support services need to be co-ordinated on an ongoing basis, and private sector involvement in the framing of priorities needs to be established. The Committee strongly recommends the formation of an Export Trade Development Board to supervise a more focussed and co-ordinated approach to export support services. The purpose of this recommendation is to provide an opportunity for responsible private sector participation in (a) the development of international marketing strategies and priorities (including co-ordination of those activities of the Canadian Commercial Corporation (CCC), the Canadian International Development Agency (CIDA), the Export Development Agency (EDC), Industry, Trade and Commerce (ITC), External Affairs, and others which have an impact on export trade), (b) the design and implementation of government support programs (principally within ITC), and (c) the monitoring of performance based on the policies agreed by the Board.

The Board would consist in the majority of private sector executives, diverse both in terms of industry sector and geographic region, and of the heads of the major governmental agencies, corporations and departments involved in export trade. The Board would be chaired by a private sector executive and would report to the Minister of Industry, Trade and Commerce through whom the funds for export support services are voted. Provincial co-ordination would be achieved through the geographic diversity of private sector Board members, selected with provincial government consultation, and through meetings of the Board with appropriate provincial government officers.

The need for improved co-ordination of Canada's activities abroad is urgent, and this recommendation has the vigorous support of the Committee. The kinds of issues to which the Board should address itself include:

1. Determination of markets for concentration.

2. Determination of marketing strategies for priority markets.

3. Determination of allocation of ITC funds to the maximum benefit of the priorities agreed by the Board.

4. Examination of the programs of other countries to monitor the competitiveness of the Canadian export support package.

5. Consideration of new means of support for exports.

Table 5 (below) is a chart depicting a suggested organization structure for the Export Trade Development Board.

• Tax Incentives for Innovation and Exports — Next to commitment and co-ordination, business submissions mentioned most frequently the need for tax incentives for exporters. Firms making this point were generally more concerned with being on an equal tax footing with their key international competitors than simply receiving assistance. In this area, Canada appears to be lagging behind its major trading partners, and there seems ample room in the light of the activities of other governments for significant improvement in financial incentives for Canadian exporters. Traditionally, Canada has not been anxious to use the tax system to favour any particular group or activity in society, but has tried for benign egalitarian regulation. The Committee is aware, therefore, that tax incentives for exporters will go against the established grain. But it feels the time has come, and that exports with their related downstream economic and employment benefits make a strong justification for incentives.

The kinds of incentives envisaged include:

(a) Inflated write-off for tax purposes of the full spectrum of innovation activities, not just R&D (150 to 200 per cent gross up).

(b) Deferral of export earnings to take account of the length of time receivables are outstanding.

(c) Inflated tax write-off for export marketing expenditures (150 to 200 per cent gross up). PEMD to remain in operation for those wishing to use it.

(d) Loss carry-back privileges for large contracts involving long-term progress payments.

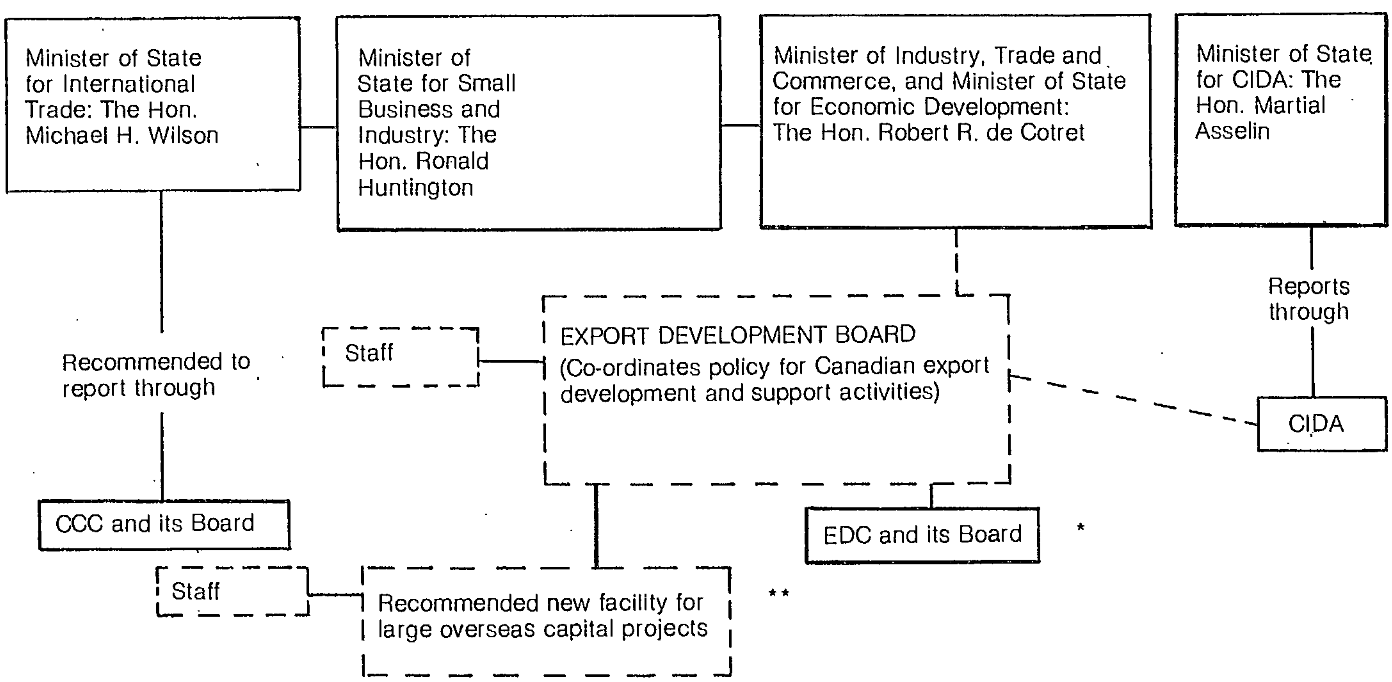
(e) Exemption of foreign dividends from Canadian tax regardless of the tax treaty status of the host country.

(f) More liberal tax treatment of Canadians working abroad in the interests of Canadian trade.

Because of the complex nature of this specialized area, the Committee recommends the formation of a government-industry task force to examine it in greater detail. To assist the task force in defining its task, the Committee has prepared a special appendix (Appendix 1, page 40) on taxation issues.

TABLE 5

A SUGGESTED ORGANIZATIONAL STRUCTURE FOR CO-ORDINATING EXPORT DEVELOPMENT AND SUPPORT ACTIVITIES OF ITC, EDC, CCC AND CIDA



*At present reports to Parliament through the Minister of Industry, Trade and Commerce.

**Structural involvement of CCC with this proposed new facility is not ruled out.

Chapter 2

EXPORT MARKETING AND PROMOTION

The Canadian Government attempts to assist its exporting firms by providing marketing support abroad and promotional activity at home. The marketing support is provided largely by the Trade Commissioner Service (TCS) which is highly regarded by the business community, and by some provinces and some other federal departments, e.g., Agriculture and Fisheries. Financial support of export marketing is provided through the Program for Export Market Development (PEMD) through which funds are available on a matching basis for market development costs, incoming buyer expenses and major project feasibility studies.

Canada is not generous in its export support programs when compared with other major industrial countries. A 1978 study by the United States House of Representatives ranked Canada seventh out of nine in terms of government support per dollar of export (Table 6 below).

Foreign Posts

The ambassador is the chief executive in a foreign post. The trade commissioners, immigration officers and defence attaches, where present, all report to the ambassador. All secretarial and support personnel, office space, telex and other administrative support facilities are budgeted and allocated through External Affairs to whom the ambassador reports. Some ambassadors are experienced in trade related matters; many are not. The emphasis given trade in a foreign post varies accordingly.

Some administrative procedures and precedents have developed in foreign posts that make it extremely difficult to open or close posts quickly. For example, when a number of posts had to be closed recently due to spending restraints it was not possible to obtain consensus between External, Immigration, TCS, etc., on which ones to close. Each department had different priorities. The result was a compromise in which each department's priorities were given equal weight. Some offices with good trade potential were closed in the trade-off. Furthermore, it has been difficult for the TCS to move on its own to establish limited operation in areas of sudden commercial interest. Normally, the TCS has had to follow formal diplomatic moves and these traditionally take longer to develop and are more costly: hence Canada's slowness in setting up in certain OPEC countries. One reason why the TCS is constrained from moving on its own is that External controls the administrative support budget. They can't even get a telex installed without External's approval.

As the Committee examined this situation it found that trade commissioners in posts where ambassadors were not supportive of trade interests were extremely frustrated. On the other hand, ambassadors with trade experience were able to use the status of their office very effectively in support of Canadian export initiatives. Thus an ambassador with trade experience was a strong potential ally to Canadian exporters.

In the past, the diplomatic role has been the key role in foreign posts. This has changed progressively toward a trade emphasis in recent years. The Committee feels it is time to acknowledge that trade should now be the primary function of foreign posts. The Trade Commissioner Service is widely regarded in the business community as one of the finest in the world and invaluable in its export support role. Surprisingly, it has not grown appreciably over the past few years. The Committee considers its growth important to Canada's export efforts. A greater proportion of government

TABLE 6

EXPORT STIMULATION IN MAJOR INDUSTRIAL COUNTRIES
1978 STUDY BY U.S. HOUSE OF REPRESENTATIVES

Country	Relative gov't. expenditure* per $1,000 of exports (dollars)	1976 Exports (U.S. $ billions)	Comments
United Kingdom	2.08	46.0	Very intensely and actively involved
Italy	1.65	36.2	Actively involved
France	1.43	56.6	Vigorous
Japan	0.90	67.7	One of the best
United States	0.56	114.9	
Netherlands	0.46	40.6	Small government programs
Canada	0.37	39.0	Modest but significant
West Germany	0.15	103.6	Modest — depends on private sector
Switzerland	0.12	14.9	Little government participation

*Direct government assistance only.

expenditures should be devoted to it. The business community is especially opposed to any attempt to consolidate the TCS under the jurisdiction of External Affairs as has been proposed. It is felt this would result in greater intrusion of diplomatic interests on trade interests and a consequent dilution of trade effort. This position leads to the following recommendations:

Recommendations

1. Trade should be recognized as the primary role of all foreign posts and should be the dominant voice in all opening and closing decisions.

2. More trade commissioners should be appointed, and the TCS should be assigned sufficient control of the administrative support budget to ensure that the essential trade objectives of the TCS can be accomplished.

3. Economic and trade skills should be a prerequisite to all new ambassadorial appointments. This trend is already evolving but needs to be accelerated. All ambassadors should be knowledgeable in Canadian trade policy and committed to trade support as early as possible.

Some Criticisms of the TCS and by the TCS

• Length of posting — The traditional posting of trade commissioners was seen as too short by the business community, especially in countries where language and culture required prolonged adjustment time. There seemed to be a persuasive rationale for regional specialization of trade commissioners so that language and cultural skills would be more transferable from assignment to assignment. An initiative in this regard is underway and should help to assuage some of the criticism about length of posting. However, the Committee recommends that postings be lengthened by one year, and that financial incentives be offered to those assigned to hardship posts to complete their terms of office. Furthermore, if a trade commissioner wishes to remain in a particular post beyond the normal tenure and is performing well he should be encouraged to stay. Frequent movements need not be the only path to promotion.

Recommendations

1. Trade commissioner postings should be increased by one year and special incentives should be given to encourage tenure in the hardship posts. It should be made clear, however, that assignment to such posts is one of the duties of office.

2. Trade commissioners should be specialized by region to promote greater transferability of cultural and linguistic skills.

• Use of Commercial Officers — Commercial officers are local nationals hired in host countries to work with trade commissioners in support of Canadian exporters. Usually commercial officers are fluent in English as well as the local language(s) and familiar with local customs and business practices. Very able local people can be hired, as a rule, for a good deal less than it costs to place a Canadian abroad, largely because of moving and other non-salary costs of temporary displacement for Canadians. The skills of commercial officers have been praised by some Canadian exporters.

A frequent criticism about commercial officers was their lack of knowledge about Canadian industrial capability. They just were not familiar with Canadian firms and what they can do; a not surprising state of affairs. The hiring of more commercial officers does offer a less expensive route to growth for the TCS and is one under active consideration. The Committee's view is that, while appealing, this should not be embarked upon in a deliberate way. There is great merit in Canada being represented abroad by Canadians, both from the perspective of the host countries and the Canadian exporters, but even more from the need to have more Canadians skilled in international trade.

Recommendation

Commercial officers of outstanding calibre should be hired when needed to assist trade commissioners in their export support role, but they should not become the primary source of growth for the Trade Commissioner Service.

• Lack of Specialized Training — A number of briefs, especially those from industry associations, complained of a lack of specialized industry knowledge in the Trade Commissioner Service. The feeling was expressed that foreign posts in countries constituting attractive markets for certain industries where Canada was especially competitive should have trade commissioners knowledgeable in those industries. The trade commissioners, on the other hand, question whether this is not a role the private sector should play itself. The Committee endorses this latter view but, in the light of earlier recommendations about regional specialization of trade commissioners, feels that some industry specialization appropriate to the assigned region might be developed during the trade commissioners' recall periods in Canada.

• Canada's Disjointed Image Abroad — Trade commissioners in foreign posts voiced frequent concern about the disjointed image Canada presents to foreign buyers and governments. Not only do Canadian firms compete against one another for foreign orders in circumstances where most other countries field a "national champion", but also some provinces plus other federal departments, such as Agriculture and Fisheries, get actively involved in export promotion independently. The result is often confusion, but worse on occasions when shrewd host country negotiators play off one against another. To strengthen Canada's image abroad the Committee would like to see all government export support activities conducted abroad co-ordinated under the TCS. When other government departments feel they need active foreign representation their officers should act in concert with the appropriate trade commissioners. This approach would make active ministerial support of Canadian initiatives easier to secure.

The Committee also sees merit in the use of "flying squads" — teams of experts with different skills to pursue export orders of significant size and complexity. When Canada obtains an important order abroad, the trade commissioner should try to get local press coverage on it to draw Canadian capability more forcefully to the attention of local buyers.

Recommendation

All government export support activities should be co-ordinated under the Trade Commissioner Service. Joint specialist teams should be formed to pursue significant export opportunities of a very technical nature.

• Lack of Preparation by Canadian Exporters — Several trade commissioners commented on the lack of preparation by Canadian exporters when they visited foreign markets. This criticism was levelled mostly at firms using the PEMD to finance export market development costs. It appears some do not exert much effort either in advance or after they arrive, with consequent waste of the trade commissioner's time.

• Poor Information Flows — Some trade commissioners were concerned at an apparent lack of export orientation in the ITC sector branches. The concern reflected a lack of response by some sector branch staff to export enquiries from trade commissioners. The enquiries are usually requests for potential Canadian suppliers, but in the words of one trade commissioner, "enquiries just die in there". Inasmuch as the complaint was not raised very often, it is evident that many such enquiries are acted on promptly by sector branch officers. Ultimately, the Business Opportunities Sourcing System (BOSS) program will permit export enquiries to go directly to the firms via computer, but it is not functional yet and may well take a long time to get working properly. Meanwhile, the sector branches should be urged to get all export enquiries through to firms quickly.

Export Promotion at Home

The most persistent theme in all the briefs and meetings the Committee was exposed to was the need for high profile public commitment to export activity. The message was that export is not on the public agenda; that somehow it has to be put on the map. Many suggestions were made to accomplish this objective. Among the major ones was the notion of "one-stop shopping" in Canada for export services.

• One-Stop Shopping — This suggestion, which the Committee strongly endorses, envisages single outlets in major centres across Canada where information can be obtained on export marketing, financing, insurance, aid programs, foreign market opportunities and foreign buyer credit ratings. Such centres would allow exporters to find answers to their export enquiries more quickly and in a more co-ordinated form.

These outlets would involve both federal and provincial officials working together in arrangements appropriate to regional circumstances. They would provide a more effective service by eliminating duplication and bringing together the more detailed regional knowledge of industry by provincial officials with the federal government's greater knowledge of international market opportunities.

• Publicity — An extensive publicity program should be launched to stimulate greater public awareness of the importance of exports. The "one-stop shopping" theme would assure a co-ordinated, focussed approach. The current EDC advertising, while not co-ordinated with other export services, is still a refreshing and welcome initiative and should continue until better co-ordination can be achieved.

• Education — In concert and harmony with the provinces, the Ministry of International Trade should encourage the development of an educational syllabus on exporting for use in high schools, trade and vocational schools and community colleges, with emphasis on keeping Canada competitive in world markets. The Committee sees this as an important ingredient in the "fundamental public commitment to export" recommended so forcefully in Chapter 1. The Committee also endorses encouraging foreign nationals through foreign posts to come to Canada for university level education. Such activities can have far-reaching commercial effects over the years. It is not recommended that Canada subsidize the education of foreign nationals as a general practice, but for those LDCs selected for bilateral aid focus some CIDA support may be justified.

• Other Promotional Ideas — To encourage greater participation in exporting, the Ministry of International Trade should consider (a) an Export Awards Program with related publicity, (b) regular release to the media of the top 50 exporters in Canada and (c) sponsoring the publication of a Canadian Export Magazine emphasizing Canada's industrial capability for distribution through foreign posts and elsewhere, (d) supplying posts with media material to emphasize Canadian export in local areas.

Recruiting and Training of TC's

Business experience as well as business training should be featured in the recruiting of trade commissioners. The Committee would like to see some movement of people between the private sector and TCS, and feels the greatest stumbling block is the private sector. Very few firms seem to be willing to hold a spot open for a manager while he spends a year or two with the TCS. A more likely possibility is the use of the trade commissioner training program to train corporate employees. The training program is well regarded and consideration should be given to opening it up.

Implicit in these suggestions is the Committee's view that more trade commissioners be recruited and trained, (a) to achieve the increased trade emphasis needed in foreign posts, (b) to handle overlap between arriving and departing trade commissioners as a means of insuring some continuity in foreign posts, and (c) to enable some transfer of trade commissioners into the private sector.

The Program for Export Market Development (PEMD)

• Export Promotion — The principle embodied in PEMD is to share with the exporter or would-be exporter the cost of entering foreign markets, in light of the fact that it is usually higher than the cost of penetrating domestic markets. If the market enquiry turns up business, then the government's contribution is repayable over time as a percentage of the business generated. The repayment provision is seen as a requirement under GATT rules, but the French get around this by calling theirs an insurance program with 50 per cent premium.

General reaction to PEMD from the business community has been favourable. It has attracted precisely the kind of users that it was intended to help. An analysis of the 100 most frequent users of the program indicated that about 85 per cent are Canadian-owned firms, that there is a roughly even split between manufacturers and service companies (including construction), and more than half the firms have sales of less than $10 million. Table 7 (page 23) shows the frequency of use of the various sections of PEMD and the amounts spent under each section since the inception of the program.

Most complaints about the program had to do with the slow speed of approvals and the sheer volume of paperwork involved for each project, especially if repayment was necessary. In order to streamline procedures and make the program better known among Canadian exporters, the Committee recommends the following.

Recommendations

1. Integrate regional offices on the "one-stop shopping" principle and grant them approval authority.

2. Introduce a "blanket authorization" in lieu of the "case by case" application method for corporations with a well-defined and proven performance.

TABLE 7

PROGRAM FOR EXPORT MARKET DEVELOPMENT
APRIL 1, 1971 TO MARCH 31, 1978

Program	A	B	C	D	E
	Participation in Capital Projects	Market Identification or Adjustment	Participation in Fairs Outside Canada	Incoming Foreign Buyers	Export Consortia Assistance
	To provide an incentive to suppliers of Canadian goods and services to participate in major international projects.	To make a contribution to a company's cost of defining a market opportunity and/or the cost of adjusting its marketing methods.	To share the cost of participating in trade fairs outside Canada where there is no official government participation.	To assist in bringing to Canada non-Canadians who can influence the purchasing of exports.	To assist the study and development of export consortia by Canadian manufacturers.
No of Applications Received	3,089	3,458	1,696	364	25
Amount Expended	12,684K	4,792K	3,825K	122K	488K
Average Amount Expended per Applicant	$4,106	$1,386	$1,937	$355	$19,520

3. Extend the program to cover prefeasibility costs and registration of patent and trademark rights in other countries.

• Missions and Trade Fairs — Trade missions came in for extensive criticism over lack of focus in the selection of participants and lack of discernible results. There would appear to be grounds for better co-ordinated and focussed missions with more advance notice, and with active ministerial involvement.

Trade fairs were perceived more positively, but opinion was mixed as to their sales effectiveness. Private sector participation seems to be getting more selective. There would appear to be merit in Canada participating in fewer fairs overseas but doing a more thorough job when we do participate. The Committee recommends that at these selected fairs all Canadian participants be encouraged to group together in a Canadian pavilion type of arrangement where this is practical with prearranged booths manned by private sector representatives who pay their own way.

PEMD covers incoming buyer expenses, and since industrial Canada is not well known abroad Canadian firms should be encouraged to bring foreign buyers to establish trade fairs in Canada where the firms are in a position to exhibit their products.

Conclusion

Canada's export support programs are modest but working relatively well. The Trade Commissioner Service is a great national asset worth building on. A greater proportion of government expenditures should be allocated to it and it should be freed to act more quickly in the opening or closing of foreign posts. Trade should become the dominant criterion for judging whether new posts should be opened, even if it means opening them without diplomatic presence, and all existing posts should be re-evaluated accordingly. Delivery of export services to Canadian firms could be greatly improved by use of regional "export centres" and the "one-stop shopping" principle.

Chapter 3

EXPORT FINANCING AND INSURANCE

In Canada, the Export Development Corporation (EDC) plays the key role as supplier of export financing and export credits insurance. The Canadian commercial banks are involved in medium-term export financing, normally through suppliers' credits, and participate to a limited degree with EDC in long-term financing, but EDC is clearly the leader. Notwithstanding EDC's key role, there has developed a wide gap between how EDC sees itself and how it is perceived in the provinces and by the business community. Indeed EDC has the curious distinction of making a regular operating profit as a crown corporation and being strongly criticized for it by the private sector.

To understand this situation it is necessary first to understand the policies and practices of EDC, and to compare its performance to the export financing agencies of other countries. This chapter attempts to do this and then follows with an examination of EDC's programs in financing and insurance with a separate consideration of how its programs have an impact on small business. Because of the technical complexity of this subject and the large number of quite varied comments and recommendations made by business firms, industry associations and provincial governments, an appendix is attached to the chapter listing a selected range of quotes by topic heading. The Committee's own recommendations are contained in the body of the chapter. These are of a more general nature and seem to us the most important issues, but they should not preclude consideration by EDC officers of the many private recommendations listed in the appendix.

EDC — Policies and Practices

EDC was established in 1969 as successor to the Export Credits Insurance Corporation with the mandate to ". . . facilitate and develop export trade by the provision of insurance, guarantees, loans and other financial facilities." Budgetary ceilings were imposed upon it, but because of its rapid growth they were raised in 1974 and again in 1977 and 1978.

EDC is a federally-owned schedule D crown corporation which reports to parliament through the Minister of Industry, Trade and Commerce. As such, it has legal status to sue and be sued and to borrow on its own account — which it does actively. It is governed by a board of directors, chaired by the president of EDC, with six members from government and five from the private sector. Its 365 employees are organized into two policy divisions — finance, and corporate planning and development, and two geographic operating divisions — Africa and Asia, and Europe and Americas. The operating divisions are responsible for all lending, insurance, and foreign investment guarantees in their geographic areas.

Fundamental to the activities of EDC is its mandate to assist Canadian exports. Canadian content is therefore a key criterion in granting loans. EDC's policy is to achieve a minimum Canadian content of 80 per cent before it will finance an export contract, and in 1977 actual Canadian content of EDC supported exports was reported to be, in fact, 80 per cent. While this is commendable as an objective, some criticism has been voiced by firms claiming excessive rigidity in the content regulations. The criticisms usually relate to situations where goods are not available competitively in Canada or where international consortia are bidding together, with national content related to level of participation in the consortium. These are situations calling for careful judgment, and that judgment might be improved if subject to close consultation with the appropriate industry specialists in ITC. Furthermore, evaluation and audit of Canadian content delivered (rather than promised) appears to be necessary, and implementation might be more efficient and effective if the "Canadian content" activities of EDC, ITC and CIDA were merged into one operation.

• **EDC and International Competitiveness** — Responses to the Committee from firms, provinces and industry associations were unanimous that EDC was not competitive on interest rates with other countries. Data published by the Export-Import Bank of the United States in 1976 and 1977 tend to confirm this view (see Tables 8, below, 9, page 25.)

TABLE 8

UNITED STATES EXPORT-IMPORT BANK
Examples of Long-Term "Interest" Rates

. . . in a February 1976 semi-annual report of the Export-Import (Ex-Im) Bank of the United States to the U.S. Congress*, Ex-Im Bank compared the long-term (five years and over) "interest" rates (including all fees and premiums, and blending of funds where applicable) considered most typical for seven countries. The rates for the seven countries, from lowest to highest cost, were given as follows:

Germany, 7.8 to 10.0 per cent for a good credit risk and 8.8 to 11.0 for a bad credit risk.

France, 8.1 and 9.5, respectively, for six years and over.

Japan, 8.3 and 8.5, respectively.

United Kingdom, 9 and 9.5 respectively.

United States, 9 to 9.1 and 9.3 to 9.6, respectively, for six to 10 years.

Italy, 9.8 and 10.3 respectively, for two to 10 years.

Canada, 10.5 and 10.6, respectively.**

A similar comparison was published in the July 1977 annual report of the Export-Import Bank of the United States to the U.S. Congress . . .*** The rates (as defined above) for good credit risks for the same seven countries from lowest to highest cost, were given as follows: France, 8.2 per cent; United States, 8.3 per cent; Germany, 8.6 per cent; Japan, 8.6 per cent; United Kingdom, 8.9 per cent; Italy, 9.0 per cent; and Canada, 9.2 per cent.

*Export-Import Bank of the United States, Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the United States for the Period July 1, 1975 Through December 31, 1975 (Washington, D.C., Semi-annual Report, February 1976), Appendix, pp. 3, 11, 18, 26, 32, 40 and 46.

**It should be noted that the real cost of these long-term borrower credits would be materially affected by an adjustment for exchange rate fluctuations.

***Export-Import Bank of the United States, Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the United States for the Period July 1, 1976 Through June 30, 1977 (Washington, D.C. Annual Report, July 1977), Annex, p. 21.

Again these data are not cited to criticize EDC, but to point out that much of its rapid growth of late must be due to the improved competitiveness of Canadian firms. When Ex-Im Bank studied the reasons why contracts were sometimes lost to foreign competition the primary reason given by the buyer was uncompetitive pricing of the goods, followed by product quality with financing a close third. In other words, a good price/product can carry a weak credit deal. And when a contract is lost or won who is to say what the primary reason was? Financing is just a part of the package. It is this kind of dilemma which permits EDC to claim its financing packages are competitive (e.g., no deals are lost because of financing) while industry claims the reverse. The problem is that the evidence is often elusive. And it is always possible that in claiming competitiveness in financing terms, EDC is not counting the charge back to the Canadian exporter which certainly is part of the effective cost.

Another way of measuring the competitiveness of export financing services used by the U.S. Ex-Im Bank involved three central criteria:

1. Whether export financing, etc., is available as a matter of right, with the onus of explanation on the government in cases where it is withheld;

2. Whether the level of export credit support is constrained by budgetary ceilings; and

3. Whether annual subsidies are given from the national treasury to the official export credit agency, and how large they are.

Table 10 (page 26) categorizes the principal trading countries according to these criteria. The comparison does not augur well for Canada or the United States. Other major nations have substantially greater government commitment to official export credit support. Recently, the U.S. indicated its intent to match competition in financing terms leaving Canada potentially in sole possession of last place.

Recommendation

Canada should increase the level of its commitment to official export credit support to match the commitment of the governments of our major trading partners.

Lack of financial competitiveness is, however, not the only criticism levelled at EDC by the private sector. The corporation is also perceived as aloof and unwilling to co-ordinate its activities with other government agencies involved in export. Evidence for this criticism is seen in EDC's opening of independent regional offices at a time when exporters want "one-stop shopping" for export services; in its relatively infrequent participation with CIDA in parallel financing arrangements; in the fact that it sometimes finds itself in the

TABLE 9

EXPORT-IMPORT BANK OF THE UNITED STATES
DERIVATION OF EXPORT CREDIT INTEREST RATES
BUYER CREDITS OVER FIVE YEARS; MARCH 1977
(Per cent per Annum)

Country	Official Participation	Per cent Rate	Per cent of Contract	Other Participation	Per cent Rate	Per cent of Contract	Blended Rate	Insurance (I)* and Fees (F)	Effective Cost of Export Credit
Canada	EDC	8.5	60	Commercial Bank	10.25** (Prime + 1.5)	25	9.0	0.2 F	9.2
France	Bank of France/BFCE	—	60	Commercial Bank	—	25	7.5***	0.5 I 0.2 F	8.2
Germany	KIW	8.0	45	AKA: C. line Commercial Bank	7.25** 7.75** (Prime + 1.25)	10 30	7.8	0.7 I 0.1 F	8.6
Italy	Mediocredito	8.5	85	None	—	—	8.5	0.5 I	9.0
Japan	Ex-Im Bank	7.5	50	Commercial Bank	9.2	30	8.1	0.31 0.2 F****	8.6
United Kingdom	ECGD	8.0	85	None	—	—	8.0	0.6 I 0.3 F	8.9
United States	Ex-Im Bank	8.4	42	Commercial Bank	7.75** (Prime + 1.5)	43	8.1	0.2 F	8.3

*Insurance premiums and fees for good credit risks.

**Variable

***Combined public and private rates for credits over five years always yield a balanced export credit rate conforming to the interest rate minimums specified in the Consensus Understanding.

****No fees associated with supplier credits.

Source: Export-Import Bank of the United States. *Report to the U.S. Congress on Export Credit Competition and the Export-Import Bank of the United States* (Washington, D.C. July 1977). Annex, p.21.

embarrassing position of having to refuse credit to countries/markets recommended by ITC; and in frequent misunderstanding by business of what EDC is or is not doing. For example, there were complaints from the West and the Maritimes that EDC will not finance exports of agricultural commodities while EDC claims it will. And there were suggestions that EDC should treat exports through trading houses in the same way as exports from Canadian manufacturers, which EDC claims it already does as long as the trading house takes title to the goods.

Rather than try to resolve each issue separately, it seemed more sensible to recommend a different structure for EDC which would improve its basic link to the private sector and promote co-ordination with other relevant government agencies.

Recommendation

The board of directors of EDC should have a majority of its members from the private sector, and a private sector chairman. Co-ordination with other government agencies involved in export should be handled by membership of EDC's president and chairman on the proposed Export Trade Development Board.

• The Heart of EDC's Problems — At the heart of the operating philosophy of EDC is the view that "we don't subsidize exports," coupled with the private sector view that export financing costs should be internationally competitive — by subsidy if necessary. Whether they should we address later. For now we focus on EDC's competitive strategy in the light of its mandate and its resources. Essentially EDC has three sources of capital: (a) government equity and retained earnings ($344 million at the end of 1978 with no dividend expectations), (b) loans from the government at the crown corporation lending rate (8 to 10 per cent), and (c) private loan placements largely via foreign capital markets (reportedly more than $1 billion by the end of 1978). During 1979, EDC plans to raise all its capital requirements (approximately $850 million) in the open international capital markets. Recent placements have been at nominal interest rates of 9.85 and 10 per cent.

How can EDC be internationally competitive with its financing services to Canadian exporters when it borrows at such high rates of interest and operates with a positive spread to cover costs and profit margins? Countries like Germany and Japan can raise funds at low domestic rates while in France, the United Kingdom and Sweden export financing is subsidized by government grants. EDC's view is that the absence of subsidy in its ongoing operations has kept it free from the vagaries of government priorities, and has permitted more rapid growth and more decisive leadership. Certainly the growth has been impressive and if EDC can grow profitably without subsidy, why then are the commercial banks not involved? Their view is that EDC is in fact subsidized and has too strong a competitive edge. They see the subsidy in the form of government equity without dividend obligation, top credit rating by virtue of government ownership, and freedom from income tax. These are some of the reasons why private sector managers expect EDC to act more in the national interest — take a loss if necessary to win an export contract — rather than in its own self interest.

The strategy of EDC has been to find a way to compete in its financing operations within the constraints of its mandate and to do it at a profit. In reality, this strategy has had two key ingredients. First, a deliberate attempt to open lines of credit with selected countries and to use length of term to compensate for an otherwise unattractive interest rate. This has meant a number of very long-term loans (12 to 20 years) with repayment loaded toward the later years. The approach has been most successful with large projects where adequate cash flow was expected to take years to develop. Sec-

TABLE 10

NATIONAL COMMITMENT TO OFFICIAL EXPORT CREDIT SUPPORT

Country	Available as Matter of Right	Degree of Budget Limitation	Access to Annual Appropriations	Amount Appropriated ($ millions)
Canada	No	Substantial	No	—
France	Yes	None	Yes	$500*
Germany	Yes	Modest	**	—
Italy	***	Substantial	Yes	N.A.
Japan	Yes	Modest	**	—
United Kingdom	Yes	None	Yes	$210****
United States	No	Substantial	No	—

*This is the estimated subsidy cost for 1978 of the inflation risk insurance program only.

**Due to the low level of domestic interest rates, there is no need for official export credit subsidies.

***In principle, official export credit support is available as a matter of right; in practice, severe budget limitations have led to the rationing of credit support.

****Figure for 1977/78 fiscal year.

ond, a policy of passing back part of the financing cost, when necessary, to the Canadian exporter. This has taken the form of a fee or service charge to the exporter to cover what would otherwise have been a loss to EDC in meeting competitive financing terms. The result is that, while EDC can correctly say its rates are competitive, part of the cost of financing is being absorbed by the Canadian exporter either through lower margins or higher prices. Thus while EDC has been successful in its chosen area (very long-term projects), Canadian exporters have been impeded in other areas.

The mandate of this Committee has to do with increasing exports. From this perspective EDC leaves much undone, and this because of a deliberately chosen mode of operation. The Committee does not question the efficiency of EDC, but does question seriously the constraints and measures of performance that cause it to act the way it does. EDC needs to be internationally competitive in a broader range of financing services without blunting the competitiveness of Canadian exporters to do it. To make this possible EDC needs access to less costly funds and better links with the commercial banks. Possible sources of such funds include (a) parallel financing arrangements with CIDA, (b) systematic government grants to EDC, and (c) the use of tax-free bonds in Canada for export financing. In addition, EDC could use its profit margins, which in 1978 were four times its administrative costs, to make sure exporters could always obtain internationally competitive export financing, particularly for small transactions.

Recommendation

The government should insure that EDC has access to funds which permit the *effective* cost of its offers to finance to be internationally competitive, especially in five to 12 year term loans, and that when significant Canadian export business is at risk, EDC is able to match competitive financing by utilizing concessional rates.

The Financing Activities of EDC

There is a pressing need in the view of many business respondents for EDC to get involved earlier in the negotiation stage of major international contracts. EDC's preference is to enter when an agreement is concluded and to arrange financing directly with the buyer. Where the terms of financing are such that EDC passes back part of the burden to the Canadian exporter in the form of a fee, it is then too late for the firm to adjust the price. Clearly, if EDC gets involved earlier, it will be more difficult to judge whether any money was left "on the table" in relation to competitors' packages. It will also be more difficult to negotiate financial service charges (often called cosmetic charges) with the exporter in circumstances where the exporter knows all the details of the buyer financing package. However, given the prevalence of "cosmetic" charges to the exporter, and the competitive usefulness of firm financing terms during negotiations, the weight of evidence would tend to support joint participation by EDC in the early stages. The mechanism should involve informal approvals followed by later formal agreements. Such a practice would also alleviate criticisms of slowness in the decision time for EDC approvals — a criticism which could not be validated because relevant information was not available from EDC.

Recommendation

EDC should provide Canadian exporters with firm and explicit financing commitments in the pre-bid and negotiation stages of export sales, and should enter into joint negotiations with the client/buyer on invitation. Paperwork requirements on small loans should be minimized so that lines of credit can be used by host countries for more than just very large projects.

Short and Medium-Term Financing

At present, EDC does not provide short-term finance to Canadian exporters. The banks do but at floating rates. It is often difficult for the small exporter to discount short-term export paper (180 to 360 days) at reasonable rates. The provision of non-recourse guarantees to the Canadian banks by EDC would undoubtedly draw the banks more actively into this area.

An Ex-Im Bank report cited Canada as the only country surveyed that did not offer official financing for medium-term credits. Under the U.S. discount loan program the Ex-Im Bank can refinance up to 100 per cent of the financing extended by commercial banks; its discount rate in early 1979 was 9 per cent. In France and Japan, the commercial banks participate directly with the official credit agency in medium-term credits. The contract usually carries the minimum interest rate permitted by International Agreement for the country in question, but the banks' interest rate, which is usually higher, is compensated by a concessional rate from the public agency. In Germany, where in 1978 the domestic interest rate was below the minimum permitted under International Agreement, short and medium-term credits were handled directly by the banks.

Interest rates have been climbing rapidly in North America of late, widening the gap between bank rates and the International Agreement minimums. With EDC unable to handle concessionary financing on medium-term credits because of the cost of its funds, there is no role possible for the banks under present arrangements. The only way Canada can offer competitive medium-term financing is for EDC to bid the going rate and pass back a "cosmetic" charge to the exporter. And the higher Canadian interest rates go, the higher that "cosmetic" charge is likely to be. One business respondent commenting on this state of affairs stated that, "we have lost many contracts where competitors have quoted higher prices . . . but because of two, three and five year low-interest financing arranged through their government agencies, their price over the financing terms is less." Another firm made the blunt statement, "No medium-term financing is available, except at higher commercial rates."

The area of short and medium-term financing is in need of urgent attention in the view of the Committee, because the present situation is seriously impeding the efforts of small and medium-sized firms to compete in the international marketplace. There is in this connection a pressing need for more active co-ordination between EDC and the Canadian banks; this is a relationship much in need of cultivation, and the Committee was disappointed in this regard not to receive a submission from the banking community.

Recommendation

EDC should establish a program to provide short and medium-term financing for Canadian exporters at rates that are internationally competitive and fixed wherever necessary. Where possible, the credit granting agency should be the commercial banks with EDC supplying guarantees and re-discount facilities. The program should be extended to include feasibility studies and project front-end costs as well as exports.

Long-Term Financing

Of 37 business respondents to a recent survey by the Canadian Export Association, 15 felt that the terms and conditions of EDC long-term financing gave them a fair opportunity to compete in export markets for capital goods and services while 22 felt that they did not. Undoubtedly the split reflects EDC's stronger position with very long-term (12 to 20 year) contracts where their relatively high interest rates can be compensated by weighting repayment toward the later years. This device is especially effective for large projects which require expenditures over many years before cash flows are generated. However, the rising interest rate in North America threatens to impede competitiveness even in these very long-term contracts due to rising "cosmetic" charges in the price. On the other hand, five to 12 year contracts, which are still viewed as long-term, are much more sensitive to actual rates of interest. Again, in order to compete in this range, EDC often passes part of the real financing cost back to the exporter in the form of a "cosmetic" charge. These are the exporters who feel EDC does not give them a fair opportunity to compete.

Furthermore, EDC normally requires the foreign borrower to make a cash payment of at least 15 per cent of the export contract price. France and Japan, admittedly the most competitive countries, will finance 100 per cent if necessary; others will go as high as 90 or 95 per cent. In practice, it appears EDC's 85 per cent financing limit is relatively low.

Canadian legislation provides that if EDC's board turns down a loan that is deemed in the national interest, the government through an Order-in Council can authorize EDC to make that loan. Such a loan is a levy on the Consolidated Revenue Fund under Section 31 of the act, and does not appear on the financial statements of EDC. This process appears to work relatively smoothly with EDC carrying the ball for the exporter who often is only vaguely aware that his application has gone through this special procedure. On the other hand, since there have been no defaults as yet against the "high risk" Section 31 loans, the assertion that EDC is overly risk-averse appears to be strengthened. This judgment, however, needs the passage of a few more years.

Recommendation

EDC should extend itself to take more risks, and should be willing to finance a higher percentage of a contract to reduce the buyer's cash payment when necessary to meet competition.

Credit-Mixte

The definition and purpose of credit-mixte are covered in the chapter dealing with foreign aid. Briefly, credit-mixte involves combining government foreign aid funds with official export credit to produce a concessional financing package. The resulting package normally has a lower interest rate and longer repayment term than would be permitted under the International Agreement. Nevertheless, a number of countries are actively engaged in it, and some 20 briefs submitted to the Committee urged that Canada should follow suit.

In the first six months of 1978, France extended six mixed credits with interest rates and repayment terms averaging 3.5 per cent and 20 years, respectively, on the aid portion. Credit-mixte was formally introduced in the U.K. in May, 1978. The Italians do not use it, there is conflicting evidence in the case of Japan, and Germany seems to have opted for parallel financing via KFW. During 1978, the U.S. Ex-Im Bank began to match foreign mixed credits on a selective basis using its own resources rather than drawing on foreign aid funds. In 1979, it was announced that a mixed credit facility would be opened in the U.S. to meet similar competing financial facilities in other countries.

The U.S. experience is instructive. The initiative arose with the Ex-Im Bank rather than with the aid agency. As a result the U.S. program is now administered by Ex-Im Bank although terms of mixed credit loans must be approved by a government advisory council. In general, the Americans intend to use mixed credits only when others are using them, and in conditions where their firms are internationally competitive. This kind of competitive information is unlikely to reach the aid agency. Certainly in Canada EDC is likely to be much more used to dealing in a tough competitive environment than is CIDA.

The view of EDC on credit-mixte is that it is a battle Canada cannot win (we are smaller than the competing nations) and it contravenes the International Agreement. This is why EDC favours linked parallel financing which has a similar effect to credit-mixte while maintaining the separate roles of CIDA and EDC. The concern of the Committee in this area is that (a) parallel financing is available only in countries eligible for aid, (b) the need in the marketplace is for swift reaction to competitive practices, and (c) parallel financing arrangements are likely to be too slow because of the involvement of separate agencies with separate negotiations.

Recommendation

EDC should have the responsibility to put together linked parallel financing packages, and to negotiate the entire package with the host country. Terms of the package should be subject to the approval of the Export Trade Development Board. A portion of CIDA's budget should be set aside explicitly for parallel financing.

The Insurance Activities of EDC

EDC's export credit insurance program is designed to allow Canadian firms to insure their exports against non-payment by foreign buyers. A brief description of the services offered appears in Table 11 (page 29). A number of risks involved in export trade are not covered by EDC's insurance program. These include (a) cost inflation escalation insurance by which the exporter is covered for losses arising on export contracts due to inflation beyond a reasonable level: in effect, this insurance would permit the exporter to provide for a more modest contingency in his export price, and is especially important where products with long fabrication time are involved; and (b) foreign exchange fluctuation insurance by which the exporter is covered against losses which may be incurred when the contract payment is denominated in a foreign currency and that currency depreciates relative to the domestic currency between date of tender and contract award. Insurance should be available also to cover the loss in exchange arising from late payment by buyer of accounts for which the exporter has entered into foreign exchange contracts with commercial banks.

It is important, however, to point out here that Canada has traditionally lagged behind other countries in the export services it offers and has seldom taken any initiatives of its own. The French are especially noted for their innovative approaches to supporting their exporters while remaining, as a rule, within international agreements. Canada's emphasis, it seems is on compliance with the agreements and

TABLE 11

EXPORT DEVELOPMENT CORPORATION
EXPORT CREDIT INSURANCE/FOREIGN INVESTMENT GUARANTEE PROGRAMS

Principal Risks Covered	Types of Policies	Percentage of Coverage	Premium Rates/ Methods of Payment
Export Credit Insurance Commercial Risks Political Risks	Short term (up to 180 days) For general commodities, two types of policies are (a) Contract Policy operating from date of order and (b) Shipment Policy operating from date of shipment	Normally 90 per cent on all export credit insurance policies	Vary by country; type of goods, credit terms and average premium. For comprehensive policies about 1/2 to 1 per cent. No rates are published.
Does not cover trade disputes or risks normally insured by commercial insurers	Medium term (up to five years). Specific Contract Policies are issued covering individual contracts for the sale of capital goods and services.		
Foreign Investment Guarantees	Cover restricted to a maximum of 15 years. Investor may elect to insure for one or more risks.	Maximum of 85 per cent of the investment. Reduced for coverage beyond $10 million. Coverage extended to new investments only and limited to those in developing countries; 15 per cent co-insurance must be carried by investor.	If all three risks are covered total fees are 1 per cent of investment per annum.

avoidance of anything that might be deemed contrary. The result is that Canada seems always to be faced with the problem of catching up with what others are doing, and traditionally our speed of response has been such that by the time we have caught up others have moved on to something new. This is why the Committee must make so many recommendations. For years other countries have given thoughtful consideration to a multitude of ways in which they can help their exporters. These are Canada's competitors. If we are to increase our exports we must put our firms on a competitive footing, or better yet keep them slightly ahead.

The French and the British have taken steps to provide limited and relatively expensive coverage for both cost escalation and currency fluctuation losses above a "normal" level. This permits British and French contractors to bid on foreign projects with more modest contingency costs — plus the insurance premium. The Committee recommends that similar coverage be provided in Canada as an option to Canadian firms to help make the massive risks of large export projects more manageable. Furthermore, since many Canadian exporters are of modest size by world standards, it is recommended that this insurance be made available at relatively attractive rates to encourage a more aggressive export orientation. Until experience is gained with such policies, they will be difficult to cost on actuarially sound terms. The proposal is to take advantage of this temporary period of uncertainty to price attractively, and to help give Canadian firms a small competitive edge in international markets for a change.

Recommendation

Insurance coverage should be provided at relatively attractive premiums through EDC for cost escalation and currency fluctuation beyond a "normal level" for Canadian firms bidding on export contracts. The period of coverage should include from tender to contract award or to contract completion at the option of the exporter.

Program Administration

Criticism of the insurance program of EDC was widespread and again not always well-informed. Frequent adverse comments were made about the speed of decisions, the lack of flexibility in coverage, the extent of coverage and the absence of automatic coverage within limits for frequent exporters.

Several firms complained about the volume of paperwork and the slowness of EDC in approving insurance applications and settling claims. One firm claimed that it often had to accept a transaction without knowing whether or not it was insured even though it had paid the insurance premium. Sometimes, specific confirmation did not arrive until after the shipment was complete and payment received. There would appear to be ample room to provide automatic coverage for repeat buyers with prompt payment records and rapid approval for small new buyers. The need for specific contract approval should be limited to large contracts and buyers with a poor payment record.

The coverage offered by EDC is normally 90 per cent of the export credit given. While this is reasonably competitive with other countries' policies, there is a precedent for offering 100 per cent coverage for small exporters.

Recommendations

1. EDC should continue to provide policy holders with more flexible and higher discretionary limits below which orders from customers need not be referred to EDC before acceptance for insurance.

2. Insurance should be available for 100 per cent of the export credit for small exporters.

EDC normally insists on blanket insurance coverage involving both commercial and political risks to the same degree of coverage. In this way they adopt a "spread of risk" principle to avoid "adverse selection." Firms, on the other hand, would like to specify coverage more selectively and pay appropriate premiums. The comments of these firms are included in the appendix at the end of this chapter. While this area is rather technical and the Committee finds it difficult to comment on an item by item basis, there does seem to be sufficient evidence, and sufficient precedent in other countries, to conclude that EDC's "whole turnover" approach to insurance is too inflexible.

Recommendation

EDC insurance policies should be re-designed to permit a greater degree of selective risk coverage with varying deductibles, including "political risk only," at the exporter's discretion.

A number of Western briefs complained about EDC's inattention to insurance of agricultural commodity exports, which EDC claims to offer when requested. This misconception is probably due to recent initiatives by the Ex-Im Bank to step up its support of U.S. agricultural exports. The U.S. program has two key elements: first, Ex-Im Bank/CCC supports the financing of the overseas storage and transportation facilities which are required for agricultural exports; and, second, Ex-Im Bank/FCIA supports bulk commodity exports by making it easier for farmers and agribusiness to obtain commercial bank financing (it provides short-term commercial and political risk coverage).

Ex-Im Bank has taken a similar initiative in providing a new guarantee program for U.S. contractors overseas. The program provides protection against losses due to unconvertibility and confiscation of the contractor's tangible property and bank accounts used in projects overseas. It also guarantees against damage to tangible property due to war and protects contractors in certain other disputes.

Farmers and contractors in Canada have become aware through the competitive network that their competitors are yet again ahead of them with tangible support programs. The Committee feels strongly that Canadian exports in these areas will not increase substantially as long as Canadian exporters feel disadvantaged in the marketplace. Rather than frame specific recommendations for farmers and contractors, the Committee wishes to underline its basic recommendation that

> *Canada make a fundamental commitment to export, and use the proposed Export Trade Development Board to help keep Canadian exporters on a competitive footing over time.*

In this way, the private sector will have a choice in monitoring the programs of other nations, and the potential to greatly improve its own knowledge of what is available in Canada.

One final suggestion in the insurance area that came from a number of responding firms was that EDC should develop a credit information gathering system. Export support agencies in other countries (U.K., U.S. and Japan) accept credit reporting as a specific responsibility, and open their files to assist exporters where they can. In the U.S., this is supplemented by the World Traders Report Service which is maintained by the U.S. Department of Commerce. This is one more example of government support of export in other countries that provides practical encouragement to the exporter to take the risks of foreign trade.

The Impact of EDC on Small Business

It is not surprising given the competitive strategy of EDC to learn that small firms feel excluded. Many voiced this view. Their needs for short-term export credit, complete insurance coverage on contracts, and faster decisions with less red tape cannot be expected to be well served by a strategy that emphasizes very long-term, large-scale projects.

The view that EDC is only for the giants is not altogether true. Small firms often participate as sub-contractors on the major contracts funded by EDC, and their participation is probably enhanced by EDC's Canadian content policy. There seems little doubt, however, that EDC financing goes heavily to very large firms although it was not possible to get substantiating data from EDC on this point. On the other hand, small firms are more active users of EDC's insurance programs. According to EDC, 35 per cent of its 931 policy holders had export sales under $50,000, and during 1978, 55 per cent of the 174 transactions covered by EDC were for contracts under $1 million (30 per cent were for contracts under $250,000).

Many of the recommendations in this chapter, if implemented, would make EDC much more useful to the smaller exporter. The ones that are particularly important are pulled together in the following paragraphs so that the needs of the small exporter can receive the focus they deserve. By way of preamble, it is useful to point out that France and the U.S. both have specific programs geared to small and new exporters. The U.S. program provides consultation on commercial bank financing, advice on Ex-Im Bank programs, and a toll-free hot line staffed by Ex-Im Bank loan officers to help get enquirers through to the right person. So far EDC's efforts to help small business have focussed on urging the heads of the regional offices to spot key threshold exporters and give them special attention. Small business needs more than this.

1. EDC regional offices should be co-ordinated for one stop shopping with the regional offices of other export support agencies, and should be given more operating authority so that they can act on the needs of small business directly rather than passing them back to head office for approval.

2. EDC should have a program for short-term financing of export receivables utilizing guarantees to commercial banks and rediscount facilities for export paper.

3. Export credit approvals should be faster for small export orders. Approvals should be automatic (subject to normal bank references) for orders under $20,000 and that figure should be raised to $50,000 for repeat buyers.

4. EDC should insure 100 per cent of both commercial and political risk on the contracts of small exporters without increasing premiums Ex-Im Bank comes close to this with its present program for firms with assets below $2 million, and annual exports below $350,000 that are new users of its programs.

5. Trading houses, when they represent small Canadian firms abroad, should be given insurance privileges similar to what the small firms could obtain if they exported directly.

Conclusion

This chapter on export financing and insurance has reflected a number of major criticisms of the Export Development Corporation voiced by the business community, the industry associations and the provincial governments. Recommendations have been made to improve financing and insurance facilities for Canadian exporters to bring them more into line with what other major trading nations are doing for their firms. The Committee feels these recommendations are important to its mandate to find ways of increasing Canadian exports.

Two concluding observations are necessary, however.

First, many of the important recommendations for change do not constitute direct criticism of EDC. If one takes account of the constraints and performance expectations that surround EDC, it is clear that many of the recommendations cannot be acted on by EDC because of the way the corporation is financed and measured. At the heart of the problem is the fact that EDC does not, cannot and will not subsidize exports. It simply is not set up for it. Neither, for that matter, is any other agency in Canada. EDC has carved out a niche in the export financing area where it can function within its constraints, and in that niche it is succeeding in a sound businesslike manner. Criticisms about slowness in decisions, greater flexibility, and earlier involvement in the negotiating process, etc., that relate to current operating performance are administrative in nature.

Of greater importance are criticisms about the lack of international competitiveness in medium-term financing, the absence of short-term financing for small exporters, the lack of involvement of the commercial banks, and the absence of an immediate competitive response to credit-mixte financing to other nations. And these are areas where EDC cannot reasonably act under its present arrangements because to match what other nations are doing requires subsidy. EDC is a profit-oriented firm, and while Canadian exporters wish it wasn't, it still nevertheless has fundamental reservations about what will happen to its operating autonomy if it becomes the government's export subsidy arm and hence subject to government fiscal priorities. At the same time, other nations that are subsidizing export financing have found ways of responding swiftly and decisively in competitive conditions.

The second concluding observation is related. It has to do with whether Canada, at a time of spending restraint, should take the steps necessary to make its export support services internationally competitive with countries that are subsidizing exports. The Committee comes down unanimously in the affirmative. If it did not, many of the key recommendations in this chapter would be impractical. Canada should subsidize exports at least to the same degree other major trading nations do. The Committee notes and endorses the efforts of the Canadian government to negotiate firm commitments from other nations to restrain export subsidy activities, but notes also that the U.S. has given up this course as its sole effort and has determined to match other nations until the situation is resolved. Many firms submitting briefs to the Committee commented on this dilemma. They were opposed to subsidies in principle but found them essential in practice because their foreign competition had access to them. If Canada is to move aggressively to increase her exports, it is essential that we realize how the competitive game is played by other nations. Export financing and insurance have become important elements in the indirect export subsidy competition, and Canada must respond quickly to put her exporters on an equal footing with their foreign competitors.

International trade is a highly competitive activity. If Canadian firms are to make substantial gains in trade against aggressive and experienced foreign firms, Canada's export financing and insurance activities must be made internationally competitive, and kept that way in a dynamic, fast-moving climate.

Selected Quotes from Briefs Submitted to the Committee — Organized by Topic

Canadian Content Requirements

1. EDC's participation is insufficient for large projects, which require international groupings and thus a smaller proportion of Canadian content.

2. The EDC/CIDA attitude on Canadian content does not enable us to take a leading position in a multinational consortium.

Commercial Orientation

1. Provincial government briefs: The commercial emphasis of EDC should be shifted away from profitability and toward the provision of services on the principle of international equivalency in terms of rates, term and coverage.

2. EDC should not operate on a profit-making principle, it should be providing to Canadian industry a service which is competitive with that offered by all our trading partners.

3. EDC should obtain government support (subsidy) in order to lower its interest rates.

4. Since EDC is profit oriented, its rates are close to that obtainable from alternative private sources.

Finance

Long-Term

1. Briefs: 29 briefs noted that EDC's long-term lending rate tends to be high in relation to that of other countries. Not one brief noted that the rate was competitive.

2. Canada's export financing facilities are close to the bottom of the scale (that is, they are not competitive with those provided by similar agencies in Japan, Germany and France).

3. EDC is competitive as far as length of term is concerned, but certainly not on the interest rate aspect.

Short and Mid-Term

1. Steps should be taken to introduce a short-term guarantee program for exporters to supplement export credits insurance, the program to be competitive with that in place in other industrialized countries (e.g., the two British ECGD guarantee programs for short-term exports). (CEA)

2. The government should establish a program to provide fixed rate medium-term financing for Canadian exporters with terms and conditions comparable to those provided by the official credit organizations of other competitor countries.

3. No medium-term financing is available, except at high commercial rates.

4. It should be noted that, on an ad hoc basis, EDC may provide medium-term buyer credits to match competition.

Small Businesses

1. The needs of smaller Canadian manufacturers in developing their export business requires a more flexible approach by EDC. EDC should step-up its efforts to tailor its services, service orientation and facilities to the other unique requirements and management limitations of smaller manufacturers. A similar flexible service attitude should be extended in the financing of small contracts. (CMA).

2. CEA Survey:
(1) To the question, "Do you consider the export financing difficulties of small exporters to be serious?", 14 respondents agreed and only three disagreed.

(2) To the question, "Is there merit in Canadian banks and EDC exploring a scheme along the lines described in the discussion paper to support small exports and ease the administration of small accounts for EDC?", 15 respondents agreed and not one disagreed.

3. CEA Survey:
(1) To the question, "Are small exporters satisfied that EDC had 'tilted the scale in their favour' through the Small Business Program?", one (qualified) respondent agreed and five disagreed.

(2) To the question, "Should EDC be more explicit in indicating what it will do under this program, as does the Ex-Im Bank in the U.S.?", 13 respondents agreed and not one disagreed.

(3) Respondents generally indicated that they did not know enough about this program to comment usefully.

Credit-Mixte

1. CIDA should recognize the legitimacy of tied aid and should work with EDC.

2. Concessional rates should and could be subsidized out of CIDA budgets for contracts in developing countries.

3. There is a need for more active and frequent participation of EDC, CIDA and private institutions to make interest rates more attractive by use of "credit mixte".

4. Need "credit mixte" for large projects, especially large turnkey projects.

5. Many competitors use aid for benefiting on export contracts.

6. Japan, France and now the U.K. have systems of "credit mixte" concessionary export financing available to their exporters. (CEA)

7. CEA Survey: To the question, "Have you pursued business which was eventually lost to foreign competitors who had access to mixed aid/trade financing?", 35 respondents agreed and 20 disagreed. It should be noted that while 11 capital goods exporters agreed and two disagreed, eight other manufacturers agreed and 13 disagreed.

Concessional Rates

1. Export financing, usually at subsidized interest rates, is an integral element of export selling.

2. Low interest rate, risk-sharing loans would enhance the competitive position of Canadian-based exporters.

3. There are no facilities within EDC to provide concessional rates of interest. With the intensification of international competition, Canada can no longer afford not to meet the competition.

4. EDC: It will match competition if contract award is dependent upon the interest rate.

Negotiations

1. EDC should enter into joint negotiations with exporters.

2. Exporters are excluded from the financial negotiations between EDC and the foreign buyer. This places the exporter at a disadvantage in establishing a firm price for the contract as he/she has no way of knowing the extent of the cosmetic charge EDC will ask for, which results in the exporter either raising his price to the buyer or lowering his profit margin. The former course of action can result in an uncompetitive bid and a lost sale. Joint negotiations between the exporter and EDC would be a most positive step.

3. A firm pre-bid commitment by EDC is necessary, since at present a Canadian exporter does not know the extent of the "financing and service" charges that EDC will ask for. (This results either in a higher price or a potentially lower profit for the exporter.) Furthermore, in a number of cases, the customer will evaluate an exporter's offer at the highest rate of interest and the shortest term offered.

Insurance

General

1. There is a present tendency for EDC to be slow in providing a definite yes or no as to the provision of insurance coverage. In these instances the company is required to pay the insurance premium without coverage confirmation and with specific confirmation often arriving after the shipment is complete and payment received.

2. In the context of EDC insurance, we recommend (No. 1, CEA):
(a) That export trading houses automatically be extended "selective" risk privileges on the basis of source of supply as would be the case if each supplier had directly exported;
(b) That insurance cover be extended to third country sourcing by Canadian-based export trading companies on the grounds that:
(i) the profit on the transaction is returned to Canada,
(ii) a market is established which can later more readily be filled by Canadian goods, and
(iii) a Canadian presence is established which will benefit sales of Canadian lines also carried by the trading houses (note: such cover is available in other countries).

Credit Ceilings

A significant number of companies find that EDC credit ceilings are too low and, after evaluating the risks, ship beyond those ceilings with the risk on their own account. In most cases, no difficulties are encountered, but when default does occur EDC claims 90 per cent of any subsequent recoveries including on goods shipped at the exporter's risk if EDC's own claim is not fully satisfied. It is suggested that a fairer division of recovery would be a percentage calculated on the ratio shipments at the EDC's and at the exporter's risk. (CEA)

Coverage

1. EDC should reconsider its "whole turnover" approach to insurance to permit selected risks at appropriately higher premiums as an option to "whole turnover" in light of the number of companies who do not insure with the Corporation and who have foregone markets because of the present requirements. (CEA)

2. It is mandatory to carry EDC insurance for all export projects. As the exporter may in fact only require EDC assistance in special high risk cases, the insurance burden for non-risk projects erodes the exporter's competitive position.

3. EDC is not sufficiently flexible in agreeing on exclusions from cover on its "whole turnover" insurance requirements.

4. EDC should be prepared to offer political risk or commercial risk only policies at appropriately lower premiums on a basis comparable to other countries. (CEA)

5. EDC:
(1) EDC uses a 'spread of risk principle' to avoid 'adverse selection'.
(2) Since specific political risks are very highly correlated, separate cover would result in little risk, and thus little cost reduction.

6. EDC should develop a mechanism to provide cost escalation insurance so as to cover the difference between contract escalation provisions and actual escalation costs. (CMA)

7. While EDC will insure contracts invoiced in foreign currencies (in addition to Canadian and U.S. dollars) in a number of specified countries, EDC will not provide any coverage against foreign currency fluctuations, as do a number of other export financing agencies.

Agricultural Products

1. EDC insurance is not readily available for agricultural commodities. Furthermore, EDC insurance is inadequate for agricultural products in that it is not generally available for risks at the "other end."

2. A specific concern on the Prairies was that EDC will not provide export credits for perishable goods, although they will for capital projects. This bias against agricultural products makes it difficult for agricultural producers to compete with the U.S. Commodity Credit Corporation which, by its policies, places Canadian producers at a disadvantage. Thus, particularly in those relatively infrequent sales involving exotic items (that is, breeding swine), Canadian sellers must make sales in cash whereas the U.S. competition has a complete credit facility available to them.

Administration

1. There is a need for more local authority in insurance decision making.

2. In the process of decentralization, EDC should ensure that regional offices have adequate authority and should not just become another layer in the administrative process. (CEA)

3. The smaller firm, in particular, requires well co-ordinated government assistance (preferably through a single agency).

4. Provincial governments briefs: It would appear from some recent experiences that in conjunction with opening a regional office in Halifax, EDC has affected other changes in personnel and procedures which have resulted in the Halifax regional office becoming basically a 'branch' of the Montreal office, thereby moving provincial applications one step further away from the centre. Where previously questions and/or applications went from Montreal and sometimes thence to Ottawa; they now go to Halifax, then always

to Montreal, then sometimes thence to Ottawa. Obviously, any frustration caused to the system because of the new "chain of command" can be determined only as counter-productive, suggesting that the regional EDC office now in Halifax, and the one that should follow for Fredericton, be given equal and not branch status to other regional EDC offices in the country.

Intra-Government Co-ordination

1. Not sufficient co-ordination between EDC, CIDA, ITC, CCC, etc. (No. 16).

2. There is an unfortunate level of co-ordination between EDC, which is the principal government agency for implementing export financing, and ITC, including the TCS, which is responsible for export promotion and trade policies.

3. There is some apparent difficulty in the interface between EDC and CIDA, probably due to the absence of common objectives.

4. There should be a "one-stop" office for pulling together all opportunities, programs, assistance, etc.

5. EDC: It co-operates and co-ordinates its efforts with other government departments/agencies.

Credit Information Gathering Service

1. Steps should be taken to devise a foreign credit report information system, which would be available to Canadian exporters and which would form the basis for EDC's documentation requirements for export credits insurance. In developing a Canadian system there should be examination of the means which may be possible to link up with the similar systems now in existence in the U.S., U.K. and Japan. (CEA)

2. Especially for small firms, EDC must provide a foreign buyer credit information system.

Chapter 4

THE TRADE-AID INTERFACE

In the view of the business community, the Canadian International Development Agency (CIDA) has, especially since 1970, taken an overly philanthropic giveaway approach to aid. Officially, aid has been weighted toward the very poor countries with annual incomes below $200 per capita. Pursuit of this emphasis has minimized the use of Canada's technical and managerial resources and the dialogue between CIDA and the private sector has withered away. At the same time, the policy has probably not done as much for development as it might have done if more of Canada's industrial and professional know-how had been brought to bear on the task. And certainly the way the policy has been implemented has not taught Canadians much about the development process.

Essentially, CIDA's approach has been to allocate its budget (just over $1 billion in 1977-78) to more than 90 recipient countries and in excess of 60 multilateral agencies. To maintain adequate institutional links with so many administrations being all but impossible, CIDA simply dispensed the funds while the actual aid was supplied largely by global and national agencies elsewhere. This kind of policy has left CIDA insulated not only from the private sector but also from other federal departments involved in international activities. The International Development Board which used to bring CIDA officers into regular contact with officers from ITC, Finance, External and Agriculture has fallen into disuse. Public support of aid has been seriously impaired in the process, and the Committee noted widespread provincial government and private sector criticism of CIDA in the briefs submitted to it.

The Committee's own view is that Canada could do more for development if its aid activities were more focussed and more closely integrated with its trade strategy. Since the managerial and technical skills so much needed for effective development lie largely within the private sector in Canada, there is also need in the Committee's view for much closer industrial co-operation in aid implementation. To make this possible, CIDA needs to come in out of the cold and start rebuilding relationships that past policies have caused to fall into disrepair. The present administration of CIDA appears ready to attempt this, and the change appears to have ministerial support.

It was not possible for the Committee to examine all aspects of CIDA's activities, nor was it within the Committee's mandate to do so. In the brief time available to it, the Committee chose to examine only those issues related to aid which most affected Canada's trade potential with less-developed countries. These issues were viewed in relation to the practices of other countries and included: (a) the mix of Canadian aid between bilateral and multilateral channels, (b) tying-untying of bilateral aid, (c) competing with subsidized credit-mixte financing, and (d) other issues affecting private sector involvement in development. What follows is an examination of the Committee's findings on these issues and the central recommendations that flow from them.

Multilateral and Bilateral Aid Channels

Canada ranked seventh in 1976, after Sweden, The Netherlands, Norway, France, Denmark and Belgium, in terms of aid as a percentage of GNP (Canada = 47 per cent). Canada's aid goes more heavily to food assistance and to multilateral agencies than that of other major donors. Multilateral assistance accounted for 40 per cent of CIDA's disbursements in 1976 compared to 14 per cent for France, Germany (25 per cent), U.K. (30 per cent), Japan (32 per cent), U.S. (34 per cent). Ironically, while one of the leading supporters of multilateral agencies, Canada has one of the worst records in procuring contracts through them. Various explanations were offered for this remarkable state of affairs: (a) Canadian firms are not aggressive enough in bidding, (b) information is not readily available or available early enough on upcoming contracts, (c) Canada is perceived by the agencies involved as a high cost supplier and is not recommended, (d) Canada has too few technical or policy representatives on the agencies' staffs, (e) the Germans and the Japanese, etc., have contract procurement down to a fine art and, year after year, always obtain more in procurements than they give in donations. The list goes on, but the reality is that Canada has persisted in a policy of extensive funding of a large number (60 or so) of multilateral agencies from which relatively little benefit has flowed to Canada.

One of the advantages of pursuing such a policy is that it is easy to administer: it takes only 3 per cent of CIDA's $30 million administration budget to run the multilateral program. The real overhead, of course, is in the multilateral agencies themselves, and according to current CIDA officials that overhead relative to their programs is many times higher than the overhead of CIDA (five times higher).

Bilateral aid disbursements in 1977-78, including food aid, reached $553 million and the poorest countries received 63 per cent of them. This percentage is high in relation to other major countries whose aid seems to reflect political as well as developmental objectives. In 1976, the percentage for Japan was 61 per cent, the U.K. (55 per cent), Germany (39 per cent) and France (18 per cent). Furthermore, Canada's bilateral aid is disbursed to some 90 program countries. This degree of dispersion makes the program difficult to administer effectively since it is virtually impossible to build satisfactory institutional links to so many countries. As it is, bilateral aid administration involves 44 per cent of CIDA's $30 million operating budget. It is perhaps not surprising that Canada trades less with LDC's than the other major donors who have developed a more focussed approach to bilateral aid. In part, this is because our assistance is too widely dispersed and also because most of the nations we assist are too undeveloped for much meaningful trade to result.

In summary, Canada devotes 40 per cent of its $1,046 million aid budget to multilateral agencies for relatively modest return, 13 per cent to food aid, and 40 per cent to bilateral assistance disbursed to too many countries, most of them with limited trade potential. The rest of the budget goes to research (3 per cent) and to co-operation with non-governmental charitable agencies in Canada (4 per cent). Industrial co-operation attracts 0.1 per cent of the budget. Furthermore, as current budget constraints begin to be felt, it appears that bilateral programs are more vulnerable to reduction than are multilateral agency contributions: the latter represent longer term commitments, involve the Department of Finance, and are classified as assets rather than expenses in the national accounts.

In this way multilateral contributions are artificially insulated from restraint programs because they are not classified as expenses. The word artificially is deservedly underlined.

Recommendations

1. While preserving the humanitarian purpose underlying CIDA, aid policy should be more closely integrated with Canada's trade strategy. To ensure continuity of this policy, CIDA should report through the Export Trade Development Board on those aspects of its program that have an impact on trade.

2. CIDA should reduce its multilateral assistance and focus it on fewer agencies with preference to those engaged in development financing. Canada should seek to improve its staffing and its executive representation in those agencies in order to promote a better return on its contributions.

3. CIDA should increase its bilateral assistance to a minimum of 60 per cent of total aid commitments, excluding food aid, without increasing its staff. To make this possible, CIDA should employ more technical and fewer administrative staff, should set aside a portion of the bilateral budget for parallel financing, and focus the remainder on fewer countries to whom Canada's technical capabilities are most useful, and with whom there is trade potential.

Tying-Untying of Bilateral Aid

At issue here is the degree to which Canadian aid should be tied to purchases in Canada. Many LDC's have voiced the view that they could get more mileage from aid if they could spend it competitively in whatever country they wished. Overall, Canada's assistance is more untied than most major donors partly because of the high percentage of multilateral assistance in Canada's budget. For Canada to take the initiative in untying would undoubtedly result in more Canadian aid money being spent in other countries without an increase in their aid being spent in Canada if other nations failed to follow suit. As it is, Canada has a relatively generous record in that its overall assistance is less tied to specific projects than is the case with other major donors. Although 88 per cent of bilateral disbursements were tied to Canadian purchases, according to CIDA, Canadian content on material was about 75 per cent, this still constituted only 26.4 per cent of the total aid budget (e.g., 75 per cent of 88 per cent of the 40 per cent now allocated to bilateral aid).

The view of Canadian business managers responding to the Committee was that aid should be firmly tied to purchases in Canada, and that specifications should favour Canadian products — rather than competitive foreign products as they sometimes have. One business executive complained that on one project his company's product was purchased only until the Canadian content requirement was satisfied, and the rest of the project was serviced by a U.S. competitor.

It was noted that only four people at CIDA were responsible for controlling Canadian content at the implementation stage for bilateral loans. This may be insufficient, especially for ensuring that replacement parts, etc., are not supplied by foreign based affiliates. The matter of project maintenance and availability of replacement parts three and four years downstream came in for additional comment. A number of aid projects evidently have been launched and completed satisfactorily, but once the contract maintenance period ended, equipment has been allowed to fall into disrepair. It seems futile to authorize additional aid to countries that have not maintained the viability of earlier projects. Again, this is a problem that is easier to handle when bilateral aid is focussed toward fewer countries. At minimum, it would appear that some CIDA funds should be set aside for project maintenance to guard Canada's reputation as a country that cares about what happens to its aid efforts.

The view of the Committee was that Canada should manage and supply its own aid projects as far as its firms are able: more particularly, that Canada's industrial capability be an important constraint at the conception stage of country programs.

Recommendation

Bilateral aid should be tied to Canadian procurement wherever possible. Control of Canadian content at the implementation stage should be improved by co-ordinating the "content" activities of CIDA, EDC and ITC into a single office, utilizing existing facilities.

Credit-Mixte Financing

A number of major donor countries have begun to compete for large overseas projects by offering subsidized interest rates as part of the package. The term credit-mixte implies combining conventional export financing with aid money to lower the net interest rate to the receiving country. Canadian firms in pursuit of large overseas contracts note a definite increase in the use of this competitive weapon by a number of countries beginning with France and now apparently including the United States. Of the many business firms that offered comments on credit-mixte financing, all felt that Canada should find a way to meet the competition.

In Canada's case this would appear to mean greater co-operation between CIDA and EDC in circumstances where speed of response is critical. From CIDA's legal position only "eligible" countries could be considered, and eligibility is determined by cabinet. Even then there is a preference in Ottawa for the notion of parallel financing rather than credit-mixte. Parallel financing implies two separate loans; one at a low interest rate — presumably through CIDA, and one at the going commercial rate — presumably through EDC. The example was given by CIDA and EDC officers of a parallel financing initiative in Indonesia in which CIDA financing at concessional rates helped to build a jetty while EDC financing at commercial rates helped to build a cement plant. The net interest rate on the two contracts combined made Canadian financing competitive with credit-mixte alternatives from other countries, and CIDA and EDC, while acting together, negotiated separate agreements within their normal patterns of operation.

The Committee endorses this initiative, and feels that funds should be set aside from the "enlarged" bilateral aid budget so that parallel financing arrangements can be entered into systematically, as a matter of course, when they are needed to win an important contract. The setting aside of funds would make possible better co-operative planning, and swifter response when competitive circumstances require it.

Recommendation

CIDA should set aside funds from the bilateral aid budget to enable it to engage in parallel financing with EDC when it is necessary to meet competition.

Industrial Co-operation

A very small portion of CIDA's budget is devoted to industrial co-operation, because earlier aid policies did not envisage much private sector involvement. The present management takes the view that the profit motive and the development needs of poorer countries are not natural enemies. Indeed, since CIDA does not manage the projects it finances, it is difficult to understand how its mandate could be administered effectively in the field without private sector involvement.

Two recent proposals originating with CIDA — but stemming from private initiative — have the support of the Committee. These proposals attempt to draw private sector firms into the development process on terms that are acceptable to the host countries and at the same time not too risky to Canadian firms. The first of these relating to front-end studies was formally announced just prior to the printing of this report. The proposals are:

1. Front-End Studies — It is proposed that CIDA make available between two and three million dollars annually from the Industrial Co-operation Fund to pay for project feasibility studies in eligible countries. The project must be consistent with the development priorities of the host country and within the competence of Canadian industry in terms of engineering, and materials and equipment supply at competitive prices. The objective is to get Canadian firms involved in development projects at an earlier stage so that the projects may ultimately be bid on terms and specifications attractive to Canadian industry, and able to be financed by CIDA, EDC or other agencies.

2. Joint Ventures and Know-How Exchange Agreements in Less-Developed Countries (LDC's) — Most donor countries make available government funds for participation in joint ventures in LDC's, and CIDA now proposes to do the same although on a modest scale. The approach normally taken is to form a private, non-private company to take an equity position in a joint venture alongside a domestic firm and a host country firm. The objective is to reduce the financial risk for the domestic firm, hold the balance of voting power in the early formative years, and sell out at a pre-agreed price when the joint venture is operating well. A private sector committee has been urging CIDA for some time to adopt a similar program to help Canadian firms — especially small and medium-sized firms — to get involved in joint ventures and through them transfer their specialized managerial and technical know-how under contract to developing countries. The new administration of CIDA indicates it is looking favourably at this proposal, and the Committee wishes to emphasize its support, express its regret that it has been so long coming forth and its hope that being so late it will not be too little.

In September 1978, Treasury Board did approve a program to fund "starter studies" for joint venture projects by providing grants up to $10,000, and feasibility studies up to $100,000 on a flexible matching basis. Already, under this program, some 300 opportunities have been considered and, by the end of 1978, 14 joint ventures had been undertaken. It is likely that additional ventures might have come into being if CIDA equity participation had been available.

Recommendations

1. CIDA's move toward industrial co-operation should be accelerated, and the Committee is pleased to note that grants can now be provided for front-end studies of projects which match the development needs of host countries with the capabilities of Canadian industry.

2. Joint ventures between Canadian firms and host country organizations should be encouraged further by the formation of an equity participation fund to reduce the overall risk to Canadian firms.

3. CIDA should guarantee payment to Canadian firms, licensing technology or know-how to less-developed countries.

Conclusion

The business community and the provincial governments tend to view CIDA as largely philanthropic, impractical and secretive. This view is not surprising given CIDA's policies since 1970. Greater concern for industrial co-operation does now seem to be taking shape in CIDA, and this orientation has been perceived in some quarters. It will take more than concern to restore CIDA's credibility, however. Much harm has been done, and confidence will have to be won back by decisive program commitments of real substance.

When Canada's total aid commitment is compared with other countries' Canada comes out more or less in line. The smaller OECD donor countries tend to give more as a per cent of GNP than we do. The larger countries overall do not. Comparative figures, of course, can easily mislead: they fail to put into proper perspective the link between official and private disbursements. Some countries count as aid what other countries exclude. Furthermore, the figures cannot take account of the subtle and important linkages between foreign policy, aid policy and trade policy. Whereas those linkages are clearly established in countries such as France, Japan, the U.K. and Germany, integration of aid policy into trade policy in Canada is clearly insufficient. The needed institutional arrangements are simply not operative in this country.

The same question can be approached from another angle, namely the efficiency of CIDA. Even though the cost of aid compares fairly well for Canada with other nations, one cannot help but wonder about the fact that out of 1,000 people employed by CIDA, only some 50 are in the field. There are only 115 technical people in the resources department, yet for 1978-79, some 446 manyears are authorized for departmental administration out of a total of 969. These figures support the view held by the business community and the provinces that CIDA suffers from a lack of technical expertise and from bureaucratic overdose.

The Committee's recommendation that CIDA should report through the proposed Export Trade Development Board with respect to its trade related activities is an attempt to improve the delivery of aid given for development, and to get Canadians involved more directly in development aid rather than funding others to do it. This is why the Committee recommends more bilateral aid and more industrial co-operation. Development has proved a complex problem. It should not be left only to CIDA staff and their consultants. Broader personal and corporate involvement is needed from Canadians. CIDA should facilitate that involvement by more extensive industrial co-operation and the movement of some of its own people out of administration and into the field.

Chapter 5

CAPITAL PROJECTS ABROAD

Since the oil rich nations acted to raise oil prices and transfer massive financial resources into their relatively undeveloped economies, there has been a surge of major turnkey capital project opportunities. The sheer size of them is staggering. A project with a value of $250 million is considered of modest size. Large projects run to a billion dollars and more. One source estimated the value of large capital projects active in 1979 at close to $70 billion.

Canada has a number of firms with a worldwide reputation in engineering, and a smaller number with project management experience. Hence, we have a very large market opportunity and a capacity to tap into it. In the view of the Committee, this opportunity to increase exports is of such magnitude as to warrant separate consideration. This chapter is therefore devoted to ways of increasing Canada's participation in capital projects abroad.

What Assistance Is Needed?

There appear to be two major impediments to greater participation by Canadian firms in the capital projects market. The first has to do with market knowledge: specifically, how Canadian firms become aware of major projects. The second is risk — risk of a magnitude that dwarfs the asset base of most Canadian firms.

The chapter on the aid-trade interface in Canada has already touched on the first problem. While a number of Canadian firms are aggressively seeking out foreign projects themselves, Canada is not well represented in the multilateral financial institutions through which many capital projects abroad originate. By the time Canadian firms become aware of a new project, other countries often have a headstart in negotiations. A recommendation has already been made to strengthen Canada's participation in these institutions and to secure earlier flow of project information.

The more serious impediment, however, is the magnitude of risk inherent in undertaking a very large contract. Take, for example, a two hundred million dollar project with a three-year time horizon in an OPEC country. The first major risk is whether to bid on the project. It may cost a million dollars in bid preparation costs against an uncertain outcome. These pre-bid expenses are at present covered by the federal PEMD program through which the government will reimburse one half of the pre-bid costs on approved applications. Regulatory procedures seem to limit the actual reimbursement to between 40 to 45 per cent according to experienced contractors. Furthermore, only the costs directly related to a specific project are included. Contractors indicated they incur significant overseas marketing costs to monitor the international environment and maintain overseas relationships which cannot be with any specific project. Because of the magnitude of these costs and the importance of capital projects to Canadian exports, the Committee feels that overseas marketing activities in pursuit of such projects should be actively encouraged. As noted in Chapter 1, the Committee recommends preferential tax treatment of all international marketing costs regardless of the type of export. The recommendation is repeated here because it is felt to be particularly applicable to the costs involved in identifying and pursuing major projects abroad.

Recommendation

Overseas marketing expenditures in pursuit of major capital projects should be granted a deduction of 150 to 200 per cent for income tax purposes, while PEMD should remain in operation for those wishing to use it.

However, most Canadian firms will be intimidated less by the bidding cost than by the risks of winning the contract. Overseas contractors face major risks for which insurance coverage is not at present available, and for which contractual exemptions cannot always be negotiated. Costs may escalate because of inflation in the host country where much of the equipment and supervision will be sourced. They may also escalate because of currency movements during the contract period, or from the time the bid is tendered to the time the contract is awarded. Then there are the surprises, such as equipment and materials lost in transit which, while insured for their own value, still cause delays. Naturally, a reasonable estimate for cost inflation, currency adjustment and surprises can be factored into the bid price. But if a company would be decimated by a $5 to $10 million loss, it is likely to be very pessimistic in its cost estimates and hence uncompetitive in its bid price. A company that figures this out in advance, or experiences it once, is not likely to be an active bidder in future contracts, given the cost of bidding. The problem then is how to remove the fear of bankruptcy from firms, or groups of firms, bidding on major capital projects, thus enabling them to submit more competitive bids.

The Canadian Commercial Corporation

The federal government's response to the problem thus far has been to dust off the old Canadian Commercial Corporation (CCC) and give it a new mandate. After Cabinet decisions in 1977 and 1978, CCC's operating role was defined as:

1. to continue as a procurement agency through the Export Supply Centre.

2. to serve as prime contractor for capital project exporters who need a government-to-government arrangement, and

3. to share the unusual risks that are inherent in large overseas projects.

The second and third responsibilities represented a radical departure from CCC's traditional role as a procurement agency for foreign governments (largely U.S.) who were seeking Canadian suppliers of defence related products. Private sector reaction to the new mandate was mixed. It was difficult for many observers to understand how CCC's procurement role equipped it to handle participation in major capital projects. A number of firms responding to the Committee expressed serious concern about CCC taking a project marketing role in competition with Canadian firms. There was general agreement that CCC's role should be responsive and supportive rather than initiating, and that it should avoid the role of prime contractor wherever possible. There were also some suggestions that CCC should assist in organizing Canadian consortia to bid on capital projects abroad.

In 1978, CCC began to prepare for its new role by the appointment of a new Board of Directors with a majority from the private sector. Responsibility for CCC was transferred from the Minister of Supply and Services to the Minister of Industry, Trade and Commerce. As a schedule C crown corporation, CCC cannot borrow on its own account. Therefore, at present, any risk sharing commitment can be made only on a case by case basis after Cabinet approval.

At a meeting outlined in September, 1979, with this Committee, the President of CCC outlined a tentative plan for tackling the important risk sharing responsibility. By way of prelude, the President first indicated CCC's commitment to stay out of active project management, and out of marketing activities abroad. Its major function is to be risk analysis and risk sharing.

The proposal for risk sharing would work approximately as follows:

Assume a Canadian group was about to bid $200 million on a major overseas contract but was concerned about the inherent risks, and assume that the project was costed at $190 million with $10 million as expected profit. CCC would offer to share in losses resulting from uninsurable or non-commercial risks up to a maximum of 10 per cent of the project value, e.g., $20 million on the $200 million project cited.

If the project came in on plan, CCC would share in the $10 million profit on the basis of a percentage agreed to with the companies involved. If the project came in at more than $200 million as a result of uninsurable or non-commercial risks, CCC would agree to share in the losses on the basis of a percentage agreed to by CCC and the Canadian companies when the contract was signed, up to the maximum of $20 million, e.g., 10 per cent of $200 million. CCC's agreement would be with the Canadian group. The group would contract with the foreign government or agency.

The President indicated that excess costs due to inefficiency or mismanagement would not be covered. He further indicated that CCC would deal with project applicants on a first-come, first-served basis, or deal with the company preferred by the foreign customer. Consideration would be given on the basis of Canadian content and on Canadian ownership.

In reviewing this proposal, the Committee was struck by the amount of subjective judgment CCC would have to apply to each case. In particular, it appeared that the exclusion of costs due to "inefficiency" as estimated by CCC still left the bidder potentially liable to an unknown degree. It also seemed that CCC lacked the skilled personnel to undertake risk analysis, or to judge managerial efficiency in large project management. The Committee's view is that the arrangement for coverage of potential losses, no matter what the cause, should be fixed at the outset based on project estimates at the time of the bid. If the arrangement is for coverage of only 75 per cent of the project losses, a sufficient incentive for good management would still be present. The new mandate for CCC has not yet become an operating reality. There is, therefore, no track record to examine, and it is difficult to criticize verbal plans that may change with experience.

A Proposed New Facility

The Committee concluded that the private sector should play a more active role in enacting these plans and in monitoring changes to them over time. The Committee, therefore finds merit in creating a public-private facility on a joint ownership basis for risk evaluation and assumption of major risks on large capital projects abroad. This joint facility would operate on principles of cost recovery rather than subsidy as long as other nations do not force the pace. It would report to the Minister of Industry, Trade and Commerce through the proposed Export Trade Development Board in accordance with the organization chart in Table 1 (page 13). A risk fund of $100 million for contingent liability would be established by the federal government for the joint facility. Majority ownership would be with the federal government in the early stages and minority shares would be contributed by the private sector. If CCC were the vehicle chosen by the federal government to undertake this task, it would be preferable if its procurement role were hired off to another agency. The Committee sees no reasonable connection between the task of this new facility and the traditional procurement role of CCC. Other characteristics of the joint facility could be as follows:

1. It shares in profits commensurate with risks underwritten on a project by project basis.

2. It responds to private consortia or Canadian companies which cannot assume alone major or residual risks in large overseas capital projects. (It should restrict itself to projects valued above $50 million.)

3. It will not undertake project marketing or project management.

4. A small staff competent in financial/project risk analysis and monitoring will be developed.

5. A mixed public/private board of directors, with majority from the private sector, will guide the facility's day to day operations.

6. Capitalization of the proposed new facility be set at $10 million. Private sector firms wishing to utilize the risk fund must first purchase shares in the facility. Initially, project loss coverage would be paid 90 per cent from the risk fund and 10 per cent from the assets of the facility. Profits would accrue to the facility.

7. As the facility grew in experience and asset base it would gradually assume a greater proportion of project loss coverage until ultimately the government risk fund would no longer be required.

Conclusion

If Canada is to share adequately in the growing proportion of world trade arising in the form of major turnkey capital projects, Canadian firms need faster access to information on multilaterally funded projects and a program to protect them from the full weight of potentially crippling unforeseen risks for which insurance is difficult or impossible to obtain. A third form of support is also necessary to put Canadian firms on a similar footing with their foreign competitors. Other countries frequently provide high level political support to their firms when major projects are at stake. Prime ministers, presidents and monarchs all have been used for this purpose. Major turnkey projects, because of their sheer size and their impact on technology and employment in the country of the successful bidder, have become politicized. It is time that Canadian political leaders added their weight to the efforts of Canadian firms. Historically, they have tended to accompany Canadian bidders on a ceremonial basis only when the contract was won. There is need in Canada to recognize that firms pursuing major contracts abroad deserve to be treated as "national champions" carrying the Canadian flag as it were. They should receive consistent, high-level ministerial support in the selling process as well as the contract signing ceremonies.

Appendix 1

TAXATION AND CANADIAN EXPORTS

Canadian federal and provincial governments can greatly assist Canadian exports by establishing a favourable domestic climate from which exporters can operate and by providing useful stimuli through trade promotion programs. However, the decision on whether or not to export is one which can only be made by those who produce and provide services, and in the final analysis this will depend on the extent to which exporting is profitable. No one set of policies under the control of government has as much direct impact on profit as taxation.

Tax measures are potentially the most powerful instrument in the stimulation of exports. The impact of tax-based incentives in other fields, such as oil and gas exploration, demonstrates the validity of this observation. If growth in exports is to be a national priority, then appropriate tax measures to stimulate exports should be implemented.

There is little in Canada's taxation policy which caters to export operations, since the Canadian tax system is based on a "closed economy framework." Thus, unlike many of our competitors, Canadian tax law enactment and enforcement is based on domestic and not global equity.

Each tax function in Canada is vested with a different entity. Enactment is vested with the Department of Finance, and enforcement is vested with the Department of National Revenue. These two departments have at times operated at cross-purposes, especially in the international sector.

Constraints

There are four major constraints involved with the adoption of export-specific tax incentive policies. These are:

1. GATT requirements against direct export subsidies/tax breaks.

2. Vulnerability to countervailing duty on export subsidies, particularly by the U.S., which accounts for approximately two-thirds of Canada's exports.

3. Potential cost of such incentives in an economy in which exports account for a large percentage of GNP.

4. Cost/benefit effectiveness of tax measures as export stimulants.

Practices in Other Countries

In reviewing the practices of other countries, Canada would appear to stand almost alone in not making concessions in one form or another on the taxation of export-related activities. The range of mechanisms is large. They include preferred treatment of offshore income and export development expenses, accelerated depreciation, investment allowances, relaxed inter-company pricing rules, tax-free export oriented investment reserves, special and more generous treatment of entertainment expenses related to export business, VAT tax exemptions on machinery and material purchases used in production of goods for exports, rules to permit exporters to establish tax deductible reserves for such purposes as absorbing export credit risks which are higher than in domestic sales, as well as operational losses including foreign exchange losses. They range from comprehensive packages of export tax allowance schemes such as is found in New Zealand, through value added tax (VAT) systems, to personal tax sparing incentives to encourage individuals to undertake assignments related to export activities abroad.

Unlike Canada most of our international competitors extensively utilize indirect export tax incentives to stimulate exports. The cumulative magnitude of the resultant benefits to exporters has been quantified by a Special Committee for U.S. Exports as shown in Table 12 (below).

Export-related incentives and tax breaks fall into the following categories:

1. Non-taxation, or reduced taxation, of export income;

2. Tax concessions (or grants) for export market development;

TABLE 12

EFFECT OF CERTAIN FOREIGN EXPORT TAX PRACTICES

Effect Attributable to Export Tax Incentives on a $10,000 Export Sale

Country	Increase in After-Tax Profit (dollars)	Increase in After-Tax Profit (per cent)	Possible Export Price Reduction (dollars)
Belgium	300	28.7	330
Brazil	200	14.3	223
France	280	28.0	300
Ireland	1,000	100.0	1,000
The Netherlands	290	27.9	320
Spain	65	5.1	90
United States (DISCs)	240	24.1	

3. Preferential taxation of off-shore income, and safe-haven rules which permit preferential treatment of income from foreign branches, foreign subsidiaries and dividends from export operations;

4. Income tax deductibility, grants or concessional interest loans for investment in export production;

5. Special deductions, credits or reserves for export-related expenses and industrial development; and

6. Administrative practices which permit special tax treatment.

How Canadian Competitiveness Might Be Improved

It is recommended that an industry/government task force be established to review the relative tax position of Canadian exporters, by sectors, to determine the degree to which the level of Canadian tax on export income is a burden to Canadian exporters in meeting competition in markets abroad. Some of the areas that this task force should examine, and suggested measures that might be taken, are discussed in the following paragraphs.

It is the experience of many exporters that, on the average, accounts receivable in respect of export sales of goods or services are outstanding for a much longer period than for similar sales on the domestic market. Yet, for tax purposes such receivables must be included as income in a corporation's accounts from the date they are invoiced. This puts Canadian corporations at a relative cash flow disadvantage and makes it more difficult to offer competitive extended credit terms.

It is recommended that legislative steps be implemented to permit corporations to take export receivables into income on dates which would provide for the deferral of tax until collection of the outstanding account. One way of accomplishing this objective would be to provide for special reserves for exporters of goods and services where amounts are due for services rendered or goods supplied but not yet paid.

Through the PEMD program, administered by the Department of Industry, Trade and Commerce, the government has recognized the fact that export market development requires greater expenditure of time and money than does the development of domestic markets. It is suggested that companies in a taxable income position should be allowed a special income deduction basis for export development costs, as an alternative to a government grant system. Such an alternative would leave decision making regarding export development in the hands of the exporters themselves. For companies without significant taxable income but with substantial export potential, the PEMD system would remain in place.

Specifically, it is proposed that as an option exporting taxpayers should be allowed to defray their export development expenditures themselves, subject to being granted a deduction of 150 per cent of those expenditures for income tax purposes. Such a deduction would be similar in certain respects to that available for research and development expenditures.

One discriminative feature of the current tax system is that the 6 per cent reduction which applies to manufacturing and processing profits is not applicable to income from services. As the provision of export services (including engineering and managment consulting, trading company activity, and project management) is becoming an increasingly important element in the Canadian export mix, it is recommended that income arising from these services should also be eligible for the 6 per cent manufacturing and processing credit.

Companies involved in exports and exposed to foreign taxes frequently find that there is no continuity in their relationship with any given foreign country. Accordingly, they are put at a disadvantage by the requirement that the foreign tax credit afforded by Section 126 be calculated on a country-by-country basis. As well, unused foreign tax credits expire after a period of five years.

By way of contrast, it is possible for a Canadian corporation having subsidiaries in more than one foreign country to pool the underlying foreign taxes of those subsidiaries and to obtain relief in respect of those taxes on a global basis and without time restrictions by use of a foreign holding company. Thus the Canadian tax system favours the establishment of foreign subsidiaries.

It is recommended that Canadian taxpayers be permitted to calculate their foreign tax credit on a global basis if they so desire. Consideration should also be given to eliminating the five-year restriction on the foreign tax carry-forward.

The loss carry-back provision of the Income Tax Act is limited to one taxation year. Many exporters are required to enter into long-term contracts involving relatively higher risks than domestic contracts. Losses may occur in the latter stages of such overseas contracts. It is recommended that export taxpayers be permitted to carry-back losses to at least the term of the contract, including extended warranty periods, if applicable.

Where a Canadian firm acting alone or in consortium participates in overseas projects for the design, manufacture and installation of plant, and for on-site engineering and construction, its contract may be broken into two portions, one for services performed in the customer's country and the other for goods and services furnished from Canada. Indeed, such a division is often desirable in order to ensure freedom from tax in the customer's country on that portion of the contract which relates to goods and services furnished from Canada. The income which arises from services performed in the customer's country is truly income earned outside of Canada. Nonetheless, if it is earned by a Canadian taxpayer, it is subject to Canadian tax.

By way of contrast, other countries favour such foreign-source income with tax-related concessions which enhance the competitiveness of their export industry. France for example exempts foreign-source income, thereby encouraging French companies to channel their exports through foreign-based sales office or subsidiaries located in lower tax countries which subsequently repatriate the profits in the form of tax-free dividends. Likewise, Dutch and Swiss companies are not taxed on the profits of permanent establishments located outside The Netherlands and Switzerland.

It is possible for Canadian companies to achieve somewhat the same results by incorporating foreign subsidiaries to provide services which generate income arising outside of Canada. In order to reduce exposure to foreign taxes, exchange controls and other governmental restrictions in the customer's country, these subsidiaries may well be established in a third country. This may entail the location of administrative personnel at premises situated in the third country, as well as expenditures on goods and services in that country.

Until 1976, the earnings of service or marketing subsidiaries abroad could be repatriated to Canada by way of dividend without further Canadian tax at the corporate level. This permitted Canadian corporations to be more competitive with engineering and manufacturing companies from other countries. However, since 1976, the rules regarding the profits of such companies have been considerably changed, in some instances to result in the immediate taxation in Canada of the income of such companies and in other instances to provide for the application of Canadian tax when the profits of those companies are repatriated to Canada.

Thus Canadian groups earning foreign-source income in these circumstances are often faced with the choice of immediate Canadian tax, or deferral or possible exemption coupled with the effort and expense of establishing an office in some third country. Canada's export competitiveness is thereby impaired.

It is suggested that Canadian companies be permitted to set up special status Canadian subsidiaries which apart from receiving logistical support in Canada (management, accountancy, etc.) from their Canadian parent for a fee, would only conduct business outside Canada. Such special status corporations would be tax exempt. A precedent for this approach would be the foreign business corporation, which was phased out after 1971.

Dividends received by a Canadian corporation out of the active business earnings of its foreign affiliates may be exempt from further Canadian tax, or may be subject to Canadian tax with recognition of the underlying foreign taxes paid. Essentially, the former treatment is only granted where the foreign affiliate is resident and carries on business in one or other of the countries listed in Regulation 5907(11). This list of countries is very incomplete, containing only those countries with which Canada has negotiated an income tax agreement or is in the process of doing so. Many foreign countries do not have income tax agreements, and amongst them are a number of countries which offer excellent opportunities for Canadian exports, notably countries in South America, the Middle East and North Africa.

In this context it is worth noting that countries such as these frequently require Canadian companies vying for engineering or construction contracts to take an equity participation in the local company with which they are dealing. CIDA actually encourages Canadian companies to do this. On the other hand, the Canadian income tax system discourages such participation. This is because developing countries often rely less on direct corporate tax than on indirect taxes and levies, so that on its earnings from a foreign affiliate in such countries, a Canadian company may have an overall tax burden in excess of that which it would have on domestic earnings.

The distinction between listed and unlisted countries inherent in Part I IX of the Income Tax Regulations should be eliminated, given the likelihood that on present criteria so many of the countries important to the Canadian export industry will never be added to the list found in subsection 5907(11).

Canadian companies which are obliged to take participations in foreign affiliates in circumstances such as those described above should be permitted to amortize their investment by way of deductions in computing income over a period of three years.

In the personal tax field steps should be taken to make it more attractive for Canadian-based personnel to accept assignments abroad in conjunction with Canadian export activity, both in terms of the individuals themselves and in terms of adding to the competitive position of Canadian exporters. For example, it is often the case that supervisory personnel have to be resident on-site during the construction and erection stage of a foreign capital project, often requiring a period abroad of some months. It is therefore proposed that the industry/government task force look into the definition of residence requirements to make them more flexible. In particular the July ruling of the Department of National Revenue tightening the residency requirements should be reviewed with the objective of rescinding it.

Two further specific proposals are:

1. Individuals working abroad on CIDA projects should not be required to pay tax to Canada as deemed residents. This simply increases the cost of operating abroad.

2. Special incentives in the form of tax sparing reductions should be given to personnel who because of their work relating to exports must spend a considerable amount of time abroad in each year. Suggestions range from a U.K. scheme which permits businessmen travelling abroad on business more than 30 days in a tax year to claim a 25 per cent deduction on income tax for the time period spent abroad to full exemption for temporary assignments abroad (which some tax jurisdictions permit).

All of the above suggestions relate to taxation at the federal level. It is also to be expected that changes in taxation at the provincial level would make exporting more attractive, and this area might well be the subject of subsequent examination by the proposed task force.

Appendix 2

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