

# INVESTING IN CANADA

Vol. 4, No. 3 – Winter 1990

A NEWSLETTER ON CANADA'S INVESTMENT CLIMATE

INDUSTRY, SCIENCE AND  
TECHNOLOGY CANADA  
LIBRARY

NOV 17 1994

INFORMATION CENTRE

CENTRE D'INFORMATION

JAN 11 1991

INVESTMENT CANADA  
INVESTISSEMENT CANADA

## CANADA — U.S.A. — MEXICO: A NEW FTA?



Initial talks are currently under way on a trilateral free trade agreement involving Canada, the United States and Mexico. More formal negotiations, which will concern the scope, elements and procedures of the proposed agreement, are anticipated to begin in May 1991. Our feature article, Canada — U.S.A. — Mexico: A New FTA?, examines the levels of economic activity among the three nations, and offers insights into the economic arguments for and against a North American free trade zone.

As well, the article entitled: Experts Talk About Foreign Investment and Technology, offers highlights of a conference hosted in September by Investment Canada. Economists from Canada, the U.S., Britain and Sweden presented papers on various aspects of foreign investment and technological development from which a book will be published in the spring of 1991.

### INSIDE THIS ISSUE

<b>E</b> xperts Talk About Foreign Investment and Technology	p. 4
<b>I</b> nvestment Barometer	p. 6
<b>T</b> estimonial: Raychem Corporation	p. 7
<b>I</b> NTER COMM 90	p. 8
<b>A</b> t Your Service	p. 8

	GNP/GDP* (US\$ Billions)	GNP/GDP* (US\$ Per Capita)	CURRENT ACCOUNT DEFICIT (US\$ Billions)	INFLATION RATE (%)
<b>CANADA</b>	531.6	20,214	16.6	5.0
<b>UNITED STATES</b>	5,200.8	20,904	110.0	4.8
<b>MEXICO</b>	201.4	2,365	5.4	20.0

\*GDP for Mexico; GNP for Canada and the United States; 1989

(p. 2) ▼



INVESTMENT  
CANADA

INVESTISSEMENT  
CANADA

## CANADA – U.S.A. – MEXICO: A NEW FTA? ▲ (cont'd from p. 1)

There is some controversy as to whether Canada should enter the trilateral free trade talks involving Canada, the United States and Mexico. While certain people believe that such an agreement would cost Canadian workers their jobs, this argument is countered by those who believe it would lead to a substantial expansion of economic growth in Mexico. This, in turn, would generate strong growth in the import demands of Mexico's large and expanding market, and the consequent trade-generating effects of these developments would benefit all partners in the trilateral agreement.

The impetus for the free trade discussions came from Mexico, which proposed free trade negotiations to the United States in March 1990. Mexico is the United States' third most important trading partner after Canada and Japan, while the U.S. is overwhelmingly Mexico's most important trading partner.

Almost three-quarters of Mexico's exports go to the U.S., with a slightly larger proportion of imports coming from that country. The U.S. also accounts for two-thirds of the estimated \$32 billion of foreign direct investment in Mexico. It is estimated that Mexicans hold assets in the U.S. ranging from \$47 billion to \$94 billion.

The large amount of economic activity between Mexico and the United States makes the desire for closer economic integration obvious. However, the reasons for Canadian involvement in these discussions are more complex.

Canada and the U.S. are each other's largest trading partners, with approximately \$200 billion annually crossing the border in two-way trade. Cross-border investment is also substantial. At year end 1989, American direct investments in Canada amounted to approximately \$79 billion, the largest concentration of American direct investment in any host country. The

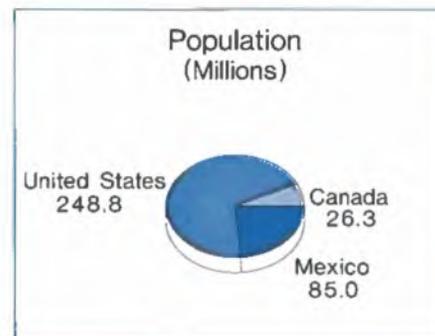
U.S. ranks as the favourite destination of Canadian investors, with more than 70 per cent of the Canadian direct investment abroad being invested in the American market.

By contrast, the amount of trade and investment between Canada and Mexico is very limited. Although Mexico is Canada's leading trade partner in Latin America, less than half of one per cent (\$588 million) of total Canadian exports are destined for the Mexican market. Imports from Mexico to Canada are \$1.6 billion, or a mere one per cent of total Canadian imports.

The level of bilateral direct investment between the two countries is also very small. Mexican investments in Canada are virtually non-existent, while the stock of Canadian direct investment in Mexico accounts for only \$424 million, or 1.5 per cent of foreign direct investment in Mexico.

This is a situation, however, where trade and investment figures do not tell the entire economic story. The most compelling reason for Canada to become involved in a trilateral free trade agreement concerns the future. Mexico has the potential to become an important market for Canada. It is estimated that Mexico's population will reach 100 million by the end of the century.

Sweeping economic reforms, notably liberalization of its trade and investment regulations, could propel Mexico towards the remarkable achievements in economic growth similar to those



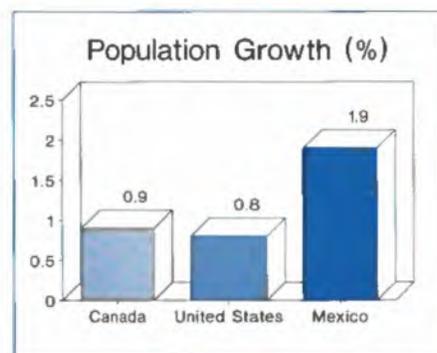
attained by certain Southeast Asian countries in the 1970s and 1980s. Formulation of a North American free trade agreement would gain Canadian exporters access to the Mexican market, while helping Mexico achieve economic liberalization and expansion.

For Canada, the creation of a North American free trade zone would add to the large and secure Canada-U.S. trading system. With the inclusion of Mexico, the market for Canadian producers would increase from 272 million customers to almost 360 million, almost three times the size of Japan's domestic market of 123 million customers and larger even than the EC's market of 326 million. A September 25, 1990 *Financial Post* editorial puts the matter in perspective:

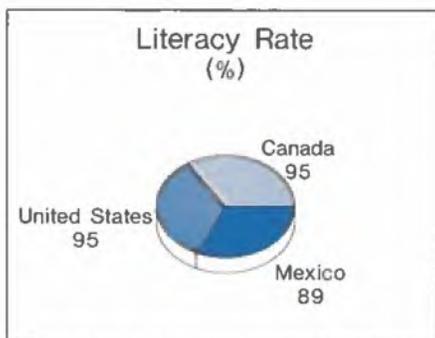
"It has been said that the foreign policy of states lies in their geography. One overwhelming reason for proceeding with a North American free trade area is proximity. What more obvious place to increase trade flow than on a continent with relatively low transportation costs and a communications network of rail, road, air and telecommunications..."

The major argument of those in opposition is the loss of Canadian jobs to Mexico that would supposedly occur after the signing of such a trilateral agreement. Critics fear that Mexican hourly wage rates of about \$1.50 would lure companies to close operations in

(p. 3) ▼



## CANADA – U.S.A. – MEXICO: A NEW FTA? ▲ (cont'd from p. 2)



Canada and open production facilities in Mexico.

But this flow of Canadian jobs to Mexico would be unlikely to occur. While Mexico is a low wage country, it is also a very low productivity country. Unit labour costs in Mexico are high, except in those firms where modern management techniques and modern capital equipment can offset the lack of skills of the labour force.

Low wages are only one of the factors that a company considers when making a locational decision. Factors that are equally important are the economy's overall efficiency, the educational level of the labour force, the quality of management, the efficiency of the transportation system, and the political stability. Canada becomes an attractive location when these factors are entered into the equation since it offers a highly skilled labour force, a highly competent and motivated managerial class, a modern economic structure, an efficient financial system and a stable political environment.

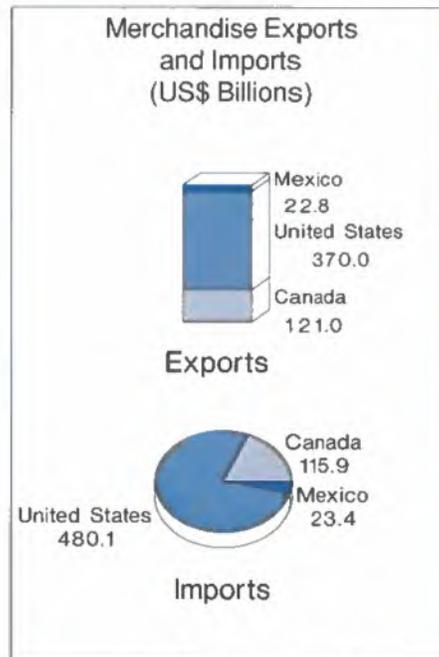
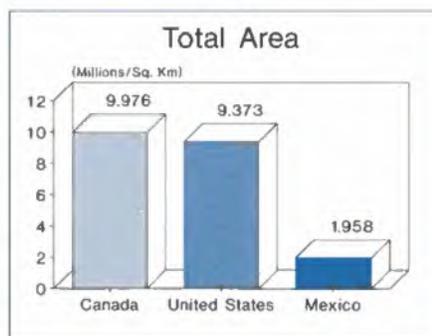
Aside from the advantages of entering into a North American free trade agreement, there are dangers to note in not participating. If the U.S. and Mexico sign a free trade agreement, and Canada is not a signatory, substantial trade and investment diversion could be expected. American goods would have duty-free access to both Mexican and Canadian markets, while Canadian and Mexican goods would have duty-free access only to the American market.

Firms wanting to serve all three markets would be attracted to the U.S. as the only location having access to all three parts of that market. This would be a particularly strong incentive for multinationals deciding on locations from which to service the entire market.

Richard Lipsey, one of Canada's most respected economists, wrote a commentary for the C.D. Howe Institute entitled: "Canada at the U.S./Mexico Free Trade Dance: Wallflower or Partner". In this August 24, 1990 article, Dr. Lipsey argues that Canada's own interests, and the cause of free trade among the countries of the western hemisphere, would be well served by Canadian participation in the free trade talks. It would set western hemisphere trade arrangements on a course toward "plurilateral regionalism" in which all countries would bargain together, and have equal access to the markets of all participants.

This would be far preferable to the "hub and spoke" model, in which the U.S. would negotiate separate agreements with each partner, making it the only country with tariff-free access to each market, thus gaining far greater bargaining power.

The U.S. and Mexico are committed to proceeding towards a free trade agreement. Any negotiations leading to a free trade agreement between the U.S. and Mexico will inevitably have direct and indirect effects on Canada whether Canada participates or not. Canadian



participation in the free trade talks will permit Canada to influence the course of trade and investment flows among the three countries. Access to the Mexican market will offer Canadian companies further incentives to specialize and benefit from economies of scale in production, distribution and marketing, all elements of an increased competitiveness.

While many Canadians may be concerned that the extension of the free trade agreement to include Mexico might lead to job losses, the ultimate outcome should, in fact, be better job and income prospects for all participants to the trilateral free trade agreement – including Canadians.

– Geoff Nimmo, Investment Canada

*Geoff Nimmo is a senior policy analyst with the Investment Research and Policy Division of Investment Canada.*

## EXPERTS TALK ABOUT FOREIGN INVESTMENT AND TECHNOLOGY



"The number of acquisitions of Canadian high-tech businesses that we have dealt with represents a very small fraction of our total caseload. But they have accounted for a disproportionately large part of our review activities and effort. This should not be too surprising. In a world where a country's capability in the field of high technology is a key to its international competitiveness, the acquisition of indigenous high-tech companies is of more than passing interest. The Canadian public has a vested interest in the future of such companies."

*Paul Labbé, President, Investment Canada*

"The perspective on foreign direct investment has shifted to those firms which develop technology indigenously. This shift in emphasis from inward technology transfers to outward technology flows is relatively new for Canada."

*Richard Harris, Simon Fraser University*

"Multinationals will locate research facilities in countries with similar fields of technological competence. By this means, the firms are better able to integrate their own unique technological characteristics with local systems and to more effectively transfer the fruits to other parts of their international network."

*John Cantwell, University of Reading*

"Canada is one of the countries with the highest share of technological activities undertaken by the "other" category, that is: non-giant firms, government agencies and individuals."

*Pari Patel, University of Sussex*

"The Swedish Government has, for a long time, supported firms to undertake R&D in Sweden. At present, Sweden has the highest R&D expenditures in per cent of value added in the world. The result of this policy is, so far, rather bleak. There has been no shift towards exports of high-tech products in Sweden since 1970."

*Magnus Blomström, Stockholm School of Economics*

"The social rate is the rate of return to the use of R&D capital in society, while the private rate is the return to the performance of R&D capital accumulation. Studies dealing with U.S. and Canadian firms and industries all show that the social rate of return exceeds the private rate. Therefore, there are significant spillovers associated with R&D capital formation."

*Jeffrey Bernstein, Carleton University*

More than a dozen leading economists presented papers on foreign investment and technology at a conference sponsored by Investment Canada on September 6 and 7. The results will be published in the spring of 1991.

"This project was inspired by foreign takeovers of Canadian high-technology firms which have recently generated a great deal of public controversy," said Alan Nymark, the Executive Vice-President of Investment Canada, in his opening remarks, "for example, the Connaught-Mérieux case, and now the sale of de Havilland."

Globalization has also radically changed the environment in which these takeovers are taking place. Today, the prime agent is the global corporation which operates in world markets. Technology and investment are the driving forces.

The race for the technological frontier has become a central part of the globalization process. Multinational corporations not only have to invest in the markets where they wish to trade, but they must also conduct R&D in markets recognized for their technological advantages.

"The fundamental issue is that in Canada the relatively poor record of technology development is often laid at the door of the foreign multinational," said Alan Nymark. "But the evidence has tended to show just the opposite – that access to the technology possessed by the multinational and the productivity gains bring major benefits to the host country."

In this era of globalization, foreign direct investment to both the U.S. and Canada is twice what it was a decade ago. Canadian direct investment abroad has also expanded rapidly in the 1980s and faster than direct investment coming to Canada.

## FOREIGN INVESTMENT AND TECHNOLOGY ▲ (cont'd from p. 4)

Don McFetridge of Carleton University was selected as the conference coordinator. Economists from Canada, the U.S., Britain and Sweden were chosen to present papers on various aspects of foreign investment and technological development. They made short presentations outlining their papers, which were followed by commentaries from expert discussants. Over 50 people attended the conference from the private and public sectors.

A number of major themes emerged. As a small country, Canada is undoubtedly a large net beneficiary from foreign direct investment and it will likely remain so. Canada can benefit from productivity gains arising out of the acquisition process and from so-called "R&D spillovers" that are transferred from foreign affiliates to Canadian industries.

Several authors remarked that fostering competition is the key. Through competition, the domestic market can capture the productivity and spillover benefits from foreign direct investment in Canada. Thomas Kierans, President of the C.D. Howe Institute, emphasized that Canada "should concentrate on developing human skills and unshackling universities to become centres of research excellence".

Richard Harris, of Simon Fraser University, added the importance of "access to foreign markets, which will counter the small size of Canada's own market, and an efficient capital market that gives Canadian firms financing at internationally competitive rates".

— John Knubley, *Investment Canada*

*John Knubley is Director of Investment Research for Investment Canada. Queries regarding the conference should be directed to Mr. Knubley at (613) 995-7077.*

"Canadian affiliates will have more freedom in the 1990s to define their strategic roles within the multinational enterprise. However, this implies more choices and the ability to make these preferences heard. The information technology revolution has already led to downsizing and restructuring. It will be essential for Canadian firms to identify and strengthen their firm-specific advantages."

*Lorraine Eden, Carleton University*

"Turnover activity (i.e. acquisitions, divestitures, openings, closings and expansions) in high-tech industries is large and important. Although this sector is concentrated and foreign-controlled, there is almost as much turnover here as elsewhere; and, the merger process produced large productivity gains. This should not be surprising. It is in high-technology industries where the possession of an intangible asset is most likely to lead to such gains."

*John Baldwin and Paul Gorecki, Statistics Canada*

"Significant foreign investment signals the inability of U.S. high-tech firms to grow to maturity without infusion of capital and other resources from elsewhere. The solution lies not in impeding the flows of foreign investment, but in building the infrastructure — education, skills, savings, employee commitment and the like."

*David Teece, University of California, Berkeley*

"While theoretical rationales exist for government intervention into the foreign acquisition process, compelling arguments suggest that such intervention can reduce the economic welfare of Canadians. We better go very slowly before we start rejecting or trying to raise the price of acquisition of high-tech companies."

*Steven Globerman, Simon Fraser University*

"It has proven difficult in Canada to introduce changes to meet the Japanese competition in the automobile industry because it is not simply a matter of introducing new technology. Rather it requires company-wide changes, including fundamental new attitudes, skills and behaviours. Substantial learning is taking place in the Canadian automobile industry but there are difficulties in labour-management relations and the educational infrastructure."

*Bernard Wolf and Glen Taylor, York University*

"Entry of foreign subsidiaries at an early stage of the technological cycle offers better chances for success than at a later stage when the technology is relatively standardized. It took 40 to 50 years for a Canadian aircraft industry to consolidate itself. We are only now reaping the benefits from foreign subsidiaries coming to the country in the 1920s."

*Chris DeBresson, et. al.,  
Centre for Research on the Development of Industry & Technology,  
University of Quebec at Montreal*

"We need to explore some further areas in the high-tech takeover process: the role of arbitragers, the cost of equity capital, the costs of foreign state-owned firms acquiring Canadian high-tech firms, the implications of oligopoly 'rents' accruing to labour rather than capital, and how technology can be path-dependent with enormous long-term consequences."

*Richard Lipsey, Simon Fraser University*

## INVESTMENT BAROMETER

The second anniversary of the Canada-U.S. Free Trade Agreement (FTA) has arrived. With Canada's decision to participate in discussions with Mexico and the U.S. concerning a trilateral free trade agreement, it is appropriate to examine what has occurred since the FTA was implemented on January 1, 1989. After just two years of operation any conclusions concerning the FTA cannot be definitive. What can be seen, are indicators as to the eventual success of the agreement.

According to trade and investment figures, the FTA had a quiet but effective first two years. Canadian merchandise exports to the U.S. increased from \$102.6 billion in 1988 to \$106.1 billion in 1989, a rise of 3.4%. While this figure is lower than the 4.1% increase in Canadian exports to the U.S. from 1987 to 1988, it is perhaps more impressive considering the rise in the Canadian dollar. With the 1990 three-quarter merchandise export figure at \$81.8 billion, there is every likelihood of a similar increase for 1990.

Canada and the U.S. are important sources of direct investment in each other's economies. The U.S. accounts for 68% of the stock of foreign direct investment (FDI) in Canada, while Canada remains the fourth largest source of FDI in the U.S., at 8% of the total. In 1988, there was a net inflow of FDI to Canada from the U.S. of \$148 million, with this figure increasing to \$1.2 billion in 1989. For Canadian

direct investment abroad, there was a net outflow to the U.S. of \$3.9 billion in 1988, and \$2.3 billion in 1989.

An important element of the FTA is the confidence that business has in it. Canadian manufacturers increased their capital expenditures from \$17.7 billion in 1988 to \$20.3 billion in 1989, an increase of 14.7%. A further increase of

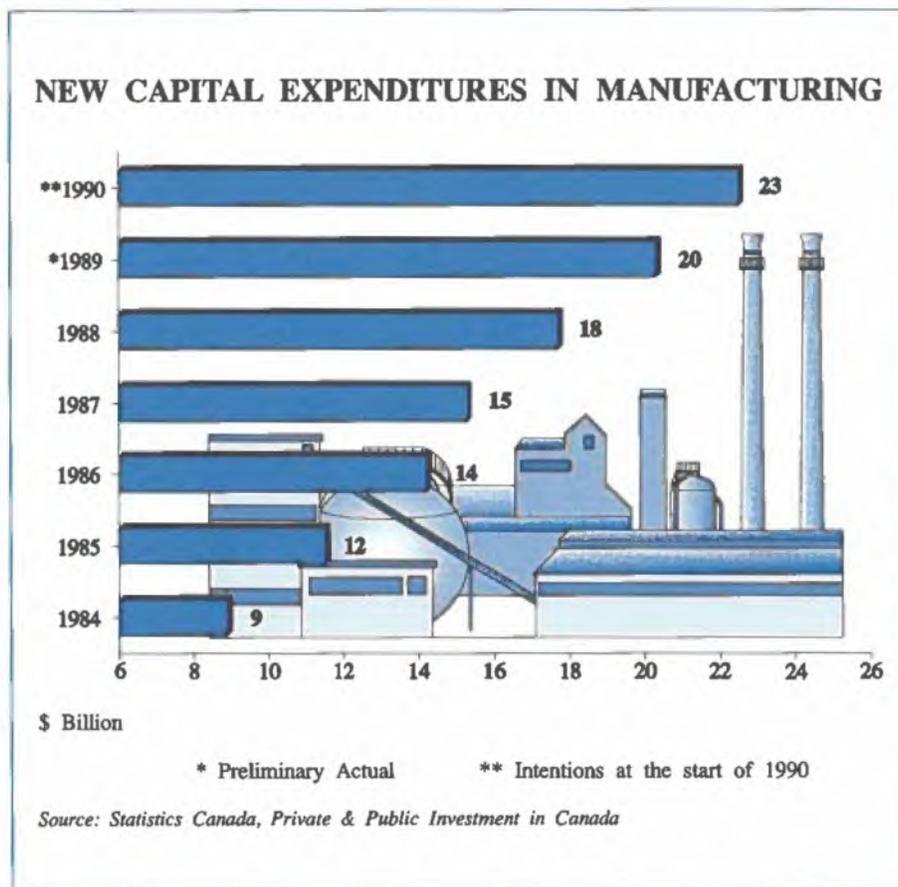
items covering approximately \$3 billion of Canadian exports to the U.S., and roughly the same amount of imports from the U.S. A second round of tariff accelerations is now being discussed, with implementation expected by July 1, 1991. This is a clear indicator the business community believes there are benefits in having a border with no tariffs.

Settling trade disputes through FTA procedures has been well received. Thirteen challenges have been requested under the review mechanism that covers anti-dumping and countervailing duty matters. There will be cases where the Canadian position is considered right, and cases where it will not. The important point is trade disputes are being examined expeditiously, in a structured and impartial format.

The prospects for long-term benefits from the FTA are significant. The agreement provides a necessary guarantee that our border will remain open to

trade in both goods and services, with unimpeded direct investment flows, allowing businesses to plan strategies based upon servicing the whole North American market. The more secure the economic linkages, the greater the benefit to both parties.

— Geoff Nimmo, *Investment Canada*



10.8% is forecast for 1990. Much of this spending increase is for plant and equipment, indicating businesses' confidence in the future, and their recognition that improved productivity is necessary to compete in American and overseas markets.

In response to both the Canadian and American business communities, tariff elimination was accelerated on 400

## TESTIMONIAL: "WE INVESTED IN CANADA"

### RAYCHEM CORPORATION

#### *The Venture*

March 1990 was the official opening of the US\$2 million Advanter facility in Richmond, British Columbia. The new facility is a division of Raychem Canada, a subsidiary of Raychem Corporation of Menlo Park, California.

#### *Products*

Aluminum and stainless steel connector accessories for the wiring harness business.

#### *Size*

This state-of-the-art machining centre will occupy 20,000 square feet, and is expected to create 45 to 50 new jobs within the next five years.

#### *Markets*

Aerospace, automotive, construction, electronics, defence and telecommunications industries, worldwide. Raychem Canada is a major supplier of wire, cable and connector accessory parts to Saint John Shipbuilding.

#### *Future*

The intention is to supply Raychem's worldwide market needs from Canada.



*Advanter's computerized system requires minimal set-up by employee, Pat McFadden. Inset: Specialized adapters produced by Advanter.*

In 1987, Raychem Corporation of Menlo Park, California set up a distribution and warehouse facility in British Columbia, and by May 1989, decided that Richmond, B.C. would be the home of Advanter. The Advanter facility, a highly automated, state-of-the-art machining centre, is the first major high-technology investment in B.C. by a California company.

In the past, Raychem purchased connector accessories from a number of outside manufacturers who found it increasingly difficult to meet Raychem's price, quality and delivery needs. Due to the highly differentiated nature of the wiring harness business, the adapters for these connectors must conform to a large variety of sizes and specifications.

Quality is also a crucial factor since the wiring harnesses on which the connector accessories are used are key components in complex applications, such as fighter and commercial aircraft, nuclear submarines, high-speed trains, military fire control systems and automotive braking systems.

Raychem needed fast, competitively-priced delivery of many small orders of connector accessories. Since 60 per cent of its orders are for 10 or fewer connectors, this involved many time-consuming production line changeovers,

which often resulted in long lead times. Raychem's answer was to create Advanter to accommodate short production runs and minimize downtime for production line changeovers.

Iain McLean, Advanter's General Manager, explains that back in 1982, prior to the company's decision to manufacture its own connector accessories, the company had been seriously looking for a manufacturing site in Canada and the Vancouver area was a favoured contender.

"The area has an attractive lifestyle similar to California's," says McLean. "There is a large pool of skilled labour and several internationally-known universities and training institutions eager to establish ties with local high-technology companies."

"The great majority of these connector accessories will be exported and the intention is to supply Raychem's worldwide market needs from Canada," says McLean. "The new plant is already supplying 25 per cent of Raychem's worldwide market for connector accessories. It's an ever-changing market with major applications in the aviation, telecommunications, and many other very large and important industries."



*Robert J. Saldich, President and CEO of Raychem Corporation, Menlo Park, California.*

## INTER COMM 90

**I**NTER COMM 90, the Global Telecommunications Congress and Exhibition, took place in Vancouver in October 1990. Investment Canada, together with Western Economic Diversification Canada, and Industry, Science and Technology Canada (ISTC), organized a breakfast briefing to promote joint ventures and strategic alliances between Canadian and foreign firms.

Mike Pascoe, Vice-President and General Manager of Newbridge Networks Corporation, provided an overview of the Canadian

telecommunications industry, followed by representatives of nine Canadian firms who presented overviews of their companies, major products and markets with hopes of attracting foreign partners.

The telecommunications industry has been identified by Investment Canada and ISTC as having high potential for attracting investment, particularly from the U.S. The event was one in a series of Investment Canada projects designed to increase investment in Canada's telecommunications industry.



*Mike Pascoe, V.P. and General Manager of Newbridge Networks Corp., addresses audience. Seated is moderator, Audrey Turner, Senior Investment Program Manager of Investment Canada.*

## INVESTMENT CANADA: AT YOUR SERVICE

### QUESTION:

Our shareholders invested \$2 million over the last three years to develop a laser digitizer which remarkably reduces the time required to design manufactured products and to verify the quality of finished products. A U.S. manufacturer, who has been testing our product, has said they will place a large order within the next few months. Our shareholders, however, are reluctant to make further investments and our search for venture capital in Canada has been unsuccessful. Can you assist us in locating potential investors?

### ANSWER:

Your problem is typical to many small, single product technology companies. Investors, whether venture capitalists or private parties, are reluctant to invest in single product technology companies. They prefer more mature companies with a proven management team and an established and varied product base that has been tested and accepted in the marketplace.

It is possible that your company needs more than capital. It might need experienced management with capabilities in marketing, distribution and financial planning. Investor Services can assist

you in finding corporate investors with these capabilities. We would search corporate technology data bases in Canada and the U.S. to identify companies with complementary products and technologies.

In conjunction with ISTC sector specialists and investment counsellors abroad, we would profile these companies to determine the likelihood of their interest in investing in your company. These investors could also provide an established network of distributors to access international markets, and would have the proven marketing and financial expertise to direct your company through a period of rapid growth.

We would suggest this is the most likely method of successfully obtaining the investment, whether it be capital, market knowhow or technology development.

If you have a question in mind regarding an investment opportunity or a business proposal, contact:

*Investor Services,  
Investment Canada,  
P.O. Box 2800, Station D,  
Ottawa, Ontario. K1P 6A5  
Tel: (613) 996-7874  
Fax: (613) 996-2515*

*Investing in Canada* is published quarterly by Investment Canada, the investment development agency of the federal government. The mandate of Investment Canada is to promote investment in Canada, by both Canadians and non-Canadians; to carry out research and provide policy advice on investment matters; and to review major foreign investments to ensure they are of net benefit to Canada.

Editor-in-Chief – Richard Bégin

English Writer/Editor – Lillian Rukas

French Writer/Editor – Vincent Beaulieu

Production – Bernard Cossais

Publishing Officer – Suzanne Le Blanc

*Investing in Canada,  
P.O. Box 2800, Station D,  
Ottawa, Ontario. K1P 6A5  
Tel: (613) 995-9525  
Fax: (613) 996-2515*