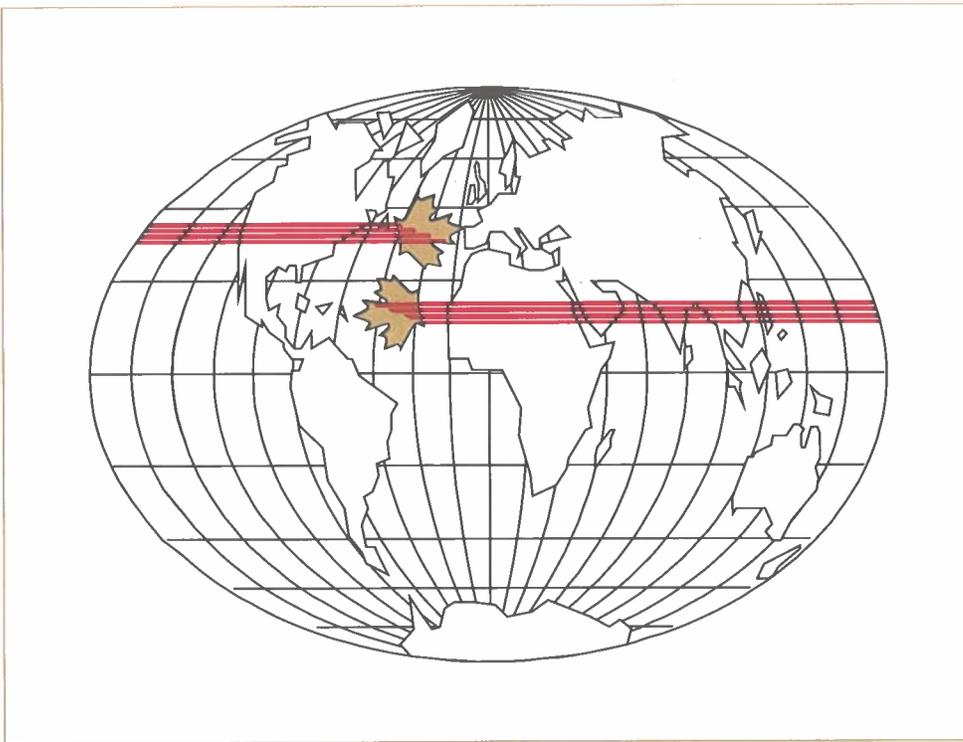
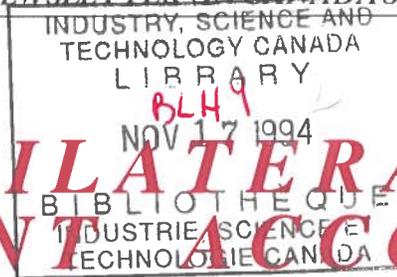


# INVESTING IN CANADA

A NEWSLETTER ON CANADA'S INVESTMENT CLIMATE

Vol. 5, No. 2 — Fall 1991

## A MULTILATERAL INVESTMENT ACCORD?



*Foreign direct investment, as well as domestic business investment, are critically important in an era of global restructuring. For Canada and other countries, the hope is for expansion of international trade and the continued liberalization of international investment. Impediments to the free flow of capital, however, threaten the expansion of trade, technology networking, and other benefits associated with the closer integration of world economies.*

*Changes to the structure and operation of the global economy have given rise to a number of new international investment issues that are not amenable to the traditional methods for solving them. This has led to a search for a new multilateral accord on international investment. Our feature article illuminates the various elements of today's political and economic environment which are affecting international investment policies.*

*Investment Canada's Working Paper Number 8: A Multilateral Investment Accord: Issues, Models and Options* examines three main alternatives for a new multilateral initiative to address both old and new investment issues: revitalizing the OECD; placing investment more definitively under the auspices of GATT; and, promoting a substantive negotiation on investment between two of three members of the Triad—the dominant trading blocs of Europe, the United States and Japan.

While the paper examines each alternative and explains why it is feasible or not, several features of today's political and economic environment are examined which provide focus to the international investment policy decisions the world is facing. These include:

**1. The Dominance of a Triad of Trading Blocs Made Up of Europe, United States and Japan** (Table 1). The economic and political dynamics among the three have begun to pose threats to an open global trade and investment system, including the usage of new forms of protectionism.

(p. 2) ▼

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INVESTMENT CANADA INVESTISSEMENT CANADA

## A MULTILATERAL INVESTMENT ACCORD? ▲ (cont'd from p. 1)

### 2. Globalization

This phenomenon is best defined in terms of the internationalization of capital, including modes of corporate reorganization and activity. The relationship between globalization and the continuing struggle between competing national economic systems is fundamental to understanding the international trade and investment policy environment today.

### 3. The New Complexion of Investment Issues

This refers to the proliferation of new sorts of protectionism, which can generally be categorized as:

- **Structural impediments:** These include competition policy, procurement measures, social and business policy practices and norms, and fiscal and monetary policies.
- **Non-tariff barriers:** The NTBs that are most effective relate to market access.
- **Strategic trade policies:** The theory of strategic trade policy has been developed to counter the consequences of imperfect competition. The theory is providing governments with intellectual justification for intervention in trade-sensitive areas, especially high technology.

### 4. The Point of Diminishing Returns

This means that the limit may have been reached with respect to the removal of traditional barriers to investment flows. Many of the formal barriers to foreign investment are being

eliminated in most developed countries. It is the less overt, informal barriers to foreign investment that constitute the impediment to the free flow of foreign investment. Whereas existing multilateral institutions, such as the GATT and the OECD, have been effective in addressing the problem of formal barriers to investment, they do not

to finance both old and new demands for capital while maintaining economic expansionism.

The review of major international political and economic policy themes in Working Paper Number 8 demonstrates that global developments are posing complex challenges. For investment, the critical question is whether existing multilateral institutions and instruments can be adapted to meet these new challenges, or whether a new international forum is needed.

Since the end of World War II, international investment issues have been dealt with in a variety of institutional forums and between individual nations. Among the most significant are:

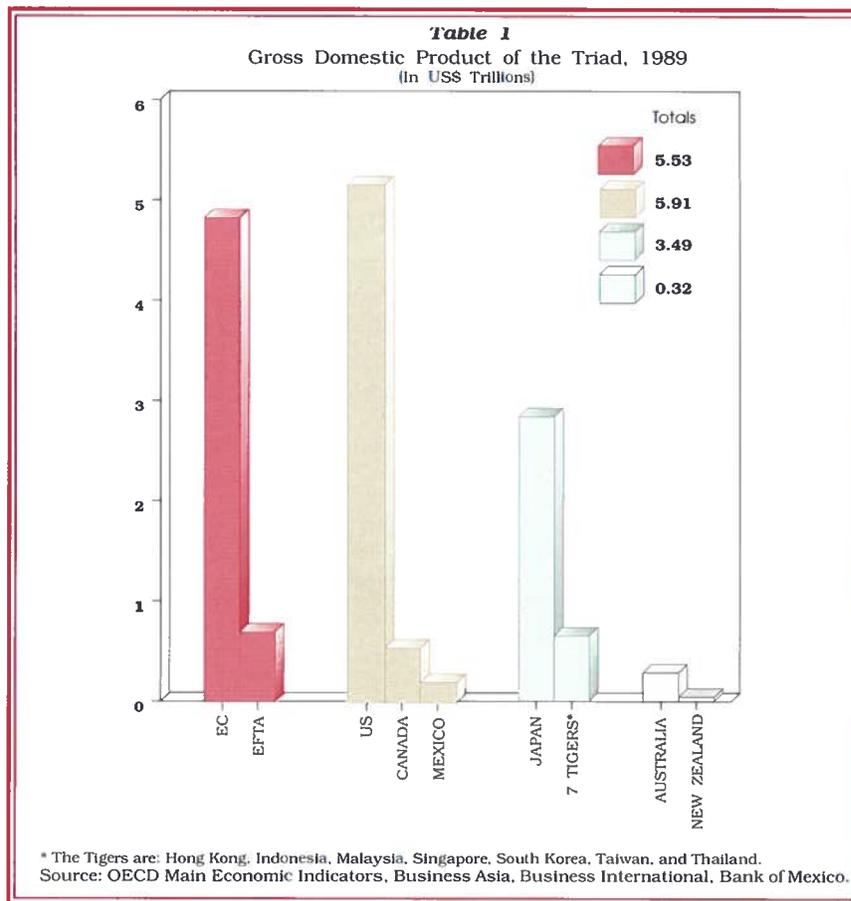
#### □ **Bilateral Investment Treaties**

Existing bilateral investment treaties (of which there are over 250) have typically been negotiated between industrialized countries and developing countries.

Their objective is primarily to protect a country's investments.

#### □ **Specialized International Agencies**

The Multilateral Investment Guarantee Agency (MIGA) and the International Convention for the Settlement of Investment Disputes (ICSID) have been used primarily to address investment protection issues between industrialized and developing countries and their nationals. (p. 3) ▼



have the mandate or capacity to handle the informal barriers.

### 5. Global Competition for Capital

Efforts to manage the new investment issues are taking place in an increasingly difficult macroeconomic environment. Since 1987, a global credit squeeze has emerged. The critical macroeconomic issue facing finance ministers today is how to ensure the international financial system will generate enough new credit

**A MULTILATERAL INVESTMENT ACCORD?** ▲ (cont'd from p. 2)

**Table 2: Alternative Dispute Settlement Mechanisms**

Instrument	Standing	Dispute Settlement Process	Remedies
<b>FTA Chapter 18</b>	Parties to the Agreement. Private parties can appear before panels.	Binding arbitration available upon mutual agreement of the parties, otherwise conciliation by the Trade Commission. Binding on safeguards.	Parties obligated to comply with the Trade Commission or arbitration decision. In event of non-compliance, benefits of equivalent effect may be suspended.
<b>GATT</b>	Signatories to the agreement.	Investigation by panels, findings submitted to council of signatories. Adoption based on consensus rule.	Unspecified.
<b>ICSID</b>	Investors of member countries and governments of member countries.	Conciliation or arbitration. No positive obligations to accept or reject results.	Unspecified.
<b>OECD</b>	OECD members.	Article 17 complaint mechanism. No positive obligations.	N/A

❑ **The UN Draft Code of Conduct for Transnational Corporations**

Negotiations on the Code of Conduct have reached a stalemate. The objective of the Code was to provide a stable, predictable and transparent framework that would facilitate the flow of resources across national boundaries and thereby enhance the role of foreign investments in economic and industrial growth.

❑ **The Organization for Economic Co-operation and Development (OECD)**

The OECD Codes of Liberalization (of Capital Movements and of Current Invisible Operations) are legal instruments through which members commit themselves to a process of progressive liberalization. The OECD is now discussing a National Treatment Instrument whereby governments would commit themselves to not discriminating between domestic investors and foreign investors once established.

❑ **General Agreement on Tariffs and Trade (GATT)**

When Trade Related Investment Measures (TRIMs) were placed on the agenda of the Uruguay Round of the GATT, it marked the first time in a multilateral forum that trade and investment issues had been addressed together. It is increasingly unclear, however, whether the Uruguay Round will be successfully completed.

The Working Paper concludes that the possibility of further liberalization of capital movements within these institutions and instruments is not encouraging. To deal with the new international investment issues, a comprehensive and coherent multilateral framework for investment will need to be developed. The new multilateral forum will need to possess a mandate to deal with the new investment issues such as market access, national innovation and competition policy, and structural differences between national economies.

American authors Edward Graham and Paul Krugman, in their 1989 study, Foreign Direct Investment in the United States, put forward a proposal for a new accord on investment and multinational enterprises that would, initially, involve only the world's largest industrialized nations. The authors suggest that Chapter 16 of the Canada-U.S. Free Trade Agreement (FTA), dealing with investment provisions, might serve as a model for such a new accord.

While Chapter 16 of the FTA is suggested by Graham and Krugman as a model, the specifics of their new investment accord embrace both more and less than what is included in the Chapter. Some of the key concepts include:

**a) National Treatment and Right of Establishment**

The accord should contain a formal declaration of the basic rights and responsibilities of home nations, host nations and multinational enterprises, including right of establishment (p. 4) ▼

## A MULTILATERAL INVESTMENT ACCORD? ▲ (cont'd from p. 3)

and national treatment for local subsidiaries of foreign parentage.

### **b) Acceptable Deviations**

The accord should enumerate acceptable deviations, such as national security exemptions, from basic rights and responsibilities.

### **c) Extraterritoriality**

The accord should address the issue of the extraterritorial application of a country's policies and laws. It asserts that: "If the (foreign) subsidiary's efforts to obey local laws comes into conflict with directives from the parent company (perhaps to comply with laws or policies of the home government), obeying the local laws shall take precedence".

### **d) Reporting Requirements**

The accord should ensure common standards for disclosure and reporting are established which apply to all business enterprises exceeding a specified size threshold.

### **e) Performance Requirements**

In the accord, there should be restrictions on the use of performance requirements. Graham and Krugman believe that the FTA provides an appropriate model for such restrictions.

### **f) Investment Incentives**

Contrary to the FTA, Graham and Krugman propose that investment incentives be addressed in the investment accord.

### **g) Nearby Domains**

The accord should provide mechanisms for co-operation and future work with respect to such "nearby domains" as taxation, competition policy, and restrictive business practice matters. The FTA did not address these domains, nor did it set up any particular mechanism for working on them.

### **h) Dispute Settlement**

The final element of the proposed accord is a dispute settlement mechanism modelled on Chapter 18 of the FTA. Table 2 contrasts the Chapter 18 dispute settlement mechanism with other major international dispute settlement mechanisms.

Although the Graham and Krugman proposal is intriguing, an accord based solely on the Chapter 16 FTA model would be insufficient to accomplish the desired purpose. The main elements of Chapter 16 concern transparent and formal barriers to direct investment. A new investment accord must be able to go beyond traditional and formal barriers to direct investment, and address those informal and non-transparent barriers that today constitute the real impediments to investment flows.

The Investment Canada Working Paper moves beyond the Graham and Krugman proposal in considering the substance of a new investment accord. The new accord should enshrine the progress made to date on removing the traditional barriers to investment; rectify the omission of dispute settlement provisions from the OECD Codes; and be broad enough to embrace those areas which, although typically regarded as nearby domains to investment policy, are becoming central to multilateral investment policy issues.

The substance of a new multilateral investment accord cannot stand apart from considerations relating to its structure and shape. Three options are put forward in the Working Paper. First is an agreement within the OECD. This option is essentially that propounded by Graham and Krugman. It suggests that an investment agreement should initially involve only the world's largest industrial nations—members of the OECD—and could be based on many of the main elements of the investment chapter of the FTA.

The second option is the creation of a World Trade Organization (WTO) agreement. This option is based on the assumption that a policy agenda for both trade and investment cannot be adequately housed within the confines of the existing GATT system. The WTO could be the institutional mechanism for overseeing the development of a new investment code that is integrated with, or complementary to, rules governing the international trade system. A Canadian proposal for a WTO was announced in April 1990.

The final option lies in the negotiation of substantive investment accords within the context of free trade areas created between two of the three emerging trade blocs (North America, Europe and Japan).

The Working Paper concludes by outlining the key considerations for Canadian decision-makers when examining the potential multilateral investment arrangements. While Canada has forwarded a proposal for placing investment under the auspices of a WTO, this has not received strong support by Triad members. From a Canadian perspective, the OECD option is an attractive one, although it is not clear that political incentives exist to give the OECD such an expanded and ambitious role.

The least desirable option for Canada is certainly the investment accords between trading blocs. This option could be destabilizing for global politics as well as for investment matters, and it would greatly minimize any negotiating leverage Canada would possess in investment matters.

—Geoff Nimmo, *Investment Canada*

*Geoff Nimmo is a senior policy analyst with the Research and Policy Division*

## NAFTA UPDATE

*Alan Nymark, Executive Vice-President of Investment Canada, has been appointed head of the Canadian negotiating team for investment in the North American Free Trade Agreement (NAFTA) negotiations.*

It is essential that Canadian negotiators know the conditions facing Canadian firms in the countries with which they are negotiating. As a result of the free trade negotiations and Canada's historical economic ties with the United States, much is known about doing business in the United States. Practical knowledge about doing business in Mexico, however, is less readily available.

In preparation for the negotiations, Investment Canada has conducted research on Mexican investment policies; however, we have little information about how the new system works from the practical perspective of a foreign investor. If your company has investments in Mexico, or has investigated setting up an operation in Mexico, it would be valuable to hear of your company's experience. The information that would be most useful is your company's views on Mexican government regulation of business, particular-

ly the investment approval process and any requirements (such as local equity participation or minimum export levels) to receive such approval. This information will enable Canadian negotiators to determine where the real impediments to Canadian investors are, and target their negotiations accordingly.

Of particular interest is the effect of the 1989 changes to Mexican regulation of foreign investment. The new regulations are complex and leave considerable discretion to the government to approve or reject proposals for foreign investment. Information on how the new laws are implemented will be vital for our negotiators.

All company-specific information transmitted to Investment Canada will be held strictly confidential, and will be used only for research within Investment Canada. Please send your information to:

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Ottawa, Ontario K1P 6A5  
Tel: (613) 995-9603  
Fax: (613) 996-2515*



*Henry Yau, Manager - Asia, Investment Promotion and Services, Investment Canada.*

Henry Yau of Investment Canada carried his investment message to Southeast Asia earlier this year, promoting Canada as the gateway to the North American market. Mr. Yau's visit coincided with Opportunity Canada '91, co-ordinated by the Canadian High Commission in Malaysia. These series of business seminars help to develop and encourage the two-way flow of trade and investment between Canada and Southeast Asia. In addition, Mr. Yau participated as the keynote speaker for the cross-country investment seminars in Taiwan, taking the opportunity to meet with local venture capital companies to gather market information, and to carry out the necessary follow-up activities with firms interested in investing in Canada.

*In an ongoing effort to promote business investment in Canada, Jon Church of Investment Canada accepted an invitation in June to speak at the investment symposium of the Independent Petroleum Association of Canada (IPAC) in Calgary, Alberta.*



*Left to right: Gerry Protti, Executive Director, IPAC; Norman Gish, President, North Canadian Oils Ltd.; Philippe Guérin, President, Chambre de commerce, Paris, France; Jon Church, Vice-President, Investment Development, Investment Canada; Dennis Flanagan, Chairman and CEO, Lasmo Inc. Canada.*

## VENTURE CAPITAL IN ASIA PACIFIC

*Investment Canada is currently exploring ways in which Canadian advanced technology companies can participate in investment and partnering opportunities emerging in the Asia Pacific region.*

Investors from Taiwan, Singapore and South Korea are quickly joining the ranks of their Japanese counterparts by investing in promising North American enterprises with leading technologies. Brimming with cash, Asia Pacific is the fastest growing venture capital market in the world. The region's venture capital base more than doubled over the last year and is expected to reach US\$20 billion by year end. Much of this capital, however, is increasingly focusing on supporting technological partnering agreements overseas.

The partnering dimension to Asian venture capital investment stems largely from the close relationship between fund managers and their industrial partners. Industrial corporations in Asia Pacific are looking to form strategic linkages with foreign technology companies and direct minority equity investments are viewed as a way to seal such deals.

For recipient companies in North America, Asian venture capital investment has been particularly rewarding. In addition to meeting their capital requirements, young technology firms

are often offered an opportunity to forge manufacturing and distributor relationships with their Asian partners—opening a passage to profitable strategic linkages to the Asia Pacific marketplace.

Momenta Corp., for example, is a U.S. high-tech company which stands to profit from this type of arrangement. This six-month-old California computer maker recently secured \$7 million in funding from Taiwanese and Singaporean investors to develop a handheld PC with a pen-based input. One of the investors, Vertex Management, is the venture capital subsidiary of the technology-based engineering and services company, Singapore Technologies. Vertex invests in up-and-coming companies which are interested in technology transfers and joint venture opportunities involving manufacturing, marketing and product development in the ASEAN (Association of Southeast Asian Nations).

Hundreds of other such agreements involving the Asia Pacific region have been made over the last couple of years, largely because outward investment activity of this type is highly encouraged by the local Asian governments, who themselves are aiming to advance their economies into the technology era. In fact, South Korea, Singapore and Taiwan now offer tax

concessions for certain overseas venture capital placements involving technology.

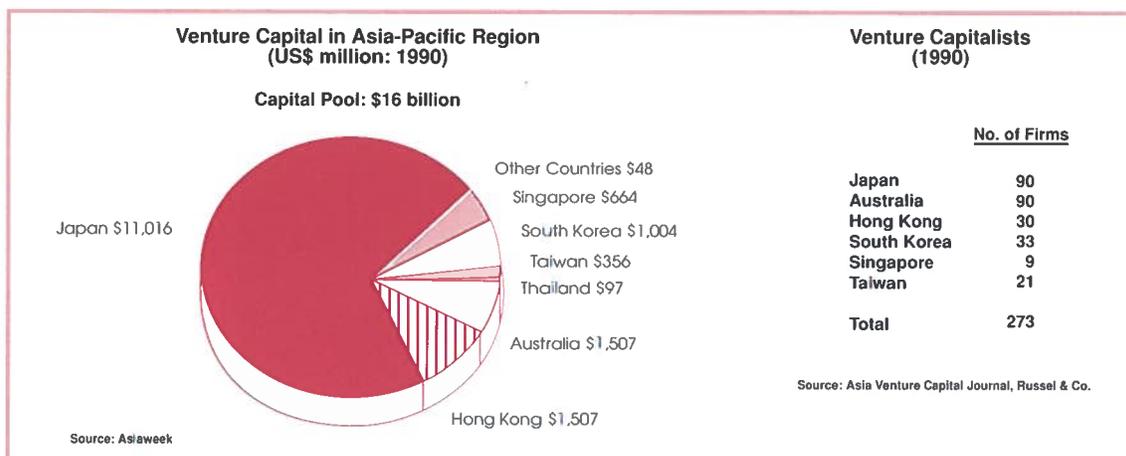
As the Asia Pacific economies continue to expand rapidly—diversifying further into biotechnology, semiconductors, advanced optics and health care—the level of overseas technology-driven venture capital investments and strategic alliances is expected to increase.

Most of the activity thus far has focused on the U.S., but Investment Canada is currently exploring ways in which it can assist Canadian technology companies to participate in this new wave of financing and alliances with Asia. The Agency has recently completed two studies highlighting venture funding opportunities: 1) Venture Capital in Singapore and, 2) Taiwanese Venture Capital. Both studies indicate that the Asia Pacific region holds promise for Canadian advanced technology companies looking for financing and international strategic alliances.

*—Dinesh Kakadia, Investment Canada*

If you would like a copy of these studies, contact:

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## INVESTTECH '91

Just as there are signs the economic climate has begun to improve, it is important to realize the companies that will begin to experience the quickest and most substantial gains in the post-recession period are ones that have been preparing for it while immediate prospects looked bleakest.

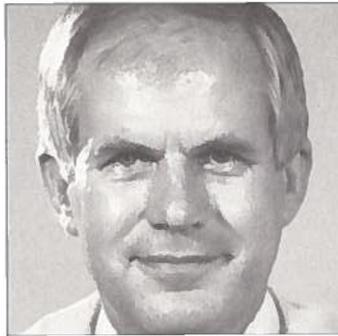
But what about companies that lack the resources to spend on R&D, or do not have the international reach to access foreign markets, investments or technologies? Small Canadian companies find it far too expensive to go prospecting for contacts in foreign countries. They may have markets and technologies attractive to foreign companies, but if they can't demonstrate what they have to offer, profitable relationships will never happen.

A record 800 companies sent senior personnel to InvesTech '91, a recent Canadian cross-country tour of investment and technology officers brought from embassies and consulates abroad. These officers are stationed in foreign posts to help Canadian companies seeking business partners, management expertise, technology transfers or other forms of alliances.

Anyone who has looked for capital or hunted for the right joint-venture partner, especially in areas of high technology, knows how tough it can be to find in domestic markets alone. During the InvesTech tour, many companies made connections with officers whose job is to put foreign companies together with Canadians who are looking for technology, capital, or strategic alliances to further their business plans.

"There seems to be a higher level of sophistication and a much better understanding of what foreign investors are looking for now," said Otch von Finckenstein, Investment Counsellor based in Bonn. "I noticed a shift from the usual search for straight equity money to requests for partnerships and

strategic alliances. I am returning to Germany with a lot of good partnership requests."



*Otch von Finckenstein*

Wayne Wright, President of Arrohawk Developments in Comox, B.C., feels that even though he had not been actively looking abroad, it was useful to make contacts with the foreign posts. Arrohawk is developing lighter-than-air craft. "Our provincial economic development board suggested we attend. We found avenues we had never even considered."

Randy Wallman, of Universal Robotics in Winnipeg, is looking for new capital and possible joint-venture partners. "I have been in contact with the New York



*Randy Wallman*

investment officer for several months, and he has been a great help. At InvesTech '91, I met with officers from other

countries, and I will send them information packages so overseas investors can learn about our company and the opportunities here."

In St. John's, Newfoundland, Plex Acrylics President, Mark Butler, said the contacts the technology and investment officers find can be important. "We are now talking to some American companies about joint-venture possibilities. The Canadian Consulate in Houston is helping us distribute a study we recently conducted to other U.S. companies, but it is up to us to pursue the leads they generate for us. I will shortly be finalizing a deal that began with an earlier InvesTech contact."

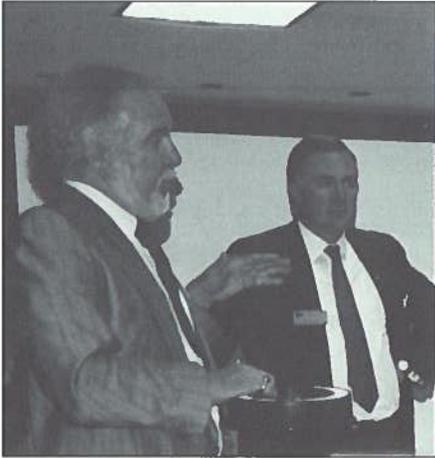
A lot of information changed hands during InvesTech '91. Over 2,000 interviews were held. Of the 800 companies that participated, some had a specific investment or technology goal with a plan to acquire it, while others were looking for advice on how co-operation with foreign partners might help them.

External Affairs and International Trade Canada, the National Research Council, Industry, Science and Technology Canada, and provincial governments mounted InvesTech '91. These departments, along with Investment Canada, help companies with technology and investment requirements. Companies can contact any of the departments directly for advice about their products or services, or to investigate the feasibility of approaching foreign markets for investment and technology possibilities. Outreach initiatives such as InvesTech continue to create vital links in assisting Canadian companies to develop their business opportunities abroad.

*-Mick Steers*

*Steers, Steers & Associates handled media relations and communications for the InvesTech '91 tour.*

## INDUSTRIAL WASTEWATER MANAGEMENT



*Dr. Norbert Schmidtke (left), Investment Canada's consultant, with moderator Mr. David Lenihan, Senior Investment Adviser at the New York Consulate General.*

A strategic alliance seminar for companies in the Industrial Wastewater sector was held in New York City in June, 1991. Organized by the Canadian Consulate General in conjunction with Investment Canada, the agenda consisted of presentations in the morning, followed by question and answer periods. After lunch, one-on-one meetings were arranged for participants to allow for private discussions.

Dr. Norbert Schmidtke, a sector expert, and founding director of the Wastewater Technology Centre, presented an overview of the Canadian industry and its research capabilities by giving specific examples of the distinctive products or processes of individual companies. Mr. Ken Murray, a partner

with the Ottawa firm, Deloitte & Touche, made a persuasive case for conducting R&D in Canada by comparing the tax incentives available in Canada and the U.S.

Seminar participants were provided with detailed sector information along with investment kits which contain profiles of 25 Canadian firms and five research bodies interested in forming strategic alliances.

—Susan Gates, Investment Canada

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## JOINT VENTURE IN OCEAN TECHNOLOGIES

Investment Canada, on behalf of the federal government's Investment Development Program, recently entered into an agreement with Nova Scotia, New Brunswick, Newfoundland and British Columbia to co-operate on a project to attract investment into Canada's ocean technologies sector.

This joint effort will seek to attract investment to Canadian firms in such sectors as cold ocean technologies, marine

information and charting systems, and marine robotics. Once the project is fully under way, investment opportunities with firms in Canada will be brought to the attention of potential investors in Japan, Europe and the U.S.

"We hope to initiate more projects in co-operation with provincial authorities, and indeed, with private sector intermediaries," says Jon Church, Vice-President, Investment Development.

## FINDING JAPANESE PARTNERS

It is not always practical for small and medium-sized Canadian companies to travel to Japan to find potential investment partners. To facilitate contacts between potential Japanese investors and Canadian companies seeking capital, technology or business alliances which will provide them with greater access to Asian markets, Investment Canada seeks to bring their interests to the attention of Japanese companies.

In October, Richard Lovatt of Investment Canada attended the Osaka Chamber of Commerce annual investment symposium and matchmaking event.

Mr. Lovatt took with him the profiles of a large number of Canadian small and medium-sized companies to share with Japanese and other companies participating in the Osaka symposium. These profiles describe the individual Canadian companies, what they are looking for in an investment partner and what they have to contribute to such a partnership. For more information contact:

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