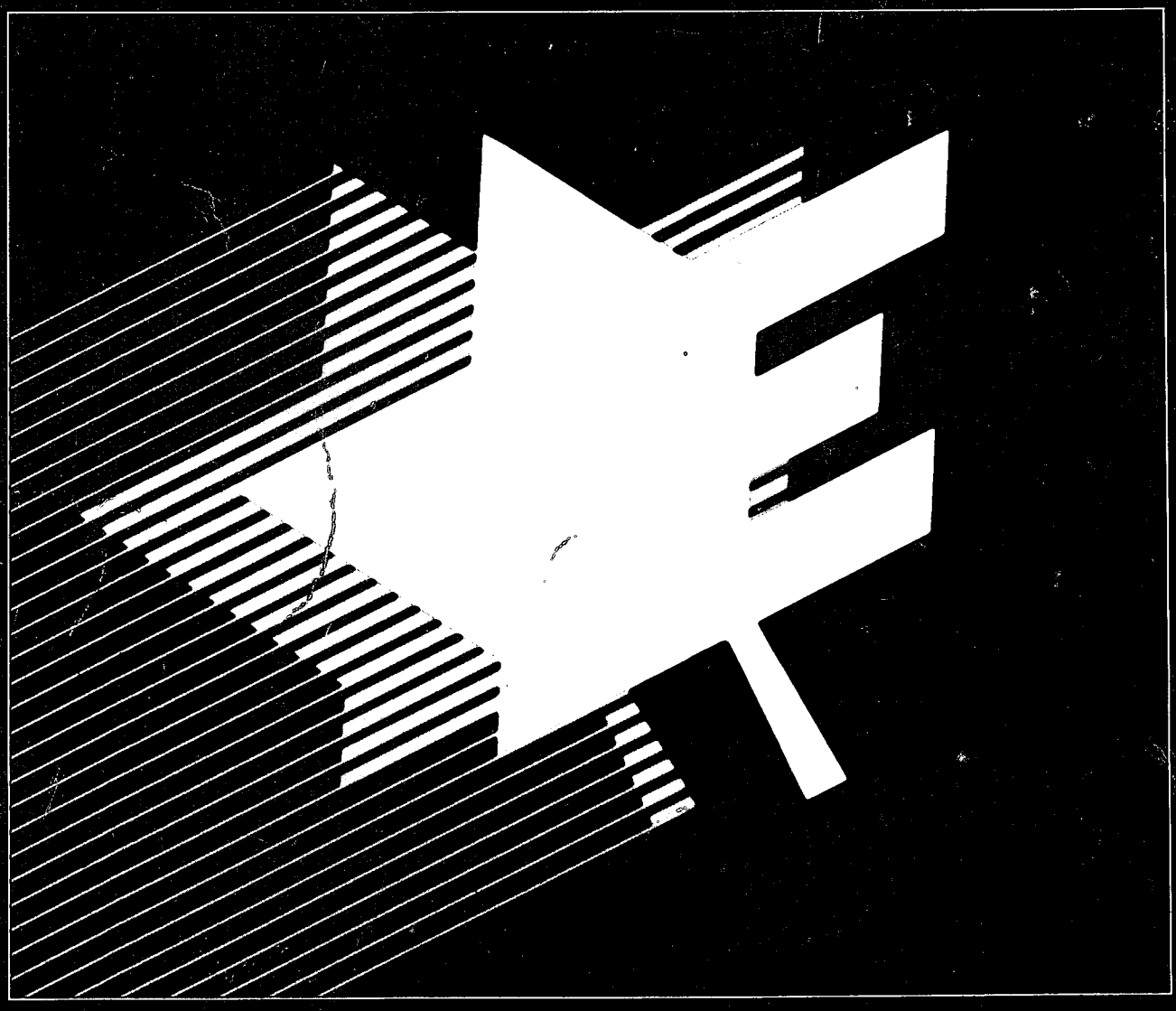

International Trade
Department of External Affairs

Commerce extérieur
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Canada

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DEVELOPMENTS IN THE GLOBAL ECONOMY

AND THE BUSINESS OF ENGINEERS

April 1989

Export Finance and Capital Projects Division
Department of External Affairs

CONTENTS

INTRODUCTION

As with many activities today, the business of engineers requires an awareness and understanding of events unfolding beyond the borders of Canada, and indeed North America, in order to comprehend the challenges and opportunities emerging in an interdependent and dynamic global marketplace. To this end, the following pages review a broad range of issues which contribute in shaping the nature of this marketplace and which can have a profound impact upon the ability of Canadian firms to compete effectively in an increasingly complex environment.

The first section reviews the importance of international transactions to the Canadian consulting engineering sector and assesses the current success of Canadian firms vis-à-vis their competitors abroad. Section two examines developments in the international economy which have a significant bearing on the volume of international project activity and the ability of Canadians to continue to compete effectively for these projects. Particular emphasis is placed on the impact of the external debt of developing countries and the marketing tools employed by Canada's competitors such as concessional financing and mixed credits. This section also reviews the nature and potential impact of the current round of multilateral trade negotiations and the Canada-U.S. Free Trade Agreement.

The appendices to this paper discuss sources of assistance available to Canadian exporters. For this purpose, conference participants will find attached a comprehensive guide prepared by the Department of External Affairs entitled: International Financing Data: A Business Guide to Export Finance and Other Financial Assistance. Appendix I reviews the federal government's most recent export assistance mechanism - the International Trade Centres - which were established in June 1988. Appendix II outlines the role of the Export Finance and Capital Projects Division in the Department of External Affairs.

SECTION I

Canadian Consulting Engineers in the International Market

In proportion to the size of its economy, Canada probably exports more consulting engineering services than any other country in the world. In fact, a recent US study of the world's top 200 international design firms showed that Canada's share of the 1987 foreign market was second only to the United States. Of the approximately US $4 billion in foreign billings, Canada's share, involving 13 of the 200 firms totalled $517.7 million, or 12.9 percent of all Billings.[1] Only the United States had a higher share at 25.9 percent, or $1,042.5 million. Canada's share compares favourably with established competitors, i.e. British (11.2%), Dutch (8.9%), German (8.9%), French (6.5%) and Japanese (6.4%).

Moreover, 1987 represented the first year since 1981 that a non-US firm headed the list of top international design firms. That achievement went to Lavalin Inc, with the SNC Group and Monenco Ltd. placing in the number seven and nineteen positions respectively.

A similar export survey undertaken by the Department of Regional Industrial Expansion (DRIE). based on the responses of 31 engineering consulting firms, revealed

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1. Engineering News-Record. August 4, 1988, Pages 30-37.

that 1986 export billings totalled almost CDN $400 million (see Appendix III). Export sales by region as a percentage of total exports, as demonstrated by the Canadian survey, showed less dependence on the US market, at only 17 percent, than the American study. The DRIE results demonstrated proportionately greater activity in developing countries: Africa (30%), Asia (20%), Latin America (12%), Middle East (4%), USSR and E. Europe (7%), and the Caribbean (2%).

Analysis presently being completed for 1987 indicates that export billings will likely increase for that year by approximately 20 percent for a total value of almost $500 million. The proportion of activity allocated by region will also likely change for 1987 billings, with volume of activity in Africa declining significantly and Asian business increasing.

The DRIE survey for 1986 also demonstrates that export sales involve a diverse range of industry sectors, with the power industry representing the greatest activity at 22 percent of total exports in 1986. Other sectors included: forestry (15%), industry (13%), transportation (12%), oil and gas (12%), mining (7%). Significant sales were also achieved in the municipal sector, buildings, irrigation and telecommunications.

SECTION II

The Business of Engineers and the Contemporary Market

Introduction

Although Canadian engineering firms have demonstrated considerable success competing in export markets, they will continue to face significant challenges in the coming years. Most observers would agree that the international marketplace for engineering and construction services has become more competitive, complex and unpredictable since the 1960s and 1970s. It appears that competition has increased as a result of forces which have squeezed the profession simultaneously from opposite directions. Not only has there been a declining number of attractive capital projects since the early 1980s, particularly in middle-income and other developing countries, but there has also emerged an increasing number of firms competing for these projects. Moreover, evolving international governmental financing and development assistance policies are affecting the ability of efficient firms to compete fairly for projects in many LDCs, particularly the developing nations in Asia critical to world trade in these sectors.

The changing character of today's marketplace for engineering and construction services can be attributed to several structural developments in the global economy.

First, we have witnessed, on the supply side of the equation, the recent development of domestic engineering and construction industries among developing countries. The emergence of these firms appears to be based to a large extent on the application of infant-industry strategies, many of which remain an important factor today.[2] Importantly, many of these firms are now expanding their activities beyond domestic projects and are increasingly competing for international work. This is most notable for South Korean firms but includes participants from such countries as India, Pakistan, Brazil, Argentina, Mexico, China and Yugoslavia.[3]

A second and more profound influence upon the level of international project activity can be attributed to the general economic conditions prevalent during the 1980s.

With respect to the industrialized countries, world economic recession in 1980-82 was followed by the need to rationalize industrial capabilities and reduce public sector spending in the wake of increases in manufacturing capability and productivity, aggressive international competition and growing public sector debt. The 1980s is also characterized by the globalization of world industry as firms attempt to

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2. See "International Competition in Engineering and Construction" in International Competition in Services: Banking, Building, Software Know-how. Congress of the United States, Office of Technology Assessment; Washington, D.C., July 1987.

3. Ibid.

circumvent trade restrictions, establish local production in response to anticipated economic integration in Europe, pursue cost-reduction in response to increasing competition, and respond to the realities of dramatic exchange rate fluctuations. Reflecting these trends, the value of total world-wide direct foreign investment outstanding at the end of 1986 was estimated to be around US $755 billion, an increase of 20.4 percent over the previous year's total of $644 billion.[4] The Japanese example is revealing. In 1987 Japanese manufacturers increased their foreign investment 100 percent over the level invested a year earlier. The ratio of Japanese overseas production to domestic projection is expected to increase to 12 percent in 1993 as compared to 3.1 percent in 1986.

Some observers and practitioners suggest that a linkage exists between global industrial restructuring and levels of capital project activity in the developed countries. Echoing this assessment, a United Nations study recently undertook an in-depth examination of nine traditional manufacturing industries world-wide and arrived at the following conclusion:

> Almost without exception, industries in developed market economies underwent extensive restructuring during the first half of the 1980s, slimming down their productive capacity and employment in response to the looming overcapacity and prospects for weaker demand. The

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4. Industry and Development: Global Report 1988/89. United Nations Industrial Development Organization. Vienna, 1988. p. 19.

> restructuring of the industry world-wide has been carried out not only through the closure of obsolete plants, upgrading capacity, trimming the work-force, increased research and development expenditures and a shift in production toward higher-value-added output, but also through mergers, take-over bids and acquisitions. **5**

This analysis of the manufacturing sector during the first half of the 1980s is consistent with growth rates in construction activity world-wide for that period. Appendix IV demonstrates that the European Community (EC), Japan and North America experienced rates of growth, respectively, of -1.7 percent, -4.0 percent, and 1.2 percent of the period 1980-1985.

The 1980s has been a difficult decade for many developing countries and economic prospects contrast sharply with the developed nations of the world. The recession of the early 1980s was followed by a continued slide in the terms of trade for much of the developing world, dramatically lower oil export revenues for many countries, and, of greatest concern, a paralyzing debt service burden.

Most observers agree that, as a result of this economic malaise, investment activity has declined substantially in the 1980s compared to previous decades. Appendix IV demonstrates that growth rates in construction activity among developing countries have declined

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5. Ibid: page 133. Industries examined were: (1) textiles and apparel; (2) leather and fur products; (3) paper and paper products; (4) chemical industries; (5) petrochemical industries; (6) pharmaceutical products; (7) petroleum refineries; (8) iron and steel; and (9) the automobile industry.

appreciatively over the period 1980-85 compared to the previous 10 years. An exception is the region of East Asia and South East Asia which has demonstrated more or less consistent growth rates during the 1970s and early 1980s.

Construction activity appears to have increased in the post-1945 period among developed market economies. In contrast, the mid-1980s failed to mark a turnaround in project activity among most developing countries. In 1986 new business opportunities of the top 250 international construction contractors declined in all four developing regions: Latin America (-21.5%), Middle East (-25.4%), Africa (-14.8%) and Asia (-2.61%).[6] 1987 witnessed a further decline in all developing regions except Latin America: Latin America (+43.4%), Middle East (-16.4%), Africa (-31.3%) and Asia (-10.5%).[7]

Declining international construction activity is reflected in the ratio of foreign contracts to total contracts emerging in the second half of the 1980s. Foreign work represented only 32% of the new business won by the most active international contractors in 1986, in contrast to 42% in 1984.[8] The ratio of foreign to total billings among international engineering firms has also demonstrated a steady decline in recent years, and stood at 31.1% in 1987 down from 34.1% a year previous.[9]

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6. Engineering News Record: July 16, 1987.
7. Engineering News Record: July 7, 1988.
8. Op. Cit. (ENR), July 16, 1987.
9. Op Cit. (ENR), August 4, 1988.

External Debt of Developing Countries[10]

Most of the indebted developing countries have witnessed no improvement in their economic conditions since the debt crisis erupted in 1982.[11] In fact, the World Bank reports that the long-term debt of developing countries has almost doubled over the period 1982-1988, increasing to US $1,020 million from US $562.58 million. Debt service payments on a cash basis were one-third higher, at US $131 billion in 1988 than in 1982.

Despite the continued rapid growth in developing country debt, we have also witnessed since 1984 a net resource transfer on long-term debt from developing countries to their creditors. In 1988 alone it is estimated that these debtor countries transferred net resources totalling US $43 billion to their creditors.

While economic growth in the industrialized countries over the last few years has generally exceeded predictions, growth on a per-capita basis has not resumed in many developing countries. Despite adjustment measures undertaken among the highly-indebted countries (HICs)[12], which

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10. Refers to the ninety-country group plus Poland and Hungary, used for analytical purposes by the World Bank.

11. World Debt Tables, 1988-89 Edition. The World Bank, Washington, D.C. December 1988.

12. Includes Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Cote d'Ivoire, Ecuador, Jamaica, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela and Yugoslavia.

collectively have a total external debt (long and short-term debt) of US $527 billion in 1987, growth rates and investment levels are well below those reached during the 1970s. Net resource transfers on long-term debt from these countries to their creditors during 1985-87 amounted to US $74 billion, or the equivalent of 3 percent of their combined GDP. The World Bank notes that, while per capita income and consumption have declined in these countries, the adjustment burden has fallen mainly on investment. In fact, investment in 1988 among the HICs is estimated to be only two-thirds of the average level in the 1970s.[13]

A major challenge facing most developing countries is to regain their creditworthiness. External financing for adjustment programs has remained scarce. For instance, in 1988 new money commitments from commercial banks to all developing countries were a modest US $7.5 billion. The task of demonstrating improvement in the debt ratios of many countries, however, will continue to be difficult. For example, in 1988 the HICs had an average debt service ratio - based on long-term debt - of 36 percent. There has been little improvement since 1982 when the ratio stood at 37 percent.

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13. Op. Cit. World Bank tables.

The impact of the debt crisis has been even more severe on the countries of Sub-Saharan Africa (excluding S. Africa) than on the highly-indebted middle-income countries. Their total debt of $129 billion has coincided with declining export revenues in 1986 and 1987, resulting in 1988 debt service obligations amounting to 47 percent of the region's total export revenues.

There are also some encouraging developments in the otherwise gloomy external debt situation. On March 10, 1989, US Treasury Secretary Brady outlined a number of proposals concerning an international debt strategy. Included was a proposal for a role by the World Bank and the IMF in financing debt reduction programs of debtor countries, for example through debt/bond swaps or debt buy-back schemes. The Brady Plan was the focus of discussion at the meetings of the IMF's Interim Committee and the World Bank/IMF Development Committee in early April. Canada and other major industrialized countries are currently studying the proposals but have already indicated broad support.

With respect to Sub-Saharan Africa, some progress has been made to provide debt relief to these countries, notably in the framework of the Paris Club. Following agreement at the 1988 Toronto Summit, a number of Sub-Saharan African countries, including the Central African Republic, Niger, Senegal, Tanzania, Madagascar, Uganda and Mali have received reschedulings on concessional terms. Donors,

including Canada, have also forgiven concessional loans to many countries in the region. Moreover, International Financial Institutions (IFI) have undertaken special measures through the World Bank's Special Program of Assistance and the International Monetary Fund's (IMF) Enhanced Structural Adjustment Facility.

The management of external debt by most Asian countries has also been much less problematic than the experiences of the Sub-Saharan countries and the HICs. Asia has been able to achieve steady growth throughout the 1980s, with several of the South-east Asian countries and to a lesser extent China, recording impressive economic gains, including strong exports earnings.[14]

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14. See World Economic Survey, 1988, United Nations, New York 1988.

Growth in Concessional Financing

In an effort to cope with the existing financial malaise afflicting most LDCs, many countries are hesitant to contract new debt unless the terms are very advantageous. As already noted, most developing countries have cut back sharply on the large public sector projects for which export credit insurance and financing have traditionally been sought. However, for those purchases which are still being made by developing countries, there is a growing demand for officially backed financing or financing on concessional terms.

In the context of weak demand, competition among national governments, through their official credit agencies, has intensified. Some agencies have adopted a very aggressive position in markets they consider desireable. In those LDC markets which have managed to avoid severe financial constraints, exporters and their governments have offered concessional financing to such a degree that several of the most important markets, including China, India and Indonesia, are considered "spoiled". This term reflects the fact that their governments will only consider making major purchases of goods or services from suppliers able to offer below market-rate financing. For instance, there is a regulation in Indonesia, spurred by aggressive Japanese

financing, which requires highly concessional financing terms on bilateral deals carrying a minimum grant element of approximately 48% for the major purchase of foreign goods or services.

Mixed credits or associated financing - a combination of development assistance (aid) funding and loans at commercial rates - have also been used increasingly to win export contracts in countries that would not necessarily be major aid recipients. This "associated financing" is attractive to certain lender countries because it enables the assembly of large financing packages at below-market rates, the entire amount of which can often be reported to the Development Assistance Committee of the OECD as Official Development Assistance (ODA).[15]

Canada and the United States have attempted to limit the use of mixed credits. Our government's efforts in the context of the OECD will continue in view of growth and increasing cost of this form of financing. In fact, offers of mixed credits notified to the OECD have increased from SDR 3.6 billion in 1982 to SDR 9.2 billion in 1987.[16]

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15. Those countries most active in supporting their exporters in this manner are primarily European.

16. As reported in the London Financial Times, April 30, 1988. Special Drawing Rights (SDR) were introduced by the International Monetary Fund (IMF) in 1970 as an international reserve (currency) asset intended for use in settling international transactions. Weighted against five major currencies in 1981, the value of the SDR approximates that of a U.S. dollar.

Developments Within the Export Credit and Development Assistance Committees of the OECD

The Arrangement on Guidelines for Officially Supported Export Credits (the Consensus Arrangement) was first put into place in 1978 and intended to limit competitive subsidization of export financing. It is adhered to by 22 members of the OECD Group on Export Credits and Credit Guarantees. The Consensus Arrangement sets minimum allowable interest rates (known as matrix rates) and maximum repayment terms for official export credit. Consensus also allows for concessional credits and grants which can be mixed with official export credits. These mixed credit facilities must be notified in advance to all members who have the opportunity to "match" financing offers with mixed credit facilities of their own.

The arrangement has been strengthened over the years. Essentially, minimum allowable interest rates have been set more flexibly to better reflect market conditions, and the cost of mixed credits has been made more expensive by progressive increases in the minimum concessionality level allowed.

The most recent changes came into effect July 1988. These changes move further in the direction of raising the cost of mixed credits to discourage their use and of adapting the rules on minimum interest rates to market conditions.

The minimum concessionality level for mixed credits was increased from 25% of the credit to 30% in July 1987 and to 35% in July 1988. Moreover, for the least-developed countries, the minimum concessionality level was increased to 50% in July 1987.

Although it is too early to determine the effect of the most recent increases, the use of growing ODA budgets for associated financing purposes has tended to undermine the discipline intended by increases in the minimum permitted grant element.

Growing attention has also been focussed upon the impact of Japan's aid and lending activities, which have increased as a result of Japan's elevation to the status of world's largest net creditor nation and dominant banker.

The Japanese Aid Program and Recycling Effort

In 1989 Japan is set to overtake the United States as the world's largest donor of Official Development Assistance. (It should be noted, however, that part of the apparent increase in Japanese aid as expressed in US dollars is the result of the growth in the value of the yen.) 70% of Japan's bilateral aid goes to Asia, and much of that is spent in middle-income developing countries such as those in ASEAN, which do not qualify for 100% grant assistance. Japan is still heavily involved in project lending (84% of all ODA loans in fiscal 1985), at a time when the rest of the

aid-giving community is moving away from this form of assistance.

About 70% of Japan's ODA is untied, well above average for the DAC group, but some observers state that about 80% of the money is ultimately spent on Japanese goods and services. The overall grant element as a proportion of Japanese development assistance is lowest in the DAC. The Japan International Cooperation Agency (JICA) extends technical cooperation and implements the bilateral grant program of the Ministry of Foreign Affairs. The Overseas Economic Cooperation Fund (OECF) is responsible for the implementation of the Japanese ODA loan and equity program.

OECF's activities can be very difficult to match. Yen loans are typically provided to medium-income developing countries at 3 - 3½% interest, 7 years grace and 25 years repayment, which meets Consensus guidelines. Japanese exporters aggressively pursue capital projects in developing markets and, due to their presence in these countries, are successful in convincing public sector buyers to take advantage of OECF funding. The size of these facilities has the effect of spoiling the entire market in some countries for public infrastructure projects and compels other countries to match. As noted earlier, Indonesia has taken this phenomenon to its logical conclusion by requiring offers of financing for bilateral deals to match Japanese terms.

Japan has pledged to re-cycle some US $30 billion of its foreign exchange surplus over the 1988-90 period. Of

the $30 billion of funding programmed, a total of $18 billion is expected to be provided to and administered by the IFIs. A further $9 billion will be co-financed by OECF and EXIM, the Japanese Official Credit Agency, in keeping with IFI project programming. A further $3 billion will be provided direct to executing agencies by EXIM for use on an untied basis on projects through international competitive bidding. The $9 billion to be lent under OECF and EXIM co-financing arrangements will generally be tied to purchases of Japanese goods and services. However, large amounts will be in commercial-rate funds raised on Japanese financial markets by IFIs (the World Bank and regional development banks), and a similarly large proportion will be lent by Japan through the IMF and IBRD in the form of special facilities to promote economic adjustment and stabilization, thus making the funds effectively untied. It should be noted that the current geograpical distribution of Japanese aid in which roughly 70% goes to Asia (one-half of this to ASEAN) and 10% each to Latin America, Africa and the Middle East, is not expected to change substantially over the next few years.

Japanese ODA financing can potentially be used for procurement from Canada and other foreign sources. Some countries seem to be involved already in joint projects with the Japanese, using concessional loans for financing.

Japanese aid agencies tend to have small administrative staffs and seem genuinely interested in

collaboration with Canada primarily because we are viewed as able to help them improve the quality of their aid program, particularly in human resource development and related areas. Canadians are recognized as being strong in the field and having a good record on project implementation. With Japanese ODA growing at a rate apparently faster than their capacity to deliver their aid program, the Japanese may try harder to disburse in ways that increase the quality of their program. They might also become more dependent upon Japanese trading companies whose large overseas staff already plan an important role in identifying projects for aid financing. The trading companies' staffs are larger than the field offices of Japanese aid agencies and the increase in Japanese aid should reinforce these companies' competitive advantage.

As an international marketing strategy, Canadian firms might strive to develop ideas in the field with Japanese aid officials, trading companies and other actors in areas where we possess competitive advantages or where our expertise complements Japanese requirements. Even if the Japanese win the overall contract for any particular project, Japanese firms are considered cost-conscious and, particularly in the light of yen appreciation, there should be opportunities for participation by Canadians. It appears that Japanese trading companies are doing more foreign procurement for aid projects because the high yen makes some Japanese sourcing too expensive. As Japanese policy is to leave the identification of projects and the listing of

priorities in the hands of the recipient country, it might be beneficial for Canadian firms to work with Japanese firms directly at the local level.

The Emergence of Build-Operate-Transfer (BOT)

The Build-Operate-Transfer (BOT) model, alternatively known as BOOT (Build-Own-Operate-Transfer) is attracting increasing attention in the international capital projects market. BOT represents a growing attempt to undertake project development which would otherwise be unattractive or impossible due to constraints associated with large sovereign debt burdens facing much of the developing world. The BOT model allows developing countries to minimize the impact of project debt on their national balance sheets by eliminating or reducig the need to provide sovereign guarantees. In theory, the need for balance sheet financing can be avoided by requiring the contractor to assume a significant equity interest in the project as well as operating it until the contractor is paid by the project's revenues. In general, ownership is to be transferred to the purchasing country when the contractor has been paid according to the terms of a pre-arranged agreement. The BOT financing mechanism is thus a potentially attractive approach for purchasing countries. It may increase the level of capital project activity among developing nations which would otherwise be possible under conventional financing methods.

The BOT model also introduces an additional and potentially complicating dimension to the international

capital projects landscape. BOT implies, for instance, that contractors may assume a greater degree of risk in undertaking certain capital projects abroad. It also raises important questions regarding the amount of managerial expertise which must be tied up throughout the duration of a BOT project, which may be many years before a transfer of ownership occurs.

It is much too early to issue a verdict on whether BOT represents a boon or burden for the international engineering and construction sectors. BOT is a broad concept which has potential application for a wide range of projects in a diversity of countries. While numerous projects across the globe have now been tendered or are contemplated on a BOT basis, no significant patterns of experience have yet been established on which to form definitive conclusions.

There are still many uncertainties surrounding BOT. It is clear, however, that it is a concept which is attractive to certain developing countries. Accordingly, and in view of persistent debt concerns facing many developing countries, BOT can be expected in at least the short term to be the basis for an increasing number of international capital, particularly infrastructure, projects.

Trade in Services: The Uruguay Round

Another factor which may affect the nature of international business undertaken by engineering firms in the future is currently unfolding in the Uruguay Round of multilateral trade negotiations.

Inaugurated in 1986, the Uruguay Round is the eighth in a series of negotiations since the General Agreement on Tariffs and Trade (GATT) was established in 1948. New issues incorporated under the sweeping umbrella of the present negotiations include investment, intellectual property and services. With the mid-term review recently completed in Montreal, the Uruguay Round participants are now working towards a deadline of the fall of 1990 to reach an overall agreement.

Canada supports the development of new trade rules in services and considers this objective a priority in the Uruguay Round. Trade in services such as transportation, telecommunications, consulting, financial and professional services, is becoming an increasingly important feature of the global economy. Estimates are that trade in services now represents about 20 percent of world trade. In Canada the service sector is the fastest growing source of employment and already accounts for 70 percent of Gross Domestic Product and more than 8.8 million jobs.

As a result of Canadian experience and expertise in many service sectors, Canada has an established competitive

advantage in these economic activities. The Canadian engineering industry has demonstrated its competitiveness in providing design and project management services in the international capital project market. This competitiveness is reflected further by the achievement of a substantial balance of trade surplus in the area of "consulting and other professional services" (made up mainly of consulting engineering) over the past decade. Available statistics indicate, for instance, a 1986 trade surplus of $441 million, down somewhat from the years 1985 and 1984 which witnessed surpluses of $731 million and $686 million respectively.[17]

Canada's economic growth prospects could be enhanced by securing greater access to world markets for our service exports. For this reason, Canada is working to develop a new framework of multilateral rules for trade in services which reduces existing restrictions on our exports of services to foreign markets. It is Canada's view than an agreement on services should contain mechanisms for avoiding and settling disputes and should incorporate basic GATT principles such as: market access; non-discrimination; national treatment; and transparency.

The recent Ministerial Mid-Term Review Meeting achieved substantial progress on several important issues, with preliminary consensus achieved in 11 of 15 negotiating

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17. Canada's International Transactions in Services, Statistics Canada, Catalogue 67-203. September 1988.

areas of this phase of the negotiating process. Differences were not yet resolved in agricultural talks, intellectual property, safeguards and textiles. However, a special meeting has been scheduled for April of 1989 to deal with these issues.

The question of whether to include trade in services within the ambit of the negotiations was particularly contentious in the discussions leading up to the launch of the Uruguay Round. Differences in views emerged at an early stage essentially along developing and developed country lines. India and Brazil, in particular, advance the view that a need for international rules for trade in services had not been adequately established. Furthermore, concerns were harboured over the implications of liberalization in services trade for their development prospects.

The tug-of-war between these two opposing positions, while far from fully resolved, has nevertheless resulted in agreement in Montreal on detailed guidelines for the negotiations to develop a framework of principles and rules to govern trade in services in a manner analogous to the GATT for trade in goods. There is considerable optimism that new rules for trade in services will ultimately be established and will serve the mutual interests of developing and developed countries alike. It is still far too early to predict, however, what elements might be included in such an agreement and even which service sectors could be affected.

While the Montreal agreement marks an important and necessary milestone, a final agreement of substance on rules for services in trade will still require considerable effort by all participating nations. The Canadian government, through the Sectoral Advisory Groups on International Trade (SAGIT), established by the Multilateral Trade Negotiations Office (MTNO) and the International Trade Advisory Committee (ITAC), will continue to consult the engineering industry for its advice and views as these negotiations evolve and the final outcome begins to crystalize.

As a guide to continuing GATT negotiations, some key excerpts of the Montreal agreement on services and an outline of the agreed upon schedule for future work follow:

Components (Actual Text)

- Ministers agree that work would proceed, without excluding any sector of trade in services on a priori basis, with a view to reaching agreement on the sectoral coverage under the multilateral framework in accordance, inter alia, with the considerations that coverage should permit a balance of interests for all participants, that sectors of export interest to developing countries should be included, that certain sectors could be excluded in whole or in part for certain over-riding considerations, and that the framework should provide for the broadest possible coverage of sectors of interest to participants.

° Ministers agree that negotiations on the elaboration of a multilateral framework of principles and rules for trade in services should proceed expeditiously. To this end, the following concepts, principles and rules are considered relevant:

- transparency
- progressive liberalization
- national treatment
- most-favoured-nation/non-discrimination
- market access
- increasing participation of developing countries
- safeguards and exceptions
- regulatory situation (i.e. recognition that governments regulate service sectors)

An agreed upon outline and schedule for future work involves: (Actual Text)

° The compilation by the secretariat of a reference list of sectors by February 1989. This process could be assisted by submissions by participants.

° Invitation to participants to submit indicative lists of sectors of interest to them with a target date of May 1989.

- The process of examining the implications and applicability of concepts, principles and rules for particular sectors and specific transactions should begin as lists become available.

- Further work as necessary on the role of international disciplines and arrangements and on the question of definition and statistics.

- (The Group on Negotiations on Services, or GNS) should endeavour, by the end of 1989, to assemble the necessary elements for a draft which would permit negotiations to take place for the completion of all parts of the multilateral framework and its entry into force by the end of the Uruguay Round.

The Canada-U.S. Free Trade Agreement

No discussion of recent market development would be complete without commenting at least briefly on the Canada-US Free Trade Agreement (FTA) which came into effect January 1 of this year. In recognition of the important contribution of service industries to the prosperity of Canadians and the fact that Canada-US trade in services is substantial and growing, Canada and the United States have negotiated an unprecedented trade agreement with binding obligations in the services sector. Approximately 62 percent of Canada's global trade in services is with the United States. The value of Canadian service exports to the US amounted to $10.9 billion

in 1986, while exports from the US were slightly greater at $13.5 billion.

The Canada-US Free Trade Agreement contains several elements of significance for Canada's engineering sector. The Agreement directly addresses such issues as temporary business travel and professional accreditation. The FTA also sets out a general principle that future new regulation in either country will not discriminate against service providers from the other country in those service sectors covered by the Agreement which include engineering, architectural and management consulting services. This will ensure a limitation to future barriers to services trade and secure the relatively free access that already exists in the North American services market. (More information on the significance of the FTA for the services sector can be obtained by contacting the Department of External Affairs or by consulting the document prepared by the Department entitled The Canada-U.S. Free Trade Agreement and Services (1988).)

CONCLUSION

Recent developments in the international economy suggest that competition for attractive capital projects will remain intense for the forseeable future, particularly in middle-income developing countries. The basis for the present state of the international engineering marketplace can be traced to several interdependent factors including: the development of advanced engineering and construction firms in developing countries; the continuing external debt problem; and the emergence of "spoiled markets" as a result of competitive concessional financing and growth in the use and cost of mixed credits, or associated financing. The ability of Canada to match the financing practices of some of our competitors remains constrained. However, the Canadian government will continue to work towards resolving these concerns in the context of the OECD Consensus Arrangement.

The current round of multilateral trade negotiations has established as an objective, for the first time, the development of rules governing multilateral trade in services. Canada is supportive of this initiative due to a high level of competitiveness in the services sector, and considers trade rules in services a priority in the Uruguay Round. While significant progress on the issue of services has already been achieved by the end of the mid-term review in December, it is too early to predict what form new trade

rules might ultimately resemble, or even if trade in engineering services would be included under the ambit of such an agreement.

Canada's commitment to trade liberalization has also been advanced through the negotiations of the Canada-U.S. Free Trade Agreement, effective January 1st of 1989, which contains unprecedented binding obligations in the services sector. Exports of engineering and related services to the United States will be enhanced by addressing such issues as temporary business travel and professional accreditation, as well as setting out a general principle of non-discrimination with respect to future regulations in the important North American market.

The preceding analysis of present market conditions for international projects suggests that it is more important than ever for engineering and construction firms active in international markets to develop sound marketing strategies. A pre-requisite to formulating such a strategy is an up-to-date awareness of global economic developments and a familiarity with changing government policies in potential target markets.

In view of persistent debt problems experienced by many developing countries and their related difficulty in acquiring project funding, firms should be realistic in their marketing expectations when pursuing possible projects in such countries. The governments of all industrialized

countries are extremely hesitant to increase their debt exposure to high risk economies. Commercial banks will rarely advance new loans to certain countries today for new project purposes. As a result of these economic realities, firms are generally advised to concentrate scarce marketing resources on countries which can clearly afford to purchase their goods and services - despite the tough competition to be expected in these markets.

Internationally competitive firms should, nevertheless, become familiar with every available source of financing to take advantage of existing opportunities to market their goods and services in capital-poor countries. A knowledge of procurement practices administered by international financial institutions such as the World Bank and regional Development Banks should accordingly be acquired. Japanese Development Assistance spending and foreign exchange recycling could also be explored for possible procurement opportunities from Canada. Finally, firms are advised to maintain a close relationship with the Export Development Corporation as their federal governmment contact agency for determining the availability of export financing and insurance. The Department of External Affairs works with the EDC and can provide additional information and assistance concerning other export inquiries and needs.

APPENDIX I

SOURCES OF ASSISTANCE

For sources of information regarding international capital project development and export promotion, the attached brochure, entitled International Financing Data: A Business Guide to Export Finance and Other Financial Assistance (7th Revision 1989), is a comprehensive and popular source of guidance. The fact that such marketing tools can play a major role in stimulating exports is reflected by the DRIE study referred to earlier (Appendix III). It demonstrates that, of the exports by Canadian consulting engineering firms which required financing, more than a third were supported by either CIDA or EDC. In addition, 20 percent were financed by IFIs. Topics covered by this document include the role of, and services provided by:

- Canadian Chartered Banks
- The Export Development Corporation (EDC)
- The Canadian International Development Agency (CIDA)
- Multilateral Financial Institutions
- Provincial Export Funding Programs
- Federal Government Program for Export Market Development (PEMD)
- Info Export
- Canadian Commercial Corporation
- Department of External Affairs

A new export assistance mechanism recently established by the Department of External Affairs, which is not mentioned in the guide, is the International Trade Centre (ITC). ITCs were established in June 1988 to enhance the delivery of trade programs and services to the business community in the regions. They will be undertaking new export awareness initiatives and developing new support mechanisms such as a trade information computerized network between the ITC and Department of External Affairs (DEA) Headquarters. This system will provide the ITCs with key up-to-date information on market opportunities and trade promotion events (both domestic and international).

While located in the Department of Industry, Science and Technology (ISTC) provincial offices, the ITCs are distinct and visible entities managed by a Senior Trade Commissioner. Ten centres have already been established (St. John's, Halifax, Moncton, Charlottetown, Montreal, Toronto, Winnipeg, Saskatoon, Edmonton and Vancouver). This network will be augmented by four new centres in Quebec City, London, Calgary and Regina.

APPENDIX II

THE EXPORT FINANCE AND CAPITAL PROJECTS DIVISION

DEPARTMENT OF EXTERNAL AFFAIRS

The Export Finance and Capital Projects Division has the responsibility in the Department for monitoring and analyzing developments which may affect international markets for capital projects. Specifically, the Division:

- follows major capital projects in key world markets including those financed by International Financial Institutions (IFI), such as the World Bank, Asian Development Bank and African Development Bank;

- works closely with the Department of Industry, Science and Technology (ISTC) and their Capital Projects Division to bring key projects to the attention of industry;

- provides information on countertrade practices and experience in international markets;

- follows developments in export financing and insurance;

- plays a role in processing of Canadian concessional financing under Section 31 of the Export Development Act.

The management of the Canada Account is particularly important to the success of Canadian firms in many markets, especially highly-indebted and middle-income developing countries. The recent developments in the international economic environment discussed in the paper have also increased demands by Canadian exporters upon this program. As a result of increased risk perceived by commercial banks, the private banking system has reduced its activities in the developing world, transferring much financing of project activity to official export credit agencies, such as the EDC.

The Canada Account serves as a facility of last resort which can respond to exporters' requests for export finance, trade-related insurance and foreign investment insurance in circumstances where EDC is not able to provide such services on its own account. There are three circumstances in which the Canada Account provides services the EDC would otherwise undertake:

1. Although the risk is acceptable to EDC, the amount of financing or foreign investment insurance required is too great for EDC to adopt on its own account. The Canada Account is thus necessary to support exporters pursuing very large capital projects such as urban transportation systems, mining, or hydro-electric facilities.

2. The risk, whether commercial or sovereign is considered greater than that which EDC can accept.

3. Concessional financing is required to maintain the Canadian exporter's competitive position because similar financing support has been offered by competitors.

At the end of 1987, the Canada Account, which is administered by EDC, had outstanding loans and commitments to foreign borrowers totalling $956 million.[18] Insurance and related guarantees at the end of 1987 administered under the Canada Account were valued at $370 million.

The Export Finance and Capital Projects Division works closely with the Export Development Corporation and Canadian Commercial Corporation. As a result of this position in the Department and our access to up-to-date market information, we have been designated as a contact point for consultants, engineering firms, the construction industry and other exporters of goods and services.

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18. See Export Development Corporation Annual Report, 1987.

APPENDIX III

DRIE MINI-EXPORT SURVEY FOR 1986
SUMMARY OF RESULTS

1. Survey results are based on responses from 31 firms (ACEC firms).

2. Total sales were:

	1985	1986	1987 (est.)
Domestic	740.8	729.2	794.7
Export	414.4	393.4	376.0
Employment	14,561	16,120	16,578

3. Export sales by region as a percentage of total exports.

Africa	30 %
Asia	20
Middle East	4
Latin America	12
Caribbean	2
Australia and New Zealand	5
Japan	0
USA	17
USSR	6
E. Europe	1
W. Europe	4
	100 %

4. Export sales by financing agency as a percentage of total exports.

CIDA	17 %
EDC	18
ILAs	20
Private - Canadian	4
Private - Host Country	26
Government - Host Country	8
	100 %

5. Export sales by field as a percentage of total exports.

Power	22 %
Forestry	15
Mining	7
Industry	13
Transportation	12
Oil and Gas	12
Municipal	3
Buildings	3
Agriculture	1
Irrigation	2
Tourism	2
Telecommunications	8
	100 %

APPENDIX IV

Growth Rates in Construction Activity Worldwide*

Region	% of World of Construction Authority	Growth Rates			
		1970-75	1975-80	1980-85	1985
World	100 %	2.7 %	2.3 %	-0.2 %	0.4%
Africa	3.3	8.6	4.6	-1.9	0.9
Caribbean and Latin America	6.5	6.0	5.5	-5.1	1.3
Middle East	4.7	19.7	3.3	-1.4	-9.9
E. Asia/ S.E. Asia (excl. Japan)	5.4	5.7	8.0	5.0	2.5
E. Europe (incl. USSR)	15.2	6.4	2.5	3.0	3.3
Japan	12.4	3.9	2.4	-4.0	-0.8
EEC	23.3	0.0	0.5	-1.7	-2.5
N. America (incl. Cda and USA	19.6	1.0	2.2	1.2	2.4

* Source: Adapted from National Aggregate Statistics: Analysis of Main Aggregates, 1985. United Nations. New York, 1988

ABBREVIATIONS

ASEAN	Association of South East Asian Nations
BOT	Build-Operate-Transfer
CIDA	Canadian International Development Agency
DAC	Development Assistance Committee (OECD)
DEA	Department of External Affairs
DRIE	Department of Regional Industrial Expansion (predecessor to ISTC)
EC	European Communities
EDC	Export Development Corporation
FTA	Canada-U.S. Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GNS	Group on Negotiations on Services (Uruguay Round of GATT)
HIC	Highly indebted countries
IFI	International Financial Institutions
ILA	International Lending Agency
IBRD	International Bank for Reconstruction and Development (World Bank)
IMF	International Monetary Fund
ISTC	Department of Industry, Science and Technology (successor to DRIE)
ITAC	International Trade Advisory Committee
ITC	International Trade Centre
JICA	Japan International Co-operation Agency
LDC	Less Developed Country
MTNO	Multilateral Trade Negotiations Office
ODA	Official Development Assistance
OECF	Overseas Economic Co-operation Fund (Japan)
OECD	Organization of Economic Co-operation and Development
SAGIT	Sectoral Advisory Group on International Trade
SDR	Special Drawing Right