External Affairs Canada   Affaires extérieures Canada

Statements and Speeches

No. 83/5

ECONOMIC NATIONALISM

An Address by the Honourable Gerald Regan, Minister of State (International Trade), to the Bankers' Association for Foreign Trade, San Juan, Puerto Rico, April 13, 1983

I am pleased to join you here in beautiful and sunny Puerto Rico to talk about the broad and recurring phenomenon of economic nationalism. Bankers and businessmen have some national preferences in relation to how business is carried out. First, they want as little interference as possible from government. Second, they want whatever rules they have to tolerate to be the same throughout their over-all area of operation. Third, they want those rules to be consistent, predictable and not constantly changing.

Unfortunately, these conditions are only attainable to a limited extent within national boundaries. When we venture into the world of international trade and investment, we encounter a jungle of variations in rules, tax schedules, prohibitions and local idiosyncrasies. In many countries today you can add to that problems of credit worthiness.

Despite the myriad of conditions, international trade and investment have grown at a phenomenal rate in the years since the end of the Second World War with a resulting growth in the standard of living of all involved and the emergence of export markets as a significant factor in the economies of the industrialized world.

The banking industry has served this growth well and has shown an amazing ability to adjust to changing circumstances.

Bankers have realized that in a world of nation states, nationalism in both its political and economic manifestations is inevitable. All countries take steps to protect what they perceive to be their essential economic interests and preserve their political and cultural independence.

The optimum system strictly from the point of view of corporate efficiency would be unfiltered free trade and investment flows without limitation of political boundaries or the incursion of other political factors.

Practical experience shows us that this is impossible to achieve. Whether governments are directly elected or more authoritarian, they share the conviction that their primary responsibility is to the people within their jurisdiction rather than to the international community and, therefore, establish rules and conditions that relate to the needs of that particular country which may be at variance with those that exist elsewhere.

If they are wise governments and cognizant of the benefits of an efficient multilateral trading system, they strive to avoid national laws that are so extensive or protectionist as to disrupt the normal functioning of international economic relations.

No country is free of some degree of economic nationalism. Restriction on foreign investment manifests itself in different forms in various countries. Special protectionist measures against importation of certain types of goods and services vary according to the economic needs of the particular country, but they always exist.

If one takes the United States for instance, you find long-standing restrictions on foreign investment in such sectors as shipbuilding, dredging, fishing, air transport, communications, finance, nuclear power, mining and defence procurement industries. Other laws relating to anti-trust, securities etc., can be used to prevent acquisitions by foreigners when these are not in the US interest. All of these restrictions exist in a country that has never had the threat of any appreciable percentage of foreign ownership of its industry. I'm sure that US legislators over the years have felt that they had good and sufficient reason for these laws, but they nevertheless restrict the free flow of international investment capital.

In relation to the other aspect of restriction of international business, that of protectionism against the importation of products of other countries, we again find that all countries find it necessary to maintain some measures to protect domestic production.

Here again I use the example of the US not because it is a leading transgressor like Japan, but merely to show that even the strongest, most developed economies find such measures necessary.

You are probably aware of the Surface Transportation Assistance Act that gives a "buy America" preference on federal-funded highway and urban mass transit projects including restrictions on cement and rolling stock imports. Other preferential buy America acts exist in a number of states. There are new restrictions on the defence procurement of foreign-produced specialty metals that will hurt US economic partners. In fact, new trade protectionist measures abound in Congress: from reciprocity legislation to domestic content for automobiles. US industry is active in initiating restrictions against foreign imports under US trade law. These developments are a reflection of difficult economic circumstances, tough foreign competition and high unemployment.

As a minister in the Canadian government, I want to suggest to you that in this admittedly imperfect world Canada adheres to the principles of free trade and accessibility of international investment as well as other developed industrial countries.

In almost every sector of the economy Canada has permitted a higher percentage of foreign ownership than any other industrialized country. While foreign control of non-financial industries in Canada has declined in recent years, it remains at 27 per cent, the highest in the industrial world. It is particularly high in important industries: oil and gas — about 60 per cent; transportation equipment — 70 per cent; electrical equipment — 60 per cent; and mining — 38 per cent. In the US foreign investment controls about 2 per cent of non-financial industries: 18 per cent of petroleum; 5 per cent of mining and 3 per cent of manufacturing. While 19 of the 50 largest firms in Canada are foreign controlled, this is the case for only two out of the largest 50 firms in the USA. The stock of foreign investment is now higher in the USA than Canada, but of course the USA economy is ten times as large. The US has six times as much foreign investment in Canada, comprising 80 per cent of the total, as we have in the USA.

Again, we have allowed as great or greater access into our market of the foreign goods than most other countries in many sectors. Because the Canadian industrial structure is not as diversified as other larger countries, we generally import a greater percentage of manufactured goods in relation to our total needs than other countries.

The policies adopted by countries will vary greatly depending on their economic size, commercial competitive advantages, position as capital importer or exporter, or host or home country to multinational enterprises (MNEs) and their international political role and perceptions. Canada and Australia, as primarily host countries to foreign investment, employ investment screening mechanisms and may restrict foreign involvement in some sectors for cultural or economic reasons. The investment restrictions of large home countries, like the US and Britain, are often on a sectoral basis and involve considerations of security and defence as well as economic considerations. France and Japan employ a variety of administrative measures to protect their trade and investment interests.

These differences in circumstances and policies must be considered when attempting to define international norms of behaviour: within the GATT [General Agreement on Tariffs and Trade] system with respect to trade and in the various OECD [Organization of Economic Co-operation and Development] and UN investment instruments which include guidelines for MNEs and principles of fair and equitable government treatment of foreign investors.

There are no absolute rights and wrongs. There must, however, be a balance of interests among states that recognize their national responsibilities and the desirability of a relatively liberal international trade and investment climate. MNEs must commit themselves to contribute to development by following the laws and policies of the countries in which they operate, and international guidelines. This co-operation can minimize excessive or ill-considered economic nationalism that can have negative effects or lead to disaster.

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I want to spend a few minutes explaining a number of Canadian policies in the investment area, including the Foreign Investment Review Agency and the National Energy Program [NEP]. We do not consider that Canada's policies are particularly unique. While they have raised some controversy in the international business community, the concern about our policies was probably at a maximum about a year ago. Since then, the difficult international economic circumstances, a realization that many other OECD countries employ measures to achieve goals similar to Canada's and our own efforts to streamline and explain our own policies, have accounted for these improved perceptions.

Canada's economic development strategy has always been a pragmatic one, free of ideology, relying upon both international investment and public enterprise to supplement private domestic investment. The railway sector in Canada, comprising publicly-owned Canadian National Railways and Canadian Pacific Railways, the largest investor-owned railway which nevertheless had both government support and foreign investors, is an example of this tradition. A more recent example of this "Canadian" approach to development is the establishment of Petro Canada as a public corporation competing with private companies, both domestic- and foreign-owned, in the oil and gas sector.

This pragmatic approach to development has served Canada well and has certainly not deterred international investors from taking a stake in Canada. No other country in the industrialized world – and probably in the whole world – has relied as heavily on the process of international investment, sustained it as effectively and benefited from it as continuously as Canada has over recent decades. It is little wonder then that Canada supports a positive environment for international investment.

Stated another way, Canada welcomes foreign investment that will bring significant benefit. We are also particularly interested in MNEs in Canada being good corporate citizens along the lines set out in the OECD guidelines and our own domestic guidelines: by engaging in economically viable export activities; sourcing in Canada where competitive; carrying out independent research and development in Canada; providing equity participation and management responsibility to Canadians; providing significant management independence to the Canadian enterprise; and seeking to use profits and resources generated in Canada to the benefit of the Canadian economy.

At the same time, the high levels of foreign investment in Canada have led to concerns about the implications of this for economic progress and independence and, in turn, to a number of moderate policies that respond to these concerns.

The Canadian approach to foreign investment has three main approaches. The first approach is to minimize legislative regulatory or administrative impediments to the operations of foreign-owned or controlled companies in Canada. We have consistently "extended" national treatment to foreign-owned firms. Once such firms are established in Canada, they are generally subject to the same tax provisions, regulations and eligibility conditions for government grants and loans as Canadian-owned enterprises.

The second approach is that the few significant exceptions to this rule where some restrictions on foreign ownership apply relate to three key areas of the economy: financial institutions, communications and culture, and the oil and gas industry. The relevant measures in these sectors have generally been spelled out in legislation and regulations rather than being left in an *ad hoc* uncertain way. The short list of key sectors in Canada compares quite favourably with the US and a number of other OECD countries.

Perhaps I could comment briefly on these three Canadian sectors. With respect to financial institutions, it should be noted that in chartered banking we have moved in the direction of greater reliance on foreign investment and enterprise. Prior to the recent revision of the Bank Act, foreign banks were not permitted to engage in banking activities in Canada, although they could and did play an active role in the provision of commercial loans and other financial services. The new banking legislation enacted by Parliament in 1980 has significantly opened up this sector to international investment. Foreign banks are now allowed to establish subsidiaries in Canada as single-branch wholesale banks. Ministerial approval is required for additional deposit-taking branches, but representative offices may be opened at will. (At least half the directors of a foreign bank subsidiary must be Canadian citizens, and the foreign-owned banking sector is limited in the aggregate to 8 per cent of all banks' total domestic assets. Foreign controlled banks have broadly the same business powers as domestically-controlled ones.) Since passage of this legislation, 57 new foreign-owned banks with total assets of some $18 billion have received their charters.

The restrictions in the communications sector are based on the development of a distinctive independent Canadian cultural output. Since 1971, the Canadian Radio Television and Telecommunications Commission [CRTC] has issued broadcasting licences only to companies 80 per cent owned by Canadians. The CRTC also requires broadcasters to devote specified proportions of their program schedule to Canadian programming. Canadian advertisers may only deduct their domestic advertising expenses for tax purposes when using Canadian media to reach Canadian markets. Programs have been introduced to encourage the Canadian film and publishing industries, to make sure that Canadians, along with the wide choice of foreign cultural products available to them, also have access to those of Canadian intellectuals and artists.

I mentioned earlier that special circumstances dictate different sectoral or legislative limitations in various countries. Canada's special circumstance in the communications field arises from our geographical location and linguistic pattern with our population of 24.7 million scattered along more than 3 000 miles of the border with a southern neighbour that uses English — one of our two official languages. We have awesome problems in maintaining a distinct culture; in developing our own literature; or supporting our own artists. Obviously, this sort of problem does not exist for Australia to the same extent because of the factor of distance.

The third and most controversial key sector is the oil and gas industry. The principal objective of the National Energy Program is to ensure energy security for Canadians. Achievement of this objective requires that more of our oil and gas industry be controlled by Canadian interests, and that there be appropriate participation by the national government, on behalf of the Canadian people in the future development of that industry. Between 1975 and 1979, the Canadian oil and gas industry generated net outflows of capital totalling $3.8 billion – $2.1 billion in direct capital and $1.6 billion in dividend and interest payments. The outflow took place at a time when enormous amounts of capital were required to ensure the rapid development of Canada's oil and gas potential, a national imperative if self-sufficiency is to be achieved. These factors necessitated some form of encouragement for investment in new oil and gas development that would be attractive to Canadian investors and led to the establishment of the Petroleum Incentives Program and the Canada Oil and Gas Lands Administration. Our ownership goal is modest: to have Canadians own 50 per cent of the Canadian industry by 1990.

Canada is by no means the first country to treat energy supplies as a matter of strategic national importance and seek security over oil and gas supplies through ensuring significant domestic ownership and some government involvement in the industry. The entire oil and gas industry is under government control in most producing countries including Venezuela and Mexico. The USA is the exception, rather than the rule, being the home base for the world's largest oil companies which no doubt accounts for the fact that foreign control in the United States oil and gas sector is low. Regarding public enterprise, Petro Canada is still a youngster – though a strong and fast growing one – in the large family of oil companies wholly or partly owned by governments: British Petroleum in the UK, Statoil in Norway, Agip in Italy, La Compagnie Française des Pétroles in France, Veba in West Germany, the National Oil Company in Japan, Petrobras in Brazil.

The foreign oil industry will continue to prosper in Canada. A comparison with policies and practices in Norway, Britain and the USA, among others, shows that Canadian legislation is less stringent and provides as high or higher rate of return on new oil for foreign investors than do these other countries. Assets are not being nationalized. Rather, acquisitions, through private purchases at market prices, have been on terms highly favourable to the sellers of those assets. Moreover, Canada is providing large incentives to foreign companies operating in Canada for oil and gas exploration and development. The regime in the NEP will be more favourable to foreign investors than in virtually any other country. But the incentives are being made even more favourable to Canadians so that they may increase their participation in a growing Canadian petroleum industry.

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The key elements of the NEP have now been enacted by Parliament. There is a flexible and comprehensive framework in place for the development of the petroleum industry in Canada in which Canadian, as well as foreign firms, will more actively participate. Oil prices, interest rates and general economic conditions will of course affect the pace of development of this sector. We are also on schedule with our Canadianization target. Canadian participation has increased about 10 per cent in the sector. The 50 per cent target for 1990 remains and is achievable, but we do not wish to press the pace of Canadianization of foreign energy holdings in the years ahead. It is expected that increases in Canadian ownership will come largely through participation in joint ventures and active involvement of Canadian companies in exploring for and developing new oil and gas resources.

The third approach to foreign investment is our system of monitoring or reviewing as embodied in the Foreign Investment Review Agency [FIRA]. FIRA and its Australian counterpart are the best known one-stop integrated processes for reviewing foreign investment activities in the world. Most other countries have taken a diffuse approach and have put in place a multiplicity of legislative provisions, regulations and administrative procedures to prohibit, restrict or otherwise control the activities of foreign investors in their territories. Our view is that the integrated approach, while it can be improved, is the better one for us.

Let me give you some facts. Fact one is that the scope of the FIRA process is quite limited. In 1981, proposed direct investment reviewed by FIRA amounted to $2.6 billion. In the same year, however, the value of Canadian assets held by foreign-owned companies already doing business in Canada increased by $25 billion primarily due to new investments in current and related business not subject to review. Portfolio investment or non-controlling share ownership, and bonds and debentures issued by Canadian businesses and governments totalled $10.8 billion in 1981, none of which was subject to FIRA review.

Fact two: FIRA approves the great bulk of foreign investment proposals, over 91 per cent on average over the eight years of FIRA operations.

Fact three: The FIRA process is not arbitrary nor uncertain although the weight given to five factors considered in each case may vary. These factors include: the effect on economic activity, including the use of Canadian inputs and exports; (2) the degree and significance of participation by Canadians; (3) the effect on productivity, industrial efficiency, technological development and innovation and product variety; (4) the effect on competition; and (5) the compatibility with national industrial policies, taking into account provincial policies.

Fact four: During the past year a number of announcements have been made to streamline FIRA. The processing time on cases has been reduced and the review process expedited through increasing the small business size limits, the issuance of interpretation notes on legal aspects of the Act and formal opinions on reviewability, and the announcement by the responsible minister of the formation of an advisory panel drawn from the private sector.

If the policies of Canada and other predominantly host countries have been criticized from time to time, particularly by the USA, as being too nationalist, I would be remiss in not mentioning a nationalist element in US policy, as a home country, that is extremely detrimental to the international investment climate. This is the insistence by the US in applying its domestic laws to the foreign affiliates of US MNEs in some circumstances, particularly strategic export controls, against the will and policy of the host country with jurisdiction over that entity. I need hardly dwell on the complications such actions produced last year in the Siberian pipeline. We find such actions unacceptable, legally and politically, and very negative economically if for no other reason that they put US MNEs into difficult circumstances and call into question whether they can be good corporate citizens in the countries in which they operate. We hope the USA will take appropriate action to correct this problem.

The sum total of Canadian measures, I would submit, represents a minimal and flexible response to the situation of a major host country in which Canada finds itself. Nor do we consider ourselves in bad company. While Canada is not as prone as the USA to criticize the restrictive elements in the investment policies of other countries – I do not wish to dwell here on how France, Japan, Australia, or Sweden, pursue their objectives – they do exist, as perhaps you in the private sector know better than I. Judging from the continuing increases in applications to FIRA the Canadian measures have not, nor do we intend to let them, hamper the positive role that foreign investment has played in Canada, but they do provide the context in which such positive contributions can be made. We are for a liberal international investment environment, and for the fair and equitable treatment of MNEs under international law. In fact, in recent years Canada has been a net exporter of direct investment as Canadian MNEs have grown. But we are also sensitive to the concerns that can exist about foreign control of any economy. From time to time national policies may entail some deviation from the very positive precept of national treatment to protect essential economic interests, or some restrictions on the establishment of foreign investors.

As I said at the beginning, investment is not the only area in which economic nationalism can manifest itself. Trade policies or specific trade measures can also be motivated by nationalistic objectives which may not correspond entirely to basic economic interests. Indeed, one would be hard put to find an example of a country whose trade policy applies the principles of free trade in all respects. As regards agriculture for instance, most countries would attach some priority to ensuring security of food supplies through the maintenance of domestic production although they could be obtained more cheaply from imports. The same holds for other sectors considered vital for the preservation of some measure of economic independence. In most countries, procurement from domestic sources over foreign imports is given support, sometimes through legislation, as we see in a number of US measures. Exports may be restricted for security reasons. Such policies and measures affect international trade.

In times of economic difficulties, such as we have been experiencing over the last few years, the tendency to protect domestic industry from the brunt of foreign competition becomes much greater. Governments are under strong pressures to enact measures aimed at preserving employment either through actions at the border to limit imports or through export support mechanisms such as subsidies which distort international trade. The last few years have witnessed a multiplication of measures affecting trade ranging from regular safeguard actions taken under the GATT to bilateral arrangements (such as voluntary export restraint agreements) to subsidized exports and fierce export credit competition. You are also well aware of proposals now before the US Congress for domestic content legislation and for trade reciprocity legislation.

I am not saying that all these measures are illegitimate or unjustified. Indeed safeguard actions constitute an integral part of the international trade system embodied in the GATT: countries have the right to resort to safeguards when imports create or threaten to create injury for domestic producers. What I am saying, however, is that the rise in unemployment and the crisis situation in which many of our industries find themselves have engendered in some quarters a negative attitude towards imports: there is a greater tendency now to blame our economic woes on "unfair" competition from abroad and to justify protective measures by the fact that others are also resorting to them. This is a trend that must be resisted forcefully by governments if we are to avoid the disastrous experience of the Thirties.

Economic recovery will no doubt help to ease the pressures but we should not allow ourselves to become complacent about the threats facing the international trading system. The GATT ministerial meeting last November reconfirmed the international community's commitment to open trade and to resist protectionist pressures. It adopted a work program which, if implemented diligently, will help to restore the health of the trading system. The momentum achieved last November must be maintained and efforts must continue to preserve and strengthen the multilateral trading system.

Canada's stake in the open multilateral trading system is enormous. Approximately 30 per cent of our gross national product is generated by trade, which makes our economy one of the most open in the world. This means that our economy is even less insulated than others from the trends in the world economy and the present crises has been felt particularly strongly in Canada in terms of high inflation, interest rates and unemployment. The Canadian government, like that of other industrialized nations, has been and continues to be under strong pressures to protect its industry and, like others, we have been obliged to take temporary measures to safeguard employment. We have kept such measures to a minimum and have been very active on the international scene in defence of open trade. Indeed, for Canada, economic nationalism in the field of trade, dictates that we maintain a firm commitment to free trade and that we encourage others to adopt the same attitude. It is vitally important for us that our principal trading partners, and, in the first instance, the United States of America, maintain their markets open for our exports in the same way as we are determined to maintain our market open to their exports.

We have to work particularly hard to maintain the broad balance of interests in our trade and investment relations and avoid the narrow type of reciprocity conception, on a sectoral and national basis, that seems to have some credibility in the USA. Particularly if extended to the unagreed area of right of establishment of foreign investment, reciprocity would be a new and highly disruptive form of nationalist protectionism. It would vary trade and investment protectionism among economic partners and upset the broad balance of interests in the international economic system.

Coming from a country, Canada, that has not experienced the excessive levels of nationalism that have produced wars and hardship for other nations, I can be perhaps permitted a rather more balanced view of its economic variety. International economic welfare dictates that we should resist excessive nationalistic measures whether they relate to investment or trade. But common sense tells us that economically nationalist measures will continue to exist. The challenge is to understand the different national circumstances that are the basis for our policies and to work together to define generally accepted norms to keep economic nationalism under control.

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