CANADA

# STATEMENTS AND SPEECHES

INFORMATION DIVISION
DEPARTMENT OF EXTERNAL AFFAIRS
OTTAWA - CANADA

No. 67/26 **CANADA'S ECONOMIC DEVELOPMENT**

An Address by the Honourable Robert H. Winters Minister of Trade and Commerce to the Twentieth International Banking Summer School, Kingston, Ontario, August 24, 1967.

...In the hundredth year of our nationhood, Canadians have positioned themselves in the midst of a new and exciting phase of economic development. Changes now under way have far-reaching implications for the structure of our industry, the size and composition of our trade and for our economic well-being generally.

Two of the outstanding influences which have determined the nature of our economy are Canada's rich heritage of natural resources and our proximity to the United States. Our development as a nation depends in part upon our ability to hold the gap in our living standards, compared with those in the United States, to moderate proportions. Otherwise the attractions of that great and dynamic country are too great for Canadians to resist.

Our resource-based industries have required a scale of production far in excess of domestic needs, to enable us to achieve the level of productivity necessary to be competitive. The resulting surpluses have, for the most part, found a ready demand in foreign markets. Thus, from its beginnings, the Canadian economy has been heavily dependent on foreign trade, the exchange of raw and processed materials and food for goods we can't produce economically at home.

Even before our first permanent European settlement, Canada was known abroad as a source of fish and fur. Later, lumber, wheat, newsprint, base metals took turns in leading our economy. Today a sizeable portion of our production and exports are new products such as iron ore, petroleum, natural gas, uranium and potash -- all of which have come to prominence only in the last decade or two. And new and major additions to our resource industries loom on the horizon.

Canada's "National Policy" of 1879 made tariff protection one of the principal instruments in the development of our secondary manufacturing. The protection afforded by the tariff and later by the Commonwealth preferences assisted in the establishment of manufacturing plants, not only by Canadian companies but also by foreign suppliers, who have found it profitable to set up subsidiaries in Canada rather than to sell foreign-produced goods over the tariff wall. The two World Wars gave a renewed impetus to the development of manufacturing.

But, despite its well-established position in the economy, secondary manufacturing has tended to follow development, not to lead it, and to be confined primarily to the domestic market, which generally has not been large enough to permit the degree of specialization and scale of production necessary for maximum efficiency and competitiveness. Thus, while traditional policies have contributed importantly to the establishment of industry in Canada, much of this industry has been relatively high-cost.

Even a few years ago, 94 per cent of the value of our secondary manufactured products was sold domestically. There have, of course, been notable exceptions, such as farm machinery, some electronic goods and others, which have enjoyed a high level of exports, and on a broad front the insularity of our secondary industries is now dramatically changing. In the past few years, more and more secondary manufacturers have been looking to foreign markets. This new outward orientation is reflected in the changing composition of our exports. In the past five years, exports of "end-products" have increased fourfold and now comprise well over one-quarter of our total sales abroad. In other words, "manufactured products", which a decade ago comprised just over 10 per cent of our total exports, now rank above agriculture -- about equal with forest products and just below metals and minerals -- in the spectrum of our exports.

This new momentum is soon to be reinforced by the substantially-improved access to the major industrial markets of the world resulting from the conclusion to the Kennedy Round of trade negotiations which, in the overall, was successful.

The eventual outcome should be a basically stronger industrial structure in Canada, involving a more productive role for secondary manufacturing, new dimensions to our foreign trade, and higher living standards for Canadians generally.

Keep Demands within Reasonable Proportions

Canada seems now to be in the midst of major industrial advance. But, to realize fully our opportunities, we Canadians must be willing to devote the necessary energy and resources to industry-building pursuits, and we must be prepared to keep our demands upon the economy to reasonable proportions.

Self-evident as the advantages of such an approach may seem, these are pretty big "ifs" right at this moment. Under pressure of public demand, expenditures at all levels of government are too high. In a speech last September, I warned that:

"One of our difficulties arises from the fact that, in common with what seems to be current general practice, Canadian governments at all levels have been spending too much money -- not in relation to the needs for services of all kinds, for we all recognize that there is much more that must be done, but in the light of what we can currently afford."

Things haven't changed much since then and the Federal Government is now in the midst of a rigorous exercise in order to keep our expenditures and revenues within a manageable relation for next year. But we must work toward the longer-term objective of reasonable balance between expenditures and revenues so as to take some of the pressures off the economy and move forward again to do some of the things we should like to do to give all Canadians the benefits of our advancing economy.

But right now costs are rising while productivity is lagging and profit margins are shrinking. I don't believe there is general appreciation of the extent to which corporate profits and private savings are the bulwarks of the private enterprise system. It is from these sources that new enterprises are developed and old ones enlarged and regenerated.

At the same time, as our economy is straining to meet the demands we are placing on it and as Canadians are seeking to make the optimum use of our every productive facility, there is one particular resource about which I should like to speak briefly - that is, foreign capital.

## Foreign Capital

Foreign capital has always played a positive role in Canada's economic development and must continue to do so. It brings many problems but great benefits and, properly managed, can make a continued substantial contribution to our economic well-being and our essential standard of living.

To disclose the results of a study made on foreign ownership by the Department of Trade and Commerce, I spoke on this subject last month in Montreal. But again, having in mind the international complexion of this gathering, I thought those of you from other countries might in particular be interested in the general principles and results of those surveys and something about my views on the subject.

One major reason for the ready availability in past years of foreign capital has been the confidence with which the Canadian investment climate could be regarded. Confidence is a fragile thing, all too easily destroyed. Therefore, the voices of those who would create a climate of unreasoning hostility to foreign investment in Canada must be countered and the issues examined realistically and objectively if serious and costly national economic error is to be avoided.

I should like to take this opportunity to provide you with some indication of the ways in which I believe Canada must respond to the challenges and problems of foreign investment. First, let me emphasize two points: There is an old saying that "All generalities are wrong". This applies to the present debate on foreign ownership. First, blanket condemnations charging that foreign ownership, *per se*, is against Canada's national interest are simply unfounded in fact. Secondly, it would, of course, be equally misleading to claim that all foreign-owned companies are pure as the driven snow, or that none could improve their performance in any way. The truth lies somewhere in between.

Foreign capital has made, and will continue to make, a major net positive contribution to Canada's economic well-being. But on some counts some foreign-owned companies could, and must, do better. The same, of course, applies to wholly Canadian-owned companies. And in both cases it is the Government's policy to urge any laggards on.

But there is one important difference, one reason why we must pay greater attention to the Canadian activities of foreign-owned companies. And that is simply the fact that foreign-owned companies, to a greater or lesser degree, may be vulnerable to foreign decision-making, and thus may to some extent force Canadian companies to courses of action which are neither in their own best interests or those of Canada. Vulnerability to foreign influences is, of course, greater in the case of foreign-owned subsidiaries exercising relatively little independence of action. It is possible in such cases for a subsidiary to be relegated to an unnecessarily limited role within the international organization, which could inhibit growth and hinder the proper development of the Canadian operation.

Another point I should like to make at the outset is that, while our main concern is naturally with the economic activities of foreign-owned concerns, we must also be alert to non-economic considerations.

Other cultural and social problems, harder to pinpoint and more difficult to control, naturally arise. Some of these flow from the mere fact of the huge American presence just across our border. But such matters as educational, research and managerial opportunities for Canadians are properly our concern. Foreign-owned companies should, to the greatest practical extent, undertake part of their research programmes in Canada. Similarly, Canadians willing and able to assume positions of responsibility must be able to find these opportunities in Canadian firms -- domestically or foreign-owned. The easy flow of managerial skills back and forth across international borders is healthy in developing the fullest potential of foreign capital. These are general considerations.

## Guiding Principles

Let us now briefly examine some specifics about the activities of foreign-owned subsidiaries in Canada. About a year ago, I set out some principles that should guide the behaviour of foreign-owned companies in Canada and sought information on how well these standards were upheld.

The first step in this programme was the enunciation of "Twelve Guiding Principles of Good Corporate Behaviour in Canada", which were communicated by a letter dated March 31, 1966, to foreign-owned companies in Canada. The principles emphasized primarily the importance to foreign-owned companies of seeking identification with the Canadian community. They stressed the need to play a dynamic role in Canada's development through appropriate attention to export opportunities, the further processing of Canadian materials, the searching out of economic sources of supply in Canada, the development in Canada of research facilities, the retention of sufficient earnings to support growth opportunities and other such objectives.

Replies, which were not mandatory, have been received covering about 2,500 companies. This represents a high proportion of response from the 3,300 companies on the foreign-subsidiary list. Many of those not replying are now dormant, are simply nominees, have been merged with other companies or are of a type which could not contribute to our study. On the whole, the replies have been both constructive and informative. Companies generally seem to have welcomed the enunciation of criteria of good conduct, partly as a norm against which to judge their own practices and also for their usefulness in clarifying the question of the appropriate role of foreign-owned subsidiaries in Canada. A preponderant proportion of the replies have expressed agreement with the basic intent of the principles or have indicated a broad measure of conformity with them. At the same time, there is widespread indication of intent to take new steps in line with the objectives proposed and to work progressively towards these objectives.

The relevance and applicability of particular "Guiding Principles" varies from one company to another, depending on the nature of the company's operations and other circumstances. The guide-line urging more processing of materials, for example, has greater relevance for a resource-based company than for one engaged in secondary manufacturing. In this connection, many of the companies have gone to considerable pains to describe their historical development in Canada and to explain their operations, practices and future plans in relation to the various "Guiding Principles". While I do not propose to elaborate upon the reaction to each of the 12 "Guiding Principles", some indication of the general tone of the response to particular guide-lines might be useful by way of illustration.

Some 450 companies made reference to the guide-line urging "maximum development of market opportunities in other countries as well as Canada". Of this number, 350 companies indicated conformity; that is, they were engaged in export, while the remaining 100 companies were not. However, this latter group included companies in the service trade with little or no opportunity to sell abroad. Among goods-producing companies, reasons advanced for not engaging in export include: (1) high costs arising from relatively small production runs; (2) affiliated plants in other countries were in a better geographic position to serve foreign markets; (3) the products of the plant were not suitable for export (for example, too bulky or perishable); and (4) the company was set up to meet a domestic requirement and was fully occupied in doing so.

A number of companies indicated that export opportunities were limited because of marketing arrangements established by their parent or as a result of licencing arrangements. On the other hand, a considerable proportion of the replies stated that the subsidiary enjoyed complete, or a large measure of, freedom in seeking out export markets even in direct competition with the parent firm or affiliated companies in other parts of the world. Many instances were also cited where parent firms had been of substantial assistance in the development of export business for the subsidiary.

A number of observations stress the important role of plant specialization in building up and maintaining export markets. The surprisingly large number of subsidiaries producing items not manufactured by the parent are usually allowed a free hand in selling these specialized non-competing products abroad. Not infrequently, specialized products developed by the subsidiary for the Canadian market are found to have good sales possibilities in other parts of the world.

Thus, while instances were cited where the parent-subsidiary relation tended to inhibit export activity, the response to this point, taken as a whole, is indicative of a growing participation by foreign-owned subsidiaries in markets abroad. A considerable number of companies have advised of plans to give increased attention to foreign market opportunities, including some venturing into the export field for the first time. About 60 companies volunteered information indicating an anticipated growth in export sales in 1967 and future years, whereas relatively few companies foresaw any decline.

While the response on this point has been encouraging, there is a continuing need for new and additional efforts to achieve the degree of participation in foreign markets necessary to take advantage of the opportunities before us.

Another of the "Guiding Principles" of particular importance to the growth and financial strength of the economy urges Canadian subsidiaries "to search out and develop economic sources of supply in Canada". Nearly all of the 440 companies reporting specifically on this guide-line indicate general conformity and leave the impression of a widespread and purposeful effort towards domestic sourcing. Many companies report substantial and progressive increases in Canadian content over the course of their development. This trend has been reinforced in recent years by improved domestic availability of secondary manufactured products and equipment.

The need for continued emphasis toward the development of economic sources of supply in Canada, both on the part of foreign-owned companies and business at large, is exemplified by the latest trade figures. For the first six months of 1967, compared with the same period last year, the healthy 17 percent advance achieved in exports has been closely followed by a more than 14 percent increase in imports.

As I have indicated on other occasions (but it bears repeating), this trend in our trade balance is not acceptable on a continuing basis. If Canada is to meet her growing obligations in the form of debt-servicing charge, aid to less-developed countries and the like, and at the same time move closer to overall external balance, our merchandise exports must expand at a significantly faster pace than imports. Basically, this calls for improved performance in foreign and domestic markets alike.

As regards research and development, companies were urged in yet another of the guide-lines "to develop technological research and design capability as an integral part of the Canadian operation". Of the 326 companies commenting on this objective, 230 reported conformity, whereas 96 indicated that they did not have such facilities.

Most of this latter group of companies explained that they were too small to carry on effective research or that, in the particular circumstances relating to their organization, it was simply not economic to decentralize this type of activity.

Other replies relating to this objective lead to the conclusion that, although there is not much pure or basic research being carried on in Canada at present by foreign-owned companies, a great deal is being done by way of product development, modification and adjustment to meet the specialized needs of the Canadian market. In a number of cases the "Canadianized" product had found markets overseas, and frequently the improvements and modifications made by the Canadian subsidiary have been incorporated in the parent's own products.

A sizeable number of replies did indicate that the companies concerned were developing their own products and processes, with or without the help of their parents, and that this type of activity was expected to increase in the future as the volume of domestic business grows. Several firms stated that their parent had asked them to undertake specific research programmes at the parent's expense. Several respondents said that they had been allocated specific areas of research and were responsible for all the company's activities in these sectors.

Generally speaking, the replies on this point indicate a growing involvement by foreign-owned subsidiaries in research and development activity. A large number of respondents reported that they had firm plans, or were considering action, to initiate or enlarge research and development operations in Canada in the future.

The level of research in Canada, judged by any yardstick, is not as high as that of the United States or the United Kingdom, for example. As the recent report of the Science Council stated: "Research and development expenditures in Canada, expressed in terms of gross national product, were about one-third those in the United States and one-half those in the United Kingdom". Improvement is being made and some subsidiaries are doing really good work. But this is an area in which more parent companies could appropriately delegate research projects and programmes to their Canadian subsidiaries with mutual benefits.

Most of the other objectives set out in the "Guiding Principles" have met with widespread acceptance. The main exceptions relate to the points suggesting provision for equity participation by the Canadian public and periodic publication of information on company operations. Most of the subsidiaries to whom I wrote are wholly foreign-owned, and for these companies compliance with the equity principles would involve a change from existing company organization.

As regards the principle proposing "to have the objective of a financial structure which provides opportunity for equity participation in the Canadian enterprise by the Canadian public," of the 750 companies commenting on this specific principle, 85 per cent raised objections of one kind or another. Some of the smaller companies pointed to their limited size as the overriding consideration, making a public offering impractical. A large number of companies indicated that, because of limited profitability or the need to retain earnings for growth purposes, they had seldom, if ever, paid a dividend and, as a consequence, a public offering of equity would be neither feasible for themselves nor attractive to the Canadian public. Wholly-owned subsidiaries of foreign public companies are prone to argue that equity participation in their organization can be achieved through the purchase of shares in the parent company, and that these shares provide a more secure investment than would a separate offering of the Canadian company. Another point advanced is that a public offering of stock can give rise to basic conflicts of interest between minority shareholders and parent companies, with adverse effects upon the company's performance. I personally do not attach great weight to this argument but, for these and other reasons, most of the companies in the wholly foreign-owned category seem to feel that this particular principle relating to equity participation by the public should not have universal application.

In commenting on the response to the principle, I should first point out that the "Guiding Principles" were not intended as rigid or mandatory rules but rather as a recommended course of action designed to help foreign subsidiaries achieve appropriate complementarity with the basic interests and objectives of the Canadian community. Companies with consistent records of earnings and dividends to their parents are being asked to have it as a desirable objective to offer stock in their Canadian operations to the public as one way of achieving greater identity of interest with the Canadian community. No company which has not achieved the status where it could issue a prospectus sufficiently satisfactory to prospective investors should be expected to offer shares to the public.

Some companies have indicated their intention to work toward a public-stock offering, and others, to keep the feasibility of such a step under review.

Public Information Makes for Better Management

The guide-line proposing periodic publication of information on company operations also gave rise to numerous reservations on the part of the subsidiaries wholly foreign-owned. Most of these companies took the position that their responsibility in this regard is to their shareholders and, moreover, that, unless their competitors also published, they would be making available information that would harm their competitive position. At the same time, in the interest of a better understanding of the workings of our economy, and improved decision-making in both the private and public domain, there is a growing need for and trend toward additional information on individual company performance.

I personally believe also that the availability of equity and/or disclosure of information has a bearing on the efficiency of management. One of the problems of a company that does not publish is that management does not have an opportunity to be judged or recognized by the financial community for the results achieved. Good management takes pride in its results and responds to the opportunity to disclose them. One president of a wholly-owned company told me some time ago that being sheltered from public scrutiny tended to make him feel he was living in a vacuum. In my own business days, I was a strong believer in the merits of periodic publication of results.

I am, therefore, pleased to report that, following the issuance of the "Guiding Principles", a number of foreign-owned subsidiaries have started publishing periodic financial statements on their Canadian operations. This exemplary and far-sighted action will, I hope, encourage other companies to follow the same course.

Looking at the full range of information provided by foreign-owned subsidiaries, in the form both of replies to the "Guiding Principles" letters and of the questionnaire returns, one impression which stands out is the tremendous scope and diversity of the participation by foreign enterprise in the Canadian economy. These enterprises extend over the full spectrum of economic activity, from primary producers to highly-integrated manufacturing complexes, and from distributive organizations to investment holding companies. The companies themselves fall into many different categories -- new and long-established, large and small, some with a long history of profitable operation and others encountering losses, some generating funds in excess of their own needs and others heavily dependent on capital from their parent, some largely export-oriented and others selling only in the domestic market, some highly-integrated internationally and others conducting a separate and independent line of activity.

Because of the widely-differing nature of foreign-owned companies and the diverse circumstances affecting their operation, it is hard to establish rules or objectives equally applicable to all. Even so, a particularly heartening feature of the overall response to the "Guiding Principles" programme is the extent to which it displays widespread and genuine acceptance, on the part of these companies, of the underlying meaning and purpose of the Principles.

Given a co-operative and constructive attitude on the part of foreign-owned companies,and particularly management of the foreign concern, there is nothing in the nature of foreign ownership which need thwart the tremendous contribution to Canada's sound growth emanating from foreign participation in the nation's development. In fact, it is sobering to contemplate what the standard of living of Canadians and, indeed, the character of our nation, would be now, had there not been here a friendly climate for foreign investment. That is the other side of that coin.

We must recognize the tremendous contributions which foreign-owned enterprises make to Canada's development. In addition to providing needed capital funds, this direct form of investment brings to Canada managerial and technical know-how which would not otherwise be so readily available. Many of the foreign-based enterprises in resource fields have been developed to supply affiliated companies, thus contributing a greater degree of market stability than is normally possible in the marketing of basic materials. Then, again, in today's increasingly interdependent world, the international company affords a ready-made means to the international specialization often necessary to achieve greater productivity and expanded trade opportunities. The automotive programme forcibly illustrates how foreign affiliation can be adapted to contribute to more efficient and productive industries through rationalization of operations on an international basis.

The positive features associated with the participation of international companies in Canada's development could be even greater in the future than in the past. Yet, the greater the potential contribution of these companies, the greater is the need to face realistically and constructively any difficulties arising from foreign ownership of Canadian industries. In these circumstances, it seems to me, the sensible approach to foreign investment is to set a course which will make full use of the positive and constructive features of international companies while minimizing the risk of restrictive tendencies which may arise from external decisions affecting Canadian companies.

However, as I emphasized in Montreal last month, recognition of the contribution of foreign capital to Canada's economic development is in no way inconsistent with the need for greater domestic participation. Canadians will reap a larger share of the proceeds of industrial development to the extent that we participate more fully in the creation and ownership of industry. The important thing to realize, however, is that greater Canadian participation is not apt to be achieved through restrictions upon foreign investment. The proportion of our new development which can be carried out with internal resources is determined first by the pace of development and, secondly, upon how we Canadians choose to use our resources and our energies and the proportion which we are prepared to devote to industry-building pursuits. The resources which Canadians put to such pursuits are not likely to be increased by keeping out foreign capital. On the contrary, they are apt to be diminished. The surest way to bring about greater Canadian ownership is to foster our economic development, provide opportunities for capital to be accumulated and then to encourage use of the proceeds from this growth for the expansion of our own capital resources and for the further development of the management, research and other capabilities necessary to foster new enterprise.

A larger internal flow of investment resources is basic, not only to increased ownership of domestic industry but also to greater Canadian participation in enterprises abroad. As Canada grows, we shall naturally want to do more of this. We must, therefore, strive for a proper balance among the various objectives.

Ours is an economy heavily dependent upon a large flow of trade with all the world. To reap the full advantages of the international market-place, we must live in an international world and measure the benefits against whatever hazards there may be. It is the Government's role to create a climate that will maximize the benefits and minimize the hazards. This is, in essence, the objective of the "Guiding Principles" programme.

---

S/A