Minister of Industry,
Science and Technology and
Minister for International Trade

CANADA

Ministre de l'Industrie, des
Sciences et de la Technologie et
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Statement Déclaration

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AN ADDRESS BY

THE HONOURABLE MICHAEL WILSON,

MINISTER OF INDUSTRY, SCIENCE AND TECHNOLOGY

AND MINISTER FOR INTERNATIONAL TRADE,

TO THE ARTHUR ANDERSEN SYMPOSIUM - 1992

"THE GLOBAL BUSINESS CLIMATE: PROSPECTS AND PERILS"

ST. CHARLES, Illinois
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It is a pleasure to help launch this high-powered symposium for 1992. I am also delighted that Robert MacNeil is here as your moderator. His success demonstrates the quality Canada brings to its exports. And, I say with some temerity, it's a lesson that will be repeated when Toronto's Blue Jays win the World Series this fall.

I've been asked to speak about "Today's Global Business Climate: Prospects and Perils." I think it is fair to say that we face plenty of both. Just as important, they are often one and the same.

By now, of course, globalization is a familiar theme in business. Perhaps the best illustration of this fact of life is the true story of a small U.S. town reported recently on Canadian radio. They purchased a Komatsu tractor and then got rid of it because local opinion demanded a U.S. product. The loyal City Fathers duly went out and bought a John Deere product, only to discover later that the Komatsu was made in the U.S. and the John Deere in Japan.

Globalization means that firms -- certainly the large ones, but increasingly medium- to small-sized businesses as well -- have to situate their corporate strategy in an international setting. And they must apply this perspective not just in selling goods and services, but also in building partnerships and alliances, investing in new plants and equipment, in hiring and training, and in identifying new sources of funds.

The driving forces at work are powerful and unavoidable. As Purdy Crawford, Chief Executive Officer of the Canadian multinational Imasco Ltd., puts it:

> "Today, a global economy is emerging. It is driven by such forces as structural changes in political and economic systems, the creation of regional free trade blocks, integrated intercontinental electronic information systems, and, perhaps most important of all, a heightened awareness by consumers of the full range of choices open to them.
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> The end result is that today's and tomorrow's successful economies must be dedicated to competing for consumer preference within and outside their borders on the basis of price, quality and service. Only in this way can sufficient national wealth be created in the future to preserve our standard of living, to maintain and expand our vital social and cultural programs, to incorporate the principles of sustainable development into our economic processes and to contribute in a responsible way to Third World development."

That's the challenge we all face, because globalization also entails new and growing responsibilities for government and every stakeholder in our societies. It's essential that we work together -- nationally and internationally -- to ensure that we give businesses everywhere that opportunity to compete in a stable and healthy global economic environment, under well-defined and balanced rules of the game.

Nowhere is the double-edged nature of the global dynamic clearer -- the choice between prospect and peril -- than in the issue you will be exploring in some detail at this symposium: regional trading arrangements.

There are conflicting views of regionalism. On the one hand, some see these arrangements as foundations for a more open trade environment that can deliver significant benefits. That's the way I view the Canada-U.S. Free Trade Agreement (FTA), where both our countries have increased their exports during a worldwide recession.

On the other hand there are those who take an opposite view. For example, Paul Krugman of the Massachusetts Institute of Technology has warned:

> "The formation of regional trading blocs can threaten trade warfare. Since regional trading blocs are larger than their components, they may be tempted to engage in more aggressive trade policies, which damage the trade between blocs and leave everyone worse off."

In the next few minutes, I want to share with you my perspective on these and other issues, and how they are shaping, and also being shaped by, the current economic climate. And in the process, I'm going to take advantage of the presence of many leading business men and women to make some observations on what they mean for Canada. I also want to take a few moments to talk about the policy approaches the Canadian government is applying to position Canadian firms and workers for renewed success in the fiercely competitive global economy.

To start, I want to comment on the near-term economic environment. There is obviously no question that most of the industrialized economies have not performed as we had hoped over the past year. But looking ahead, I believe we can be optimistic. We have already seen encouraging signs of recovery in some of our economies. Moreover, in many countries, the conditions for sustainable growth are in place.

- Inflation has declined in most Organization for Economic Co-operation and Development (OECD) countries, and that trend is expected to continue. In Canada, for example, year-over-year inflation was 1.7 per cent for the first four months this year -- the lowest sustained level since 1964.

- In turn, dramatic declines in short-term interest rates in some countries are helping to restore consumer and business balance sheets. Citing Canada again, our central bank rate is down to the lowest mark in two decades, helping make possible significant gains in both housing starts and resale activity.

- Third, in both major economies and developing nations, there has been continuing action on the restructuring effort that is absolutely necessary to respond to the new global environment.

I am not trying to gloss over the fact that in many countries, including both Canada and the U.S., this restructuring has complicated the already difficult effects of the economic downturn. But we must also recognize -- and reinforce public understanding -- that this change is a fundamental necessity for countries, firms and workers to hold on to their existing markets and win new ones. If anything, we have to move forward with greater vigour on structural reform in order to improve the flexibility and productivity of our economies, facilitate adjustment to changing consumer needs and evolving technology, and create new opportunities for growth and jobs.

As a result of these positive factors, agencies such as the International Monetary Fund (IMF) and OECD are predicting modest, positive growth for all Group of Seven leading industrial countries (G-7) in 1992. And this recovery will gain greater momentum in 1993. I believe that this outlook is a credible and realistic one, and that we can be hopeful about the future.

Nevertheless, we must not be blinkered to the real risks that remain. Consumer and business confidence are still very weak. In many countries, including my own, we are facing unacceptable levels of unemployment. In these circumstances, all of the industrialized countries have a responsibility to continue their co-operative efforts at strengthening the global recovery. Our objective must be to get our economies going and to keep them going.

On the part of government, the mix of fiscal, monetary and structural policy to achieve this objective clearly has to reflect the individual circumstances of each country. But it is equally vital that these policies be set within the context of a medium-term strategy for sustainable growth -- including the price stability that is the only sure way to bring interest rates down and keep them down.

That strategy has been the core of G-7 and OECD policy prescriptions throughout the last decade. It is a strategy that emphasizes controlling inflation and inflationary expectations through both monetary discipline and fiscal responsibility; in other words, deficit control and reduction. It also means pursuing structural reforms to build more open, market-oriented economies with less government intervention.

This leads me to one of the "perils" we face today. All governments in the industrialized world are under pressure to abandon their medium-term focus in the face of the current economic weakness. There are strident voices who want us to spend our way out of the recession, drop the commitment to stable prices, or reverse the movement toward liberalized trade and open competition.

This is particularly true in countries like Canada, where the recession has masked the benefits that the medium-term strategy helped deliver through much of the 1980s. The simple fact is that it sustained one of the longest periods of economic expansion since the Second World War.

If we are to restore sustainable growth, we must not lose hold of this medium-term policy anchor. It represents nothing less than the best way that governments can contribute to a successful, competitive business climate in today's globalized environment.

As business executives -- and especially as financial officers -- you understand intimately the crucial importance of controlling costs in maintaining a competitive edge. You will also understand the key role that inflation plays in driving up interest rates and the cost of capital. It was no accident that during most of the 1980s, the countries with low inflation, Japan and Germany, also enjoyed the lowest rates of interest and, coincidentally, among the best rates of growth and lowest rates of unemployment.

But to effectively control inflationary expectations, we can't rely on monetary policy alone -- not unless we are willing to live with the risk of further recessions and the wrenching dislocations these involve. We must partner disciplined monetary policy with the disciplined fiscal policy that restrains government spending in order to reduce deficits. This is the only way to stop the rise in tax burdens while freeing up savings for productive business investment rather than paying interest charges on public debt.

This is the policy framework that has guided our own economic policy-making in Canada. In 1984, when our government took office, we faced a serious fiscal challenge. Our deficit was the second highest of the G-7 countries, and rising, and total federal government expenditures had reached almost 25 per cent of the Gross Domestic Product (GDP). For every dollar raised in taxes, the government was spending $1.33 on programs. Since then, I am glad to say that we have made significant progress.

Both Canada and the United States have deficit problems. In Canada, we have made some meaningful progress. Since the present government came into office in 1984, on a comparable accounting basis, Canada's deficit has gone from about 6.8 per cent of GDP to around 4 per cent this year. In the same period, the U.S.

federal deficit has grown from about 20 per cent lower than Canada's -- as a share of GDP -- to where it is currently more than 50 per cent higher.

With respect to monetary policy, we both have also made major progress on the inflation front. As I indicated earlier, inflation in Canada is down significantly. This has not been an easy task. In the 1970s and early 1980s, Canada had one of the industrialized world's highest inflation levels. To return to the status of a low inflation country, as we were in the 1950s and 1960s, required a wrenching structural change. But it was important for our medium-term prosperity to see this change through. With the Bank of Canada, we established firm, realistic inflation targets aimed at bringing inflation down in stages to below two per cent by mid-decade. As a result, looking at our performance so far this year, we are well on track to meet these targets.

But the current deficit and inflation outlook in leading G-7 countries represents real perils today. The world's leading economies must complete the job of restructuring begun in the 1980s. If we are to do this, it is essential that governments put both their fiscal and inflationary positions on a sustainable level. Unfortunately, several important G-7 countries are going the wrong way on fiscal policy. The U.S. deficit remains too high and the U.K. and Germany have increased their deficits significantly in recent months. Inflation rates in the U.K. and Germany, in particular, are far too high for this point in the current business cycle.

In Canada, in addition to the tough measures we have taken to control inflation and put our fiscal house in order, we are also vigorously pursuing fundamental structural reforms. These are designed to improve the flexibility of the Canadian economy, encourage adjustment to market forces and increase our growth potential.

We have, for example, privatized more than 20 government-owned Crown corporations. We have deregulated our energy and transportation sectors. We have reformed an antiquated sales tax system that was hurting Canada's ability to compete. And we are shifting our unemployment insurance system to focus on training and more flexible labour markets. We have also reformed the rules governing Canada's financial sector to allow financial institutions to compete more directly with each other. Foreign-owned institutions will benefit from these enhanced opportunities in the same manner as our domestic players.

I have used these Canadian examples to illustrate the nature of the structural reforms that can be taken. Other nations must do what is appropriate for their own economies, but it is clear that we all have a good deal more to do.

Perhaps no area of structural reform is more important than doing away with barriers to international trade. As we all experience the realities of a global marketplace, we are all becoming more and more dependent on trade and more exposed to international business influences.

That is why the General Agreement of Tariffs and Trade (GATT), and strengthening it through a successful conclusion to the Uruguay Round, is so critical to the future of economic restructuring. Most of the recent attention has focused, of course, on the agricultural sector.

The Uruguay Round represents a desperately needed opportunity to provide an effective brake on the cutthroat competition and dislocations on world cereal markets caused by trade-distorting export subsidies. But the Uruguay Round also encompasses other vital issues reflecting the evolution of the global economy and trade flows over the last two decades. Rules on trade-related intellectual property would encourage increased innovation and technology transfers that benefit us all. Trade in services, which now represents over one-fifth of all world trade, would, for the first time, come under multilateral disciplines.

But the most important immediate achievement of successful Multilateral Trade Negotiations (MTN) could well be their contribution to the world economic climate. It's another example of the double-edged sword of prospect and peril we face. As Arthur Dunkel, Director General of the GATT, so aptly said yesterday at the World Farmers Congress in Quebec City:

> "A successful conclusion to the Uruguay Round is urgent. Policy-related uncertainty is among the worst enemies of economic actors who have to make investment decisions practically on a daily basis."

I believe that success in the talks should bring about a tremendous and badly needed boost in international business confidence. It would signal a continued commitment to order and stability on world markets, and ensure a credible, modern, rules-based trading system. This could provide the spark that could stimulate a more robust recovery.

Failure, on the other hand, would unleash protectionism and renew innumerable bilateral trade disputes that are being held in abeyance pending the ultimate outcome of the Uruguay Round. It would send an alarming signal to the business community that may well result in a prolonged period of instability in the global economy. This would diminish trade and investment opportunities -- and limit growth prospects in all our economies. It could do so at the very time when dramatic new demands for investment capital are emerging, especially for the reconstruction of Eastern Europe and the former Soviet Union.

Discussion of the GATT, of course, leads directly to the issue of regional trading arrangements. The question here is whether these are substitutes for, or complements to, the multilateral trading system.

All of us -- the U.S., Canada and Mexico, all members of the GATT -- have agreed since the outset of the North American Free Trade Agreement (NAFTA) talks that North American free trade must be complementary, and not an alternative, to the global agenda of the GATT. Indeed, I see it as a means of accelerating trade liberalization and promoting the principles of fair trade that are fundamental to the GATT.

These principles formed the foundation upon which the Canada-U.S. Free Trade Agreement (FTA) was built. Equally it is the basis for negotiating other trading arrangements, of which there have been 23 over the last 25 years. Furthermore, the GATT will provide the basis for expanding continental trade with the emerging European Community and the high-growth Asia-Pacific region.

Let me just make a few quick comments about the FTA and the potential NAFTA. I know that, here in the U.S., critics of the NAFTA have raised many concerns about the future of some industries in the U.S. In fact, they have given you a flavour of what we, in Canada, have faced in putting the Canada-U.S. Free Trade Agreement into place. But I have yet to hear critics on either side of the border explain why such a supposedly bad deal has seen steady growth in Canada-U.S. trade since the agreement, despite a long downturn in the North American economies. I guess it's hard to argue with success!

There's another point I want to emphasize. The FTA has not eliminated all trade disputes between Canada and the U.S. I'm sure that no one here this morning is naive enough to imagine that there would never be any trade disputes in the largest two-way trading relationship in the world, with an annual value of more than $200 billion.

What the FTA does provide is a superior method of resolving disputes when they do arise. The FTA recognizes that trading partners will inevitably face disagreements from time to time, and so provides a fair, efficient and timely format in which to resolve them. In that respect, the FTA is a solution, rather than the source of the problem.

The confidence our government places in the FTA is reflected in our decision to join the U.S. and Mexico in negotiations for a North American-wide agreement. It is a logical extension of the FTA, adding a market of 85 million people to the existing free trade area.

Canada has a number of objectives in these talks, none more important than our desire to be part of the richest and largest market in the world. Mexico has a growing economy; we want Canadian companies to become part of that dynamic growth.

Through the NAFTA, international investors will be assured that North American companies, whether located in the U.S., Canada or Mexico, will all enjoy the benefits of being able to serve the whole North American market. Serving this US$6 trillion market of 360 million people will require that companies in each of our countries forge strategic alliances with business partners in all the other countries, placing all the players involved on a better footing to meet global competition.

We have another important objective in these talks. After more than three years experience, we see prospects for fine-tuning the Canada-U.S. agreement. It is clear, particularly in light of the U.S. ruling on Honda imports from Canada, that rules of origin must be more clearly articulated in the NAFTA than is the case with the FTA. Canada and the U.S. can also agree on some improvements of customs procedures, to ease the flow of goods and services across our common border.

Ultimately, preservation of the FTA has been our position from the beginning, and it has not and will not be compromised. Canada and the U.S. negotiated a good agreement in 1988. And we have both made it very clear, inside the negotiations and out, that any changes in that agreement will not be made unless they serve the interests of our respective citizens well.

Trade liberalization is critical for the economic betterment of all nations. In particular, bringing down barriers is a key step in sustaining and broadening the dramatic economic transformation taking place in Eastern Europe and the former Soviet Union, and that is being echoed in varying degrees in many developing nations.

This is another reason for a successful and early conclusion of the Uruguay Round of the MTN. A growing world market, with an open international trading system, is the best policy framework for providing the reforming economies with an outlet for their goods and services, and for them to acquire much needed investment and technology.

But again, the positive prospect also carries with it the potential for peril: for opportunity passed by. We have to recognize that this transformation is just beginning, particularly in the former Soviet Union.

Macroeconomic stabilization, together with structural reforms, are absolutely essential for economic growth in that region. To meet this challenge, tough but necessary decisions must be taken. The ex-Soviet republics have to adopt and persevere with strong, though admittedly difficult, reform programs; debt service payments have to be maintained and a stable and competitive exchange and trade system achieved.

An important objective of the reform effort in the newly independent states must be to encourage domestic savings and investment, as well as private sector capital flows to the region. This will require the development of an institutional framework that permits private markets to flourish and foster long-term growth. These framework policies will also generate the technical assistance and technology transfers that can be just as important in the reform process as transfers of money.

These policies include private property rights, measures to end monopolies, an effective bankruptcy law and comprehensive financial sector reforms. As well, establishing a legal framework for private markets is especially important if privatization plans are to succeed. And they must succeed, because the privatization of state-owned enterprises provides these reforming states with the best opportunity for growth. Indeed the countries themselves are not alone in seeing opportunities since many Western businesses also enjoy virtually unparalleled opportunities as the transformation of these parts of Europe proceeds. In Czechoslovakia alone, there will be something like 4,000 companies being privatized over the next 18 months.

Western government financial assistance is only part of the answer. Why? Governments can only provide money, but private sector investors can provide so much more. They can provide the thousands of tools that businesses in these countries so desperately need to adjust to the newly competitive environment. The tools they need are those which Western businesses have, tools like transfer of technology, management and production know-how, market access and marketing expertise, financial resources and all the other advantages which strategic partners enjoy.

Therefore, it is critically important that these countries transform their policies so as to make Western private sector investment possible. They must not shrink from the essential job of economic reform, which will put them on the path to economic growth and prosperity. The race is on to transform Eastern Europe and the former Soviet Union from command economies to market-based economies. The winners in this race will be those countries that adopt these reforms the soonest.

One of the perils we all face in making policy and investment decisions is the possibility that economic decline causing social unrest, combined with ethnic tensions, could transform these countries into battlegrounds. In this regard, the circumstances of several of the former Soviet republics and Yugoslavia are wake-up calls to the rest of the world. No people can long tolerate privation without the hope of better days ahead. We cannot afford to wait for others to take the first steps.

I've covered a lot of ground this morning and merely scratched the surface of the complex and exciting issues that globalization entails for us all. Before finishing, I just want to focus back on North America and the further actions we can take to restore confidence and growth, and to position our countries and their corporate sectors for enhanced competitiveness in the global arena.

I see that your panel discussion at lunch today is entitled "Worldwide Tax Competitiveness." A few minutes ago, I outlined the fiscal, monetary and structural policies the Canadian government has been pursuing, emphasizing the medium-term framework required for sustainable, non-inflationary growth. These foundations for Canadian economic renewal have been built on and expanded in our government's February budget.

We moved to reduce taxes to instil confidence, boost economic growth and increase industrial competitiveness. But to pay for these tax cuts, in line with our commitment to bringing the deficit down, we also cut government spending. A major initiative in the budget was action to help Canada's manufacturing and processing sector -- representing about one-fifth of Canada's output and employment -- meet fierce global competition. The tax rate for these companies will be reduced by two points, to 21 per cent, over the next two years. As well, we increased the capital cost allowance rate for manufacturing and processing equipment from 25 to 30 per cent. These proposed changes will lower the marginal effective tax rate on investment in machinery and equipment for a large Canadian manufacturer by nearly three percentage points. This will be a full percentage point lower than the U.S. tax rate on a comparable new investment.

We also announced in the budget that we are prepared to reduce the withholding-tax rate on direct dividends paid to non-residents to five per cent. Currently, the Canadian subsidiary of a U.S. company faces, on average, a four-percentage points higher statutory tax rate on income than its American parent (43 per cent in Canada versus 39 per cent in the U.S.). When our changes are fully phased in, that burden will be reversed. The Canadian subsidiary will enjoy a one-point tax advantage (38 per cent in Canada versus 39 per cent in the U.S.). For wholly Canadian firms, the advantage will be greater -- fully four percentage points (35 per cent versus 39 per cent).

There is another budget initiative I want to highlight. This is our commitment to streamline the administration of the scientific research tax credit system -- already the most generous among the G-7 nations -- and in this way enrich it by a further $230 million.

This measure recognizes that, in the global arena, innovation has become a driving force for market success. Companies must develop new products that meet new consumers needs. They also must develop and apply new technology to increase their productivity and quality in producing existing products and services.

Steady improvement in our competitive position is the challenge facing both Canada and the U.S. Keeping up with the competition means re-examining our governments and businesses from the ground up. Among other things, it will require companies on both sides of the border to turn the principles of total quality management into more than current business management seminar buzz words.

How can we do this? -- by radical surgery on our business and government organizations, investments in people and technology, and by a commitment to quality in delivery of every product and service. That commitment must extend to continual improvement in our products and processes. Some may question such a tremendous investment of leadership, management time and capital. However, I am convinced that keeping up with the Japanese and Germans, let alone the newly industrializing countries of the Asian Pacific Rim, demands more than lip-service to these principles. We must keep up with these economies if we are to remain prosperous in the 1990s and beyond.

Why should we be concerned about keeping up with these economies? Well, they are becoming North America's major trading partners. After all, transpacific trade has now outstripped transatlantic trade with North America. Growth in much of the Asian Pacific Rim is in double digits and the trend of transpacific trade is bound to continue. This presents great opportunities to both our countries as rapidly growing numbers of middle-income consumers seek to build their homes in these countries. On the other hand, if our policies and practices are not transformed to ensure we can keep up with these rapidly growing and ever more competitive countries, we imperil our prosperity.

Another of the perils of doing business in the 1990s is that the targets you have to shoot at keep changing. Whereas growth was the answer to nearly every concern in the past, today you have to deal with the reality of sustainable development, which means that growth is not always the only answer. Not only does this present a critical challenge to business, it presents us all with great new opportunities for turning our technological and management solutions to meeting this challenge into winning competitive strategies.

If we in North America are to keep up with an ever-changing and more competitive global marketplace, we must transform our countries and companies into strong global competitors. The U.S. and Canada are still viewed as safe havens for investment. This is an advantage we cannot afford to squander. We must take advantage of this favourable position by putting into place the appropriate policy frameworks for investment and business growth.

I believe that a critical element in any strategy to transform our economies into better competitors is increasing the quantity and quality of our investments. We view increasing savings and investment as a national priority for Canada: it is critical to the success of our restructuring effort; it is essential if we are to reduce our level of foreign indebtedness; and I believe it should be a priority for both our countries. Why? Over the last 20 years, the U.S. has enjoyed a net national savings rate of 6 per cent, Canada's was 11 per cent and Japan's was 23 per cent. If Canada's savings rate constitutes a national investment challenge for Canada, then the U.S. savings rate should be even more worrying to policy-makers here.

In Canada, we have embarked on a broad consultation process to draw individuals, business, labour and governments into the development of a plan of action aimed at making Canada more competitive. This process is designed to increase the awareness and understanding to a broad spectrum of Canadians of the competitive challenges we share. These challenges range from training through investment, research and development to the way in which labour and management relate to each other.

Meeting each of these challenges is critical if Canada, or any other country, is to be an effective competitor in its domestic market and is to be able to take full advantage of access to international markets. We are engaged in a country-wide process of public and industry consultations aimed at laying the basis for new, co-operative partnerships among all Canadians: management, labour, educators, and all three levels of government.

In closing, let me say that global competition is a race without a finish line -- but not without winners. The U.S. and, I believe, Canada have long been in or near the winners' circle. The prospects and perils will be continually changing and no less daunting as we move through the nineties. Our challenge is to keep ahead of the wave, to keep our leading place and enhance it, within an ever more competitive market. I'm convinced we can do it -- and we will do it -- because we must do it.

Thank you.