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## Discussion Paper

The attached paper has been commissioned as a part of the "Look Ahead" component of the Trade Commissioner Service Centennial. It has been designed to engender consideration and discussion of trends and issues that will effect the direction of the service as it enters its second century.

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## A ROLE FOR THE TRADE COMMISSIONER SERVICE IN FACILITATING INVESTMENT INTO CANADA

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## INTRODUCTION

The traditional role of the Trade Commissioner Service (TCS) -- to facilitate Canadian exports -- has been a relatively focussed one which the TCS has executed with demonstrated competence. In the future however, such a focus may not be sufficient for Canadian economic prosperity.

As this paper will argue, the primary economic issue in Canada and the rest of the industrialized world, is and will be, job creation. The TCS has helped create Canadian jobs by helping Canadian businesses -- especially small and medium sized enterprises -- sell their goods and services elsewhere.

Canadian jobs are also created by firms (Canadian or otherwise) which make greenfield investment in Canada. Canadian jobs are lost when Canadian firms choose to invest in other countries, and when they import items which could be sourced domestically.

The TCS has traditionally played no direct role with respect to either import substitution or the encouragement of foreign direct investment into Canada. Both are arguably useful functions for someone to play. The focus of this paper will be on whether the TCS should play a role in facilitating foreign investment into Canada, and if so, what that role should be.

This paper is organized into three sections. The first will demonstrate, from a global perspective, why jobs are moving from North to South, and why this is the primary economic issue facing Canadians. The second section will explore why trade commissioners will be called upon to play an expanded role with respect to job creation in Canada, and how this could potentially include facilitating investment. The final section will introduce some of the specific questions which require resolution if the trade commissioner is to play a role in facilitating investment. These relate to the types of investments, the use of strategic alliances, and the role of technology.

## SECTION 1 - THE MIGRATION OF JOBS FROM NORTH TO SOUTH

On our behalf, our governments undertake noble objectives: to provide foreign aid, to facilitate international trade, and to protect the local ecology, among other activities. All of these however, have unintended impact both on competition and employment.

When foreign aid is successful, this is one of the factors that leads to the actual economic development of the particular nation. This has the positive benefit of creating a new market for some industries' goods. At the same time however, it has the negative impact of creating a new competitor, often in different industries. The economic development successes of countries such as China and Mexico do eventually create a market for the goods and services from high income countries such as Canada. However, in the short term their immediate impact is to be a low cost manufacturing competitor.

Similarly, agreements such as NAFTA, GATT, and so forth, are all intended to reduce tariffs. The good news from these trade-facilitating agreements is that it makes it easier to export, which in turn makes some industries more profitable. On the negative side however, it similarly makes foreign imports easier, which makes other industries less profitable.

Third, if we look at ecological protection, we know that this has meant that we reduce, reuse, and recycle, all positive things, but which also result in reduced employment. Similarly, with an emphasis on ecological preservation, there is a slowing of businesses' ability to establish new enterprises, in part due to the need for things like impact studies. Again, slowing job creation.

At the same time as these three major activities are taking place, there is the relentless pressure to provide better customer value. This has meant increased quality, increased productivity, and downward pressure on prices. Improved quality and productivity have resulted in the creation of some additional design and engineering jobs. However, it has meant far fewer manufacturing jobs and the need for a much smaller number of after-sales service jobs since quality is now built in. Take for example, American Telephone and Telegraph. At one point they had a million employees. Their successor companies have 600,000 employees, yet they are able to handle 30 per cent more calls. This is productivity.

Overall then, there are two new realities. Less work is now required for equivalent output, and workers in the south, or in many other low income countries, will do an equivalent job for less pay. What does this mean for employment? First it means an increase in the overall number of unemployed in the OECD countries. The number of unemployed now stands at 32 million in the OECD countries alone, and this number is expected to increase. In addition, the relative number of unemployed in these countries, versus those who are employed, will continue its 30 year upward trend. This trend incidentally, is as true in Japan as it is in other parts of the world.

Where are the jobs going? These jobs are now moving from high minimum wage locales such as Canada, to 'right to work states', to 'have to work' countries, such as Mexico. Let's look at the example of Mexico with or without NAFTA. Manufacturing jobs will continue to be Mexico bound. Why? Because of both increased incentives and fewer barriers.

The first of the increased incentives is the continuing supply of low cost labour. Any basic demographic analysis in Mexico shows that over 50 per cent of Mexico's 90 million people are under the age of 20. There are millions of Mexicans entering the workforce each year who will take <u>any</u> job in order to survive.

The second incentive in Mexico is a welcoming attitude. There were no great debates in Mexico in regards to NAFTA like those which occured in the U.S. or Canada. NAFTA was widely considered a very positive undertaking because it was an opportunity to improve the standard of living for most people.

The third incentive is local market access which is now not only possible, but desirable. Within Mexico, perhaps as much as one third of the population has per capita income of roughly US$4,000. This is widely considered the hurdle point at which people enter the market for consumer goods. Finally, the other incentive for entering Mexico is that it does represent a gateway to Latin America.

In addition to all of these incentives, there are now far fewer barriers to entering countries such as Mexico, than existed before. The first of these reduced barriers is the ease of staffing. At one point it was very difficult for multinational enterprises to find a supply of well trained, local managers. This in no longer the case. There are first rate training schools and schools of business in Mexico. As well, the academic community in the industrialized countries has become far more adept at training people for international assignment. This is due to the internationalization of management education. Textbooks, one of the primary sources of knowledge, are now widely distributed and translated. Student foreign exchanges are frequent, and academic partnerships are common.

The second reduced barrier is infrastructure improvement. This has made cross border coordination much easier. The existence of reliable telecommunications, including fax, has made it easier to maintain a distant facility.

Third, a track record now exists. The follower companies, not just the missionaries, can prosper in countries such as Mexico.

Finally, there is a demonstration that quality control can in fact be managed, even in countries where there was no great tradition of quality control in manufactured goods. There are companies within cities such as Monterrey, Mexico which have manufacturing facilities where they measure defects in terms of parts per million. This is the same as the best manufacturing plants in the world.

If this overall analysis is correct, what are the implications? First, let's begin with the alternatives. There are essentially four choices. The first is to do nothing and hope things improve. This is pretty much the status quo right now and ignores the new reality. To sit still, to postpone, to hope things turn around on their own, will result in places like Canada seeing taxes and social unrest continue to increase, without understanding the root cause. I would argue that this is untenable, but it may in fact be what we observe for the next few years until the new reality sinks in.

The second alternative is to return to protectionism. Protectionism was a comfortable world for a long time. We can batten down the hatches; we can reduce trade with the outside world; we can live with greater inefficiencies. This means that we will work longer, we will pay higher prices, but in the short term at least we will have more jobs. The difficulty of course, is that Canadians have demonstrated an unwillingness to pay higher prices. Evidence the incidents of cross border shopping which have been rampant at various times recently.

The third alternative is to share the work. Sharing the work would result in a reduced work week; more leisure time, albeit enforced leisure time; a lower standard of living; but arguably lower social unrest; and perhaps a higher quality of life, one that was somewhat less materialistic. The difficulty here is that most Canadians will not voluntarily accept a lower standard of living. They would treat such an option as giving-up.

These three alternatives ignore however, a fourth possibility -- strengthening our international capability. To strengthen Canada's international capability will require emphasis on continuing to do the things that we have done well in the past, and learning to do well things that we have not emphasised to this point. Canada of course, must continue to be an exporting nation if it wishes to maintain anything close to its current standard of living. What needs to take place however, is a diversification away from reliance on the U.S. market. This does not mean doing less business in the U.S. It means maintaining our existing share of the U.S. market, while simultaneously emphasising other markets. The greatest growth area in Canada for Canadian goods is Asia. Asia is the fastest growing economic region in the world. At the same time, the primary source of immigration into Canada in the past decade has been Asia. We have to place much greater effort on using these new Canadians to do business in their countries of birth.

A second area which Canada must emphasize in internationalization relates to technology transfer. Canada does not have to be the world's primary source of innovation and technology development in order to be prosperous. It does however, have to be adept at understanding and applying new technologies, wherever they are created in the world.

The assimilation of the relevant technologies requires an infrastructure, much of which already exists in Canada. Canada can emphasize basic research, however, this is unlikely since we are one of the lower national spenders on primary research. Or Canada can emphasize what in fact it has implicitly been emphasising all along - the adaptation and assimilation of best practices wherever they are created. From a public policy perspective, increased technology transfers to Canada will occur automatically with enhanced foreign investment into Canada.

Consistent with an emphasis on technology assimilation and adaptation, is the third dimension of what is required for Canada to succeed internationally. This relates to Canada's role as a strategic partner. Many Canadian firms and managers already possess the necessary geocentric attitude or world view to allow them to be an effective, international strategic partner.

A final dimension of what Canada needs to do to succeed internationally is to be successful at attracting appropriate foreign direct investment. Canada should not want all types of investment. Things such as acquisitions create no real jobs in Canada. Greenfield investment on the other hand, does create new investment and can be the source of jobs within this country.

If one accepts that job reduction and migration is not a single nation or short term phenomena, and if one accepts that due to global integration, beggar thy neighbour job policies are both inevitable and unsustainable, then increased Canadian emphasis on internationalization takes on even added importance. Within this strategy of increased internationalization, the Trade Commission Service has the potential to play a much greater role in Canada's future prosperity. This will be the subject of the second section of this paper.

## SECTION 2 - THE TRADE COMMISSIONER AS JOB CREATOR

Canada in the mid 1990s is characterized by persistently high unemployment. As we saw from the previous section, this is not a short term phenomena. In order to survive, the private (and increasingly public) sector is enforcing a new philosophy with its employees of justify-your-existence. In practice, this has meant both delayering of organizations, and increased scrutiny by everyone with respect to what matters for success. More so than most government areas, the trade commission service has been well placed to justify its existence. Traditionally, it has been able to argue that its efforts have contributed to millions of dollars in international sales. In fact, performance has in part been measured according to the level of international sales.

Increased sales lead to increased jobs for Canadians, and a ratio of 9,000 jobs created for each additional billion dollars in exports is often also cited. In the future, and consistent with what is taking place in the private sector, we can expect that the measure of success for evaluating trade commissioner performance will evolve from "international sales facilitated" to "number of Canadian jobs saved or created."

Furthermore, the current general ratio between international sales and jobs created will be rigorously examined. This general ratio cannot hold true for all industries -- some are far more labour intensive than others. The bottom line for the individual trade commissioner will be "did my efforts generate enough new economic activity to justify my own job and maintain/create Canadian employment?"

This bottom-line focus on job creation will inevitably result in the TCS de-emphasizing certain of its current activities on the basis of cost-benefit analysis. However, it will also create an opportunity for the TCS to become more innovative and entrepreneurial, and engage in activities with which it has not traditionally been involved. A primary example of this, and one which is totally consistent with an emphasis on job creation, is to facilitate foreign direct investment in Canada.

Nearly all countries of the world welcome foreign investment for its job and wealth creating benefits. Yet enormous variability exists both between countries, and within countries in terms of how it goes about attracting investment. Much of the current emphasis is reactive -- different states, provinces, cities, or municipalities compete for those investors who have already declared a potential interest in investment.

But what about those potential foreign investors with limited knowledge or awareness of Canada? At the present time they are not being rigorously pursued from the domestic side because it is difficult to identify them prior to their declaration of interest.

Canada does have a number of sources of comparative advantage -- of which many potential foreign investors remain blissfully unaware. As a consequence, Canada does not enter their set of alternative investment sites, and jobs are not created in Canada.

Yet there is one group of Canadians who has both awareness and access to foreign entrepreneurs -- the TCS. The TCS can legitimately fill the role of investment facilitator; and is arguably the best group available. Such a role is consistent with their mandate to "promote Canada and things Canadian to foreigners."

## SECTION 3 - THE TRADE COMMISSIONER AS FACILITATOR OF INVESTMENT INTO CANADA

If the emphasis within the TCS is now to include foreign investment facilitation, numerous strategic and operational questions arise. Here we consider some of the strategic questions: types of investments to be sought, the use of strategic alliances, and the role of technology. All of these are reviewed in the context of the real and perceived sources of advantages of investing in Canada.

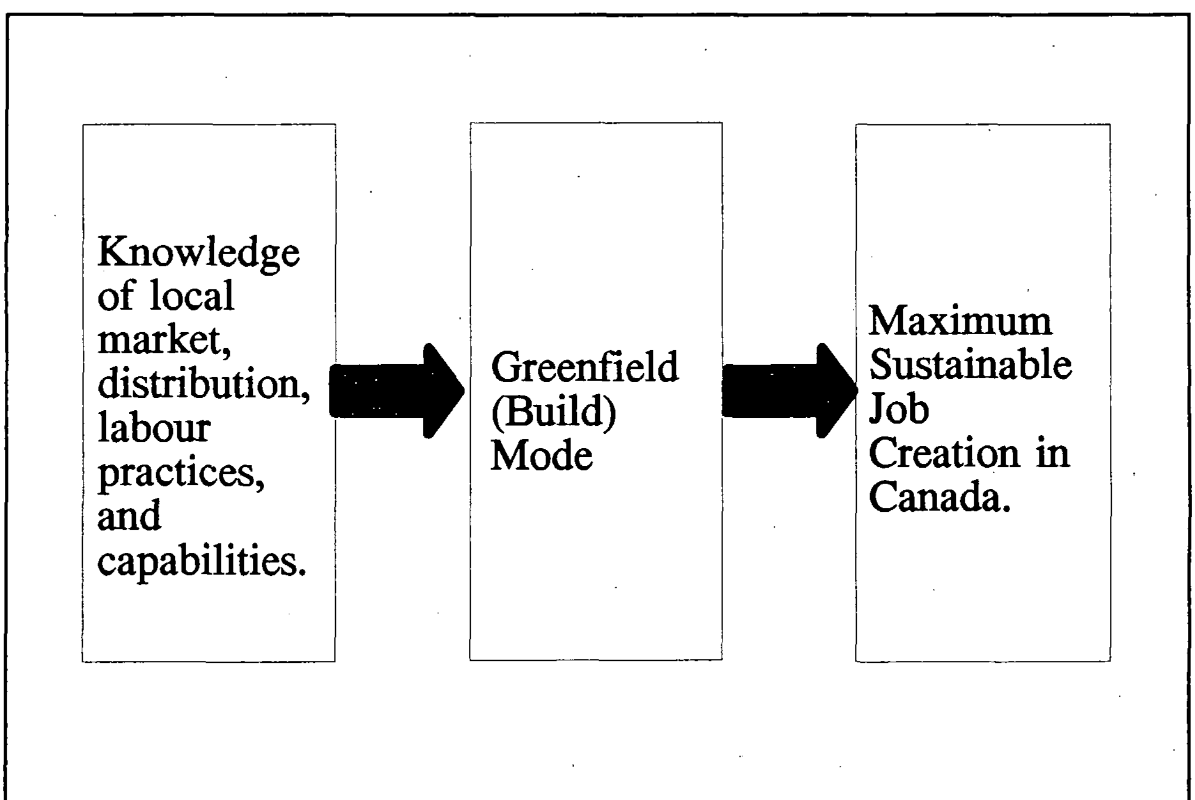
### Sources of Canadian Advantage

Most potential investors to Canada require basic education regarding the Canadian environment. The attached two-page Table 1 provides an overview of some of the key dimensions of the Canadian environment -- from political, economic, social, and technological perspectives. These are divided according to those points to be emphasized/de-emphasized. Despite the long-standing Canadian tradition of minimizing the advantages of living in Canada, as the table suggests, there is much objective data which supports the choice of Canada as a superior investment locale. It is in this context that the trade commissioner would be able to help the foreign entrepreneur move from the general question of 'whether to invest in Canada', to the more specific strategic questions which follow.

**Type of Investments to be Sought**

Foreign investment may occur through various forms: acquisition (buy), greenfield (build), or joint venture. Given the suggested emphasis on job creation, investment by acquisition is clearly the least desirable form. Fortunately, there is new, large-sample, objective evidence to suggest that acquisition is the poorest-performing form of investment. This allows the trade commissioner to argue for other forms of investment, not on the basis of what is best from a Canadian public policy perspective, but according to what is in the best interests of the foreign investor.

Increased knowledge of the firm's industry -- in particular local production and market considerations -- increases the foreign firm's willingness to invest using a build (greenfield) mode. Thus any assistance the TCS can provide at the post and in Canada regarding the local market, distribution, labour practices, and capabilities, will have a positive influence on the selection of the greenfield mode. (See model below.)



Any emphasis on greenfield/joint venture investment must also incorporate an industry-specific context. For example, Travel and Tourism, already the largest industry in the world in terms of revenues, also creates twice as many jobs as the average of other industries for the same amount of investment.

**The Use of Strategic Alliances**

Strategic alliances are among the most frequently utilized forms of foreign investment in Canada. Alliances are typically chosen when the investor requires local knowledge. While much more profitable than acquisitions for the investor, alliances are nonetheless less profitable than greenfield investments.

The Trade Commissioner can argue that Canadian firms may be the ideal alliance partner because of their demonstrated comfort and competence in dealing with firms from all three areas of the triad -- USA, Europe, and Asia. No other country can make that claim. Canadians know the American market better than any group of foreign investors. At the same time, Canada's historic European ties, and more recent Asian links, mean an ability to move easily between the various cultures. No where is this truer than in Toronto, which is the world's most multicultural city.

**The Role of Technology**

Foreign investors look at technology from several perspectives. First, is there a sufficiently educated workforce to produce the particular technology? Canada has one of the most highly educated workforces in the world, with ample competence in CAD-CAM and other areas.

Second, do the development clusters of technical people exist? Canada has clear strengths in various regions in such areas as telecommunications and software, as well as certain market niches.

Third, is there a large domestic market for high technology goods and services? With a population of nearly 30 million high income consumers, the Canadian market is clearly large enough in many technical areas to justify investment. All of these points can be highlighted by the TCS to allay concerns and highlight opportunities for potential technology-oriented investors.

## CONCLUSION

Should Canada decide to move forward with the idea of having the trade commissioners facilitate investment, numerous organizational issues arise. For example, what will this mean for the organizational structure of the TCS? What will the new links be between the TCS and groups such as Investment Canada, and the provincial and municipal governments? Will the trade commissioner at the post who identified the potential investor have to be the same person who now organizes junkets to Canada? These organizational questions require resolution but are secondary to the strategic issue.

# WHY INVEST INTO CANADA?

## POLITICAL

+ stable democracy
+ interprovincial trade barriers being resolved
+ ready access to USA/Mexico via NAFTA
+ non-discriminatory (National Treatment)
+ peacekeeping/mediator attitude makes for good alliance partner
+ respected

## ECONOMIC

+ lowest inflation rate of G7
+ highest growth of industrial production of G7
+ modern, efficient infrastructure
+ low cost energy, land, natural resources
+ faster growing productivity than USA in auto assembly
+ low employer-paid fringe benefit costs
+ lower cost <u>and</u> higher quality health care (vs USA)
+ lower competition than in USA
+ high quality products
+ moderate cost of capital; national banking system
+ capital incentives available
+ low interest rates
+ easy to start-up on a small scale
+ no restrictions on profit repatriation
+ attractive market

## SOCIAL

+ low crime (peace, order, and good government)
+ less litigious than USA
+ multiculturalism well accepted/welcoming environment
+ well educated and loyal workforce
+ high quality of life
+ clean
+ individual rights well established
+ English widely spoken

## TECHNOLOGICAL

+ receptive to foreign technologies (no Not-Invented-Here syndrome)
+ able to deal with Metric and other standards
+ adept at assimilating technology
+ most generous R & D tax credits of G7
+ leading-edge in some sectors
+ good government-government and government-industry collaboration and institutional support
+ Canadian standards are internationally recognized

# WHY NOT INVEST INTO CANADA?

## POLITICAL

- visas limited to 5 years
- National unity question (however, evolution not revolution is likely)

## ECONOMIC

- high taxes (personal & corporate)
- high labour rates vs. Southern USA
- high national debt may affect borrowing costs
- transportation costs higher due to great distances
- overdependence on USA
- weather and bilingual packaging increases costs
- currency instability?

## SOCIAL

- incentive to work reduced through overgenerous social programs
- pro-union (although heaviest unionization is in public sector)

## TECHNOLOGICAL

- low levels of primary R & D
- fewer technology-intensive supporting industries