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Changing Partners: Trends in Canada's Regional Economic Relations

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CHANGING PARTNERS:
TRENDS IN CANADA'S REGIONAL ECONOMIC RELATIONS

When faced with the task of measuring such complex phenomena as economic and military power...officials relied extensively on easily computed measures, trade statistics for economic power and number of battleships and infantry reinforcements for military strength. Unfortunately, such statistics often hid more than they revealed.

Virts commenting on Friedburg's *The Weary Titan*

Executive Summary

This Paper looks at the long-term, aggregate trends in Canada's economic relations with different regions of the world. An annex describes some of the limitations of Canada's international economic statistics.

Canadian exporters have kept a fairly steady share of the world export market over the past twenty years. However, the United States and the Asia-Pacific region have become increasingly important destinations for Canadian merchandise exports, while Europe has declined significantly in importance.

Foreign investment in Canada has grown markedly since the early 1980s. However, the majority of this investment comprises portfolio holdings in debt securities issued by Canadian governments instead of direct investment in the Canadian private sector. Most foreign portfolio investment has come from the United States and from Europe, particularly the U.K.. Japanese investment grew rapidly in the latter part of the 1980s but has fallen somewhat in recent years.

Foreign direct investment in Canadian industry has grown, but is smaller than the portfolio holdings described above. Also, the proportion of total world direct investment in Canada has fallen since the early 1980s. Although U.S. direct investment in Canada continues to grow and still comprises the largest share, the U.S. share of total foreign direct investment in Canada has been steadily declining as European and, to a certain extent, Japanese investments take larger stakes.

The trend for sources of foreign technology used by Canadians matches, with one important exception, direct investment trends. The U.S. is by far the most important source of technology for Canada, although European sources have become somewhat more important, primarily through the activity undertaken by their affiliates in Canada rather than through direct licensing of patents or trademarks. There appears to be almost no Japanese industrial R and D spending in Canada.

Canadian direct and portfolio investment abroad has grown rapidly. Although this investment has increased in Europe, particularly the U.K., the Asia-Pacific region and Latin America, the U.S. still takes the largest share of both portfolio and direct Canadian investment. Most Canadian portfolio investment abroad is in stocks rather than bonds and other debt securities.

Although Canadian business services exports have grown more rapidly than Canadian merchandise exports, business services exports are still small compared to merchandise exports. The pattern of business services exports roughly follows the

pattern of merchandise exports. Tourism is another form of services trade. Although U.S. tourism remains by far the most important, both the number of visits and spending by tourists from Asia and Latin America have grown, while the number of European visitors has also increased.

Changes in Canadian trade policy interests parallel changes in Canadian trade and investment interests abroad. These trade policy interests remain focused on the world's major economies: the U.S., Japan and the EU. However, there is increasing scope for cooperation on specific trade policy issues with some of the dynamic economies of Asia and Latin America.

The Paper concludes by pointing to several trends with policy implications as areas for further research, including understanding why Europe's share of Canadian merchandise exports has fallen and why Japan-Canada technology links are so comparatively weak.

Résumé

Ce document porte sur les tendances globales à long terme des relations économiques du Canada avec différentes régions du monde. Une description des limitations que comportent les statistiques économiques internationales du Canada figure en annexe.

Les exportateurs canadiens ont réussi à conserver une part assez constante des marchés mondiaux depuis vingt ans. Toutefois, ils exportent de plus en plus leurs marchandises vers les États-Unis et la région Asie-Pacifique, et beaucoup moins vers l'Europe.

L'investissement étranger au Canada a connu une croissance marquée depuis le début des années 1980. Il s'agit cependant en général d'acquisition de portefeuilles de titres d'emprunt émis par les gouvernements du Canada, plutôt que d'investissements directs dans le secteur privé canadien. La plupart des acquéreurs étrangers de portefeuilles sont américains et européens, en particulier britanniques. L'investissement japonais s'est accru rapidement vers la fin des années 1980, mais il a quelque peu diminué ces dernières années.

L'investissement direct étranger dans l'industrie canadienne a connu un essor, mais il demeure inférieur à l'investissement de portefeuille. La proportion de l'investissement mondial direct destiné au Canada a en outre chuté depuis le début des années 1980. Même si l'investissement direct américain au Canada continue

d'augmenter et demeure le plus important, sa part diminue de plus en plus au profit de l'investissement européen et, dans une certaine mesure, japonais.

En ce qui concerne les sources de technologies étrangères employées par les Canadiens, la tendance suit celle de l'investissement direct, à une importante exception près. Les États-Unis sont de loin la plus grande source de technologies étrangères pour le Canada, quoique les technologies européennes aient pris quelque peu d'importance, surtout du fait de l'activité qu'exercent les filiales européennes au Canada plutôt qu'en raison de l'attribution directe du droit d'exploiter des brevets ou des marques. Les Japonais semblent n'effectuer presque aucune dépense industrielle de R-D au Canada.

L'investissement de portefeuille et l'investissement direct canadiens à l'étranger sont en pleine expansion. Même si l'Europe, notamment le Royaume-Uni, occupe une place de plus en plus grande, la région Asie-Pacifique, l'Amérique latine et les États-Unis demeurent les principales destinations tant pour l'investissement direct que pour l'investissement de portefeuille. Les Canadiens acquièrent surtout à l'étranger des portefeuilles d'actions plutôt que des portefeuilles d'obligations ou de titres d'emprunt.

Bien que les exportations de services commerciaux canadiens se soient développées plus rapidement que celles des marchandises, elles demeurent relativement restreintes en regard des exportations de marchandises. La tendance des exportations de services commerciaux suit en gros celle des exportations de marchandises. Le tourisme est une forme de commerce de services, et le tourisme américain demeure de loin le plus important. Toutefois, le nombre de visites de touristes asiatiques et latino-américains a augmenté ainsi que leurs dépenses, tout comme les visites de touristes européens.

Les intérêts du Canada en matière de politique commerciale suivent en parallèle ses intérêts sur le plan du commerce et de l'investissement. Les grandes économies mondiales, à savoir les États-Unis, le Japon et l'Union européenne, demeurent les principaux pôles d'attraction. Les économies dynamiques de l'Asie et de l'Amérique latine offrent cependant de plus en plus de possibilités de coopération sur des questions particulières de politique commerciale.

Plusieurs tendances qui ont des répercussions sur le plan de la politique et qui pourraient faire l'objet de recherches plus approfondies sont répertoriées en conclusion. Ces recherches permettraient de comprendre notamment pourquoi les exportations de marchandises canadiennes vers l'Europe ont diminué et pourquoi les liens technologiques entre le Canada et le Japon sont si faibles comparativement.

1. INTRODUCTION

The pattern of Canada's economic relationships with the rest of the world has shifted significantly over the past ten years. The rapid industrialization of East Asia, the growth of Japan's economic presence abroad, renewed economic vitality in Latin America and the opening of Eastern Europe to the West are all issues that have occupied the attention of policy makers in Canada and elsewhere. These changes have reshaped Canada's trade, investment and technology relations with the world. This Paper identifies the strongest and most persistent currents of change in Canada's international economic relations. It looks at these trends using the available statistics on Canadian international economic activity, while considering, where possible, weaknesses in these data. A more detailed discussion of problems with the statistics is included in an annex.

2. THE SHIFTING TIDE: CHANGING EXPORT MARKETS

Canadian exporters have maintained a fairly steady share of world exports over the past twenty years.[1] However, the importance of different regions as markets for Canadian exports has changed significantly. Two strong, long-term trends are clear from Canadian merchandise trade statistics.[2] The Asia-Pacific region and the United States are becoming increasingly important as export markets for Canadian companies. Europe, particularly the United Kingdom, is declining in relative importance. These changes reflect the rapid growth of Canadian exports to the Asia-Pacific region and the United States and the comparatively stagnant level of exports to Europe.

Exports to Latin America have recently grown faster than exports to Europe, although at a rate slower than exports to the Asia-Pacific region and the United States. As a result, Canadian exports to Latin America have a relatively small share of the total. Canadian merchandise exports to the Middle East and Africa take the smallest share of any region. Within this region, shipments to the oil-producing nations of the Persian Gulf have grown substantially, although the dollar value of these exports remains comparatively small.

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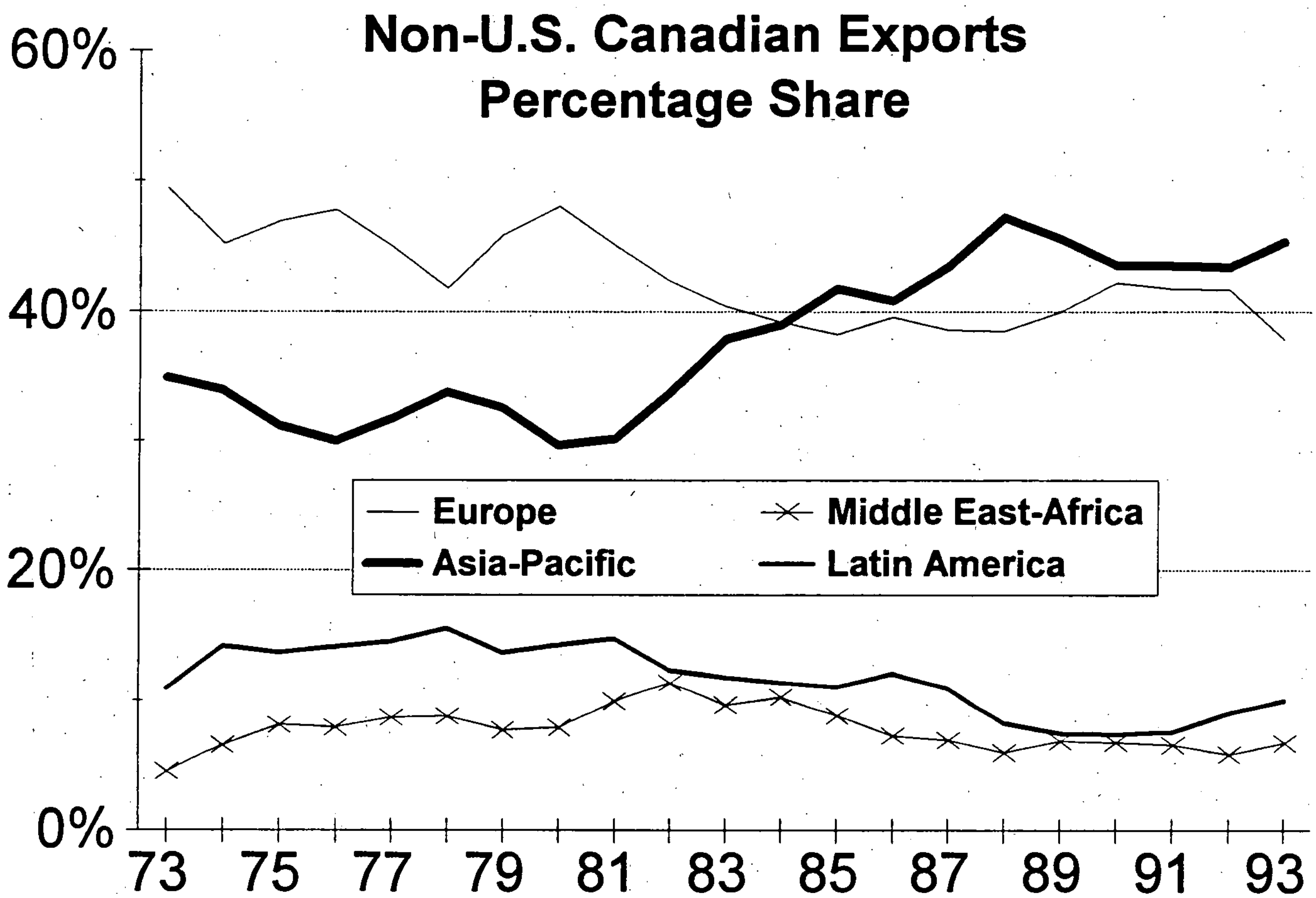
[1] Canada's share of total world exports was 4.6% in 1973, 3.9% in 1987 and 4.7% in 1992. GATT Secretariat, **International Trade Statistics** Vol. II (Geneva 1988), p. 7. GATT Secretariat, **International Trade Statistics** (Geneva 1993), p. 5.

[2] All export statistics in this paper, unless otherwise specified, are drawn from Statistics Canada, **StatCan: Cansim Disc 1994-2**, Matrix 3687 - Exports to Individual Countries.


Non-U.S. Canadian Exports
Percentage Share
60%
40%
20%
0%
73
75
77
79
81
83
85
87
89
91
93
Europe
Middle East-Africa
Asia-Pacific
Latin America

2.1 Asia-Pacific

The Asia-Pacific region has been Canada's most important export market, after the United States, since 1985. Although exports to the region have grown significantly, the even more rapid growth in exports to the United States has meant that Asia-Pacific's share fell to 9% in 1993 from 11% in 1973.[3] The importance of the Asia-Pacific region is more pronounced when the effect of export under-reporting to the region due to data quality problems, such as transhipment through the United States, is considered. Much of the more recent growth of Canadian exports in the Asia-Pacific region is due to increased sales to South Korea and the other newly industrialized economies of East Asia, rather than increases in exports to Japan or China.

Canadian exports to the Asia-Pacific region have tended to be in natural resource products.[4] In recent years, fabricated and raw materials and agricultural products have made up more than 80% of Canadian exports to the region. It might be assumed that, because these exports are not end products, such as telecommunications equipment, they are in some sense less valuable as exports. However, a recent analysis of the economic effects of different kinds of exports using Statistics Canada's input-output model of the Canadian economy suggests that Canadian exports to the Asia-Pacific region result in greater job creation per dollar of exports than Canadian exports to the EU or the U.S..[5] It is also worth noting that the jobs created pay fairly well. This analysis strengthens the case for the growing importance of the Asia-Pacific region to the Canadian economy.

Despite the greater importance of Asia to Canada's merchandise trade, Canada remains a marginal trading partner for Asian countries. For example, in 1993

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[3] However, Asia-Pacific's share of Canadian exports to countries other than the U.S. grew from 31% in 1975 to 42% in 1985 to 45% in 1993.

[4] Statistics on export composition are drawn from statistics on exports broken down by Sector Export Group (SEG) for the years 1988 - 1993 prepared for CPE by Statistics Canada. The SEG categories are: Live Animals; Food, Feed, Beverages and Tobacco (covering the whole range of food products from barley to whiskey); Crude Materials (mostly metallic ores); Fabricated Materials (predominantly processed resource products such as paper and refined metals); End Products (primarily machinery and consumer goods) and Special Transactions (a very small category compared to the others).

[5] This discussion of the economic impacts of export composition is based on James McCormack, **The Impact of Exports: An Input-Output Analysis of Canadian Trade**, Policy Staff Paper 24/94 (December 1994). The greater job creation impact is largely explained by the fact that exports of resource and resource-based products have very high Canadian content levels, whereas many non resource-based end products produced in Canada depend heavily on off-shore inputs, thus lowering their overall level of domestic content. Canada depends on off-shore inputs for products ranging from apparel to automobiles to computers to a greater degree than most other OECD economies.

Canada accounted for roughly 2% of South Korea's exports and imports.[6] The situation is much the same in the other Asian newly industrialized countries (NICs). For example, Chinese imports from Canada declined steadily from 3% of total Chinese imports in 1988 to 1% in 1993.[7] Despite the strong growth in Canadian exports to the region, Canadian exporters' share of the Asia-Pacific market is still relatively small.

2.2 Japan

It is well known that Japan is Canada's second largest export market after the United States. What is perhaps less well known is that our exports to Japan have grown quite slowly compared to our exports to the Asian NICs. Canadian exports to Japan were 5% of total Canadian exports in both 1983 and 1993.[8]

Statistics Canada and the Japanese Ministry of Finance reconciled Japanese and Canadian bilateral trade statistics for 1989, 1990 and 1991.[9] These reconciliations showed that there was significant under-reporting of Canadian exports to Japan. However, even the higher, reconciled Canadian export numbers for these years show that Canadian exports to Japan fell during this three year period.

Canadian exports to Japan have an even smaller proportion of end products than our exports to the Asia-Pacific region as a whole. These proportions have changed very little over the past twenty years. In 1993, end products made up 7% of Canadian exports to Japan. Nonetheless, the input-output model analysis mentioned above suggests that Canadian exports to Japan result in strong job growth per dollar of exports. This is because of the very high Canadian content of resource and resource-based exports to the Japanese market.

From the Japanese perspective, Canada is not a very important trading partner and is becoming less important. Japanese imports from Canada in 1993 were 3% of their total imports compared to 4% in 1988.[10] During this period, Japan's imports grew by 29%. Japan's exports to Canada have been roughly 2% of their total exports during the past five years.

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[6] IMF, **Direction of Trade Statistics Yearbook 1994**, p. 247.

[7] IMF, **Direction of Trade Statistics Yearbook 1994**, p. 134.

[8] It is also worth noting that Canadian exports to Japan were 7% of the total Canadian exports in 1973.

[9] Statistics Canada Press Releases, **Canada-Japan Trade Reconciliation** (March 2, 1992) and **1990/1991 Canada/Japan Merchandise Trade Reconciliation** (September 22, 1993).

[10] IMF, **Direction of Trade Statistics Yearbook 1993**, p. 240.

2.3 Europe

Europe's importance as a market for Canadian business has been steadily declining for over thirty years.[11] In 1960, 29% of our exports went to Europe. This proportion had fallen to 7% in 1993. Canadian exports to Europe have grown very slowly in comparison to the growth of our exports to the world overall. During recent years, Canadian exports to Europe have been quite flat. The poor Canadian performance cannot be blamed on slow growth of European imports. European import growth has, in fact, been fairly strong. For example, the EC's total imports from outside the EC grew by 40% between 1988 and 1993,[12] while EC imports from Canada fell by 9% over the same period.[13] [14]

Any attempt to analyze Canada's bilateral trade with individual European countries is complicated by transhipment within the continent. This data problem has become particularly acute since the fuller establishment of the EU's unified market in 1992. Since goods are not now subject to Customs registration within the EU, it is difficult to judge if Canadian exports to one European country actually stay in that country. For example, the Canadian Embassy in Rome reports that goods destined for Italy are increasingly being unloaded in France because of overcrowding in Italian ports. Are these goods being recorded as exports to Italy or France? The onward shipment to other EU destinations from the Dutch port of Rotterdam, shipments no longer registered at internal EU borders, provides another example of the increasing problem of identifying the ultimate destination of Canadian and other non-EU exports to European markets. The statistical agencies of the EU are themselves grappling with the difficulty of measuring intra-EU trade. Statistics for Canadian bilateral trade with individual EU members must, therefore, be used with some caution.

These caveats aside, the trend of Canada's exports to the United Kingdom provides a dramatic example of how radically traditional trading patterns have changed. In 1973, 6% of our total exports and 39% of our European exports went to Britain. By 1993, only 2% of our total exports and 21% of our European exports went to the U.K.. Indeed, the value of our exports to the U.K. was 18% higher in 1988 than in 1993. Canadian exports to our other major trading partners

[11] Europe is defined in this context as all the countries of Western and Eastern Europe, including the Former Soviet Union.

[12] GATT Secretariat, International Trade Statistics 1993 (Geneva 1993), p.85.

[13] IMF, Direction of Trade Statistics Yearbook 1993, p. 57.

[14] By comparison, EU imports from the U.S. grew by 30% between 1988 and 1993. EU imports from Japan grew by 23% during this same period. IMF, Direction of Trade Statistics Yearbook 1994, p. 72.

in Europe, with the exceptions of Germany and Switzerland, have followed this general trend.

Canadian exports to Europe have had a somewhat lower proportion of end products than the average for Canadian exports. However, the proportion of end products increased markedly from 22% in 1988 to 31% in 1993. It is tempting to conclude that this shift to end products means that Canadian exports to Europe are now producing superior economic benefits for Canada. However, the input-output model analysis mentioned above would not support this conclusion. The results of this study showed that the job creation effects of Canadian exports to the EU did not, per dollar of exports, produce markedly better paying jobs when compared to Canadian exports to the Asia-Pacific region or the U.S.. Moreover, as noted earlier in the section on the Asia-Pacific region, exports to the EU produced, per dollar of exports, fewer jobs than exports to the Pacific Rim.[15]

For Europeans as well as Asians, Canada is not an important trading partner. In both 1988 and 1992, roughly 1% of the EU's total imports came from Canada.[16] Similarly, in both 1988 and 1992 roughly 1% of EU exports went to Canada. Western European exports to the world (excluding intra-EC trade) grew by some 30% during this period.[17]

2.4 Latin America

Latin America has not been as good a market for Canadian exports as the East Asian NICs or the United States. The region's share of Canadian merchandise exports fell to 2% of total exports in 1993 from 5% in 1983.[18] Over the full period reviewed, the rate of growth of Canadian exports to Latin America has been consistently lower than the average rate for Canadian exports. However, Canadian exports to Latin America have been persistently under-reported because of transhipment through the United States. For example, registered Chilean imports from Canada were US$50 million more than Canadian registered exports to Chile in 1993.[19] More accurate statistics on Canada's trade with Latin America, if they were possible,

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[15] McCormack, **The Impact of Exports**, pp. 50-1.

[16] GATT Secretariat, **International Trade Statistics 1993** (Geneva 1993), p. 84.

[17] IMF, **Direction of Trade Statistics Yearbook 1993**, p. 57.

[18] Canadian exports to Latin America were 4% of total Canadian exports in 1973.

[19] IMF, **Direction of Trade Statistics Yearbook 1993**, pp. 149, 156.

might well show both faster export growth and a modestly larger share of Canadian total exports.

Moreover, the published statistics do show that, since the late 1980s, Canadian exports to some of the region's more dynamic economies have begun to grow quite quickly. Exports to Chile, Brazil, Argentina and Venezuela grew at a rate faster than the world average between 1988 and 1993. Mexico, given the acknowledged problems with under-reporting in our export statistics for this country, should also be included on this list.

The two largest economies of the region, Brazil and Mexico, are taking an increasingly larger share of our exports to the region. For example, Brazil, which took 13% of our exports to the region in 1973, took 23% in 1993. Similarly, Mexico, which took 13% of our exports to the region in 1973, took 24% in 1993. The shares of Argentina, Chile and Venezuela have all grown over the past five years, but the growth of their shares has not been as important as in the cases of Mexico and Brazil.

This trend is even more pronounced if we take into account the effects of the substantial under-reporting of our exports to Mexico. Some measure of this problem is provided by the fact that Mexican merchandise import statistics on goods from Canada were 40% higher than the corresponding Canadian export numbers in 1992.[20]

From the Mexican perspective, Canada is becoming a more important export market. In 1988, roughly 1% of Mexican exports went to Canada. By 1993, almost 9% of Mexican exports went to Canada. In 1993, Canada accounted for only a little more than 1% of Mexican imports. This is a smaller proportion than in 1988 despite a 68% increase in imports from Canada over this period. The real percentage of Mexican imports that come from Canada is probably considerably higher. This is a mirror image of the Canadian export data problem. A substantial number of goods imported by Mexico are probably recorded as imports from the U.S. rather than from Canada, their true country of origin.

From the Brazilian perspective, Canada is not an important trading partner. In 1993, roughly 1% of Brazil's exports went to Canada compared to 3%

[20] Ibid., pp. 156, 273. The same source is used for Mexican trade statistics in the following paragraph.

in 1988. In 1993, a little more than 2% percent of Brazil's imports came from Canada, marginally less than in 1988.[21]

The composition of Canadian exports to Latin America remained fairly stable between 1988 to 1993. Compared to the average for Canadian exports, the region takes a higher proportion of agricultural products and a lower proportion of end products. Proportions for raw and fabricated materials roughly match those of the average export mix.

2.5 The Persian Gulf

Canadian exports to the Middle East and Africa are quite small compared to exports to other regions. However, Canadian exports to Saudi Arabia, Iran and the United Arab Emirates are reasonably large when measured on a bilateral basis and have grown consistently over the past ten years. Canadian export performance in these countries compares quite favourably with that of many other countries. Canadian exports to the Middle East grew by 150% between 1988 and 1993.

2.6 The United States

The recent growth of Canadian exports to the United States is part of a very long-term trend. In addition to the obvious geographic and economic forces at work, the results of trade negotiations such as the Auto Pact of 1965, subsequent GATT Rounds leading to substantial tariff reductions on bilateral trade, and most recently the FTA and NAFTA, have been instrumental in improving and securing access to the U.S. market, thereby encouraging Canadian exports. Exports to the United States have been steadily growing as a share of total exports for more than 30 years. This is largely because the rate of growth of our exports to the U.S. has been consistently higher than the average rate during this period. Indeed, Canadian exports to the United States have consistently had the highest growth rate of our exports to any major region. Data quality problems, such as the transhipment of goods through the U.S. to third country markets, mean that published statistics may slightly overstate Canadian export growth to the United States and understate that to other regions.

Canadian exports to the United States have the highest proportion of manufactured end products of Canadian exports to any major market. Again, it might seem reasonable to assume that these exports have superior job creation effects per dollar of exports than Canadian exports made up to a greater extent of resource

[21] Ibid, p. 223.

products. The input-output model analysis referred to earlier does not support this assumption. This analysis suggests, instead, that the domestic employment effects of exports to the United States, per dollar of exports, are less than those generated by Canadian exports to the EU and the Asia-Pacific region. However, it should also be noted that exports to the United States produced the highest wages to jobs created ratio.[22]

3. FINANCING OUR DEBTS: FOREIGN PORTFOLIO INVESTMENT IN CANADA

The recent drop in the value of the dollar has focused attention on the relatively large amount of Canadian debt held by foreigners. At the end of 1993, some 4% of all outstanding debt securities (i.e., treasury bills and bonds, etc.) in the world had been issued by the Canadian public sector. The Canadian private sector's share was much smaller. By comparison, the U.K. public sector's share was 3%.[23] Between January 1991 and May 1994, Canadian borrowers issued 7% of all new bond issues in international bond markets. Again, the Canadian share is comparable to that of much larger economies such as France (9%) or the United Kingdom (9%).[24] Canada accounts for a relatively large share of world portfolio investment, an indication of our heavy reliance on off-shore financial markets to finance government deficits.

In 1993, foreign portfolio investment in the liabilities of Canadian governments, mostly bonds, was 45% of total Canadian liabilities to foreigners.[25] In 1983, the proportion was 31%. Foreign portfolio investment in Canada, which is increasingly in government rather than private sector securities, began to surpass foreign direct investment in Canada in the late 1970s. This trend continued through the 1980s and 1990s. In 1993, foreign portfolio investment in the debt paper of Canadian governments, including crown corporations, was $264 billion.[26] In contrast, the stock of foreign direct investment in Canada in 1993 was $146 billion.

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[22] McCormack, **The Impact of Exports**, pp. 50-51.

[23] Bank for International Settlements, **64th Annual Report** (Basle June 1994), p. 111.

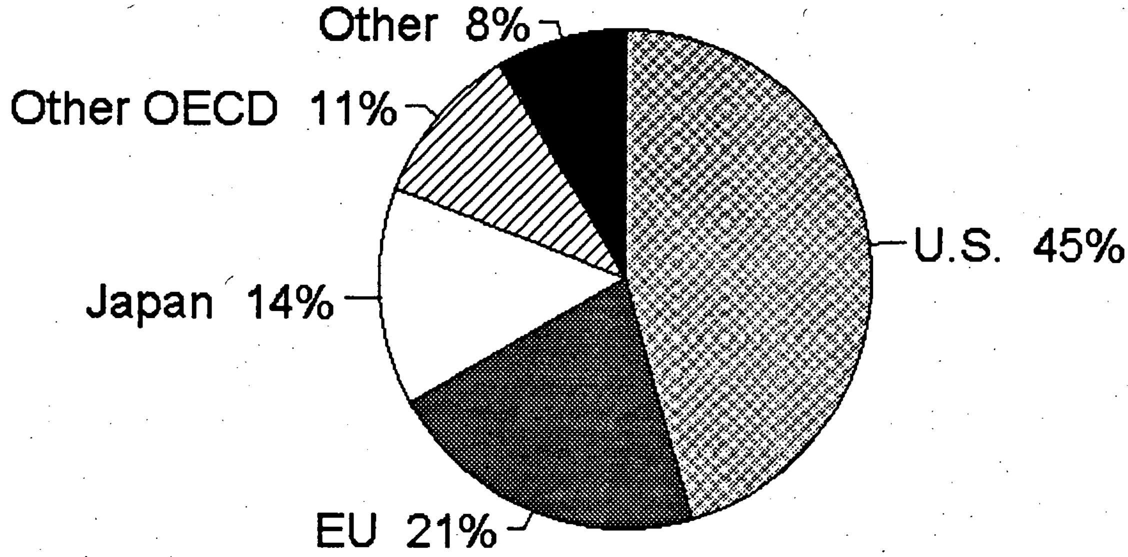
[24] OECD, **Financial Market Trends** (Paris, June 1994), p. 91.

[25] Unless otherwise noted, statistics on foreign portfolio investment in Canada are taken from **Statistics Canada's StatCan: Cansim Disc 1994-2**, Canada's International Investment Position, Matrixes 4180-4187, 2700 and 2705.

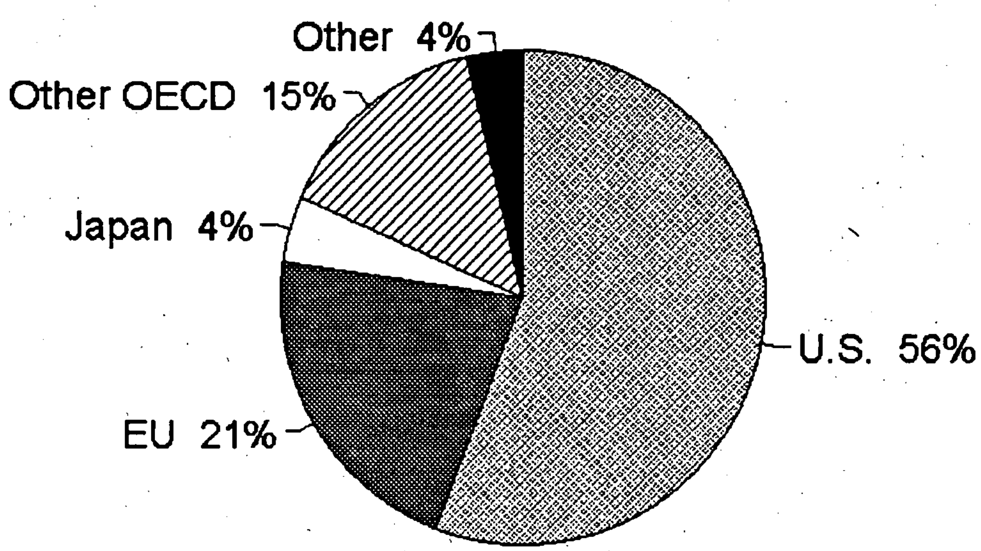
[26] Statistics Canada, **Canada's International Investment Position 67-202 1993**, p. 114.

Foreign Portfolio Investment in Canada

Regional Shares of Total Stock



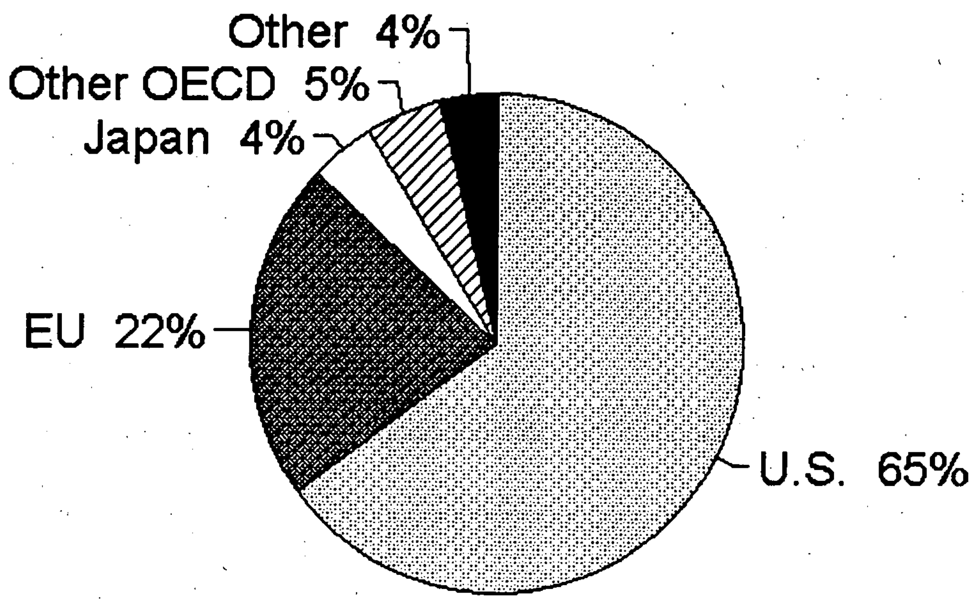
1993



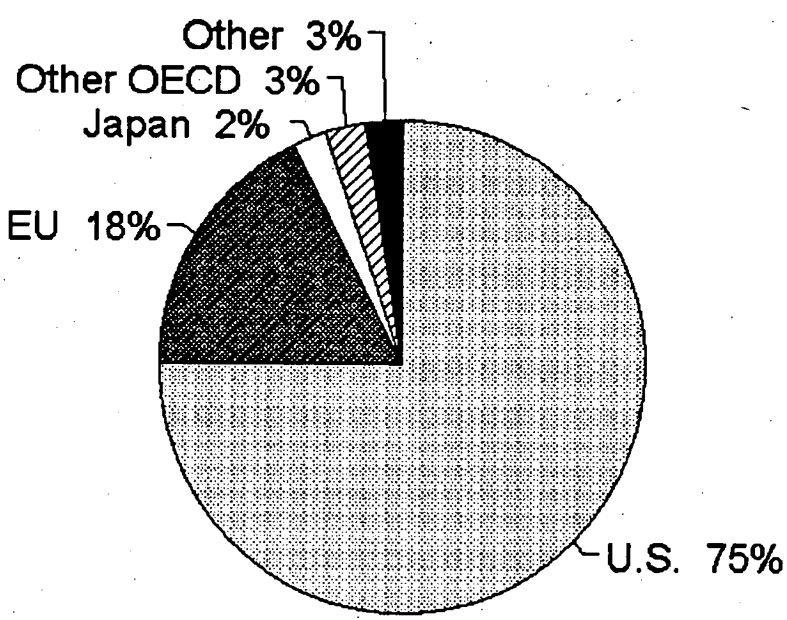
1983

Foreign Direct Investment in Canada

Regional Shares of Total Stock



1993



1983

Where is this portfolio investment coming from? In 1993, the United States held the largest share of portfolio investment (roughly 45%). In the 1980s, U.S. portfolio investment in Canada grew quite slowly, while portfolio holdings by Japanese and European investors increased substantially. As a result, the U.S. share of portfolio investment in Canada fell to roughly 36% of the total in 1988. U.S. portfolio investment in Canada increased rapidly in the 1990s, however, restoring the U.S. share of portfolio investment to its current, somewhat higher level. The present U.S. share of foreign portfolio investment in Canada is nonetheless considerably reduced compared to that of 20 years ago. In 1973, Americans held 79% of foreign portfolio bond investment and 65% of foreign portfolio investment in stocks.

After the United States, the Japanese held the largest share of portfolio investment of any individual country in 1993 (roughly 14%, compared to 4% in 1983). Almost all Japanese portfolio investment was in bonds. Statistics Canada has reported, however, that Japanese investment in Canadian bonds fell from $49.5 billion in 1992 to $46 billion in 1993. Independent surveys by the Canadian Embassy in Tokyo have shown the same trend.[27] The Embassy's surveys indicate that Japanese investors' holdings of Canadian portfolio paper fell by $8.4 billion between 1993 and 1994. The Japanese share of foreign portfolio investment in Canadian bonds fell from 21% in 1992 to 17% of total foreign holdings in 1993. It remains to be seen if Japanese portfolio investment flows into Canada will return to the levels of the 1980s.

The total European share of portfolio investment in Canada (21% for the EU in 1993 and 1983) is larger than that of the Japanese (14%), but smaller than that of the U.S.. This investment grew steadily during the 1980s, although at a rate slower than that of Japanese investment.[28] The U.K. remains the largest European portfolio investor in Canada and its investments are becoming particularly important (9% in 1993 vs 4% in 1983). Portfolio investments from the U.K., primarily in bonds, grew at a much faster rate than those of other EU members during the ten years between 1983 and 1993.

[27] Canadian Embassy, **Japanese Portfolio Investment in Canada 1994 Survey** (Tokyo, August 1994), p. 1. It should be noted that Statistics Canada refers to this data when preparing their statistics on portfolio investment.

[28] EU portfolio investment in Canada grew 233% between 1983 and 1993, while Japanese portfolio investment grew by 984% during this period.

Unfortunately, there is very little detail available on portfolio investment in Canada.[29] Statistics Canada's geographic categories are limited to the U.S., the U.K., the EU, Japan, "other" OECD countries and "all other countries". Portfolio investments are often managed by intermediary institutions, such as banks, in large financial centres. Because of these difficulties, we can only guess at what proportion of portfolio investment in Canada comes from Latin America, the Middle East and Asian countries other than Japan. The share of portfolio bond investment in Canada of the "all other countries" category did grow from 3% in 1983 to 6% in 1993.

4. FOREIGN DIRECT INVESTMENT

Canada is now a relatively less important destination for foreign direct investment than it was ten years ago. In 1982, roughly 14% of the OECD countries' stock of foreign direct investment was invested in Canada. By 1992, Canada's share had declined to roughly 7%.[30] During this ten year period, world flows of foreign direct investment increased dramatically. For example, the cumulative direct investment flows of the OECD countries were more than four times greater between 1981 and 1990 than between 1971 and 1980.[31] Even after taking into account problems with the quality of investment statistics, Canada is clearly attracting a smaller share of world foreign direct investment flows than it did in the past.

Americans have owned the majority of foreign direct investment in Canada since well before the second world war. This continues to be the case. However, the U.S. share of foreign direct investment in Canada has been slowly falling since the 1940s.[32] U.S. direct investment was 65% of the total stock in 1993, compared to 75% in 1983 and 82% in 1973. This is not to say that U.S. direct investment in Canada has not been growing in value terms. However, foreign direct investment from other sources, mostly from some European countries and to a certain extent from Japan, has been growing at a faster rate.

Data on foreign control of Canadian industry collected by Statistics Canada under the authority of the Corporations and Labour Unions Returns Act

[29] Statistics Canada is working to improve Canadian and world portfolio debt statistics as part of the Task Force on Portfolio Investment Abroad of the IMF's Standing Committee on Balance of Payments.

[30] OECD, **International Direct Investment Statistics Yearbook 1994**, p. 16.

[31] Bank for International Settlements, **63rd Annual Report** (Basle June 1994), p. 90.

[32] Unless otherwise noted, statistics in this section are taken from **Statistics Canada's StatCan: Cansim Disc 1994-2**, Canada's International Investment Position, Matrixes 4180-4187, 2700 and 2705.

(CALURA) also show a decline in the importance of U.S. direct investment in Canada. In 1983, American firms controlled 15.8% of the assets and 22.3% of the operating revenues of Canadian non-financial industries. In 1992, they controlled 14.4% of assets and 18.9% of operating revenues.[33]

The relative decline in the importance of U.S. investment in Canada parallels a similar decline worldwide. In 1983, roughly 45% of all foreign direct investment in the world was of U.S. origin. By 1992, the U.S. share had fallen to roughly 30%.[34] U.S. direct investment abroad has continued, but direct investment from Europe and Japan has become increasingly important. Canada has also become a less important destination for U.S. direct investment. In 1983, 21% of U.S. direct investment abroad was in Canada. By 1992, Canada's share had fallen to 14%.[35]

European direct investment in Canada grew at a higher rate than U.S. direct investment between 1983 and 1993. As a result, Europe's share of direct investment in Canada grew from 20% in 1983 to 27% in 1993. The U.K. is, by far, the largest European investor. Most of the remainder was accounted for by France, Germany, the Netherlands and Switzerland. The CALURA data on the "control" of enterprises show the same trend. In 1983, EC firms controlled 5.3% of the assets and 4.9% of the operating revenues of Canadian non-financial industries. In 1992, their shares had modestly grown to 5.9% and 5.4%.[36]

Canada is, however, becoming a less important destination for European direct investment abroad. Unfortunately, an EU comparison cannot be made because data for France are unavailable. However, the U.K. and Germany accounted for more than 20% of total OECD direct investment abroad in 1992 and they can be used to indicate the trend. Canada accounted for a somewhat smaller share of total British and German direct investment abroad in 1992 than it did in 1984. For example, in

[33] Statistics Canada, **CALURA, Part I. Corporations, Preliminary 1989, 1990, 1991, 1992, SC 61-220**, pp. 34-5. "Control" in terms of the CALURA Act means not just ownership sufficient to influence company policy (the definition used to determine flows and stocks of direct investment), but having a sufficient level of ownership to determine the way in which an enterprise operates, generally implying ownership of at least one third of voting shares when this block of shares is larger than any other block of equity. However, most of the companies considered foreign controlled in the CALURA report are actually more than 50% foreign owned.

[34] OECD, **International Direct Investment Statistics Yearbook 1994**, p. 16.

[35] OECD, **International Direct Investment Statistics Yearbook 1994**, pp. 264-265.

[36] Statistics Canada, **CALURA, Part I. Corporations, Preliminary 1989, 1990, 1991, 1992, SC 61-220**, pp. 34-5.

1984 roughly 7% of British direct investment abroad was in Canada. By 1992, the Canadian share had fallen to 5%.[37]

While Japanese direct investment in Canada grew rapidly in the 1980s, this investment is still quite small (4% of the total stock in 1993) compared to that of the U.S. (65%) or the U.K. (12%). Canada has maintained a fairly constant 2% share of total Japanese direct investment abroad since 1983.[38]

Direct investment from non-OECD countries grew between 1983 to 1993 from 3% to 4% of the total. The largest non-OECD investor is Hong Kong. Direct investment from Hong Kong grew by almost 2000% (from a very low base) between 1983 and 1992 to 2% of total direct investment in Canada. Other non-OECD direct investment in Canada comes from a broad range of countries, not principally from any one region.

5. TECHNOLOGY

Canada, as a medium sized economy, relies to a large extent on research and development done elsewhere for new technology. Some of this technology is acquired by licensing of patents for technology developed abroad. Also, one of the benefits of foreign direct investment for the Canadian economy is the transfer of technology and expertise through research and development activity in Canada. However, all foreign investment is not equal in this regard.

5.1 Patents

The United States is by far Canada's most important source of new technology. For the past ten years roughly half of all Canadian patent applications have been filed by U.S. residents. In recent years, this proportion has fallen slightly. The Canadian Intellectual Property Office reported that, in the 1992-93 fiscal year, 44% of all Canadian patent applications were filed by Americans.[39] More importantly, the statistics for patent and trademark royalty payments show that, in 1992, 81% of these royalty payments by Canadians went to the United States.[40] While very high,

[37] OECD, **International Direct Investment Statistics Yearbook 1994**, pp. 250-1.

[38] OECD, **International Direct Investment Statistics Yearbook 1994**, pp. 158-9.

[39] Canadian Intellectual Property Office, **1992-93 Annual Report**, p. 31.

[40] **Statistics Canada's StatCan: Cansim Disc 1994-2**, Business Services Details, Matrix 2324.

this is the lowest percentage recorded since the statistics were first published for 1983.

Europeans have maintained a fairly constant share, roughly 30%, of Canadian patent applications filed since 1980.[41] However, patent and trademark royalty payments from Canada to EC residents have fluctuated between 6% and 10% since 1983.[42] This suggests that only a comparatively small number of patents granted to Europeans in Canada are actually used or "worked".

Japanese patent activity increased in Canada during the 1980s. In the 1992-93 fiscal year, Japanese residents filed 14% of all Canadian patent applications.[43] This is a substantial increase from 8% in 1980.[44] Unfortunately, Statistics Canada does not publish statistics for patent and trademark royalty payments between Canada and Japan.

5.2 Research and Development

Most foreign-financed research and development in Canada is done by affiliates of U.S. firms. Among a list of the 100 top companies in Canada for research and development spending in 1993, U.S. affiliates were responsible for 68% of the spending by foreign affiliates.[45] The share of U.S. affiliates was 76% in 1989. This R and D was spread through a wide range of industrial sectors. Although there is not enough data to demonstrate a long-term trend, the apparent decline of the American share appears to be due to the growth of R and D spending by European affiliates. The share undertaken by European affiliates grew from 24% in 1989 to 32% in 1993. A little less than half of European R and D activity in Canada was in the pharmaceutical sector.

Canadian firms do a significant amount of their research and development in the United States. In 1990, U.S.-based affiliates of Canadian companies spent almost US$2 billion on R and D in the United States.[46] To put this in context, in 1990

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[41] OECD, **Basic Science and Technology Statistics** (Paris 1993), p. 70.

[42] Ibid.

[43] Canadian Intellectual Property Office, **1992-93 Annual Report**, p. 31.

[44] OECD, **Basic Science and Technology Statistics** (Paris 1993), p. 70.

[45] Data on top 100 R and D spending is based on research by Evert Communications Ltd. of Ottawa.

[46] OECD, **The Performance of Foreign Affiliates in OECD Countries** (Paris 1994), p. 67.

R and D spending by Canadian firms in the United States was about 50% of the value of Canadian firms' R and D spending in Canada.[47]

The list of the top 100 companies in Canada for R and D spending shows that Japanese affiliates do almost no R and D in Canada. For example, none of the Canadian subsidiaries of Japanese car manufacturers are on this list. By comparison, R and D spending by Japanese affiliates in the U.S. in 1990 was comparable to that of other foreign affiliates.[48] The lack of Japanese R and D in Canada seems strange, given the relatively large Japanese direct investment in this country.

6. CANADIAN DIRECT INVESTMENT ABROAD

Canadian direct investment abroad is beginning to approach the value of foreign direct investment in Canada. In 1993, the stock of Canadian direct investment abroad was $115 billion while foreign direct investment in Canada was $146 billion.[49] By comparison, in 1983 Canadian direct investment abroad was $42 billion while foreign direct investment in Canada was $80 billion.

Although the majority of Canadian investment abroad is still in the United States (56% in 1993), Canadian direct investment in Europe has recently grown more quickly than in the United States. As a result, the proportion of Canadian direct investment in Europe grew from 14% in 1983 to 21% in 1992. Half of this investment is in the United Kingdom, while the rest is concentrated in the industrialized countries of Northern Europe (Belgium, France, Ireland, the Netherlands and Switzerland all take large shares).

Canadian direct investment abroad also grew at a comparatively fast rate in the Asia-Pacific region. The region's share of Canadian direct investment abroad grew from 7% in 1983 to 10% in 1992. Canadian direct investment growth in Latin America was slower and this region's share fell slightly from 4% in 1983 to 3% in 1992.[50] Given the recent surge of Canadian investment in South America (e,g., in the

[47] Statistics Canada, **Service Bulletin, Science Statistics Vol. 17, No.5** (August 1993), p. 4.

[48] OECD, **The Performance of Foreign Affiliates in OECD Countries** (Paris 1994), p. 67.

[49] Unless otherwise noted, statistics in this section and the next are taken from **Statistics Canada's StatCan: Cansim Disc** 1994-2, Canada's International Investment Position, Matrixes 4180-4187, 2700 and 2705, Canadian Direct Investment Abroad, Matrix 4188 and Foreign Direct Investment in Canada, Matrix 4189 .

[50] Latin America is defined for this section alone as South and Central America including Mexico but not the Caribbean. This imperfect definition is used to try to ensure that investment in offshore tax havens does not distort the Latin American total. Admittedly, this excludes some bona fide investment in the Caribbean , including in the banking and mining sectors.

mining sector in Chile), the 1994 figures, if they were available, might well show that Latin America's share of Canadian direct investment abroad has grown since 1992.

Measuring the actual level of Canadian direct investment abroad, particularly in the developing world, is somewhat problematic. Chile provides a timely example. The Chilean government's Foreign Investment Committee reported that there was US$ 765 million of Canadian investment in Chile in 1992.[51] Statistics Canada, on the other hand, reported that total Canadian direct investment in all of South and Central America (other than Brazil, Venezuela and Panama) was Cdn $943 million in 1992, of which about half was not located in Chile. Part of this discrepancy may be due to the financing of direct investment with capital raised in third countries. Also, direct investment abroad is sometimes done through intermediary companies in offshore financial centres. In this regard, it is interesting to note that Statistics Canada recorded $2.7 billion of Canadian direct investment in Bermuda and $2.2 billion in the Bahamas in 1992.

Estimates which include planned investment will be much higher than the official statistics. The Canadian Embassy in Santiago estimated that Canadian investment in Chile in August 1994, including planned investment for projects under development, was US$ 3.9 billion.[52] Actual Canadian direct investment stocks in Chile in 1994 were probably closer to the most recent Chilean Foreign Investment Committee's estimate of US$ 1.4 billion of materialized investment.[53]

7. CANADIAN PORTFOLIO INVESTMENT ABROAD

Canadian portfolio investment abroad is predominantly in stocks rather than bonds. Canadian investment in foreign equities has grown steadily since the 1950s and began to accelerate in the 1980s and 1990s. As a result, in 1985 Canadian portfolio investment in foreign stocks surpassed foreign portfolio investment in Canadian stocks. By 1993, Canadian portfolio investment in foreign equities was more than double foreign portfolio investment in Canadian stocks.

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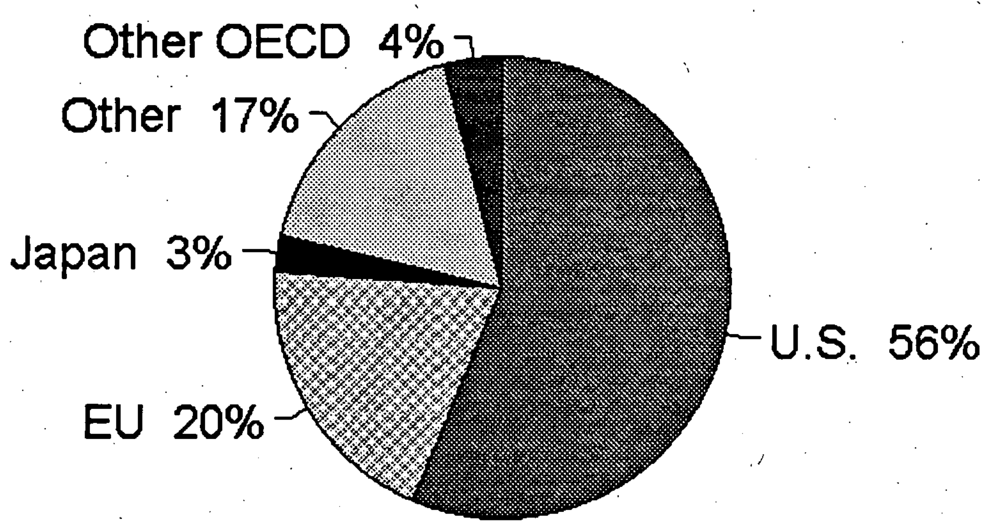
[51] Foreign Investment Review Committee, **Chile Investment Review July 1994**, p. 4.

[52] Canadian Embassy, **Estimated Canadian Investment in Chile**(Santiago August 1994).

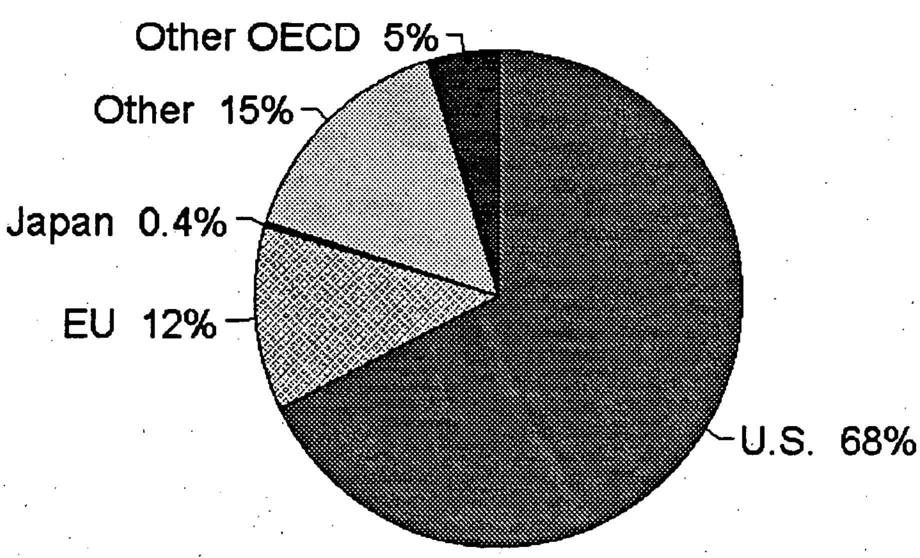
[53] Foreign Investment Review Committee, **Chile Investment Review July 1994**, p. 4

Canadian Direct Investment Abroad

Regional Shares of Total Stock



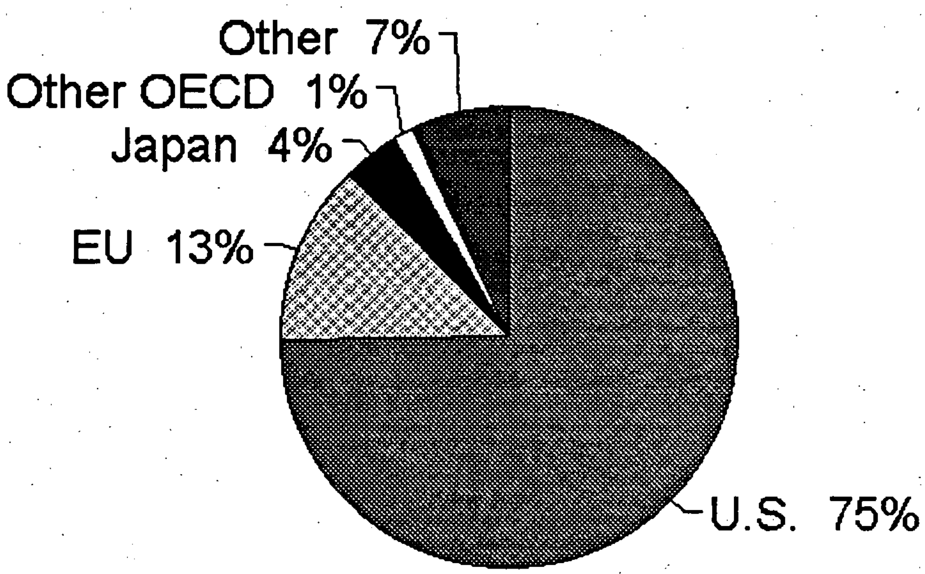
1993



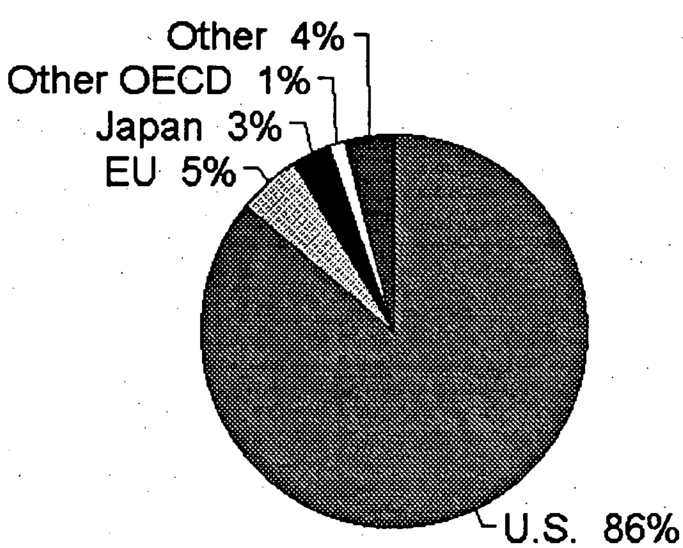
1983

Canadian Portfolio Investment Abroad

Regional Shares of Total Stock



1993



1983

Since 1983, Canadian portfolio investment abroad has grown fastest in the U.K. and in non-OECD countries. As a result, the U.S. share of this investment has declined slightly. However, the U.S. share (76% of total Canadian portfolio investment in foreign stocks in 1993) remains by far the largest. Canadian portfolio investment abroad is concentrated in the United States to an even greater extent than Canadian direct investment abroad. Canadian portfolio investment in Japan and European countries has grown substantially, but at a slower rate than Canadian portfolio investment in Britain and the non-OECD countries.

8. BUSINESS SERVICES EXPORTS

According to statistics published by the GATT Secretariat, Canada has maintained a fairly constant 2% share of world commercial services exports since 1982[54]. Between 1983 and 1993, Canadian business services exports grew at a rate almost 50% higher than the rate of growth of Canadian merchandise exports.[55] However, our business services trade is still relatively insignificant when compared to merchandise trade. In 1993, the total value of business services exports was 5% of total merchandise exports.

Most Canadian business services exports are to the United States. Between 1983 and 1993, the United States' share of the Canadian business services export market grew from 54% to 58%. In 1992, the latest year for which these statistics are available, roughly half of these exports to the U.S. were sales between affiliates of the same company. Intra-firm exports were concentrated in a few categories: management and administrative services, research and development, insurance and charges related to the automotive industry (including tooling).

Europe takes the second largest share of Canadian business services exports (22% in 1992), but these exports have been growing slowly compared to those to other major regions. Intra-firm trade is important. In 1992, roughly a third of Canadian business services exports to the EC represented sales between affiliates of the same company. In 1992, business services exports to Europe were worth 14% of our merchandise exports to Europe. By comparison, our business service exports to the U.S. were only 4% of our merchandise exports to that market in 1992.

[54] GATT Secretariat, **International Trade Statistics** (Geneva 1993), p. 88.

[55] Statistics on Canadian business services exports were taken from **Statistics Canada's StatCan: Cansim Disc 1994-2**, Business Services Details, Matrix 2324 and the 1990-1994 editions of Statistics Canada, **Canada's International Transactions in Services SC 67-203.**

Exports of business services to the Asia-Pacific region have grown faster than those to any other region. As a result, the region's share of Canadian business services exports grew from 8% in 1985 to 11% in 1992. Most of this growth was in exports to the East Asian NICs.

Exports of business services to Japan have not grown as quickly and Japan's 3% share has remained fairly constant since 1985. Although Statistics Canada does not break down our business services trade with Japan on the basis of affiliates and non-affiliates, it is interesting to note that the proportion of affiliate business services trade in the "other countries" category which includes Japan (i.e., not the U.S. nor the EU) has increased substantially since 1983. Since affiliate business services trade is related to foreign investment and the 1980s saw a large increase in Japanese direct investment in Canada, it is not unreasonable to assume that a certain proportion of our business services trade with Japan is intra-company trade.

The remaining 9% of total Canadian business services exports is divided fairly evenly between Latin America and the Middle East/Africa. Business services exports to Latin America have been growing slowly, with the exception of such exports to Mexico. Exports to Mexico grew from $34 million in 1991 to $87 million in 1992. The pattern for the Middle East and Africa is less clear.

9. TOURISM

Tourism brings in revenues to Canada comparable to those for business services. Canada has maintained a fairly constant 2% share of the rapidly growing world tourism market since 1980.[56]

Americans still make the vast majority of visits to Canada by foreigners, but their share of the total number of overnight visits fell from 87% in 1984 to 80% in 1993.[57] The importance of U.S. tourists has declined somewhat as visitors from other regions, particularly Asia and Latin America, have begun to spend substantially more on average than U.S. tourists. The travel receipts section of the balance of payments current account illustrates this trend. Travel receipts from the United States grew by 19% between 1988 and 1993, while receipts from all other countries grew

[56] World Tourism Organization, **Yearbook of Tourism Statistics** (Madrid 1994), p. 23.

[57] Statistics Canada, **Touriscope 1993** SC 66-201, p. 12.

by 83% during this period.[58] U.S. tourists spent, on average, $87 per day in 1993 compared to $67 per day in 1988.[58]

The number of visits by tourists from Asian countries other than Japan has grown rapidly in recent years. These tourists made 428,000 over-night visits in 1993 compared to 374,000 in 1988.[60] Their spending in Canada has also increased substantially from an average per visitor of $53 per day in 1988 to $90 in 1993. Japanese tourists have the highest average spending of any group. They spent on average $157 per day in 1993 compared to $110 in 1988. The number of Japanese visits grew from 324,000 in 1988 to 409,000 in 1993.

Although their number is smaller than that of tourists from Asia, spending by tourists from Latin America has grown substantially. Tourists from South America spent on average $96 per day in 1993 compared to $64 per day in 1988. In 1993, average spending per day by visitors from Mexico ($114) was surpassed only by Japanese tourists.[61]

Europeans are the second largest group of visitors to Canada after Americans. The number of visits by Europeans has grown from 1.6 million in 1988 to 1.8 million in 1993. Average spending per day by Europeans was comparatively low at $70 in 1993. Visitors to Canada from the oil producing states of the Persian Gulf are lumped into the "other" Asian category by Statistics Canada because of their small number. There is no easy way to break this number out.

10. TRADE POLICY PARTNERSHIPS

The most important trade policy partners for Canada will continue to be the major players in the world's economy: the U.S., Japan, the EU (i.e., the EU Commission)[62] and the most important economies in the EU (i.e., the UK, Germany

[58] Statistics Canada, **Canada's International Transactions in Services 1992 and 1993 SC 67-203**, p. 30.

[59] Statistics Canada, **Touriscope 1993 SC 66-201**, p. 15 and Statistics Canada, **Touriscope 1989 SC 66-201**, p. 14.

[60] These and the statistics which follow in this section are taken from Statistics Canada, **Touriscope 1993 SC 66-201**, p. 19 and Statistics Canada, **Touriscope 1988 SC 66-201**, p. 18.

[61] There were 90,800 over-night visits from South America in 1988 and 79,000 in 1993. There were 67,200 over-night visits from Mexico in 1988 and 86,000 in 1993. Statistics Canada, **Touriscope 1993 SC 66-201**, p. 19 and Statistics Canada, **Touriscope 1988 SC 66-201**, p. 18.

[62] With Canada, the trade ministers of these three economies meet on a regular basis as the Quadrilateral Group to discuss issues affecting the development of the international trade and investment system.

and France). These are the world's dominant economies whose actions determine, to a large extent, the direction of the global trading system. The United States remains Canada's primary partner in all areas of economic activity described in this Paper. The other major players have become increasingly important as sources of investment capital in Canada. At the same time, Canada's interests do not always converge with those of several or all of its Quadrilateral partners, for example, with regard to the urgency of reforming the anti-dumping practices of governments, the use of agricultural export subsidies, or the nature of the relationship between trade and environmental and labour standards and their enforcement.

On the other hand, some of the most important economies of the Pacific Basin and Latin America are of growing importance in achieving Canadian trade policy objectives. These are countries which have both important economies and an increasingly strong commitment to a <u>rules-based</u> international trading system rooted in their own national interests. The list of these countries includes: Mexico, Chile, Brazil, Argentina, Colombia, South Korea, Australia, New Zealand, Indonesia, Singapore, Malaysia and Thailand. It is not coincidental that many of these nations are becoming increasing important economic partners for Canada.

While the focus of much of our trade policy efforts is on the Quadrilateral grouping, we should continue to give increased consideration to working more closely with countries from this second list on an issue-specific basis. Many of them have proven to be good allies on trade policy issues where our interests coincide. During the lead-up to the launch of the Uruguay Round of multilateral trade negotiations, several of these countries worked closely with Canada in Geneva to emphasize the importance of significant further liberalization in trade in resource-based products. More well-known and institutionalized, the Cairns Group on agriculture was another example of the MTN-related usefulness of alliances with these countries in pursuing Canadian trade policy objectives.

There are at least two potential forms of cooperation on trade policy issues with these other "middle powers". Canada can take the lead in forming coalitions of nations with similar interests to help achieve our objectives in WTO-related negotiations. We can also work on a bilateral level and regionally to build formal structures that will solidify and strengthen already existing economic relationships. Extending the NAFTA accession process to South America, and possibly across the Pacific, would be one way that this might be accomplished. Other avenues we should pursue on a complementary basis include the 2010/2020 free trade vision endorsed by leaders of the Asia Pacific Economic Cooperation (APEC) forum in November 1994 and the 2005 target for establishing a free trade Area of the Americas agreed to during the Miami Hemispheric Summit held last December.

In summary, Canadian trade policy recognizes the growing economic importance, both to Canada and globally, of a range of countries in Latin America and Asia-Pacific. This does not mean that our trade policy relations with the Quadrilateral economies should be in any way ignored, but rather that Canadian trade policy partnerships are issue-specific and strategic, reflecting Canada's broadening economic relations with the world.

11. CONCLUSIONS

The broad trends of Canada's economic relations are reasonably clear. Merchandise trade continues to dominate Canada's private sector economic exchanges with other countries. Canadian exporters are maintaining their share of the world export market. Canadian exports are growing most in the Asia-Pacific region, the United States and, to a lesser extent and more recently, in Latin America and the countries of the Persian Gulf. Canadian merchandise trade with Europe has been steadily declining in relative importance.

Foreign investment in Canada has become increasingly concentrated in Canadian public sector portfolio debt, with Europeans and the Japanese holding more such debt paper than a decade ago, but still less than the share held by U.S. investors. Foreign direct investment is growing, but Canada's share of world foreign direct investment flows is falling. Although the United States is still by far the largest foreign investor in Canada, foreign investment from some European countries, Japan and Hong Kong has grown steadily over the past ten years.

Canada's sources of foreign technology reflect, with the exception of Japan, foreign investment patterns <u>in</u> Canada. Although European R and D activity in Canada has increased in recent years, Canada continues to rely predominantly on the United States as its primary source of foreign technology.

Canadian private sector investment abroad is beginning to reach levels comparable to foreign private sector investment in Canada. The largest share of this investment is in the United States, although Canadian investment is growing quickly in Europe, particularly the U.K., Asia-Pacific and, more recently, Latin America.

Business services exports are growing at a faster rate than merchandise exports but are still very small when compared to merchandise trade. The pattern of business services exports is much the same as Canadian merchandise exports. Canadian tourism revenues are comparable in size to business services exports. An increasing proportion of these revenues is due to tourists from Asia and Latin America.

Canada's network of potential trade policy partnerships is now also much wider than 10-15 years ago. Our Quadrilateral colleagues remain central to managing the international trading system, but for a surprising number of rule-making issues Canada can benefit from working with selected Latin American and Asian countries depending on the specific question in play.

There are several issues raised in the Paper which have definite policy implications and should be considered further. It would be useful to investigate why Canadian exports to Europe have declined in importance despite the substantial growth of EU imports from outside the EU and whether the reasons behind this decline have any relevance for the international business development strategy developed by the Department of Foreign Affairs and International Trade. The data described in the Paper indicate that Canada has been attracting a smaller share of world foreign direct investment flows in recent years. What are the reasons behind this decline and what steps, if any, can the Department take to make Canada more attractive to foreign investors? The R and D spending patterns of affiliates of foreign, and particulary Japanese, companies may well be worth looking at in greater detail, given the data described in this paper which suggest that Japanese companies do almost no R and D spending in Canada.

ANNEX: THE LIMITATIONS OF INTERNATIONAL ECONOMIC STATISTICS

There are significant problems with all the statistics used to measure Canada's economic relationships with the rest of the world. I have set out below a brief description of the problems with statistics measuring merchandise trade, services trade and foreign investment.

- **Merchandise Trade**

The global and growing extent of problems with merchandise trade statistics is perhaps best illustrated by a recent example from Jacob Ryten, the Assistant Chief Statistician at Statistics Canada. The sum of all countries' imports should equal the sum of all countries' exports. In 1970, total world imports were 10% greater than total world exports (this gap can be partly, perhaps mostly, explained by the difference between FOB and CIF-based data). However, by 1991 this difference had grown by 50 percent. These "imports from nowhere" are a significant proportion of world trade and point to a growing international problem with trade statistics. As the bulk of world trade is within the OECD, trade statistics problems are not restricted to countries with poorly developed administrative systems.

For Canada, these problems mean that our trading partners, except the United States, often have bilateral trade statistics that differ significantly from Canadian statistics for this same trade. These discrepancies arise from technical differences in methods of calculating trade statistics and from problems with the export data on which these statistics are based.[63]

We do not have this problem to the same degree in our trade statistics with the United States. Since 1990, we have agreed to use U.S. import data to measure Canadian merchandise exports to the United States and the U.S. has agreed to use our import statistics in an analogous way. Prior to this agreement, Canadian and U.S. trade numbers showed large discrepancies. For example, in 1989 Canadian statistics for imports from the U.S. were US$16 billion higher than the matching U.S. numbers for exports to Canada.

These problems distort our understanding of Canadian trade patterns. If merchandise exports are significantly understated because of reporting problems, then the proportion of our merchandise exports that go to the United States is probably somewhat smaller than Statistics Canada's published data would suggest.

[63] A more detailed description of problems with Canadian merchandise trade statistics is available in the Economic and Trade Policy Division (CPE) publication, **How to Prepare and Use Merchandise Trade Statistics.**

This is because, as noted above, our merchandise export statistics for the United States are based on U.S. import statistics. Import declarations must be filed in order for goods to enter the United States. Our export statistics for the rest of the world, however, are based on export declarations which are increasingly not filed to a significant extent. In addition, some of our exports recorded as exports to the United States are in fact being shipped through the United States to other markets. In other words, it is certain that the U.S. took modestly less than the 80% of total merchandise exports reported by Statistics Canada in 1993. As a result, our perception of changes in Canadian trade patterns has been somewhat distorted, particularly when attempting to track trends in our trade relations with countries other than the U.S..

Thus, reported statistics may be modestly misleading because of problems in export reporting. If it is assumed that unreported exports and exports transhipped through a third country to their final destination were distributed throughout the world in patterns approximating those of our recorded exports, then the real changes in the shares of total exports will be somewhat different from those presented officially. The shares of total Canadian exports to Asia Pacific, Latin America and the Middle East likely declined modestly less than is shown in the available data. The effect of these considerations for Europe is ambiguous. Without adequate information, we cannot measure the relative effects of export under-reporting, which would increase Europe's export share, and of export transhipment through Europe to third markets, which would decrease Europe's export share.

- **Business Services**

For their part, services statistics have been collected for only a relatively short time and are certainly less standardized than merchandise trade statistics. The data problems with services trade are probably greater than the difficulties with merchandise trade. Services trade is broken down into several broad categories: business services, travel, freight and shipping, government services and "other" services. Canadian services trade statistics are only available at any useful level of geographic detail for business services and travel. These two categories make up the greater part of Canadian services trade. In this paper, I have used Statistics Canada business services statistics which are part of the Balance of Payments statistics. I have used Statistics Canada data on tourism to look at travel services trade because these statistics are available on a fairly detailed, geographic level.

The GATT Secretariat compiles statistics on world business services trade and has published some interesting material on problems with the data. There are limits to the usefulness of these statistics, as they are based on national statistics which sometimes use quite different concepts and methods to quantify business services trade. For example, the value of merchandise bought and sold by trading companies is sometimes recorded as services trade. This causes an overestimation of services trade. On the other hand, the GATT Secretariat also believes that many services trade transactions are not recorded. Services trade statistics are not available for some countries which are not members of the IMF, while reported statistics may include important omissions due to problems with the data used by national statistical agencies. These include non-reporting of transactions by firms and the misclassification of services trade as merchandise trade or investment flows. To quote the GATT Secretariat: "It is impossible to determine to what extent ... the available statistics underestimate the actual level of trade in services."[64]

The problems with Canadian services trade statistics parallel the data problems with Canadian merchandise trade statistics. Canadian and U.S. bilateral services trade data are reconciled in much the same way as Canadian merchandise trade statistics. Statistics Canada and the U.S. Department of Commerce exchange and reconcile each other's services import data to produce bilateral services export and import numbers. As a result, our statistics for services trade with the United States are considered quite good. As this reconciliation process does not happen with countries other the U.S., there is the strong possibility that Canadian statistics for services trade with other countries may be less accurate and perhaps under-reported.

In preparing its business services statistics, Statistics Canada examines the Revenue Canada administrative data for international transactions between related parties filed by Canadian companies. Statistics Canada is, therefore, quite likely to have very good statistics for services trade between affiliated companies. The data for trade between unaffiliated companies may be somewhat less reliable.

When Canadian services providers establish offices overseas, the services sales of these offices may or may not be counted as service exports. If these offices are considered as long-term establishments, then the profits of these offices are recorded by Statistics Canada as investment income in the current account. If an office considered to be a long-term establishment does not report a profit, for whatever reason, then it is unlikely that its sales will be reflected in any Canadian statistics.

Another possible problem with services data is the under-reporting of services imports. Statistics Canada has a fairly sophisticated understanding of which Canadian companies export services and believes it captures most of their service

[64] GATT Secretariat, **International Trade Statistics** (Geneva 1989), p. 328.

exports in its surveys and other data collection processes. However, almost any Canadian company could potentially purchase services from abroad. It is quite possible that purchases of services from unaffiliated companies in countries other than the United States are somewhat under-reported. In short, Canadian business services trade statistics probably under-report business services trade with unaffiliated companies, especially those resident in countries other than the United States.

- **Investment**

Finally, there are three major flaws with investment data. Since investments, especially but not only portfolio investments, are often channelled through holding companies or other intermediary institutions, errors are made in recording the final destination or true ownership of the investment. Secondly, investments are sometimes made with capital raised in financial markets outside Canada. These investments may not be recorded as "Canadian" by Statistics Canada. The investment statistics available for Chile are compared in this Paper to illustrate the problems. Thirdly, the most important flaw in the data for our understanding of the changing shares of direct investment in Canada of different countries is the fact that direct investment stocks are calculated on the basis of book value instead of market value. This means that older investments are in effect under-counted, thereby distorting in practice the country of origin calculations for foreign direct investment in Canada. Older direct investment in Canada, much of it from the U.S. and the UK, is likely somewhat undervalued compared to more recent direct investment.

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