UNCLASSIFIED

External Affairs and International Trade Canada

POLICY PLANNING STAFF PAPER

NO. 93/01

Globalization and Public Policy in Canada:

In Search of a Paradigm

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(January 1993)

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Canada

Globalization and Public Policy in Canada:

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EXECUTIVE SUMMARY

This paper identifies the key, far from unambiguous characteristics of economic globalization and briefly outlines the broad implications for public policy. Most of the paper then focusses on specific policy fields (including investment, competition policy, technology policy, and trade and the environment), and their impact on a much more comprehensive and intrusive trade policy agenda. The paper develops a number of specific "micro" policy suggestions. It concludes by emphasizing the growing importance of policy coherence between different levels of government and within the federal public service.

The paper begins by expressing some scepticism about the extent of the globalization of economic processes and the "emergence" of global (or "stateless") firms. Much of the increase in trade in goods and services has occurred on a regional basis. Generally speaking, most G-7 economies have not become more trade dependent in recent years (if measured as a proportion of GDP), although several smaller and/or new entrants have. Cross-border intra-industry trade has increased, but not everywhere to the same degree and much occurs on a regional basis. International intra-firm trade apparently has not grown proportionally more important. The degree of investment-based foreign presence in several G-7 economies has remained the same or declined, although it has increased in the U.S. and the U.K. in particular. We should treat claims about the emerging dominance of "stateless" firms with caution: the direction of intra-firm trade and the commitment to significant research and development efforts are linked primarily to the home base of major international traders.

Yet, at the broadest level, borders have become increasingly fragile in the face of the movement of goods, services and capital at rates that have been increasing considerably more rapidly than global production. Firm behaviour in more countries has rapidly become more outward-looking. Greater telecommunications and transportation efficiencies are reinforcing this growth. Product life cycles have shortened in key areas. Consumer demands for quality, customized products, and after-sales service are increasing and often override local product loyalty.

Increasing economic internationalization puts a premium on improving Canadian competitiveness. Our productivity record is not good in this regard, whether measured in terms of output per worker or total factor productivity growth. Much has been and must be done domestically to address this weakness. Innovative trade policy has a major role to play in the process of recovery.

Traditional trade policy issues continue to matter. Tariffs and quantitative restrictions still impede access for Canadian exports, not only in growing LDC markets, but also in the EC and Japan. Policy makers will have to give further consideration to reducing unilaterally Canadian import duties on essential inputs facing lower duties when imported into the U.S. by competitors. North American rules of origin will require careful management. The liberalization of cross-border trade in services requires more work. There remains much more to do on the government procurement front. And there is still a requirement for reform of trade remedy procedures, especially anti-dumping.

Canada's need for quality investment is increasing. Some estimate that future gross investment requirements may be up to one-third higher than our recent performance, at a time when government deficits detract significantly from the national savings effort. Canada requires foreign investment to bridge the gap, although the competition for investment has become tougher. At the same time, Canadian direct investment abroad can be positive. International networking provides access to new technologies and assists in opening markets for Canadian exports.

At home, Canada has to ensure the creation of an environment that foreign and domestic investors will consider attractive. In addition to getting the domestic policy mix right, trade policy can build on FTA and NAFTA achievements by addressing such issues as the extension of the higher foreign investment review threshold to other OECD countries, the retention of some regulatory leverage to address major acquisitions, and the extension of investment disciplines to non-OECD countries through accessions to the NAFTA and the negotiation of further bilateral Foreign Investment Protection Agreements (FIPAs).

Competition is at the heart of market based economics. Competition policy prevents abuses of economic power, while remaining sensitive to economic efficiency needs. Competition policy can more effectively adapt to normal market-place pricing realities in a cross-border context than can anti-dumping procedures. The rationale for seeking to replace the latter with the former is persuasive. Canada should build the domestic consensus needed to pursue this goal actively, although recognizing that negotiations with the U.S. and others will not be easy. However, we should treat with caution suggestions that we promote a broadly based effort to harmonize the detail of competition policy internationally given Canada's different (more modern) mergers policy and our continuing need for flexibility with respect to strategic alliances related to research and development and export promotion.

The innovation resulting from research and development can combine with a greater investment and savings effort to underpin economic growth. There is an important correlation between R&D performance, and sales growth and increased market shares. Regrettably, Canada's R&D record is not good, especially with respect to the effort of the private sector which falls significantly below that of our OECD competitors. Trade policy can contribute to improving this situation by: creating a treaty-based environment of security and stability for investment, reducing overseas barriers to exports from our resource sectors as an important contribution to firm profitability, preserving ample scope for government R&D funding that is safe from the trade remedy harassment of other countries, working toward the full application of national treatment by other governments when Canadian companies with their own funding and expertise seek to join international technology consortia, and preserving high quality intellectual property standards while developing a better understanding of the economic impact of further changes to these standards.

The trade and environment agenda is quickly expanding and becoming more complex. Environmentalism reflects concerns close to the every day life of voters, is easily packaged for emotional public debate, and yet addresses significant, very real-world problems at the heart of economic and social development. The combination of political sex appeal and substantive merit is powerful. There is a crying need for the trade policy community to get out in front of the environmental wave with innovative, well-reasoned proposals if it hopes to shape public debate effectively so that fundamental Canadian trade and economic interests are not jeopardized. In this regard, the paper makes several specific suggestions related to the use of border measures to enforce consensual standards (including user fees), how to discipline environmental "rogue" states, inspections in other jurisdictions, and dispute settlement procedures. The design of environmental economic instruments should reinforce Canadian competitiveness objectives and avoid tripping over international trade obligations.

The trade policy negotiating agenda will certainly expand further. The closer interaction of domestic and external policies will continue to gather steam. In essence, Canada faces one policy playing field. The coordination of players and plays must be agile and comprehensive. In this regard, close federal-provincial cooperation is crucial. The policies of one level of government can severely undermine the efforts of another jurisdiction to provide a stable environment for investment and growth.

Moreover, as the trade agenda continues to expand, the importance of coordination and policy coherence <u>within</u> the federal government can only increase. In this regard, the paper concludes by recommending the consolidation of all trade policy instruments under one roof.

Between the middle of the fifteenth century and the late seventeenth, Europeans learned to think of the world as a whole and of all seas as one....The age saw not only the most rapid expansion of geographical knowledge in the whole of European history; it saw also the first major victories of empirical enquiry over authority, the beginnings of that close association of pure science, technology, and everyday work which is an essential characteristic of the modern western world.

J.H. Parry, ***The Age Of Reconnaissance. Discovery, Exploration and Settlement 1450-1650.***

The world of 1789 was, for most of its inhabitants, incalculably vast. Most of them, unless snatched away by some awful hazard, such as military recruitment, lived and died in the county, and even the parish, of their birth....The rest of the globe was a matter of government agents and rumour. [By 1848,] the known, mapped, and intercommunicating area of the world was larger than ever before, its communications unbelievably speedier...Science had never been more triumphant; knowledge had never been more widespread.

E.J. Hobsbawm, ***The Age of Revolution 1789-1848.***

There is a marked contrast in the relation of technological discoveries to actual changes between...the Industrial Revolution ...and the twentieth century. The revolutions in cotton textiles and in pig iron and bar iron production, and the introduction of steam in the second half of the eighteenth century were in response to long-felt needs and followed a long search ....Necessity was the mother of invention, and the period of gestation was long. In contrast, many economically important inventions in the late nineteenth and the twentieth centuries were the results of attempts to apply new scientific discoveries....Here, the addition to the stock of knowledge came first, and one might say that invention fostered need.

Simon Kuznets, "Reflections on the Economic Growth of Modern Nations" (1957).

What actually happened was probably far more complex than this summary.

Jorge Luis Borges, ***The Book of Sand.***

GLOBALIZATION AND PUBLIC POLICY IN CANADA:

IN SEARCH OF A PARADIGM

I. By Way of Introduction

Each generation seeks to anchor its perceived uniqueness in the bedrock of a breathlessly proclaimed paradigm. Globalization, or the creation and growing integration of a world system, has become such a touchstone in the late twentieth century. Yet continuity is as remarkable as change.

The short-term, long distance movement of peoples has accelerated with the advent of air, motor vehicle and high-speed rail travel, especially since the 1940s. But long-term mass migration between continents has been with us since the transatlantic slave trade began in earnest 300 years ago.

International trade in goods, especially intermediate goods, is a driving force behind current economic integration. Yet growth in the value and volume of trade has radically shaped international and domestic economic integration since the Industrial Revolution, including in many so-called peripheral countries.

The specifics of technological innovation change, and the shelf-life of much high-tech machinery and many consumer products has shortened. But technology has revolutionized the world before and presumably will do so in the future.

Capital markets are much more sophisticated today and foreign direct and portfolio investment flows accelerated in the 1980s, outpacing both the growth of global production and trade. Yet the process is not new; the trend is uncertain, and incomplete. For every "stateless" multinational company reflecting the new paradigm of global integration in terms of equity and management, there are many more Japanese, American, French or German transnationals that have grown abroad while remaining Japanese, American, French or German (or perhaps increasingly European) in a number of key ways.

The end of the Cold War and the bankruptcy of the central planning paradigm have created unprecedented consensus in favour of economic and, although to a lesser degree, political pluralism. Yet the outcome of this earthquake is by no means certain, with competition for quality investment capital and the resurgence of ethnic unrest at the sub-national level in many areas of the world.

This essay is the first in a series of papers that are underway or in the developmental stage in the Economic Policy Division (CPE) of the Policy Planning Staff of External Affairs and International Trade Canada. These papers will review several aspects of globalization and other foreign policy issues, and will attempt to identify policy directions and practical tools for coherent Canadian responses. Work is underway on trade and investment links, the impact of trade on job creation in Canada, energy markets in the 1990s, the effectiveness of economic sanctions, and Canada's relations with Latin America. In consultation with other parts of the Department, the Division will undertake additional work by next spring.

This paper launches the current work cycle. It identifies the key, far from unambiguous characteristics of economic globalization at the beginning of the 1990s and briefly outlines the broad implications for public policy. Most of the paper then focusses on specific policy fields (including investment, competition policy, technology policy, and trade and the environment), and their impact on the much more comprehensive trade policy agenda that has emerged since the 1970s and is still evolving. I make a number of specific suggestions, with a view to encouraging forward-planning of trade policy responses. In the conclusion, I offer several final thoughts about policy coherence at the federal and provincial levels in light of the international trends and national objectives identified in the body of the paper.

What follows is by no means definitive. Nor can it be new in all, or even most of its individual aspects. In part, its originality rests in some of the prescriptive suggestions made at the "micro" policy level. But more importantly, I believe that its balance of continuity with change and the attention given to several areas of public policy in one paper emphasize the complexity and interconnections of the agenda Canada must face, as well as the importance of identifying carefully crafted, integrated responses to the issues raised.

II. The Scope of Globalization

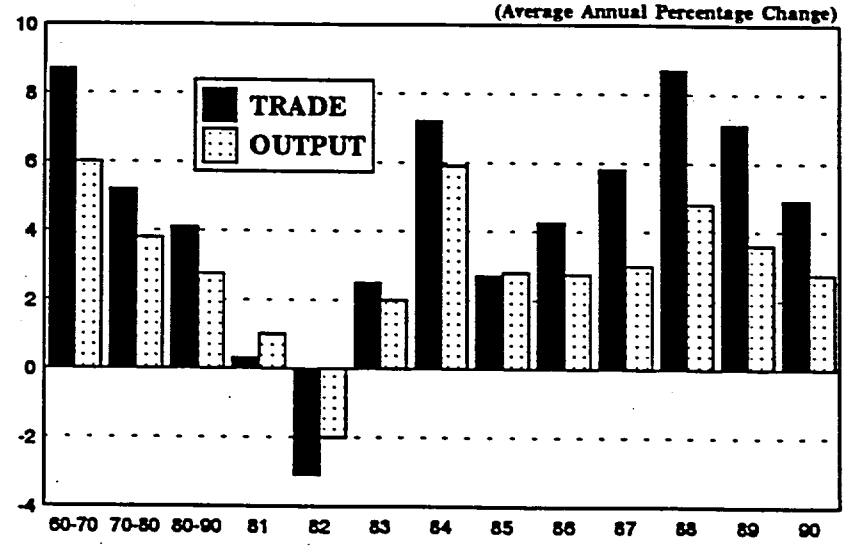
1. Key Characteristics

How pervasive is global economic integration? How strong is the trend? How truly "global" is globalization? The answers to these questions are not straightforward. In a debate in which much of the information available is qualitative and anecdotal, and some of the numbers suspect and certainly incomplete, this section attempts to develop a reasonably balanced response by looking at various characteristics of globalization frequently identified in the literature on this issue.

- Trends in Trade in Goods and Services

First, increases in the volume of world merchandise exports have consistently outpaced the growth of world output of goods (see Chart 1 for the record since 1960), driven in particular by increases in exports of manufactures. So producers are shipping an increasing proportion of output across international borders. But whose borders? Between 1980 and 1990, the most dynamic growth in trade occurred between Asia, and North America and western Europe respectively. The share of world trade covered by these two relationships increased by over half to almost 18%.

CHART 1
Volume of World Merchandise Trade and Output
1960 -1990



Source: GATT

Nonetheless, the greatest absolute increase followed a different pattern. In 1980, 43% of world merchandise trade occurred on a regional basis (led by intra-western European trade at 27% of the world total). Ten years later, this share had increased to 52% of world trade (with cross-border traffic within western Europe

accounting for 33%).[1] Regional trade within North America and east Asia also grew (the share of world trade accounted for by intra-Asia trade increased by more than half to 10.3%). **Regionalization in these three key areas, therefore, occurred side-by-side with globalization.**

Analysts often also focus on the globalizing impact of trade in services. There is a problem here of the under-reporting of services data. On the basis of information available, however, so-called commercial services may account for approximately 20% world exports.[2] A case can be made for lowering this standard estimate somewhat to a level closer to 15% because of anomalies related to the inclusion of "travel" in commercial services trade (see Table 1 and the considerations therein), but we should also recall that the services component of traded goods could represent up to 15% of the export value of these products.[3]

These caveats aside, international **trade in services** appears to have at least kept pace with growth in trade in goods, and thus, like goods, has also **outpaced growth in domestic production** (see Table 2). Much of this growth has likely taken place on a regional basis, given the intimate connection with trade in goods (western Europe accounts for 53% of commercial services exports, much presumably undertaken on an intra-European basis).

But services have also made a more fundamental contribution to increased global integration that statistics on trade shares cannot capture. **The dramatic decline in the cost of international communications has made an important, some would say critical, contribution** that has clearly greased the wheels of trade and, consequently, of global integration. For example, the cost of semiconductors falls 30% for every doubling of cumulative production volume. When coupled with the even more important performance revolution associated with certain integrated circuits (the memory capacity of the so-called DRAMs has been doubling every four years), as well as increased competition flowing from deregulation, the cost and quality of

[1] GATT, International Trade 90-91, Vol.II, p.9.

[2] International transport, "travel", and other private services including communications, non-merchandise insurance, brokerage, leasing, professional and technical services, etc.

[3] Of course, the value of a traded service also includes the imputed cost of goods associated with the development and delivery of that service.

TABLE 1
TOTAL WORLD EXPORTS
(value in Billions of SDRs)

	1970 - 74	1975 - 79	1980 - 84	1985 - 89	1990
World Merchandise Exports	1,897	4,296	7,717	9,432	2,406
World Commercial Services Exports	421	915	1,643	1,993	527
(% of Total 1 World Exports)	(18.2%)	(17.6%)	(17.6%)	(17.4%)	(18.0%)
World Cross-Border Services Exports	300	673	1,214	1,362	353
(% of Total 2 World Exports)	(13.7%)	(13.5%)	(13.6%)	(12.6%)	(12.8%)

Source: IMF, Balance of Payments Statistics Yearbook, various years. Values have been converted to Special Drawing Rights (SDRs) to adjust for major exchange rate fluctuations.

(1) The GATT includes some property and labour income in its definition of commercial services. This paper follows more recent IMF practice which excludes these items. The difference is not major. Note that there is consensus that available services data significantly under-represent the value of international trade in services (largely due to various forms of incomplete coverage and/or reporting). There is no evidence that the downward bias is any greater today than 20 years ago; if anything, the quality of the data should have improved for later years, thus potentially creating an upward bias in growth rates.

(2) This category covers the same items as commercial services, less international travel. This item includes goods purchased while a person is temporarily visiting abroad and brought back to the country of residence. That is, Customs includes such goods as services in national accounts, creating an upward bias in this data that may have increased with greater cross-border shopping in North America and western Europe. Moreover, over 80% by value of travel (if 1991 expenditures of Canadians travelling to the U.S. and U.S. residents visiting Canada are any guide) comprises, in addition to goods purchased, expenditures on food, lodging, in-country transportation and entertainment that represent local consumption, not internationally tradeable services normally subject to trade negotiations.

TABLE 2
WORLD EXPORTS of GOODS and SERVICES (1970 -1990)
(% Growth in SDR Value during Indicated Periods)

	1975 / 70	1980 / 75	1985 / 80	1990 / 85
World Merchandise Exports	128%	131%	25%	37%
World Commercial Services Trade	101%	130%	23%	47%
World Cross-Border Services Trade	108%	133%	17%	40%

Source: IMF, Balance of Payments Statistics Yearbook, various years.
Note that values have been converted where necessary to Special Drawing Rights (SDRs) to adjust for major exchange rate fluctuations

international communications have changed significantly.[4] Funds move electronically throughout the world with a speed and volume unimaginable by most even 15 years ago. With respect to transportation, bulk carriers, container ships and larger scale aircraft for cargo have helped to sustain the growth in trade in goods, although the impact has likely been less than that of telecommunications.[5]

Countries are trading a greater proportion of goods and services across borders. As discussed above, much of this growth is on a regional basis. But how have increasing trade flows affected key individual economies? Have all become more internationalized? If judged on the basis of exports of goods and services as a proportion of gross domestic product (GDP), there is not a simple answer (see Table 3A).

In six of the G-7 countries, exports represented a higher proportion of GDP if we compare the late 1980s with the early 1970s (only Japan ends up unchanged at the end of this period). But a reversal of sorts took place in the second half of the 1980s which witnessed a decline in the relative importance of exports for G-7 countries such as Canada, Italy, the UK and Japan, with the U.S. and France registering little change. Only Germany continued to score a major proportional gain for exports vis-à-vis GDP after 1985, and even here over 70% of German exports was shipped to other European destinations by 1990. Increasing export globalization has not been a recent hallmark of G-7 trade. Increased internationalization of exports has, however, been very much the trend for a number of dynamic developing economies and smaller European traders, as can be seen in Table 3A.

On the other side of the ledger, Canada's overall imports of goods and services as a proportion of GDP has not increased appreciably over the past 15 years (although the import penetration of many manufactures has increased). Imports have become relatively less important for Japan in recent years. In France, Italy and Germany, the import share increased in the early 1980s, and subsequently showed some tendency

[4] OECD, **Globalisation of Industrial Activities - Four Case Studies: Auto Parts, Chemicals, Construction and Semiconductors** (Paris, 1992), pp. 136, 148, 158; OECD, **Universal Service and Rate Restructuring in Telecommunications** (Paris, 1991), pp. 146-67.

[5] Although comprehensive time series are not readily available, the real cost of transportation of wheat (in US $ per tonne) has clearly fallen - see International Wheat Council, **World Wheat Statistics** (1983 and 1987), p. 79 and p. 73 respectively. International air cargo rates (individual shipments under 45 kilograms) fell in real US dollar terms between 1980 and 1989, although not significantly when expressed in the currencies in which sellers sold the goods transported - see International Civil Aviation Organization, **Annual Report of the Council**, various (Montreal).

TABLE 3A
TRADE AS A MEASURE OF INTERNATIONALIZATION
(Exports of Goods & Services as a % of GDP)

	1970/74	1975/79	1980/84	1985/89	1990
CANADA	22.9	24.2	27.0	26.6	24.9
FRANCE	17.4	20.2	22.5	22.1	23.1
GERMANY	24.0	27.1	31.6	33.8	36.2
ITALY	16.1	20.8	20.6	18.8	19.2
U.K.	23.2	27.6	26.9	25.5	24.8
U.S.A.	6.3	8.4	8.8	8.2	9.9
JAPAN	11.4	12.5	14.4	11.4	10.8
AUSTRALIA	14.9	15.4	15.4	16.2	16.3
INDONESIA	18.6	24.0	26.7	23.1	25.9
MALAYSIA	42.3	50.4	53.2	63.3	78.0
THAILAND	17.9	20.2	22.8	30.3	36.8
PHILIPPINES	17.8	18.4	19.4	24.9	27.8
KOREA	21.1	29.8	35.3	38.1	31.6
CHINA	3.9	5.2	8.4	12.8	....
MEXICO	8.1	9.5	15.8	....	....
BRAZIL	10.0	7.1	10.2	9.9	7.3
NETHERLANDS	47.3	48.5	57.6	56.6	56.7
SWEDEN	26.5	28.4	32.8	33.1	30.5

Source: IMF, International Financial Statistics Yearbook (1991). Calculations based on data in national currencies.

TABLE 3B
TRADE AS A MEASURE OF INTERNATIONALIZATION
(Imports of Goods & Services as a % of GDP)

	1970/74	1975/79	1980/84	1985/89	1990
CANADA	21.5	24.4	24.3	25.6	24.4
FRANCE	16.9	19.7	23.2	21.7	23.0
GERMANY	21.2	24.7	29.9	28.1	29.7
ITALY	18.0	21.6	23.2	19.4	19.7
U.K.	24.3	27.9	25.5	27.2	27.3
U.S.A.	6.5	8.9	10.1	10.8	11.2
JAPAN	10.3	11.8	13.4	8.6	10.1
AUSTRALIA	14.2	15.6	17.4	18.2	17.3
INDONESIA	18.5	20.3	23.6	21.7	25.0
MALAYSIA	41.0	44.5	56.5	55.3	78.1
THAILAND	20.3	24.9	28.0	31.2	43.5
PHILIPPINES	18.8	23.9	24.3	23.1	33.4
KOREA	28.9	33.9	38.4	33.0	32.2
CHINA	3.3	5.0	7.6	14.6	....
MEXICO	9.5	10.6	11.5	....	....
BRAZIL	8.8	9.2	9.2	6.1	5.5
NETHERLANDS	46.0	47.0	54.3	52.5	52.0
SWEDEN	25.6	29.1	32.2	31.3	30.0

Source: IMF, International Financial Statistics Yearbook (1991). Calculations based on data in national currencies.

to decline. Of the G-7, only in the U.S. has the relative importance of imports increased consistently since 1970, but slowly and from a low traditional level. Once again, the increasing internationalization trend was clearer among the other economies listed in Table 3B, although with some indication of tapering off in the late 1980s in some of them. If anything, the increasing insertion of economies in international trade appears to hold more clearly for smaller countries, including new entrants that have banked heavily and successfully on trade over the past 20 years.

- Intra-industry and Intra-firm Trade

The rationalization of production facilities on a wider international basis is a dynamic element underpinning the greater flow of production across borders. Intermediate goods imported as inputs are playing a more important role than previously. Dynamic intra-industry trade defines much of the production process related to such internationalized industries as computers, textiles and apparel, non-ferrous metals, communications/semiconductors, aerospace, and motor vehicles. The ratio of goods sourced abroad to goods sourced domestically increased steadily from the early 1970s. This ratio increased in Canada, the U.S., Japan, Germany, France and the UK (the subject of a recent OECD study). Nonetheless, this trend needs careful interpretation.

Canada's ratio increased from 33% to 50% of domestic sourcing, but this trade in intermediate goods is heavily centred on firms based in the U.S., i.e., it is very regionalized. Now accounting for 35%-40% of domestic sourcing levels, the regional dimension of increased trade in intermediate goods is also evident, although not as strongly in relative terms, in Germany, France and the U.K. (the transatlantic connection with U.S.-based firms remains important). There is considerable intra-industry trade between the U.S. and Japan, although in different industries (e.g., U.S. aerospace and wood exports to Japan; Japanese motor vehicle inputs and computer components to the U.S.). But the importance of this trans-Pacific dynamic in intermediate product trade is less fundamental to date than it may appear at first blush: these are precisely the two countries (of those surveyed) where the ratio of imported inputs to domestic sourcing is smallest (increasing from 5% to only 7% in Japan since the early 1970s; from 7% to 12% in the U.S.). There is a trend, but to date it is hardly indicative of a quantitative leap into global integration.[6]

Nor is there clear evidence of a trend with respect to a related phenomenum: intra-firm trade between a parent company and affiliates abroad as a driving force behind globalization. The best available material is from the U.S. market. If anything,

[6] OECD, "International Sourcing of Intermediate Inputs", DSTI/STII/IND(92)1, March 1992.

intra-firm trade between U.S. parents and overseas affiliates was modestly lower in the late 1980s compared to ten years earlier as a proportion of total U.S. exports and imports. With respect to trade between foreign parents and U.S.-based affiliates, the evidence is more mixed. Exports to the U.S. from Canadian and European parents in fact declined as a proportion of total U.S. imports. However, exports from Japanese and Korean firms to their affiliates did increase significantly their share of total U.S. imports following investments in the United States.[7]

Something of the same pattern can be detected perhaps in the doubling and tripling of the value of Japanese exports between 1985 and 1990 to Asian recipients of new Japanese investment (exports jumped from US$16.5 billion to US$47.6 billion during this period to Malaysia, Thailand, Korea and Taiwan).[8] Whether this represents a one-shot surge following major greenfield investments or the beginning of even greater intra-firm trade remains to be seen, but the U.S. experience would suggest that there may be no longer-term trend. Moreover, it is telling that we can identify some increase in intra-firm trade related to the U.S. market precisely with respect to Japanese and Korean companies for which strategic internationalization of production does not imply, as we shall explore further below, the creation of global, supra-national firms.

- The Investment Dynamic

If the results with respect to trade are somewhat ambivalent about the scope and speed of globalization, the impact of capital flows appears clearer. A growing number of countries are actively competing for direct foreign investment (FDI). During the second half of the 1980s, **FDI grew at a rate exceeding both world output and trade in goods and services.** Annual average outflow in the late 1970s was in the order of U.S. $35 billion, increasing by about 20% during the first part of the 1980s, not dramatic growth (see Table 4). But the average annual outflow lept by over 200% during 1985-89, and by a further 65% in 1990 (reaching U.S. $220 billion), before falling off in 1991. During the mid and late 1980s, FDI outflows expanded at three times the rate of world merchandise exports. It was a period particularly rich in mergers and acquisitions.

Moreover, the international pattern became more diffuse and complex, with the U.S. share of outward flows falling by two-thirds, and the share of Japan tripling. With respect to total world FDI stocks, the U.S. share fell significantly, that of Japan

[7] OECD, "Intra-firm Trade Study", TD/TC/WP(92)68/REV1, December 1992.

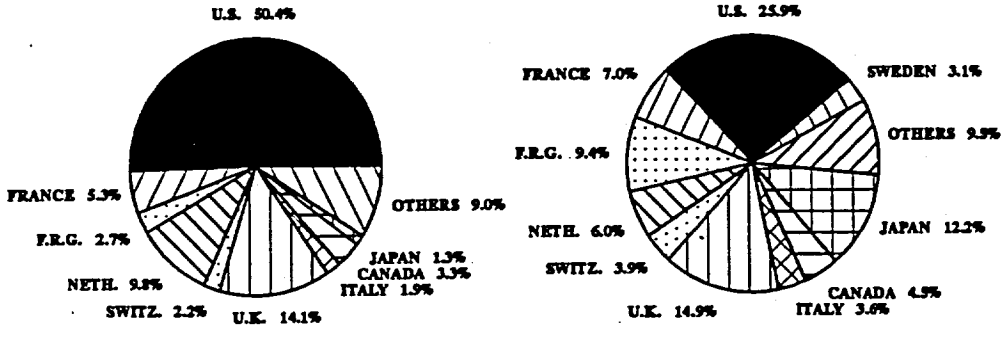
[8] IMF, **Directory of Trade Statistics Yearbook**, various years.

TABLE 4
FOREIGN DIRECT INVESTMENT
(Billions of US$, annual averages)

	1975 - 79	1980 - 84	1985 - 89	1990	1991
TOTAL OUTFLOWS	35.3	42.4	134.9	222.4	177.3
Ind. COUNTRIES	34.7	41.0	128.4	204.5	165.5
of which: U.S.	15.9	9.6	22.8	33.4	24.5
JAPAN	2.1	4.3	23.8	48.0	30.7
E.C.	14.2	20.9	59.4	97.5	80.5
TOTAL INFLOWS	26.9	52.6	117.6	179.6	157.9
Ind. COUNTRIES	19.9	36.2	98.1	148.7	115.2
of which: U.S.	6.1	18.6	48.2	37.2	22.2
JAPAN	0.1	0.3	0.1	1.8	1.4
E.C.	11.4	14.2	38.4	85.9	67.7
Dev. COUNTRIES	7.0	16.4	19.5	30.9	42.7
of which: ASIA	1.9	4.7	10.8	19.9	25.7
Eastern EUROPE	0.0	0.1	0.1	0.5	2.3
LATIN AMERICA	3.6	5.4	5.7	7.8	12.0

SOURCE: Bank for International Settlements, 62nd Annual Report (Basel, June 1992), p.93.

CHART 2
World's Stock of Direct Investment Abroad
Distribution by Major Source Countries



Source: U.S. Department of Commerce

and Germany increased markedly and that of the U.K., Italy and Canada grew more moderately (see Chart 2).

Portfolio capital movements (e.g., stocks, bonds) among industrial countries began to accelerate even sooner than FDI flows. Compared to the late 1970s, the annual average outflow grew by over 200% in the early 1980s, and then by over 300% in the late 1980s. As with FDI, 1990 and 1991 have been more erratic. The EC and Japan have become the dominant players on both the outflow and inflow side of the portfolio ledger (see Table 5). By the late 1980s, the currency denomination of international bond issues had changed considerably, with the share in U.S. dollars declining by more than half to approximately 40%.

TABLE 5
PORTFOLIO CAPITAL MOVEMENTS in INDUSTRIAL COUNTRIES
(Billions of US$, annual averages)

	1975 - 79	1980 - 84	1985 - 89	1990	1991
TOTAL OUTFLOWS	12.4	41.8	176.8	151.6	277.6
of which: U.S.	5.8	5.8	9.5	28.5	46.2
JAPAN	2.6	13.8	89.9	39.7	74.3
E.C.	3.8	18.9	62.6	79.8	144.0
TOTAL INFLOWS	25.0	57.8	186.0	159.1	388.7
of which: U.S.	4.6	16.7	59.2	2.9	52.3
JAPAN	3.0	11.9	23.3	34.7	115.3
E.C.	8.5	17.7	70.4	94.4	173.7

SOURCE: Bank for International Settlements, 62nd Annual Report (Basel, June 1992), p.94.

But again some caution in interpreting these figures is required. With respect to the pattern of FDI stocks, twists and turns typify the extent of internationalization. As can be seen in Chart 3, the U.S. in particular, but also the German and U.K. economies have become the home of a greater share of world FDI. When the stock of foreign investment in G-7 countries is measured as a percentage of gross private non-residential capital stock, however, there were clear increases during the 1980s

only in the U.S. and the U.K. (see Chart 4).[9] Moreover, the proportions still remain remarkably low (less than 5% in the case of the U.S.). Japan, for its part, received a mere U.S. $6 billion of FDI inflow between 1975 and 1991 (see Table 4), well below the growth in its economy. There were few mergers or acquisitions by foreigners in Japan during the late 1980s, unlike the situation in North America and the U.K. in particular. As a result, cumulative FDI represents a minuscule proportion of Japanese non-residential capital stock, never rising above 0.3% (see Chart 4).

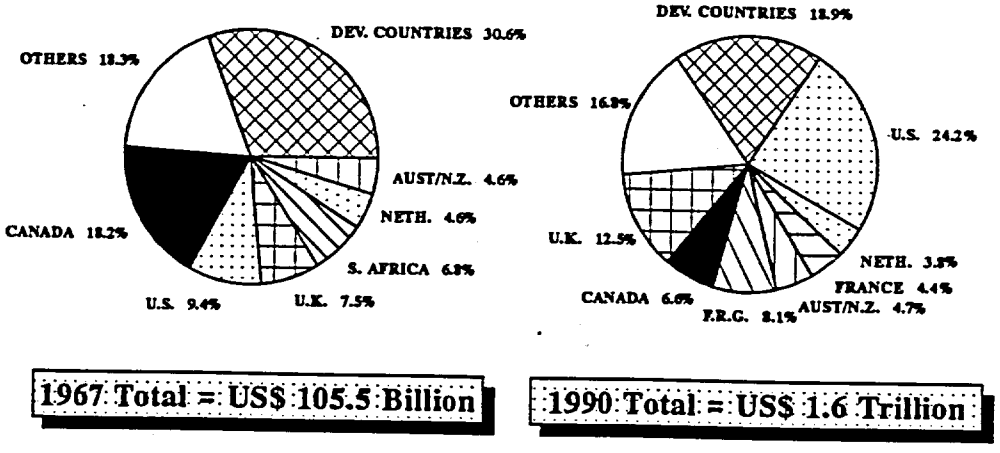
Another way of viewing the investment dynamic is to take FDI stock as a proportion of gross domestic production. Although this approach is not the best (as it compares a stock to a flow), the available data allow us to include a number of newly industrializing economies. The same broad pattern emerges (see Chart 5A). The share of FDI stock increases gradually and most clearly in the U.S., the U.K. and Italy, but only for the U.K. does the increase become clearly significant in terms of overall weighting (i.e., approaching the Canadian level). Chart 5B indicates that the weight of FDI appears to have increased in some developing countries, although not in Malaysia or Korea where domestic expansion apparently has kept pace with increases in foreign investment.

For Canada, we also have respectable time series on **foreign-control** - i.e., data that measure not total FDI stock in the Canadian economy, but the control FDI may or may not imply. Through this prism, **the Canadian economy, despite a significant absolute increase in FDI, has become less internationalized.** Since the early 1970s, foreign control of the corporate assets of non-financial industries declined through 1985, increasing somewhat thereafter primarily as a result of foreign acquisitions in the energy sector (see Chart 6). Seen from the perspective of revenue and profits, however, the trend throughout the period is for lower foreign-controlled shares, suggesting that internationalization with respect to who gets into the profitable boardrooms of Canada is less than it was twenty or even ten years ago (see Chart 7).

[9] A word of caution. There is a notorious lack of comparability of FDI data of different countries. For example, Japan, Germany and France do not include reinvested earnings as FDI, while the U.S., the U.K. and Canada do. With respect to Chart 4, the discrepancy in the case of Japan is statistically meaningless (given low FDI overall). For Germany, the Investment Canada (INVC) estimate likely corrects much of the difference (it reflects fuller internal German data). But the French data still likely underestimate the level of FDI. In summary, the Chart usefully tracks trends within a given country and, if used cautiously, provides insight on a cross-country basis.

CHART 3

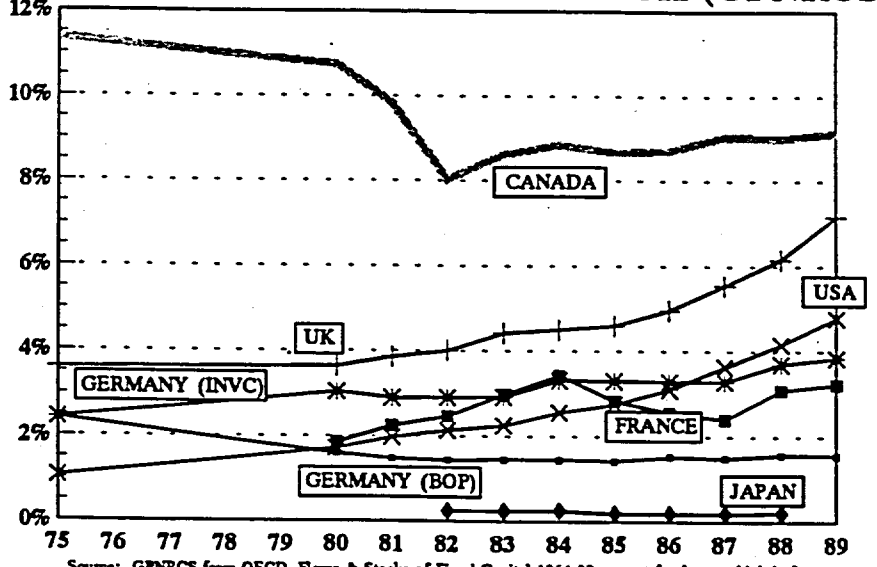
World Stock of Inward Direct Investment Distribution by Major Host Countries



Source: U.S. Department of Commerce

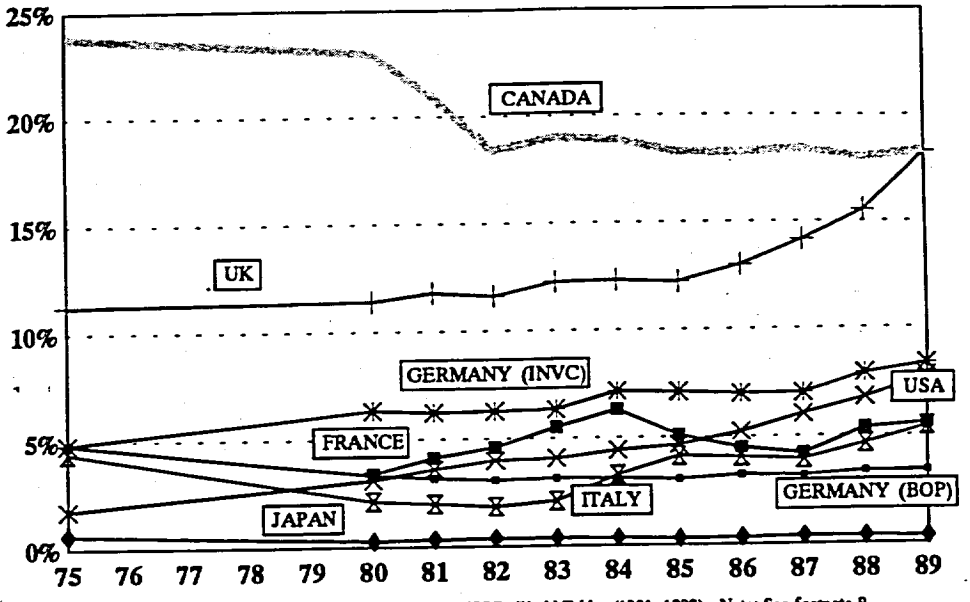
CHART 4

FDI STOCK AS PERCENTAGE OF GROSS PRIVATE NON-RESIDENTIAL CAPITAL STOCK (GPNRCS)



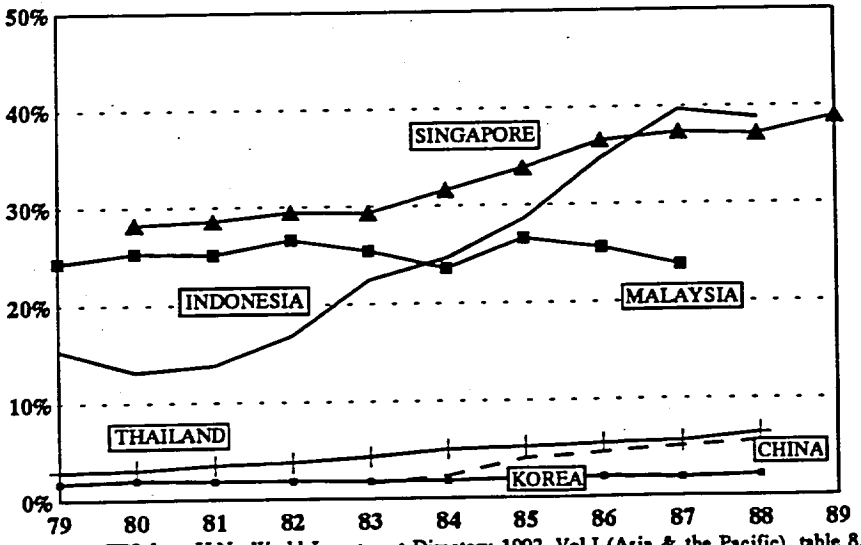
Source: GPNRCS from OECD, Flows & Stocks of Fixed Capital 1964-89, except for Japan which is from domestic sources tabulated by Investment Canada.
FDI from OECD, Economic Outlook, No.50 (Dec. 1991) for 1975; for other years, from IMF, Balance of Payments Statistics Yearbook, various years, except for Germany (INVC) and France, which are based on domestic sources tabulated by Investment Canada (the IMF source has no FDI stock data for France).

CHART 5A
FDI STOCK AS PERCENTAGE OF GDP
G-7 COUNTRIES



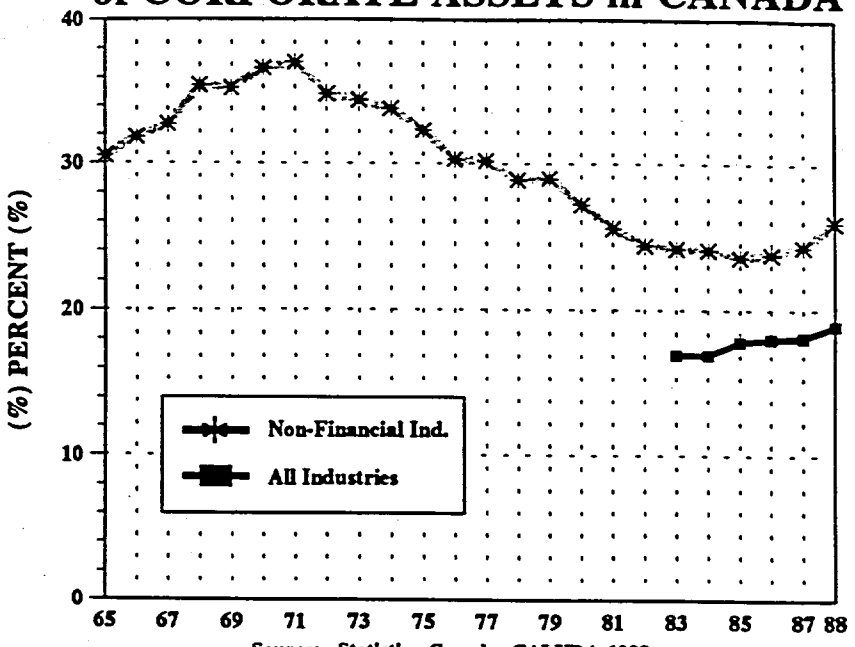
Source: FDI - see Chart 4. GDP from IBRD, World Tables (1991, 1992). Note: See footnote 9.

CHART 5B
FDI STOCK AS PERCENTAGE OF GDP
(SELECTED ASIA)



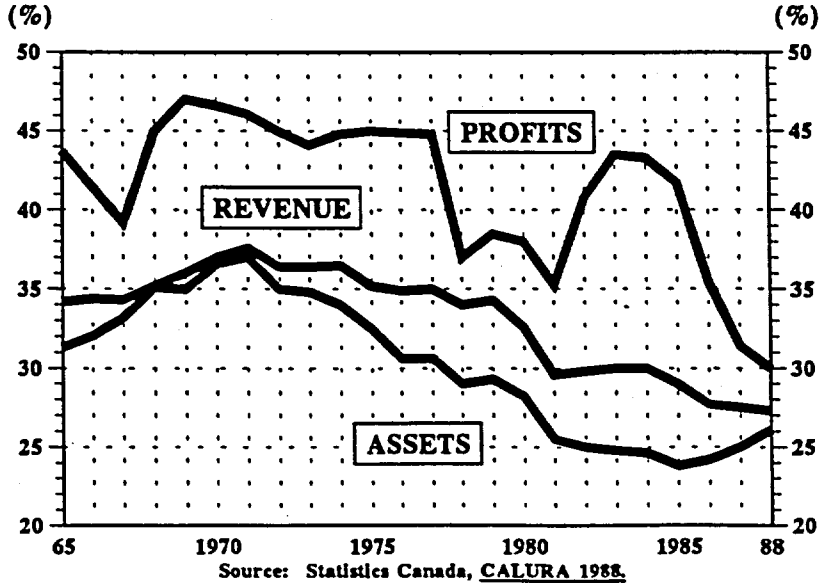
Source: FDI from U.N., World Investment Directory 1992, Vol.I (Asia & the Pacific), table 8.
GDP from IBRD, World Tables (1991).
Note: See footnote 9.

CHART 6
FOREIGN CONTROL of CORPORATE ASSETS in CANADA



Source: Statistics Canada, CALURA 1988.

CHART 7
Foreign-Controlled Shares of Assets, Revenue & Profits Non-Financial Industries 1965 - 1988



Source: Statistics Canada, CALURA 1988.

- The "Global" Firm

The internationalization of production reflected in trade and capital flows outgrowing world output has influenced and is influenced by firm strategies. Since the 1970s, technological innovation has also had an increasing impact on market trends in a number of areas.

During the past 15-20 years, **products in several key industrial areas have been adapting to shorter life cycles, greater product diversity, more emphasis on niche marketing or market segmentation, and greater emphasis on product quality.**[10] For example, in the auto industry the standard model life cycle has shortened considerably from ten to four years or less, while the number of distinct models available to the consumer increased. Perhaps the most cited example is found in the semiconductor industry where certain integrated circuits (DRAMs) have had an astounding four year product cycle coupled with a quadrupling of the amount of information that each new generation can store.[11]

The **international network of alliances within the private sector has increased** strongly to meet changing circumstances: the growing cost of research and development, locational pressures from trading partners, the need for more effective responses to local consumer preferences and higher expectations for after sales service, and the need for some protection against exchange rate fluctuations. Alliances, including among rivals, take the form of joint ventures, subcontracting, licensing, and R&D agreements - creating complex networks of information on research, production and marketing.

While most firms in all countries have not participated actively in this alliance building, industry leaders clearly have. The number of R&D alliances (mostly among U.S., EC and Japanese companies) grew from about 200 in 1980 to over 4000 in 1990. Technology sharing is now a feature of about half of all agreements among transnational enterprises (compared to 10% in 1980), with joint R&D included in

[10] K.J. Blois, "Trends in Marketing and Their Implication for Manufacturing", International Journal of Technology Management, Special Issue on Manufacturing Strategy, Vol. 6, Nos. 3/4 (1991), 385-94; J.D. Goldhar, M. Jelinek and T.W. Schlie, "Flexibility and Competitive Advantage - Manufacturing Becomes a Service Business", International Journal of Technology Management, Special Issue on Manufacturing Strategy, Vol. 6, Nos. 3/4 (1991), 243-59. The capability to produce variety for niche markets defines "economies of scope" which are becoming as important as economies of scale.

[11] OECD, Globalisation of Industrial Activities, pp. 46-7, 136.

about 20% compared to almost no such arrangements ten years ago.[12] In the motor vehicle sector, the Big 3 in North America formed a consortium for joint research on automotive applications for plastic components. European automakers are collaborating on developing electronics systems (the Promethus Project), and (in conjunction with chemical and other companies) on new materials, focussing on plastic composites, ceramics and reinforced metals (the Carmat Project). With respect to semiconductors, in the 1980s three Japanese firms joined in a group to develop micro processors and new designs, while major European companies pooled R&D efforts to try to catch U.S. and Japanese industry leaders.[13]

Moreover, there is a mushrooming literature on "global management", with the emphasis on the increasing importance of a flexible process capable of integrating assets, resources and diverse human skills across international operations, standardizing where feasible while remaining sensitive and responsive to local markets.[14] Product division mangers are located where the strengths of an internationalized firm's operating companies are found and developed. For example, with respect to its power-transmission business, the Swiss-headquartered electrical engineering corporation Asea Brown Boveri has its manager for switchgear in Sweden, the manager for power transformers in Germany, the manager for distribution transformers in Norway, and the manager for electric metering in the U.S.[15]

Yet again, some caveats are useful. With respect to research and development, a detailed review of almost 700 of the world's largest and most technologically active firms (prime candidates for "global" status) reveals that they perform more than 90% of their basic research at home.[16] Much of the R&D that <u>is</u> pooled is done among firms within the home country (e.g., the Big 3 consortium on plastics) or, and this is where much of the increase in "globalization" has occurred, among western European

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[12] OECD, "The Interrelationship Between Trade and Technology Policies", TD/TC/WP(92)22, March 1992. Different (lower) numbers and percentages, but the <u>same</u> trends, can be found in OECD, DAFFE/CLP(92)12, October 1992, pp. 8-10.

[13] OECD, Globalisation of Industrial Activities, pp. 48, 51, 73, 140, 154.

[14] For a recent article that captures the enthusiasm for this phenomenum rather well, see Christopher A. Bartlett and Sumantra Ghosal, "What is a Global Manager?", in Harvard Business Review (September - October 1992), pp. 124-32.

[15] <u>Ibid</u>., p. 127.

[16] Pari Patel and Keith Pavitt, "Large Firms in the Production of the World's Technology: An Important Case of Non-Globalization", Journal of International Business Studies, Vol. 22, No. 1 (First Quarter 1991), 3, 6-7, 10, 14, 16-7.

firms in Europe. Again, the issue of regionalization (in this case, the emergence of more truly integrated European firms) is pertinent both to R&D and, more broadly, for overall firm management.[17] A recent review of the impact of globalization on local and regional competitiveness in a number of OECD countries indicates that globalization, including its foreign direct investment component, tends to reinforce regional specialization and the geographic clustering of production, especially with respect to craft industries, high technology sectors attracted by established sites of science and technology excellence, and certain service industries.[18]

The available information on intra-firm trade also does not sustain the view that "stateless" or truly global firms are rapidly emerging. According to 1989 data on the U.S. market, in almost all instances parent firms export more to off-shore affiliates than the reverse, by ratios ranging between two and five to one (U.S. parents to affiliates abroad; foreign parents to affiliates in the U.S.). The ratio for Japanese manufacturers with affiliates elsewhere in the world is three to one.[19] This pattern is consistent with Canadian experience related to trade and investment in the automotive sector with Japan.

Industry leaders in manufacturing and services are actively networking on a global basis. In a number of instances (as a result of the dynamics of a common market and much greater integration to come), more truly European firms (in terms of control as well as operational management) are emerging. **Yet U.S. and Japanese firms, while even more globally based operationally, have not become demonstrably more "stateless", while "European" firms will likely remain heavily influenced by the industrial policies of several national governments and the EC Commission. Trade flows and R&D, to highlight the two factors outlined above, remain primarily focussed on the health and welfare of home base.**[20]

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[17] Specific examples of more truly integrated European operations can be found in Bartlett and Ghoshal, "Global Manager?" - see their references to Electrolux and Procter & Gamble's European operations; other examples can be found in OECD, **Globalisation of Industrial Activities**, pp. 33 (autos), 137 (semiconductors). The European Commission financially encourages trans-national European R&D cooperation by the private sector through its "Framework Programmes for Community Research and Technological Development".

[18] OECD, "Globalisation and Local and Regional Competitiveness", DSTI/IND/WP6 (92)8/REV1, July 1992.

[19] OECD, "Intra-Firm Trade", paragraphs 34-5.

[20] In this regard, the work of Michael Porter on the importance of encouraging in-Canada "home-bases" for transnational corporations seems to me more relevant than Robert Reich's theory of the "stateless" firm.

2. Impacts

Although sceptical about the extent of the globalization of economic processes and the "emergence" of global (or "stateless") firms, the above review does clearly point to the increasing fragility of borders faced with the movement of goods, services and capital that has been increasing considerably more rapidly than global production. Firm behaviour in more countries has rapidly become more outward looking, in areas as diverse as mergers and acquisitions abroad, or R&D. Greater telecommunications and transportation efficiencies are reinforcing the presence of a broader, more immediate world outside national boundaries. Product life cycles have shortened in key areas. Consumer demands for quality, customized products and after sales service are increasing and often override local product loyalty.

Whether globalizing or regionalizing, the above trends have significantly reduced the viability of national polices based primarily on the domestic market. Government policy, consequently, has had to become increasingly sensitive to external factors. Comparative advantage is created, more so today then ever before, by the domestic policy framework that best works with, rather than against global factors, while attempting to mold the process in ways sensitive to national interests. The rapidly expanding international trade policy agenda (itself something of an accelerating growth industry) should become even more intrusive with regard to domestic policy through the foreseeable future.

III. Canadian Competitiveness

Increasing economic internationalization puts a premium on improving Canadian competitiveness, particularly when persistent fiscal deficits work to preserve high interest rates in real terms which in turn delay or deflect full adjustment through sufficient changes in the exchange rate. Improved productivity performance can help to address this dilemma, as well as underpinning the development of new, highly innovative products that are less sensitive to price cutting through the operation of the exchange rate. Regrettably, our productivity record is not good. Growth in Canada's productivity (defined as output per employed person) has been the weakest among the major industrial countries, apart from the U.S. With respect to the manufacturing sector, Canadian productivity growth has been the least dynamic of all the G-7. Total factor productivity (TFP) growth - i.e., output growth unexplained by additional labour and capital inputs - has declined from an average annual rate of 2.0% over the 1960-73 period, to 0.8% in 1973-79 and to almost no growth during 1979-1990. Other G-7 countries also experienced a considerable slowdown in TFP growth in the 1970s as the extraordinarily favourable circumstances of the post-War

period ended. In contrast to stagnation in Canadian TFP growth in the 1980s, however, all other G-7 countries experienced positive growth over the past decade (see Table 6).[21] Only part of our weaker performance can be explained by the greater impact of the oil shocks of the 1970s on the Canadian economy, the result of the greater intensity of industrial energy use in Canada and our slower adjustment to the reality of higher energy prices.

TABLE 6

Productivity Growth[1]

(Percentage Changes at Annual Rates)

COUNTRY	1960 - 73	1973 - 79	1979 - 90
Canada	2.0	0.8	0.0
United States	1.6	-0.4	0.2
Japan	5.8	1.4	2.0
Germany	2.6	1.8	0.8
France	4.0	1.7	1.8
Italy	4.4	2.1	1.4
United Kingdom	2.3	0.6	1.6
Total OECD	2.8	0.5	0.8

1. Business sector.

Source: OECD, ECONOMIC SURVEYS - CANADA, 1992, p.56.

Our poor productivity performance has been undermining our ability to sustain economic growth in, and the social well-being of Canada. The government has reacted by addressing the competitiveness dilemma in a comprehensive manner. Progress has been made in restoring macroeconomic balance through reducing budget deficits as a proportion of GDP (although recession-induced revenue shortfalls have

[21] Organization for Economic Co-operation and Development, **OECD Economic Surveys - Canada** (Paris: OECD, 1992), pp.52-9. See also the discussion, which does not modify the overall conclusion of a comparatively weak Canadian performance, outlined in David Slater, et al., "The Contribution of Investment and Savings to Productivity and Economic Growth in Canada" Investment Canada Working paper No.10 (March 1992), pp.21-6, 97-8, 107-09.

undermined progress on this front), and by lowering inflation to a level unseen in a generation. Moreover, the government has implemented several critical structural reforms: a modern Competition Act (1986), deregulation in the transportation and energy sectors, the liberalization of the foreign investment regime, the privatization of numerous state enterprises, comprehensive tax reform, changes to the unemployment insurance system to shift additional funding to labour force skills development, and improved market access through the FTA and the NAFTA. There are now tentative signs that these adjustments are beginning to create real gains. Not only is Canada's inflation rate now the lowest among the G-7 countries, but productivity (measured as national output per worker) perhaps began to rebound in 1992.[22] Moreover, those sectors liberalized through the FTA have witnessed an overall increase in exports to the U.S. that has outpaced imports in the same sectors, a trend that is particularly strong with regard to non resource-based products.[23] Nonetheless, sustained effort over an extended period of time will be required to recuperate lost ground in the productivity race.

The lowering of the real cost of capital through effective monetary and fiscal policies, the promotion of strong domestic rivalry among firms, the removal of inter-provincial barriers to trade, and further regulatory reform to encourage efficient domestic markets will all strengthen Canada's competitiveness. For its part, outward-looking, innovative trade policy also has a major role to play in this process of recovery. Improved market access abroad will encourage the growth of Canadian exports of goods and services. Clearer, more comprehensive trade rules enshrined in international treaty obligations will provide greater security of access to markets abroad by limiting the capacity of our trading partners to implement unilateral restrictions against our goods, services, and investment. Continuing the post-War opening of Canada's domestic market will encourage needed structural adjustment at home, within the context of clearly defined transitional rules to ease the process of adjustment where required. More secure markets abroad and the incorporation in trade treaties of non-discriminatory rules related, inter alia, to investment and intellectual property can help to reaffirm Canada as a preferred investment site for domestic and foreign capital. And innovative, flexible trade policy can accommodate legitimate concerns related to environmental protection. Trade policy is, therefore, a critical component in the struggle to recuperate Canada's competitive edge.

[22] "Canada's Current Economic and Fiscal Situation", Department of Finance, October 1992.

[23] Daniel Schwanen, "Were the Optimists Wrong on Free Trade? A Canadian Perspective", C.D. Howe Institute Commentary No. 37 (October 1992), pp. 5-9.

IV. Out With the Old?

(i) Background:

Do tariffs and other "traditional" border measures still matter? Put more broadly, is a "new" trade policy focussing on the domestic instruments required to encourage investment supplanting an "old" trade policy emphasizing the tools of border protection? As outlined elsewhere in this paper, much has changed. Tariffs are certainly lower. Successive rounds of GATT negotiations have reduced the average level of import duties in industrialized countries from about 40% in the late 1940s to approximately 5% today. Consequently, the trade and investment distortions implicit in the use of a high tariff as an industrial policy tool have declined. Moreover, the trade policy agenda has clearly become more complex and reaches more comprehensively into domestic economic policy and practice than 45 or even 5 years ago.

Yet, to suggest that there has been a sudden break between the "old" and the "new", although it might make good copy, rather misses the mark.

First, border issues continue to have a major impact on domestic policy choices. They are likely to remain central to Canada's trade policy agenda for some time to come. In a sense, the focus on border protection has even expanded, given the increasing attention placed on liberalizing cross-border trade in services: here the language appears new, but the access issues (QRs, prohibitions, licensing requirements) are often familiar. Moreover, even at current rates, the tariff is in many instances a more effective barrier than it has been in over 20 years. Although exchange rate fluctuations comprise a more important factor in many instances, the combination of low inflation and lower economic growth means that even a relatively modest import duty can count more than before in the balance books of a company scrambling to address tight profit margins. The result is a bit like a 400 metre hurdle race in which the height of the hurdles remains the same, but the track has become more hazardous because of rain.

Second, non-border measures have long been an important part of international trade law and practice, certainly since the establishment of the GATT. There has been no break as such, but rather more a steady expansion of the number of issues for which explicit disciplines are being sought as a result of greatly increased international investment and trade flows and the growing importance and internationalization of technological innovation. Overall, there are strong currents of both continuity and change in the challenges facing trade policy.

A brief description of several issues that demonstrate the degree of continuity follows:

- In an increasingly competitive, globalizing economy, even relatively small import duties can affect corporate profits and influence investment decisions in a low inflation, low growth environment (e.g., the concern generated by the U.S. Customs finding that Honda Canada's Civics do not qualify for the FTA exemption from the U.S.'s 2.5% duty on cars).[24]

- Developing countries will provide much of the impetus for continuing growth in world trade (world exports to these countries increased by 72% between 1985-90, compared to 89% to developed countries; but exports to south-east Asia and, more recently, to several Latin American economies are considerably more robust). Import duties of many developing countries remain comparatively high, and largely unbound by international obligations restricting unilateral increases.

- The import duties of industrialized economies on resource-based manufactures of importance to Canada, and for textile and clothing products, remain comparatively high: in Japan, such duties currently range up to 35% (for certain agricultural products), and rates in the 10%-15% range are common. Duties in export markets that rise with the level of processing (tariff escalation) create quite high effective rates of protection that impede resource processing in Canada.

- Differential tariffs exist and discriminate against Canadian goods: e.g., dressed spruce-pine-fir lumber (an important Canadian export) faces an unbound 8% Japanese import duty, while a another fir item sourced largely in the U.S. and tropical lumber from LDCs enjoy duty-free treatment into Japan.

- The tariffication of import quotas in the agricultural sector will lead to import duties that will range up to 300%-350% if the MTN concludes successfully. Financial support policies will continue to distort significantly agricultural markets, even if some helpful reform is achieved through the MTN process.

[24] Canada, of course, promptly and correctly challenged this incorrect U.S. interpretation of the relevant FTA rule of origin.

- The use of import quotas to limit access to Canada for dairy products, poultry and eggs is the linch-pin sustaining our domestic supply management regime. Pressures for reform from competitors abroad and food processors and consumers at home will continue to ensure that this area of trade policy will continue to require careful attention into the foreseeable future.

- Even in a free trade agreement eliminating import duties, the tariff remains a central concern: negotiators dedicate considerable attention to developing rules of origin that are clear (of particular importance to the smaller trading partners), and that protect margins of tariff preference against non-parties to the agreement. Whether or not products originating in the free trade area have undergone the substantial transformation required to benefit from tariff preferences becomes a major element in the on-going management of a free trade agreement. A company that fails to meet the substantial transformation test faces not only the added expense of paying the import duty, but also risks damaging its "local" image in the regional market-place with negative consequences for its sales. Both these issues underlay Honda Canada's concern about the U.S. Customs audit of its production of Civics in North America.

- The GATT has dealt not only with tariffs and quantitative restrictions, but also myriad domestic measures that discriminate against imported goods after they have cleared Customs, including taxation policy and sourcing requirements related to foreign investment. GATT jurisprudence has focussed heavily on such domestic measures, beginning in 1949 with Brazilian internal taxes and Australia's subsidization of ammonium sulphate production, through the distribution and pricing policies of Canada's provincial liquor boards since the 1980s.

- The GATT exception for government procurement is gradually coming under greater discipline, but much remains to be done. For example, even after entry into force of the NAFTA, which registers important new gains in a regional context, the U.S. will still deny competitive access to Canadian suppliers for over 90% of U.S. government procurement at all levels (the "residual" is worth an estimated US $760 billion annually).

- Governments address issues related to domestic subsidy and dumping practices by using duties at the border to provide relief against injurious imports. These regimes when combined with a broader variety of other

border measures covering a wider range of sectors, including so-called voluntary export restraints and orderly marketing arrangements, currently affect 18% of world imports.[25] These measures will be with us for some time to come. The draft MTN text on safeguards may help to limit the use of such grey area measures as VERs and OMAs, while the text on subsidies and countervailing duties represents an important step forward in the process of more clearly defining the relevant rules, thus limiting the potential for unilateral actions by Canada's trading partners. Nonetheless, the current texts do not complete Canada's agenda. With respect to countervail, for example, concepts such as "net subsidies", as well as a tighter definition of "industry", including regional industries, require further effort in future negotiations in order to secure Canadian exports more completely from harassment in major markets, particularly the U.S.

(ii) Trade Policy Responses:

The above issues and practices are not new and will continue to require considerable dedication of resources to ensure their successful management in a manner consistent with Canada's trade and economic development interests. Tariffs and quantitative restrictions still impede access for Canadian exports. Further consideration will have to be given to reducing unilaterally Canadian import duties on essential inputs facing lower duties when imported into the U.S. by competitors, especially in light of the FTA and NAFTA obligation applicable to almost all products to phase-out duty drawbacks (i.e., the refund of import duties on inputs when the final product is exported). Rules of origin will require careful management. More work is required to liberalize cross-border trade in services. There remains much more to do on the procurement front. And trade remedy reform is still needed (in this regard, the discussion below on competition policy is relevant).

V. The New Agenda

The management of traditional trade policy concerns will remain critical to ensuring continuing economic prosperity in Canada. Yet globalization has pushed new issues forward (e.g., environmental practices), and dragged others more firmly toward centre stage (e.g., treatment of foreign investment, competition policy, research and development). We will deal with each of these issues in turn.

[25] OECD, **Progress in Structural Reform: An Overview** (Paris, 1992), pp.37-41.

1. Investment

(i) Background:

Investment policy cuts both ways. Canada needs to promote further domestic and foreign investment in Canada, while at the same time remaining open to the important benefits that flow from Canadian investments abroad.

Canada's overall effort to induce quality investment will have to increase significantly to meet a number of needs: incremental investment in machinery and equipment to capture accelerating technological advances and lower growth in labour supply, particularly skilled labour; additional capital expenditures to meet more stringent environmental standards; overdue public infrastructure renewal; and the infrastructural needs of an aging society. Moreover, Canada's geographic size, climate, limited population, and the capital-intensive nature of an economy still heavily defined by large resource-based industries indicate an on-going need for a greater investment effort than in most other industrialized countries.

Gross capital formation in Canada has not exceeded 24% of GDP since 1966-70. During the 1970s, it fell to 23.5%, declining further to just over 22% in the 1980s. With the domestic savings rate also declining from over 23% in the late 1960s to 21% twenty years later, foreign capital inflow has made an important incremental contribution to domestic capital formation (see Table 7). The contribution would appear even more important if we included re-invested earnings in Canada by foreign firms (80% of current foreign investment stock) as direct foreign investment inflow, rather than counting this funding as domestic savings.

On the basis of reasonable assumptions about labour productivity growth and the historical trend in the capital output ratio, one recent study has suggested that Canada's future gross investment requirements may be in the range of 26%-27% of GDP. Even higher levels could be required to meet incremental infrastructural and environment-related improvements.[26] Such an effort would push gross investment in Canada toward the record OECD performer in the 1980s: Japan (at 31% of GDP).

Whether or not we accept these specific projections, the need for a significant investment effort in Canada is apparent. It is not at all clear that this incremental effort can be met by significantly higher domestic savings in light of government dissaving caused by somewhat improved, but still persistent budget deficits. In this regard, many observers have suggested that the hunt for investment abroad in the

[26] Slater, "The Contribution of Investment", pp.59-74.

TABLE 7
Canadian Investment and Savings Rates
(1951 - 90)

	Ratio to GDP (in current dollars)		
	Gross fixed capital formation	Net capital inflow	Implicit savings rate
1951-55	.2158	.0142	.2016
1956-60	.2420	.0352	.2068
1961-65	.2240	.0169	.2071
1966-70	.2403	.0064	.2339
1971-75	.2328	.0089	.2239
1976-80	.2365	.0198	.2167
1981-85	.2169	.0020	.2149
1986-90	.2275*	.0175*	.2100*

* Estimate by David Slater, based on Statistics Canada's National Accounts, Income and Expenditure forecasts for 1990.

Source: M.C. Urquhart, Canadian Economic Growth, 1870-1980, Discussion Paper 734 (Kingston: Queen's University, 1988), as reproduced in David Slater, "The Contribution of Investment", p.27.

1990s is becoming tougher. The Japanese economy, which generated significant investment outflows in the 1980s, has moved into a more troubled period, while the adjustment costs of German reunification have exceeded original overly optimistic projections. Eastern Europe and Russia as well as major Latin American economies rebounding from the "lost decade" of the 1980s represent incremental competitors for investment funds. The U.S. also faces major economic restructuring and rebuilding if it is to regain more of its competitive edge. Other analysts suggest that incremental global needs (i.e., superior to current flows) through the mid 1990s may be relatively modest. They make a distinction between capital needs in principle, and the likely demand for capital in practice given a number of factors, including economic instability in the former Soviet Union and the dampening effect of possibly higher real interest rates within OECD countries.[27] However this debate works out in practice, at the global level the case for incremental quality investment in Canada remains strong. This requires cultivating a domestic environment that encourages saving, and attracts foreign investment (both new inflows and retained earnings).

[27] F. Desmond McCarthy, "Is There a Capital Shortage?", (World Bank, October 1992).

For its part, Canadian outward direct investment grew faster during the 1980s than foreign direct investment in Canada (with stock increasing from $16 billion in 1978 to $85 billion in 1990, compared to $50 billion and $125 billion respectively). Canadian investment abroad can make a positive contribution to Canada's economic development prospects. International networking through licensing arrangements, joint ventures and strategic alliances with firms abroad lessens the risk and cost of increasingly expensive R&D in the high tech sectors. Such networking also provides an effective framework for local sales, marketing and after-sales servicing in foreign markets. The establishment of Canadian financial institutions abroad can facilitate finding solutions to the marketing challenges faced by Canadian exporters.

Moreover, trade often follows direct investment abroad in a major way. On the basis of data available for the U.S. market covering trade between parent companies and their affiliates (one of which is based in the U.S.), trade in almost all instances is strongly composed of parents' sales to their affiliates rather than the reverse. For example, in 1989 European firms sold almost four times as much to their affiliates in the U.S. than vice-versa. U.S. firms sold twice as much to their European affiliates than the reverse. The ratio for Japanese firms vis-à-vis the U.S. market was almost four to one. Although the ratio for U.S. firms with Canadian affiliates was one to one, it was a highly favourable five to one for Canadian firms with U.S. affiliates (a relationship of considerable importance, given that more than 70% of Canada's direct investment abroad is in the U.S.).[28]

(ii) Trade Policy Responses:

Investors, domestic and foreign, base their location decisions on a range of factors, several not directly related even to the more over-arching trade policy agenda of the late twentieth century: taxation levels, infrastructure, proximity to markets and inputs, cost of capital, price and currency stability, skills and stability of the labour force, and government regulations affecting all aspects of business operations from labour and environmental policies to internal barriers to trade and antitrust practices. The creation of an environment considered attractive to foreign and domestic investors in the 1990s will require the close collaboration of all levels of government in Canada and a clear understanding of how these policy instruments interact.

[28] OECD, "Intra-Firm Trade", paragraphs 33-5. Further work, hopefully expanding coverage to include more countries, is underway in the OECD.

The recent report of the independent Steering Group on Prosperity focussed in particular on the urgent need to ensure that our educational and training programmes and culture more adequately reflect the needs of our market place.[29] Both the provinces and the private sector must take a hard look at this area. Inter-provincial trade barriers constrain growth prospects. Regulatory shifts related to labour or environmental standards that are perceived as radical (rightly or wrongly) when compared with approaches taken in other, competing jurisdictions will undermine investor confidence, as will provincial fiscal practices that are out-of-step with a low inflation environment and a relatively stable exchange rate. Ontario has been the stated destination of 54% (by value) of intended greenfield investments and acquisitions subject to the Investment Canada Act since 1985 (far outstripping the second most popular destination: Quebec at 17%). Foreign-controlled firms also generated 54% of their 1988 revenue (the latest year available) in Ontario (and about 16% in Quebec).[30] Consequently, Ontario has a particularly high profile and central role in underpinning the view of Canada as a whole as an attractive site for doing business.

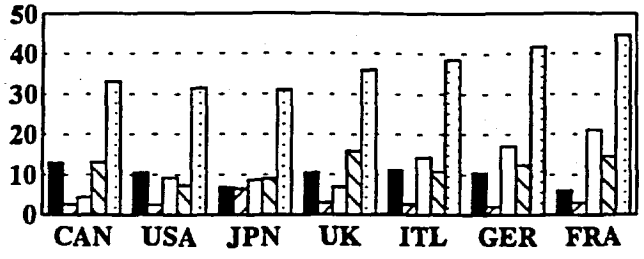
Canada's overall tax burden, including corporate taxes, as a proportion of national output is generally similar to that of other G-7 countries, but care must be taken to ensure that misalignments do not occur (see Table 8). In this regard, the higher burden of personal income and consumption taxes in Canada compared to the U.S. could become an issue if it encourages high skill labour to migrate in the future. Moreover, the Canadian investment environment has been hurt by the relatively high cost of raising money since the late 1970s, especially when compared with Japan and Germany where the average cost of capital after taxes and inflation has been approximately half that in Canada.[31] The stunning fall in our inflation rate, if not upset by fiscal laxness by the federal and major provincial governments, should help to improve this record. There is also considerable merit in further review of Canada's tax system (at all levels of government) to ensure greater fiscal coherence, and to identify those areas (perhaps, for example, capital gains tax rates, capital cost

[29] Steering Group on Prosperity, "Inventing Our Future: An Action Plan for Canada's Prosperity", (Ottawa, October 1992).

[30] Investment Canada, "Foreign Investment in Canada: Measurement and Definitions", Working Paper No.12 (August 1992), p.19; Statistics Canada, "CALURA 1988", p. 69.

[31] Investment Canada, "International Investment and Competitiveness", Working Paper No.9 (January 1992), pp.55-7; Canada Consulting Group, "Under-funding the Future" (October 1992); Richard G. Lipsey, Economic Growth: Science and Technology and Institutional Change in a Global Economy, Canadian Institute for Advanced Research Publication No. 4 (Toronto, June 1991), pp. 127, 169-70.

TABLE 8
INTERNATIONAL COMPARISON OF TAX BURDEN
AS A PROPORTION OF GROSS NATIONAL PRODUCT
1989



	CAN	USA	JPN	UK	ITL	GER	FRA
PERSONAL	12.9	10.5	6.9	10.4	11.1	10.4	6.1
CORPORATE	2.6	2.5	6.5	2.9	2.6	2	3
SOCIAL SECURITY	4.3	9.2	8.6	6.8	14.2	17	21.1
INDIRECT	13	7.3	8.9	15.8	10.7	12.3	14.4
TOTAL TAX	33	31.4	30.9	36	38.5	41.7	44.6

PERSONAL CORPORATE SOCIAL SECURITY
INDIRECT TOTAL TAX

SOURCE: Department of Finance, Quarterly Economic Review June 1990

allowance depreciation rates, interest deductibility, etc.) where we might be out-of-step internationally, especially if it can be determined that such differences do influence investment location decisions.

Trade policy also has a major role to play. Domestic changes since 1985 have streamlined the foreign investment review process and removed restrictions in areas such as the oil and gas sector. International agreements contribute to a good investment climate by ensuring that Canada is part of the process of liberalizing barriers in export markets, while establishing clearer and more precise trade rules on issues as diverse as rules of origin and intellectual property rights.

Trade agreements have also formalized and extended broad non-discriminatory investment obligations in order to increase investor security. The FTA, the MTN and the NAFTA all build on domestic practice to ensure that Canada is perceived as an excellent site in which to invest. In this regard, the FTA and NAFTA exempt from review by Investment Canada all acquisitions of Canadian businesses by firms based in North America if the value of the acquisition is under a certain threshold (an indexed C$150 million will be the standard). The extension of this threshold benefit to

investors based outside North America seems logical and consistent with the practice of other OECD members. Any merger or acquisition would still remain subject to review under the terms of the Competition Act.

However, it is useful to recall here the propensity of foreign investors in manufacturing to engage in intra-firm trade favourable to the parent country[32], as well as the major role that large firms can play in stimulating research and development and Canada's poor R&D record. In this light, it would be prudent to retain the current threshold, thereby permitting the review of major acquisitions for net benefit to Canada, as well as the ability to link government funding to R&D performance requirements. Canada should retain some modest, judiciously managed regulatory leverage.

By being a party to trade agreements, Canada ensures that investors here enjoy at least the same access and security of access to key markets and the same ground rules encouraging research and development as our major competitors. These are important gains that should be preserved and extended through the implementation of NAFTA and the establishment of improved multilateral rules, preferably through the successful conclusion of the MTN. Moreover, the acceptance of these obligations by other countries provides greater security abroad for Canadian investors seeking to undertake R&D, marketing and other alliances, while exporting heavily to overseas affiliates. In this regard, the trade policy agenda for the rest of the decade will also have to address positively the adherence of other, particularly non-OECD countries to international norms. Accessions to the NAFTA and the negotiation of further bilateral Foreign Investment Protection Agreements (FIPAs) represent two useful approaches.

As we move further into the 1990s, trade policy will be called upon to address other issues that will have an impact on Canadian competitiveness and our investment climate. For example, the economic inefficiencies created by continuing restrictions in the transportation sector must be addressed, including the U.S.'s highly distorting maritime shipping practices and the lack of adequate competition in domestic routes for all modes of transportation (i.e., cabotage restrictions). The competitiveness of Canada's domestic telecommunications structure and tariffs requires a close look and has a clear impact on Canada's attractiveness as an investment site. The interface with investment also underlies much of the detailed discussion related to the next three topics of this paper: competition, innovation and environmental policies. Each will figure more prominently in the 1990s. Each can help or hinder investment and growth prospects in Canada depending on the success we have in identifying the relevant connections and developing a set of mutually reinforcing responses.

[32] With Big Three auto trade being a major exception.

2. Competition Policy

(i) Background:

Competition is at the heart of market-based economics. It defines the process whereby sellers independently seek buyers of their goods, services or knowledge in terms of price, quality, originality, timeliness of delivery, after-sales service, and other factors. Competition forces sellers to remain or become efficient and innovative. On the other hand, sellers also acquire and/or seek discretionary market power that can distort market signals, decrease economic efficiency and lower overall consumer welfare. Competition policy, in turn, seeks to maintain the competitive process in order to prevent or minimize abuses of economic power and to achieve economic efficiency, although a number of supplementary objectives are also occasionally invoked (e.g., regional development, employment, control of inflation). At this level of generality, competition policy appears so sweeping in scope that some urge that it be viewed as a "fourth cornerstone" of government economic framework policies along with monetary, fiscal and trade policies.[33]

Without pursuing that debate, there clearly is much in common between competition and trade policies. Both put considerable emphasis on key principles such as non-discrimination (national treatment and most-favoured-nation) and transparency in rules, procedures and action. Both are firmly embedded in market economics and seek to promote economic efficiency and growth. There is growing recognition that these two dimensions of public policy can and should be mutually reinforcing, and that each has lessons for the other. Trade liberalization has expanded the geographic scope of anti-trust investigations. Competition policy may be able to address more effectively the pricing and other production and marketing practices of firms than is possible under current trade rules. But a static application of competition policy could also undermine the export and R&D efficiency gains possible through greater inter-firm cooperation or even international mergers important for a small economy facing increasingly sharp competition at home and abroad.

Two key crosswalks between these increasingly inter-related policies are explored more fully below:

- whether competition policy should or can usefully replace the various trade policy tools collectively referred to as contingency protection (anti-dumping and countervailing duties, and emergency safeguards); and

[33] S. Khemani, "Objectives of Competition Policy", OECD document DAFFE/CLP(92)2, (May 11, 1992), p.15.

- whether Canada should seek greater international convergence or harmonization in competition policy regimes, including the possible impact of narrowly cast competition policy on inter-firm alliances in support of exports and innovation.

The tension between exclusivity, competition and innovation, with reference to the special case of intellectual property rights, will be considered in the subsequent section on Trade and Technology Policy.

(ii) Trade Policy Responses:

Contingency Protection: Toward a Replacement Regime?

As citizens of a smaller, more heavily trade-dependent country, Canadian policy makers have increasingly come to see contingency protection as comprising an arsenal more effectively wielded by larger, less trade dependent countries than by Canada. Although technically neutral on paper, the leverage of economic power (including the power to do considerable damage) rests with the more naturally self-contained, self-sufficient economy. This imbalance undermines Canada's efforts to export and to attract investment. The trade mechanisms in question are meant to address (i) the injury caused by the "unfair" trade practices of dumping and the subsidized production of goods that are subsequently exported, and (ii) "fair" trade that nonetheless causes injury in the import market to an industry that needs breathing space to adjust to greater import competition (the case of emergency safeguards).

A key Canadian trade policy objective has been to reduce the ambiguity in the GATT disciplines governing these areas, and gradually to restrict the scope of their impact on Canadian exports. During the 1986-88 negotiation of the Canada-U.S. Free Trade Agreement (FTA), the Canadian objective became even sharper. Canada proposed that each Party undertake to exempt the other from its respective contingency protection regime. The results were helpful, but modest: the FTA Chapter 19 binational review of domestic countervail and anti-dumping procedures (i.e., whether a Party properly applied its own legislation which was not, however, clarified in the FTA); and some useful procedural improvements lessening the likelihood of inclusion of goods from one Party in a global safeguards action taken by the other FTA partner.

Further negotiations have led to additional progress. In NAFTA, the FTA "side-swipe" exemption from safeguard actions has been strengthened considerably. More generally, the combination of tighter procedures in the MTN safeguards text and the further improvements included in the NAFTA result in a web of obligations that make

it highly unlikely that Canadian exporters (including foreign investors in Canada who export) will suffer serious fallout from U.S. or Mexican global safeguard actions in the future.[34]

With respect to subsidy/countervail, the MTN agreement will bring a number of valuable improvements, including more precision for such key concepts as: subsidy, specificity, serious prejudice, circumvention, sunsetting, and de minimis. Further gains in future negotiations are reasonable goals to pursue multilaterally (depending on the MTN result), or perhaps regionally, given the U.S.'s greater willingness to negotiate in this area in return for further discipline on subsidy practices. The search for improvements could focus on establishing:

- a tighter definition of industry (to mean all producers of a specific good in the territory of a Party, thereby restricting the ability of regulators to play fast and loose with the composition of the "industry" subject to investigation); and

- the concept of net subsidy (whereby the level of the subsidy potentially countervailable is the amount of benefit conferred on the exported good less any bounty enjoyed in the importing country by the locally produced like product allegedly suffering damage from imports).

In any event, competition policy does not lend itself easily to replacing countervail. The former addresses the market behaviour of firms. The latter redresses the trade distorting impact of government largesse.

The same is not the case with regard to anti-dumping. Dumping occurs when a firm introduces a product into the commerce of another country at less than its normal value, that is, when the export price is less that the comparable price, in the ordinary course of trade, for the same product when destined for consumption in the exporting country. Defined this way, different kinds of "dumping" exist, several of which have little to do with the abuse of market power.

[34] The same cannot be said with the same assurance with respect to other countries, as the waiving in the MTN text of the traditional compensation requirement for global measures of less than three years duration may actually increase the number of safeguard actions, while the MTN definition of domestic industry is looser than that in the NAFTA and provides import regulators with continuing scope for "creative" misuse of the safeguards regime.

Anti-dumping duties may be imposed when such imports cause material injury or threaten to cause material injury to, or the material retardation of the establishment of, an industry in the importing country. Canada and the U.S. have been among the most frequent users of anti-dumping duties.

Current anti-dumping law is often portrayed as addressing certain anti-competitive pricing manifestations of restrictive business practices, i.e., abuse of market power. Yet in practice, its reach is much longer. The complexity of the pricing behaviour of firms cautiously emerges in the GATT dumping code in a number of provisions. Thus, there are references to "production and sales in the ordinary course of trade", "due allowance ... for differences which affect price comparability, including differences in conditions and terms of sale", "an evaluation of all relevant economic factors affecting the domestic industry" when determining injury, and the requirement to examine other factors that may be injuring an industry, including "trade restrictive practices of and competition between the foreign and domestic producers". The draft MTN agreement on dumping repeats these homilies.

Genuflection in the direction of recognizing the varying realities of market-place pricing has been considerably less than effective in practice. Relief should be granted to domestic firms facing imports traded by enterprises that can sustain cut-priced (including below cost) sales abroad financed through supra competitive profits earned at home, not when goods are exchanged in the "ordinary course of trade". The worst anti-competitive abuse occurs when such profits permit a firm to charge "predatory" (i.e., below cost) prices for a period of time to drive out competitors, to deter new entrants, or to increase market share. However, predatory pricing is, in reality, relatively rare.[35]

Overall, anti-dumping regimes have provided poor responses to normal market situations calling for a more sophisticated approach. This is in large part because the factors to be considered when determining the effects of dumping weigh heavily in favour of the firm in the importing country without full regard for its own pricing practices or for the meaning of "ordinary course of trade".[36]

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[35] See OECD, Trade Committee, "Interrelationship Between Competition and Trade Policies", TD/TC/WP(92)20/REV1, (December 1992), paragraph 57; OECD, Committee on Competition Law and Policy, "The Economic Effects of Antidumping Policy", DAFFE/CLP/WP1(92)2, chapter 2, p.13.

[36] MTN.TNC/W/FA, December 20, 1991, pp.F.5; OECD, DAFFE/CLP/WP1(92)2, chapter 3, p.20; The Committee on Canada-United States Relations of the Canadian Chamber of Commerce and the Chamber of Commerce of the United States, "Competition (Antitrust) and Antidumping Laws in the Context of the Canada-U.S. Free Trade Agreement", March 11, 1991, pp.22-4.

First, current practice does not adequately take into account domestic market distortions when determining injury caused by dumped imports. A high degree of concentration that characterizes a local industry (as in a recent case involving the B.C. beer market) reduces price competition and inflates the level of the anti-dumping duty that might be required to redress the "injury".

Second, current trade remedy practice has not been able to resolve satisfactorily frequent cases of "technical dumping" (the great majority of dumping investigations initiated). This involves imports that are sold at less than the home market price (or a related value constructed with some flexibility by government regulators in the import market) in order:

- to compete with a cut-priced domestic product seeking to increase local market share, or as part of loss-leader marketing involving other products; or

- to introduce a new, directly competitive product (e.g., through pricing aimed at presenting a high technology good in a market, while recouping costs through the full life of the product).[37]

If an exporter prices his product in the import market in order to carry out these normal competitive practices, he can nonetheless run afoul of the importing country's anti-dumping regime. This is bad economics and bad public policy.

How can we respond to the issues and pressures just outlined? Observers have highlighted two broad approaches: a full-fledged shift from an anti-dumping regime to one based on competition policy; or the incremental, but still significant reform of anti-dumping procedures to reflect key insights from competition policy.

Competition law addresses domestic geographic price discrimination by suppliers who use different pricing practices in different regional markets to lessen competition through the subsidization of sales in one region from receipts earned in another. In practice, such geographic discrimination rarely occurs domestically. The same issue in a cross-border context is sometimes called "strategic dumping".[38]

[37] The pricing of semiconductors raises additional problems related to rapidly falling production costs combined with a short product cycle pointing to aggressive pricing to recuperate overall costs through high volume, low margin sales before the next generation appears - see OECD, Globalisation of Industrial Activities, p. 157.

[38] See OECD, "Economic Effects", pp.7-8.

This concept implies the support of home country authorities through the preservation of tariff and non-tariff barriers, and perhaps a deliberate policy of not enforcing domestic anti-trust policy. To remedy this problem, trade negotiations can lower the tariff and non-tariff barriers protecting the home industry in the exporting country from off-shore competition, thus reducing the scope for supra competitive profits earned at home and used to finance low-cost exports. Within a free trade area or common market, the scope for this form of dumping is reduced. Moreover, greater international cooperation with regard to competition policy (including stronger domestic enforcement) will also be necessary to address this concern adequately (the U.S.'s 1989-90 Structural Impediments Initiative with Japan was a bilateral manifestation of such activity).

Anti-dumping procedures can and do address cases of predatory pricing by exporters in importing countries. On the other hand, competition policy can also combat this problem. More active international antitrust cooperation could make further gains with respect to predatory pricing as well as strategic dumping by seeking to prevent abuse at the source through the greater use of the "positive comity" concept. Under positive comity, if the country where the dumping occurs (or a third country suffering trade diversion because of the dumping) so requests, the country in which the firm undertaking dumping is based accepts the commitment to investigate whether the dumping results from an anti-competitive situation. A September 1991 agreement between the U.S. and the EC includes such a provision. Canada is actively seeking to establish the same procedure bilaterally with the U.S. and the EC.[39] We should extend this work to Mexico in light of NAFTA implementation. The ultimate test will come through efforts to extend this pro-active cooperation to Japanese antitrust authorities.[40]

Positive comity could also help to address possible abuses in intra-firm trading, but only as part of a process of greater overall international cooperation among trade and competition policy authorities. Cross-border transfer pricing may include the dumping of imported inputs between the parent company and a subsidiary. Anti-dumping policy has attempted to adapt to this case through the development of rules on circumvention, whereby authorities in the importing country may challenge the operation of so-called screwdriver assembly plants located in the import market if

[39] In the case of the U.S., positive comity builds on the cooperative basis already established through a 1984 Memorandum of Understanding on antitrust notification and consultation, and the 1990 Treaty on Mutual Legal Assistance in Criminal Matters.

[40] A succinct U.S. view on the distance yet to travel to encourage the vigorous application of competition policy in Japan can be found in James F. Rill, "Statement Before the Senate Judiciary Committee Concerning Japanese Competition Policies and the U.S. Response", (July 29, 1992).

certain criteria are met.[41] Under the theory of enterprise unity, such an internal practice generally falls outside competition law, except where authorities can demonstrate the abuse of dominant position by the firm. Further adaptation in this area of competition policy could focus attention more clearly on the operations of the firm allegedly guilty of anti-competitive practices. Public policy should focus the spotlight to verify whether there is a real problem of competitive behaviour, and look toward the longer-term fix of the problem at its source.

When the domestic industry claiming injury is itself highly concentrated, almost certainly creating price distortions that would not be present under the full force of competitive market discipline, then surely anti-dumping procedures should, at the very least, adapt by introducing and applying a strong public interest test.[42] Wherever else the replacement or reform debate may lead, this is one area where competition policy has an unavoidable lesson to teach. Not only would the consumer benefit, but greater attention given by the competent authorities to this area would also nudge the domestic producer itself further toward competitive practices to the benefit of the economy as a whole.

Finally, the key issue of "technical dumping" remains. This is where the case for outright substitution by competition policy appears strongest, following the example of internal EC practice and the Australia-New Zealand Closer Economic Relations Agreement. Within a national economy, we do not apply anti-dumping duties against "imports" from another region. Yet we do so against our closest neighbours despite the fact that the degree of economic integration achieved between, for example, Ontario/Quebec and New England is already greater than that between Central Canada and B.C. The FTA and NAFTA clearly drive this process even further, by encouraging firms in each country to develop integrated marketing strategies regardless of frontiers in order to achieve the greater efficiencies required to compete more effectively at home and abroad.

The fact is that in practice anti-dumping regimes have not adequately addressed phenomena that clearly represent important instances of normal competitive practice that governments should not penalize. The threat of penalties in such circumstances can only detract from the attractiveness of Canada as a good investment site for efficient producers. Despite the protectionist urgings of some Canadian firms, surely

[41] See Article 12 of the "Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade", in MTN.TNC/W/FA, December 20, 1991, pp. F.21-F.23.

[42] Section 45 of Canada's Special Import Measures Act is a public interest provision, but its impact has been modest in practice - see OECD, DAFFE/CLP/WP1(92)2, chapter 3, paragraph 22.

the national goal should be to secure the best possible and most economically rational access, if not to all markets, then at least to the U.S., a frequent user of "creative" anti-dumping procedures, our principal export market, and the country to which Canadian prosperity and economic structure are inextricably linked.

This rationale argues strongly for reaffirming that the replacement of anti-dumping by competition policy, at least with respect to the U.S., must remain a major trade policy objective for the 1990s. Moreover, replacement need not lead to complete harmonization of Canadian and U.S. competition law and practice. These are two separate issues. The switch to competition policy in both jurisdictions would greatly reduce the degree of harassment related to normal price competition. With the focus more sharply on instances of predatory pricing, each side can preserve its unique procedural characteristics (e.g., treble damages in the U.S.), as long as each side treats firms from the other Party as it treats its own firms within its own jurisdiction (i.e., non-discriminatory national treatment).

Yet, how feasible is the replacement goal? The NAFTA at least provides an institutionalized approach in the form of a forward-looking Working Group on Trade and Competition, with a mandate to report within five years on the relationship between competition laws and policies and trade in the North American free trade area. But U.S. opposition to change this, above all other areas, remains visceral. The U.S. thwarted significant improvements during the MTN and refused to entertain the matter in the NAFTA negotiations. Anti-dumping is one of the main bastions of U.S. protectionism and is driven by entrenched special interests. What might create movement in this area?

Perhaps the U.S. mood will change as its economy becomes increasingly integrated into the world economy and as its exports become even more exposed to the vagaries of anti-dumping actions taken by its trading partners. Concurrent work in the trenches through such mechanisms as the NAFTA Working Group and active lobbying in the U.S. by Canadian trade and sectoral associations could also help. Yet progress may well be slow. Despite the greater internationalization of trade, only 9-10% of U.S. GDP depends on exports, the lowest proportion within the G-7 and a share that has increased only modestly from the 4-5% range in effect before the 1970s.

Another concurrent approach might be to continue to work on incremental improvements to anti-dumping practices without waiving too obviously the "red flag" of replacement by competition policy. In this regard, we could focus greater attention on defining more clearly what is meant by "ordinary course of trade" so that it captures specific examples of normal price competition, i.e., the pricing behaviour of

domestic firms in the importing market and the special life-cycle characteristics of high technology goods must come under greater scrutiny and be taken into fuller account when investigating the alleged injurious impact of imports. As in subsidy/countervail actions, a tighter definition of "domestic industry" would also be useful.

Convergence: A Two-Edged Sword?

Some observers perceive a need for greater international convergence or harmonization of competition policy regimes to keep pace with the internationalization of markets. The central concern in this regard is potential abuses of market power by transnational enterprises that have decentralized the production process (through intra-firm trading across borders) and gained leverage through greater international acceptance of intellectual property rights and their enforcement, and through increased vertical integration with suppliers in order to meet the requirements of successful just-in-time manufacturing. In this view, TNEs could manipulate transfer prices, enter into cross-border alliances, and pursue market segmentation strategies that reduce competition to the detriment of overall economic welfare. Policy convergence among industrialized countries could also usefully encourage a similar level of commitment among developing countries and the emerging market economies of eastern Europe to combat restrictive business practices. This, in turn, could help to prevent TNEs from avoiding control by engaging in cross-border mergers that emphasize location in less stringent merger environments, with resulting distortions in trade and investment flows.

At first blush, greater convergence and international cooperation in competition policy appears natural and praiseworthy. Yet the pursuit of this objective in a multilateral or even a regional context as part of a broader trade negotiation begs a very important question. In practice, negotiations are not a neutral technical exercise so much as they are a process driven by specific national interests reflecting different economic structures. A comprehensive negotiation would create pressures for Canada to harmonize its approach to competition in ways that may not adequately reflect other Canadian economic interests. Care is required.

Given the historic weakness of the private sector's research and development effort in Canada and the relatively small size of our manufacturing firms, alliance building domestically and internationally by Canadian firms is an important component for increasing our competitiveness and for ensuring a healthy investment climate. Although little used by the private sector to date, Canada's Competition Act permits specialization agreements, export consortia, and research and development joint

ventures.[43] In this regard, growing interest in international fora in favour of greater policy convergence with a view to limiting the scope for export cartels could be unfortunate from a Canadian perspective unless carefully circumscribed to focus on predatory behaviour, rather than on cooperative marketing that may even increase competition in international markets.[44]

Another interesting example of potential concern lies with merger policy. Chart 8 illustrates the gap between the Canadian approach and that of several other OECD members.

What some call the "modern" approach to competition policy tends not to prevent the operation of certain market structures unless they are likely to result in abuse of market power. As an open economy with a small base relative to internationally efficient levels of production, Canada has favoured a case-by-case "rule of reason" approach to mergers that places considerable emphasis on total economic efficiency, with a dynamic view of economic welfare. This approach works in support of attracting rather than harassing investors, and is particularly appropriate for high technology innovative firms for which narrowly constructed guidelines may well hinder the process of innovation.[45] A recent Consumer and Corporate Affairs Canada study concluded that "only a very small percentage of mergers are found to be likely to lessen competition substantially... [while] many others facilitate the process of industrial rationalization and contribute to Canadian international competitiveness".[46]

Yet clearly, the "modern" approach meets with resistance. Authorities in key countries often take a narrower view that is considerably more static in its evaluation of economic welfare, emphasizing shorter-term consumer welfare or per se prohibitions or restrictions. In this light, are negotiations leading to greater policy convergence the appropriate route to take into the foreseeable future? Or are they more likely to lead to the establishment of guideposts that will tend to reflect too

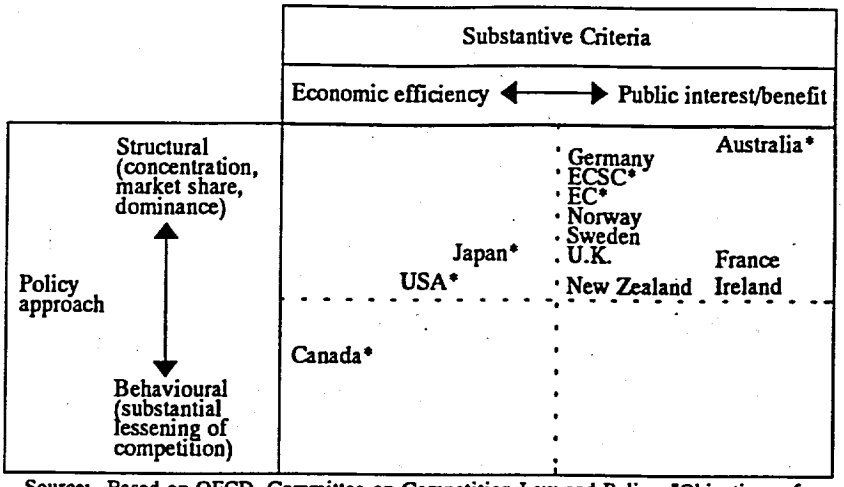
[43] "CCAC Priority Project: Canadian Marketplace/ International Directions Summary Final Report", August 1992, p.21. The following section on Trade and Technology Policy contains a fuller discussion of the technology consortia issue.

[44] For example, see OECD, "Interrelationship Between Competition and Trade Policies", paragraphs 59-60.

[45] Thomas M. Jorde and David J. Teece, eds., Antitrust, Innovation, and Competitiveness (New York: Oxford University Press, 1992), chapter 1.

[46] "CCAC Priority Project", August 1992, p.48; and as confirmed in "Business Performance Following a Takeover", Investment Canada Working Paper No.11 (April 1992).

CHART 8
Schematic Illustration of Alternative Approaches To Merger Policy: A Cross Country Comparison



Source: Based on OECD, Committee on Competition Law and Policy, "Objectives of Competition Policy", DAFFE/CLP(92)2, March 23, 1992, pp. 14-15.

Notes:

* Australia has a mixed system comprising prohibition of mergers leading to strengthening of market dominance but with a procedure for advance authorization subject to a wide public benefit test.
* Canada has no rigid concentration or market share thresholds specified in the competition legislation or administrative practices. Specific exemption for efficiency gains that are greater than and outweigh substantial lessening of competition is provided.
* European Communities. ECSC Treaty Article 66 provides systematic control of mergers only in the iron and steel industries. Mergers are prohibited subject to prior authorization. The EC merger control regulation (1990) applies to mergers above a certain market share/size threshold. There is no specific defence based on economic efficiency gains.
* Japan's administrative procedure standards (1980) for examining mergers specifies market share thresholds among other factors. No specific reference to efficiency is made, but "overall business capability", "technology", etc. are considered. July 1991 guidelines on distribution systems and business practices rely on thresholds.
* United States Department of Justice Merger Guidelines (1984) set the administrative procedures adopted in examining mergers which include concentration (Herfindahl-Hirschman Index) level thresholds and efficiency as among the relevant factors. No legislative defence or exception is provided for mergers giving rise to substantial lessening of competition which may also result in significant efficiencies. The substantive criteria places emphasis on consumer vs. total economic welfare.

closely a per se approach because it is easier to codify and is more compatible (even if not economically optimal) with the larger economies for which strategic alliances, including export and technology consortia, are not as immediately essential?

Some of the modern persuasion in the U.S. have proposed a "safe harbour" for cooperative agreements among competitors innovating and commercializing innovation with a market share of less than 25%, while applying rule of reason criteria for other cooperative agreements.[47] But such a hybrid system is not official U.S. policy. In any event, even this proposal continues to reflect the rigidity of percentages that makes rather less sense in a smaller market economy with a more limited range of players in any given sector.

In summary, we should continue to work toward greater international cooperation through positive comity for such issues as abuse of dominant position, especially in the case of predatory pricing. With regard to unfair pricing practices, differences between Canadian and U.S. law related to class actions, contingent fees and treble damages could be the subject of further discussion, although there is little support for adopting such U.S. legal practices in Canada.[48] Our view of the merits of the rule of reason approach to mergers/antitrust activity should be actively shared with others. We should undertake technical cooperation with Mexico to facilitate that country's implementation of a modern competition policy regime that would in turn favour work under the NAFTA aimed at replacing anti-dumping law with respect to trade among the North American economies.

But before encouraging the holus-bolus inclusion of competition policy harmonization in the next round of multilateral trade negotiations or regionally, we sorely need a clearer picture of the likely outcome. In many instances, the vigorous application of national treatment may well suffice. Only if we are reasonably convinced that the result of a more comprehensive process will emphasize a case-by-case approach that avoids narrow structural or numerical triggers would it likely be in Canada's interest to engage in promoting such negotiations.

[47] Jorde and Teech, **Antitrust**, pp.11-12.

[48] Chambers of Commerce, "Competition (Antitrust) and Antidumping Laws", pp.178-182.

3. Trade and Technology Policy

(i) Background:

Research and development is the creative work undertaken on a systematic basis to increase the stock of scientific and technical knowledge and to use this knowledge in new applications. Such innovation can combine with a greater investment and savings effort to underpin continuing economic growth. The use of new knowledge and techniques can create comparative advantages for industry, especially if linked to the development of specialized labour and suppliers. Purchasing technology from the outside can be less "expensive" in the short term for a given firm. The cost and availability of an innovative product, process or service will depend in large part on the nature of the proprietary rights enshrined in domestic and international intellectual property disciplines affecting patents, copyrights, and other such regimes. On the other hand, in-house R&D can have a significance that goes much beyond any specific innovation at a given point in time. In-house research can significantly enhance a firm's ability to learn, and to use and adapt knowledge effectively, including someone else's knowledge. Firm size is also a factor in this regard, with smaller companies less able to reach the financial and personnel threshold needed to carry out significant R&D. A central issue here is how to ensure that governments, business and research institutions cooperate to ensure the effective diffusion of technology.

A number of studies have identified an important correlation between R&D performance, and sales growth and increased market shares, including in Canada.[49] Although not all investment in R&D necessarily yields a competitive rate of return, expenditures on R&D can be an important indicator of the effort devoted to creative activity underpinning a country's competitiveness. The quality of statistics on R&D expenditures suffer from a number of practical short-comings. Nonetheless, R&D expenditure levels, especially when used to gauge cross-national comparisons, do provide a useful benchmark. Canada's record, regrettably, is not good.

[49] Lawrence G. Franko, "Global Corporate Competition: Who's Winning, Who's Losing, and the R&D Factor as One Reason Why", Strategic Management Journal, 10 (1989), pp.449-74; Guy P.F. Steed, "Technology Strategies and Competitiveness: A Canadian Perspective", Science Council of Canada (May 1992), pp.39-41.

As a percentage of GDP, and excluding the slump in expenditures on R&D reflecting the impact of the two oil shocks of the 1970s, Canada's total research and development expenditures have registered only a modest increase over the past 20 years, from just below 1.3% of GDP in 1971-1972, to just over 1.4% since the mid 1980s.

Moreover, our performance has been consistently poorer than that of many of our principal competitors for markets at home and abroad (see Table 9).

TABLE 9
Gross Domestic Expenditures on R&D (GERD) as a Percentage of Gross Domestic Product for Selected OECD Countries

Country	1985	1986	1987	1988	1989	1990	1991
			(Percent)				
Canada	1.42	1.45	1.40	1.36	1.35	1.42	1.43
France	2.25	2.23	2.27	2.28	2.34	2.40	.....
Germany	2.72	2.73	2.88	2.86	2.88	2.81	.....
Italy	1.13	1.13	1.19	1.22	1.24	1.35	1.35
Japan[1]	2.77	2.75	2.82	2.86	2.98	3.07	.....
Sweden[2]	2.89	.....	3.00	.....	2.85	.....	.....
U.K.	2.31	2.34	2.25	2.23	2.27	.....	.....
U.S.A.[3]	2.93	2.91	2.87	2.83	2.82	2.80	2.82

1 Overestimated or based on overestimated data.
2 Underestimated or based on underestimated data.
3 Excludes most or all capital expenditure.

Source: Main Science and Technology Indicators, No. 1, STIID, OECD, 1992; reproduced in Statistics Canada, Science Statistics, "Total Spending on Research Development in Canada, 1971 to 1992", July 1992, p.3.

The contribution of business has been particularly worrying. Business enterprises funded only 29% of R&D in Canada in 1971-1975 (they accounted for 35% of actual expenditures). By 1986-1990, business funded 42% of R&D (55% of expenditures). Yet, business continues to under-invest in R&D compared to the much superior performance of their competitors elsewhere. In 1990, spending on R&D by business enterprises in Canada was equal to less than 0.8% of GDP, compared to

2.2% in Japan, 1.9% in the U.S., 2% in Germany, and 1.5% in France.[50] R&D expenditures by firms in Canada remained stagnant in real terms in 1991. 1992 projections suggest only a marginal increase in real expenditures. Moreover, of over 40,000 manufacturing companies in Canada, only about 3,500 reported performing any R&D in 1990, and of these only 15 companies spent more than $50 million each[51]. In the not-unrelated field of private sector training programmes, the record is no better.[52] The amount spent by Canada's private sector on training and education (0.25% of GDP) is less than half of U.S. and only about one-eighth of U.K. and German expenditures.

We can offer several explanations for this disappointing performance, some of which are less convincing than others. First, resource-based sectors of Canadian industry (of continuing importance to our prosperity) are affected by a propensity to significant price fluctuations, higher extraction costs, uncompetitive labour costs, and increasingly strict environmental controls. However, these factors do not constitute a convincing explanation of poor R&D performance. Firms in a resource-rich industrialized country like Sweden spend twice as much on R&D as their Canadian counterparts as a proportion of GDP. To take another example, Canadian forest product firms invest a meagre 0.3 - 0.4% of their sales in R&D (1990), less than half the level in western Europe and the U.S.. Canadian resource industries have simply under-rated R&D for too long.[53]

Second, given Canada's traditionally low military posture, defence-related expenditures make little contribution to R&D in Canada compared to the U.S. in particular, but also the U.K. and France[54]. But Canada's situation in this regard is similar to that of Japan, Germany and the Netherlands, all of which enjoy much higher total R&D expenditures as a proportion of GDP.

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[50] Statistics Canada, Industrial Research and Development, 1992 Intentions, Catalogue No.88-202, pp.14, 58, with 1990 GDP in Table 2, p.58 corrected to reflect current dollars.

[51] Ibid., p.17.

[52] OECD, Canada, p.69.

[53] However, resource industries may be more prone to "shop-floor" or "mine-face" innovation by staff that is not easily picked up as formal R&D.

[54] OECD, Canada, p.71.

Third, relatively small scale production has long typified Canada's manufacturing base outside the resource and automotive assembly sectors. As this production, including that generated by a limited domestic machinery sector, has not been strongly export-oriented, it is not surprising that small and medium sized firms spend little on R&D: only $1.4 billion in 1990 by the 3,150 firms in Canada with fewer than 500 employees that undertake research and development.

Finally, foreign controlled firms tend to have higher R&D to sales ratios than Canadian firms across a wide range of manufacturing sectors regardless of the size of firm.[55] But this is not to say that foreign investors in Canada dedicate the same resources to R&D here as they do in their home markets. The high degree of foreign ownership has affected R&D expenditures in at least two critical sectors: motor vehicle assembly and parts manufacture; and, to a lesser degree, petrochemicals and oil and gas. Relatively successful R&D industries such as aerospace and telecommunications have dedicated between 12% and 20% of sales to R&D in recent years. On the other hand, the auto sector has performed miserably at only 0.2% of sales in 1990, compared to 3.2% in the U.S. and Germany, and 3% in Japan, thus reducing the opportunities for contributing to a stronger R&D culture in Canada. Moreover, Canadian-owned companies control only 20% of the auto parts sector, but do almost half of the little R&D that is performed. Big 3-related parts producers make only a marginal R&D effort.

(ii) Trade Policy Responses:

We cannot remain competitive over the long haul with this track record on research and development. More can and must be expected of business, the education system and governments. Trade policy can assist in a number of ways, as outlined below.

Investment and R&D

Clearly defined and comprehensive rules on investment in the host country create a climate of security that is conducive to further investment and the increased pace at which new technologies are introduced through capital stock and through in-house R&D. This security is further enhanced by incorporating these rules in treaty form as recently done in the NAFTA. From an R&D perspective, the development of such rules should remain sensitive to the poor R&D performance of much of the private sector in Canada and the consequent need to retain the use of public policy tools (e.g., government funding linked to R&D; performance requirements to undertake

[55] Investment Canada, "Business Performance", Tables 3A and 3B.

R&D and employee training, or to transfer technology) that can, if used judiciously, encourage foreign investors to undertake research and development in Canada. The NAFTA, for example, preserves Canada's right to use these tools.

Market Access and R&D

Canadian resource industries must become much more innovation conscious. They are already export focussed. Although not as restrictive as in the apparel, footwear and agricultural sectors, tariffs and other traditional measures (including product standards) remain relatively high for semi- and fully manufactured resource-based products in several key markets, including Japan and the EC. The effective rate of tariff protection on higher value-added products can be several times more restrictive than nominal rates. The elimination of such barriers has long been a key Canadian trade objective. It has largely been achieved into the U.S. and now Mexico. But much work elsewhere remains. Better access abroad will contribute to creating more financially secure resource-based industries at home that should, consequently, be in a better position to invest in R&D. Elsewhere, improved market access abroad for commuter aircraft (e.g., liberalized government procurement practices) and telecommunications can reinforce and help to sustain our current strengths in these areas.

Opening our domestic market more fully to competition should oblige industry to restructure and to face more clearly the need to compete through further specialization and innovation. The steady elimination of the tariff where still a factor and the phase-out of non-tariff barriers can be structured to occur over time. Moreover, domestic production will continue to have access to relief in instances where injurious imports are being dumped or subsidized. Modernized competition policy can complement and perhaps, to an increasing degree, supplant such trade remedy tools to deal more effectively with predatory cross-border transactions. But clear domestic liberalization targets with firm time periods for achieving results must be actively sought through trade agreements if possible (in order to preserve negotiating leverage), but unilaterally whenever necessary to underpin the performance of higher value-added industries that require cost-effective inputs to remain competitive in domestic and export markets. Moreover, competition policy can assist by encouraging strong rivalry within domestic industries and markets that continue to enjoy protection from import competition and foreign direct investment. Strong rivalry enhances foreign technology transfer.[56]

[56] D. McFetridge, "Foreign Investment, Technology and Economic Growth", in **Host Country Benefits of Foreign Investment**, Investment Canada publication (1991), pp.93-108: rivalry in the domestic market helps to enhance technology transfers into the host country. Both competition

Trade Remedies and R&D

Improved, more transparent trade rules related to subsidies and countervailing and anti-dumping duties will increase the long-term stability of the environment within which businesses plan their research, production and marketing activities. In this regard, the current MTN text will significantly clarify key definitions and procedures related to subsidy and countervail practices, with some modest, yet still helpful improvements related to the international disciplines on the use of anti-dumping duties.

More specifically, the MTN text is directly permissive of government funding of private sector R&D in two ways. First, generally available grants, loans or tax incentives are not subject to countervailing duties, and the scope of "general availability" encompasses classes of firms defined horizontally (e.g., by number of employees or size of enterprise), a provision that permits some tailoring of programmes to focus on the needs of small and medium sized enterprises. Second, when a subsidy is specific to an enterprise or industry and would therefore otherwise be potentially subject to countervail, it will nonetheless remain exempt if the subsidy covers only a defined proportion of basic and applied research[57]. This partial carve-out would represent an improvement compared to current GATT disciplines, but a fuller exemption would be helpful and is perhaps achievable in future negotiations.

Canadian government funding of R&D is already generous by OECD standards (including investment tax credits at rates of 20%-35%) and will remain especially important into the foreseeable future until the private sector's historically weak effort improves significantly. Therefore, Canadian trade objectives must continue to focus on the successful conclusion of the MTN, including approval of the existing subsidies/countervail draft. The approach contained in this draft is important in part because it will shield Canadian exports dependent on government-financed R&D from the destabilizing threat of countervailing duties. Indeed, with or without a successful MTN, the shielding of Canadian R&D from U.S. (in particular) trade remedy action must remain an on-going priority. Greater security from the abuse of these trade rules will encourage the longer-term business planning needed to foster a greater commitment to research and development.

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and investment policies can help to promote such rivalry.

[57] MTN.TNC/W/FA, pp.I.1-2, I.9-10.

Technology Consortia and R&D

Canada must continue to encourage the participation of our firms in cooperative research efforts undertaken by the private sector in countries accounting for most of the world's R&D: the U.S., the EC and Japan. Such technology consortia have become increasingly important and can eventually stimulate much broader cooperation through more comprehensive inter-firm alliances on production and marketing. One key policy issue in this regard is whether government involvement with technology consortia (e.g., through government funding, defence-related and other contracts, and anti-trust or other regulation) creates disguised and unfair discrimination among investors through a denial of national treatment. Analysis of U.S. technology consortia indicates that, in many cases, Canadian firms are excluded, either explicitly or implicitly.[58]

In the NAFTA negotiations, Canada sought, for greater certainty and with some support from Mexico, explicit recognition of the applicability of the non-discrimination principle to government dealings with technology consortia that might include enterprises of another NAFTA Party that were prepared to bring their own funding and research capability to the consortia. The final NAFTA text does not include such an explicit provision. There are strong national treatment and MFN provisions in the chapter on investment, but these do not apply to procurement, subsidies or grants provided by a Party. This caveat could allow U.S. authorities to claim that a potential Canadian participant in a U.S. consortia that enjoys U.S. government funding or contracts would "inevitably" profit, even if only indirectly, from such benefits and, therefore, that the non-discrimination principle need not apply, even if discrimination could be proven. This approach can effectively block Canadian participation.

Currently in the EC, Canadian companies can participate as sub-contractors on projects enjoying Community funding and with an important R&D component. However, the Canadian firm has no proprietary rights to the intellectual property that may result from a project. Canada and the EC will soon engage in negotiations aimed at ensuring national treatment for Canadian firms that seek to participate as full partners in EC-funded projects, with rights to the intellectual property created. It is for consideration whether we should seek to expand this cooperation one stage further to so-called "programmes" covering designated sectors, although this would entail a larger government-level commitment to financing that may not be feasible into the foreseeable future.

[58] For an example, see Lipsey, "Economic Growth", pp. 211-2.

In any event, it is clearly in Canada's interest to continue to seek to establish unambiguous and explicit ground rules based on national treatment that facilitate the participation of Canadian firms in international technology consortia. Moreover, Canada must continue to ensure that such consortia do not run afoul of evolving international competition policy practices. At present, most anti-trust statutes include export consortia and R&D joint venture exemptions to their conspiracy provisions, although inter-firm agreements in the U.S. are subject to a case-by-case rule of reason approach. Tolerance of technology cooperation favours Canada and should receive continuing support.[59]

Intellectual Property and R&D

During the 1980s, such intellectual property rights (IPR) as copyright, trademarks, patents, industrial designs and even layout designs for semiconductor integrated circuits became an integral part of the international trade agenda, as evidenced in the MTN process and the North American Free Trade Agreement. There is every likelihood that major intellectual property producers, led by the U.S., the EC and Japan, will ensure that this prominence continues. Consequently, the impact of international intellectual property disciplines on R&D in Canada requires careful review.

Strong IPR can help to create the environment required to attract and retain investment and to encourage domestic innovation. A weak intellectual property regime can only discourage R&D activity, especially in light of the growing competition for investment from the increasing number of countries (including LDCs) that are strengthening IPR standards and their enforcement. It is likely that Canada will remain a large net importer of technology into the foreseeable future. Clearly, Canada should encourage a proprietary system that does not obstruct the process of cross-border diffusion of technology, nor the further strengthening of in-house innovation by firms in Canada.

Three examples, should suffice to illustrate the nature of the issue. First, there is broad consensus internationally as to the minimum period of time during which an intellectual property right holder should normally enjoy the exclusive use of his right (e.g., 20 years from date of filing for patents, 10 years for layout designs for circuits, 10 years for industrial designs, etc.). Based on a web of specific international conventions, these obligations have been somewhat strengthened and brought together with stronger enforcement provisions and subject to well-defined trade-

[59] Derek Ireland, "Interactions Between Competition and Trade Policies: Challenges and Opportunities", (November 1992), Appendix, pp.52-3,87(fn.18); OECD, "Interrelationship Between Competition and Trade Policies", paragraphs 72-4; Jorde and Teece, Antitrust, pp.11-12, 15-16.

related dispute settlement mechanisms in the draft MTN agreement and the NAFTA. Any unilateral attempt by Canada or any other Party to introduce standards below this minimum would represent a breach of a binding obligation (potentially leading to trade retaliation sanctioned through these agreements), and would send a negative signal to innovators at home and abroad.

Second, certain narrowly cast limitations or exceptions circumscribe most IP rights (e.g., provision for compulsory licensing of patents without the authorization of the right holder in instances of non-working of a patent). Such exceptions should remain exceptional. Their too broad use will lessen the environment of stability required for long-term research and development activity, especially if other competing jurisdictions rarely invoke them.

A third example relates to the "exhaustion" of IP rights. This concept provides that the first sale of an article embodying intellectual property "exhausts" the right holder's entitlement to restrict subsequent sale. The doctrine of exhaustion applies within many jurisdictions (e.g., the U.S. and the EC, but not necessarily in Canada). It does not generally apply to the importation of patent-embodying or copyrighted goods traded across international boundaries. That is, under patent and copyright legislation, Canadian right holders have the right to exclude from import into Canada products manufactured abroad that embody IP rights that are held in Canada and have been, for example, licensed for use abroad only. Should Canada modify its approach to exhaustion in general, or at least in respect of intra-North American trade (analogous to the situation in the EC)? The need to strengthen in-house R&D at home, while continuing to rely on the purchase of off-shore research through licensing and other arrangements would argue that we should not. Wide-spread use of exhaustion related to patents in particular would undermine the financial incentive for original innovation in Canada and for the international transfer of technology into our market. In the latter case, transnational firms, with the value of the licensing of their technology to a Canada-based firm lessened, would be more inclined to simply export the relevant product to Canada from their home base. Thus, Canadians would retain the benefit of being able to buy the good in question, but at the expense of losing the invaluable in-house learning process of adapting to new technologies.[60]

Nonetheless, intellectual property rights, if excessive, can reduce competition through the unjustifiably extended entrenchment of monopoly proprietary rights. In this regard, it is useful to recall that the world's 700 largest technologically active

[60] For further background, see R.D. Anderson, P.J. Hughes, S.D. Khosla and M.F. Ronayne, "Intellectual Property Rights and International Market Segmentation: Implications of the Exhaustion Principle" (Ottawa: Consumer and Corporate Affairs Canada, October 1990).

firms perform 90% of their basic research at home, and this home is rarely Canada.[61] In addition, only large countries can spread their R&D activities across most technological fields. Globalization and the increasing strength of transnationals surely will reinforce these trends.

In this light, we should approach with care any future efforts to expand the scope and rigidity of current intellectual property standards. For example, Canada should proceed very cautiously with respect to any initiative to extend the current periods of protection for the different IP rights. We should take a hard look at what a reasonable return on investment in R&D might be. When does this rate of return slip into anti-competitive and inefficient economic rent? It would be useful to undertake an analysis as to whether a term greater than 20 years (to take the case of patents) provides a "fair", an "excessive", or a "too limited" economic return in light of development and opportunity costs. The answer may vary by sector, the class or degree of innovation, or other variables, opening the door to some flexibility to reflect more accurately the specifics of each case. Any such suggested change would require building consensus internationally, as well as domestically. At the very least, analysis on this matter would better prepare us for future negotiations launched by technology-rich countries.

Finally, it will be important to retain clear guidelines to ensure that competition policy can continue to override intellectual property rights, if required to remedy anti-competitive practices as determined through an independent administrative or judicial process. The procedures must be transparent, disciplined and consistent with internationally established practice. Canada's Competition Act contains several provisions that can override intellectual property rights because of anti-competitive behaviour determined on a case-by-case basis with fairly high thresholds for action.[62] The NAFTA fully preserves the right of each Party to "adopt or maintain...appropriate measures to prevent or control..." abuse of intellectual property rights having an adverse impact on competition as specified in domestic law.[63] This approach preserves the ability of each signatory to address effectively any attempt by transnational enterprises to use IPRs and general IP exemptions under antitrust laws in order to segment markets, to distort trade in goods and services, and to engage in anti-competitive price discrimination between markets. The judicious use of

[61] Patel and Pavitt, "Large Firms" pp. 5, 10.

[62] Anderson, et al., pp.21-4; Chambers of Commerce, "Competition (Antitrust) and Antidumping Laws". pp.64-76.

[63] See Articles 1704 and 1110(7).

competition policy in this regard does not detract from a healthy technology transfer and innovation environment in Canada, and is considerably superior to any attempt to claw back from what are widely recognized international IP standards.

4. Trade and the Environment

(i) Background:

The "greening" of public policy during the 1980s has been remarkable and gives every indication of remaining a key element of policy debates into the foreseeable future. The appeal of environmentalism cannot be underestimated. It reflects concerns close to the every day life of voters, is easily packaged for emotional public debate, and yet addresses significant, very real-world problems at the heart of economic and social development. The combination of political sex appeal and substantive merit is powerful.

The trade policy community has reacted slowly and, for the most part, defensively to the new phenomenum, detecting protectionism by another colour behind every bush. For their part, many environmentalists have viewed trade negotiators as not much better than lackeys of perceived private sector growth-at-any-cost advocates and their supposed allies in government.

One result has been a lack of sufficient creative exchange and thinking on how trade rules might better reflect legitimate and growing environmental concerns. Another result has been the negotiation of a number of important environmental protection agreements without detailed trade policy advice, sometimes leading to the inclusion of sloppily drafted trade provisions that are unnecessary from an environmental perspective and potentially very damaging to Canadian trade interests. The Basel Convention on the transboundary movement and disposal of hazardous and other wastes is a particularly disturbing case in this regard.[64]

[64] Article 4(8) of the Basel Convention allows the exporter of undefined "wastes" to be the judge, subject to as yet undefined "technical guidelines", as to whether another country's waste handling facilities are environmentally sound. One example of how U.S. protectionism could abuse this provision may be useful. Canada now has 20 mills capable of recycling old newspapers that by 1995 will rely on foreign, mostly U.S., suppliers of waste paper for roughly half their needs. Once Basel enters into force in the U.S. (it did so in Canada in November 1992), the U.S. will possess a tool that it could misuse under pressure from its own recycling industry by claiming that the Canadian plants are not maintained in an environmentally sound manner.

The trade and environment agenda is quickly expanding and becoming more complex. Areas of interest include:

- The use of trade instruments to enforce compliance with domestic health, safety and environmental standards, better defining the criteria used to evaluate trade measures to ensure that protectionist restrictions are not disguised as environmental measures (of particular concern for a trade-dependent economy such as Canada).

- The appropriateness of the use of trade measures against the products of non-complying states as leverage to encourage such countries to become parties to international environmental agreements.

- Whether import restrictions should be used to enforce standards in other countries related not to the characteristics of a product, but to the "production and processing methods" (PPMs) involved in manufacturing the product (whether or not the manufacturing process is directly connected to the good threatened with import sanctions in the other country). The treatment of PPMs lies at the heart of how we are to address the well-being of the global commons, including ozone depleting processes and the carbon sink role of forests. PPMs also lie behind occasional demands for some form of environmental "countervail", on the assumption that lower standards constitute a subsidy to production affecting the cost of exports.

- The concern that another country's industry can exploit its less than stringent environmental regulations to the competitive disadvantage of Canadian producers, raising the spectre of companies flocking to "pollution havens".

- The increasing attractiveness of using market-based economic instruments over the traditional regulatory approach to achieve environmental objectives. The former approach may encourage the development of more innovative and cost-effective solutions. An impressive array of such economic instruments has been identified, including non-tax measures such as tradeable permits, user charges, and deposit-refund schemes, as well as tax instruments such as environmental charges and tax incentives. The trade policy implications of these instruments need close attention.

(ii) Trade Policy Responses:

Four considerations might be of use when addressing trade and environment policy decisions in future.

First, the trade policy community often casts the debate in terms of concern over extraterritoriality. It might be more helpful to identify consistently and up front that the essence of the danger is unilateral action, one country deciding to apply its (perhaps appropriate, perhaps not) standards on another country with no rule or procedures except its own. However, if trading partners can develop common rules, then the extraterritorial reach of sanctions is unobjectionable in principle.

Second, the public and political pressures to use trade sanctions and to reflect environmental concerns more clearly in trade agreements can only increase.

Third, there is a crying need for the trade policy community to get out in front of the environmental wave with innovative, well-reasoned proposals if it hopes to shape public debate effectively so that fundamental Canadian trade and economic interests are not jeopardized.

Fourth, the domestic consultative process on NAFTA and the environment initiated in mid 1991 clearly demonstrated that trade negotiators and environmentalists can work together constructively. The NAFTA usefully breaks ground in a number of areas and in a manner sensitive to both trade and environmental concerns, including the broad precedence of the trade provisions of selected international environmental agreements to the extent of any inconsistency with NAFTA obligations, the right of the responding Party in a formal dispute raising a range of trade-related environmental issues to choose the trade forum where the dispute will be heard (either GATT or NAFTA), and an important statement of principle that Parties should not derogate from their domestic environmental standards in order to attract a specific investment.

More specifically:

Domestic Environmental and Health Standards

Current GATT Article XX exceptions permitting import restrictions to protect domestic human, animal or plant life or health and to conserve natural resources, as well as GATT disciplines on industrial standards and phytosanitary measures (as improved in the MTN and NAFTA), generally strike the right balance between trade and the environment. These provisions clearly provide a government with powerful,

environmentally sensitive tools, circumscribed only by reasonable requirements to act in a non-discriminatory manner, on the basis of standards that do not clearly fly in the face of sound science (in practice, the benefit of the doubt is that they do not), and in the least trade restrictive manner possible while still achieving the goal of protecting the population and/or the domestic environment.

Pollution Havens

The "pollution haven" argument is over-cooked. There is little empirical evidence that lower environmental standards in another jurisdiction are an important factor in a company's decision to relocate. Environmental regulations can be a more central factor for industries producing very toxic or carcinogenic products (copper, lead, zinc). But generally, pollution control costs, even in heavily polluting industries, are rarely much more than 1% to 2.5% of total costs.[65]

Moreover, the "problem" (as discovered in the recent NAFTA negotiations with Mexico) often is not a question of formal standards, but their enforcement. For greater reassurance, Canada sought an obligation whereby a country would not, in order to attract a specific investment into its territory, waive its own generally applicable standards related to air, water quality and the handling of hazardous substances. If a Party did so, it would be subject to formal dispute settlement proceedings and, if the infringement were not corrected, to the compensation/retaliation discipline of the NAFTA.

Although not adopted, this proposal demonstrated the possibility for innovative collaboration between the trade and environmental communities. The proposal would have addressed the most flagrant kind of abuse distorting trade, investment and the environment. There would be no unilateral extraterritorial application of standards - each government would be held accountable for the management of its own freely and democratically implemented laws and regulations. And violations would be met firmly, helping to counter fears about "pollution havens". We may well not have heard the last of this proposal, in light of President-elect Clinton's call for a supplementary agreement on the environment to reinforce the current provisions of the NAFTA.

[65] See the literature summarized in pp.11-15 of Globerman's draft chapter, "Trade Liberalization and the Environment", in Steven Globerman, ed., Assessing The North American Free Trade Agreement, Vancouver, The Fraser Institute, forthcoming; North American Free Trade Agreement: Canadian Environmental Review, (Ottawa: October 1992), pp. 55-64.

Consensual Standards and TREES

Trade negotiators, especially from smaller, trade-dependent economies like Canada, are correctly cautious about suggestions to use border measures to enforce environmental goals unilaterally in other countries. In the real world, the line between environmental protection and outright protectionism is often a fine one, especially in the hands of trade regulators in our principal export markets subject to domestic lobbying seeking unilateral "creative" action against competitive Canadian exports. Moreover, if unilateralism is encouraged, a smaller, more trade-dependent and therefore more vulnerable country may find itself adjusting its environmental standards toward the not necessarily appropriate level of larger trading partners.

Yet it should be possible to work toward commonly agreed minimum standards on specific issues affecting the global environment that take into account variations among countries based on climate, topography, population density and so on. The work now underway in the aftermath of last summer's UNCED meeting in Rio de Janeiro on sustainable forest practices hopefully will lead in that direction. A carefully crafted global convention on forest practices could emerge from this process.

Minimum standards harmonization on this or other matters (for example, reduction targets for carbon dioxide emission levels implemented by means of a carbon tax) could also be achieved regionally. If so, then the use of tariff surcharges or other border measures when such standards are violated would seem reasonable, as long as they are subject to consultations and challenge under dispute settlement procedures to ensure that the measures are not a disguised restriction on trade. The right to take such border measures to address practices in another jurisdiction (could we call them Trade-Related Environmental Enforcement Safeguards - TREES?) with respect to endangered species is already implicitly accepted in GATT practice, and explicitly authorized in NAFTA. In these circumstances, the carefully circumscribed use of border measures to address production processes that have a negative impact on the global commons and that are banned or limited through international agreement should be acceptable.

User Charges

It makes sound environmental and economic sense for users to pay the full cost of the resources used to produce a good. The IMF and IBRD frequently make this proposal a part of their structural adjustment programmes - and with good reason. The "polluter pays" or "user charges" concepts capture the same principle from different angles.

If industry in one jurisdiction is paying substantially less than the full local cost of publicly regulated inputs (water, for instance) that are environmentally sensitive from a more local viewpoint, and if foreign competitors are obliged to pay the full or proportionally closer to the full cost of the resource in a second country, then the latter faces a competitive and arguably an unfair disadvantage. If the below-cost practice in the first jurisdiction is applied generally and is not firm or industry specific, then it is not actionable under current international subsidy/countervail disciplines. And carefully defined disciplines in this area are a long-standing Canadian trade policy objective, in order to limit the scope for unilateral rule-making by major trading partners, including the U.S.

Nonetheless, a fresh look would be useful. Methodologies exist to measure the cost of local inputs such as water, or the handling of wastes. If a government consistently charges its non-household users less than the full cost of such inputs, there is a strong economic and environmental case that the difference between the price charged domestically and the real local cost represents a trade and investment distorting incentive that should be "countervailable" in another jurisdiction (or, put another way, subject to a TREES). In recognition of the local (rather than global) environmental impact, the use of a TREES could be conditioned, in order to ensure discipline in its use, on a given good being traded and causing injury to a competitor abroad, net of any short-fall between the price charged and the full cost of the same input in the import market for the producer of the like good.[66]

The implications of this approach for Canada if extended to the pricing of all environmentally sensitive inputs (e.g., related to forestry management practices such as stumpage, and electrical utility rates) would require careful scrutiny. Moreover, the exception to the "general availability" rule should occur only when sound environmental practice is undermined (e.g., failure to charge full cost for environmentally sensitive inputs), not when an instrument is used to achieve better environmental performance (e.g., various general tax incentive programmes).

Finally, generally available, government-financed social programmes (e.g., the national health care system, unemployment insurance, etc.) must remain exempt from challenge, even if the general availability principle were changed in the case of

[66] It may be that the full internalization of environmental costs could lead to a higher price for the end product than would otherwise be the case. In addition to a realignment of trade patterns in favour of those who can produce efficiently at the higher level of internalization, this result could also lead to slower trade growth until innovation overtakes the cost of internalization through more efficient (and environmentally sound) production processes and distribution practices.

environmentally sensitive services such as water and waste handling. This surely is achievable, given the sensitivity of social measures for all governments.

Rogue States - the Free-Rider Issue

The question here is whether governments should have access to trade sanctions when they cannot negotiate common standards with another country, and that country insists on using a production process about which there is broad multilateral consensus expressed in treaty form that the process damages the global environment (the failure of Pakistan to ratify the 1987 Montreal Protocol on ozone depleting substances, or Korea's failure to ratify the 1990 London Amendment to this Protocol come to mind).

Frankly, this is a judgement call. We need to keep a careful eye on what such a practice, ostensibly aimed at extending international consensus, might mean with regard to our forest management practices in light of the role forests play as carbon sinks. On the one hand, we can make a strong case that governments should have the option to discipline actions having a significantly negative impact on the global commons taken by a "rogue" state in the face of broad and representative international consensus that a particular production process is inappropriate. On the other hand, the question of what constitutes such a "consensus" requires careful thought. Presumably any such consensus must be based on sound science and should include most, but not necessarily all, the major producer countries capable of using the condemned process. As a practical matter, such consensus is likely essential if the sanctions imposed on a non-Party are to be successful in modifying the behaviour of that country. Canada should take the lead in defining the terms of such consensus, given our economic stake in the result. If we do not, others will do it for us, with the result perhaps not to our liking.

In addition, if the sanctioned country is also a GATT Contracting Party (CP) its rights under the General Agreement remain intact, including the right to seek redress if other CPs block its exports pursuant to the provisions of a broadly-based international environmental agreement. This situation is unsatisfactory. Canada should work with other CPs to rectify this matter by seeking an appropriate amendment to Article XX or through the formal waiving of obligations under GATT to ensure the effectiveness and primacy of specific trade obligations set out in consensual international environmental agreements. The GATT provides for both amendments and waivers. For the former, two-thirds of CPs must agree; for the latter, two-thirds of the countries casting a vote must concur.[67] These voting

[67] See GATT Articles XXX:1 and XXV:5 respectively.

requirements will ensure that CPs will not create exceptions lightly and that the debate will be thorough and transparent, and in the context of sound science and non-discrimination.

Verifying the Facts

If a government can invoke trade sanctions because commonly agreed or generally accepted environmental standards are not met or because user charges do not represent the full cost of a given resource, then governments must accept some method for verifying the facts. This raises the spectre of investigators entering other jurisdictions, violating sovereignty. Yet this already occurs to varying degrees by mutual consent.

Customs audit teams and agricultural inspectors routinely visit other jurisdictions (the Canada-U.S. experience is useful in this regard) and carry out on-site reviews at specific firms. Authorities undertaking subsidy/countervail or dumping investigations may carry out their work in the territory of other signatories under certain conditions and may even do so on the premises of a firm, examining its records if the firm agrees. Mutually agreeable (and this is the key) procedures have been and can be developed to assist in verifying the facts in other countries.

Dispute Settlement Procedures

When governments raise environmental issues at the level of state-to-state dispute settlement, they could allow non-governmental parties (including environmental organizations) to present briefs, as is already done with regard to domestic emergency safeguards, anti-dumping and subsidy/countervail hearings. This procedure would go considerably beyond what is nonetheless an innovative feature of the NAFTA, whereby a panel may request technical advice on environmental and other scientific issues from a Scientific Review Board selected by the panel itself from among highly qualified, independent experts.

Whether NGOs should be present during government-level presentations and debate is perhaps more questionable. Nevertheless, allowing the presentation of outside briefs would increase the transparency of the dispute settlement process and ensure that interested parties can present their views.

Competitiveness

Governments must carefully design economic instruments aimed at facilitating environmentally sound domestic adjustment so that they do not run afoul of subsidy/countervail disciplines (e.g., the use of firm or industry specific tax incentives), or proprietary rights underpinned by international investment obligations (e.g., tradeable permits could confer property rights under the NAFTA if sold through auction and subsequently subjected to forced reallocation under certain conditions).

Governments must also continue to be sensitive to the impact of economic instruments and regulation on Canadian competitiveness. One potentially helpful approach in this regard is to combine an emission charge or a charge on a final product with tax credits (perhaps transferable or "tradeable") for subsequent use only in investment in pollution abatement technology.

More generally, we should encourage R&D through high standards, but with an adjustment period appropriate to the capacity of a given sector or industry to respond imaginatively. Where possible, the strengthening of domestic standards should take place concurrently with, or at least not too far in advance of, the establishment of consensual international norms on the environment (e.g., the Montreal Protocol on ozone depleting substances) to ensure a level playing field with our major competitors. In this regard, Canada cannot resolve on its own issues such as global warming (e.g., through a carbon tax on fossil fuels or tradeable permits to reduce carbon dioxide emissions beyond already announced commitments). To attempt to do so would not be environmentally effective (Canada accounts for only about 2% of global CO^2 emissions generated by burning fossil fuels), and would put Canadian industry at a competitive disadvantage. Clearly this is an area where Canada should continue to seek international agreement on further reduction targets and timing applicable to all major players.

VI. Conclusions

The internationalization or integration of the world's economies is a complex and incomplete business. The previous pages have described some of this complexity and pointed out several important linkages between and among different policy fields. In addition to prescriptive guidance at the micro level, this review also suggests a number of tentative general conclusions.

The open, multilateral trading system has served Canada well, both because it has helped to improve and secure access outside North America for Canadian exports

and needed off-shore inputs, and because active participation in this broader system has helped us to channel and shape reasonably constructively the trade and economic policies of the United States that have an impact on Canada.

The world is, economically speaking, a smaller place than 20 years ago. OECD leaders such as Germany and Japan, as well as new, dynamic players have reinforced their presence in the trade and investment game, taking a gradually greater share of the increasing benefits derived from the global trading and production system.

We have also seen that globalization, while increasingly important, is nonetheless less sweeping and linear than its popular renditions would have it. Much of the increase in world trade has occurred on a regional basis (especially influenced by intra-European trade). Many, perhaps most transnational enterprises are no more "internationalized" or "stateless" than in the past with respect to key aspects of their operations, such as R&D and trade between parents and affiliates. Japanese firms remain, well, characteristically Japanese. Much of the anecdotal evidence on "global" firms relates to experience within Europe where we could more accurately characterize the phenomenum as regional (the emergence of the European firm), rather than truly global.

Yet these caveats do not detract from the general conclusion that Canada must promote itself abroad even more vigorously and with greater creativity. Our future investment needs are enormous. Without trade and the specialization and innovation encouraged by trade, the Canadian economy would decline precipitously. But to compete at home and abroad in a more competitive and intrusive world, Canada must trade and produce smarter. Like other small and mid-sized economies, our future will depend on our capacity for flexibility and adaptability in the face of growing competition for export markets and quality investment.

While encouraging as global an outlook as possible, the immediate benefits of enhanced trade and production on a regional basis must be fully explored. Western Europe certainly has done and is doing so through the combination of the European Community, the European Free Trade Association, and the Europe 1992 process. The FTA and NAFTA represent a foundation that we can build on to tap into the dynamism created when several like-minded countries and their industries combine strengths. In this regard, accession to NAFTA by selected Latin American and Asia Pacific economies could reinforce growth prospects in Canada and create sufficient critical mass (leverage) for a more fruitful negotiation with Europe and Japan than the MTN has been able to deliver to date. If played with vision, we can develop regionalism as a way-station toward fuller multilateral disciplines that address, and indeed reinforce, globalization to the benefit of Canada.

The trade policy agenda has expanded considerably in the face of the increasing global pressures on what governments and populations have generally taken to be domestic policy instruments. The negotiating agenda will almost certainly expand further into the investment field, and have to address creatively additional new issues, including those explored in some detail in this paper. Exploratory preparations have already begun in this regard and must be maintained. This process of closer interaction will continue. In essence, we face one policy playing field. The coordination of players and plays must be agile and comprehensive.

In this regard, close federal-provincial cooperation is crucial. The policies of one level of government can severely undermine the efforts of another jurisdiction to provide a stable environment for investment and growth. The single playing field paradigm catches all major policies, ranging from education and labour relations to tax policy and the cost of capital. Provincial actions can strengthen or weaken the coherence of policies related to all the issues explored in detail in this paper: investment, competition policy, R&D and the environment. Continuing inter-provincial trade barriers undermine Canadian competitiveness and, indeed, the Canadian union. To date, Ontario has been the flagship location in Canada for foreign investors, and thus bears a special responsibility for ensuring the effectiveness of pan-Canadian efforts to attract quality investment.

Finally, it is clear that increasing policy cohesion is essential to managing the significantly more complex and intrusive trading system of the 1990s. Governments can facilitate this cohesion through greater coordination in the administration of and policy development related to the ever increasing array of policy instruments caught in the process of globalization. External Affairs and International Trade Canada interacts daily with the impact of global pressures on Canada and provides the central interface between domestic policies and evolving international trade disciplines across a broader front than any other government department. As the trade agenda continues to expand, the importance of coordination and the need for policy coherence can only increase as well.

Effective management of the multifaceted internal-external interface requires a holistic approach. The consolidation of all trade policy instruments under one roof (including statutory responsibility for the tariff and trade remedy legislation, as well as all aspects of investment promotion) should be actively pursued. For its part, External Affairs and International Trade must continue to reassign and train officers to reflect more fully the rapidly growing importance of managing the trade policy and economic files. Globalization demands better coordination and deployment of legal instruments, increasingly scarce funds, and appropriately trained human resources.

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