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Robert E. Hudeo

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I would like to address myself briefly to some of the implications which I see in the Canadian proposals about direct foreign investment.[1] I believe there are issues here which relate to trade liberalization in general, and also to the sectoral approach on the Canadian Auto Parts model that we are charged to discuss this afternoon.

I should begin by drawing around my remarks the protective cloak of academia. I am not sure that what I have to say is going to be an accurate description of the specific Canadian policy, or of the reasons for this new Canadian policy; nor is it by any stretch of the imagination an authoritative forecast of what is going to happen as a result of that policy. I see in this new Canadian policy some elements of a larger trend. I would like to explore some of the possible reasons for that larger trend, and some of the consequences likely to follow from it.

I would like to start with the hypothesis that efforts to regulate foreign investment — of the kind being proposed by the Canadian government — are very probably the wave of the future.

A key element behind the proliferation of these regulatory endeavors is a growing consensus that the behavior of the foreign investor (primarily but not entirely the multinational enterprise) tends to differ from the behavior of a local producer. The behavior of the foreign investor, the consensus seems to say, produces a worse cost-benefit balance to the host country. Why? The conclusions appear to be the following: Foreign investors are less inclined to do local sourcing because they tend to draw upon home establishments for components, regardless of possible cost advantages of sourcing locally. They will tend to be less aggressive exporters, because they have arranged their export markets to be served by various other parts of the multinational enterprise, again regardless of possible cost advantages of exporting local production. Finally, they tend

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* Professor of Law, University of Minnesota Law School; Minneapolis, Minnesota.

[1] The Canadian proposals are discussed in the remarks of Mr. Roberto Gualtieri.

to generate fewer collateral economic benefits in areas such as research and development, management training, development of entrepreneurial skills and so forth.[2]

There are two factors which are often cited to explain this supposed behavioral deviation. The most common is the alleged tendency of the foreign investor to be motivated by what is called an ethno-centric point of view — the tendency to keep as much of its operations in the home country as is possible. I am not sure why ethno-centricity is always attributed to foreign investors. One supposes that some of the difference between the behavior of foreign and domestic investors might just as easily — indeed, more easily — be the product of the ethno-centricity of the domestic investors.[3] But that really makes no difference. Either way, the host country winds up with less economic benefit coming from a foreign investor.

The second reason for the supposed difference in behavior is complimentary. It is that the multinational enterprise has risen above, or is capable of rising above, considerations of comparative advantage. Most factors of production have become extremely mobile, and large multinational enterprises have the capacity to move these factors of production relatively cheaply. Consequently, much of what the multinational enterprise does can be done just about as efficiently in one country as in another. If that is so, of course, decisions about where to produce will necessarily be made on the basis of considerations other than efficiency.[4] This conclusion both reinforces the conviction that the behavior of foreign investors will be tilted unfavorably to the host country and, equally important, provides an economic justification for the host country asking for more beneficial local activity.

These hypotheses enjoy a high degree of acceptability, and they are being acted upon. Governments around the world have begun

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[2] The Gray Report may be the most candid official (or semi-official) exposition of this theme. *See* A CITIZEN'S GUIDE TO THE GRAY REPORT, 49-62 (CANADIAN FORUM 1971).

[3] The hypothesis would be that, as compared with purely local enterprises, the multinational firm is much more likely to have had its ethno-centricity diluted by the added perspective gained from a world-wide mode of operation.

[4] This assumption commonly parades under the more general complaints about the awesome economic power of the multinational giants, but it has been articulated by Professor Behrman. *See* Behrman, *International Sectoral Integration, An Alternative to Free Trade*, 6 J. WORLD TRADE L. 269, 282 (1972). A variant of the argument is that pure efficiency considerations will be obliterated in any event by the investment subsidy policies of other governments, so that even the purely rational firm will not be making efficiency choices.

to regulate the inflow of direct foreign investment for the purpose of maximizing the cost-benefit balance received from that foreign investment. Once governments begin such regulation it is a little like tasting blood. The regulation seems to work. One can see a certain amount of admiration in government documents (and I think the Gray report is one of them) for the success that governments like Japan have had in managing the inflow of foreign investment.[5] More than just admiration, the documents also exhibit a serious concern about being left behind. If governments like Japan are getting more out of the multinational enterprise than the multinational enterprise is normally willing to give, that means that less is being done in some other country — typically a country like Canada which up to now has not been trying to exert counter-bargaining pressures.[6] There is a growing feeling that you either play the game or get left quite far behind.

What does all this have to do with trade? I think Canada may be an advanced example now of where these two seams come together. Accept, for a moment, the hypothesis about the behavior of the foreign investor. Then, take as a given that somewhere around 50% of Canadian manufacturing is controlled by non-residents, and increase that figure substantially in certain key sectors.[7] Adding the two together, you might begin to ask whether trade liberalization will really produce the results one normally expects in these foreign-dominated sectors, — *i.e.*, that your local efficient firms will aggressively pursue the new export opportunities created for them by the reciprocal trade concessions you have negotiated. It may, of course, happen that with removal of the trade barrier the foreign investor will rationalize his production, as has happened, at least in form, with regard to the Canadian Auto Parts agreement. On the other hand, removing the trade barrier may give vent to all of those dark forces that one suspects really motivate the foreign investor, namely, the desire to return "home" and to service his Canadian market with homemade exports now that the tariff barriers are down.

If we look at the behavior of the automobile companies under the Canadian Auto Parts agreement,[8] we see conflicting evidence

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[5] A CITIZEN'S GUIDE TO THE GRAY REPORT, *supra* note 2, 109-18.

[6] *Id.* at 57.

[7] UNITED STATES INTERNATIONAL ECONOMIC POLICY IN AN INDEPENDENT WORLD, Report to the President submitted by the Commission on International Trade and Investment Policy, July, 1971, at 230. (U.S.G.P.O. No. 0-438-834).

[8] Agreement Concerning Automotive Products with the Government of Canada, Jan. 16, 1965, [1966] 1 U.S.T. 1372, T.I.A.S. No. 6093.

with regard to this question. There has been a substantial amount of investment and rationalization in Canada. One conventional expanation is that, although the automobile companies were forced by the letters of understanding to guarantee a certain amount of increased investment, the companies discovered much to their surprise that it was actually efficient to be investing in Canada, and so they did even more than was required.[9] This interpretation would, I suppose, support a fairly optimistic forecast of what would happen when you tear down trade barriers in an industry largely foreign-controlled.

But on the other hand, one also finds testimony such as that given by a representative of General Motors to the Williams Commission.[10] Seeking to explain the adverse balance of payments impact of the automotive products trade, the G.M. representative reported that, in large part, the reason for the trade deficit was an inaccurate forecast by the automobile manufacturers. The manufacturers had hoped, he said, to keep Canadian production about equal with Canadian consumption; the reason for the deficit was that, although Canadian consumption of automotive products did move as forecasted, the consumption of American-type automobiles did not, due to a larger-than-expected import penetration of small third-country automobiles.

If you think about that testimony for a while, you might come to a different conclusion about the principles which guided the level of investment in Canada. Was it an efficiency decision? The testimony seems to suggest no, that investment decisions were guided, at least in terms of total size, by the desire to accommodate a political situation.

If one listens more generally to the debate which goes on in the United States between the Congress, on the one hand, and the multinational enterprises, on the other, one finds some other evidence that may be of concern. Some members of Congress are charging the multinational enterprises with running to low-cost for-

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[9] *See* Trezise, *U.S.-Canadian Economic Relations*, in UNITED STATES INTERNATIONAL ECONOMIC POLICY IN AN INTERDEPENDENT WORLD, *supra* note 7, PAPERS, vol. II, 217, 224-27.

[10] Welch, *U.S.-Canada Automotive Trade Agreement*, in UNITED STATES INTERNATIONAL ECONOMIC POLICY IN AN INTERDEPENDENT WORLD, 239, 247-51. This description of company investment and production policy does not, of course, serve as any evidence of what would happen if both the Canadian and U.S. governments had kept their hands off.

eign sources in order to export back to the United States.[11] Now if that charge were true, it would indicate, I suppose, that the multinational enterprises were indeed behaving in an economically rational fashion. When the firms reply to the Congress, however, they seem to be saying that the investments abroad are not nearly so rational. We invest abroad, they say, only when we have to in order to save the market; we prefer producing in the United States unless it is really a question of losing the market. Moreover, they add, when we do invest abroad, we generate lots of exports that we would not otherwise have.[12] The suggestion of this latter point is that captive foreign subsidiaries will buy from the parent, whereas local firms probably would not.

A Canadian listening to that testimony would have to be rather concerned about the economic motivation of the multinational enterprise. One has to take this testimony, of course, with a grain of salt. The multinational enterprises are caught in a political crossfire. Each government wants a trade surplus. That is a rather difficult objective to achieve, across the board. The multinational enterprise is doing the logical thing with these illogical demands. It is promising every government a surplus. As I say, one has to take these promises with a grain of salt.

Nonetheless, the fear of noneconomic business decisions is real, and the fear leads logically to the conclusion that one cannot approach trade barrier reduction, at least in foreign-dominated sectors, without concern for the subsequent behavior of the foreign investors who are there. That concern, in turn, may well lead governments to make trade liberalization contingent on "understandings" concerning the subsequent behavior of foreign investors. I am saying, in other words, that the possibility of governments demanding such understandings may be a far more common problem than we have thus far assumed in our thinking about the Canadian Auto Parts agreement.

Now the question I would put is this: Assume that what I have said so far is right. On what basis are governments going to talk to each other when it comes to the question of regulating, accom-

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[11] This point of view has been represented in the main by the support given to the so-called Burke-Hartke bill which has been before the Congress for the past several years, thus far without success. The bill proposes to limit foreign investment generally by means of both less favorable tax treatment and direct regulation. *See, e.g.*, H.R. 10914, 92d. Cong., 1st Sess. (1971) Titles I, VI.

[12] *See, e.g.*, EMERGENCY COMMITTEE FOR AMERICAN TRADE (ECAT), THE ROLE OF THE MULTINATIONAL CORPORATION IN THE UNITED STATES AND WORLD ECONOMIES, 14-27 (1972).

modating, coordinating and reaching agreement on the legitimacy of each other's demands on the behavior of foreign investors? What is an appropriate demand for the government to make?

Although my sources of information are about fourth hand by now, a typical problem seems to have arisen under the Canadian Auto Parts agreement. The United States officials are now taking the position that the letters of understanding were transitional and transitional only, and that the ultimate objective in the North American automotive production field should be to let market forces determine where production is sited. I take it that the Canadian government is not completely committed to that view. There is at least some mention of a continuing commitment on the part of the automobile companies to keep their production in Canada roughly correspondent to the Canadian percentage of automobile consumption.[13] This is the kind of problem I see. How are we going to approach it?

Looking at the positions emanating from various United States government sources, one will see a certain degree of uncertainty among ourselves about the demands we want to make on this process. In the report of the President's Commission on International Trade and Investment Policy (the Williams Report), some interesting comparisons can be made. There is a very strong denunciation of Japanese policy toward investment; Japan must open up.[14] There also is another general section in which the Commission recommends that the United States, as a matter of general policy, try to amplify and strengthen the commitments of the OECD Code of Capital Liberalization,[15] a code which essentially aims toward a free market for foreign investment. But then, in the section devoted to United States policy toward developing countries, the Commission recognizes that each country has a "sovereign right" to determine when and what direct foreign investment is consistent with its national goals.[16] The difference between the policies toward developed and developing countries is never . . . well, developed. I am not saying that these policies are necessarily inconsistent. One can think of many possible distinctions. But the question is not discussed.

Emanating from the legislative branch of government we have

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[13] *See* Trezise, *supra* note 9, at 225-26.

[14] UNITED STATES INTERNATIONAL ECONOMIC POLICY IN AN INTERDEPENDENT WORLD, *supra* note 7, at 221-23.

[15] *Id.* at 193-95.

[16] *Id.* at 255.

the Burke-Hartke bill.[17] Now the Burke-Hartke bill does not rest on any concern about the noneconomic behavior of foreign investors. Quite to the contrary, it assumes that foreign investors behave with complete economic rationality. But even so, Burke-Hartke is asserting a competing claim — that the United States should also have a hand in determining what investment goes *out* of the country. If you think about it, Burke-Hartke is really a logical response to what is going on in the rest of the world. If governments around the world continue to exert stronger and stronger controls over what foreign investment comes in and how it must behave, one cannot expect the United States to stand aside while others decide where an industry's economic activity shall be located. At some point, the United States will have to assert its own interests in the investment outflow.

The variety of positions appearing within the United States is typical of the unsettled nature of the problem generally. The question remains: On what basis are we going to talk to each other? One solution is that there are no rational, neutral standards such as the free market place to which we can appeal, and that what we must do instead is to accept the fact that this is simply a question of cutting up the pie of economic benefits. Under this view, we should treat the problem much as we treat some of the cooperative procurement arrangements that we make under NATO, where, when NATO forces build a fighter plane, everybody gets a piece.[18]

Another solution, the one which government officials would think of first, is to call a conference and try to create a GATT for investment. Indeed that title is now quite well known, at least in academic circles.[19] One of the difficulties with this approach (though certainly not a bar) is that if one looks at the conventional sources of what might be called the common law on this subject, we really have not moved very far toward consensus. The conventional international events and documents have a strange disharmony with actual practice. We have the United States pursuing very aggressively a free market policy in its treaties of friendship, commerce

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[17] *See* note 11 *supra.*

[18] Professor Behrman has given thoughtful consideration to this approach, and to its utility as a means for industrial development and integration. *See* Behrman, *supra* note 4; Behrman, *Sharing International Production Through the Multinational Enterprise and Sectoral Integration,* 4 LAW & POLICY IN INT'L BUSINESS 1 (1972).

[19] *See, e.g.,* Kindleberger & Goldberg, *Toward a GATT for Investment: A Proposal for Supervision of the International Corporation,* 2 LAW & POLICY IN INT'L BUSINESS 295 (1970).

and navigation.[20] Indeed we have treaty commitments with many of the countries who are regulating foreign investment, treaties in which those countries are promising *not* to regulate investment.[21] We have the OECD Code of Liberalization of Capital Movements, mentioned above, which has been the apex of this free market effort. Here we are, then, moving toward a more and more formal declarative consensus in favor of the free market place, while at the same time governments are increasingly turning toward greater regulation in fact. If we were to call a conference, I do not think we would have very much with which to start.

I leave you with the question, where do we go? I think this is a question which, while it now comes up with regard to Canada, is probably one that is going to influence more and more trade negotiations generally, the more that foreign investment occupies sectors of various industries around the world. Canada faces the problem in acute form. But think for a moment how many other countries have already permitted a substantial degree of foreign investment penetration.

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[20] *See generally,* Walker, *Modern Treaties of Friendship, Commerce and Navigation,* 42 MINN. L. REV. 805 (1958).

[21] *See, e.g.,* Torem & Craig, *Control of Foreign Investment in France,* 66 MICH. L. REV. 669, 706 (1968).