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# Japanese Perceptions of the Canada-U.S. Free Trade Agreement

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Japanese direct investment in Canada has grown at unprecedented rates over the last few years. By 31 March 1990, Japanese direct investment in Canada had surpassed $4.5 billion, doubling the level set only three years earlier (Ministry for International Trade and Industry 1990). Moreover, since the mid-1980s the traditional concentration of direct investment in the resource sector has given way to a much broader portfolio of activities involving investments in automobile assembly, auto parts production, technology, computers, and pharmaceuticals (Mark 1990).

One of the most significant developments believed to be affecting opportunities for Japanese companies is the Canada-U.S. Free Trade Agreement (FTA). By the end of the 1980s, the FTA was perceived as not only facilitating the transborder flow of Japanese goods but also providing an opportunity for Canada to attract even greater shares of Japan's foreign direct investment (FDI)—see, for example, Hampson (1988: 9) and remarks by Lambert (1989).

Several advantages of the FTA have been cited as attracting further Japanese investment in Canada, including improved access to a larger U.S. market, beneficial exchange rates, generally lower labour

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costs, a skilled work force, and cheaper land costs and energy inputs (see remarks by D'Aquino 1989). Even before implementation of the FTA, the Gleneagles International Consulting Group Inc. had predicted that Canada would be a major recipient of Japanese investment in North America as a result of the FTA, and it went on to warn that "if the FTA does not receive legislature approval . . . Canada's ability to attract its share of [Japanese] investment will be seriously impaired" (Gleneagles Group 1988: v). Rugman (1990a: 33) also suggested that, in theory, Canada should attract more than its potential 10 percent[1] share of Japanese FDI in North America, other things being equal, mainly because of the benefits obtained from the spreading of risk in two separate political and legal jurisdictions, even in the face of further economic integration. He concluded that "the FTA itself is the single most important magnet to attract Japanese DFI [direct foreign investment] to Canada".

Not all commentators in Canada have accepted this view, however, and Rugman himself mentions the possibility that "the FTA will be mistakenly interpreted by the Japanese simply as an opportunity to retreat to the more familiar US investment market, from which the Canadian market can be serviced with exports" (Rugman 1990a: 34). Supporting this scenario, Wright (1990) notes that Japanese firms did little manufacturing in Canada before the agreement even though trade barriers were already inconsequential in most sectors and adds that "in fact, much of Japan's manufacturing investment in Canada is here precisely because trade barriers existed".

In Japan, initial reaction to the FTA was very cautious as Japanese business grappled with the real intent of the agreement. There was concern that the overall effect of the agreement might be negative. "Did it signal a retreat from multilateralism? Was it a first step in the building of a 'fortress North America'? Would it be used against Japanese business? Would it really open up opportunities for trans-Pacific trade?" (D'Aquino 1989: 32). Given these concerns, the Japan-Canada Economic Committee of *Keidranren* (the powerful Japanese

1. This 10 percent figure is often cited as Canada's "fair share" of Japanese direct investment in North America, based on its approximate share of continental population and market. The logic of this and other discussion of Japanese direct investment in Canada lies, of course, in assuming that Japanese firms are willing to treat Canada and the United States as similar investment opportunities. But applying the same reasoning, the United States might expect to account for only 25 percent of total Japanese foreign direct investment (compared with the 48.2 percent it achieved in fiscal year 1989), which is the proportion approximately equivalent to its relative share of the world gross national product. Obviously, a special "U.S. factor" is at work, and the reality is, of course, that Canada never has been, and is never likely to be, treated with the same considerations as the country that occupied Japanese terrority. For a more realistic perpective on this issue, see Pringsheim (1990) and Wright (1990).



employers association) conducted a survey in late 1988 to study trends in Japan's direct investment in Canada. Of the 226 Japanese companies that responded to a question on the impact of the agreement, 140 answered that it would not influence their direct investment in North America, and 78 companies answered that the agreement would promote direct investment in the region. Of these 78 companies, 45 said that they had no preference between the two nations as prospective locations, and 29 declared that they preferred the United States. Only four companies in the survey preferred Canada over the United States (*Keidranren* 1989).

This hardly auspicious initial Japanese reaction to the FTA was followed by the much more up-beat evaluation of the so-called Morohashi investment mission (October-November 1989)—the third major Japanese investment mission to Canada in recent years (Morohashi et al. 1990)—which appeared to be impressed generally with Canada and, more important, to want to allay Japanese concerns over the objectives of the FTA. Thus, even though the agreement was barely one year old at the time of the visit, the mission proclaimed that it did not reflect a "fortress North America" mentality or prejudice the interests of Japan in its bilateral trade relations with Canada, but rather that the FTA would likely contribute to general trade liberalization. The mission also noted that while "investment friction" and an increasing rejection of Japanese investment had been observed in the United States, Canada still welcomed direct investment from Japan.

The question of whether the Morohashi mission sent strong, lasting signals to Japanese investors that, following the FTA, Canada was a desirable location for long-term direct investment remains unanswered. For fiscal year 1989-90, levels of Japanese investment in Canada did indeed turn up significantly and reached US$1.36 billion, more than double that achieved in the previous year (Ministry for International Trade and Industry 1990). But did this imply a resurgence of Japanese direct investment in Canada and a more positive assessment of Canada by Japanese companies as a direct result of the FTA?[2]

This article addresses these questions by (1) examining the North American investment activities and strategies of a sample of Japanese manufacturing corporations to understand how they might react to the FTA in the future, and (2) considering under what situations Canada might hope to take advantage of the FTA and attract higher levels of

2. In fact, of the increase in Japanese direct investment in Canada over the three years 1987-1989, 31 percent was in the pulp/paper sector, most of which was oriented toward Japanese markets rather than North American markets (derived from unpublished data provided by the Japanese Ministry of Finance; see footnote 3).

Japanese investment to Canada. The next section of this article reports on a survey of 36 Japanese manufacturing companies undertaken during 1989-1990. This survey assesses their current organizational network in North America and their likely reactions to the new environment set by the FTA. The concluding section presents a prognosis for Japanese investment in Canada and its regional dimensions over the decade of the 1990s.

## Strategic Behaviour of Japanese Manufacturers and Their Likely Responses to the FTA

To assess the likely Japanese response to free trade, survey interviews were conducted during 1989 and 1990 with those Japanese companies that had established or were likely to establish manufacturing operations in either Canada or the United States and had acquired at least 50 percent equity in their subsidiary. The sample was taken from those firms identified as manufacturers in the *1989-90 Directory: Japanese-Affiliated Companies in USA and Canada* (Japan External Trade Organisation 1988). Although it cannot be claimed that the sample is completely random, it is believed that the firms interviewed having plants in Canada (n = 27) represented approximately 90 percent of total employment in Japanese-controlled manufacturing enterprises in Canada at the end of the 1980s (based on an analysis of data derived from Japan External Trade Organisation [1988] and Ontario House [1990]).[3]

The survey addressed the question of whether, following the FTA, Japanese firms would invest or retain a manufacturing presence in Canada and take up the Canadian government's challenge to export to markets south of the border and beyond, or whether they were likely to disinvest as tariffs declined and so import more products into Canada from U.S. locations with lower production costs. In theory, a central issue in light of trade liberalization is whether transborder trade would substitute for previous patterns of investment in import substitution. The traditional economic literature, working within the Heckscher-Olin-Samuelson framework, has considered trade and direct investment direct substitutes. Accordingly, some observers have believed that, with the reduction of trade barriers, Japanese investors would no longer produce in Canada in order to avoid the high trade tariffs levied on manufactured goods. Specifically, concern has been expressed that some of the 50 or so Japanese-controlled manufacturers (such as Toyota, Sony, and Mitsubishi Electric) operating in Canada at the end of the 1980s (Japan External Trade Organisation 1988; Ontario House 1990) would close their Canadian subsidiaries after free trade. Such an *a priori* argument can be made on the basis of production functions and the belief that multinational branch plants in Canada might be replaced by larger, more efficient plants in the United States.

3. The survey interviews, which took place in both Japan and Canada, excluded pulp, paper, and other timber processing plants, as forest products were specifically omitted from the FTA. Trade in pulp, for example, was not affected by the agreement just as it was not affected by tariffs before the FTA. While "fine papers" attracted approximately 3 percent tariffs before the FTA, the overwhelming major grade of paper exported to the United States from Canada is newsprint, which faces no trade barriers. Surveys by the author of Japanese-owned enterprises in the timber products industry indicate that transborder trade does not especially dominate. Japan is the major market for Japanese wholly-owned Canadian subsidiaries, and in the case of joint ventures with Canadian firms, the markets tend to be shared fairly equally among Japan, the United States, Canada, and other countries.



Counter to this viewpoint, Rugman argues (1990b: 39) that Canadian branch plants may not suffer many adverse adjustments in their post-trade liberalization status because a major motivation for foreign direct investment is the need to overcome transaction costs and other exogenous natural market imperfections—an explanation entirely separate from considerations of tariffs. Thus, it is reasoned increasingly that modern multinationals compete on economies of scope, whereby they need to customize products for segments of national markets and utilize sophisticated flexible manufacturing systems to combine production efficiency with local market diversity. According to this perspective, managers are loathe to shut down production centres in smaller markets even after a bilateral free trade area is introduced.

To test these opposing contentions, this survey was designed to examine the motivations and strategies, as well as the nature of their existing operations in North America, of the Japanese corporations identified. More specifically, using a framework established in a previous study of Japanese investment (Edgington 1990a), this survey gathered evidence on these firms' investment motivations, marketing strategies, regional research and design activities, and higher order management functions.

### Profile of Firms

The firms interviewed are distributed almost evenly among car assembly and parts manufacturing, consumer electronics and other consumer products, and various industrial product and component makers (Table 1). Of the 37 firms interviewed, 36 were found to have at least one manufacturing investment project in either Canada or the United States (that is, only one company had not yet made an manufacturing investment in North America).

The dates of commencement of production by the surveyed firms in both the United States and Canada are shown in Table 2. This indicates that there was a steady increase in Japanese production facilities in North America from the early 1970s, when industrial products predominated, to the late 1980s, when an array of Japanese auto manufacturers and their parts suppliers predominated. The results for Canada mostly parallel patterns of plant openings in the United States, except that Canada appears to have missed out on the wave of consumer electronics plants built in the United States during the late 1970s, arising from the antagonism in the U.S. Congress over trade with Japan.

## Investment Motivations

When firms were asked why they originally invested in either the United States or Canada, firms with a plant in the United States (n = 30) most often cited some form of trade conflict, such as the direct "voluntary" restrictions imposed on automobile exports and hammered out between the U.S., Canadian, and Japanese governments in 1981, or the threat of protectionism and the political pressure placed on Japanese consumer electronics companies to produce colour TVs, videocassette recorders, and so forth in the U.S. market (Table 3). Such trade conflicts also indirectly compelled auto parts suppliers in the survey to set up production facilities in either the United States or Canada because of their close links to the major Japanese auto assemblers.

Other, more roundabout constraints to trade in the United States, such as tariffs, were found to be insignificant in the decisions of the firms surveyed to make their predominant production investment in that country. At the time of their investment, most firms interviewed felt they could match any tariff by superior production performance from a Japanese base.

Investment motivations directly related to the need for closer links to the local market (for example, because of market growth or the need to have close client relationships), or the taking of a market diversification opportunity (for example, a merger or acquisition), accounted for just under one-half of the firms surveyed and, interestingly, was the response given by all those firms oriented primarily toward industrial markets.

Where companies had made a separate Canadian production investment or where Canada was the only investment location (n = 27), motivations for investing in each country were surveyed separately (Table 4). Responses were fairly evenly divided among four major motivations. The first, "strategic choice," was revealed to mean, after

**TABLE 1 Distribution of Companies by Product Type (n = 36)**

| Group/Company Type | Number | Percent |
|---|---|---|
| A Automobile assemblers | 5 | 13.9 |
| B Auto parts manufacturers | 6 | 16.7 |
| C Consumer electronics | 8 | 22.2 |
| D Other consumer products | 4 | 11.1 |
| E Industrial products and components | 13 | 36.1 |
| Total | 36 | 100.0 |

**TABLE 2 Date of Commencement of Production or Japanese Ownership (n = 35)**

| Group | | 1965-1969 | 1970-1974 | 1975-1979 | 1980-1984 | 1985-1990 |
|---|---|---|---|---|---|---|
| A | — USA | | | | 1 | 3 |
| | — Canada | | | | | 3 |
| B | — USA | | | | | 4 |
| | — Canada | | | | 1 | 5 |
| C | — USA | 1 | 2 | 4 | 1 | |
| | — Canada | | 3 | | 1 | |
| D | — USA | | | | 2 | 1 |
| | — Canada | | | | 1 | 1 |
| E | — USA | 1 | 5 | 1 | | 4 |
| | — Canada | 2 | 2 | 1 | 2 | 6 |
| Total | — USA | 2 | 7 | 5 | 4 | 12 |
| | — Canada | 2 | 5 | 1 | 5 | 15 |

**TABLE 3 Motivation for Setting Up Manufacturing in the United States (n = 30)**

| | Group | | | | | |
|---|---|---|---|---|---|---|
| Motivation | A | B | C | D | E | Total |
| Strategic choice | | | | | 1 | 1 |
| Trade conflict | | | | | | |
| Direct | 4 | | 8 | 1 | | 13 |
| Indirect | | 3 | | | | 3 |
| Tariff | | | | | | — |
| Market considerations | | | | | | |
| Market diversification | | | | 1 | 3 | 4 |
| Growth of local market | | | | 1 | 4 | 5 |
| Proximity to customers | | | | | | |
| Particular | | | | | | — |
| General | | 1 | | | 3 | 4 |
| Total | 4 | 4 | 8 | 3 | 11 | 30 |

**TABLE 4** Motivation for Establishing a Separate Production Centre in Canada (n = 27)

| Motivation | Group A | B | C | D | E | Total |
|---|---|---|---|---|---|---|
| Strategic choice | 2 | 1 | | | 2 | 5 |
| Trade conflict | | | | | | — |
| Direct | | | | | | |
| Indirect | | | | | | |
| Tariff | | | 4 | 1 | 1 | 6 |
| Market considerations | | | | | | |
| Market diversification | | | | | 2 | 2 |
| Growth of local market | 1 | | | 1 | 2 | 4 |
| Proximity to customers | | | | | | |
| Particular | | 2 | | | | 2 |
| General | | 1 | | | 4 | 5 |
| Cheaper costs | | | | | | |
| Wages | 1 | | | | | 1 |
| Other costs | | | | | 1 | 1 |
| Access to raw materials | | | | | 1 | 1 |
| Total | 4 | 4 | 4 | 2 | 13 | 27 |

further probing, that, having made the decision to set up in North America, firms found it then politically astute to "share" manufacturing plants on both sides of the border (that is, to engage in a philosophy of "one market, one factory"). This response was given by two of the three auto assemblers operating in Canada. The second motivation, market considerations—such as growth of the local market or the need to be close to a particular Japanese customer (that is, one of the major car assemblers)—induced four auto parts producers and eight industrial parts producers to manufacture in Canada. The Canadian tariff, the third motivation, influenced six companies to establish plants in Canada, including all four consumer electronics firms and a single miscellaneous consumer goods producer. One car assembler and two industrial companies, citing a fourth motivation, indicated that access to raw materials and Canada's favourable wage and other costs (up to the late 1980s) were material influences in choosing a Canadian location.

In summary, there seemed to be a relatively clear distinction between the major motivations for producing in the U.S. and Canadian markets. In the case of factories in the United States, the political necessity stemming from trade conflict dominated (57 percent of cases). In the case of Canada, trade tariff and market-oriented decisions collectively were the most important (together resulting in 48 percent of cases).



Only in three cases did respondents reply that relatively lower Canadian costs provided a significant advantage over the United States, and only in one case did this involve cheaper labour costs. In another case, involving the production of a metal car part, the cost savings in Canada due to cheaper energy costs appeared to be an important reason for choosing a Canadian location to serve a combined North American market.

### Marketing Strategy and Exports to the United States

Of the 35 firms interviewed that were already manufacturing in North America, 13 were already producing in both countries and exchanging output between the two markets, and eight were producing exclusively in the United States and exporting at least some of their output to Canada (Table 5). Conversely, only five firms were located exclusively in Canada and exporting part of their output to the United States. Those firms manufacturing in both Canada and the United States were asked how they rationalized their production for the joint North American market among their plants. Thirteen out of the 22 firms producing in both countries had some production or market complementation strategy—that is, they arranged production between their factories either by having their Canadian and U.S. plants produce different products or, where the situation warranted it, by dividing the continent into different regions (for example, East Coast and West Coast, where transportation costs were important). The remaining nine firms (predominantly small auto parts and industrial products enterprises) had, at the time of the survey, decided to manufacture similar products in both markets.

Of those firms producing in Canada and marketing their products in the United States (n = 24), most had substantial exports, indicating either significant integration of their North American production facilities or that the decision to produce in Canada was made with the knowledge that the market would be continental in scale (Table 6). Further probing indicated that the rationalization of production between Canadian and U.S. plants occurred, with only two exceptions, before the Free Trade Agreement was announced. Those firms recording the highest percentage of exports tended to be the large-scale auto assembly and auto parts manufacturers whose large production capacity necessitated a North American-wide market (see Booz Allen and Hamilton, Inc. and Pilorusso Research Associations Inc. 1990).

## Location of R&D Facilities and Regional Corporate Headquarters

One part of the interview questionnaire was designed to test whether some of the recent localization tendencies among Japanese corporate strategies (Edgington 1990b) had occurred in North America. More specifically, Japanese firms were asked whether they had set up an R&D centre in America or established a North American regional headquarters to coordinate their subsidiaries in Canada and the United States, or both (Table 7). Of the 37 firms in the survey, 25 replied that they had set up separate R&D centres for their North American operations and that this involved some aspect of either design or product development activities. In many cases, of course, the principal research and product specifications were still centralized in Japan. Only in four cases could any significant research or design capacity associated with the Canadian plants of Japanese companies be detected. Nine of the corporations had created a regional headquarters to oversee their North American plants and marketing operations, and, as may be expected, all but one were located in U.S. centres (for example, New York, Boston, and Chicago). By and large, therefore, the evidence appears to suggest that the localization of R&D functions and regional management functions has to date benefited most those locations favoured by the Japanese in the United States.

## Implications of the FTA

Finally, firms were asked to assess the likely implications of the Free Trade Agreement for their corporate strategies in North America over the 1990s (Table 8). The results distinguish between corporations who produce only in either the United States or Canada and those who produce in both countries.

Those firms who had set up only in the United States responded that they could not foresee that the FTA by itself would induce them to expand their North American capacity by setting up a plant in Canada. The only type of response recorded was that they would try to increase their market share in North America by means of U.S.-based production or from their traditional sources in Japan.

For those firms that supplied North America from only a Canadian location, the single response was again that the FTA per se would have no effect on their strategies—for example, by either rationalizing production or closing their Canadian factory. This appears to indicate that their locational decision in favour of Canada

**TABLE 5 Marketing Strategy for U.S. and Canadian Markets for Those Firms Having Factories in Canada or the United States or Both (n = 35)**

| | Group | | | | | |
|---|---|---|---|---|---|---|
| Marketing Strategy | A | B | C | D | E | Total |
| Producing in both markets and sharing output by: | | | | | | |
| Product type | 2 | 1 | 3 | 2 | 4 | 12 |
| Region | | | | | 1 | 1 |
| Producing in both markets but no sharing of products | | 2 | 1 | | 6 | 9 |
| Producing only in Canada but exporting to the U.S. | 1 | 2 | | | 2 | 5 |
| Producing only in the U.S. but exporting to Canada | 2 | 1 | 4 | 1 | | 8 |
| Total | 5 | 6 | 8 | 3 | 13 | 35 |

**TABLE 6 Percent of Canadian Production Exported to the United States (n = 24)**

| | Group | | | | |
|---|---|---|---|---|---|
| Marketing Strategy | A | B | C | D | E |
| By product sharing | 60-70 | 70 | 45-60 | 25-50 | 40-50 |
| By region | | | | | 35 |
| Producing only in Canada but exporting to the U.S. | 100 | 10[a]-80 | | | 10-30 |
| Producing similar products in both countries but exporting to the U.S. | | | | | 6 |

a. Includes one firm exporting 90 percent of production to Japan.

**TABLE 7 Number and Location of North American R&D Centres and Regional Headquarters (n = 26)**

| Group | R&D Centres | Regional Headquarters |
|---|---|---|
| A | 4, U.S. | 1, U.S. |
| B | 2, U.S. | 2, U.S. |
| C | 7, U.S. | 2, U.S.[a] |
| D | 4, U.S.<br>1, Canada | 1, U.S. |
| E | 4, U.S.<br>3, Canada | 2, U.S.<br>1, Canada |
| Total | 21, U.S.<br>4, Canada | 8, U.S.<br>1, Canada |

a. Includes an international purchasing office located in the United States.

**TABLE 8 Implications of the Free Trade Agreement for Corporate Strategy in the 1990s (n = 35)**

| | Group | | | | | |
|---|---|---|---|---|---|---|
| | A | B | C | D | E | Total |
| 1. Firms producing only in the U.S. (n = 8) | | | | | | |
| Set up plant in Canada | | | | | | 0 |
| No change/expansion in the U.S. | 2 | 1 | 4 | 1 | | 8 |
| Unsure | | | | | | 0 |
| 2. Firms producing only in Canada (n = 5) | | | | | | |
| Set up plant in U.S. | | | | | | 0 |
| No change/expansion in Canada | 1 | 2 | | | 2 | 5 |
| Close down plant | | | | | | 0 |
| Unsure | | | | | | 0 |
| 3. Firms producing in both markets (n = 22) | | | | | | |
| Expand plant mainly in Canada | | | | | 1 | 1 |
| Expand plant mainly in the U.S. | 1 | | | | | 1 |
| No change/expansion in both U.S. and Canada | 2 | | | 1 | 10 | 13 |
| Close down Canadian plant | | | 1 | | | 1 |
| Unsure | 2 | | 4 | | | 6 |

had already been based soundly on Canada's comparative advantages (for example, labour or energy costs) or strategic access to critical Canadian markets rather than on tariffs per se, so that no further rationalization due to the FTA was envisaged.

A more complex pattern of responses emerged from the group of firms that had production facilities in both countries. Yet here too "no change" was also the most common response. As we have seen, in part this reflected the extensive integration that took place between the North American plants of Japanese firms before the FTA was announced. This conclusion mirrors the results of a similar study carried out by Rugman to assess the impact of the FTA on U.S.-based multinationals operating in Canada (see Rugman 1990b:176). It appears, therefore, that most Japanese firms in Canada are thus far well positioned to weather the environmental changes associated with the FTA.

A notable minority of Japanese firms manufacturing in both the United States and Canada did volunteer, however, that free trade had either (1) nullified the viability of their Canadian plant, resulting in its closure (one case); (2) caused the parent firm in Japan to question seriously the viability of the Canadian operation (four cases, not recorded in Table 8); or (3) in the medium term caused a reevaluation of the attractiveness of Canada as a location and thus slowed the schedule of investment expansion in the Canadian plant (two cases). Conversely, although there have been recent reports of



Japanese plants attracted to Canada because of the opportunities afforded by the FTA, none were included in the author's survey.[4]

## Evaluation

Although the survey results may not be entirely representative of all Japanese production subsidiaries operating in either Canada or the United States, a number of conclusions can be drawn.

First, if the recent past is a reliable guide, Canada may continue to face an uphill battle in attracting investment from Japan in new production facilities—or even joint ventures with local Canadian manufacturers. A majority of the major Japanese firms have already made the strategic decision to manufacture in some capacity in the North American market, yet the long-standing U.S.-Japan trade imbalance problem has led most Japanese firms to feel that their interests are better served by creating an initial manufacturing facility in the United States rather than in Canada. Consequently, in a post-free trade environment the majority of Japanese producers are not facing a neutral locational decision between Canada and the United States. Rather, it is likely they are already well established in North America and that most firms are pursuing their next stage of development from an entrenched U.S. manufacturing base. As the survey shows, some of the larger Japanese companies have even established elaborate U.S.-based organizations, including R&D centres and regional corporate management activities.

This is not to say, of course, that no Japanese company will ever consider producing in Canada after free trade, or that no firm would change or extend its network of North American plants in order to manufacture in Canada. The fact remains, however, that because the U.S. market is about nine to ten times larger than that of Canada, many Japanese producers setting up in the United States appear to have largely perceived Canada as no more than a regional market. The lack of any political clout equivalent to that held by the United States has further reinforced this view.

Second, the results of the survey indicate that the majority of Japanese firms drawn to manufacture in Canada have done so already knowing they must rely on a continental integration of production and an ability to export competitively to the United States—even before

4. Examples of Japanese investments reportedly taking advantage of the FTA include the Telesat Mobile joint venture, established among Telesat Canada, Canadian Pacific Ltd., and the Japanese trading company C. Itoh, representing five Japanese companies. This joint venture, owned 20 percent by the Japanese consortium, was set up to produce satellite-based mobile telephones for a start-up cost of CDN$360 million. C. Itoh cited access to the American market stemming from the free trade deal as a reason for the venture (*Vancouver Sun*, 13 December 1988).

commencement of the FTA. This result alone suggests it is unlikely that the FTA by itself (that is, without any further inducement or pressure from the federal or provincial governments) would present any additional advantage for Japanese producers contemplating serving the North American market from a Canadian location.

Third, conversely, because of the relatively high level of complementarity among Japanese North American operations, it is unlikely on balance that a large number of companies presently carrying on production in Canada would retreat from manufacturing to importing following the FTA. While the survey uncovered one such example (involving the closure of a formerly protected mature consumer product with very slender profit margins), other Japanese-controlled factories of consumer products (for example, colour TV factories) were expected to sustain only minimal adjustments in the short term.

It is true that many firms were originally induced to set up in Canada because of tariffs and that some consumer-oriented firms in the survey did express uncertainty about the net impact of the FTA. Nonetheless, Japanese firms operating overseas in markets similar to that of Canada (such as Australia) have been known to tolerate losses on manufacturing (rather than "lose face" by repatriation) in order to secure access to their existing markets on a continuing basis (Edgington 1990a). Japanese MNCs are concerned primarily with secure, stable sales. Thus, while it may be postulated that with trade liberalization certain categories of Japanese investment in Canada might slow down, the bulk of existing Japanese direct investments in Canada are highly unlikely to be repatriated because of the existence of costly exit barriers and the aversion to losing face. Long-term adjustments after the FTA may occur, but these are expected to depend on other factors such as enduring shifts in exchange rates and the relative growth rates of Canadian and U.S. markets.

Fourth, in the specific case of automobile production, any new plant currently opening in Canada automatically faces a cost disadvantage because of the FTA. Under the provisions of the agreement, the Canadian investment climate for the auto sector has worsened because of the pending removal of duty remission on imported auto parts in 1994 and duty remission on fully built-up imported vehicles by 1998. By unilaterally closing off membership in the Auto Pact and eliminating the duty remission and duty drawback programs, the FTA increased the cost of doing business in Canada for Japanese transplants. This has caused them to believe that they received inequitable treatment in Canada when compared to the traditional North American motor vehicle manufacturers, the "Big Three" (interview with H. Imanaka, Corporate Secretary, Toyota Motor Manufacturing



Canada Inc., Cambridge, Ontario, August 1989). Consequently, it is unlikely that Canada could attract any additional assembly plants from Japan. Until Canada lowers its most-favoured-nation tariff on auto parts from 9.2 percent to the U.S. rate of about 3 percent or less, the Japanese manufacturers will find it less costly to assemble motor vehicles in the United States to serve both the U.S. and Canadian markets. Nissan, for example, recently upgraded its Mexican and U.S. production centres to meet market growth in continental North America (interview with S. Kawasaki, Manager, International Corporate Communications Department, Nissan Motor Company Ltd., Tokyo, June 1990).

## Conclusion

The basic question posed in this article is whether a single North American market will stimulate major strategic changes among Japanese manufacturers or whether we are likely to see a continuation of existing tendencies. This question has been addressed partially by examining the recent development and current structure of Japanese manufacturing investments in Canada and by identifying ways in which a single market might affect the industries concerned.

In a volatile economic, technological, and political economic environment, it is hazardous to make unequivocal predictions, yet it is likely that the more extreme general predictions about the effects of the FTA (both the very optimistic and the very pessimistic) on Japanese investment will not be experienced simply because many of the changes have already occurred. The major producers have, in effect, already anticipated a single market.

How then can Canada capitalize on the FTA and the optimism expressed in the Morohashi report? Lacking any political leaverage equivalent to that exercised by the United States, Canada is unlikely to receive a larger share of Japanese foreign direct investment unless it promotes itself to a much greater degree in Japan itself. The benefits of doing business with Canada must be made clear, yet, conversely, Canadian promotional policies should be based on realistic evaluations of national strengths and weaknesses. Obviously, Canada's advantages will vary product by product. While Canada traditionally has been perceived as having an edge on the United States through comparatively lower labour and energy costs, these advantages can be devastated by shifts in exchange rates and the additional labour costs associated with provincial taxes and benefit charges. Moreover, low labour costs and abundant energy may not give

Canada much of an advantage if they account for only 10 percent or so of the total cost of producing in high-technology sectors.

Finally, it is interesting to speculate on what might be the next wave of Japanese direct investment in Canada. Notwithstanding the rapid growth of Japanese investment reported during the 1989-90 financial year in the paper/pulp and machinery sectors (Ministry of Finance 1990), I believe that the most likely increase during the 1990s will be in services and property development, based on the rise in Japanese tourism here. Since 1987, Canada has been the third fastest growing market for Japanese tourists, behind Australia and Hong Kong (see Edgington 1990c). If present trends continue, tourism will have a substantial impact on the regional distribution of Japanese investment. An analysis of investment trends in the 1980s has shown that Japanese interest shifted away from the British Columbia/Alberta axis to central Canada, matching other tendencies in the national economy (Edgington 1990c). The reason lay mainly in the shift of Japan's priorities for investment in Canada and the shift in growth sectors over the decade (automobile assembly and finance) toward locations in southern Ontario. Up to the early 1980s, the reason for most of Japanese investment in Canada was to secure a supply of strategic resources, and, logically, British Columbia held great attractions. During the 1980s, however, Japanese interest shifted more and more toward manufacturing and the finance/insurance sectors. Consequently, British Columbia lost its natural competitive advantage in attracting Japanese investment against other provinces, notably Ontario.

In the foreseeable future, however, it is unlikely that Canada will be able to attract further rounds of Japanese automobile production or finance-oriented companies (see Edgington 1990c). If Japanese tourism continues to boom and Japanese firms continue to expand overseas into this and related service areas, it is probable that British Columbia ski resorts, hotels, and property will follow copper, coal mines, and forests as captive of the most dynamic economy in the Pacific. If this occurs, Japanese interest is likely to swing westward once more and focus on British Columbia's so-called "Golden Triangle" area (Vancouver-Whistler-Victoria), thereby directly and indirectly benefiting Vancouver's business and other service industries—although in this case, of course, the FTA is unlikely to influence these trends. As I have raised elsewhere, the larger question then becomes whether a rise in Canada's tourism profile among Japanese business could lead to a better appreciation of the storehouse of collaborative research and technology opportunities that exist in Canada (Edgington 1990c; also see Donnelly and Kirton 1988).



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