DECLINE AND GROWTH:

CANADIAN-JAPANESE ECONOMIC RELATIONS, 1978-1988

By

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B.A., The University of British Columbia, 1987

A THESIS SUBMITTED IN PARTIAL FULFILMENT OF

THE REQUIREMENTS FOR THE DEGREE OF

MASTER OF ARTS

in

THE FACULTY OF GRADUATE STUDIES

(History)

We accept this thesis as conforming

to the required standard

THE UNIVERSITY OF BRITISH COLUMBIA

August 1990

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Date Oct. 10/1990

DE-6 (2/88)

Abstract

This thesis examines the development of Japanese economic interest in Canada between 1978 and 1988, with a special emphasis on multinational decision making. The paper takes an eclectic approach to the issue because the trends within different industrial sectors varied widely, from strong growth in forestry investment and trade to slow expansions of technological ties. As a result of the increasing importance of the United States and the European Economic Community in the eyes of Japanese managers, coupled with the decline of the energy crisis in mid decade, resource suppliers like Canada declined in relative importance to Japan during this period, although Japanese investment and trade here expanded steadily in real terms.

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Acknowledgements

The thanks deserved are numerous. It seems that at least one point everyone I know has given me invaluable advice regarding either writing this thesis or gathering together the intestinal fortitude to complete it. Even so, Joanne deserves special thanks for putting up with my talk of this paper. My adviser, Bill Wray, also deserves thanks for readings my numerous manuscripts, which must have been tedious. Thanks as well to David Edgington, Ed Wickberg, and Dave and Randy Frank for valuable assistance.

I. *Introduction*

The internationalization of the Japanese economy, the increasing protectionism of the developed nations, competition from developing nations, and the end of the oil crisis all decreased the strategic importance of Canada to Japan between 1978 and 1988, although Japanese ties here expanded and diversified substantially. In the late 1970s, Canada was a key source of strategic resources for Japan, and in 1978 Japan had an enormous trade deficit with Canada, amounting to U.S. $1 billion.[1] As the energy crisis declined in the mid 1980s and the Japanese economy internationalized, the role of resources became less critical, and in the early 1980s, the Japanese trade deficit with Canada was reduced, largely by growth in Japanese

[1]Statistics Bureau, Prime Minister's Office, Japan Statistical Yearbook, 1980, Vol. 30., p. 313.

automobile exports. Thus, in the years 1985 through 1987, Japan even ran a trade surplus with Canada.[2] With the decline of the energy crisis, the Japanese corporate emphasis changed from obtaining resources to achieving market share for manufactured goods in increasingly protectionist developed countries and fighting off the industrial competition of the developing countries.[3] Between 1978 and 1989, Canada's share of Japanese foreign direct investment declined from 2.5 to 1.8 percent of the cumulative total although investment here increased steadily and Canada attracted a higher annual rate of investment in the late 1980s than it did earlier in the decade. In 1989, for example, Japanese direct investment in Canada doubled over 1988, and attracted two percent of Japan's total that year.[4] Canada also received considerable, long awaited investment in Japanese manufacturing, finance, and high-technology for the first time in the 1980s.

Changes in Japanese economic involvement with Canada came in waves, altering with international trends, U.S.-Japan relations, Canadian incentives and barriers, and Japanese domestic demand. From the late 1970s to the early 1980s, the key Japanese external concern in Canada and

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[2]ibid., various years.

[3]For a discussion of this in relationship to Canada, see Charles McMillan, "Japan and Canada, the bilateral economic relationship," pp. 16-23, in Canada and Japan: Bilateral Relations in a Global Context, edited proceedings of a conference sponsored by the Canada-Japan Trade Council in cooperation with the Japanese Embassy, November 8, 1989, (Ottawa), pp. 21-22.

[4]Japanese Ministry of Finance figures and JEI Report, No. 23B, p. 10.

internationally was resource procurement.[5] When this shifted to obtaining market share and investment in developed markets, Japanese emphasis in Canada shifted towards manufacturing, such as automobile assembly, although resources continued to grow in importance. Japanese financial firms from Japan expanded in Canada throughout the period. Canadian non-tariff barriers and incentives particular to projects were crucial in attracting multinational investment, but international trends like oil prices also shaped Japanese decisions relating to Canada.

A. The Eclectic Approach

As the Japanese business trends in Canada were diverse and complex, this thesis adopts an eclectic approach to Japanese multinational investment by integrating three separate streams of literature -- Canadian works on bilateral economic ties with Japan, writings on modern political economy, and economic theory relating to Japanese and multinational investment and decision making. An eclectic perspective must be used in combining these fields because, although Japanese investment and trade with Canada have been dominated by multinationals, these firms have responded differently to political change, economic cycles and opportunities in different industries. Each sector and the actors within it must be examined separately and the

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[5]Robert Ozaki, "Introduction," in Japan's Foreign Relations: A Global Search for Economic Security, Robert Ozaki and Walter Arnold, eds., (Boulder: Westview Press, 1985).

forces favouring or opposing investment in the minds of multinational managers must be weighed on a case by case basis. This helps to explain the uneven sectoral growth in Canadian-Japanese business relations while outlining the larger economic pattern. For example, an eclectic analysis explains why Japanese investment grew rapidly in the pulp and paper sector of the Canadian economy during the 1980s but expanded slowly in high technology manufacturing. To explore these differences, this thesis presents a series of case studies which examine the varying Japanese economic relations with Canadian firms during the 1980s.

The changes in Japanese investment in Canada between 1978 and 1988 are explained in terms of Japanese multinationals responding to the need for international market access, strategic resources, and portfolio and bond investment opportunities as economic and political trends changed. The economic relationship between Canada and Japan in this period consisted of ties between Canadian and Japanese multinationals, as well as U.S. firms in some cases. The main actors in all these exchanges were the Japanese firms, and Canadian multinationals generally responded to their initiatives. An example of this was the two new coal mines, Quintette and Bullmoose, which were constructed in Northeast British Columbia in the early 1980s. In this case, the majority owners were Canadian firms but the

economic planning and strategies were Japanese.[6] Small- and medium-sized Japanese firms did enter the economic relationship, but usually through the enormous sogo shosha, which organized much of the trade between the two countries.[7]

The dominance of Japanese multinational involvement was also related to the importance of resource extraction in the bilateral exchange and the enormous sums of capital required for these industries. Mining and forestry remained at the centre of Japanese economic ties with Canada. Combined, these two sources accounted for over half of Canadian exports to Japan in 1988.[8] The trade in both cases was closely monitored and organized by enormous Japanese multinationals associated with the keiretsu system of firms, which are horizontally interlinked companies centred around a bank;

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[6]For a discussion of this see Christopher Catliff, Japan's Government and Steel Industry Policies Towards Coking Coal Procurement, M.A. Thesis, Department of Political Science, UBC, 1985, which will be discussed later in this chapter.

[7]For a discussion of the continuing importance of Sogo Shosha in Canada while they declined in importance in the U.S., see Tamiko Kurihara, "Japanese Foreign Direct Investment in the United States and Canada by Sogo Shosha since 1951," UBC, Department of Geography, Ph.D. thesis, 1987, pp. 289-299. For a more general view of trading companies in the development of Japanese exports and imports, see Yoshi Tsurumi, Sogoshosha: Engines of Export-Based Growth, Revised Edition, (Montreal: The Institute for Research on Public Policy, 1984); and/or M.Y. Yoshino and Thomas B. Lifson, The Invisible Link: Japan's Sogo Shosha and the Organization of Trade, (Cambridge: The MIT Press, 1986).

[8]The percentage of exports was arrived at by adding the mineral fuels (which is mostly coal), raw materials, and non-ferrous metals columns from the Japan Statistical Yearbook, 1989, p. 351.

their historic roots are in the enormous zaibatsu conglomerates that were dismantled after the Second World War. It has been pointed out that Japanese firms did not require majority equity positions in the extraction operations that procured these resources, but that did not change the fact that it was multinationals associated with Japan's keiretsu system that dominated trade with Canada. Japanese multinationals also controlled the import trade into Canada. These firms were different from the companies dominating Canada's export trade, but the overall pattern remained, with firms such as Sony, Honda and Toyota organizing Canadian imports of most Japanese goods.[9]

As the case studies and strategies of Japanese multinationals are observed together, a new emphasis on the international perspective and its relevance to the Canadian-Japanese bilateral relationship emerges. The importance of multinationals and the continuing role of the large Japanese trading firms remained central, as Kurihara recognized.[10] Canada and Japan, and their connections, cannot be understood in terms of only bilateral

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[9]See Richard Wright, Japanese Business in Canada, The Elusive Alliance, Montreal: The Institute for Research on Public Policy, 1984.

[10]Kurihara commented that while the importance of the large trading firms was declining in the U.S. as smaller companies entered that market, the trading firms were increasingly involved in Canada. See Kurihara, pp. 408-410.

trade.[11] A new emphasis must be placed on Canada's international position and multinationals by combining the three streams of literature mentioned above.

B. Canadian Literature on Bilateral Ties

Before 1980, no Canadian scholar had carried out a major study regarding Canadian-Japanese relations since the Second World War, but since then numerous works have been published to explain the importance of the bilateral relationship, and to weigh its advantages and disadvantages.[12] One of the first and best known works was Zavis Zeman's study The Men with the Yen, in which he exhorted Canadians to study Japan because Canada's international economic position was declining and Japan's was quickly rising. In his alarmist tone, Zeman argued that:

> "There exists a marked gap between Japan's condition and the general level of its understanding in Canada. A comprehensive

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[11]See James H. Taylor, "Keynote Address," pp. 4-9, in Canada and Japan: Bilateral Relations in a Global Context, edited proceedings of a conference sponsored by the Canada-Japan Trade Council in cooperation with the Japanese Embassy, November 8, 1989, (Ottawa).

[12]The last major Canadian academic works discussing Canada and Japan were written during the Second World War era and included A.R.M. Lower, Canada and the Far East, 1940, New York: Institute of Pacific Relations, 1940; and H.F. Angus, Canada and the Far East, 1940-1953, Toronto: University of Toronto Press, 1953.

> and massive policy study, reappraising Japan from the perspective of the upcoming 1980s, is overdue."[13]

Unfortunately, the author did not say who in Canada would be capable of completing this study or who would finance and organize it. His comments, however, remain valid a decade later.

Following Zeman, Klaus Pringsheim and Frank Langdon each published a descriptive text on Canadian-Japanese economic and political relations.[14] Both scholars explored the connection and periodized it, but in essentially bilateral terms. Langdon's focused work discussed the development of economic ties between the two nations following the Pacific War when Japanese industry sought strategic resources in Canada and Canadian governments attempted to restrain Japanese manufactured imports while increasing value-added exports to Japan. Pringsheim's book described the development of diplomatic and political ties following the establishment of Canada's first embassy in Tokyo in 1929 until the early 1980s.

A number of more detailed works aimed at understanding the commercial side of the relationship were published in Canada in the 1980s

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[13]Zavis Zeman, The Men with the Yen, Occasional Paper No. 15 (Montreal: The Institute for Research on Public Policy, 1980), p. 121.

[14]The works referred to here are, respectively, Neighbours Across the Pacific, The Development of Economic and Political Relations Between Canada and Japan (Westport, Conn.: Greenwood Press, 1983), and The Politics of Canadian-Japanese Economic Relations, 1952-1983 (Vancouver: UBC Press, 1983).

by Richard Wright, Keith Hay, and Wendy Dobson. Aside from Hay's practical, export-oriented pieces, these works were generalist in tone.[15] Wright was the first author to explore the panorama of Japanese business dealings in Canada and to explain the numerous corporate interrelationships involved. Filled with enormous quantities of up to date statistical information, Wright's works showed a cross-sectional view of Japanese business in Canada.[16] In her work examining the trade and investment links between Canada, Japan and the United States, Dobson argued that relations between the three nations were triangular in nature with the policies of one impacting upon the others.[17] The emphasis of her study, however, was trades flows and it therefore overlooked the crucial question of multinational involvement, portfolio investment and the larger, international context of the economic relationships.

Numerous widely differing and often particular smaller articles and theses discussing the economic ties were published in the mid 1980s. These

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[15] Many of Hay's works were written for the Canada-Japan Trade Council with an eye to increasing Canadian exports to Japan. They therefore provided much background detail but little overview. Examples of these works are: Keith A.J. Hay and Sue Hill, Canadian Forest Products for Japan, (Ottawa: The Canada-Japan Trade Council, 1984); Keith A.J. Hay, Canadian Fish for Japan, (Ottawa: The Canada-Japan Trade Council, 1979); and Keith A.J. Hay, S.R. Hill, and S.S. Rahman, Canadian Coal for Japan, (Ottawa: Canada-Japan Trade Council, 1982).

[16]Wright, Japanese Business in Canada, The Elusive Alliance.

[17]Wendy Dobson, Canadian-Japanese Economic Relations in a Triangular Perspective, Observation No. 30, Calgary: C.D. Howe Institute, 1987.

publications ranged from Phil Resnick's argument that Japanese investment in British Columbia is similar to that of a classical imperial power to Anthony Hampson's work calling for Canada and Japan to ally closely in international trade negotiations because they both rely upon the multilateral system.[18] David Anderson argued that Canadian government and business must examine Japanese monopsony, and used the case of the Japanese coking coal procurement system to back up his argument.[19] Christopher Catliff concluded that although monopsony was involved in Japanese coal purchases, the involved companies had not conspired unfairly to reduce world prices and create a glut, and that Canada was not a victim in the development of Northeast coal.[20] Tamiko Kurihara's thesis described the development and diversification of sogo shosha trading company activity in Canada and the United States since 1951 and their continued importance in Canada.[21] These works began to discuss the international aspects of

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[18]Phil Resnick, "B.C. Capitalism and the Empire of the Pacific," in B.C. Studies, No. 67, Autumn 1985, pp. 29-46; and Anthony Hampson, Nikka Kankei: Japanese-Canadian Relations, The Opportunities Ahead, Observation No. 33, Toronto: C.D. Howe Institute, 1988.

[19]David L. Anderson, An Analysis of Japanese Coking Coal Procurement Policies: The Canadian and Australian Experience, Kingston: Centre for Resource Studies, Queen's University, 1987.

[20]Catliff, Japan's Government and Steel Industry Policies Towards Coking Coal Procurement.

[21] Kurihara.

Canada's relations with Japan, but most were too particular or narrow in focus to explore the overall picture.

In the late 1980s, a number of monographs with an emphasis on how Canada could obtain Japanese technological investment, expertise, and managerial skills were published, all of which discussed Canada within a global context. These included papers by Charles MacMillan, a former Senior Policy Advisor to Prime Minister Brian Mulroney, which called for more provincial and federal attention to attracting Japanese business. Specifically, he called for attention to and emulation of Japan's scientific programs and research.[22] Two other academics asked the federal government to consider potential areas where Japanese investment could be attracted when allocating research dollars.[23] All these monographs assumed that Japan would be a key international source of technological expertise in the 1990s and emphasized the need for increased Canadian attention to this.

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[22]Charles T. McMillan, Bridge Across the Pacific: Canada and Japan in the 1990s, Ottawa: Canada-Japan Trade Council, 1988, and Investing in Tomorrow: Japan's Science and Technology Organization and Strategies, Ottawa: Canada-Japan Trade Council, 1989.

[23]Michael W. Donnelly and John Kirton, The Potential for Partnership: Canadian-Japanese Investment and Technology Relations, Policy Study No. 3, Toronto: Joint Centre for Asia Pacific Studies, 1988.

C. Political Economy

The second field of academic discussion that is introduced in this thesis is recent works on political economy and related topics. Contemporary historical and political works have emphasized the interlocking nature of the world and the need for an interdisciplinary approach to understand it.[24] For example, Robert Gilpin argued that the evolving international economy must be understood in terms of the decline of American leadership, the increasing integration of the American and Japanese economies, and the shift of economic power to the Pacific.[25] Paul Kennedy described the world as a series of economic and military blocs constantly struggling for preeminence.[26] The MacDonald Commission also stressed the importance of a broad, international outlook, but then turned this argument upon its head and said that as a result of Canada's weak global position it should turn even more towards its largest market, the United States.[27] The need for adopting an

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[24]One example of this trend was the publication of The Political Economy of Japan, Vol. 1-3, Yasusuke Murakami and Hugh T. Patrick, general eds., Stanford: Stanford University Press, 1988. Collected in these works are the writings of economists, political scientists, historians and business scholars discussing the political economy of modern Japan.

[25]Robert Gilpin, The Political Economy of International Relations, (Princeton: Princeton University Press, 1987), pp. 5-7.

[26]Paul Kennedy, The Rise and Fall of the Great Powers, Glasgow: William Collins Sons & Co., 1989.

[27]Royal Commission on the Economic Union and Development Prospects for Canada, Report, Volume 1, Ottawa: Minister of Supply and Services Canada, 1985.

international approach to understand Japanese investment in Canada, including the political, business and financial perspectives, is paramount, because only then can the bilateral trends be understood.

D. Multinational Arguments

Literature regarding multinational strategies must be integrated into the discussion. Works of interest include those by Kiyoshi Kojima and Terutomo Ozawa on Japanese multinationals. Kojima noted that the majority of Japanese foreign investment in the 1970s was directed towards developing countries by small companies in industries where Japan was losing comparative advantage.[28] Japanese investment was also less interested in control or equity share than was "American" investment, he argued. This changed in the late 1980s as large Japanese manufacturing firms increased their holdings in developed nations in order to circumvent protectionist barriers, but Kojima's emphasis on small Japanese companies investing overseas to maintain comparative advantage generally remains true, as does his attention to cultural differences in the nature of foreign investment.

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[28]Kiyoshi Kojima, Japanese Direct Foreign Investment, A Model of Multinational Business Operations, (Tokyo: Charles E. Tuttle Co., 1979), p.15.

Ozawa complemented Kojima by explaining the development of Japanese foreign investment from the 1960s to the late 1970s as being motivated by the uncertainty of overseas resources and the growing scarcity of labour and industrial space in Japan. To illustrate this point, he added that: "Placed in the above perspective, the behaviour of Japanese firms shifting their corporate production overseas can perhaps be likened to that of an immigrant who settles in a foreign country, having left a homeland in which living conditions are deteriorating."[29] After observing the nature of Japanese investment in other nations, one can understand the extent to which Japanese capital in Canada was aimed at resource extraction.

The classic economic approaches to multinational decision making must also be kept in mind when exploring the Canadian-Japanese relationship. The two key arguments relate to Industrial Organization and Product Cycles, and were initially developed by Stephen Hymer and Charles Kindleberger, and by Raymond Vernon, respectively. According to the first view, argued by Hymer in 1960, the key to the growth of multinationals following the Second World War was the superior ability of international companies to manage production and to integrate operations when the corporations

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[29]Terutomo Ozawa, Multinationalism, Japanese Style, The Political Economy of Outward Dependency, (Princeton: Princeton University Press, 1979), p. 70.

stretched across national borders.[30] These views were expanded by Kindleberger, R.E. Caves and a massive body of subsequent literature.

Vernon, by contrast, developed the product cycle argument of international development.[31] According to this theory, in the initial stages of development the home industry produces a good or service, but competition increases in the market after the introductory stage and profits decline. Manufacturing and such, therefore, is located at overseas sites with cheaper labour costs while new goods are introduced in the home country factories. Most arguments since the 1960s relating to multinational foreign investment have relied heavily upon either the product cycle or the industrial organization argument, but these views do not work entirely well in the context of Japanese multinationals in Canada because they do not take into account the special characteristics of Japanese investment, such as the numerous small companies involved, or the importance of trading companies acting as intermediaries.

To soften the rigidity of the two theories quoted above, British economist John Dunning developed an eclectic framework for international

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[30]The original work regarding this view is Hymer's Ph.D. dissertation, The International Operations of National Firms: A Study of Direct Investment, 1960, Ph.D. Thesis, MIT.

[31]Vernon's first major article developing the product cycle argument was "International Investment and International Trade in the Product Cycle," in Quarterly Journal of Economics, No. 80, 1966, pp. 90-207.

production based upon two strands of economics, 1) that factor endowments do exist, some of which are mobile, and that greater geographical disparity therefore increases international trade; and 2) in the case of market failure, the greater the ability of multinationals to overcome this through internalization, the greater the tendency towards multinational production.[32] By examining these interrelated trends, Dunning argued that multinational investment can be understood in all cases. Although he made little allowance for national differences in corporate behaviour, his loose model is very effective at explaining the divergent investment patterns in Canada while simultaneously allowing for these patterns to be woven into a larger international picture. Dunning's model is broad enough to allow for sectoral and industrial differences while still allowing a framework within which to understand the enormous economic shifts of the 1980s.

Geographer David Edgington provided a related eclectic model that allows for cultural differences -- both national and firm related -- in the decision making process of multinationals and helps bridge the gap between economic theory and each company's decision making. Edgington's perspective is broader than Dunning's because he argued that allowances for

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[32] John Dunning argues that modern market failure is the major reason why his eclectic approach must be used when examining international production. See "The Eclectic Paradigm of International Production: A Restatement and Some Possible Extensions," in Explaining International Production, (London: Unwin Hyman Ltd., 1988), pp. 41-70.

the perceptions of the actors and historical interaction must be made.[33] As a result of his studies, Edgington wrote that cultural differences within Japanese companies must be understood, and perceptions, rather than just statistical data, must be examined when explaining multinational decision making.

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To explore the political and economic trends driving Japanese investment in Canada during the 1980s, this thesis draws upon these three disparate strains of academic discourse mentioned above. Previous Canadian works have often stressed Canada's bilateral relationship with Japan without setting it within an international context, while works on political economy and/or multinationals written in Japan or the United States seldom give Canada more than passing notice.

This thesis brings these perspectives together, beginning with a chapter on Japan's changing international economic priorities between 1978 and 1988. The paper then discusses, in historical sequence, the waves of Japanese industrial interest in Canada during the 1980s starting with Chapter III, which examines Japanese investment in natural resources,

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[33]David Edgington, Japanese Business Down-Under: Patterns of Japanese Investment in Australia, 1957-1985, (Sydney: University of Sydney, 1988), "Introduction."

particularly energy and forest products. Chapter IV describes Japanese investment in the Canadian auto industry, and Chapter V, the increased role of Japan in Canadian finance and high technology manufacturing and research. Chapter VI concludes and notes the relative lack of immediate affect that the Free Trade Agreement had upon Japanese views of business in Canada.

The emphasis throughout this paper is on the diversity of economic interactions and the declining strategic economic importance of Canada to Japan as multinational investment trends and protectionism increasingly favoured attention to the United States and Western Europe, although economic ties with Canada increased. In the case of particular industrial sectors such as forestry, however, Canada became more important to Japan. In a way, this thesis explores a paradox: the Canadian-Japanese economic relationship expanded and became more complex while Canada's importance to Japan shrank.

II. Japanese Investment and Trade in Perspective, 1978-1988

The rapidly growing economic importance of Japan during the decade led to Japan's reputation as an economic power. The change was both perceptual and real. As an Economist editorial writer noted, "In many ways the 1980s were to Japan what the 1920s were to the United States."[34] These were periods when these powers were first internationally recognized as such. Table II-1 shows the rapid increase in Japanese direct foreign investments that occurred, particularly after 1985, the year that the yen appreciated. Japan quickly became the world's largest creditor and one of the most important investors nations. In both Washington and Tokyo, dealing with the new realization of Japan's economic, and increasingly,

[34]The Economist, "Japan Unfurls," July 21, 1990, p. 9.

political, power became one of the key issues of the ten-year period. The economic prestige led to political authority because Japanese investors were more important to Western economies and thus influenced them and Japan challenged the ascendancy of the United States in multilateral organizations such as the Asian Development Bank.[35] As the Japanese economy expanded internationally, its nature also changed as services, particularly financial ones, grew in importance and Japanese corporations invested in more overseas technology and value-added assembly and/or manufacturing. As Japan increasingly struggled for economic preeminence with the United States and the European Economic Community (EEC), the importance of Canada to Japan's economic plans declined. While the previous chapter introduced the thesis of this paper, this one examines the growth of Japanese trade and investment during these ten years and its relationship to Canada. To better explain the trends, this chapter moves from an international discussion of Japan's changing position to a discussion of the implications for Canada.

A. From Oil Crisis to Trade Barriers

In the late 1970s, Japan's international economic ties were essentially trade ties. Kojima's arguments regarding Japanese foreign direct investment applied readily. As he argued, manufacturing investment in Southeast Asia

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[35]See Gilpin, The Political Economy of International Relations, pp. 336-339, for a discussion of how Japan's new economic power gives it political authority in the United States and thus through the world.

was primarily in areas of manufacturing in which Japan was losing comparative advantage. In resource investments in Australia, Canada, South America and Asia, Japanese investors were often not in controlling positions.[36] In 1980, 24.3 percent of cumulative Japanese investment was in the United States; 12.1 percent in Indonesia; 8.0 percent in Brazil; 5.9 percent in Australia; and 5.5 percent in the United Kingdom.[37] The money in Indonesia, Brazil and Australia was largely in resource development, while a large proportion of the investments in the United States and the United Kingdom were in services to support the sale of Japanese manufactured products.

Table II-1

Japanese Direct Foreign Investment: 1978 through 1988
(Millions of U.S. Dollars)

Year	Assets
1979	4,995
1980	4,693
1981	8,931
1982	7,703
1983	8,145
1984	10,155
1985	12,217
1986	22,320
1987	33,364
1988	47,022

Source: Japanese Ministry of Finance

In 1978, energy was Japan's major international concern and oil was its key import. Much of Japan's foreign policy in the late 1970s was defined by its reliance on foreign sources for 99.8 percent of its oil and its resulting

[36]Kojima, Chapter 4.

[37]Japanese Ministry of Finance.

consciousness of oil diplomacy.[38] In 1980, after the Iranian Revolution and the subsequent increase in energy prices, the five petroleum exporting nations of Saudi Arabia, Indonesia, Iraq, Iran and Kuwait ranked, respectively, as Japan's second, third, sixth, seventh and tenth largest sources of imports in terms of cost.[39] The importance of oil to Japan at this time increased its interest in alternative Canadian sources although the Canadian government restricted bulk shipments of light petroleum.[40] However, as the oil prices of the 1970s declined during the 1980s, and after they collapsed in 1985-86, energy policy became decreasingly relevant to Japanese business and government.

Japanese success in designing fuel-efficient cars to deal with the high energy costs of the oil crisis decade led to conflict with Japan's trading partners. As the Japanese economy expanded in the late 1970s, manufacturers looked primarily to markets in the developed countries to sustain growth. Increased exports of automobiles and electronic goods resulted in growing protectionist sentiments in the United States and

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[38]Robert Ozaki, "Introduction," in Japan's Foreign Relations: A Global Search for Economic Security, Robert S. Ozaki and Walter Arnold, eds., (Boulder: Westview Press, 1985), p. 9.

[39]Statistics Bureau, Prime Minister's Office, Japan Statistical Yearbook, 1981, p. 318. These exporting nations were extremely important to Japan throughout the 1970s; the figures for 1980 merely underline this.

[40]Robert Blain and Glen Norcliffe, "Japanese Investment in Canada and Canadian Exports to Japan 1965-84," in The Canadian Geographer, (No. 2, 1988, pp. 141-50), p. 146. For further discussion see Chapter 3.

Western Europe.[41] The 1980s began with Japan and the United States negotiating Voluntary Export Restraint (VER) on automobiles following the growth of Japanese exports there after the oil crisis of 1979. In response to this non-tariff barrier, the large Japanese manufacturers built assembly plants in the United States. This pattern of trade restriction followed by investment was a key form that Japanese multinational foreign investments took in the 1980s. However, this occurred mainly in the EEC and the United States which had large enough markets and sufficient international political clout to pressure Japanese government and business into changes. In Canada, by contrast, the federal government had to haggle longer and harder with Japanese business and government to receive a Voluntary Export Restraint on automobile exports to Canada because it did not have the political and economic strength of the United States.[42]

B. Japanese Responses in the 1980s

To counter the increasing protectionism of the developed nations, Japanese multinationals used numerous approaches, including joint-ventures

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[41]See Ryutaro Komiya and Motoshige Itoh, "Japan's International Trade and Trade Policy, 1955-1984," in The Political Economy of Japan, Vol. 2, The Changing International Context, pp. 173-224, Takashi Inoguchi and Daniel I. Okimoto, eds., Stanford: Stanford University Press, 1988.

[42]Frank Langdon, "Canada-Japan Trade Friction, The Automobile Issue," Working Paper No. 12, in Canada and the Changing Economy of the Pacific Basin, (Vancouver: Institute of Asian Research, UBC, 1983) p. 51.

to gain technology and management expertise, and direct investment to enter guarded markets. Japanese multinationals also sought technological links with Western firms possessing valuable technology in the United States and Europe in order to remain competitive and to assist in developing more expensive product lines. Throughout the twentieth century, Japanese industry received technological transfers from foreign companies to develop new products and this was an extension of that trend. To expand into new areas in the 1980s, multinational corporations often signed cooperative agreements with foreign firms. The Suzuki-GM plant in Ingersoll, Ontario that produces vehicles to Auto Pact standards is a good example of this. In the late 1970s and 1980s Japanese companies also moved increasingly into value-added forms of electronics and automobiles. For example, Honda established the new Acura line to compete in the luxury ranges of North American automobiles and NEC marketed more complex varieties of computers and telecommunications equipment.

The Japanese financial community also moved rapidly overseas, and increased its investment in all international centres. The growth of Japanese banks and brokerages was much discussed in the late 1980s because the world's ten largest banks were Japanese then. The liberalization of Japanese banking during the early 1980s and declining domestic demand for corporate loans as profits soared were the major causes of the excess capital that was

used to finance overseas investments.[43] Much of the Japanese financial investment in the early 1980s went into bonds. Gilpin commented that "whereas the Japanese gross purchases of [U.S.] Treasury bonds amounted to only $197 million in 1976, in April 1986 alone the figure was $138 billion."[44] Japanese annual investment in Canadian bonds, both provincial and federal, also swelled during the 1980s and peaked in 1986 at an annual purchase of $11.7 billion.[45]

As Japan's trade and current account balances with the United States and many European nations increased, the Group of Five and the United States agreed to depreciate the dollar against the yen, which Japan allowed to happen in September 1985. The Japanese currency moved from an average of 239 per dollar in 1985 to 169 in 1986.[46] As the appreciation of the yen, called endaka, made overseas investments relatively inexpensive, Japan's balance of international portfolio investment leaving the country moved from US $41.75 to $102.04 billion between 1985 and 1986.[47] Endaka

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[43]"Mitsui-Taiyo Kobe Merger Creates a Megabank," in Tokyo Business Today, October, 1989, pp. 16-21.

[44]The New York Times, November 7, 1985, p. D1, as quoted in Gilpin, p.331.

[45]Statistics Canada, 67-001, Fourth Quarter, 1988, p. 41.

[46]International Monetary Fund, International Financial Statistics, Yearbook, 1989, (Washington), p. 443.

[47]ibid., p. 445.

thus sizeably increased the flow of Japanese funds into international investments.

Japanese trade and current account balances with many EEC nations and the United States remained heavily weighted in Japan's favour after endaka, and Japanese investment in the United States and Europe continued to increase rapidly. This resulted in more protectionist rhetoric in the United States and Europe, drawing Japanese business attention to the danger of being shut out of its major export markets, particularly as over 40 percent of Japan's external markets are in the U.S. alone. In 1988 the U.S. Congress passed The Omnibus Trade Bill, the most powerful of such acts to date. It gave the President special powers to retaliate against unfair trading practices. The chairman of the trading company Mitsui Bussan symbolized Japanese concern with protectionism when at a Keidanren roundtable discussion he noted that "when one looks at the movements in the world economy, the protectionist and regionalist movements centred in Europe and the United States are the most increasingly important."[48]

The likelihood of increased protectionism in the EEC after 1992 and a desire to be inside this market before the door closed led to increased investment there in the late 1980s. In 1988 Sony Chairman Akio Morita told reporters that "Japanese are not fools... We have four years until 1992.

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[48]"Zadankai," in Keidanren Geppo, (December 1988, pp. 2-11), p. 2.

Japanese managers know what they should do during those four years. Japanese industry will move technology into Europe."[49] Therefore, by 1985 Great Britain had 22 major Japanese assembly plants that produced goods ranging from ball bearings to consumer electronics.[50]

In the mid 1980s, the increasing competitiveness of the Asian Newly Industrialized Countries (NICs) -- South Korea, Taiwan, Hong Kong and Singapore -- in traditional Japanese export markets and the increased importance of Asian imports to Japan were the second largest issue for Japan, following protectionism in the developed nations.[51] The NICs were also taking export markets away from Japan in the consumer electronic, light manufacturing and automobile sectors. Between 1978 and 1988 South Korea, for example, doubled its exports to Japan from approximately 3.2 to 6.3 percent of the total, and became Japan's second largest source of imports, although it continued to run a trade deficit with Japan.[52] Some Japanese manufacturers feared that the NICs, and developing Southeast Asian nations,

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[49]The Financial Post, August 9, 1988, p. 17.

[50]Ian Gow, "Raiders, Invaders or Simply Good Traders?" in Accountancy, (Vol. 97, March, 1986, pp. 66-73), p. 68.

[51]For a related discussion see Charles E. Morrison, "Japan and the ASEAN Countries," in The Political Economy of Japan, Vol. 2, The Changing International Context, pp. 414-445, Takashi Inoguchi and Daniel I. Okimoto, eds., (Stanford: Stanford University Press, 1988), pp. 433-436.

[52]Statistic's Bureau, Prime Minister's Office, Japan Statistical Yearbook, 1980, p. 304; 1989, p. 348.

would take domestic and international markets away from Japan at an accelerating rate.[53]

However, the increased competition and economic ties with Asia also led to talk of forming a trade union with these countries. Economist Miyohei Shinohara argued that manufacturing competition in East Asia was part of an inevitable international division of labour in which the NICs would develop industries that supported and complemented Japan.[54] Three weeks after the signing of the Canada-U.S. Free Trade Agreement, the Japanese Ministry of International Trade and Industry formed a committee to examine the possibility of (1) a Japan-U.S. free trade agreement or (2) a Japan-Asia free trade zone which would include some NICs and the Association of South East Asian Nations (ASEAN).[55] The decision to examine free trade with Asia displays the importance of East and Southeast Asia to Japanese economic plans by 1988.

Japan's primary international economic concern switched from resource procurement in the early 1980s to access to markets and industrial competition, and emphasis on direct investment therefore increased. As Table II-2 shows, yearly direct investment over this period shifted from an

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[53]The Japan Times, February 7, 1988, p. 15.

[54]Nihon Keizai Shinbun, May 2, 1988, p. 15.

[55]ibid., January 29, 1988, p. 3.

emphasis on Latin America, Southeast Asia and the United States to an emphasis on Europe and a greatly increased interest in the United States. The table, however, does not show that Japanese foreign direct investment increased sixfold between 1979 and 1987. As Ozawa explained, the pattern in 1979 had been Japanese investment in cheap labour for manufacturing and in raw resources.[56] In the late 1980s, more investment in services and assembly plants in the increasingly protectionist developed nations was the trend.

Table II-2

Percentage of Yearly Japanese Foreign Direct Investment
Selected Areas

	1979	1983	1987
U.S.	26.9	31.5	44.1
Europe	9.9	12.2	19.7
Latin America	24.2	23.1	14.4
Asia	19.5	22.7	14.6

Source: Japanese Ministry of Finance.

[56]Ozawa, Chapter Two.

C. Multinationals: the "Tetra-Polar" Argument

During the 1980s, as Japanese multinationals expanded, they increasingly divided their overseas operations into regions whose headquarters were situated in key developed nations. The earlier pattern had been to run all international operations through the head office in Japan. Edgington has referred to this trend as a movement from international offices with a linear link to the head office to the "Tetra-polar system."[57] According to Edgington, in the 1970s Japan's key market was the United States, and Southeast Asia was a secondary market and assembly site. Japan produced finished goods with resources it received from Australia, Canada and Brazil. The Japanese head office controlled all decisions during this period.

In the transition period of the late 1980s, according to the argument, Europe became increasingly important as a market and assembly site, the United States became an assembly location as well as a key market, and Japan increasingly produced medium technology products in Southeast Asia while retaining the head office, R&D and high technology production domestically. In the third "tetra-polar" stage that Japanese companies are entering, Edgington argues that the Japanese headquarters remains crucial

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[57]David Edgington, "Academic View on Recent Investment," at a conference titled "Canada and Japan in the Nineties," Vancouver, March 14, 1990.

but that the regional offices in the United States, Europe and Southeast Asia are more independent and make decisions separate from the Japanese office. As the system becomes international, the importance of the resource suppliers declined.

Edgington's argument works well and many of the successful international Japanese firms moved to some form of the "tetra-polar" system during the 1980s, although he overemphasizes the equality of the different regional headquarters. After all, chief executives for regional headquarters generally still come from Japan. Conversely, American Honda designed and manufactured automobiles in the United States separate from its Japanese operations, and the company expected to export 50,000 Ohio-made cars to Japan per year by 1991.[58] Honda became so American-oriented that in 1986 it sold 43 percent of its production in the United States.[59] As Japanese multinationals increasingly set up regional bases, however, certain nations -- those chosen as headquarters areas -- received much more investment than adjoining nations. In the case of the Americas, both North and South, the United States was the clear choice of Japanese multinationals looking for a regional headquarters. Japanese business links with Canada were increasingly organized from the United States as in the case of Fukuda Place

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[58]Business Week, April 25, 1986, p. 91.

[59]ibid.

Kogyo, a Japanese automobile parts maker which situated a plant in Tottenham, Ontario in cooperation with American Honda.[60]

D. Canada's Changing Position

Like the United States, Canada had had an extremely strong trade position with Japan in the decades immediately after 1945. Japan turned to Canada for resources and agricultural products during its economic recovery and the era of high speed growth from the 1950s to the early 1970s.[61] In 1968 Canada, still buoyed by its relative economic strength following the war, remained Japan's third largest source of imports, although they accounted for only five percent of Japan's total.[62] Non-ferrous metal ores and raw materials (including wood and pulp) accounted for 53 percent of Canadian exports.[63] This was a golden period in Canadian-Japanese relations as far as the Canadians were concerned, although Japanese officials disliked their nation's trade deficit with Canada, worth U.S. $175 million in 1968, a figure that seems paltry today.[64] Despite this deficit, Langdon argued that the

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[60]Nikkan Kogyo Shinbun, December 12, 1987, p. 9.

[61]See Langdon, The Politics of Canadian-Japanese Economic Relations, 1952-1983, Chapters Two, Four and Seven.

[62]Statistics Bureau, Prime Minister's Office, Japan Statistical Yearbook, 1969, p. 302.

[63]ibid.

[64]ibid., p. 309.

1960s "was a time of economic cooperation between Canada and Japan, as the two countries' leaders constantly mentioned in the 1970s."[65] Japanese trading companies also initiated their first wave of investment in Canadian mining and forestry between 1964 and 1973.[66]

This golden age did not lead to Japanese purchases of Canadian manufactured goods, however. Despite Prime Minister Pierre Trudeau's visits to Japan and his espousal of the "third option" for diversifying Canada's international economic ties, Japanese government departments and agencies and Japanese companies balked at buying value-added Canadian goods such as the CANDU reactor and DASH-7 aircraft.[67] In response to Liberal pressures for increased purchases of Canadian manufactured goods and investment in Canada, the Keidanren industrial council organized the 1976 Makita economic mission to Canada. Its report bluntly stated that Canadian labour problems and intergovernmental strife were a barrier to investment in Canada and that it should emphasize its resource-supplier role with Japan because in that way the two nations were complementary.[68]

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[65]Langdon, The Politics of Canadian-Japanese Economic Relations, 1952-1983, p. 116.

[66]ibid., p. 119.

[67]For an example of this, see The Oriental Economist, September 1979, p. 3.

[68]Ho-Ka Keizai Shisetsudan Jimukyoku Henshu Iinkai, Sogo Kyoryoku e no Apurochi, 1976 Ho-Ka Keizai Shisetusudan Hokokusho, Tokyo, 1976.

By the late 1970s, Japan's purchase of Canadian resources continued to cause an enormous trade deficit with Canada, which in 1978 reached U.S. $1 billion. Aside from oil exporting nations, only Australia had a larger trade surplus with Japan at the time.[69] According to Japanese statistics, Canada even had a service surplus with Japan worth U.S. $32 million.[70] Metallurgical coal for Japan's steel industry was Canada's largest export and Japanese business was looking increasingly to Canada for alternate energy sources as a result of the 1973 oil crisis and increased energy costs.[71] Trudeau failed to attract Japanese interest in Canadian technology during the 1970s, but Canada's trade position with Japan was strong.

During the early 1980s exports of automobiles and consumer durables eliminated the Japanese trade deficit with Canada, and between 1985-1987 Japan ran a trade surplus with Canada for the first time since the Second World War. It stretched to over $1.5 billion in 1986.[72] The reduction of the trade gap was largely the result of an increase in "machinery and equipment" exports to Canada. This Japanese statistical category covers automobiles,

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[69]Statistics Bureau, Prime Minister's Office, Japan Statistical Yearbook, 1981, Vol. 31, p. 313.

[70]ibid.

[71]Blain and Norcliffe, pp. 145-147.

[72]Statistics Canada, Canada Year Book 1990, (Ottawa: 1989), table 21.5.

motorcycles, audio equipment, televisions, and other mechanical and electrical goods. Between 1978 and 1988 the importance of these Japanese exports grew from 260,429 to 661,082 yen, from 66 to 80 percent of total exports, or 1.6 times in real terms.[73] Increases in automobile exports to Canada were the most visible of this market growth; these exports moved from 22 percent of the total in 1978 to a high of 36.5 percent in 1987.[74] Thus the importance of value-added goods in Japanese exports to Canada increased steadily, while the importance of value-added goods in Canadian exports to Japan remained stable and low, leaving Japan in a more favourable strategic position.

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Although trade between Canada, Japan and the United States had triangular aspects, as Dobson argued, Canada was the weakest partner by far in this relationship.[75] In the cases of lumber tariffs and automobile voluntary export restraints, Japanese economic measures towards Canada

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[73]Statistics Bureau, Prime Minister's Office, Japan Statistical Yearbook, 1980 and 1989, pp. 305 and 349. The real increase was calculated by converting the value of 1978 yen into 1988 yen based on market rate figures in the International Monetary Fund's International Financial Statistics, Yearbook 1989, (Washington: 1989), p. 442.

[74]Statistics Bureau, Prime Minister's Office, Japan Statistical Yearbook, 1980 and 1988, pp. 305 and 349.

[75]Dobson, "Conclusion."

were taken after the U.S.-Japanese agreements in these sectors had been hammered out. Japanese investment decisions were also increasingly made by multinational executives in Japan within the context of an expanding international economy, and Canada's special place in relationship to Japan eroded as the depth and strength of other economic links continued to grow. Canada remained an important Japanese trade partner, but its importance declined with the strategic needs for energy and resource procurement. Accordingly, the special place of Canada in the eyes of Japan in the post Second World War international economy slowly eroded between the 1960s and the mid 1980s as other countries developed in importance and the nature of international business changed.

III. Forestry and Energy: Continuing Strong Ties

Between 1978 and 1988 the importance of Canadian forestry nearly doubled for Japan, with direct investment following, and energy resources remained relatively significant although some projects were cancelled or caused bilateral tension.[76] Japanese ties with the Canadian coal, natural gas and petroleum, and forestry industries varied with changing domestic demand, Canadian politics and economics, and international resource markets. Massive Canadian government incentives were an intrinsic aspect of much of the increased investment.

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[76]Between 1978 and 1988 the relative importance of Canadian forestry to Japan doubled, providing approximately 15 percent of Japanese imports by 1988; Statistics Bureau, Prime Minister's Office, Japan Statistical Yearbook, 1980 and 1989, pp. 307 and 351 respectively.

As case studies, the energy and forestry industries illustrate the need for an eclectic approach to Japanese multinational relations with Canada, because the history of the two industries during the 1980s varied considerably with different macro and microeconomic concerns and the perceptions of Japanese managers. On the one hand, ties with the Canadian forestry industry expanded to the extent that both lumber and pulp production received more Japanese investment between 1978 and 1988 than any other Canadian industrial sector -- $641 million worth.[77] In the energy industries, on the other hand, although trade and investment grew, Canadian-Japanese relations were often rocky.

The 1980s began with the hope of enormous Japanese investment in Canadian energy resources -- oil, liquified natural gas, and coal -- but ended with unrealized plans, depressed world markets, and conflict over one of the enormous projects of the decade. Massive international market shifts were the key. The 1970s left the world, and Japan, with the fear of a continuing energy crisis, but by the end of the 1980s the world oil market had collapsed, reducing related international tension. Thus, despite vast plans to diversify Canada's energy trade, coal remained Canada's largest source of export dollars from Japan, and the energy trade changed little in nature, although coal exports to Japan between 1977 and 1987 increased from $529

[77]Japanese Ministry of Finance.

million per year to $1.2 billion.[78] The only area of realized potential in the energy industry was the construction of two coal mines in Northeast British Columbia, but a glut of metallurgical coal, depression in the Japanese steel industry, poor mine-site planning at one mine, and enormous debts plagued these mines. Other plans died.

A. Japanese Energy Concerns and Coal

Japan wanted dependable energy sources because it had been hard hit by the first oil shock following the Yom Kippur War of 1973 and by the second after the Iranian Revolution of 1979. The costs of the first oil crisis and increasing pollution in metropolitan areas of Japan had resulted in a national push for fuel efficiency and alternatives fuel use during the 1970s. Instability in Japan's coal supply during 1980 as a result of labour strife in Australia, the United States, and Poland made Japanese industrialists and bureaucrats even more concerned about secure energy supplies.[79] The oil shock and the instability of coal producers were closely related because the steel industry was shifting from oil- to coal-fired mills.

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[78]Statistics Canada, Exports by Canada, 65-003, January to December 1977 and January to December 1987.

[79]Catliff, p. 3.

It is against the backdrop of these concerns with energy that Japan's interest in Canadian sources increased in the early 1980s. Canada had supplied coal to Japan since a 1968 agreement in which Kaiser Resources was formed by its California parent to supply nine Japanese companies represented by the Mitsubishi Trading Company. By 1980 British Columbia was exporting approximately 19 per cent of Japan's metallurgical coal.[80] Canada was, therefore, a major Japanese source, although Australia provided approximately half of Japan's needs, and South Africa, the United States, China and the Soviet Union remained competitors.

In an effort to obtain a further stable supply, the Japanese steel companies began examining the development of the Northeast B.C. mines, Bullmoose and Quintette, in the late 1970s when economists in both Japan and Canada forecast continued rapid expansion in the Japanese steel industry. Labour strife in producer nations and projections in 1980 of continued steel market growth pushed the Japanese steel corporations towards opening new, secure coal fields in British Columbia, even if that meant subsidizing the coal.[81] As numerous corporations and the federal and provincial governments of Canada were involved, negotiating the construction of the two mines and their related infrastructure required years.

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[80]Langdon, The Politics of Canadian-Japanese Economic Relations, p. 125.

[81]Catliff, pp. 39-40.

As early as 1980 the Japanese representatives expressed reservations regarding the nature of the British Columbia government involvement in the two proposed developments. These worries included "concerns that the B.C. government was pushing ahead on political rather than on economic grounds. One steel industry source was quoted as saying 'The Japanese don't want to be whipping boys in any future election campaign.'"[82] Despite fears of a long-term recession in 1981 and the simultaneous drop in steel prices, the project went ahead, although its financial viability, at best, was far from clear. Similar developments in Australia were cancelled in 1982.[83]

After the mines began exporting, the demands of Japanese steel producers for coal price reductions from Quintette in the mid and late 1980s and its financial troubles caused a public backlash against Japanese investors. Some commentators charged that the Japanese buyers had organized a world coal glut; others argued that they were attempting to control British Columbia's coal industry in the manner of an imperialist power.[84] Certainly, numerous authors in both Australia and Canada decided that the coal producing companies and nations must examine the Japanese steel cartel

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[82]ibid., p. 47.

[83]David W. Edgington, Japanese Business Down-Under: Patterns of Japanese Investment in Australia, 1957-1985, (Sydney: University of Sydney, 1988), p. 72.

[84]Resnick, p. 40.

because it gave them a strong bargaining advantage.[85] Australian Kosmas Tsokhas argued that

> Australia has come to fit into a 'Pacific rim strategy'. According to this view, the countries of the Pacific-South-east Asian region are divided into four levels. The United States and Japan make up level one; they provide capital, technology and the overall orchestration of the scheme. Level two consists of Australia, Canada and New Zealand, which provide minerals, metals and rural products, and are de-industrializing. The third level consists of former colonies and underdeveloped Third World countries, which act as sources of cheap labour and raw materials. Finally, there are countries like China, Vietnam and Laos, which the United States and Japan are trying to form into a fourth level.[86]

Such views became common in British Columbia in late 1987 when the Japanese coal buyers took Quintette to arbitration to set new prices. At the time, the rates of the mine were close to double world prices, but for numerous reasons Quintette was financially foundering and required them. The Japanese buyers countered that they were willing to buy at above average rates, as initially agreed, but were unwilling to pay what Denison demanded.[87] Although the issue raised public concern in British Columbia, Catliff argued that the Japanese buyers are unlikely for political and strategic reasons to allow Quintette to go bankrupt.[88]

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[85]Anderson, "Introduction."

[86]Kosmas Tsokhas, Beyond Dependence: Companies, Labour Processes and Australian Mining, (Melbourne: Oxford University Press,1986), p. 3.

[87]The Northern Miner, December 7, 1987, p. 1.

[88]Catliff, chapter VI.

Despite the collapse of world steel markets during most of the decade and the development of coal mines in other nations, the majority of the western Canadian coal trade with Japan was smooth during the 1980s. The value of these Canadian exports to Japan grew from $529 million per year in 1977 to $1.2 billion in 1987.[89] Almost all excavated Western Canadian coal went to Japan, and the operations of Westar, Teck, Fording Coal and Shell continued trading to Japan with no public conflict. The Bullmoose mine of Teck Corp. in Northeast British Columbia, constructed at the same time as the Quintette mine, was quickly profitable.

B. Oil and Gas: Lost Opportunities

While coal projects were a source of conflict during the 1980s, significant Japanese investment prospects in oil and liquified natural gas disappeared during the decade. The lost possibilities were the result of both Dome Petroleum's corporate failures and the decline of the energy crisis. Japan had never been a major importer of Canadian petroleum products. Canada shipped almost all its petroleum and natural gas exports to the United States, and this changed little in the 1980s despite attempts to diversify markets. It was 1983 before the National Energy Board even granted a license for Dome and Imperial Oil to begin shipping crude oil to

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[89]Statistics Canada, Exports by Country, 65-003, January-December 1978 and 1987, pp. 216 and 230.

Japan.[90] A 1983 B.C. government report on natural gas sales complained of the lack of market diversity for natural gas, but did not mention the possibility of shipping to Japan.[91] While Canadians expressed little interest in Japanese energy markets, managers there remained unconvinced of the advantages of investing in energy resources here. By 1980, corporate Japan's experience with the Canadian petroleum industry consisted almost entirely of the disastrous investment of the Ataka Trading Co. in Newfoundland's Come-by-Chance oil refinery. It had gone bankrupt in four years. The Ataka Trading Co. was afterwards forced to amalgamate with C. Itoh after Ataka's U.S. subsidiary could not collect $75 million owed by the refinery.

Although Japan was not a traditional market, Dome Petroleum charmed Japanese investors into two major projects in the early 1980s, both of which became disasters. Dome talked Japanese bureaucrats and managers into lending it $400 million for Beaufort Sea exploration and convinced five major Japanese utilities to support a $2.3 billion liquified natural gas project in Western Canada. One journalist argued that at the time, "for employees, investors, the banks and the government, Dome was becoming less a

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[90]The Wall Street Journal, April 27, 1983, p. 4.

[91]Study Group on the Marketing of British Columbia Natural Gas, A Report on the Marketing of British Columbia Natural Gas, (Victoria: 1983), pp. 3.3-3.5.

company than a cult. It could do no wrong."[92] The company was lavished with respect in Canada and its growing international reputation attracted the Japanese investment.

Dome signed its $400 million loan with the Arctic Petroleum Company in 1980 to further its Beaufort Sea exploration, but the drilling proved fruitless and the debt soon became a burden. Arctic Petroleum was owned primarily by the Japanese government through the Japanese National Oil Company and its affiliate Overseas Petroleum. The national government had formed the Japanese National Oil Company in 1978 to ensure that oil was stockpiled, and in the late 1970s and early 1980s the company supplied one-third of the Japanese capital for international oil exploration.[93] The corporation had intended to lend the money to Dome in mid-1980. Dome officials told the investors that the announcement of the National Energy Program (NEP) in the 1980 federal budget made the loan more attractive because it helped them obtain exploration money for what appeared to be an increasingly restricted market. Two hundred and fifty million dollars of that money went into Dome's subsidiary, Dome Canada, which would receive special exploration incentives from the federal government, thus underwriting

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[92]Peter Foster, Other People's Money, The Banks, the Government and Dome, (Toronto: Collins, 1983), p. 99.

[93]Richard J. Samuels, The Business of the Japanese State, Energy Markets in Comparative and Historical Perspective, (Ithaca: Cornell University Press, 1988), pp. 214-215.

Japanese loans, Dome officials argued.[94] The problem with the loan was that it was to be paid back in petroleum production including 16 percent interest per annum.[95] According to the loan documents, if production never began, the capital and interest were due in 2030.

This loan subsequently became an albatross around the neck of Dome Petroleum and its purchaser, Amoco, and many Japanese assumed that it would not be collected, giving a bad reputation to Canadian energy projects. In the years immediately following the loan, Dome found no commercially viable oil fields in the Beaufort Sea, and the company was soon embroiled in struggles with its enormous debts. The oil market sagged and the accrued interest mounted. In 1987 a Dome spokesman estimated that the debt totalled $1.2 billion. The loan had become so large, considering the dampened commercial hopes for Beaufort Sea oil, that in 1987 while negotiating to buy Dome Petroleum, Amoco president T. Don Stanley said that "the Japanese loan is a major obstacle to Beaufort Sea oil exploration and development plans."[96] In August 1988 Amoco representatives said that they had reached an accommodation with Arctic Petroleum, but no details have been released.[97] Former International Trade Minister Pat Carney said

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[94]Foster, p. 94.

[95]The Wall Street Journal, August 25, 1980, p. 19.

[96]The Financial Post, July 13, 1987, p. 5.

[97]The Vancouver Sun, August 30, 1988, p. D4.

that many Japanese businesspeople continue to be wary of investment in the Canadian petroleum industry as a result of the uncertain future of this debt.[98]

The other project that Dome announced during the 1980s, the enormous liquified natural gas project in Western Canada, never proceeded past the advanced planning stages as a result of Dome's inability to fund and organize the development of the facilities which the Japanese utilities had agreed to support. Japanese trading companies had previously constructed enormous LNG projects in Southeast Asia and favoured LNG production because Japanese law limited the ability of trading companies to invest in petroleum. In 1981, through tax incentives, the Japanese government also encouraged the importation of LNG to diversify energy sources and to help reduce pollutants.[99] By 1986 gas represented 15.7 percent of residential energy consumption in Japan, although only 4.8 percent of total energy

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[98]Patricia Carney, interviewed by Robert Beynon in Vancouver, May 30, 1989.

[99]Yasumasa Kuroda, Fereidun Fesharaki, and Wendy Schultz, "Japan's LNG Trade: Policy Innovations and Business Risks in a Historical Context," in Journal of Business Administration, (Vol. 17, No. 1 and 2, 1987/88, pp. 219-248), p. 222.

consumption, and the Japan Gas Association estimated that demand for gas would increase at a rate of 3.6 percent annually until 2000.[100]

To meet this growing demand, the Dome project would have shipped LNG from northern Alberta and British Columbia through a liquification plant and port facilities near Prince Rupert to Japan in five carriers. After years of preliminary negotiations, Dome and the Japanese firms headed by Nissho-Iwai formally agreed to push the project through in late 1981.[101] In July 1982 the B.C. government told the public that it favoured Dome as the company to develop any major LNG project in northern B.C., and provincial energy minister Bob McClelland explained that he was not concerned about Dome's financial problems affecting the project.[102] A partnership of Westcoast Transmission and Petrocan and a third partnership of Vancouver-based Carter Oil & Gas Ltd. supported by the trading companies Sumitomo and Marubeni, vied for the deal, but were rejected.

Plagued by debt, Dome could never organize the project and by 1984 one of the Japanese utilities, Chubu Electric Power Co., said that it wanted

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[100]Sohsuke Hanaoka, "The Japanese Gas Utility Industry," in U.S.-Japan Energy Policy Considerations for the 1990s, John E. Gray and Yoshihiro Nakayama, eds., pp. 48-53, (Lanham: University Press of America, Inc., 1988), pp. 49-50.

[101]The Wall Street Journal, September 1, 1981, p. 3.

[102]ibid., July 16, 1982, p. 5.

to cancel the agreement because of delays. Through promises, Dome managed to draw the idea along for another two years before it died entirely. The provincial governments in Western Canada had hoped to see the project developed because their natural gas industries depended upon the extremely competitive U.S. market where new fields were being developed and prices were falling. However, some industry analysts argued that specialization in the United States was the only viable alternative in the 1980s considering the soft international market for energy products.[103]

The collapse of energy prices during mid-decade and the glut of worldwide energy supplies weakened the economic viability of most Western Canadian energy plans and Japanese interest declined as the decade progressed. Both Dome and the Canadian energy industries attracted world attention in the early 1980s and then collapsed into the shadows as shifting fortunes shouldered them aside. Western Canadian oil and gas exports to Japan were feasible only if petroleum prices remained high. External economic trends determined the infeasibility of the energy trade, although the coal exchange remained strong.

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[103]W.P. Wilder, "Natural Gas," in Canada's Energy: International Aspects, pp. 43-48, (Toronto: Canadian Institute of International Affairs, 1985), p. 47.

C. Forestry: Increasing Importance

By contrast, the forestry trade between Canada and Japan expanded steadily during the decade. Demand for pulp, lumber and other wood products was fuelled by domestic Japanese requirements. The trading companies had a long history of importing Canadian forestry products, dating back to the 1920s.[104] Mitsubishi Corp. and Honshu Paper Company first directly invested in Canada in a major way in 1968 when they built the Crestbrook Forest Industries pulp mill near Cranbrook for $42 million.[105] This was part of the original Japanese investment wave in Canada between 1964 and 1973.[106] Following the upward revaluation of the yen in 1985, Japanese forestry companies poured a second wave of investment into Western Canada, particularly into the pulp industry.

The Japanese invested heavily in forestry products internationally in the late 1980s to meet growing demand and to acquire rights to dwindling reserves. In Brazil, Japanese corporations invested in fast growing trees for pulp.[107] Sarawak, Malaysia alone exported $5 billion worth of wood products

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[104]Pringsheim, pp. 24-25

[105]Langdon, The Politics of Canadian-Japanese Economic Relations, p. 119.

[106]ibid.

[107]The Toronto Star, May 27, 1986, p. A1.

in 1989, mostly to Japan.[108] The Japanese paper companies had difficulty finding enough wood to meet demand in the world and therefore in 1988, Japanese direct foreign investment in pulp and lumber production increased by 90.5 percent, from U.S. $317 to $604 million as Japanese industry attempted to obtain adequate supplies.[109] Most timber for Japanese construction, however, comes from the Western United States and Canada.[110] In the late 1980s, Canada was therefore Japan's third most important source of wood products after the United States and Malaysia.

In Canada, much of the Japanese investment was aimed at Northern Alberta, which had some of the last virgin tracts of forests in the world. One columnist commented that "For a few weeks at the end of 1988 [Alberta] Premier Don Getty seemed to be announcing a new [Japanese financed forestry] project every other day."[111] The Alberta government offered numerous incentives to attract this investment. In the case of the largest proposed project, Alberta offered $75 million in infrastructure and

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[108]The Toronto Star, July 14, 1990, p. A2.

[109]Yozo Yamagata, "Japanese Business View on Investment in B.C.," a paper presented at a conference entitled "Canada and Japan in the Nineties," March 14, 1990, in Vancouver, (source of data was the Japanese Ministry of Finance).

[110]The Vancouver Sun, January 25, 1990, p. F8.

[111]The Vancouver Sun, January 5, 1989, p. A13.

$300 million in debentures to assist financing.[112] These incentives were necessary to attract Japanese money looking at Australia, Southeast Asia, and the United States. A Vancouver columnist argued that if Japanese investment for such projects were not obtained soon, Siberia's vast, untapped resources will attract all future Japanese initiatives, assuming that the Soviet Union and Japan sign a peace treaty to end the Second World War.[113]

Japanese demand caused exports of all Canadian forestry products to grow quickly in the 1980s. Canada's percentage share of total forestry exports to Japan increased during this period from seven to 15 percent of imports in the case of lumber (mokuzai). Exports of Canadian pulp to Japan grew four times in real terms between 1977 and 1987.[114] In response to growing domestic demand and the revaluation of the yen, Japanese direct investment in Canadian pulp and paper, and lumber increased rapidly in 1987 through 1989. In these three years Japanese companies directly invested $810 million in Canada, a good share of their international total investment. That was more than two-thirds of Japan's cumulative direct investment in Canadian forestry.[115] As a result of this growth in trade and

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[112]ibid.

[113]The Vancouver Sun, August 10, 1990, p. D9.

[114]Statistics Canada, Exports by Country, 1978 and 1987, pp. 216 and 230.

[115]Japanese Ministry of Finance.

investment, in the late 1980s, all forestry products combined were Canada's most important export to Japan.[116] The Canadian government wanted the trade to increase even more. Minister of International Business Pat Carney repeatedly attempted to persuade the Japanese government to decrease tariffs on Canadian softwood lumber and to change its building code to allow more uses for Canadian lumber.[117] The second push was partly successful.

Although forestry was a major source of Japanese trade and investment during the 1980s, it was far less contentious than energy development. This changed in 1989 and 1990 as the future of the proposed $1.3 billion Alberta-Pacific Forest Industries pulp mill in Northern Alberta was questioned by environmental and native groups, and then by Environment Canada. Referring to the project, a representative of Cultural Survival Canada, an environment group, argued that "Japanese investment has brought environmental destruction in country after country."[118] This project was postponed in 1990 to allow for more environmental assessment, but it did not create the tension that the Northeast coal deal had.

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[116]Statistics Canada, 65-003, Domestic Exports by Country, various issues.

[117]Patricia Carney, interview with Robert Beynon, May 30, 1989.

[118]Toronto Star, November 5, 1989, p. F4.

D. Comparisons and Contrasts

The examples of the energy and forestry industries show how different industrial investment and trade patterns can be within different nations. The coal trade grew steadily, the petroleum and natural gas industry possibilities never developed, and the forestry industry trade developed with Japanese demand. The keys were domestic markets, international supply, price, and negotiations between specific corporations. From one perspective, the trade grew as Japanese demand for resources expanded, simple economics. From another perspective, the investment and trade in the Canadian energy industry was also connected to the desire of Japanese bureaucrats and managers to ensure a stable supply in the future and to minimize risks. Catliff noted that the Japanese steel producers were willing to pay a premium for Northeast coal in exchange for security, and because the British Columbia government was willing to invest millions of dollars in required infrastructure.[119] He quoted one Mitsui executive telling him that "the (extra) $21/ton [above world prices] is for insurance premium."[120]

According to Dunning's work on multinationals, the investment or involvement of the Japanese steel companies in procuring B.C. coal displayed a number of forms of market failure. The Japanese 1) managed to obtain

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[119]Catliff, Chapter VII.

[120]ibid., p. 101.

privileged access to the resource; 2) received major incentives from the provincial government in the form of infrastructure; 3) used an arguably oligopolistic market structure to negotiate for coal; and 4) avoided risks by signing contracts at above market rates.[121] The Japanese were seeking not just the resources, but security and privilege, for which they were willing to pay. Governments on both sides were also involved for numerous reasons, including ensuring that the deal was organized in a manner amicable to both sides, and thus avoiding diplomatic conflicts.[122]

Japanese investment in the forestry industry, however, was much more market driven than strategic involvement in the Canadian energy industry. Whereas coking coal exports went to a select group of steel producers which had a degree of oligopolistic power, different forestry products are sold through numerous large Japanese trading and paper companies to a wide variety of consumers. Much less has been written on the forestry ties between Canada and Japan, but if Dunning's "market failure" criteria are applied to the Japanese-Canadian forestry trade, fewer work. Japanese companies that directly invested in forestry gained economies of vertical integration, but this was the only "market failure." Forestry appears to be a classic case of factor endowment transfer. Japanese

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[121]Dunning, p. 54.

[122]Note the importance Catliff assigns to MITI projections in Chapter VII.

investment in coal and forest products can also be contrasted because in the former case it was undertaken with an eye to meeting expected need for a strategic resource, whereas investment in forestry was to meet market needs.

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The changing demand for forestry and energy products also showed how the strategic importance of Canada to Japan increased in this case. Between 1978 and 1988 Canadian coal moved from approximately 20 percent of total coal imports to 25 percent and wood exports moved from seven to 15 percent of the total.[123] The importance of these exports to Canada did not increase to the same extent. For example, in 1978 coal accounted for 20 percent of Canada's exports to Japan and wood for nine percent. In 1988 the figures had shifted to 16 percent for coal and 13 for wood.[124] These numbers do not include the enormous growth in pulp exports to Japan. However, as the importance of resource procurement was declining to the

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[123]ibid.

[124]Statistics Bureau, Prime Minister's Office, Japan Statistical Yearbook, 1980 and 1989, pp. 306-307 and 350-351.

Japanese economy, this did not increase Canada's importance to Japan. The importance of continuing structural economic change excluded this possibility.[125]

[125]Gary Saxonhouse, "Comparative Advantage, Structural Adaptation, and Japanese Performance," in The Political Economy of Japan, The Changing International Context, Vol. 2, Takashi Inoguchi and Daniel I. Okimoto, eds., pp. 225-248, (Stanford: Stanford University Press, 1988), pp. 226-230.

IV. Automobile Investment Follows Protectionism

Induced by North American protectionism and Canadian government incentives, Japanese automobile producers invested in assembly plants in Canada during the 1980s. As the first major Japanese manufacturing and value-added investment here, they represented an important beginning. It should be noted, however, that Japanese auto industry ties with the United States determined most decisions relating to Canada. As Yoko Sazanami argued:

> "Trade and investment between Japan and Canada are not only influenced by trade barriers in Canada but also by those in the United States. In fact, the influence of the latter may be even larger. For example, Toyota Motor Mfg. Canada plans to export 60-70 percent of its compact cars produced in Canada to the United States in the fall of 1988."[126]

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[126]Yoko Sazanami, "Trade and Investment Patterns and Barriers in the United States, Canada, and Japan," pp. 90-124, in Trade and Investment Relations Among the United States, Canada and Japan, Robert M. Stern, ed.,

The Japanese plants situated in Canada were moderate in size, and in terms of planned employment, the three major Canadian sites received 12 percent of the North American total, or 3,850 jobs.[127] Still, the investment was a major shot in the arm for the flagging Canadian auto industry. As the economic relationship of Japan and the United States was a crucial factor in this investment in Canada, the development of that link is discussed first in this chapter, followed by the Canadian and Japanese reactions to it.

A. Global Competition Intensifies

Japanese automobile exports to Canada and the United States had grown strongly during the 1970s, until the decline in demand for large- and medium-sized North American vehicles after 1980 appeared to imperil the existence of the "Big Three" -- General Motors, Ford, and Chrysler -- and their Canadian branch plants. Increasing imports were blamed for their poor economic health. Japanese producers had achieved a credible market share of 10.2 percent in Canada in 1970. In 1972 worldwide Japanese exports totalled 1.4 million units.[128] The first oil crisis came as a boon to Japanese companies manufacturing fuel-efficient vehicles. This steadily expanded their

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(Chicago: The University of Chicago Press, 1989), p. 113.

[127]Business Week, August 14, 1989, p. 74.

[128]Davis Dyer, Malcolm S. Salter, and Alan M. Webber, Changing Alliances, (Boston: Harvard Business School, 1987), p. 128.

exports to the United States, from 2.7 million vehicles in 1975 to 5.9 million in 1980.[129] By then this growth had made the Japanese producers rivals of America's (and Canada's) Big Three.

Pressures to limit Japanese automobile exports therefore increased in the United States and in May 1981, at the insistence of the American companies, Japan agreed to a three-year voluntary export restraint (VER) with the United States, including a 7.7 percent reduction in exports unless the U.S. automobile industry grew in the second year. The Japanese government and producers agreed to this to avert protectionist pressures in Congress which would have hindered Japanese trade with the United States. To increase market share and guard themselves against the increasing U.S. protectionism, the Japanese manufacturers announced plans to construct plants in the United States, touching off a wave of inter-state competition for sites. In response to EEC nontariff barriers, Japanese automobile manufacturers, including Nissan, Honda and Toyota, also invested in Europe, often in Britain. Nissan, for example, reached an agreement with Motor Iberica of Spain and set up a factory in Northern England.[130] By the mid 1980s the Japanese had clearly become the industry models. Davis Dyer asserted that "the auto mecca of the world is no longer Detroit but Japan."[131]

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[129]Dyer et al., p. 137.

[130]Dyer et al., p. 141.

[131]Dyer et al., p. 97.

The fierce competition for market share and dominance in the world automobile trade increased as the 1980s progressed. Despite declines in domestic manufacturing in North America, the global industry expanded, though at a much slower rate than immediately after the Second World War.[132] The key struggle between the international players was for market share in the United States where both American and Japanese companies built so many plants that there would be an enormous automobile glut by the early 1990s. The production increase was so large that as early as 1986 a reporter wrote that "overall North American capacity could jump 27% by 1990, to 12.6 million cars. Sales will increase 15% at most."[133] Europe was in a similar state. The market there was so crowded that only three of the six major producers were consistently profitable during the 1980s.[134] To maintain market share and economic health, the manufacturers increased production to maintain economies of scale despite the growing glut.

To decrease costs, Japanese and American firms also increasingly sourced parts in countries with inexpensive labour forces and in secondary markets other than the United States and Europe. All American firms

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[132]Patrick Dennis Quinn Jr., Restructuring the Automobile Industry, A Study of Firms and States in Modern Capitalism, (New York: Columbia University Press, 1988), p. 14.

[133]The Wall Street Journal, Feb. 14, 1986, p. 1.

[134]ibid., p. 8.

began to import parts from Japan, the NICs, Southeast Asia and Mexico, although the magnitude of this international sourcing has sometimes been overestimated. A study by the General Accounting Office in 1988 showed that on average 88 percent of the parts used by U.S. producers were manufactured domestically.[135]

B. Canada's Push for Investment

While the U.S. and Japanese automobile industries were in a state of transition during the early 1980s, Canadian production entered a systemic crisis. Canada had branch plants because it had successfully attracted multinationals to Canada, primarily through the 1965 Auto Pact with the United States. However, as mid-size cars require short production runs, American firms had set up these facilities in Canada. During the early 1980s, these models were declining in popularity and the Canadian automotive parts industry shrank as American firms looked elsewhere for low cost sources. The shift in suppliers was rapid: "In 1966 the United States obtained 75% of its imported parts from Canada but in 1981 only 38%."[136] Smaller Canadian parts producers were increasingly marginalized.[137]

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[135]Business Week, August 14, 1989, p. 78.

[136]Langdon, "Canada-Japan Trade Friction, The Automobile Issue," p. 1.

[137]Manuel Werner and David Noble, "Canada's Motor Vehicle Industry," in Canadian Banker, (June 1986, pp. 6-13), p. 13.

Immediately after the announcement of the U.S.-Japan VER on automobiles in 1981, members of Pierre Trudeau's cabinet, worried by the prospect of a flood of imports into the Canadian market, demanded a similar agreement from Japan. With difficulty, Canada obtained a one-year VER with a promised six percent reduction in exports for the 1981 fiscal year, but because Japanese producers flooded Canada with vehicles in the late 1980 fiscal year, there was actually a 10 percent increase in imports in the 1981 calendar year.[138] While the Japanese were careful not to aggravate U.S. protectionist feelings during the early 1980s and supported restrictions on auto imports there, similar agreements were a source of conflict between Japan and Canada and led to the greatest tensions between the two countries since the trade war of the mid 1930s.[139] The tensions peaked with Canada's inspection slowdown of Japanese automobiles arriving in Vancouver in 1982.

Simultaneously, when Japanese firms began to discuss North American production, they made it clear that Canada was not their first choice. In 1980, after a visit to Japan by Industry Minister Herb Gray, a Toyota spokesman said that Canadian plants *might* be studied *if* American

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[138]Langdon, p. 51.

[139]Langdon, "Canada-Japan Trade Friction, The Automobile Issue," p. 10.

production was successful.[140] For all these reasons, the future of the Canadian automobile industry looked extremely grim. As this is Canada's largest manufacturing sector, Central Canada's unions, governments and business expressed strong concerns with Japanese disinterest, while the Western provinces resisted any action that might anger Japan and affect the resource trade.

In Central Canada there was growing demand for legislation requiring more local content in cars sold in Canada. The 1983 federal task force on the Canadian automobile industry requested legislation that favoured American branch plants and pressured Japanese producers to set up in Canada.[141] The task force was clearly weighted in favour of the existing industry because it was co-chaired by Pat Lavelle, president of the Automotive Parts Manufacturers' Association of Canada, and Bob White, United Auto Workers director.

As well as threatening the Japanese producers with further non-tariff barriers, the Canadian and provincial governments offered numerous incentives to them. In 1985, for example, the Ontario Liberals offered Toyota close to $30 million in benefits to place their $300-million plant in

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[140]The Vancouver Sun, June 5, 1980, p. A18. The italics are mine.

[141]Federal Task Force on the Canadian Motor Vehicle and Automotive Parts Industries, An Automotive Strategy for Canada, Ottawa: Ministry of Supply and Services Canada, 1983.

Cambridge, Ontario.[142] U.S. negotiators were frustrated by what they considered unfair competition, because in Canada both federal and provincial governments offered incentives while in the United States only the states did.[143]

Although the federal government offered few monetary overtures to the Japanese, it offered an extremely attractive tariff package -- duty remissions -- that infuriated the Americans and undermined the Auto Pact. As a result of this policy, if a foreign producer in Canada exported domestic products, they received a hefty duty remission on goods entering Canada. For example, if a Japanese firm purchased $10,000 in parts from a Canadian company and exported them to another country, the exporter could receive a remission of $920 in duties on a $10,000 automobile imported here.[144] The Canadian government initiated this program after it became clear that the United States was much more attractive than Canada for Japanese automobile production. These rebates were crucial in attracting Japanese assembly plants because the Canadian domestic market was not large. Similar incentives and trade barriers had also persuaded Nissan and Toyota

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[142]The Globe & Mail, Dec. 12, 1985, p. F11.

[143]Paul Wonnacott, U.S. and Canadian Auto Policies in a Changing World, (Toronto: C.D. Howe Institute, 1987), p. 26.

[144]Paul Wonnacott, "The Canada-U.S. Free Trade Agreement and the Auto Pact," in (C.D. Howe Institute) Trade Monitor, No. 2, (March, 1988, pp. 1-11), p. 2.

to invest in Australia in the previous decade.[145] These cases clearly support Edgington's argument that government incentives in the host country, as well as protectionism, can be a key motivating factor in multinational investment decisions.[146] The United States, arguing that the duty remission program broke the Auto Pact, threatened to raise countervailing duties against Japanese firms in Canada if no action was taken by the early 1990s.[147] Pressures to make Asian companies conform to the Auto Pact were hardening within even the governing Progressive Conservative Party.[148]

C. Secondary, Supporting Factors

During the mid and late 1980s, in response to these trends and new advantages in favour of international production, American and Japanese companies began to use Canada and other nations as bases for joint-ventures. The GM-Suzuki plant announced in 1986 was the largest example of this in Canada. This site, the first Asian one in Canada to meet Auto Pact standards, was to produce 200,000 small cars and four-wheel-drive utility vehicles per year, mostly for export to the United States. In a similar joint-

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[145]Edgington, Japanese Business Down-Under: Patterns of Japanese Investment in Australia, 1957-1985, pp. 149-155.

[146]ibid., "Introduction."

[147]ibid., p. 1.

[148]The Vancouver Sun, June 24, 1987, p. F7.

venture in 1987 Chrysler Canada announced plans to import automobiles made in Thailand by MMC Sittipol, a subsidiary of Mitsubishi. Chrysler Canada president Moe Closs said Chrysler was entering this agreement to "enhance their share of the Canadian subcompact passenger car market," a sector where Chrysler had been suffering.[149] The plan also circumvented Canadian restraints on Japanese automobile imports.

The entry of Hyundai into the Canadian market also increased Japanese attention to Canada, especially as Korea had few export restrictions aimed against it and Hyundai was taking market share from Japanese compact cars. The Korean producer announced plans to build a $25-million parts factory north of Toronto and then opened a $325-million plant in Quebec in 1989. In the mid-1980s, many Japanese feared that Korean automobile exports would quickly expand and capture Japanese markets. In 1984, its first year of exports to Canada, Hyundai sold 25,000 cars, five times what the company had expected to sell, and the company soon became the number one Canadian auto importer. However, as a result of declining consumer satisfaction and quality problems, Hyundai's market share decreased in North America during the late 1980s. Analysts have also questioned the viability of Hyundai's Quebec plant. The plant will produce 100,000 small cars a year, but a compact car plant generally must turn out

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[149]The Vancouver Sun, May 8, 1987, p. E1.

a minimum of 300,000 units a year to be more than marginally profitable.[150] The Quebec site is also far from major U.S. markets and was chosen after pressure from Prime Minister Brian Mulroney.[151] The attention that the Japanese producers paid to Hyundai therefore declined in the late 1980s.

The Japanese plants and joint-ventures were originally established in North America to overcome trade barriers and to increase market share in the face of stiff competition, but a diverse factors made them more economically viable in the late 1980s. These included: rising Japanese labour costs, the revaluation of the yen, and increased protectionist pressures in Europe and Asia. For example, in October 1988, before its Cambridge, Ontario plant was completed, Toyota Canada requested federal support to export to Europe. The company president said that the factory would double its capacity if this assistance was received.[152] Honda was another case. By 1991 it intended to export 50,000 Ohio-made cars to Japan per year.[153] The Japanese manufacturers were also using North America as a base from which to export to Asian countries with barriers against Japanese imports.

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[150]Sara L. Gordon and Francis A. Lees, Foreign Multinational Investment in the United States, Struggle for Industrial Supremacy, (New York: Quorum Books, 1986), p. 133.

[151]The Wall Street Journal, July 29, 1988, p. 12.

[152]The Toronto Star, Oct. 21, 1988, p. C1.

[153]Business Week, April 25, 1986, p. 91.

Toyota began exporting to Taiwan from the United States as did Honda to South Korea to avoid protectionism aimed at products made in Japan.[154]

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For Canada, the benefits were numerous. The new plants brought Japanese managerial and technological expertise and breathed new life into the domestic automobile industry, although American investment here remained much greater in scale. Although they were for assembly, the plants were the first major Japanese manufacturing investment in Canada, and thus broke an important barrier for both countries. The Japanese assembly plants also brought peripheral investment to Canada and increased Japanese attention to Canada. The automobile investments resulted in an increase in Japanese banking business in Canada and caused a number of small- and medium-sized Japanese parts suppliers to construct plants in Canada. For many of the Japanese banks in Toronto, working with auto-related companies was their largest source of business.[155]

Canada had become strategically important to Japanese automobile manufacturers during the 1980s, largely because Canada offered market access to the United States, but its role increased in value towards the end

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[154]The Wall Street Journal, Dec. 23 and June 15, 1988, pp. A10 and 20.

[155]The Financial Times of Canada, May 4, 1987, p. 15.

of the 1980s. Unlike Japanese patterns of foreign investment discussed by Kojima in the 1970s, these new plants were in response to trade barriers and incentives, nd represented one aspect of the entry of Japanese producers into the developed nations. In the case of automobiles, Dobson argued accurately that the relationship between Canada, the United States and Japan was triangular. Japanese investment here and Canadian government responses regularly followed American decisions.[156] However, the Japanese multinationals devised ways of using these plants for additional, profitable purposes, such as exporting cars to Asia.

[156]Dobson, pp. 10-11.

V. *Finance and High-Tech: Important Beginnings*

High-technology and finance in Canada received their investment from Japan in the 1980s, and it increased as the decade progressed, in response to financial liberalization and Canadian technological developments. Relatively rich Japanese financial institutions invested in overseas markets to take advantage of new opportunities as financial markets liberalized. Direct investment in Canada was steady while portfolio investment, particularly in bonds, was extensive. When they became aware that Canada had the requisite expertise, Japanese high-tech companies invested here to receive new technology that would assist them in an increasingly competitive world.

Statistics that Sazanami provided on Japan's investment position in the world between 1973 and 1985 make this situation clear. She noted that the major growth areas of Japanese direct investment in the early 1980s were finance, insurance and real estate, although manufacturing remained important. Sazanami's figures show that Canada's relative share of total Japanese foreign direct investment in transportation, real estate, manufacturing and construction declined steadily during this period, whereas investment in agriculture, fisheries, mining and services, remained relatively stable. In the service sector, Canada's share of Japanese foreign direct investment in commerce and trade holdings declined from 3.1 to 2.1 percent, whereas investment in finance rose from 0.8 to 1.8 percent, accounting for the stability in the service sector.[157]

A. Japanese Finance in Perspective: the 1980s

The internationalization of Japanese finance was one of the major economic trends of the 1980s, and as such, perhaps it was only natural for it to have created repercussions and debate in Canada.[158] Perspectives on

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[157]The figures in this paragraph are taken from Sazanami, pp. 107-109. Sazanami's figures came from various issues of the Finance and Banking Statistics Monthly (Zaisei Kinyu Tokei Geppo) of the Japanese Ministry of Finance.

[158]For a clear explanation of this process and what is meant by the internationalization of Japanese finance, see Yoichi Shinkai's "The Internationalization of Finance in Japan," pp. 249-271, in The Political Economy of Japan, Vol. 2, The Changing International Context, Takashi Inoguchi and Daniel I. Okimoto, eds., Stanford: Stanford University Press,

these changes in Japanese finance varied considerably. Wright argued that the Japanese were using secretive, underhanded tactics to capture international financial markets, while Edward Lincoln said that the Japanese financial boom would have to taper off sharply by the end of the 1980s as the Japanese rate of economic growth slowed.[159] David Lake showed that Japanese financial houses had become considerably more important to Canada during the 1980s because they invested heavily in government bonds.[160]

Japanese direct investment in banking, insurance and broking in Canada was substantial during the 1980s, but not enormous. Portfolio investment, however, was extensive. Between 1977 and 1988, these sectors of the Japanese economy directly invested $413 million into the Canadian economy.[161] On the Japanese side, the process began with deregulation in Japan in 1980. That year the Ministry of Finance liberalized foreign exchange controls left over from 1949, and Japanese financial institutions headed into overseas markets. In the same year Canada amended its Bank

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[159]Richard W. Wright and Gunter A. Pauli, The Second Wave: The Global Challenge of Japanese Financial Services, London: Waterlow Publishers, 1987; and Edward J. Lincoln, Japan, Facing Economic Maturity, Washington: The Brookings Institute, 1988.

[160]David Lake, "A Formidable Force in Global Finance," in Report on Business, April 1986, pp. 28-36.

[161]Japanese Ministry of Finance.

Act to allow foreign subsidiaries, thus attracting foreign financial investment.[162] Between 1981 and 1985 the Canadian share of Japan's direct foreign investment in finance climbed from 0.8 to 1.8 percent.[163] The peak was in 1986, when Japanese financial firms placed $120 million of direct investment into the Canadian economy.[164]

In the United States and the United Kingdom, Japanese financial institutions also directly invested and entered domestic loan markets and retail banking, fields they did not enter in Canada. Most of the Japanese banking operations in Toronto acted as support services for Japanese resource extraction, automobile assembly and parts manufacturing operations.[165] In California, by contrast, Japanese firms bought four of California's ten largest banks during the 1980s.[166] By early 1986 there were 29 Japanese banking operations in London, 52 securities dealers and 20

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[162]Michel Caron, "Canadian Government Policy," in Japan's Financial Services: The Implications for Canada, pp. 14-19, edited proceedings of a conference sponsored by the Canada-Japan Trade Council in cooperation with the Ontario Centre for International Business, Toronto, February 21, 1989, (Ottawa: Canada-Japan Trade Council, 1989), p. 17.

[163]Sazanami, p. 108.

[164]Japanese Ministry of Finance.

[165]The Financial Times of Canada, May 4, 1987, p. 15.

[166]Michael S. Serrill, "Bareknuckle Banking," in Time, May 21, 1990, (pp. 38-40), p. 39.

insurance firms, and they handled 22 percent of money lending.[167] In other words, Japanese firms controlled approximately that amount of the banking assets in London, the centre of British finance. In Canada, by comparison, all foreign banks combined were allowed to hold only 16 percent of domestic assets (loans), which meant that they could not control as much of the Canadian lending market as Japanese banks held in London. As well, in Canada by 1988 there were only 33 banking operations, and 14 insurance and securities companies from Japan in total.[168] Therefore, Canada received steady investment in keeping with its financial importance.

With a new willingness to take risks and with extremely low domestic interest rates that allowed them to undercut European and American offers, the Japanese banks also captured major Third World loan markets that U.S. institutions once dominated.[169] Japanese firms also formed joint-ventures with specialty American banks to gain expertise in new loan and bond markets because the U.S. firms continued to be the world's most innovative, even if their relative share of world financial services was declining.[170]

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[167]Gow, p. 66.

[168]Yozo Yamagata, Vice President and General Manager Marubeni Canada, "Japanese business view on investment in B.C.," a paper presented at a conference entitled "Canada and Japan in the Nineties," March 14, 1990, in Vancouver, (source of data in the paper was JETRO).

[169]The Wall Street Journal, Sept. 29, 1986, p. 36D.

[170]Neil Osborn, "Now, the Japanese Attack the World's Financial Markets," in Euromoney, October, 1985, (pp. 76-91), p. 91.

America's strong position in global finance slipped dramatically during the 1980s.

The Japanese also became increasingly important to the U.S. government during the 1980s as it looked for investors to buy its bonds. While the U.S. federal deficit ballooned during the 1980s, the budget was increasingly financed by Japanese institutions buying bonds issues. In April 1986 Japanese firms held $138 billion in U.S. treasury bonds at a time when the U.S. government was offering $100-120 billion of them per year.[171] Gilpin described this as a situation in which the American hegemon was increasingly subsidized and allowed to retain power by its Japanese ally.[172] As well, by 1990, Japanese banks controlled "at least 10% of all commercial loans made in the U.S."[173]

B. Steady Investment in Canada

Previous to 1980, Japanese banks had followed Japanese manufacturing and resource interests to Canada to support their overseas operations, and this changed little during the subsequent decade, although the banks set up subsidiaries in Canada after 1980. As late as 1987 resource

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[171]Gilpin, p. 331.

[172]ibid., chapter eight.

[173]Serrill, p. 39.

and trade finance remained the primary business of Japanese banks, although they were beginning to move into other areas including loans to medium-sized Canadian businesses.[174] Japanese subsidiaries also helped underwrite loans for Canadian institutions operating in Southeast Asia.[175] By 1989, 60 percent of the loans the Japanese subsidiaries in Canada extended were to Canadian entities, but one banker said that these subsidiary banks were still showing a poorer return than other foreign banks in Canada.[176]

Nevertheless, the fiercely competitive and highly protected nature of Canada's banking industry, kept Japanese banks from taking a more active interest in markets here.[177] Canadian financial legislation, designed in the 1930s, protected Canada's eight large commercial banks against international encroachment. Even after the Bank Act amendments of 1980, foreign subsidiaries could have one head office and one branch office in Canada without special permission from the Ministry of Finance. Foreign

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[174]The Financial Times of Canada, May 4, 1987, p. 15.

[175]ibid., p. 13.

[176]Masayuki Hongo, (President and Chief Executive Officer, The Bank of Tokyo Canada), "The Perspective of a Japanese Banker, " in Japan's Financial Services: The Implications for Canada, edited proceedings of a conference sponsored by the Canada-Japan Trade Council in cooperation with the Ontario Centre for International Business, Toronto, February 21, 1989, (Ottawa: the Canada-Japan Trade Council, 1989), pp. 30-31.

[177]For a discussion of the tightly regulated and competitive nature of Canadian banking, see Gordon R. Boreham and Ronald G. Bodkin, Money, Banking and Finance, The Canadian Context, Toronto: Holt, Rinehart and Winston of Canada, 1988.

subsidiaries had to have a ratio of 20 to one between assets and capital while Canadian banks were allowed ratios of 23-25 to one. For these reasons as well as the extreme competitiveness of many sectors of the Canadian financial community, in January 1987 foreign subsidiaries controlled only 12 percent of domestic assets although they were allowed to control as much as 16 percent after the Bank Act Revisions in 1984.[178]

Following the banks, Japanese securities firms and insurance companies also steadily entered the Canadian market in the 1980s, investing heavily in portfolio opportunities. Daiwa Securities bought the first Japanese seat on the Toronto Stock Exchange in 1987 for the record price of $361,000, and in 1987 two other Japanese securities firms received licenses from Ottawa in exchange for trading privileges for three Canadian firms on the Tokyo Stock Exchange. The president of Nomura Canada Inc. explained the portfolio investments here as follows:

> "This survey [by the Canadian embassy in Japan] indicated that Japanese portfolio holdings of Canadian securities amounted to $35 billion, with the life insurance companies accounting for about $20 billion of this amount. Government of Canada bonds are the most favoured investment, accounting for over half this amount, with provincial government bonds accounting for 20 per

[178]ibid., p. 84.

cent and federal and provincial crown corporations 15 per cent."[179]

As in banking, however, the Canadian securities industry was tightly regulated and Japanese traders entered the scene gradually, preferring portfolio rather than direct investment in Canada. Commenting on this trend, the first president of Yamaichi Securities in Canada, said that Canadians are only interested in dealing with the United States and ignore the rest of the world.[180]

As a result of Canada's high interest rates, Japanese portfolio investment in Canadian bonds remained strong throughout the decade. Between 1981 and 1985 Japanese brokerages and insurance firms bought $10 billion in long-term Canadian bonds.[181] This peaked in 1986 with $12 billion in bond purchases that year.[182] Contributing to this were Canada's political stability, the fact that bonds were a safe investment in the early 1980s at a time when few Japanese money managers had considerable international experience, and the ability of buyers to sell bonds easily. Although

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[179]Takashi Ohtake, "The Perspective of a Japanese Investment Banker," in Japan's Financial Services: The Implications for Canada, pp. 42-47, edited proceedings of a conference sponsored by the Canada-Japan Trade Council in cooperation with the Ontario Council for International Business, February 21, 1989, Toronto, (Ottawa: The Canada-Japan Trade Council, 1989), p. 45.

[180]The Japan Canada Journal, May 1988, p. 4.

[181]Lake, p. 30.

[182]Statistics Canada, 67-001, Fourth Quarter 1988, p. 41.

Japanese buying of Canadian bonds peaked in 1986, Japanese ownership of them remained at a high level.[183] In the mid 1980s, a major British banking journal argued that "further diversification into a wider range of international instruments [by Japanese investors] can be expected in future, with more funds following recent flows into Australia, Canada, the UK and ECU bonds."[184] Canadian bonds remained extremely attractive because Bank of Canada officials had to keep Canadian interest rates higher than those in the United States in order to attract investors.[185]

Canadian financial markets received steady but not outstanding Japanese portfolio and direct investment during the 1980s for all these reasons. Compared to the enormous money and capital markets of Tokyo, Osaka, London, and New York, Toronto and Canada were medium-sized, and the deregulation of the segmented financial sectors that occurred in the United Kingdom and the United States in the 1980s moved far slower in Canada. The Australian government allowed only 16 foreign banks to operate there, but it lifted asset ceilings which encouraged these banks to place more resources there.[186] Minoru Kanao, leader of the 1986 Japanese

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[183]The Globe & Mail, Nov. 28, 1988, p. C2.

[184]The Midlands Bank Review, "The World's largest creditor -- how long can Japan's surplus last?" Summer, 1987, (pp. 16-23) p. 22.

[185]The Wall Street Journal, June 18, 1990, p. C10.

[186]The Financial Post, Sept. 20, 1986, p. 42.

economic mission to Canada, argued that if Canada liberalized its banking laws it would receive further Japanese investment in other areas of the economy.[187] This comment implied that many Japanese businesses were unlikely to begin projects in Canada unless they could finance them through Japanese institutions. The president of Nomura Canada said that Japanese investment in Canadian equities will likely increase when Japanese investors understand Canada better.[188]

C. Technology: The Original Lack of Ties

During the 1980s Japanese managers began to take an interest in the cutting edge of Canadian technology, and followed up with investment in the Canadian telecommunications and aerospace industries. A set of booklets published since 1986 by the Japan Trade Encouragement Association displayed this reappraisal of Canada. The author noted that although Canada had the image of being only a resource provider, it was now the eighth largest producer of services and manufactured goods in the world.[189] This did not make Canada an economic superpower, but it meant that it had to be considered in any global strategy.

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[187]The Globe & Mail, Oct. 11, 1986, p. B2.

[188]Ohtake, p. 45.

[189]Kaigai Keizai Koho Senta, Nikkakan no Sangyo Geijiutsu Kyoryoku no Kanosei -- Fuain Seramikkusu Shinsozai Sangyo, (Tokyo: Nihon Boeki Shinko Kai, 1988), p. 1.

The Canadian government and business leaders welcomed these changes in attitude because the lack of technological transfer between Canada and Japan -- and the lack of Japanese manufacturing investment in Canada -- had been a sore point in relations since the late 1960s when Japanese black-and-white televisions began dominating the Canadian market. One commentator argued that the situation had not substantially changed in the late 1980s, but signs existed that the Japanese would continue to increase their value-added investment in Canada.[190]

Japanese managers have generally balked at value-added investment such as technology based industries in Canada, and as late as 1976 the leader of a Japanese economic mission said that the nation should continue to specialize in natural resource extraction and leave manufacturing to countries like Japan with an appropriate workforce.[191] Dobson noted that

> "the Japanese were slow to invest in Canada, for reasons already noted: one being their prime concern about uninterrupted access to the U.S. market from a Canadian plant and another being their uncertainty about Canadian policies and attitudes toward foreign investment."[192]

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[190]Richard Wright, "Investment from Japan: Small but Growing Rapidly," in CA Magazine, May 1987, (pp. 40-44), p. 44.

[191]Ho-Ka Keizai Shisetsudan Jimukyoku Henshu Iinkai, pp. 2-3.

[192]Dobson, p. 11.

In the 1970s and the 1980s Japanese investors pointed to the Foreign Investment Review Agency (FIRA), and later the National Energy Program (NEP), as examples of the need for wariness of federal control of foreign investment when investing in Canada.

In the early 1980s, however, Canadian governments and the business community also pointed to an apparent Japanese unwillingness to buy Canadian technology, no matter what its quality, as being at the root of the low levels of Japanese industrial interest in Canada. Langdon argued that "even when Canada had a powerful ally in the Ministry of Trade [[sic] MITI, in the case of the CANDU reactor], it failed to deflect the Japanese drive to achieve technological independence."[193] During the 1970s the Trudeau government made numerous attempts to assist Canadian manufacturers selling value-added products in Japan -- from nuclear reactors to the DeHavilland Dash-7 STOL aircraft -- but almost all failed.

By 1980, however, signs of a general change in Japanese economic attitudes towards Canada were noted. Zeman argued that "at least the recent editorials in Japanese newspapers, the 1979 Mitsui Report, and discussions during the Japan-Canada Business Coordination Committee

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[193]Langdon, The Politics of Canadian-Japanese Economic Relations, 1952-1983, p. 115.

Conference in May 1979 might suggest such a change of heart."[194] Beginning in 1983, the monthly report of the Keidanren began publishing an annual report on the Canada-Japan Businessmen's Conference, although in the 1970s the magazine had published only one article on Canada. These articles, written by the chairman of Nippon Kokan, discussed the potential for investment in Canada tourism, software, engineering plastics and other areas.[195]

D. Canadian Products Get Noticed

This slow change in attitude was clearly related to key high-tech sales by Canadian companies during the early 1980s. Spar Aerospace's contract with NASA in 1980 to provide three manipulator arms for the space shuttle -- the Canadarm -- bolstered Canada's image as a producer of world class technology.[196] In 1985, while its sales mushroomed in the United States, Northern Telecom's American subsidiary signed a $250-million, five-year contract with Nippon Telegraph and Telephone (NTT's first major foreign contract) and added considerable prestige to Canada's perceived role

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[194]Zeman, p. 102.

[195]Hisao Makita, "Dai Rokkai Nikka Keizaijin Kaigi Kokoku," in Keidanren Geppo, July 1983, (pp. 34-37) p. 37; and Minoru Kanao, "Dai Jyukai Nikka Keizaijin Kaigi Hokoku," in Keidanren Geppo, July 1987, (pp. 65-68), p. 67.

[196]The Wall Street Journal, April 15, 1989, p. 48.

in international technological development.[197] This contract for digital switching systems later doubled in value.[198] On the other hand, this increased respect for Northern Telecom only came after it based most of its production in the United States. Northern Telecom's World Trade Corporation President said that "The reality is that we probably could not have penetrated Japan out of Canada."[199] Despite the firm's growth in reputation, the president thought that the Japanese associated Canada with poor quality goods. Even so, these prestigious sales of "Canadian" goods were indeed made.

Against this background, Prime Minister Nakasone sent a second economic mission in 1986 that approved of technological investment in Canada. Symbolically, the mission titled its report: "Discovery of a 'New Canada.'" In his prologue, mission leader Minoru Kanao wrote that while the natural resource trade would remain important, the bilateral economic exchange should generally shift its emphasis to technological ties and joint-ventures between Canadian and Japanese companies operating in the Pacific Basin, and North and South America.[200] According to Kanao, all the major

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[197]The Wall Street Journal, Dec. 23, 1985, p. 5.

[198]Salter, p. 34.

[199]Business Week, May 14, 1990, p. 99.

[200]Japanese Economic Mission to Canada 1986, Discovery of a "New Canada," Report on the Japanese Economic Mission to Canada 1986, (Tokyo: 1987), p. 1.

problems with Canada listed in the Makita report 10 years earlier had been righted.

The report's positive comments showed that in that ten-year span, Japanese corporate attitudes towards investment in Canada shifted. The Senior Managing Director of Seiko and other members of the mission expressed strong interest in high-tech work by Canadian firms such as MacDonald Dettwiler and Assoc., Allelix, Spar Aerospace, Bombardier, and CAE Electronics.[201] As Dobson explained, however, the mission members' major concern was with potential events and with the role of Canadian technology in the international competition for comparative advantage developing in the late 1980s.[202] Mission members said Canada had a *basis for becoming* an important high-tech producer.

The Kanao report also was written the autumn after the controversial Maekawa report was released by an economic committee that advised Nakasone. That report called for domestic economic stimulation and attempts to increase imports to Japan at a time when it was under severe political pressure from the United States, and the Japanese government was

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[201] See the reports by Reijiro Ando, Yusaka Onaga, Wataru Yamaya, Hiroshi Okuda and Seiichi Takayanagi in particular in Discovery of a "New Canada," Report on the Japanese Economic Mission to Canada 1986, pp. 8-9, 14, 15-16, 17-18, and 19-20.

[202] Dobson, p. 26.

taking a conciliatory stance. None of these recommendations were binding and many commentators described the report as a public relations gesture. The reconciliatory mood of the Japanese government towards foreign trade complaints at this time was reflected in the extremely positive comments of the Kanao mission as well.

The political and economic background to this report was also very different from that of 1976. During the mid 1980s Canada was running trade deficits with Japan for the first time, discrediting earlier Japanese arguments that no economic exchange problem existed. Internationally, competition for cutting edge technology had also increased to the extent that multinationals looked throughout the world for new ideas. In fields such as telecommunications, research was so expensive that only the extremely successful corporations would survive. For example, one observer argued that "it's likely that only five of those 15 [international telecommunication manufacturing] companies will still be around [within 10 years], and they'll all be globe-spanning giants."[203] This level of pressure increased the willingness of Japanese multinationals to look to Canada for technology.

[203]Salter, p. 30.

E. Growing Connections

After the Kanao report, a number of Japanese high-tech firms invested in joint-ventures with Canadian firms. In November 1987, the Japanese firm Kao and the Canadian company Didak announced plans to jointly manufacture 3.5-inch floppy disks in Ontario to export to the United States with start up costs of $30 million.[204] Kao justified the plant on two grounds: (1) as a result of the Free Trade Agreement, raw materials can be imported from the United States and finished goods can be exported there with no tariff, and (2) the high yen relative to the Canadian dollar. Kao later bought 80 percent of Didak, and formed Kao-Didak.

A satellite telecommunications project was announced subsequently between Telesat Canada and Canadian Pacific Ltd. and a Japanese consortium, after Telesat failed to find investors in Canada.[205] This joint-venture, owned 20 percent by the consortium headed by C. Itoh, formed Telesat Mobile Inc. to produce satellite-based mobile telephones for a start up cost of $360 million.[206] Telesat Canada had had difficulty raising venture funds in Canada, president Michael Zuliani commented, and had turned to

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[204]Nihon Keizai Shinbun, November 12, 1987, p. 8.

[205]Nihon Keizai Shinbun, December 13, 1988, p. 1.

[206]The Vancouver Sun, December 13, 1988.

Japanese investors in desperation.[207] C. Itoh cited access to the American market as a result of the Free Trade Agreement as a reason for entering the venture.

Broader technical ties were developed, in addition to these smaller contracts. After conducting a technological complementarity study in 1988 which examined possible technological ties and joint-ventures between the two nations, the Canadian government committed $25 million to improving the technological links between the two nations.[208] Japan's burgeoning space program also turned to Canada and Europe for technological links while developing the H-2 rocket in order to avoid American restrictions on the use of licensed technology. In late 1988, Canada and Japan began an enormous joint research program involving 500 researchers from both countries working on 90 projects relating to "space development, biotechnology, communications technology and materials science."[209] The agreement followed a mission to Canada by the Society of Japanese Aerospace Companies looking for such links.[210] As part of this exchange, the Japanese

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[207]The Toronto Star, May 23, 1989, p. E6.

[208]MacMillan, "Japan and Canada, the bilateral economic relationship," p. 19.

[209]The Vancouver Sun, November 16, 1988, p. E11.

[210]The Japan Times, April 19, 1988, p. 10.

launched a $5-million Canadian Suprathermal Ion Mass Spectrometer on their EXOS-D satellite in 1989.[211]

Despite the Japanese acceptance of Canadian technological advantage in some areas, investment remained limited because Canada's high-tech industries were relatively small. With the exception of Northern Telecom (which is now based largely in the United States), Canada's high-tech industries generally follow developments in foreign multinational enterprises.[212] One observer pointed out that "the development strategies of a national technology of specific niches constitute a particular problem in the Canadian economy, which must react to US technological leadership. Most of the technological choices which determine the market of the Canadian industry are made abroad."[213]

As well, Canada had a much less developed research community than many competing nations. One measure of this was the relatively low funding that Canada provided for research and development. Two Canadian researchers noted that "OECD figures on r&d expenditure as a percentage

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[211]The Vancouver Sun, February 23, 1989, p. A15.

[212]Robert Dalpe, "Innovation and Technology in a Small Open Economy: The Canadian Case," pp. 250-261, in Small Countries Facing the Technological Revolution, Christopher Freeman and Bengt-Ake Lundvall, eds., (London: Pinter Publishers, 1988), p. 259.

[213]ibid.

of gross national product (GNP) indicate that although there has been a steady increase in Canadian r&d expenditures from 1975 to 1983, the 1983 rate (1.34) is only marginally larger than that for 1971 (1.32). Moreover, Canada's rate is the lowest of the eight countries reported [in a recent OECD report]."[214] Because of Canada's small manufacturing base and slow development of technology, Canada had deficits in all high-tech product areas in 1985, and since 1970 Canada's deficit in high-tech products had steadily increased.[215] These factors tended to dampen hopes for large-scale technological transfer in the short- and medium-term. To overcome these trends, two Toronto academics recommended that the federal and provincial governments must examine Japanese research trends when making their own funding allocation decisions if Canada wanted to attract more technological investment.[216]

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Although the strength of Japanese finance and high-technology were two of the most commonly discussed topics in the U.S. media in the late

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[214]David W. Conklin and Frances St.-Hilaire, Canadian High-Tech in a New World Economy: A Case Study of Information Technology, (Halifax: The Institute for Research on Public Policy, 1988), p. 33.

[215]Ministry of State for Science and Technology, Canadian Trade in High-Technology: an Analysis of Issues and Prospects, (Ottawa: Policy and Strategy Branch, Ministry of State for Science and Technology, 1985), pp. iv and 7.

[216]Donnelly and Kirton, The Potential for Partnership, p. 106.

1980s, their direct importance to Canadian business was important but limited.[217] Japanese investment in Canada in finance was steady during the 1980s, and it was increasing in high-technology by the end of the decade as a result of a new respect for Canadian technology, a desire for cutting edge ideas, and to some extent the Free Trade Agreement. The investment was steady but moderate, in line with Canada's medium-size industries. However, many Canadians hoped that the investment in these areas in the 1980s was the beginning of a larger trend.

[217]For an example of this fascination, see "Rethinking Japan: The New, Harder Line Toward Tokyo," in Business Week, August 7, 1989, pp. 44-52.

VI. Conclusions

The economic importance of Canada to Japanese business declined in a relative sense during the 1980s as the Japanese diversified their trade and investments internationally, and dealt with increasing protectionism in the United States and Western Europe. Canada was a medium-priority destination for capital and attention, less than some Canadians had hoped to see, although Japanese investment and trade increased substantially. Canadian business and government hopes for Japanese business connections had been inflated. As Wright suggested, "expectations that it [Japan] will become a major force in bringing new capital, technology and management skills to Canada seem unwarranted."[218] Even so, economic relations with

[218]Wright, "The unrealistic hopes for Japanese investment," p. 38.

Canada during the 1980s developed into new areas of manufacturing and services, and the changes were steady.

Despite the relative diminuation of the relationship to Japan, total Japanese trade and investment related to Canada grew steadily. From 1976 to 1988 Japanese companies invested $2.6 billion in Canada.[219] Between 1985 and 1989 Japan provided 4.2 percent of all foreign direct investment in Canada, behind the United States at 60.9 percent and the United Kingdom at 10.8 percent, but squeezing out France at 3.8 percent.[220] This is put in perspective, however, by the fact that in 1987-88 Australian investment of 5.1 percent exceeded that of Japan at 3.9 percent.[221] Conversely, trade increased steadily during this period. Between 1978 and 1988 Canadian imports increased, in yen, from 673 to 1,066 billion, and exports from 395 to 823 billion.[222]

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[219]Japanese Ministry of Finance.

[220]Yozo Yamagata, "Japanese Business View on Investment in B.C.," at "Canada and Japan in the 1990s," March 14, 1990, Vancouver, (source: Investment Canada).

[221]Investment Canada, Annual Report, 1987-1988, (Ottawa: 1988), p. 46. The figures are probably comparable for 1988-89 but Investment Canada did not break out the investment totals of nations other than Japan and the United States in its annual report of 1988-89.

[222]Statistics Bureau of the Prime Minister's Office, Japan Statistical Yearbook, 1980 and 1989. These numbers are nominal, not real.

The growth of Japanese trade and investment here was just one aspect of Japan's international economic growth during the 1980s, and Canada's position must be understood in terms of the growing importance of numerous other areas. The growth in Japanese international trade was steady; if exports and imports in 1985 are indexed as 100, exports and imports in 1975 were 45.1 and 73.0, and in 1980 they were 70.0 and 91.9 respectively. In 1988 the figures were 104.2 and 140.5. The growth in the value of exports previous to 1985, followed by the growth in imports after 1985 is particularly striking. Similarly, the annual net outflow of direct investment grew from U.S. $2.36 to $34.71 billion between 1978 and 1988. During these years, in 1985 prices, the Japanese Gross National Product grew from U.S. $1 to $1.5 trillion.[223] The importance of the United States, the EEC and Asia all increased with this trade growth.

By the end of the 1980s Japanese multinationals aimed foreign direct investment at the United States and the EEC to cope with growing or expected protectionism there. Sources of inexpensive labour were also important recipients of investment. As trade grew and Japanese corporations moved more money overseas, the nation placed more funding and effort into international institutions such as the Asian Development Bank, and took a more active role in negotiations in the international trading system such as

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[223]International Monetary Fund, International Financial Statistics Yearbook 1989, (Washington: 1989), pp. 444-445.

the Uruguay Round of GATT.[224] Japan became increasingly involved in multilateral approaches to economic issues.

The nature of this change, however, must be examined with a sector by sector -- even a case by case -- method with an eclectic viewpoint to understand the nature of Japanese investment in Canada between 1978 and 1988. For example, although the investments of Honda and Toyota in manufacturing in Canada occurred for the first time in the mid 1980s, compared with investments in the United States and the EEC, the site developments were moderate in size. These plants were also developed with the U.S. market in mind. In the case of coal, Japanese investors markedly increased their stake in Canada during the early 1980s, although their interest in energy resources dwindled by the decade's end and haggling over Quintette mine continued throughout the decade. The importance of different industrial sectors to investors declined or increased independently of each other to a great extent.[225]

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[224]Takashi Inoguchi, "The Ideas and Structures of Foreign Policy: Looking Ahead with Caution," pp. 23-63, in The Political Economy of Japan, Vol. 2, The Changing International Context, Takashi Inoguchi and Daniel I. Okimoto, eds., (Stanford: Stanford University Press, 1988), p. 35.

[225]The example of Canada in relationship to Japan during the 1980s clearly supports the eclectic economic arguments of Edgington and Dunning. The cases in the previous chapters show that multinational investment cannot be understood in terms of monocausal economic arguments. See John H. Dunning, Explaining International Production, and David Edgington, Japanese Business Down-Under: Patterns of Japanese Investment in Australia, 1957-1985.

In almost every case, within each industry, key factors relating to investment and trade decisions within Canada were determined by swings in the world and Japanese economy. This point is extremely important, because most all works regarding the Canadian-Japanese economic relationship are written within bilateral terms which emphasize Canada. For example, Dobson argued that the United States, Japan and Canada work within a triangular relationship, but it is more accurate to say that Canada responded to the enormous Nichibei economic relationship, the world's largest bilateral exchange.[226] Gilpin argued that the whole world's economic future hinged upon the success of the financial aspects of this relationship by the end of the 1980s.[227] Given this and international fears of EEC protectionism after 1992, it was not surprising that Japanese interest centred on reaching these markets and struggling with competitors there. The key factors in Canada's international economic position in relationship to Japan increasingly depended upon its economic attractiveness compared to European and Asian nations. Much of the MacDonald Commission's report

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[226]Wendy Dobson, Canadian-Japanese Economic Relations in a Triangular Perspective. Nichibei refers to Japan and the United States.

[227]Gilpin, Chapter Eight.

discussed this new global competitiveness and volatility.[228] Canada's place in this new internationalism requires further examination.[229]

Acts by the federal and provincial governments encouraged Japanese investment and trade during the decade, but the key impediments or incentives were not the commonly discussed Foreign Investment Review Agency (FIRA), the National Energy Program (NEP), or the Free Trade Agreement (FTA). A combination of incentives and protectionism encouraged Japanese trade and investment, but these were usually specific to the industry or the project. In the case of automobiles, the Voluntary Export Restraint and the Tariff Rebate Program of the federal government were crucial in attracting assembly investment, but these policies were particular to automobiles. In the case of Northeast Coal, provincial and federal investment in infrastructure made Japanese investment in and support of the mines possible, but again, these incentives were for that project only. This underlines the importance of adopting an eclectic approach to these issues.

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[228]Royal Commission on the Economic Union and Development Prospects for Canada, Report, Vol. 1, "Conclusions and Recommendations," pp. 208-210.

[229]If this thesis were to be extended, a macro view of Canada's place within one aspect of the increasingly international economy of the 1980s -- say in relationship to East Asia in general -- would be extremely valuable. Emphasis in the study of international economic exchange must shift from the bilateral to the multilateral.

The Free Trade Agreement may have long-term impact on Japanese perceptions, but in the short-term the opportunities it raised were secondary to Japanese interests in the United States and Europe. However, the doubling of Japanese investment in Canada in 1989 compared to 1988 may reflect increasing Japanese interest in the agreement.[230] Although the federal government hoped to attract foreign investment with the FTA, many business leaders in Japan saw it as protectionist. As the agreement limited membership in the Auto Pact, Japanese automobile producers saw the act as regional bloc building.[231] Japanese banks also complained because the agreement gave U.S. financial institutions the right to establish as many branches in Canada as they chose and lifted limits on authorized capital, privileges other foreign banks did not have.[232]

Japanese fears relating to the agreement being protectionist were compounded by American arguments. Dan Glickman, a Democrat Representative from Kansas, told the House of Representatives that the Canada-U.S. FTA would cause "fear in Frankfurt" and "terror in Tokyo."[233]

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[230]JEI Report, No. 23B, p. 10.

[231]Keidanren Jimukyoku, "Jiyu Boeki ga Ikinobiru Michi -- Bei-Ka Jiyu Boeki Kyotei to Sono Eikyo," in Keidanren Geppo, March 1988, (pp. 56-59), p. 58.

[232]Jean-Paul Caron, "How free trade will affect banks," in Canadian Banker, July-August 1988, (pp. 41-43), p. 42.

[233]The Financial Post, August 4, 1988, p. 5.

The Progressive Conservative government sold it as an opportunity to reach the U.S. market through the backdoor, Canada, but the investment statistics show this had relatively little effect on Japanese investors.[234] The Free Trade debate received numerous mentions in the Japanese media, but in the end it did not quickly change investment trends within Canada.

As well, most Japanese interest in the agreement related to U.S. policy. Three and a half weeks after Canada and the United States signed the agreement, MITI announced two studies to examine the possibility of (1) a Japan-U.S. agreement or (2) a Japan-Asia free trade zone which would include some New Industrialized Countries and ASEAN. MITI vice-minister Shinji Fukukawa reasoned that "on top of moving towards liberalizing the world's trading system, studying how to respond to regionalization is also necessary."[235] Even in the case of the FTA, Canada was only important to

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[234]Since the agreement's ratification, the Canadian government has begun aggressively advertising the virtues of investing in Canada in order to export to the United States. In March 1989, for example, Investment Canada published a full-page advertisement in the Nikkan Kogyo Shinbun, one of Japan's most influential business newspapers. Beneath a black and white photograph of "Ambassador Bridge" between Canada and the United States and an enormous Canadian flag, reads the headline "Kanada e no Toshi wa, Amerika Ichiba e no Kakehashi" (Investment in Canada is a viaduct to the American market). A short paragraph explains the advantages of Canada, starting with the Free Trade Agreement and explaining how Canada has assured access and geographic proximity to the U.S. market of 270 million people. For interested Japanese, there is a "hotline" telephone number and Japanese translations of the Canada-U.S agreement (Nikkan Kogyo Shinbun, March 20, 1989, p. 18).

[235]Nihon Keizai Shinbun, January 29, 1988, p. 3.

Japan to the extent that it could deliver U.S. markets. The importance of the United States was further underlined in the report by the 1989 Japanese economic mission to Canada. The mission leader commented that while Canadians argued that the agreement made Canada more attractive as a base for exporting to the United States, the opposite could be just as true, if not truer.[236]

Between 1978 and 1988 the strategic importance of Canada declined for Japanese business, but the relationship grew in terms of investment in Canada and total trade. The general picture, however, is an oversimplification. The fluctuations within different industries varied considerably with international change and government responses. Japanese business interest in Canada diversified into manufacturing, technological joint-ventures and greater financial interrelationship. Economic relationships between the two nations grew in real terms and importance to Canada.

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[236]Shinroku Morohashi, "Report by Mission Leader," in Canada: A Partner Challenging the World, (Tokyo: The Japanese Investment Study Mission to Canada 1989, 1990), p. 2.

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