

that Canadian producers are being squeezed hard trying to sell abroad.

This listing of factors which will reduce our share of offshore purchasing or reduce our total exports to Europe makes a gloomy picture and it is safe to say that the prospects of a high level of trade between Europe and Canada depend, even while ERP is functioning, on our willingness to buy European goods and Europe's ability to produce goods that Canadian consumers will buy.

The conclusion cannot be escaped that the rosy optimism of the early

months of ERP was not justified by events and that the prospects for the future are anything but bright. ERP is an attempt on the part of the United States to underwrite European recovery, to re-establish Europe as a part of the world trading economy, able to stand on its own feet financially, able to pay its way. Its purpose was not to solve, immediately, the export problems, of nations of the western hemisphere. Canadians are coming rather reluctantly to the conclusion that ERP has only postponed and eased the process of adjusting ourselves to a changed world market.

American Branch Plants and The Dollar Problem

By DONALD A. FERGUSSON

THE movement of American "branch plants" into Canada has for long constituted one of the largest and most dynamic factors in Canada's industrial development. Without this movement Canada would undoubtedly have lagged far behind its present position among the industrialized nations of the world. However, Canada's productive achievements during the war years indicate that tremendous possibilities still lie ahead; for the war-time integration of her specialized productive capacities with those of the United States actually resulted in the opening up of an entirely new industrial frontier in this country.

More recently, exchange difficulties have threatened to prevent the full exploitation of these industrial possibilities, largely because Canada's European customers have been unable to provide the convertible exchange required to keep the traditional "trade triangle" in balance. Thus emergency measures have been

necessitated to conserve American exchange.

In setting up and administering these regulations, there has been no intention of imposing drastic restrictions upon industrial development. The aim has been rather to promote industrial growth in the most constructive possible way by allocating the available American exchange to economically sound developments, i.e., those which later will be able to continue without the protection now temporarily provided by exchange controls. Even though the short-run consideration of United States exchange savings has been taken into account, particularly in the regulation of consumer goods imports, the guiding principle has been the improvement of our United States dollar position wherever possible through the expansion of production and exports rather than through the restriction of imports.

Thus, despite the exchange restrictions, the movement of new American branch plants into Canada, which continued to be one of the chief means by which her early post-war industrial de-

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velopment proceeded, has shown no sign of slackening. Such a movement seems desirable both from the long-run point of view of Canadian industrial development through closer integration with American industry, and from the short-run point of view of United States exchange savings; for the United States parent companies supply not only indispensable technology and know-how but also, in many cases, the dollars needed to import machinery and equipment from the United States.

The objectives of this article will therefore be:

- (1) To outline the development of the American branch plant movement in Canada, with particular reference to the post-war situation.
- (2) To illustrate areas in which this development is still proceeding and where opportunities exist for further integration.

In this way, some suggestion may be obtained as to the role that United States branch plant expansion will play in the future economic development of Canada.

Development of the Branch Plant Movement

American enterprise has been spilling over into Canada from at least as early a date as 1840. The early movement was chiefly into the lumbering and mining industries. Not until encouraged by the high tariff National Policy of 1879 did United States manufacturing plants move into Canada in any significant numbers. Even by the turn of the century they had become important only in the metals, textiles, and wood products industries in the Montreal, Windsor, Toronto and Hamilton areas.

However, during the next thirty years American capital was becoming the dominant influence on Canadian development. The important factors behind this movement were: the tremendous increase in American capital funds seek-

ing investment; growing United States needs for raw materials; Canada's scarcity of capital and advanced techniques; and Canadian tariff policy, the weapon used by the Dominion government in promoting industrialization.

Thus, by 1932 the present pattern of U. S. economic penetration of Canada was already pretty well set. Total U. S. "direct investments"¹ then amounted to about \$2,200 million, distributed among 1,177 firms. They were responsible for nearly one-quarter of all manufacturing; over one-third of mining, one-third of electric power, and two-thirds of natural gas output. The motion picture industry and variety stores also had a considerable American interest. On the other hand, transportation, communications, finance, merchandising, and restaurants and hotels were predominantly Canadian-controlled. Within the manufacturing category there was heavy concentration of American control in particular industries, e.g., automotive goods (82%); electrical apparatus (68%); rubber products (65%); non-ferrous metals (50%); non-metallic minerals (44%); machinery (42%); chemicals (41%); miscellaneous manufactures (40%); and pulp, paper and lumber (34%).

Whereas the remainder of the thirties witnessed a moderate decline, the years 1940-46 showed the sharpest increase in U. S. "direct investments" for any period except the boom years 1926-30. To indicate the relative importance of this recent \$547 million increase, it should be compared with total new business investment of \$4,500 million during the war years. Until 1944 the main source of this increase was the reinvestment of Canadian earnings. Since that date the influx of new U. S. capital has been considerable—in 1945 chiefly through the purchase of a large number of small existing Canadian manufacturing enter-

1. As used in D.B.S. publications U. S. "direct investment" refers to the American interest in firms 50% or more of the total securities of which were owned in the U. S.

prises and in 1946 (and 1947) through the establishment of several large new American plants.

Thus, by the end of 1946, U. S. interests controlled about one-fifth of total investment in Canadian business through direct investments of \$2,428 million. If the minority interests in these enterprises, amounting to slightly more than 25%, were included, the book value of Canadian firms under American control would rise to \$3,048 million. Half the U. S.-controlled companies and more than half the investments (\$1,366 million out of \$2,428 million) were in manufacturing. This represented close to 30% of total investment in Canadian manufacturing concerns as compared with about 25% in 1932.

[The increases since 1939 have been fairly general except in the public utilities and animal products groups of industries. However, they occurred mainly in industries undergoing sharp war-time expansion, such as iron and its products, non-ferrous metals, chemicals, and mining and smelting. The merchandising and financial categories also showed considerable expansion. The investments were thus still widely distributed with the percentage of American control varying greatly by industries. It still predominated in such important industries as the manufacture of automobiles, refining of petroleum, non-ferrous metals, and chemicals. It shared the field with Canadian capital in pulp and paper and in mining. But Canadian control continued in such industries as primary iron and steel, cotton textiles and merchandising. It is thus obvious that U. S. branch plants played a very important role in the Canadian economy at the time import controls were instituted in 1947.

Emergency Exchange Controls

The immediate objective of the whole emergency exchange control programme was to conserve and replenish Canada's supply of U. S. dollars, which had shrunk

rapidly from a war-time high of \$1,500 million at the end of 1945 to the dangerously low level of \$500 million in November, 1947. The shrinkage in reserves was particularly rapid during 1947. The current account deficit with the U. S. to November 15 of that year rose to more than \$1,100 million. Though Canada's favourable balance with the rest of the world approximated this figure, her net receipts of convertible exchange from overseas were only \$570 million, Canadian credits financing the remainder. This situation, combined with various capital movements, led to a \$750 million drain on Canadian reserves of gold and U. S. dollars.

The largest item in the current account deficit was the unfavourable balance in merchandise trade, which amounted to about \$900 million in 1947. A startling increase in commodity imports from the U. S. (by 40.5% over 1946, to a total of \$1,975 million) had taken place, whereas exports to the U. S. had increased only moderately (by 17%, to a total of \$1,046 million). The chief factors behind this increase in imports were: the high level of Canadian national income, which caused a large increase in imports of consumer goods; the tremendous investment boom, which necessitated very greatly increased imports of machinery, equipment and building materials; and the fact that the U. S., with its inflated prices, was the only country able to supply these increased demands.

Thus, the prohibitions and quotas, now included in Schedules I and II of the Emergency Exchange Control Act, aimed at lessening the immediate drain on reserves through reducing imports of non-essential consumer goods. Schedule III of the Act, regulating capital goods imports, was not so much concerned with this short-run objective. It was aimed primarily at the longer-run objective of readjustment in Canadian production and trade through the allocation of available U. S. dollars to those in-

dustrial developments which were economically sound and which would, at the same time, lead to a greater degree of balance in Canadian-American trade. Of course, the whole programme was integrated in such a way as to facilitate the accomplishment of this second and more basic objective of trade adjustment, which was a recognition of Canada's changed position both in world trade and in industrial development.

All firms proposing to carry out projects involving the import of capital goods from the U. S. were required to obtain approval of their projects before licenses might be granted for the needed imports. In addition, quotas were set for the import of production parts.

One of the aims of the regulations, so far as U. S. branch plants are concerned, was to break down the established inter-plant pattern of production and trade which has tended to persist through sheer inertia alone even though the economy in which the branch plants operated has advanced far along the road to industrial maturity. This pattern, whereby Canadian branch plants often produced only raw or semi-finished materials for their parent plants or obtained an unnecessarily high percentage of their own production parts from them, undoubtedly affected the merchandise trade and freight and shipping items in the balance of payments.

In addition, the branch plants' drain on reserves through dividend payments to their parents showed a substantial post-war increase. Accordingly, Foreign Exchange Control Board regulations were amended to provide that annual dividends be limited to one year's earnings.

Developments Since Emergency Exchange Controls

The figures for cost of materials for mining and manufacturing projects approved up to July 31, 1948, under Schedule III are used as a measure of the relative importance of the U. S. branch plant movement in the industrial expansion

which has occurred since the imposition of the controls in November, 1947.

According to this evidence, U. S. branch plant expansion constituted about 37% of total mining and 46% of total manufacturing expansion during the period.

The detailed figures indicate that branch plant expansion occurred in two main categories:

(1) In those industries the increased output of which was exported, mainly to the U. S., e.g., paper products, base metal mining, and asbestos mining.

(2) In industries producing goods formerly imported from the U. S. outstanding were petroleum, chemical products, electrical apparatus and supplies, iron and steel products, and transportation equipment.

As illustrative of the industrial expansion which has taken place and indicative of the possibilities of further development, two industries in each category are discussed briefly.

I. Pulp and Paper Products

This industry has shown by far the greatest expansion, both overall and branch plant. The largest branch projects approved were for the erection of new pulp mills at Watson Island, B.C., and at Marathon, Ontario, to produce a new acetylation-grade and a bleached sulphate pulp, both for export to the U.S. In addition to the main expansion which occurred in various types of pulp and newsprint, more highly manufactured products such as paper boxes, textile industry supplies, Kraft paper bags and wrapping paper were included in the recent branch plant expansion.

The result will be not only an improvement in the exchange situation, but also a more economical and closer integration of Canadian - American production through the movement of pulp and paper plants nearer to Canada's rich resources of pulpwood and water power.

The tremendous U. S. demand for pulp and paper products means that expansion is limited by availability of low-cost re-

sources and by the rate of exploitation of these resources permitted rather than by any market considerations. As evidence of future possibilities, the *Financial Post* of July 31, 1948, refers to the prospective establishment of two huge new mills in Alberta, a \$20 million project at Calgary, partly to produce dissolving pulp from Alberta jackpine for U. S. interests, and a \$9 million pulp and paper mill at Red Deer.

II. Base Metals

Exports of aluminum, nickel, copper, lead, zinc and related metals are further important producers of U. S. exchange. And recent U. S. demands have caused a considerable advance in base metal prices.

As an indication of the situation in the aluminum industry, 22% of Canada's exports will go to the U. S. in 1948 as compared with only 7% in 1947. The industry was actually a net user of U.S. exchange in 1947, taking into account dividend payments. In 1948, however, the favourable balance of commodity trade will increase by \$23 million. Since economical smelter capacity in the U.S. is considerably less than economical fabricating capacity, and power is scarce even for the present smelter capacity, the prospects for a substantial and permanent increase in exports to the U.S. are very bright. And since the Canadian industry is already operating at practically 100% of capacity, further expansion in production and exports depends entirely upon the possibility of constructing another large-scale smelter which could be operated at somewhat near Arvida's low production costs.

Aluminium Limited is investigating the establishment of a new smelter at Bute Inlet, north-west of Vancouver, where it is believed sufficient water power may be developed. Other sources of water power, the principal element in costs, are available on the Canadian Pacific coast. Such an establishment would encourage fabricating in Western

Canada and thus increase the already expanded domestic consumption of aluminum as well as allow for further exports to the power-scarce U. S. west coast.

Export demand for other base metals is also strong with prices rising considerably during the last few years. Again, expansion appears to be limited by the availability and rate of use of resources rather than by the market situation. And the fact that U. S. copper, zinc and lead mines are officially expected to be very seriously exhausted within 8 to 20 years accentuates this condition. Thus prospecting and development work are of greatest importance if Canada is to take advantage of her increased export possibilities.

Two smelting projects also warrant particular mention as possible opportunities for American investment in a field already dominated by American capital—a copper smelter on the West Coast and a zinc and lead smelter in eastern Canada. There is no copper smelter west of Manitoba and no zinc or lead smelter east of that province. Thus a considerable portion of the output of these metals is now exported in the form of ore.

The second category in which branch plant expansion has taken place consists chiefly of secondary manufacturing. Particular examples of this development are: the manufacture at Amherst, N. S., of a previous year's model washing machine and its parts not only for the Canadian and overseas markets but for the U. S. market itself; the manufacture at Hamilton of noiseless typewriters largely for sale in the U. S., and the manufacture exclusively in a Toronto plant of a standard model pen and pencil, four-fifths of the output to be for export. These are outstanding examples of the attempts made to offset branch plants' use of American exchange by at least equal production of American exchange. In many cases it has been found that an American firm readily agrees to produce its export re-

quirements (and, in some cases, even part of its home requirements) in its Canadian plant rather than in the parent plant. Besides making foreign exchange available, such a development makes it possible for the Canadian plant to operate on a larger scale and more economically. The controls have also aimed at encouraging a higher Canadian content in finished manufactured goods already produced in Canada.

III. Automotive Industry

The automotive industry, which is largely American-controlled, is probably the outstanding example of the latter development. A formula has been devised for this industry through the setting of quotas in such a way as to encourage the import of parts rather than complete automobiles, the use of Canadian-made components rather than American and greater production in Canada, particularly for export.

The expansion of auto parts and components manufacture is clearly indicated by the large number of project approvals for capital goods imports in this area. These projects include the manufacture of the following new items in Canada: new-type wheels; 2-speed differential carriers and case assemblies; new-type cushion spring assemblies; tapered roller bearings; new-type tubular locks and latches; and ornamented plastics. The scope for further developments is tremendous, for not only has the automotive industry been one of the leading users of U. S. exchange but Canada's wartime accomplishments also indicated her capacity to produce economically in this field.

IV. Chemical Products

U. S. branch plants were responsible for about two-thirds of the expansion which occurred in this industry. By far the two largest projects were the plants established at Toronto and Hamilton to increase production of soaps, glycerine, toilet preparations, synthetic detergents,

shortenings and drug products. Two other U. S. branch plants at Valleyfield and Toronto, will produce pharmaceuticals not previously fully manufactured in Canada and will thus reduce essential import requirements of streptomycin, sulfanomides, vaccines and serums.

Other projects involve the production of chlorine and caustic soda in a new Ontario plant and the production of ethyl alcohol in Quebec from previously wasted sulphite liquors. Another new product, now being produced in Quebec, is tri-polyphosphate, a chemical used extensively in the fertilizer industry. These examples are merely illustrative of the general expansion which is continuing in the field of chemical products.

Thus, American capital in the form of "direct investments" is continuing to play a very important part in Canada's industrial development. No evaluation of the movement has been attempted here, other than to point out its desirability from the point-of-view of exchange conservation and closer integration with American industry.

In any general appraisal its broader economic and social implications would need consideration. American control may extend to the point where Canada will become merely an economic appendage of the U. S. The objective of the controlling group, which is now heavily concentrated among a few large concerns, may conceivably conflict with the government's avowed aim of maintaining a high level of economic activity within Canada. And the very high percentage of Americans among the management personnel of branch plants already limits the opportunities available to Canadians for executive careers.

However, the "hewers of wood and drawers of water" argument applies with far different force to the two categories of recent branch plant expansion. In the long run, the turning over of rich natural resources of wood, minerals and water power for large-scale exploitation

to meet U. S. industry needs may prove to be an expensive method of obtaining the exchange required to keep the present boom going in Canada. On the other hand, expansion of secondary manufacturing may lead to a better balanced economy and thus serve somewhat to insulate Canada from the shocks resulting from a possible falling off in U. S. industrial activity.

Alternative methods of meeting Canada's capital needs would also warrant careful investigation. The United Kingdom's exchange and production difficulties are such as to limit the availability of capital from this traditional source. International Bank loans may be a possibility. Moreover, even if the U.S. continues to be the major source of Canada's imported capital goods, financing

through loan funds rather than ownership funds may prove practicable as well as less open to criticism.

Recently Canada's heavy participation in E. C. A. "off-shore" purchases has lessened somewhat her exchange difficulties. However, this improvement must be regarded as temporary only, allowing Canada a breathing spell in which to readjust her production and trade patterns. Even if substantial European recovery results and the former trade triangle is eventually restored, Canada's tremendous advances in industrialization will necessitate considerable trade readjustment. In the meantime, the discriminating exchange control weapon is available to direct further branch plant expansion into desired channels.

British Plants in Canada

By HON. ARTHUR WELSH

TO DAY there are approximately 350 branch plants in Canada which are sponsored by United Kingdom concerns, in comparison with a total of about 3,000 United States branch plants.

These figures indicate that the United Kingdom had "missed the boat" and that Canada in her own self interest should some years ago have done what we are doing now—that is, encourage the establishment of United Kingdom plants in Canada on a substantial scale.

In most cases of present economic maladjustment between two countries with a record of substantial mutual trade, the blame can usually be placed directly on the credit and exchange difficulties which built up in progressive fashion both from the first war and the late war. In this case, however, while

it is certainly true to some extent, it does not appear to give the complete answer.

In fact, the evidence of the past fifty years clearly points out that a lack of understanding of each other's domestic economic status, and each other's basic position in world trade, was the real cause of the comparatively small number of United Kingdom branch plants which have been established in Canada.

Breaking down the problem to its lowest common denominators to discover the basic trends that have resulted in the present branch plant situation in Canada, we arrive at four individuals who bear the responsibility, namely:

1. The United States Manufacturer, who has established a branch plant in Canada.
2. The United Kingdom Manufacturer, who has established a branch plant in Canada.