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The Growth of U.S. MNCs in Canada in 20th Century: Canadian Perspectives

Sikandar Ali Hayat Bhoon
Advocate, Bhoon Law Chamber, Lahore High Court, Lahore, Pakistan.
E-mail: ijaz.latif@iub.edu.pk

Muhammad Ijaz Latif
Head of the Department, Department of International Relations,
The Islamia University of Bahawalpur, Pakistan.
E-mail: ijaz.latif@iub.edu.pk

Abstract
This article examines the growth of U.S. Multinational Corporations and Canadian concerns in the 20th Century. In the 19th century, Canada was dominated by the British foreign investment. However in the 20th century, the share of the British investment in Canada decreased whereas the share of U.S. increased. The Canadian government took various economic measures in the late nineteenth century that forced the American companies to establish their industrial plants in Canada. The developments of multinational corporations in Canada reveal the United States MNCs shifted their affiliates because of high tariff introduced by the Canadian government intermittently. The United States MNCs found it difficult to compete with their rivals by exporting goods to Canada. Secondly, the multinational corporations' investment in Canada shows that it has not spread evenly or randomly across all industrial sectors. Hence all high profit sectors of the economy were dominated by the American MNCs, which sparked nationalism among the Canadian masses. The Canadian government responded to this nationalism by establishing various investigation commissions to evaluate the performance of these foreign MNCs. The reports highlighted that these MNCs had been deteriorating the economic performance of Canada and threatening its national sovereignty. To cope with these problems, the reports recommended some measures to the government which were implemented in piecemeal by different governments.

Keywords: Canada; U.S.; Multinational Corporations; Foreign Direct Investment; International Political Economy

I. Introduction

The contemporary multinational corporation is a nineteenth and twentieth century phenomenon but its roots could be traced back to the deep past of mankind. In different eras of human history, the business enterprises took different form. At the early stage, the business was carried out by traders and merchants individually but this practice was replaced by giant commercial companies like East India Company, Hudson Bay Company and Dutch East India Company in sixteenth and seventeenth centuries, which were established by European colonial powers in their colonies. The advent of industrial revolution not only expedited industrializations in Europe and U.S. but also in other parts

of the world. This industrialization gave birth to the present day multinational corporation.

II. The U.S. Multinational Corporations in Canada

The industrialization process in Canada was delayed as compared to U.S. and Europe due to its colonial status. The British government always viewed Canada as a consumer market and as a source of raw material and never encouraged industrial activity in it. This Canadian under-development also provided a market for the U.S. goods, which has easy assess due to geographical proximity and low transportation cost. The U.S. always exported finished products to Canada, which hampered its economic development. To overcome this problem, the Canadian government took different economic measures in the late nineteenth century that forced the American companies to establish their industrial plants in Canada.

The first Canadian measure, which enticed the American companies to set up their branch-plant corporations, was the Canadian Patent Act of 1872. The Act announced any patent null and void if it is not used within two years of its registration in Canada. The Act gave U.S. firms an incentive to establish their plants in Canada so that the Canadians might not use these patent rights.

The major thrust to the American multinational corporations' development came from the Canadian high tariff policy. In 1878, the Canadian government introduced a high tariff of 35 percent on all imports to protect its slow growing manufacturing industries against the influx of American finished good. This high-tariff strategy produced an inflow of U.S. branch plants and subsidiary firms to have an unrestricted access to the Canadian market and resources. The result was that Canada soon became a branch-plant economy and American corporations were dominant in Canada's most dynamic industrial sectors, while Canadian ownership was confined to only less capital intensive industries such as textile, footwear, food processing and furniture manufacturing. Naylor says "Canada was the pioneer of the process of industrialization has succinctly expressed this phenomenon by invitation [while the high tariff] was generally regarded as a sort of declaration of independence from the U.S. It becomes a matter of inviting American capitalists to shift the locus of their production northwards" (Holtfrerich, 1989: 147).

In 1897, Canada started a preferential treatment policy for British products. This action also accelerated the development of U.S firms in Canada, which envisioned the possibility that the British government might give the same privilege to the Canadian products. To have this preferential access to the British markets, the U.S. established it subsidiaries in Canada.

III. U.S. Multinational Corporations in Twentieth Century

In the 19th century, Canada was dominated by the British foreign investment. It has been estimated that by 1867, ninety percent of Canadian foreign investment was controlled by the British. However in the 20th century, the share of the British investment in Canada decreased whereas the share of U.S. increased. After the First World War, the American investment increased rapidly and it replaced Britain in Canada. By 1929, the U.S. direct investment totaled $ 7.2 billion and there were 1,057 foreign manufacturing subsidiaries of United States enterprises in the world, 446 of which were in Canada

(Fatemi, 1979). However, during the 1930s and 1940s, the U.S. multinational corporations' activities slackened due to Great Depression and World War II. Some multinational firms give up or sold out their foreign subsidiaries altogether. The multinational activities during this period were also retarded due to international cartels, which prohibited firms of one nationality from participating directly in some other national market.

The best known phases of American multinational growth started at the end of the Second World War and continued till the end of the sixties. The American MNCs in Canada got encouragement from Korean War during 1950s. The severe shortage of dollars forced the Canadian government to encourage American investment whereas the diminishing stock of strategic minerals and metals compelled U.S to look eagerly towards Canada. This resulted in a massive inflow of American capital and investment in Canada which roughly doubled each ten years after 1945 (Wilkin, 1970). The development of U.S. investment continued to rise till late 1960s but in 1970s it faced competition of Europe and Japan in foreign investment in Canada. The share of U.S. foreign investment began to decline in Canada after this period.

IV. Sector Diversity of MNCs

There are three basic sectors of multinational corporation's activities: raw material, manufacturing and services. The U.S. multinational corporations have taken a lion's share in the following sectors of Canadian economy.

a. Petroleum

Among natural resources petroleum is a major field of multinational corporations activities. This industry made its first debut in the United States in 1870s when John Davidson Rockfeller established the Standard Oil Company and monopolized the entire business in the U.S. within a short span. Standard Oil Company started its business in England in 1888 and later in Canada by purchasing the controlling interest in Imperial Oil, Canada's largest Oil Company. Imperial Oil was incorporated in the Standard Oil Company, which was giving a vigorous competition to the Standard in Canadian business market (Shaffer, 1983).

By controlling Imperial Oil Company, Standard Oil Company achieved a dominant position not only in Canada market but also in other countries. It used Imperial as an instrument for investing in those countries where Americans were not welcomed. When on the eve of World War I, Standard decide to acquire producing properties in the controversial La Brea Y. Darinas fields in Peru, it used Imperial for this purpose. Through Imperial, Standard organized the International Petroleum Company (IPC) apparently a Canadian company to run its fields and refineries in Peru.

World War I underscored the strategic importance of oil. It was used not only to power the ships but was also used in the new instruments of warfare. French President Clemenceau wrote to the U.S. President Wilson that oil was a necessary as blood. World War II illustrated even more significantly than World War I the importance of oil in modern warfare. Both the Allied and Axis forces were highly mechanized with large fleets of aircraft, lorries, tanks and ships. All these equipments consumed enormous quantities of oil.

After the Second World War, the high profit in oil business gave this industry boost and soon after, the oil supply exceeded the demand in the U.S. The government imposed limit on its production in the country, which made the oil companies to move to Canada and Venezuela for oil import. In 1950, 59 percent of U.S. imports of crude and unfinished oils came from Venezuela and it declined to 51 percent in late 1950s. However, the import remained stable because of heavy supply from Canada which also conformed to the objectives of the U.S government of favoring hemisphere oil over that of the Middle East.

The heavy penetration of U.S multinational corporations in Canadian oil industry gave them opportunity to formulate the Canadian oil policies, which is visible from National Oil Policy (NOP). The National Oil Policy divided the country into two: the country West of Ottawa River was provided oil form Alberta province whereas Quebec and Atlantic Provinces were supplied for Venezuela. This policy prevented the construction of Alberta oil pipeline from Alberta to Montreal and in lieu of this, no quota limit was imposed on Canadian oil export to U.S. This U.S. policy aimed at to supply market for Venezuelan oil which was suffering crisis because of imposition of quota in U.S. and any such restrictions in Canada for Venezuelan oil would lead to political instability and losses to United States MNCs working in that country.

The implications of this market division become apparent during the oil embargo of 1973/4, when Eastern Canada suffered oil shortages and western Canada did not have the transportation facilities to alleviate the shortage in the East. Recognizing the importance of problem, the Canadian Government signed in March 1975 an agreement with the Pipeline Company to extend the line to Montreal. This pipeline provides two-thirds of total oil to Eastern Province (Shaffer, 1983).

b. Mining

The U.S multinational corporations began their activities in Canadian mining industry in the late 1870s and soon marginalized the local investors in this field. The growing industrialization in the U.S props up the mining industry of Canada. All the major mining developments in Canada were entirely in the control of the giant U.S. MNCs like Bethlehem Steel and National Steel. In 1980, 70 percent of Canada's iron ore production was under American control and Canada was the fifth largest iron ore producer in the world (Niosi, 1985).

c. Manufacturing Sector

The multinational corporations in manufacturing sector are mostly concentrated in the developed countries due to their high per capita income. The first manufacturing firm, which became Multinational Corporation, was German Daimler when it established its subsidiary in Austria in 1902. The first American firm which became MNC was the Ford Motor Company when it established a subsidiary in Canada in 1903 (Maxcy, 1981: 64). This first move outside the home country was to neighboring Canada which provided a similar market, a familiar environment, and less risk than elsewhere overseas. Soon after the Ford establishment, a number of other American producers set up assembly and manufacturing facilities in Canada, often by purchasing local firms. The American MNCs expansion was so rapid that it captured 97 percent of Canadian automobile industry within a short period of time.

The Canadian high tariff policy and weak local industry boosted the American manufacturing industry. The limited domestic market and the technological gap made the Canadian manufacturing industry non-competitive in the world market. The wage rate was 30 percent lower in Canada than in the U.S., even then the prices of automobile were 18 percent higher in Canada. These prices might be higher than this if the Canadian manufactured automobiles had not 40% the U.S. Manufactured parts. The Canadians were facing a strange dilemma if they wanted to be competitive, they had to lower the Canadian contents in automobile but at the same time it would increase unemployment and deficit in the balance of payments. To overcome this problem, the Canadian government signed the "Automotive Agreement". The agreement provided duty free passage of automobiles and parts between the two countries with the condition that the Canadian proportion in the assembling goods remain the same as prevailed in 1964.

In these free but controlled trade conditions, the automobile industry in Canada attained economy of scale and specialization by having free access to the U.S markets. Now the automobiles manufactured in Canada could be exported to the U.S without any hindrance. This enabled the Canadian manufacturing industry to gain specialization and competitiveness in the international markets (Maxcy, 1981).

Since North America has become a single automotive market, optimum-sized plants can be established in Ontario as well as in Ohio. Hence for the American companies, the investment decision was entirely a political and administrative one. The companies would establish plant where they get more incentives. For example, in 1978 the Ford Motor Company way offered $70 million to $ 75 million to establish an engine plant in Southern Ontario.

d. Multinational Banking

The international banking also spread along with the other multinational corporations to maximize it profit and to serve it clients who were spreading across the globe. The first modern multinational banking appeared during the second half of the nineteenth century with the emergence of the British Overseas banks. In the beginning of the twentieth century, thirty-two British Overseas Banks had a network of 2,104 branches predominantly in the colonies. At about the same time, similar colonial banks with headquarters in France, Germany and Holland operated a network of about of about 242 branches in their own overseas territories. The U.S. banks had very few foreign branches at that time (8 braches in 1933). Therefore, at the start of the second half of the twentieth century, the total world figure of foreign banking offices was 1250, 40 percent of these belonged to UK, 30 percent to Continental Europe and 10 percent to Canadian and one percent to the U.S (Casson, 1983).

The American commercial banks have greatly expanded since 1960s. At the end of 1964, eleven American banks operated a total of 181 foreign branches. By the end of 1974, the number of American banks operating abroad had reached 125 and they operated 732 foreign branches. However, in 1970s, the US banks lost their relative importance and among the top 50 banks in the world, their share of deposits went down from 42 percent to 15 percent in 1978. The same happened with the British and Canadian banks, which declined in this domain form 13 percent to 7 percent and from 9 percent to 3 percent respectively (Ghertman, 1984).

Another qualitative difference of multinational banking is related to the geographical orientation of this international banking. In the pre-war period most of the moves of multinational banking (MNB) were directed towards the developing countries. But in the post Word War-II era the major base of these MNBs are the developed countries. The Canadian government tried to limit the penetration of foreign multinational banks by using stringent laws. This policy strained relations between U.S. and Canada when the U.S. Citibank purchased Dutch Bank and Canada tried to prevent this deal by threatening to expropriate it.

V. Rise of Canadian Concerns towards United States MNCs

The U.S multinational corporations' economic activities expanded at a large scale in Canada after the Second World War. The expansion was so rapid that the American MNCs dominated almost the key sectors of the economy. This heavy concentration of foreign MNCs put the Canadian investors at disadvantageous position and they feel themselves tenant in their own country. This excessive foreign investment also integrated the U.S. Canadian economics so much that any legislative changes in America directly affected the Canadian economy. This undue Canadian dependency upon the U.S decisions developed economic nationalism in Canada, which often strained relations between the two countries.

The Canadians did not show any concern towards the U.S foreign investment soon after the Second World War. In 1956, 63 percent Canadians in a survey did not show any concern about American multinational corporations' investment whereas only 27 percent showed their displeasure towards it (Wright, 1981). However, the gradual rise of American foreign ownership changed the Canadian attitude which they expressed in different surveys. A Gallup poll in January 1974, found that the great majority of the Canadians were in favor of restrictions on foreign investment. The question asked was, would you favor or oppose legislation which would significantly restrict or control foreign investment in Canada? In favor were 52 percent, partially in favor were 17 percent, 18 percent opposed and 18 percent were unconcerned (Rugman, 1976).

The heavy American ownership and interference in Canadian economic and political affairs sparked off nationalism. They thought that the independence, which they have attained after a long struggle against Britain, has been diminished. The U.S. multinationals have not only made them economically impotent but also politically fragile. They have been taken for granted in political matters and have been treated as a junior partner in economic affaires. This American attitude made Canadians critical and suspicious about the United States MNCs and they tried to be as independent as possible.

a. The Gordon Report (1957)

Walter L. Gordon has expressed the first Canadian concern about foreign investment in key sectors in his report, which has been termed as Gordon Report. The Report highlighted the question of foreign ownership, especially its economic and political effects on Canada. Mr. Gordon expressed a concern that the managers of U.S. subsidiaries in Canada if faced with a conflict between the U.S. and Canadian interests, would elect to support the U.S position.

To prevent the erosion of Canadian sovereignty through the foreign direct investment, the commission recommended that the foreign-owned subsidiaries to take

action to Canadianize themselves. The report recommended that the proportion of the Canadians in foreign investment should be increased, Canadian should be appointed in the board of directors, Canadian should be appointed at the high positions in the administration, local purchasing of foreign subsidiaries should be encouraged and corporations should be made export oriented. Most of the suggestions incorporated in this report were implemented by different governments (McCalla, 1990).

b. Canadian Concerns towards Extraterritoriality

The occasional use of U.S extraterritorial laws scared the Canadians about their national sovereignty. The implementation of antitrust law, Enemy trade Act, labor laws and U.S balance of payments guidelines brought the two countries relations at the lowest ebb. When the U.S declared its foreign investment guideline mandatory for its MNCs Canada sharply reacted to it. In an address to the Toronto Society of Financial Analysts, Kierans, then minister of health for the province of Quebec said:

"When the United States dictates the investment policy, dividend policy, purchasing policy of the greater part of the Canadian manufacturing, mining and petroleum industries in Canada, it is directly interfering in the operations of Canadian business and controlling the activities of Canadian citizens subject to our laws and economic objectives. The U.S guidelines will have a disastrous impact on the structure and organization of the Canadian economy" (Brown, 1970).

By 1967, the issue of national sovereignty had received considerable publicity in Canada and the government appointed a Task Force under the leadership of Watkins to probe situation.

c. The Watkins Report (1968)

Task force headed by Meluille Watkins made the next major investigation into foreign investment. The task force originated in fraction between the U.S and Canadian governments over the extraterritorial application of U.S. laws to U.S owned subsidiaries in Canada. The specific instance was the publication by the U.S. government of its guidelines for the U.S. direct investment abroad in 1965 and in 1966 to encourage the repatriation of foreign earnings to improve the U.S. balance of payments. As a result, Canadians who had seen foreign direct investment as beneficial for them became concerned about the U.S. subsidiaries that had followed the policies of their government, which would be detrimental to Canada. The Report recommended national legislation to obviate foreign laws interference in Canada. It suggested that (i) Canadian laws ensure that multinational corporation subsidiaries would adhere to Canadian laws and policies; and (ii) New Canadian laws should be enacted to countervail the certain U.S laws and polices, such as antitrust laws, Enemy Trade Act and U.S balance of payments policy.

The Report also marshaled data to demonstrate the foreign investment negative aspects. The Report highlighted that most of the transactions in multinational corporations took place between units within the MNCs. The parent company charges excessive prices for technology and managerial services and in this way evades tax and profit of Canadian government and shareholders. This intra-industry transaction also increases imports and decreases exports. To overcome this problem, the task force recommended creating a government agency to survey multinational corporations' activities in Canada to make more effective use of certain laws and policies such as the

Canadian company law, bankruptcy law, securities legislation and guiding principles of good corporate behavior.

d. The Wahn Committee (1970)

A parliamentary Standing Committee chaired by Wahn conducted the third major investigation of foreign control of Canadian economic activity. They Wahn Committee based its view on the work done by the Wahn group. The distinctive recommendation made by Wahn committee was that over a reasonable period of time, all foreign-owned Canadian companies should have 51 percent Canadian voting share and the members on the board of director should be according to equity proportion.

Canadians thought that foreign direct investment would bring modern technology for Canada but the situation was diametrically different. The U.S. multinational corporations instead of establishing Research and Development in Canada established branch-plant industry, which has been termed as truncated industry. The major decisions about production, planning, marketing, capital spending and research are made in Cleveland, Detroit or Los Angeles not in Canada. The plants buy parts and components, as well as engineering and other professional services from their parent companies and their associates in the United States, to the neglect of possible local sources (Brown, 1970). This MNCs behavior instead of encouraging technological development retarded Canadian advancement.

e. The Gray Report (1972)

The fourth investigation of foreign investment in Canada was conducted in 1972. This report sought to determine both the economic forces that promoted this foreign investment and to measure it benefits and costs. The Report consolidated the evidence, sharpened the analysis and reformulated the policies for dealing with the mushrooming problems posed by the foreign-owned economic sectors. Although the Report covered a wide range of topics, it gave the greatest attention to the factors affecting the development and transfer of technology. The Report saw that most of the technology used by foreign MNCs has been developed abroad in the parent company; because of their satellite nature, branch plants are functioning as truncated industry with no research and development facilities.

The Gray Report had also the premise that the multinational enterprise has different interests from those of Canadian government. The latter is charged with safeguarding the political, economic and cultural independence of the nation and seeks to draw the most possible benefits from taxation of the multinational corporations. The formers' wish is to maximize profits and may therefore attempt to avoid taxation, for example, by one of the following three devices. Firstly, the multinational enterprise may engage in transfer pricing policies by which costs of supplies from the home companies are artificially increased to reduce the profit and taxable income of the host country subsidiary. Secondly, the subsidiary can be thinly capitalized such that debt capital is issued instead of equity capital allowing the subsidiary to deduct interest charges from its taxable income. Thirdly, as no tax is paid on loans of under one year duration, the subsidiary may borrow in Canada on the short run and channel the funds back to the parent company at low interest rates (Gibson, 1979).

To reduce the foreign-ownership control, the Report suggested three policies: Canadianziation, i.e., to increase the share of Canadian equity up to 51 percent in the foreign investments, exclusion of foreign subsidiaries from key sectors of the economy, and foreign investment review agency to maximize the net benefits to Canada from foreign direct investment.

VI. Conclusion

The developments of multinational corporations in Canada reveal the United States MNCs shifted their affiliates because of high tariff introduced by the Canadian government intermittently. The United States MNCs found it difficult to compete with their rivals by exporting goods to Canada. Secondly, the multinational corporations' investment in Canada shows that it has not spread evenly or randomly across all industrial sectors. It is especially high in mega technical projects and low in small and non-technical projects. Hence all high profit sectors of the economy were dominated by the American MNCs, which sparked nationalism among the Canadian masses. The Canadian government responded to this nationalism by establishing various investigation commissions to evaluate the performance of these foreign MNCs. The reports highlighted that these MNCs are deteriorating the economic performance of Canada and threatening its national sovereignty. To counter these problems, the reports recommended some measures to the government which were implemented in piecemeal by different governments.

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