

GLOBAL BUSINESS FORUM 2006

SEPTEMBER 22, 2006

**GLOBAL ECONOMIC COMPETITION: WHERE HAVE ALL THESE
COMPETITORS COME FROM**

INTRODUCTION

THE TITLE OF THIS SESSION – WHERE HAVE ALL THE
COMPETITORS COME FROM – SAYS IT ALL: THE WORLD DOESN'T
STAND STILL,

AS BUSINESSES, WE ARE ALL AFFECTED BY EXCHANGE RATE
FLUCTUATIONS LEADING TO BASIC CHANGES IN THE TERMS OF
TRADE, VOLATILE COMMODITY PRICES, RISING LABOUR COSTS –
LOOK AT ALBERTA THESE DAYS.

IN THE MEDIUM TERM, THE GROUND RULES KEEP CHANGING:
THERE WERE LESS THAN 10 FREE TRADE AGREEMENTS IN 1980,
THERE ARE 180 TODAY; FISCAL AND MONETARY POLICY
ENVIRONMENTS ARE IN CONSTANT EVOLUTION, IF NOT IN CANADA,
THEN IN YOUR MARKETS ; NEW COMPETITORS CHALLENGE
MARKET SHARE; CUSTOMERS ARE FRIVOLOUS AND
UNPREDICTABLE.

I SAID HERE LAST YEAR THAT, WITH THE COLLAPSE OF THE SOVIET UNION AND RADICAL CHANGE TO ECONOMIC POLICIES IN CHINA AND INDIA, 3 BILLION PEOPLE HAVE JOINED THE INTERNATIONAL ECONOMY SINCE 1990.

THIS WEEK'S *ECONOMIST* SURVEY OF THE GLOBAL ECONOMY SAYS THAT OVER THE NEXT DECADE, ALMOST ONE BILLION NEW CUSTOMERS WILL ENTER THE GLOBAL MARKET PLACE.

MUCH OF THE DYNAMIC FOR CHANGE IN THE WORLD ECONOMY IN THE LAST 40 YEARS HAS COME FROM ASIA. ACCORDING TO SCOTIA BANK, EMERGING AND NEWLY INDUSTRIALIZED ASIAN COUNTRIES NOW PRODUCE 23% OF GLOBAL EXPORTS. ON A PPP BASIS, AND EXCLUDING JAPAN, THE REST OF ASIA ACCOUNTS FOR 30% OF GROSS WORLD OUTPUT, VS. 41% FOR THE G7.

YOU HAVE SEEN THESE KINDS OF NUMBERS FOR YEARS NOW, AND I WON'T BELABOUR THEM.

IN THE FACE OF ALL OF THIS, BUSINESS AND ENTERPRISES HAVE TO THINK ABOUT HOW THEY WILL PROTECT THEMSELVES AND HOW THEY ARE TO PROSPER. IN THIS REGARD, I WANT TO MAKE THREE POINTS.

FIRST, IT IS DEMONSTRABLY TRUE THAT, ON AVERAGE, ENTERPRISES THAT ENGAGE STRATEGICALLY IN THE INTERNATIONAL MARKET THROUGH TRADE, INVESTMENT, R&D

COLLABORATION AND OTHER BUSINESS TIES INCREASE THEIR COMPETITIVENESS AND PRODUCTIVITY MUCH MORE THAN THOSE THAT DO NOT.

SECONDLY, DOING BUSINESS WITH JAPAN CAN HELP YOU MAKE MONEY AND PREPARE YOU FOR OTHER MARKETS.

THIRD, CHINESE DOMESTIC GROWTH AND INTERNATIONAL ECONOMIC EXPANSION IS SET TO CONTINUE AT TODAY'S BURNING RATES UNTIL AT LEAST THE END OF THE DECADE, IF NOT LONGER. JAPAN, CHINA AND INDIA, ALL THREE ARE THE DRIVERS, THE BUILDING BLOCKS, OF CHANGE IN ASIA AND ALL THREE WILL INCREASINGLY IMPACT ON CANADA AND ON YOUR BUSINESS.

LET ME ELABORATE.

1. CANADA MEETS THE COMPETITION

FOR THE CANADIAN ECONOMY AS A WHOLE, ADJUSTMENT TO CHANGE OVER THE LAST FEW YEARS HAS OFTEN BEEN DIFFICULT, BECAUSE OF THE VOLATILITY OF RELATIVE PRICES AND IN THE TERMS OF TRADE. BUT AS DAVID DODGE AGAIN EMPHASIZED RECENTLY, "BUSINESSES HAVE FOUND WAYS TO INNOVATE AND ADJUST TO CHANGING CIRCUMSTANCES".

IMPROVEMENTS IN ENTERPRISE PRODUCTIVITY HAS TRADITIONALLY BEEN SPURRED BY MANY FACTORS. EXPORTING IMPROVES PRODUCTIVITY BECAUSE IT CAN SERVE TO OPTIMIZE PRICES, ACHIEVE ECONOMIES OF SCALE, LEVEL SEASONAL DEMAND, SPREAD MARKET RISK, IMPROVE PRODUCTS AND SERVICES, EVEN IMPROVE MORALE.

ALL THIS REMAINS VALID. WHAT GLOBALIZATION HAS ADDED TO THE MIX IS, FOR THE FIRST TIME, THE CAPACITY OF DEVELOPING COUNTRIES TO COMPETE WITH DEVELOPED COUNTRIES IN PROVIDING BOTH MANUFACTURED GOODS AND SERVICES. SECONDLY, OPEN MARKETS, INFORMATION TECHNOLOGY AND COMPUTING POWER HAVE INTERNATIONALIZED THE MACHINERY AND THE GEOGRAPHIC SCOPE FOR ACHIEVING IMPROVEMENTS IN PRODUCTIVITY. TOGETHER, THESE FACTORS PUT A PREMIUM ON DEVELOPING PARTNERSHIPS AND INVESTING ABROAD FOR MANUFACTURING, APPLIED SCIENTIFIC RESEARCH, PRODUCT DEVELOPMENT, TESTING AND COMMERCIALIZATION, AND REDUCTION IN CERTAIN COSTS OF PRODUCTION.

SELLING ABROAD IS NO LONGER ENOUGH. MEETING GLOBAL COMPETITION REQUIRES THAT WE INCREASINGLY BECOME GLOBAL PLAYERS.

WHAT WE WANT TO HEAR IN THE COMING YEARS IS NOT: "WHERE HAVE ALL THESE NEW COMPETITORS COME FROM" BUT RATHER

“WHERE HAVE ALL THESE NEW CANADIAN COMPETITORS COME FROM”.

2. THINK OF JAPAN NOT ONLY AS A MARKET BUT AS A STRATEGIC PARTNER

I AM HERE TO MAKE THE CASE THAT, FOR MANY CANADIAN ENTERPRISES, TRANSFORMATION CAN BE SPURRED BY DOING BUSINESS IN JAPAN AND PARTNERING WITH JAPANESE COMPANIES.

JAPAN HAS FOUR THINGS GOING FOR IT, WHICH REQUIRE YOUR ATTENTION.

FIRSTLY, I SUSPECT THAT MOST OF YOU ARE AWARE THAT OVER THE LAST YEAR OR MORE, JAPAN'S ECONOMY IS BACK ON TRACK.

IN 2005, THE JAPANESE ECONOMY GREW BY 2.6%, THE SIXTH YEAR IN A ROW THAT GROWTH WAS POSITIVE FOR THE YEAR. THAT GROWTH ALONE ADDED OVER US \$115 BILLION IN OUTPUT, ABOUT THE SIZE OF THE SINGAPORE OR CHILEAN ECONOMIES.

PROFITABILITY OF JAPANESE FIRMS HAS INCREASED BY 86.5% SINCE 2002. THE BREAK-EVEN POINT OF PUBLICLY TRADED MANUFACTURERS REACHED 77.5% IN 2005, THE LOWEST POINT SINCE ITS PREVIOUS LOW OF 81.6% IN 1989. IN 2005, FIXED COSTS FOR JAPANESE MANUFACTURERS INCREASED BY 1%, BUT THEIR

SALES GREW BY 7%. THE OECD ESTIMATES THAT LABOUR PRODUCTIVITY HAS RISEN BY AN AVERAGE OF 1.8% PER YEAR OVER THE LAST 4 YEARS, AND WILL BE THE HIGHEST AMONG THE G7 OVER THE BALANCE OF THE DECADE, AT 2.2%. JAPAN'S PER CAPITA GROWTH IS HIGHER THAN THAT OF CANADA, DESPITE HAVING A DECLINING POPULATION. AND SO FORTH. JAPAN HAS A VERY HEALTHY CORPORATE SECTOR.

JAPAN'S TRANSFORMATION FROM THE WEAKNESS OF THE 90s TO TODAY'S STRENGTH WAS DRIVEN BY THREE OVER-RIDING FACTORS: PUBLIC SUPPORT FOR THE REFORM AGENDA OF PRIME MINISTER KOIZUMI, WHICH OFFERED JAPAN A WAY OUT OF THE DOLDRUMS OF THE 1990s; GLOBALIZATION, WHICH FOR JAPAN HAS MEANT DRAMATIC INCREASES IN OUTWARD AND INWARD INVESTMENT AND THE INTERNATIONALIZATION OF MANAGEMENT; AND THIRDLY, FEAR OF CHINA.

JAPAN'S GOVERNMENT GOT SERIOUS ABOUT REFORM. IT PURSUED DEREGULATION AND PRIVATIZATION. KOIZUMI'S RHETORIC ABOUT REFORM EMBOLDENED THE MANAGEMENT OF JAPANESE COMPANIES. THEY READ THE WRITING ON THE WALL: KEEP INNOVATING; FOCUS ON WHAT THEY DO BEST, OR FACE BANKRUPTCY WITHOUT THE TRADITIONAL SAFETY NET.

THE RESULTS ARE EVIDENT TO ANYONE WHO TAKES THE TIME TO LOOK. NONE OF THE 8 CITY BANKS THAT I DEALT WITH IN THE 70s, 80s AND 90s EXIST TODAY. HUGE TRADING FIRMS WENT UNDER.

NICHIMEN AND NISHO-IWAI DISAPPEARED. NISSAN WAS BOUGHT AND IS NOW RUN BY DAIMLER-CHRYSLER. SONY IS NOW LEAD BY A UK BORN AMERICAN, AS IS THE NEW SHINSEI BANK. FOREIGN INVESTORS, WHO HAVE ADDED THEIR OWN IDEAS ABOUT MANAGEMENT AND RETURN ON INVESTMENT, OWN 25% OF SHARES ON THE TOKYO STOCK EXCHANGE. TOYOTA IS ON THE VERGE THIS YEAR OF BECOMING THE WORLD'S LARGEST AUTO COMPANY. JAPAN ENJOYS A TRADE SURPLUS WITH CHINA, A POSITION SHARED ONLY WITH KOREA AMONG THE TOP DEVELOPED ECONOMIES. UNLIKE MOST INDUSTRIALIZED ECONOMIES.

CONTINUITY, ON THE OTHER HAND, WAS WHERE IT WAS NEEDED. THROUGHOUT THE DIFFICULT 90s, BOTH PRIVATE AND PUBLIC SECTORS CONTINUED INVESTING HEAVILY IN R&D. JAPAN SPENDS TWICE PER CAPITA ON R&D THAN WE DO. TODAY YOU SEE THE FRUITS OF THAT FOCUS – HYBRID ENGINES, PLASMA AND LCD SCREENS, COMPOSITES FOR NEW GENERATION AIRCRAFT, DIGITAL CAMERAS, 3G AND SOON 4G BROADBAND AND SO ON. BY CONTINUING TO INNOVATE EVEN IN THE TOUGH TIMES, BY SHIFTING LOW-VALUE ADDED PRODUCTION OFFSHORE AND INVESTING IN THE HIGHER END AT HOME. ONLY A QUARTER OF THE INPUT IN TODAY'S JAPANESE ELECTRONIC PRODUCTS IS MADE IN JAPAN. BUT, THESE ARE THE MOST EXPENSIVE AND TECHNICALLY ADVANCED PARTS OF THE PRODUCTS. JAPAN HAS MOVED ALMOST COMPLETELY FROM MASS MANUFACTURING TO SPECIALIZATION IN HIGH END COMPONENTS AND ADVANCED MATERIALS.

SECONDLY, SIZE MATTERS. JAPAN IS THE SECOND ECONOMY IN THE WORLD, IN US DOLLARS, LARGER THAN ALL OF THE REST OF ASIA, INCLUDING CHINA AND INDIA. YOU CAN THINK OF IT THIS WAY: IT IS EQUIVALENT TO THE UNITED STATES, FROM THE MISSISSIPPI TO CALIFORNIA. 52 OF THE 70 FORTUNE 500 FIRMS IN JAPAN ARE LOCATED IN TOKYO, A GREATER NUMBER THAN NEW YORK OR LONDON, AND HIGHEST CONCENTRATION OF CORPORATE POWER IN THE WORLD. CHOOSING NOT TO DEAL WITH JAPAN IS LIKE CHOOSING NOT TO DEAL WITH ABOUT HALF OF THE UNITED STATES.

THIRD, TECHNOLOGICAL LEAD MATTERS. JAPAN IS THE TECHNOLOGICAL FRONT RUNNER IN AREAS THAT WILL SHAPE THE IMMEDIATE AND LONG TERM FUTURE. THIS INCLUDES IN AREAS SUCH AS DIGITAL ELECTRONICS, WIRELESS CONNECTIVITY, NANOTECHNOLOGY, COMPOSITE MATERIALS, ROBOTICS, ADVANCED MANUFACTURING, BIOTECHNOLOGY, ENERGY EFFICIENCY, AND HYBRID ENGINES. IF THE USA STILL HAS THE LEAD IN PURE SCIENCES AND SOFTWARE DEVELOPMENT, JAPAN IS STILL IN THE LEAD IN TURNING R&D INTO USABLE TECHNOLOGY AND COMMERCIALIZATION.

FOURTHLY, JAPAN'S CONSUMERS DEMAND THE LEVEL OF QUALITY AND SAFETY THAT WILL INCREASINGLY SET THE STANDARD FOR NORTH AMERICANS AND EUROPEANS AND ASIANS.

CISCO SAYS THAT JAPAN IS A “PROOF OF CONCEPT” MARKET, THAT IS, IF YOU CAN MAKE IT THERE, YOU CAN MAKE IT IN OTHER MARKETS.

STARBUCKS CONSIDERS THAT JAPANESE CUSTOMERS ARE A GOOD INDICATION OF WHERE THEIR MARKET IS GOING.

HIGH END CONSUMER PRODUCT MANUFACTURERS USE JAPAN FOR R&D AND FOR PRODUCT TESTING.

WHAT THIS MATRIX MEANS FOR CANADIAN BUSINESS IS THAT JAPAN IS NOT ONLY AN EXPORT MARKET; IT IS THE VEHICLE TO GO UP THE TECHNOLOGICAL AND QUALITY CHAIN. DOING BUSINESS IN JAPAN, MEETING VERY HIGH QUALITY AND SERVICE STANDARDS, PARTNERING WITH STATE OF THE ART MANUFACTURERS, UNDERTAKING JOINT R&D OPERATIONS, THESE ARE MEANS TO IMPROVE YOUR COMPETITIVENESS IN JAPAN, IN ASIA, IN NORTH AMERICA AND IN EUROPE.

YOU HAVE TO BECOME AN INSIDER, A PARTNER IF YOU WANT TO MAXIMIZE THE BENEFITS TO YOUR BUSINESS. AND, BECAUSE OF REFORMS IN THE PUBLIC AND PRIVATE SECTORS IN JAPAN, THIS IS EASIER TODAY THAN IT HAS EVER BEEN.

A LARGE NUMBER OF CANADIAN FIRMS ARE IN JAPAN FOR STRATEGIC AS WELL AS COMMERCIAL REASONS.

LET'S LOOK AT SOME REAL EXAMPLES. THIS IS ALL PUBLIC DOMAIN INFORMATION:

IN BIOTECHNOLOGY:

ARIUS RESEARCH OF TORONTO AND TAKEDA PHARMACEUTICAL COMPANY LIMITED, JAPAN'S BIGGEST PHARMACEUTICAL FIRM, HAVE ENTERED INTO A THREE-YEAR, MULTI-PRODUCT COLLABORATION USING ARIUS' TECHNOLOGY TO DISCOVER NOVEL TREATMENTS FOR HUMAN DISEASE.

16 CANADIAN ORGANIZATIONS PRESENT AT THE LARGE BIOJAPAN SHOW IN OSAKA EARLIER THIS MONTH, INCLUDING TWO FROM ALBERTA.

METHYLGENE INC, BASED IN MONTREAL, ENTERED INTO A COLLABORATION, LICENSE AND COMMERCIALIZATION AGREEMENT WITH TAIHO PHARMACEUTICAL, A LEADING JAPANESE COMPANY, ON A PROGRAM FOR CANCER TREATMENT. TAIHO WILL PROVIDE THE CANADIAN FIRM WITH RESEARCH FUNDING SUPPORT FOR EIGHT SCIENTISTS OVER A MINIMUM OF TWO YEARS AS WELL AS FUND PRECLINICAL AND CLINICAL DEVELOPMENT COSTS IN NORTH AMERICA.

CANADA HAS THE SECOND BIGGEST NUMBER OF BIOTECH FIRMS IN THE WORLD (MAINLY SMALL) WHILE JAPAN, AS THE WORLD'S NUMBER TWO PHARMACEUTICAL MARKET, LACKS NEW ADVANCES IN PHARMA PRODUCT PIPELINES. IT'S A NATURAL FIT.

IN THE AUTO SECTOR:

AUTO PARTS MANUFACTURER MAGNA IS PRESENT IN FOUR LOCATIONS IN JAPAN, CLOSE TO DECISION MAKERS IN SOME OF THE WORLD'S LEADING AUTO ASSEMBLERS TO ASSURE ITS COMPETITIVE POSITION AS A SUPPLIER OF AUTO PARTS WHICH RESPOND TO JAPANESE DESIGN NEEDS. IT IS WORTH NOTING THAT MAGNA'S PRESENCE IN JAPAN IS NOT JUST ABOUT EXPORTING CAR PARTS TO JAPAN, IT IS ABOUT WORKING WITH WORLD-CLASS COMPANIES AT THE DESIGN STAGE SO THAT MAGNA CAN SELL AUTO PARTS TO JAPANESE ASSEMBLY PLANTS **GLOBALLY.**

IN AGRIBUSINESS:

MAPLE LEAF FOODS AND OLYMEL SHIP CANADIAN PORK TAILORED TO JAPANESE TASTES, FROM BREEDING TO CUTTING TO PACKAGING, EARNING THEM HIGHER PRICES AND CREATING HIGHER PAYING JOBS AT HOME. LAST YEAR CANADA EXPORTED MORE PORK TO JAPAN (ABOUT A BILLION CANADIAN DOLLARS WORTH) THAN TO THE USA --SUCH A MARKET DIVERSIFICATION HELPED KEEP VOLUMES UP AND PRICES COMPETITIVE.

RANCHER'S BEEF OF ALBERTA SPECIALIZES IN MEETING NICHE DEMAND FOR THEIR HIGH END BEEF PRODUCTS TO THE EXTENT THAT THEY HAVE JUST OPENED A NEW PROCESSING PLANT IN

ALBERTA TO CATER TO SPECIFIC JAPANESE NEEDS. WE IN THE GOVERNMENT WORKED HARD TO RE-OPEN JAPAN TO CANADIAN BEEF. RANCHER'S IS ONE OF THOSE WHO RESPONDED EFFECTIVELY TO THE OPENING. SUCH SPECIALIZATION GENERATES HIGHER PRODUCTIVITY AND INCOME.

IN HIGH TECHNOLOGY:

OVER 50 CANADIAN HIGH TECH FIRMS MAINTAIN OFFICES IN JAPAN. CALGARY-BASED ZI CORPORATION, HAS SIGNED A LICENSING AGREEMENT WITH NINTENDO CO., LTD FOR ITS HANDWRITING RECOGNITION SYSTEM TO SIMPLIFY HANDWRITING INPUT AND RECOGNITION FOR GAMES USERS.

QUESTAIR OF BURNABY, BC IS ABLE TO ACCESS THE CHINESE MARKET BY SELLING ITS GAS PURIFICATION TECHNOLOGY TO THE IWATANI ENGINEERING FIRM IN OSAKA, WHICH IMPORTS AND BUNDLES THEIR TECHNOLOGY INTO A PACKAGE DEAL FOR CHINA THROUGH ITS HYDRO EDGE SUBSIDIARY.

ONTARIO HIGH TECH COMPANIES ATI AND GENNUM ARE SUPPLYING SEMICONDUCTORS AND OTHER SPECIALIZED COMPONENTS TO JAPAN'S LEADING CONSUMER ELECTRONICS COMPANIES IN HIGH VOLUMES BECAUSE THOSE INPUTS GO INTO ASSEMBLY IN CHINA AND JAPAN. LIKE MAGNA, THEY ARE WORKING WITH JAPANESE

FIRMS AT *THE DESIGN STAGE* AND SUPPLYING JAPANESE-AFFILIATED GLOBAL SUPPLY CHAINS.

COGNOS IS AMONG 20 CANADIAN SOFTWARE FIRMS WITH OFFICES IN TOKYO SELLING THEIR CAD/CAM, DIGITAL ENTERTAINMENT AND DATA STORAGE/SECURITY APPLICATIONS TO JAPAN'S MULTINATIONAL CORPORATIONS AGAIN IN LARGE QUANTITY BECAUSE THOSE LICENSES ARE OFTEN USED BY THE CUSTOMER IN THEIR WORLDWIDE OPERATIONS. WE EXPECT THE SAME TREND ONCE RIM INTRODUCES THE BLACKBERRY IN JAPAN LATER THIS YEAR.

WHEN THE NRC'S NEW NATIONAL INSTITUTE FOR NANOTECHNOLOGY (NINT) OPENED IN EDMONTON THIS SPRING, JAPAN'S NANOTECH RESEARCH INSTITUTE (NRI) WAS PRESENT AND SIGNED AN MOU WHICH WILL ALLOW CONTACTS WITH WORLD LEADING JAPANESE EXPERTS IN ADVANCED CERAMIC AND OTHER MATERIALS AND THEIR INDUSTRIAL APPLICATIONS. A JOINT LAB IS BEING CONSIDERED.

THIS IS ONE REASON IN THAT JUST RECENTLY, THE PRESIDENT OF THE NATIONAL RESEARCH COUNCIL DR PIERRE COULOMBE AND THE PRIME MINISTER'S NATIONAL SCIENCE ADVISOR DR ARTHUR CARTY VISITED JAPAN FOR MEETINGS WITH THEIR JAPANESE COUNTERPARTS IN SUPPORT OF ENHANCED EFFORTS TO COMMERCIALIZE INNOVATIVE TECHNOLOGIES.

IN ALTERNATIVE ENERGY:

BALLARD OF BC AND HYDROGENICS OF ONTARIO ARE ABLE TO TEST AND MARKET THEIR STATIONARY FUEL CELLS TO JAPANESE UTILITIES, ONE OF THE FEW MARKETS WHERE THAT IS POSSIBLE - THE SAME PATTERN IS DEVELOPING FOR VEHICLES. DYNATEK OF ALBERTA HAS A PARTNERSHIP WITH A MAJOR JAPANESE STEEL MILLER - JFE - TO SELL HYDROGEN TANKS TO JAPAN, INCLUDING TO MAZDA FOR USE IN THEIR CUTTING EDGE HYDROGEN-POWERED RX8 ROTARY ENGINE - I WAS ABLE TO TEST DRIVE THIS VEHICLE LAST NOVEMBER NEAR HIROSHIMA.

OF COURSE, ONE SHOULD ALSO FACTOR IN THE ROLE JAPANESE INVESTMENT IN CANADA PLAYS:

TOYOTA CANADA AND HONDA CANADA IN THE LAST YEAR HAVE STARTED BUILDING NEW PLANTS IN ONTARIO WHICH WILL INTRODUCE THE LATEST ROBOTIC, FLEXIBLE *KAIZEN* MANUFACTURING TECHNIQUES INCLUDING MANAGEMENT KNOWHOW. A QUARTER OF OUR AUTO EXPORTS ARE GENERATED BY JAPANESE INVESTED PLANTS - A PROPORTION WHICH WILL RISE BY 2008/09.

JAPAN CAN ALSO IMPROVE OUR CAPACITY TO INNOVATE AND COMMERCIALIZE TECHNOLOGY, A FACTOR OF INCREASING IMPORTANCE TO OUR GLOBAL COMPETITIVE POSITION. FOR E.G.: BENEFITS FROM JAPAN EXTEND TO THE PUBLIC SECTOR IN THE NATIONAL INTEREST.

INDEED, FOR THE PAST THREE YEARS CANADIAN GOODS AND SERVICES EXPORTS HAVE GROWN – TO ALMOST \$1 BILLION A MONTH - AND SO HAS FDI IN BOTH DIRECTIONS: LAST YEAR'S INCREMENT IN CANADIAN GOODS EXPORTS TO JAPAN – ALMOST \$500 MILLION - WAS ABOUT THE SIZE OF ALL OUR EXPORTS TO RUSSIA.

SO THINK ABOUT THIS.

3. CHINA IS THE OTHER UNAVOIDABLE ECONOMY

LAST YEAR, I SPOKE AT LENGTH ABOUT CHINA AND THE RISKS OF DOING AND NOT DOING BUSINESS THERE. SITTING IN JAPAN, MY ASSESSMENT OF CHINA'S FORWARD DYNAMIC HAS NOT CHANGED A GREAT DEAL.

I NO LONGER LIVE IN CHINA, AND SO DO NOT HAVE THE SAME "FEEL" FOR DEVELOPMENTS THERE. NEVERTHELESS, I BELIEVE THAT I CAN MAKE THE FOLLOWING POINTS, BASED ON THE VIEW OF THINGS FROM JAPAN:

CHINA HAS SEVERAL YEARS OF HIGH GROWTH RATES AHEAD OF IT, BUILDING ON 25 YEARS OF 9.5% AVERAGE ANNUAL EXPANSION. MORE MODERATE RATES MAY BEGIN TO EMERGE BY THE END OF THE CURRENT DECADE. THIS VIEW IS BASED ON THE TRACK RECORDS OF 40 YEARS OF ECONOMIC EXPANSION AND CONTRACTION IN THE ECONOMIES OF NORTH EAST AND SOUTH EAST ASIA. CHINA'S SECRET IS NO SECRET. THAT IS: VERY HIGH LEVELS OF SAVINGS AND CONCOMITANT LEVELS OF INVESTMENT. THIS, AND THE USE OF HERETOFORE UNDERUTILIZED FACTORS OF PRODUCTION, SUCH AS LABOR, IS WHAT SPURRED GROWTH IN JAPAN, IN KOREA, IN TAIWAN, IN SOUTHEAST ASIA. THE SAME APPLIES TO CHINA.

SEEN FROM JAPAN, THE RISKS OF DOING BUSINESS IN CHINA REMAIN AT THE MICRO-ECONOMIC LEVEL. WHILE THE BUSINESS ENVIRONMENT IS IMPROVING, IT IS STILL NOT POSSIBLE TO RELY ON INSTITUTIONAL SUPPORT FOR RESOLVING CONTRACT DISPUTES OR PROTECTING INTELLECTUAL PROPERTY. SOME PROGRESS IS BEING MADE, THANKS TO OUTSIDE PRESSURES AND THE INCREASINGLY TECHNOCRATIC MIND-SET OF CHINESE OFFICIALS, BUT CHINA WILL RETAIN THE INSTITUTIONAL CHARACTERISTICS OF A DEVELOPING COUNTRY FOR A DECADE OR MORE.

SOCIAL AND POLITICAL INSTABILITY ARE THE GREATEST CHALLENGES TO GOVERNANCE AND THE AUTHORITY OF THE COMMUNIST PARTY. RECENT CRACKDOWNS ON THE MEDIA AND

POLITICAL ACTIVISTS MAKE IT CLEAR THAT AN INCREASINGLY OPEN ECONOMY AND SOCIETY ON THE ONE HAND, AND THE CLOSED POLITICAL SYSTEM ON THE OTHER, ARE INCREASINGLY INCOMPATIBLE. DEBATE WITHIN THE CPP ON THE FUTURE DIRECTION OF GOVERNMENT WILL INTENSIFY. MEANWHILE, THE STATE'S CAPACITY TO CONTROL INSTABILITY REMAINS UNDIMINISHED. THE QUESTION FOR CHINESE LEADERS WILL ULTIMATELY BE: HOW MUCH COERCION AND EVEN VIOLENCE ARE THEY WILLING TO EXERCISE TO MAINTAIN THEIR MONOPOLY ON POWER.

WHILE THERE ARE TENSIONS BETWEEN CHINA AND JAPAN, AND CHINA AND TAIWAN, THESE ARE BEING AND WILL BE MANAGED. BARRING A UNILATERAL DECLARATION OF INDEPENDENCE BY TAIWAN – NOT AT ALL A LIKELY DEVELOPMENT – WE CAN EXPECT STABILITY ACROSS THE STRAITS. NORTH KOREA IS DIFFICULT AND SEEMINGLY IRRATIONAL, BUT BASICALLY, ALL IT WANTS IS REGIME PRESERVATION, AND FOR OTHERS TO FEED ITS PEOPLE AND SUPPORT ITS MEAGER ECONOMY. SO FAR, CHINA AND THE ROK HAVE BEEN WILLING TO BUY PEACE WITH THE DPRK, AND THAT SITUATION IS LIKELY TO CONTINUE IN ONE FORM OR ANOTHER.

BEYOND RISK MANAGEMENT, THE CANADIAN BUSINESS ISSUE FOR CHINA REMAINS UNCHANGED: AT LESS THAN \$1 BILLION, CANADIAN FDI IN CHINA IS NOT YET SUFFICIENT TO INSURE STABLE AND PREDICTABLE GROWTH IN TRADE. MOST CANADIAN COMPANIES STILL HAVE NOT FOUND IT IN THEIR INTEREST TO

DEVELOP THE TYPES OF BUSINESS RELATIONS THAT WE SEE OTHER BUSINESS COMMUNITIES EMBRACING.

IN CONCLUSION, WE ARE BEYOND THE AGE THAT CAN DEPEND SIMPLY ON SELLING THINGS. WE ARE IN A GLOBALIZED WORLD BUILT ON INVESTMENT, R&D COLLABORATION, EXPANDED SERVICES TRADE, AND IP COMMERCIALIZATION.

THIS IS WHAT BUSINESS IS ABOUT THESE DAYS. YOU KNOW THIS AND YOUR COMPANIES PRACTICE IT WITH INCREASING VIGOUR. BUT THE RISING TIDE IS IN ASIA, AND THIS IS WHERE INCREASINGLY, MANY CANADIAN BUSINESSES WILL ENSURE THEIR FUTURE.

THANK YOU.

ADDENDA

1. Canadian Business Online, November 28, 2003 "Participation in export markets improves productivity. Yes, exporting is good for you. According to the study, published in a recent edition of the Canadian Journal of Economics, Canadian manufacturers who export accounted for almost three-quarters of productivity growth in the 1990s, even though they accounted for less than 50%

of employment. For the period 1990 to 1996, exporters saw their average productivity grow by 2.7% annually; new exporters experienced a productivity rise by 3.7% per year. Firms that increased their export exposure accounted for approximately 30% of total productivity growth. In contrast, non-exporters and companies that quit exporting experienced a productivity decline. Productivity gains were greater for domestic-controlled plants and young plants entering export markets. (These groups are more likely to benefit from information gained during exposure to foreign markets, because their information acquisition systems are less fully developed than either older or foreign-owned plants.)

The report says that firms that are already more productive and innovative are more likely to begin exporting, but it also suggests that the increased international competition faced by exporters forces them to become even more innovative, efficient and productive, particularly through new capital investment. According to the study: "Entrants to export markets have to develop superior performance prior to entry and are rewarded with even stronger performance after they penetrate export markets."

So what does all this mean? "Canadian firms, and the Canadian economy, can follow an alternative path to improved productivity growth performance — through exporting," says Glen Hodgson, vice president and deputy chief economist of Export Development Corp. (EDC). "Canadian firms can raise their own productivity, and ultimately that of the nation, by committing themselves to an export-led growth strategy wherever possible. Meeting the competition around the world will compel Canadian firms to seek out new business concepts, techniques, products and relationships that keep them on the cutting edge. The study, "Export-market participation and productivity performance in Canadian manufacturing", by John R. Baldwin and Wulong Gu, can be found online at <http://www.economics.utoronto.ca/trefler/workshop/Gu.doc>

2. The benefits of export (according to US Government publication):

The benefits of exporting your products and/or services include:

Development of additional sales

For most companies, exporting is a logical way of expanding sales when the domestic market has been fully developed.

Optimising prices

You may be able to achieve a much higher price for exported goods than is possible on the domestic market.

Maximising resources

Expansion into overseas markets can be an excellent way of increasing production with corresponding economies of scale in plant utilisation and raw material purchases.

Levelling seasonal demand

Marketing internationally, especially in both northern and southern hemispheres, can achieve an overall levelling of seasonal demand for products like summer and winter clothing, sports equipment, heating and cooling equipment etc.

Distribution of market risk

A company can protect itself from the risk of a downturn in any one particular market by operating in a number of different markets, both domestic and overseas.

Increased competitive advantage

An improvement in product and service will usually flow from exposure to international competition. This in turn will lead to an increased competitive advantage in both the international and domestic areas.

Improved morale

Being part of an internationally successful company will boost staff morale, particularly if the contribution of all staff members is recognised as an integral part of the company's international success.

Capitalisation of a unique product or technology A unique product, service or technology that's difficult to sell on the domestic market may be easier to sell overseas.

A proactive measure to combat foreign competition It's possible to neutralise overseas competitors in the domestic market by exporting to the overseas competitor's market.

3. Benefits of exporting (according to Australian Trade Commissioner Service):

Exporting can be a profitable way of expanding your business, spreading your risks and reducing your dependence on the local market. Austrade research shows that, on average, exporting companies are more profitable than their non-exporting counterparts.

Exporting exposes you to new ideas, management practices, marketing techniques, and ways of competing that you wouldn't have experienced by staying at home. All this considerably improves your ability to compete in the domestic market as well.

By going overseas, you can become more efficient and increase your productivity. Exporting companies have better growth prospects, highly skilled, highly productive staff and tend to adapt technology and best practice techniques faster.

Even if you have a limited domestic market, you should think about exporting

- around a quarter of new exporters are born globals. Global brands can be built from small local companies – especially in rural and regional Australia.

Export can provide growth and profit. Austrade research has shown that exporters: pay their staff, on average, \$14,700 a year more than non-exporters provide a safer and healthier workplace offer more training and career development opportunities tend to be better in tune with new and changing technologies than their domestic counterparts.

Ambassador: this is best there is as far as "quotables" from David Dodge...unfortunately, it's not very specific....but it will serve to "flatter" the audience by saying that overall, businesses have responded well despite a very challenging environment....The full speech is linked here: <http://www.bankofcanada.ca/en/speeches/2006/sp06-10.html>....a copy is with Collette.

"It is clear that we must all adjust to these developments and be ready to take advantage of the opportunities presented by the strong global economy.

Of course, adjustment is easier said than done. And it is important to acknowledge that adjustment is often very difficult on a personal level. The adjustments over the past three years have been particularly difficult because of the speed and size of the movements in relative prices. This has been a double-edged sword. On the one hand, some firms are facing booming demand and have been unable to expand quickly enough, hindered by shortages of skilled labour, outdated machinery, and inadequate infrastructure. On the other hand, some firms have struggled to increase the value-added of the goods they produce in Canada in the face of falling prices and global competition. They have had to find ways to shift some activities offshore. This second type of difficulty has been more prevalent in traditional goods-producing industries such as clothing, textiles, and newsprint. In some cases, business owners and employees—who have invested decades of their lives in a particular firm or industry—are coming to terms with plant closures and the loss of jobs. None of this is easy. These difficulties have been plain to see in media reports and in official economic data. However, these same data also show increases in output in sectors such as wholesale trade and financial and business services, as well as manufacturing sectors such as pharmaceuticals and transportation equipment.

Despite all the challenges, we are seeing businesses across the country being inventive in responding to the necessity of adjustment. We have been tracking this adjustment through our regular communications with business groups, manufacturers, and exporters, as well as through the Bank's [Business Outlook Surveys](#). These surveys, conducted by staff in the Bank's regional offices, are available on our website, and I encourage you to look at them. Since 2003, when the Canadian dollar began to appreciate, they have told an encouraging story of how businesses have found ways to innovate and adjust to changing circumstances."

Laurence Blandford

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From: Caron, Joseph -TOKYO -HOM/CDM

Sent: September 20, 2006 5:54 AM

To: Blandford, Laurence -TOKYO -EC

Subject: RE: Material for Calgary speech

Merci, Laurence. C'est très utile pour compléter les paragraphes sur le Japon.

Tu te rappelleras aussi que j'ai besoin de notes sur la capacité des firmes canadiennes à faire face aux changements des "terms of trade", viz. fx etc, et apporter les améliorations à notre compétitivité nationale. Tu avais parlé de discours de David Dodge à cet effet. J'ai besoin de tes notes sur cette question AQP, car je quitte cette après-midi. Tel qu'on a discuter lundi, je veux

faire d'abord le point que nos firmes possèdent l'expérience nécessaire à s'adapter au changements.

Merci, JC

From: Blandford, Laurence -TOKYO -EC

Sent: September 19, 2006 5:44 PM

To: Caron, Joseph -TOKYO -HOM/CDM

Cc: MacArthur, Peter -TOKYO -TD; Iwata, Masaharu -TOKYO -EC; Drake, David -TOKYO -EC -GR; MacArthur, Karen -TOKYO -GR; Bobiash, Donald -TOKYO -GR; Iwata, Masaharu -TOKYO -EC; Lanteigne, Collette -TOKYO -GR

Subject: Material for Calgary speech

Ambassador: following our discussion yesterday, please find additional material for your speech in Calgary.

GDP: In 2005, the economy grew 2.6%, the sixth year in a row that growth was positive on average for the year (although it was barely above 0% in 2001 and 2002). In fiscal 05-06 (i.e.: march to march), the economy grew 3.2%.

2.6% growth adds over US115 Billion in output, about the output of Singapore or Chile, slightly more than Hungary, Pakistan or New Zealand. This was faster growth than the EU or UK, and faster per capita than Canada.

Japan's GDP in 2005 was about the same as the economies of China, India, Brazil and Russia combined (the famous BRICs). The BRICs together were less than 2% more than Japan. (one of the attached files has a table prepared by Iwata-san in this regard, showing GDP rankings). I have also included the full world bank list of GDP by country at the following link <http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf>

Japan's GDP is about equivalent to US GDP for all states West of the Mississippi. Or, it is equivalent to GDP of the five largest states combined (California, NY, Texas, Florida, Illinois).

GDP in Q2 2006: 2006Q2 was the 16th quarter in a row of positive year-over-year growth (i.e.: compared to the same period last year). Headline growth in 2006 Q2 was only 1% quarter/quarter annualized, but this was due to a sharp slowdown in public spending (down 5.7% q/q annualized). Private domestic demand grew at an annualized q/q rate of 3.7% on firm consumption and strong private investment, suggesting the economy remains solid and that the economy is becoming more driven by domestic private demand, as opposed to trade, as it was in earlier phases of this recovery. Trade remains supportive, of course, with exports still growing, but strong import growth (also indicative of firm domestic demand) is preventing net exports from adding to the headline growth rate. Unlike previous recoveries, the public sector continues to subtract from growth.

Break-even point: according to the *Nikkei*, the break-even point of publicly traded manufacturers reach 77.5% in fiscal 2005, the lowest point since its previous low of 1989, 81.6%. This suggests that manufacturers in Japan are in very good financial shape and can weather a significant reduction in sales before going into the red. In FY05, fixed costs increased 1%, as companies ramped up investments, but sales grew 7%, leading to a reduction in the break-even point. On average, manufacturers had a 6.8% profit margin.

Labour productivity (this is an indicator of how prosperous an economy is, as well as how efficiently it is using its human resources to produce output): the OECD estimates that from 2003-07, labour productivity (measured as GDP per hour worked) will have increased 1.8% per year, with only the US and UK having a faster rate in the G7. From 2008-2012, the OECD projects 2.2% per year growth in labour productivity, the fastest rate in the G7 and among the highest in the OECD. Japan will need to maintain rapid labour productivity growth because its labour force is declining. This means that Japan's economy will not grow as fast overall as the US, for example, because US population is rising rapidly, but it will continue to grow relatively fast in *per capita* terms, meaning that its prosperity will continue to progress. In 2005, Japan's per capita growth was faster than Canada's.

Japanese trade with China: based on 2005 national statistics (i.e.: Japan for J-C trade, Australia for A-C trade), of the 10 largest economies in the OECD (US, Japan, Germany, UK, France, Italy, Spain, Canada, Korea, Mexico), Japan and Korea are the only ones which are running a trade surplus with China (incl. HK). According to Japan stats: trade surplus in 2005 with China (incl. HK) of US\$5.6 billion. Japan and Korea produce key inputs into Chinese assembly of manufactured goods, namely high-tech components and materials and capital equipment.

Canadian exports vs.. Japan imports: you requested a comparison of Canada's top exports and Japan's total imports of these goods. One of the attached tables prepared by Iwata-san gives more information in this regard, including Canada's share of Japan's import market for these goods as well as Canada's ranking out of all exporters to Japan in these markets.

On why Japan is good for your business (only anecdotal, but good stuff nonetheless): the linked page from JETRO's website outlines why luxury companies use Japan as an R&D center and text market. It is part of a longer piece on Japan as the world's top luxury market. <http://www.jetro.org/content/361/limit/1/limitstart/2>

Also from the JETRO website, good quotes from Starbucks about how Japan consumers are a good test of global success...and how products sold there can then be introduced elsewhere...<http://www.jetro.org/content/353>

Also from JETRO (lots of good stuff there), note that Cisco systems sees Japan as a "proof of concept" market. i.e.: if you can make it there, you can make it anywhere: This is particularly useful, as it focuses on the importance of **R&D partnerships with Japanese**. <http://www.jetro.org/content/278>

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