

**THE POLITICAL ECONOMY  
OF COMPETITIVENESS IN THE NEW WORLD ECONOMY:  
THE CASE OF CANADA UNDER THE PROGRESSIVE CONSERVATIVES, 1984-1993**

by  
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the requirements for the degree of Master of Arts in Political Science**

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## ABSTRACT

This thesis examines recent transformations in international political economy, particularly the role of the nation-state in responding to the challenge of competitiveness within a new world economy characterized by globalization and technological innovation. Developing a typology of competitiveness from a survey of four leading new theories of economic competitiveness, the thesis presents a hypothesis that an evolving, post-fordist regime of accumulation shaping the new world economy requires new means of state intervention in trade, foreign investment, innovation promotion and other specific policy areas. Applying selected case studies of federal privatizations in Canada under the Progressive Conservative governments of Brian Mulroney from 1984 to 1993 -- a policy area central to the Mulroney Governments' neoconservative agenda -- against the typology of competitiveness clearly indicates that when confronted with the conflicting imperatives of global markets and economic prosperity, governments will likely choose to intervene to protect and promote the latter rather than pay homage to the former. The results of the thesis' analyses challenge the viability of neoconservative ideology and particularly the effectiveness of free market policies to respond to the challenge of economic competitiveness in the new world economy, presenting a renewed case for progressive and proactive state intervention.

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## CHAPTER ONE

### From Crisis to Competitiveness

#### **1. Introduction**

This thesis will investigate recent transformations in international political economy, particularly the role of nation-states in responding to the challenge of economic competitiveness within a new world economy characterized by technological innovation, flexible production systems and the globalization of production and capital.<sup>1</sup> Each of these competitive challenges have forced states to reassess traditional policy options for ensuring national economic security. Most relevant to our analysis is the intense scrutiny of the state's positive economic role, a role inspired by John Meynard Keynes' critique of classical economic theory and pursued by governments in industrial states following the Second World War. Long restricted to passivity by economic orthodoxy, governments in these states intervened to underwrite a compromise between labour and capital to exchange increasing productivity for increasing real wages and full employment through expansionary fiscal and monetary policies.<sup>2</sup> This opening chapter will review how prolonged economic crisis in the 1970's and 1980's provoked governments in many industrial states to replace Keynesianism with neoconservative policies intended to retrench the state in the economy and validate the traditional capitalist means of production. In this investigation, neoconservatism will refer to the ideology of returning economic, social and political power back to the capitalist class,

or "business" in the usual media or government language. Whitaker argues that this objective is accomplished in part by recourse to neoliberal, laissez-faire economic policies due to the inherent power of capital within the free market.<sup>3</sup> In the 1990's, neoconservative hegemony over public policy and discourse is increasingly under scrutiny in Western industrial democracies as global economic imperatives challenge the state's capacity to underwrite economic growth and prosperity. Just as neoconservatives challenged the orthodoxy and ideology surrounding the positive economic role of the state upon their ascendancy, so must this ideology's wisdom be challenged as we investigate what is the role and what are the limits of state intervention in the new world economy?

We will explore these topics in light of the transformation of the Canadian state's economic role from the advent of Brian Mulroney and the Progressive Conservative government in 1984 until its defeat in October 1993. In this first chapter we will see that Canada is a suitable case for analysis as it followed a similar economic policy path travelled by most post-war industrial states. Immediately after the war, the federal government instituted a unique Canadian model of the Keynesian compromise, expanding social welfare significantly until recession forced Pierre Elliot Trudeau's Liberal government to restructure the Canadian post-war settlement in the 1970's. Upon coming to power in 1984, the Conservative government intended to reject Keynesianism and institute a neoconservative agenda under the veil of "economic renewal" and in the service of increasing Canadian competitiveness in a changing world economy. The challenge for this dissertation is to determine if the Mulroney government stood behind its announced faith in the market while confronting the need to support Canadian economic competitiveness in key industries as a result of the transformation to a new world economy. Extrapolating from the Canadian case, our conclusions will suggest that contrary to the neoconservative ideological faith in the free market,

state intervention is required to support competitiveness and ensure national economic security in the new world economy.

## **2. Post-War Economic Transformation**

Our analysis of economic competitiveness and the role of the modern state begins with an understanding of the transformations that have occurred in the world economic system from the Second World War until present. Crisis and the internationalization of production have over time resulted in an emerging new world economy which favours technological innovation and supports oligopolistic competition on a global scale reducing the state's economic role relative to transnational corporations, global finance and other new economic actors. This evolution has challenged the post-war liberal international economy, an economic system structured on autonomous states and internally coherent national economies. Thus, in the emerging new world economy, the state is presented with the problematic of economic and political sovereignty restrained to a space known as the national economy, whereas production and competition occur within a space beyond the reach of the national economy.<sup>4</sup>

Upon exiting the Great Depression of the 1930's and the end of the Second World War, the international economy was gradually organized within a structure referred to by the French school of regulation as Fordism. Comprised of an intensive regime of accumulation and a monopolistic mode of regulation, the Fordist model of economic development transformed the wage relationship to establish a coherency between mass production and mass consumption.<sup>5</sup> This coherence was stabilized by the consensus between capital and labour in which higher productivity was rewarded

by higher real wages. The state facilitated this compromise through Keynesian demand management policies such as social welfare and income redistribution programs, positive labour laws guaranteeing the right to collective bargaining and an easing of the management of credit.<sup>6</sup> Between 1950 and the end of the 1960's, generally understood to be Fordism's "golden age", productivity gains<sup>7</sup> outpaced real wage increases resulting in steady and rising economic growth (Appendix A).

The autocentric character of national economic development implicit in Fordism and the presence of one hegemonic power, the United States, guaranteed the coherence of the international economy in the post-war period.<sup>8</sup> The capacity of national economies to generate sufficient rates of economic growth within the state's frontiers transformed economic relations amongst the industrial economies to one of coexistence rather than competition. For example, Alain Lipietz describes the international economy in this period as a series of autonomous, juxtaposing yet compatible regimes of accumulation "differentiated by individual rates of growth and international insertion."<sup>9</sup> At the same time, the United States possessed the power and the interest to impose the cultural, military and institutional conditions under which the liberal international economy would flourish.<sup>10</sup> The early 1970's are characterized by Michalet as "l'épanouissement progressif du régime d'accumulation intensif dans le cadre de la modalité de regulation monopoliste encore en vigueur. . ."<sup>11</sup>, the onset of a crisis which signalled the transformation from the fordist, liberal international to the emerging new world economy.<sup>12</sup>

The advent of crisis and the restructuring of production and finance on a global scale, or economic globalization,<sup>13</sup> challenged firms to change their strategies for oligopolistic competition and national governments to reconsider economic policies. In order to restore profitability, transnational corporations and banks began to coordinate production and finance on a worldwide

scale and deploy an international network of financial, commercial and technological resources.<sup>14</sup> Michalet observes that initial "multinationalization" strategies gave way to more sophisticated strategies for competition as the process of economic globalization intensified. The global strategy of the firm has evolved from one of coordinating an international network of resources to identifying its competitive advantage vis-a-vis current and potential competitors and consequentially eliminating them through mergers and acquisitions so as to become an instant world leader in a given market. Because of its importance to this organizational strategy, global finance has established itself as a dominant actor alongside states and firms.<sup>15</sup> Globalization has also fostered over time a restructuring of production in favour of knowledge-intensive industries and so-called lean production systems. Lean production systems, developed in Japan and popularized in the West mainly in response to Japanese competition, require flexible strategies of production to gain access to lower labour costs, technologies, skills, production methods, suppliers and markets with which firms can increase economies of scale, develop new products and add more value to existing goods and services.<sup>16</sup> These strategies are incompatible with fordist continuous production systems, relying instead upon innovation and global access to capital, knowledge, technology, and low labour costs.<sup>17</sup> Lipietz and other new *régulationistes* suggest, that flexible production systems and advanced manufacturing and information technologies are creating a new techno-economic paradigm<sup>18</sup> and possibly a post-fordist regime of accumulation.<sup>19</sup>

The mobility of capital and the possible evolution of a post-fordist flexible regime of accumulation have redrawn the parameters of oligopolistic competition and over time, increased pressure for reduced state intervention.<sup>20</sup> As crisis became apparent in the West, the fordist compromise came under scrutiny.<sup>21</sup> By the mid to late 1970's, the international economy was

transformed from one of coordination to a tenuous conflict between multinational oligopolies, which sought to homogenize national economic spaces, and nations-states which sought to differentiate their national economies' in an effort to gain competitive advantage over others.<sup>22</sup> In order to redress the consequences of internationalization and multinational coordination, states turned to policies of neoprotectionism and trade measures to promote their national economies' welfare at the expense of others'.<sup>23</sup> By the 1980's Laux argues that neoprotectionism gave way to neoliberal economic policies as globalization became "a premise for policy making, not a process to be resited". Within this new paradigm political elites in industrial democracies increasingly argued that economic conditions at home must rival conditions offered elsewhere. Thus nations-states sought "to improve the climate for investment" through privatization, deregulation and other programs to reduce the state's economic infrastructure replete with a growing focus on deficit reduction.<sup>24</sup> The withdrawal of the state from economic intervention in this period was intensified by ascending neoconservative regimes in advanced capitalist states most notably in the United Kingdom and the United States.

The recourse to neoconservative economic strategies in industrial nation-states in the 1980's was justified by a reactive, ostensibly neutral, urgency to align national conditions along international standards. Yet Ben Fine and Laurence Harris argue that the global economy could not have come about without the willing interventions of these regimes to strengthen the market at the expense of the state and that dismantling the Keynesian state comprised an ideological mission to reconstitute the traditional capitalist relations of production at home and abroad:

The policies actually adopted by the New Right on the basis of ideology which these theories inform is extremely interventionist. Instead of pushing back the boundaries of the state, the New Right's policies are a shift in the character of state intervention in line with a changing balance of forces and material interests.<sup>25</sup>

The neoconservative era is under scrutiny as states reassess policies and strategies in the post-fordist era of global competition. For example, some governments are encouraging the creation of alliances and other cooperative consortia for the purpose of developing national oligopolies able to compete against rivals in global markets. The European Strategic Program for Research and Development in Information Technology, more commonly referred to as ESPRIT, is an appropriate example.<sup>26</sup> Such state strategies to counter the consequences of competition reflect the continuing dilemma of the state in the new world economy and expose what Laux refers to as the "limits to liberalism".<sup>27</sup> From the onset of crisis in the late 1960's, production has increasingly favoured non-traditional, knowledge-intensive industries organized in a space more vast than national sovereignty, posing a challenge to post-war national economic security. To counter this challenge, nation-states increasingly require new strategies of insertion into the new world economy which promote the national economy's capacity to compete globally in innovation-driven industries. Yet, the ideological foundations of neoconservatism constrain the state's capacity to coordinate such strategies. Thus, the need for nation-states to ensure economic security through global competitiveness means that the prevailing ideological foundations governing state intervention, specifically *laissez-faire* capitalism, are increasingly being questioned. We will briefly review the transition of the Canadian state throughout this period of economic transformation.

### 3. The Crisis and the Canadian Response

#### A. 1945-1984: TRANSITION AND CRISIS

In 1945, victory over Nazi Germany and Imperial Japan appeared imminent. On April 12, 1945, C.D. Howe, the federal Minister of Reconstruction, presented to the Canadian House of Commons the White Paper on Employment and Incomes which outlined the plans of MacKenzie King's Liberal government "for a rapid and smooth transition from war economy to peacetime economy."<sup>28</sup> The April 1945 White Paper according to David Wolfe, also marked the official pronouncement by the government of its intent to institutionalize Keynesianism as the framework for the next generation of federal economic policy.<sup>29</sup> The transition from fiscal orthodoxy to fiscal stimulus and demand management in Canada commenced with the 1944 Throne Speech in which the government declared that the primary objective of post-war economic policy would be "social security and human welfare". In pursuit of this goal, the government committed itself to institute a minimum of social security with regard to such matters as employment, nutrition, housing and protection from unemployment, the effects of accident, ill-health and old-age.<sup>30</sup> Over the next two years the King government proceeded to establish a Department of National Health and Welfare and distribute "family allowances"; legislate price-controls for surplus supplies of maritime and agricultural commodities; implement the National Housing Act, the Export Credits Insurance Act and create an "industrial development bank."<sup>31</sup> Wolfe argues, however, that the Keynesian model in Canada was founded upon specific assumptions, most notably that Canada was an open economy specializing in the export of resource staples.<sup>32</sup> High levels of employment and economic growth

could only be assured to the degree that a liberal trading environment stimulated resource export products, thus introducing a high level of instability into the Canadian model.<sup>33</sup>

The instability inherent in the Canadian model alluded to by Wolfe became apparent upon the onset of crisis in the late 1960's. In the midst of crisis, Canada experienced what Francois Houle refers to as a "double crise" in which inflation was compounded by a manufacturing base insufficient to adjust to increased global competition.<sup>34</sup> At the outset of the first oil shocks in 1973, Canadian industry was becoming decreasingly productive compared to the United States'. This is reflected in both higher labour costs and, with the exception of automobile parts, decreasing manufactured exports compared to imports. Decreasing productivity and an anaemic manufacturing sector contributed to a deteriorating balance of payments and consequentially, increasing inflation and unemployment.

In 1975, the Liberal government of Pierre Trudeau officially rejected a renewed policy of fiscal and monetary expansion and focused on reducing inflation, implementing a statutory prices and incomes policy. This policy aimed to ensure that Canada would emerge from the recession with declining prices, especially compared to the United States.<sup>35</sup> At the beginning of the 1980's, declining GNP went hand in hand with increasing inflation and a sharp rise in unemployment.<sup>36</sup> In 1981, Canada's merchandise trade surplus fell from a record USD 7.1 billion (2.7 per cent of GNP in 1980) to USD 5.8 million with the deficit in manufactured goods rising from USD 9.8 billion to USD 12.3 billion.<sup>37</sup> Between 1975 and 1981, Canada's current account on its balance of payments was consistently in a deficit of USD four billion. Between 1963 and 1982, the current account was in surplus for only five years. Finally, the transformation to a new international division of labour

exposed a relatively unproductive manufacturing sector which was decreasingly able to attract new investment (Please see Appendix B for relevant indicators).

The period of crisis in the 1970's and 1980's revealed the incapacity of the staples, import-substitution model to foster a competitive, export-oriented Canadian manufacturing industry. Debate concerning solutions to this dilemma have historically fallen into the "nationalist camp" and the "continentalist camp", each requiring broadly different roles for the state in the Canadian economy. Williams explains that the nationalist school has traditionally focused on the deleterious effects of foreign investment on Canada's industrial development and called for the state to intervene through an industrial strategy to reorganize and reorient the branch plant economy towards a competitive export manufacturing economy.<sup>38</sup> Various programmes for this approach have been presented in the government sponsored Watkins and Gray reports of 1968 and 1972 respectively.<sup>39</sup> The continentalist school has traditionally argued that the solution to developing a competitive domestic manufacturing industry is to expose Canadian manufacturers to both the stimulus of greater competition and the potential economies of scale through free trade with the United States. Williams confirms however, that since the Kennedy and Tokyo rounds of the General Agreement on Tariffs and Trade (GATT), trade between the United States and Canada had become increasingly tariff free. Yet, in the same period, Canada experienced worsening industrial employment and balance of payment difficulties<sup>40</sup>. Regardless, Williams argues that the attractiveness of the continentalist school is accounted for by a number of reasons amongst which is its status as the purveyor of "the comfortable world of orthodox liberal economic theory taught to civil service managers in most universities."<sup>41</sup>

In response to the deepening crisis, the Trudeau government opted for the status quo. Herb Gray, the Minister of Industry, Trade and Commerce presented to Cabinet shortly after the 1980 federal election, an industrial strategy which identified foreign investment as the main barrier to a healthy industrial economy. In response, Gray called for interventionist "regulatory mechanisms" to overhaul the branch plant economy's capacity to manufacture competitive exports. The government rejected Gray's approach and opted for an industrial strategy which called for \$440 billion dollars of resource extraction "mega-projects" in which, according to Williams, domestic manufacturers would find their niche through producing inputs for industrial activity generated from the government's investment. In other words, staples exports would continue to drive Canada's economic development and manufacturing would still be focused on the domestic market.<sup>42</sup> The 1984 election of Brian Mulroney and the Conservative Party signalled the end to the status quo. Immediately upon coming to power, the Conservatives indicated their intent to reorient the economic role of the Canadian state to fit neoconservative principles. In line with this direction, one year later the government declared its intent to negotiate a free trade agreement with the United States, resolving the struggle for Canada's future economic development in favour of neoliberal continentalism.

#### B. 1984-1993: THE MULRONEY AGENDA

The Conservatives came to power in the midst of recession, high unemployment, low economic growth, decreasing productivity, high interest rates and a burgeoning federal budget deficit and accumulating public debt (Appendix C). The newly-elected government argued that Canada's deteriorating prosperity was the result of intrusive and expansive government intervention that was

inconsistent with the new era of global economic competition. Instead, the times required a commitment to policy change "to ensure that Canada's private sector can become the driving force of economic renewal in an increasingly competitive world marketplace."<sup>43</sup> The government outlined a new economic decision making framework in the November 1984 fiscal and economic statement, *An Agenda for Economic Renewal*. In it, the new Finance Minister, Michael Wilson, made it clear that restoring prosperity was contingent upon reducing the federal government's budget deficit which, in turn, was contingent upon reducing the overall scope of government in the Canadian economy. According to the government, increasing deficits were responsible for high inflation and high interest rates. These factors undermined the confidence of business and the private sector in the Canadian economy and therefore presented the foremost obstacle to economic growth. Steadfast to their commitment, Wilson declared before the House of Commons in 1984: "Because I believe that deficit reduction is the key to rebuilding confidence and confidence is the key to growth and job creation, the deficit must be our priority job for this year and for each year of our mandate."<sup>44</sup>

A review of successive federal budgets and other official documents reveals that the Conservatives aimed to realize the strategy outlined in the 1984 statement as a program for restoring economic competitiveness. For example, In the May 1985 budget speech, the Finance Minister complimented his government's initiatives thus far which were designed:

... to free-up the entrepreneurial spirit of our citizens, to remove obstacles to productive growth, to lower barriers to international trade, to control and reduce high deficits, and to let the dynamism of our renewed economies produce jobs and opportunities for all.<sup>45</sup>

The government focused its first budget on establishing the framework, procedures and policies to reduce waste, increase efficiency and reduce the barriers to private sector innovation. A Ministerial Task Force on Program Review was struck to rationalize unnecessary government programs; the

government congratulated itself on replacing the ill-perceived Foreign Investment Review Agency with a new, liberally inclined agency, Investment Canada, signalling, in the Minister's words, that Canada was once again "open for business". The Finance Minister also tabled plans to eliminate several corporate tax incentives and lower the tax rate so that this regime would "promote growth and job creation by allowing investment to be allocated more efficiently." As part of its plan to stimulate growth and innovation, the government committed itself to rationalizing the array of government subsidies and regulations in order to "remove obstacles to growth, cut waste, improve effectiveness, and make better use of limited resources."<sup>46</sup> In the 1986 budget, the government confirmed that its deregulation initiatives had been most successful in transportation, telecommunications, financial institutions and competition policy.<sup>47</sup> As a corollary to deregulation, the government signalled its intent to privatize Crown corporations "with a commercial value but no ongoing public policy purpose".<sup>48</sup>

In the 1985 budget, the government officially equated trade liberalization (interprovincial, multilateral and bilateral with the U.S.) with economic growth and jobs. Later that year the government entered into bilateral trade negotiations with the United States. Sensing the rise of a new era of liberal world trade and investment, the Finance Minister declared that the initiatives announced in the 1985 budget must be pursued to enable Canada's exporters to become more competitive in global markets. Specifically, tax reform must continue and expenditures must continue to decrease to reduce the deficit and consequentially inflation and interest rates.<sup>49</sup> By 1987, the government confirmed that each of these initiatives, including privatization, were "part of our comprehensive program to achieve our central objective of improving Canada's international competitiveness."<sup>50</sup> The completion of the Free Trade Agreement (FTA) with United States in

January of 1988 consolidated the efforts of the Mulroney government to reorient the direction of Canada's future economic development towards neoliberal, continentalist prescriptions.<sup>51</sup>

After reelection, the Mulroney government dedicated its second administration to Canada's economic competitiveness by building upon the free market reforms identified in the 1984 *Agenda for Economic Renewal* and the 1985 federal budget. The plan to pursue competitiveness in a more aggressive fashion is evident from the start. In the April 1989 Speech from the Throne, the newly-elected government's first of four priorities was:

To build a strong economy, encouraged by incentive and opportunity, an economy fully competitive among the world's trading nations and one in which all Canadians may share in its challenges, risks and rewards.<sup>52</sup>

The government's concern is confirmed by the various editions of the *World Competitiveness Report*, an annual study of how "national environments are conducive or detrimental to the domestic and global competitiveness of enterprises operating in these countries."<sup>53</sup> Although Canada was ranked as the fifth most competitive economy out of the 23 OECD members in 1991, Table 4.1 shows that this ranking and its scores in each of the eight individual factors measured by the study (Appendix D) deteriorated between 1991 and 1993.

In light of all of this, the Tories launched the *Prosperity Initiative* in October of 1991 which was billed as a series of ongoing public consultations and industry analyses for the purpose of developing "a consensus on a national action plan for the balance of the 1990's to be implemented by governments, business, labour and individual Canadians."<sup>54</sup> In the discussion papers accompanying this effort, the Tories outlined their rationale and approach to stimulating economic competitiveness. According to the government, indicators revealed that up until this point, the Canadian economy had not adjusted well to what Michael Porter has termed the "new competitive

TABLE 1.1

Factors of Competitiveness: Canada's Rank (out of 23)

Competitiveness Factor	1991	1992	1993
OVERALL	5	11	11
Domestic Economic Strength	10	15	12
Internationalization	16	17	20
Government	6	11	11
Finance	11	7	3
Infrastructure	2	3	5
Management	11	15	14
Science and Technology	17	17	16
People	5	8	11

Source: *World Competitiveness Report* (Geneva: IMD and the World Economic Forum, 1991, 1992 and 1993).

realities" of economic globalization, namely rapid innovation in technology and telecommunications, the internationalization of production and investment and the transformation to knowledge-intensive production away from production based on scale and volume.<sup>55</sup> The most significant indicator was slowly decreasing growth in Canadian real income since the mid 1970's which was due most particularly to the slowing trend in productivity growth. Reversing this trend and increasing productivity thus appeared to be the key to ameliorating Canada's economic competitiveness and restoring national income.<sup>56</sup>

This broad review of the rhetoric surrounding the Mulroney Conservative government's approach to economic policy indicates that the government aimed to increase economic competitiveness in Canada by strengthening the free market at the expense of the state. We argue that this approach was premised on an ideological vision of the market as the natural means of economic organization, similar to that held by neoconservative governments in the United States under Ronald Reagan and in the United Kingdom under Margaret Thatcher. Others argue differently. Keith Banting concludes that the fragility of the federal system presented economic and political contradictions which prevented the Mulroney government from an assault on the Canadian welfare state. Banting's argument is premised on his observation that the legitimacy of the Keynesian state in Canada is, historically, not the result of the classic compromise between social classes, as suggested by Wolfe, but determined by the degree to which it can redistribute income amongst regional and linguistic interests. This legitimacy function is realized in Canada by accommodating modes of executive inter-federalism and elite intra-federalism, each of which integrate regional and linguistic representatives into the national social spending decision making process.<sup>57</sup> Thus, Canada under Mulroney did not see a "revolution" like those experienced under Thatcher or Reagan in which neoconservative regimes attempted to fundamentally realign the capitalist relations of production through recourse to market liberalism. Instead, Banting argues that the economic goal of the Conservative government was to preserve the viability of the welfare state and therefore the legitimacy of the Canadian state through "incremental" cuts at the margin, often accomplished by the "politics of stealth."<sup>58</sup>

Others argue that the biggest challenge to the Canadian welfare state during this period was not a government ideologically predisposed to it but a fiscal crisis that threatened to eradicate it.

This line of reasoning suggests that the Tories' approach to economic development during their first administration was a non-doctrinaire and practical response to "the imperatives of the Canadian state". Andrew B. Gollner and Daniel Salée conclude that the severity of the fiscal crisis at the time the Conservatives came to power meant that the government was "forced to consider cutting down on its expenditures, reorient its various interventions and strategies or actions and review the organization and management of its activities."<sup>59</sup> Stanbury, for example, concludes that fiscal necessity and responsibility was the primary reason behind the Conservatives' privatization program:

Times change and needs change, so it is not surprising that the government's portfolio of instruments of intervention needs to be pruned as a reflection of good management. Further there has been a shift in the composition of the public agenda, but it may not have as much to do with ideology of a new government than a reaction to the severe recession of 1981-1983.<sup>60</sup>

This study does not deny the reality of the fiscal crisis of the Canadian state in the 1980's, nor the need for the Conservatives to react to it. Moreover, the stated goals of the Tory government for overcoming this crisis, namely greater efficiency, higher productivity and privately fuelled non-inflationary growth have been goals sought by all post-war governments according to Michael Prince.<sup>61</sup> The fundamental difference is that the Tories appeared to favour the market to achieve these goals and thereby abdicated political responsibility for the consequences. For example, In the 1985 federal budget, although Michael Wilson declared that the primary objective "was about jobs" in this budget and every succeeding budget of their two administrations, the government consistently devoted itself to reducing the deficit, cutting expenditure through reducing its interventions in the national economy by means of privatization, deregulation, expenditure reduction, lower taxes and liberal trade and investment regimes. These measures, the Tories claimed, would create the conditions required to foster economic growth and increase employment. By linking economic

growth and job creation to reducing expenditure and consequentially reduced state intervention, the Tories appeared to believe that government cannot play an effective role in creating wealth or stimulating the markets. Based on this evidence, Prince concluded that "for the Mulroney Tories, stopping the federal debt from growing faster than the economy is both a matter of ideology and an inescapable reality that must be dealt with."<sup>62</sup> By the early 1990's, Robert Campbell concludes that the government's focus on containing inflation through reduced expenditure was part of a broad neoconservative strategy that precluded any neo-Keynesian attempt by the government to provide for full employment.<sup>63</sup> Finally, the statements surrounding many of its earlier "framework" policies reveal the Mulroney government's vision of the Canadian state that goes beyond an efficient and fiscally prudent broker of social welfare. Economic policies clearly reflected a self-declared belief amongst the Conservatives that:

Government is not only too big, it also reaches too far into almost every corner of the economy. It over-regulates some industries and over-protects others. In trying to facilitate investment, government too often distorts it. Instead of encouraging strength, many actions perpetuate inefficiency. Too often, government frustrates and discourages initiative.<sup>64</sup>

The Mulroney Conservative governments intended to govern Canada under a neoconservative program and it follows that the policies adopted by the government, including privatization, are products of the neoconservative vision of the state's role in the national economy. Again, one could argue that these policies were a matter of necessity, a matter of government reaching its fiscal ends as opposed to a matter of ideological preference. However the market, as we recall from the observations of Fine and Harris, is not a neutral instrument of economic organization. The market favours certain interests to the detriment of others and produces its own kinds of failures. Regardless of intent, privatization, deregulation and the other policies adopted by the Tories to

strengthen the market at the expense of the state are "one way of altering the social contract without saying so."<sup>65</sup> Prince observes that upon coming to power, the Tories made it clear that their economic priority was to restructure government interventions so that the market would be facilitated rather than "hampered". This was part of the grand commitment to economic renewal in which economic growth and expansion were clearly favoured over the traditional goals of equitable redistribution of wealth and income.<sup>66</sup>

#### **4. The Research Plan**

In light of deepening economic recession, the American and Canadian electorates' rejections of neoconservative regimes in 1992 and 1993 respectively, signalled a change in attitudes and perceptions of government and the role of the state in facilitating economic competitiveness and prosperity. The Clinton victory in the United States and the election of the Liberal Party in Canada signalled to many that the ideological hegemony enjoyed by neoconservatism throughout the 1980's in Canada and other leading industrial countries can no longer be assumed. By no means conclusive given subsequent electoral victories by committed neoconservative parties in both countries, the 1992 and 1993 election results are nonetheless indicative of the rethinking amongst business economists and political economists that national insertion in the new world economy requires new definitions of national economic competition and commitments to new forms of state intervention.<sup>67</sup> Underlying this new analysis is a critical shift in economic theory away from comparative advantage paradigms, a theory premised on the classical concepts of perfect competition and price equilibrium for naturally endowed commodities.<sup>68</sup> There is now a growing consensus that ensuring economic

security depends instead upon *competitive advantage*, which we will broadly refer to as an economy's capacity to coordinate global factors of production and be more competitive than other economies, regardless of natural efficiencies. The implication for our analysis of the role of the state in the new world economy is that neoconservative ideology and free markets are perhaps an insufficient basis for competitive advantage and that the coordination of production in pursuit of this policy objective may require state intervention.

The current reassessment of competitive advantage and the role of the state is driven by the emergence of several new theories of competitiveness. Each is premised on the author's unique analysis of the constraints of the national economy within the global economy and therefore each is premised on differing conceptualizations of competitive advantage. While the premises for intervention and the degree and scope of suggested state activity vary, each of the theories propose a renewed commitment to state intervention in order to foster economic competitiveness. The new competitive theories challenge the hegemony of neoconservative ideology, its faith in the free market and consequentially, the minimalist role it affords the state in the national economy. Drawing upon the models presented in this literature, this thesis will argue that, neoconservatism, and in particular, ideological adherence to the free market, is not a sufficient basis for economic competitiveness. Conversely this thesis will argue that state intervention is integral to any strategy designed by governments to either create or protect the economy's competitive advantage.

We will develop the study's core argument through a survey the new theories of competitiveness in chapter two. Before moving to survey these theories, the study's core concept, "competitive advantage" needs to be discussed. There exist several definitions of competitive advantage in the literature. Each entails its own vision of the appropriate form and content of state

intervention in the national economy. For our research purposes, we will not stipulate a definition of competitive advantage. Rather, after a review of the literature in chapter two, we will devise a typology of state interventions and it is this typology which will form the basis for further case study analysis of the Mulroney government's approach to competitiveness in Canada.

In Chapters three and four we will focus our attentions on the practices of the Canadian state to determine whether or not the Conservative governments of Brian Mulroney acted out their neoconservative agenda or used state intervention to pursue competitive advantage. We will select one area of policy closely associated with this agenda - privatization. We will see that the government privatized several Crown corporations consistent with its ideological commitment to free-market capitalism over the state. However, contrary to the ideology of its neoconservative agenda, we will see that in the course of implementing the divestitures and afterwards, the government employed state intervention to regulate the firm's behaviour and realize policy objectives following privatization. Confronted by the need to ensure economic security in the face of the new realities of global competition, we will argue that these interventions were aimed at creating and protecting Canada's competitive advantage in new world economy industries characterized by innovation and knowledge-intensive investment and R&D. We will proceed to develop micro level case studies to test this secondary hypothesis. Specifically, we will analyze the Tories' privatization of three Crown corporations in the globally competitive aerospace, biotechnology and telecommunications industries and their consequential reinterventions into the market following each one of the privatizations. We will find that the federal Conservative government disregarded its ideological commitment to *laissez-faire* liberalism through means of intervention including a variety of policy instruments and state actors. Indeed when it came time to put their faith in the

market to the test, we will see that the Mulroney Conservatives chose to pursue state interventions consistent with some of the programs identified in chapter two which are designed to protect and promote strategic industries and firms. The material from the case studies and the typology from each case study will lead us to confirm, that despite ideological commitments to neoconservative free market policies, state intervention is integral to the pursuit of competitive advantage in the new world economy.

## **5. Conclusions**

The purpose of this study is to investigate the role of the state in the current era of global economic transformation to a new world economy. In an age where even the relevancy of the state as a coherent, sovereign unit is being reexamined, such an investigation is crucial.<sup>69</sup> In this chapter, we situated this problematic within a broad survey of the post-war economic transformation from prosperity to crisis to competitiveness. We observed that as crisis ensued within industrial democracies in the 1970's and 1980's, the fordist-Keynesian approach to economic development was not a suitable reference for state intervention in the post-fordist era of global competition, flexible specialization systems and technological innovation. Although the crisis of the 1970's and 1980's signalled a transformation to a new international division of labour and a possible new regime of accumulation, instead of adjusting modes of regulation to accommodate the new global economic realities, we observed a rising neoconservative hegemony which sought to eliminate state intervention as the preferred means of exiting the crisis and restoring national economic prosperity. Following this broad survey of post-war global economic transformation, we turned to an analysis

of the changing role of the state in one national economy, Canada. We also observed in this chapter that the federal Progressive Conservative governments of Brian Mulroney from 1984 to 1993 favoured a neoconservative strategy to reduce the role of the state in the Canadian economy. Tempered in their ideological pursuit by the unique political realities of Canadian federalism and provoked to reexamine the role of the state in the Canadian economy by unsympathetic fiscal realities, we observed that the government's policies to exit the crisis, restore prosperity and increase competitiveness were based on faith in the free market.

The ongoing transformation to the new world economy continues to challenge national governments to reassess state strategies for economic prosperity in the 1990's. The new realities of global competition -- the mobility of capital, rapid technological innovation and the diffusion flexible production systems --mean that national governments must adjust economic policies in pursuit of competitive advantage instead of comparative advantage. The balance of this study will address our argument that state intervention is required to support national economic competitiveness, contrary to the hegemonic power of neoconservative policy prescriptions in industrial countries over the past decade. We shall justify this argument by reference to several leading new theories of competitiveness and then test it by means of an analysis of the Mulroney government's privatization strategy. By focusing on the Canadian Conservative government's policy decisions and actions in three privatization case studies, we will observe how a government committed to neoconservatism reacted to the imperatives of global competition. This research will confirm a disregard for free market, *laissez-faire* policies and a recourse to state intervention, however variable in form in each case. We will conclude by situating our findings within the current context

of North American politics, an environment still dominated in some jurisdictions by extreme neoconservative parties.

## CHAPTER TWO

### The New Theories of Competitiveness

#### **1. Introduction**

The central argument of this study is that neoconservatism and free markets are not a sufficient basis for economic competitiveness and that state intervention is necessary to ensure competitive advantage in the new world economy. Our reassessment of the state in the new world economy is theorized by reference to the work on competitiveness by Michael Best, Michael Porter, Robert Reich and those economists known collectively as Strategic Trade Theorists (STT). This chapter will determine the degree to which each of these theories of competitiveness advocate state intervention as a method of achieving competitive advantage. To begin this process we will summarize comparative advantage theories of national economic specialization. We will see that comparative advantage theory is premised on the concept of perfect competition, confining economic specialization to the classical laws of market equilibrium. Relying primarily on Schumpeter's critique of the classical approach, we will argue that national economic specialization is not beholden to the market and that indeed, the state may be expected to coordinate a response to multidimensional and complex global challenges. This analysis will set the stage for a deeper analysis of the new theories, and their respective concepts of competitive advantage as an approach to national economic specialization and the role of the state in this process.

Although there is a broad consensus amongst the theories as to what determines competitive advantage and the viability of the state in the process, there is no broad consensus as to how exactly the state should intervene to achieve it. For example, Best, Porter and STT focus on the national economy's ability to create value as a measure of the success of national firms, industries and industry sectors. Reich, in opposition, argues that in the day and age of the global firm, there is no such thing as a national economy as determined by so-called national firms. Instead, the true essence of the national economy is the nation's citizens and their capacity to add value to the global economy. Reich therefore introduces a radically different concept of the national economy and consequentially, proposes a significantly different pattern of policy interventions. Similarly, there is no consensus with regard to the appropriate scope of state intervention. For example, Porter and Reich focus on the need for macroeconomic interventions while Best and strategic trade theory concentrate on the efficacy of microeconomic interventions. Instead of imposing a single definition of competitive advantage, we will divine the principal means of intervention associated with each theory in our sample and place them on a typology according to three criteria: neoliberal, direct or moderate.<sup>1</sup> Means of intervention characterized as neoliberal indicate that the invisible hand of market forces, not the visible hand of the state, is to determine the allocation of resources. Direct means are relatively coercive in that their intent is to harness the command/control powers of the state to determine what will get produced, where and for whom. These may include legislation, regulations restricting competition or barriers to trade erected through tariffs or non-tariff barriers. Finally, moderate means of intervention combine the power of the state to command the economy's resources along with the allocative efficiencies determined by the market. These means of

intervention could include subsidies, grants, tax and investment credits and any other combination of financial incentives.

The review of the theoretical literature on economic competitiveness will thus serve two functions. First it will support our initial hypothesis that state intervention in the market is required to protect and promote competitive advantage. Secondly, we will use the typology to compare our case studies in the subsequent chapters. There we will test the hypothesis by evaluating the degree to which the federal Conservative government from 1984 to 1993 employed neoliberal, statist or mixed modes of intervention to promote Canadian competitiveness in three new world economy industries.

## **2. Comparative Advantage Theory**

Neoconservative orthodoxy concerning national economic specialization is rooted in the classical school of Eighteenth and Nineteenth century liberal political economy which finds its origins in the literature of Adam Smith, David Ricardo, Thomas Malthus, James Mill and his son, John Stuart Mill.<sup>2</sup> Extending the principal of free exchange to the study of specialization between regions, this body of classical literature proposes that free trade will benefit trading partners equally as competition will compel each economy to employ scarce resources as efficiently as possible. Under free trade, economies will specialize where they possess an advantage relative to other economies by virtue of production costs, exporting goods which can be produced for less cost than what it would cost the importing nation to produce the same good at home and vice-versa.<sup>3</sup>

Differences in production costs between regions forms the basis of comparative advantage theory, the earliest antecedent of which is Adam Smith's theory of absolute advantage:

Under free trade all goods will tend to be produced in those countries where their absolute real costs of production are lowest. Countries will tend to export those goods that can be produced at lower real costs at home than abroad, and to import those goods that can be produced at lower real costs abroad than at home.<sup>4</sup>

Ricardo refined Smith's relatively crude model of absolute advantage and introduced a higher level of sophistication to the study of comparative advantage by applying the labour cost theory of production.<sup>5</sup> According to Ricardo, the basis of trade between regions is the labour cost of producing one product in comparison to the labour costs of producing another product. Even though a national economy may possess an absolute advantage across a range of goods relative to other economies, countries will tend to specialize in those industries in which it is more productive in comparison to other domestic industries.<sup>6</sup> For example, in his grand interpretation of Ricardo's theoretical model, Samuel Hollander writes, "The fundamental condition for trade is the existence of comparative advantage in productivity from country to country."<sup>7</sup>

Ohlin and Heckscher much later criticized and refuted Ricardo's labour cost theory as the basis of comparative advantage and proposed instead that the cost of labour and other factors of production, namely capital and raw materials are determined by their relative prices. These factor prices are ultimately determined by their relative supply in each region and the demand for them in each region. While Ohlin-Heckscher support Ricardo's principal assumption that relative productivity costs form the basis of trade and specialization between regions, the OH model argues that these costs are a result of commodity prices which are determined by the relative supply and demand for the required factors of production. According to Ohlin: "Nothing less than a

consideration of all the elements that constitute the price mechanism . . . can adequately explain the nature of interregional trade."<sup>8</sup>

The price theory of comparative advantage is premised on a number of questionable assumptions when compared to capitalist production and specialization in the new world economy. The Ohlin-Heckscher model is first a "double model" based on only two of each main variable: two commodities, two countries and two factors of production, primarily capital and labour. It also assumes that the techniques of producing identical goods are the same in both countries. Finally, the Ohlin-Heckscher model also assumes perfect competition in both markets, and it naturally follows, free trade between the two trading regions.<sup>9</sup> Perfect competition as described by Joseph Schumpeter is premised on the law of marginal costs developed by Alfred Marshall and Knut Wicksell. This model holds that the capitalist will expand output "until the point at which the additional cost that must be incurred in order to produce another small increment of product (marginal cost) just equals the price they can get for that increment. . . ."<sup>10</sup> Schumpeter explains that "where this is so, there exists a state of equilibrium in which all outputs are at their maximum and all factors are fully employed. This case is usually referred to as perfect competition."<sup>11</sup>

Schumpeter argues that perfect competition exists in the realm of economic fantasy. Hardly a matter of responding passively to the abstract law of marginal costs, production is a study of profit maximization which has historically involved "a sequence of moves and countermoves, an indefinite state of warfare between firms."<sup>12</sup> To understand capitalism, Schumpeter argues, is to envision it as an "evolutionary process", a struggle not to administer existing structures, but to destroy old ones and create new ones. The geist driving this process is what Schumpeter refers to as creative destruction or "the process of industrial mutation . . . that incessantly revolutionizes the economic

structure from within, incessantly destroying the old one, incessantly creating a new one."<sup>13</sup> Creative destruction fundamentally challenges price competition as the basis of economic specialization. Just as Ohlin and Heckscher reversed Ricardo's theory of comparative advantage, arguing that productivity costs are determined by factor prices, so too does Schumpeter turn the Ohlin-Heckscher model on its head, concluding that price is not determined by the market but that the market is determined by pricing and other deliberate competitive strategies:

... In capitalist reality as distinguished from its textbook picture, it is not (price) competition which counts but the competition from the new commodity, the new technology, the new source of supply, the new type of organization... competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their very lives.<sup>14</sup>

Schumpeter's critique remains extremely relevant to our current analysis of the role of the state in pursuit of competitive advantage. The theory of creative destruction suggests that economic decisions do not adhere to the abstract laws of market equilibrium but are the result of deliberate attempts to reshape the market through innovation. In chapter one we identified technological innovation as an enabler of corporate competitiveness, a process through which firms and workers produce superior quality goods and services, faster and cheaper than firms and workers in other economies. Yet innovation, as Schumpeter established and as our analysis of the new competitive theories will confirm, is not necessarily the result of allocative efficiency but requires strategy, planning and coordination, activities which do not always obey the market.<sup>15</sup>

At the level of the national economy, competitiveness reveals itself in the pursuit of specialization and insertion in the new world economy. Globalization has reversed the rules in this new order, challenging countries to compete against each other in search of advantages relative to corporate strategies, whereas in the previous order, firms would compete against each other for

access to bountiful resources in privileged nations. While globalization has changed the rules of national economic specialization, it has not left the state powerless in its wake. Indeed the centrality of knowledge, innovation, strategy and coordination to the new competition suggests that state intervention may be used by national governments to secure its own advantages relative to other national economies.<sup>16</sup> The theories of new competitiveness will support our central argument that the state and its institutions are required to intervene in the globalization process in pursuit of competitive advantage.

### **3. The New Theories of Competitiveness: Competitive Advantage Strategies**

This brief survey will reveal variations among the theories concerning appropriate degrees of state intervention in pursuit of competitive advantage. After reviewing these options, the next part of the chapter will reveal similar variations concerning the means of intervention governments should employ to either create or protect competitive advantage.

#### **A. MICHAEL PORTER -- NEO-RICARDIANISM**

Michael Porter is one of the first business economists to develop and give currency to the concept of competitive advantage, devoting a large volume to it entitled *The Competitive Advantage of Nations*. In this book, Porter studies how firms from ten advanced trading economies succeed in global competition against rivals from other nations. He concludes that competitive advantage is a direct result of the firm's capacity to compete in innovation-driven industries in a more productive fashion than industry rivals. The competitive advantage of nations is therefore contingent upon the presence of innovation driven, highly productive firms within the

national economy which are able to compete successfully against industry rival firms from other nations.<sup>17</sup>

Innovation and productivity are the pillars of Porter's theory of competitive advantage which renders it a neo-Ricardian approach to a contemporary analysis of national economic specialization. Indeed, Porter updates Ricardo's theory of comparative advantage to account for the internationalization of production and investment, worldwide sourcing and the role of technological innovation in firms' strategies. Specifically, he writes: "My perspective is Ricardian in that I view trade (and foreign investment ) as determined by productivity differences, here broadened from Ricardo's theory [of comparative advantage] to include differences in technology, factor quality and methods of competing."<sup>18</sup>

Having determined what constitutes the competitive advantage of nations, Porter's mission is to determine why firms from some nations are more able to achieve and sustain competitive advantage in their industry than firms from other nations.<sup>19</sup> The solution resides in "four broad attributes" which transmit the forces to upgrade what is produced and how, as well as the insight and tools needed for competitive advantage.<sup>20</sup> These four determinants, which when combined, create what Porter refers to as a national "diamond". Briefly these four determinants consist of:

- i. *Factor Conditions*: The nation's position in factors of production, such as skilled labour or infrastructure, necessary to compete in a given industry.
- ii. *Demand Conditions*: The nature of home demand for the industry's product or service.
- iii. *Related and Supporting Industries*: The presence or absence in the nation of supplier industries and related industries that are internationally competitive.
- iv. *Firm Strategy Structure and Rivalry*: The conditions in the nation governing how companies are created, organized and managed, and the nature of domestic rivalry.<sup>21</sup>

The diamond's systemic and interdependent nature is manifested in the clustering of competitive industries which are defined as industries linked together through various relationships.<sup>22</sup> One competitive industry helps to create another in a mutually reinforcing process. For example, such an industry is often the most sophisticated buyer of the products and services it depends on. Its presence in a nation becomes important to developing competitive advantage in supplier industries. As an example of a competitive cluster, Porter cites American leadership in complex logic chips which in turn are used in computers, telecommunications equipment and defense electronics, which are all industries in which U.S. firms are competitive.<sup>23</sup>

The role of the state and economic policy in the process is to create an environment conducive to innovation and upgrading and therefore rising productivity.<sup>24</sup> Government policy must therefore be assessed for its influence on the diamond as its determinants ultimately shape the environment in which the nation's firms will achieve and sustain competitive advantage, or wither away. For example, in the determinant of firm strategy, structure and rivalry, Porter advises us that "few roles of government are more important than ensuring vigorous domestic rivalry."<sup>25</sup> This obligation ultimately requires that the state intervene to establish a liberal climate for trade, investment and innovation. These measures will contrast sharply with the more directly interventionist tendencies advocated in the theories which will follow.

## B. STRATEGIC TRADE THEORY

For a radically different approach to the issue of competitive advantage and the role of the state in the process, we regroup a number of economists who have elaborated an approach to economic analysis known as strategic trade theory. The initial premise of strategic trade theory

is that trade and competition in the global economy are characterized not by the classical concept of perfect markets but instead by imperfect markets. Market imperfections are caused and manifested by the potential for economies of scale and the dynamics of technological innovation. Each of these render untenable the concept of trade as tied to immutable factors of production and as competitively regulated.<sup>26</sup>

The second premise of strategic trade theory is that as a result of imperfect competition, certain firms, industries or industry sectors are "strategic" to the interests of the national economy by virtue of their potential for generating economic "rents" or external economies. Paul Krugman defines rent as "payment to an input higher than what that input could earn in an alternate use" be it wages for labour or return on capital investment. External economies, more commonly referred to as spill-overs, are defined as a benefit from one activity "that accrues to other individual firms than those engaging in the activity." The theory posits that an activist trade policy which seeks to protect and promote the industries in which these benefits appear may raise national income.<sup>27</sup>

Laura D'Andrea Tyson argues that strategic trade theory is most relevant to state policies that seek to protect and promote national interests in high-technology industries. Tyson defines these industries as those "in which knowledge is a prime source of competitive advantage for producers who in turn make large investments in knowledge creation."<sup>28</sup> These industries account for 60 percent of all industrial research and development (R & D) in the United States, therefore generating substantial national and local spill-over benefits. These industries are also associated with higher than average levels of productivity and wages.<sup>29</sup> High technology industries are

therefore clearly associated with the strategic possibilities identified by Krugman and perhaps merit protection and promotion through an "activist" trade policy.

Tyson, Chair of American President Bill Clinton's Council of Economic Advisors, recommends a policy of "cautious activism" which she describes as a defensive strategy of protecting and promoting America's interests in high technology industries amidst the efforts of competing states to do the same. As we will see, cautious activism provides for a directly interventionist trade and industrial policy which seeks to ensure market access for the nation's high technology producers and protect them from unfair trading practices such as dumping and at the same time promote their viability as global competitors against foreign rivals.

### C. MICHAEL BEST -- STRATEGIC INDUSTRIAL POLICY

In his book *The New Competition*, economist Michael Best proposes a theory of the organization of production which posits that competitive advantage is determined not by the manner in which the nation allocates its economic resources, but the degree to which it organizes them so that production is targeted at achieving a strategic advantage over rival firms. While the onus is upon firms to transform their production practices away from the Taylorist methods of the Old Competition, the state can accelerate this process through a strategic industrial policy.<sup>30</sup>

Inspired by Schumpeter's theory of creative destruction, at the foundation of Best's new competition theory is the "entrepreneurial firm". The entrepreneurial firm, in contrast to the Taylorist firm,<sup>31</sup> values innovation over allocative efficiency; instead of continuity it is dedicated to continuous improvement in process in the pursuit of superior product performance and quality.<sup>32</sup> Once innovation and continuous improvement govern the relationship between firms,

price competition cannot determine inter- and intra-sectoral arrangements. In the new competition, they are shaped by what Best defines as consultative coordination and cooperation. For example, instead of delineating specific products and choosing suppliers on the basis of which ones can provide these products at the lowest cost, the entrepreneurial firm, in coordination with a limited number of suppliers distributes desired product functions and works with these firms to develop a superior product.<sup>33</sup>

This discussion attempts to illustrate that in the new competition, competition within the industry sector is neither perfect, nor solely competitively regulated. Instead the new competition includes many inter-firm practices and extra-firm agencies "each of which facilitate inter-firm cooperation." Examples include trade associations, apprenticeship programs, labour education facilities, joint marketing arrangements and regulatory commissions. In some cases these may include market coordination arrangements such as cartels. The idea of a sector as more than a collection of autonomous firms, and of inter-firm relations as involving more than price competition, suggests that both competition and cooperation are inherent in the entrepreneurial firm's formula for success.<sup>34</sup> Strategically managed inter- and intra-sectoral arrangements are informed by Edith Penrose's vision of competition as both God and the devil.<sup>35</sup> As Best explains, "what distinguishes the New Competition from the Old Competition is not an awareness of this paradox of competition, but the institutional capacity to turn the paradox to advantage."<sup>36</sup>

According to Best, Japanese industrial policy indicates how to administer the New Competition, its purpose being "to promote Schumpeterian competition and (collective) entrepreneurial firms."<sup>37</sup> Thus in Japan, the criterion of enterprise success is not allocative efficiency but strategic advantage; the criterion of economic success is not optimal resource

allocation but the continuous reallocation of resources towards higher value-added production processes and sectoral compositions. Best explains that "government is guided by a Schumpeterian accumulation (which presumes markets are instruments of growth) and not an allocation efficiency orientation (which presumes that market 'interference' is bad).<sup>38</sup> The presence of strategic institutions for the purpose of shaping market forces cannot be accounted for within the paradigm of comparative advantage. Instead, economic decision making should be guided by competitive advantage.<sup>39</sup> For example, Japanese policy makers do not choose to specialize according to measures of relative resource endowments but to maximize growth by specializing on those sectors where competitive advantage through organizational superiority can be achieved. This strategy requires information not found in factor prices but drawn from a comparison of the organizational strength and weaknesses of foreign firms sector by sector.<sup>40</sup> It also involves a number of direct and moderate interventions on the part of the state and its institutions which will be reviewed later in this chapter.

#### D. ROBERT REICH -- POSITIVE ECONOMIC NATIONALISM

The theories surveyed up to this point agree that competitive advantage results from the presence of national firms in high value-added, knowledge intensive industries which are more successful in global competition against rivals from other nations. Reich concurs with the centrality of knowledge intensive industries in national economic success, but rejects the national firm as the source of this success. Reich argues that the globalization of production, finance and technology has de-linked firms from their economies of origin. The concept of the "national champion" or what he refers to as the domestic core corporation is invalid. Instead, the state must

look to other sources of value, productivity and innovation to achieve competitive advantage namely the skills and capacities of its citizens.<sup>41</sup>

The core of Reich's argument is premised upon his vision of the organization of production in the high value-added global economy. Reich characterizes this structure as a series of "entrepreneurial webs" which are developed and coordinated by symbolic analysts: "strategic brokers" which weave so-called "problem identifiers" and "problem solvers" into the web's nexus. Symbolic analysts in the form of strategic brokers, problem solvers and problem identifiers may be individuals, firms, consortia or corporations. What unites them is that each is able contribute the most value to a product through its superior knowledge, skills and technology.<sup>42</sup> The global economy is the extrapolation of entrepreneurial webs to a conglomeration of "global webs." The malleability of these configurations severs them and the goods and services they produce from any national identity. Specifically he writes: "National champions are everywhere becoming global webs with no particular connection to any single nation."<sup>43</sup> What remains constant in the global web is that profits and power flow to the organizations and individuals capable of contributing the most value to it through superior knowledge, skills and technology.

The de-linking of the firm from the national economy is of central importance to Reich's theory of economic competitiveness. Economic prosperity is no longer mediated by the success or failure of domestic core corporations. Instead, competitive advantage is the product of the capacity of its citizens to contribute superior value to the global web and therefore weave the national economy within its more strategic and powerful layers<sup>44</sup> Therefore, national governments must begin to reassess the premises of national economic policy, a process which

must be guided by asking, for any given product, "which nation's workers have gained what sort of experience equipping them to do what in the future?"<sup>45</sup>

In order to establish the foundations for a new competitive advantage, Reich offers a program of positive economic nationalism. According to this concept: "Each nation's citizens take primary responsibility for enhancing the capacities of their countrymen for full and productive lives, but who also work with other nations to ensure that these improvements do not come at the other's expense."<sup>46</sup> The new nationalism advocated by Reich eschews zero-sum strategies of neo-mercantilism and protectionism which, while marginally improving the welfare of a state's own people, will ultimately damage the condition of others elsewhere and will ultimately come full circle.

Positive economic nationalism also rejects what Reich terms *laissez-faire* cosmopolitanism which opposes zero-sum strategies but seeks to consolidate the global position of the symbolic analyst as a new social stratum through conservative social and neo-liberal economic policies.<sup>47</sup> Rather, positive economic nationalism seeks to realize a virtuous circle of prosperity on a national and global scale. The fundamental role of the state within this agenda is to broker a new consensus by which citizens agree to reduce barriers to global trade and investment in return for the means to meet the resulting dislocations with a renewed sense of security. To this extent, Reich offers a number of strategies which we will come to after a review of the means of intervention associated with the first three new theories of competitiveness.

#### 4. The New Theories of Competitiveness: Means of Intervention

Of the three firm-centric theories of competitive advantage, the means of intervention associated with strategic trade theory are the most directly interventionist. According to this theory, the imperfect nature of markets in the current era of global competition renders it desirable for state strategies to affect market outcomes in the interests of national firms. Tyson, for example, argues that this is especially true within the global high-technology, knowledge intensive industries where intense competition and prevailing practises of intervention elsewhere oblige national governments to employ activist trade and industrial policies to protect and promote the interests of their national producers.

An activist trade policy includes measures to promote market access for national producers and to deter the unfair practices of foreign producers. In the first case, Tyson supports the United States government's imposition of Section 301 of its trade legislation and its "temporary 'Super' 301 variant." This practise is regarded as controversial because it bestows upon the United States the self-given right of stepping outside of the multilateral codes of the GATT and unilaterally defining its own list of unfair trading practices; to determine on its own when a trading partner is in violation of these practices; to demand direct negotiation with U.S. representatives to address them and if necessary to threaten and impose retaliation to realize its objectives. Tyson acknowledges the criticism of this trade policy instrument as "unilaterally aggressive" but argues in response that in a world of structural trade barriers to which the GATT does not directly speak, the United States does not possess an alternative.<sup>48</sup>

In terms of negotiating access to markets Tyson argues that efforts in this area must focus on the outcomes of opening markets as opposed to the rules of the process. The preferred tool for realizing this objective is the voluntary import agreement (VIA) which establishes identifiable targets for how much of competitor A's market will be satisfied by imports from competitor B. Tyson advocates the VIA over the voluntary export restraint (VER) as in her opinion, the former seeks to increase trade and competition while the latter, by establishing limits to trade is inherently protectionist and anti-competitive.<sup>49</sup>

In the second case, countervailing duties (CVD) are the most common remedy employed by governments to redress unfair trade resulting from unfair subsidization. The problem with these measures are many, the most important of which is that while possibly deterring future transgressions by foreign firms and governments, the CVD does not address the viability of a nation's own competitors in any given high-tech industry. For example, Tyson argues that the CVD should be replaced or complimented by a series of countervailing subsidies (CVS) that seek to rectify unfair subsidization by offering the same assistance at home that the nation's competitors receive abroad.<sup>50</sup>

The CVS is one of the measures contained in a larger domestic policy response to protecting and promoting the interests of domestic high-tech producers in the midst of "unfair" trade and competition and is meant to work in tandem with an activist trade policy. The challenge of the domestic policy response, more commonly referred to outside the U.S. as an industrial policy, is to address competitiveness in high-technology industries through policies at home rather than through trade policies which concentrate on attempts to influence external actors. The approach advocated by Tyson ultimately involves investing in some technologies at the expense of others thus picking

"winners" and by consequence "losers." A constant criticism of industrial targeting is that it is a process which is open to political abuse. In order to avoid political excess, Tyson advocates a "cautious activist" approach. This approach is limited to sector-specific measures in industries or technologies that can be characterized as beneficial in terms of high productivity, wages, return to capital or in terms of spill-over effects. Finally, the cautious activist "prefers" industrial policies that take the form of funding for cooperative, pre-competitive R & D consortia "wherever possible."<sup>51</sup>

Tyson's prescriptions for the regulation of foreign investment further elaborate the strategic approach to trade and industrial policy. In keeping with her conclusion that high-technology firms are beneficial to the national economy, any investment which seeks to foster the development of these firms is positive. Tyson qualifies this position, however, when she delineates investments and acquisitions by privately owned firms and state-owned firms. In the latter case national interests as opposed to market incentives may motivate the decision to invest which may be at odds with those of the host nation.<sup>52</sup> Whether the investment is made by a public or privately owned agent, any purchase that will increase industry concentration and reduce competition, especially in sensitive input industries such as energy and electronic components, could result in higher prices for domestic consumers and manufacturers who use these products and limitations on timely access to these inputs because "foreign suppliers can restrict the market options and impair the market performance of their American rivals." In either of these two scenarios, Tyson recommends "that investment should be carefully reviewed and in some cases blocked altogether in favour of a national solution."<sup>53</sup>

In *The New Competition*, Best concludes that governments should adhere to four principles when devising strategies. His policy priorities are the successful balancing of coordination and competition and emphasis on strategy over planning and on sectors opposed to firms. A review of

the Japanese government's approach to strategic industrial policy provides an indication of the possibilities and constraints associated with Best's model.<sup>54</sup> Industrial policy in Japan can be summarized as the targeting of industries and technologies and the deployment of protectionist and trade policies to promote their development.<sup>55</sup> The goal of these measures has historically been "to place undeveloped domestic industries with little competitive power under government's active interference and to build up a large scale production system, while limiting entry into the domestic market of foreign enterprises with already established mass production systems and restricting the competition of foreign manufacturing in the domestic market."<sup>56</sup> Once identified as a strategic sector, an industry becomes the potential recipient of both protective and nurturing instruments.<sup>57</sup> Nurturing instruments include an array of policies and institutions to provide access to capital and to research and development funding. The largest proportion of funds allocated to R & D in Japan either directly through loans, grants and subsidies or indirectly goes to the development of new products and technologies, through a network of government-sanctioned lending institutions.<sup>58</sup>

Protectionist instruments in Japan have historically included the allocation of foreign exchange controls, tariffs, quotas, constraints on foreign direct investment, policies discouraging the purchase of foreign made products in favour of domestic ones and the exclusion of foreigners from government procurement.<sup>59</sup> For example, the 1950 *Foreign Exchange and Foreign Trade Control Act* allowed the government to regulate both the nature and the quantity of commodities and technology that were imported in post-war Japan. Through the regulation and control of foreign exchange, the Ministry of International Trade and Industry (MITI) directed resources to those industries which had been selected for targeting. Tariffs, quota restrictions and non-tariff barriers such as a battery of Japanese-specific product standards and certification requirements have also

limited the nature and quantity of commodities and technologies imported into Japan. Moreover, as of the early 1990's state-owned corporations in Japan explicitly pursued a policy of purchasing from Japanese firms to the exclusion of foreign firms. Finally, the *Foreign Investment Law of 1950* placed heavy restrictions on foreign direct investment into Japan and has thus been a significant instrument of trade protection. Up until 1967, the government was able to restrict any incoming direct investment. Although these restrictions were significantly relaxed by 1970, the liberalized rules applied only to newly established enterprises and thus restrictions on the purchase and ownership of national assets by foreign firms are still heavily restricted.<sup>60</sup>

During Japan's more recent policy phase of liberalization and privatization, trade restrictions have been relaxed relative to the competitive success of the industries targeted for support. For example, the evolution of a trade surplus after 1960 reduced concerns over foreign exchange allocation, although other measures such as import licenses for newly-targeted industries such as semiconductors remained in place.<sup>61</sup> The number of industries in which import quotas were in place in Japan numbered 460 in 1962 and were down to 22 by 1973.<sup>62</sup> The decreasing intensity of protectionist measures in Japan does not indicate their growing irrelevancy. Rather, their integral role in a strategically-oriented industrial policy can be confirmed by the competitive success of the industries they still support, for example micro-electronics.<sup>63</sup>

This brief review of Japanese industrial policy is intended to determine the means of intervention associated with Best's concept of a strategic industrial policy. In some industries, the Japanese government's interventions reveals a tendency towards moderate intervention (subsidies, loans grants and institutions for R&D) and in some other industries, a tendency towards direct and active intervention (protection, nationally favoured procurement, trade and foreign investment

policy). Clearly the means of intervention associated with Best's strategic industrial policy approach involve moderate and direct interventions.

The means of intervention associated with Porter's and Reich's theory of competitive advantage, in comparison to strategic trade theory or strategic industrial policy, are relatively liberal. As much as Porter concurs with Best that competitive advantage results from innovative economy and the presence of entrepreneurial firms, he differs with Best on the administrative role of the state required to spawn these firms. As much as he concurs with strategic trade theory that prosperity resides in the capacity of nationally-based firms to compete and succeed in knowledge intensive industries, he fundamentally rejects the directly interventionist role of the state to achieve this goal. On the contrary, Porter advises us that the role of the state in fostering an innovative economy is to create an evolutionary environment in which "incentive, effort and competition" are preminent as opposed to "the tempting but usually counterproductive choices such as subsidy, extensive collaboration and temporary protection that are often proposed."<sup>64</sup> Specifically, the role of the state is to provide an economic framework that will contain the competitive challenges firms require to innovate and become more productive. This is ultimately the function of the industry "diamond" and its four determinants. As such, state policy should aim to make each one of these an effective transmitter of competitive advantage.

Porter prescribes policy in three areas which exemplify appropriate state intervention to stimulate and maintain competitive advantage. First, a liberal competition policy is "uniquely important to fostering innovation" and to ensuring that "a nation's firms gain advantages from other parts of the diamond."<sup>65</sup> Porter rejects the theory of the national champion as the primary source of competitive advantage and argues that governments should legislate competition policies which

disallow anti-competitive practices such as mergers, alliances and industry cartels. Governments should also reassess their economic and regulatory infrastructures to ensure a more conducive environment for competition. Measures in this area include tax regimes which encourage private investment and innovation. Specifically Porter recommends the elimination of capital gains taxes to encourage long term equity investments in firms. Porter also advises governments to pursue the deregulation of competition and the privatization of state monopolies. They should discourage protection "in its various forms" (tariffs, quotas, export restraints, subsidies and favourable national procurement) and eliminate regulations which insulate firms from the pressures of international competition.<sup>66</sup>

Secondly, Porter strongly supports a liberal foreign investment policy. Policies which seek to restrict or regulate the flow of incoming productive investment are deemed counterproductive to economic competitiveness except in cases where the investment dampens domestic competitive rivalry or where the investing firm is benefiting from unfair trading practices at home.<sup>67</sup> Liberal policies in this area are necessary because foreign investment "will still raise productivity by stimulating improvements by domestic firms and supplanting less efficient rivals."<sup>68</sup> In any event, foreign ownership is an inevitable consequence of rigorous competition in which the market obliges firms to upgrade and become more productive or decides which ones will wither. Governments can best counter increasing foreign ownership and the declining competitiveness that it indicates by making their national economies more susceptible to innovation and competition through the liberal means already described in this chapter.

Thirdly, Porter states that creating factor conditions, such as skilled human resources basic scientific knowledge, economic information, or infrastructure, is among the most important and

traditional roles for government. However, Porter also stipulates that state policy must not only ensure that these factors are available, but that there exist "unique institutional mechanisms to upgrade them continually."<sup>69</sup> Therefore, government should create an environment in which the access to factors and their creation is either a stimulant to innovation and competition or is a product thereof. For example, in terms of R&D, "the overarching principle in addressing science and technology should be to create an innovation policy and not just a science and technology policy." As this relates to measures to encourage firms to undertake R&D, Porter advises governments that other parts of the diamond such as vigorous domestic rivalry, sophisticated home demand and access to market and technical information are more effective than R&D incentives "and offer the best approaches for advancing science and technology in the nation as a whole as well as stimulating R&D in firms."<sup>70</sup>

Porter offers a series of more specific means to encourage R&D within the economy such as partial funding of specialized research institutes linked to industry clusters. Direct grants and subsidies however, are not included on this list. According to Porter, the purpose of these measures is to reduce the cost to factor inputs but in so doing they have the delirious effect of delaying innovation. Tax incentives and indirect subsidies in areas such as education, research universities and advanced infrastructure "are much better investments of government funds from the perspective of improving the competitive position of a nation's industries."<sup>71</sup> This moderate approach to using the government's fiscal levers as a means of investing in the economy's innovative capacities must, in Porter's prescriptions, be matched by a conservative monetary policy which will ensure ample capital at a low cost for private investment. Governments must encourage savings and investment through low taxes, low inflation and low real interest rates. To this extent, Porter advises that

controlling government deficits "that are not being used to finance productivity enhancing investments in the economy is the most direct way in which government can influence the pool of investible capital."<sup>72</sup>

In the choice of the means of intervention, each of the analyses considered thus far reveals a fundamentally different vision of the capacity and of the state to stimulate and maintain competitive advantage. Some strategic trade theory economists, like Tyson, advocate a broadly interventionist agenda while Best's theory of strategic industrial policy confirms the viability of either moderate or direct interventions on the part of the state and its institutions. Porter, in contrast, argues that the state and its institutions are strategic players in the process of creating and sustaining competitive advantage, but only to the extent that they create a competitive environment in which firms are compelled to innovate and do not directly intervene. Regardless of the scope afforded to the state in each of these theories, all are premised on the assumption that competitive advantage is directly linked to national firms, or firms based in a given national economy.

Robert Reich, as we have already established, rejects firm-centric state strategies and argues that creating and sustaining competitive advantage depends not on which nation's citizens own what, but "which nation's citizens learn how to do what, so they are capable of adding more value to the world economy and therefore increasing their own potential worth."<sup>73</sup> From these premises, Reich develops a significantly different set of policy prescriptions than those already reviewed. Whereas the previous policy prescriptions focus on protecting and promoting the firm's capacity to produce wealth, Reich argues that governments should instead focus on the redistribution of wealth to equip citizens with the skills and knowledge they require to weave themselves and the national economy in the strategic layers of the "global web."

The responsibility of governments to invest in the capacities of its own citizens is at the core of Reich's agenda for positive economic nationalism. Therefore, Reich goes beyond Porter in his vision of the state as an active player in the national economy. Yet contrary to the prescriptions of strategic trade and strategic industrial policy, these interventions are not inspired by what Reich perceives as a "zero-sum nationalist" agenda, but on the premise that economic opportunity spawns a virtuous circle of economic opportunity elsewhere, and so on. These premises require a reassessment of current state strategies in areas of trade, foreign investment, research and development, macroeconomic policy and social welfare policy.

National competitiveness in high-technology industries first requires an open climate for trade, investment and technological innovation. This is to be accomplished by a liberal foreign investment regime and non-discriminatory trade and R&D policies which are moderately interventionist. According to Reich, voters and their politicians wrongly believe that if national assets are purchased by foreign firms, the recipient nation will be at the mercy of the foreign firm's home government's economic, political, and perhaps military interests. This fear is particularly acute when the transaction involves the purchase of high-technology firms. The underlying assumption is that the nation's technological assets are the providence of nationally-owned firms and it follows that governments (or so strategic trade and strategic industrial policy economists claim) should restrict foreign ownership of these assets and restrict public support only to those firms which hoist the national flag. Reich argues that this proposition is increasingly inconsistent in light of the declining relevance of corporate nationality and the increasing preponderance of the global web. Instead, Reich declares that the nation's real technological assets are "the capacities of its citizens to solve the complex problems of the future,"<sup>74</sup> a capacity which is lost only if insufficiently nurtured

or developed. Contrary to strategic trade and strategic industrial policy, foreign investment may be the agent not the destroyer of economic opportunity, bringing with it the potential of deploying and augmenting the skills of the nation's labour force. Governments should therefore adopt liberal foreign investment policies.

Reich details the history of the American military-industrial policy apparatus to support his view. It played a significant role in the development of military technologies with commercial applications, namely microelectronics, mainly as a result of subsidies and procurement from the Pentagon and the United States Department of Energy. By the 1980's, however, Reich argues that subsidies to American corporations to develop new technologies began to "have less and less bearing on what Americans learn to do."<sup>75</sup> This is precisely due to the fact that firms, regardless of the nationality of their ownership, weave themselves into where value is greatest. As an example, Reich cites the case of SEMATECH, a consortium of American semiconductor firms created at the urging of the Pentagon for the purpose of establishing American superiority over the Japanese in the computer microchip industry. As the consortium began operations, some of its partners, such as Texas Instruments, began to weave global webs of their own, with the latter building a USD 250 million dollar semiconductor fabrication plant in Taiwan and joining with Hitachi to design and produce (what were at the time viewed as) 16K architecture "superchips."<sup>76</sup> Reich employs this example to confirm his assertion that governments should be less interested in "helping American owned companies earn hefty profits from new technologies than in helping Americans become technologically sophisticated." Thus, while Reich supports government subsidies for technological development, he argues that such subsidies should be made available to any corporation regardless of nationality, so long as the company agrees to undertake research and development and fabrication

in the United States "using American scientists, engineers and technicians." To further develop the link between skills and government assistance, the amount of assistance could be tied to the number of Americans involved in the research, development and engineering.<sup>77</sup> Similarly, American trade promotion policy must not focus entirely on opening foreign markets to American owned firms regardless of where they create value, but instead, opening foreign markets to companies that employ Americans even if those companies happen to be foreign owned.<sup>78</sup> More important than reducing trade barriers to the exports of "national" companies, Reich writes that governments should focus efforts on reducing structural impediments to economic opportunity such as domestic-content rules. According to Reich, these rules deprive citizens of the opportunity to compete for jobs at home, "jobs that produce valuable skills, knowledge and experience."<sup>79</sup>

Beyond establishing the necessary environment for competitive advantage, Reich argues that the state must invest in the programs and services the nation requires to take advantage of open investment, trade and technological innovation. Far from a *laissez-faire* approach to state activity, Reich "would encourage public spending within each nation in any manner that enhanced the capacities of its citizens to lead full and productive lives . . . ." He therefore advocates replacing the Keynesian social policies of passive income maintenance by mechanisms such as increased spending on health care and access to post-secondary training, skills upgrading and job retraining and improved public infrastructure. These public investments "would form the core of national economic policy."<sup>80</sup>

Given the global web, Reich argues that governments must go beyond trade and private investment as the only policies on which they can cooperate. He advocates a multilateral approach to national public investment. For example, positive economic nationalism would seek to ease the

transition of a nation's workforce out of older industries and technologies in which there exists world-wide overcapacity. This assistance would take the form of various income maintenance and subsidy programs and should be paid for through an international fund, as the global economy benefits from the reduction of world-wide overcapacity. In order to ensure that national subsidies are not employed in a zero-sum fashion, Reich argues that an agreement should be negotiated by states under the auspices of the GATT specifying acceptable amounts of subsidy, their targets and other issues such as implementation. Other kinds of subsidies should result from the pooling of national funds to support projects in various regions "whose fruits are likely to travel almost immediately across international borders." How these funds are to be apportioned amongst jurisdictions and to what ends would be subject to negotiation.<sup>81</sup>

Contrary to Porter, Reich asserts the effectiveness of the state and the capacity of its institutions to stimulate economic growth and prosperity. Porter asserts the efficacy of private actors and therefore regards state intervention in the market as ultimately ineffective and counterproductive. This debate is exemplified in their opposing prescriptions for macroeconomic policy. According to Reich, national prosperity is significantly affected by the degree to which the state actively invests in the economy through public expenditure and increased taxation. Porter asserts that prosperity is ultimately the result of private investment which requires a macroeconomic climate characterized by low taxes, low inflation and consequentially, low interest rates.<sup>82</sup> Reich maintains that low inflation, interest rates and taxes are the result, not the cause, of economic growth. Thus, Reich supports using the government's fiscal levers to invest in the capacity of its citizens, not its firms, to add value to the global economy and fuel national economic growth.

## 5. A Typology of State Intervention

At this point we are able to extract the principal means of intervention associated with each of the new competitive theories and construct a typology depicting their relative position as proponents of liberal, moderate or directly interventionist state policies. In figure 2.1, we are able to see that all of the new theories of competitiveness postulate that state intervention in the market is integral to the purpose of achieving competitive advantage. This general conclusion must be amplified by other observations based on this chapter's reading of the new competition literature. First, there is no broad consensus among the theories' respective proponents on the degree to which the state should intervene in pursuit of competitive advantage. At one end of the spectrum, Porter advocates a relatively liberal approach while on the other end, Tyson's Strategic Trade Theory model advocates a relatively interventionist program. Secondly, there appears to be a sharp divide on the role of the state in regulating foreign investment, with Reich and Porter arguing for a liberal approach and STT and Best's strategic industrial policy model advocating a directly interventionist approach. However, Reich insists that a liberal foreign investment policy must be complimented by other redistributive interventions, while Porter opposes any intervention that will disrupt a conservative, anti-inflationary macroeconomic policy. On trade policy Porter calls for the elimination of the directly interventionist measures while strategic trade theory and Best's model of strategic industrial policy call for a trade policy which protects and promotes national producers. Thirdly, there is a broad consensus in support of moderate state interventions to foster research and development through public expenditure. Yet even within this consensus there appears to be varying degrees of separation. Strategic trade theory and strategic industrial policy elaborate a possibly

Figure 2.1

## A Typology of State Intervention For Competitive Advantage

TYPE	BEST STRATEGIC INDUSTRIAL POLICY	PORTER NEO-RICARDIANISM	REICH POSITIVE ECONOMIC NATIONALISM	TYSON (STT) CAUTIOUS ACTIVISM
NEO-LIBERAL	COMPETITION POLICY	<p>COMPETITION POLICY</p> <p>PRIVATIZATION, DEREGULATION</p> <p>TRADE POLICY:</p> <ul style="list-style-type: none"> <li>• Elimination of protection i.e. Tariffs, quotas, subsidies, import/export controls</li> </ul> <p>FOREIGN INVESTMENT POLICY:</p> <ul style="list-style-type: none"> <li>• Very limited interventions (i.e. only when industrial concentration will result)</li> </ul> <p>MACROECONOMIC POLICY:</p> <ul style="list-style-type: none"> <li>• Encourage savings &amp; private investment through low inflation &amp; reduced taxes</li> <li>• Reduce public expenditure &amp; budget deficits</li> </ul>	<p>FOREIGN INVESTMENT POLICY:</p> <ul style="list-style-type: none"> <li>• Attract and encourage quality, skills enhancing private investment</li> </ul>	

TYPE	BEST STRATEGIC INDUSTRIAL POLICY	PORTER NEO-RICARDIANISM	REICH POSITIVE ECONOMIC NATIONALISM	TYSON (STT) CAUTIOUS ACTIVISM
MODERATE	<b>R&amp;D POLICY:</b> <ul style="list-style-type: none"> <li>• Subsidized capital</li> <li>• Loans, grants, subsidies</li> <li>• Government sponsored investment institutions</li> <li>• Strategic analysis &amp; industrial targeting</li> <li>• Focus on industry sector</li> </ul>	<b>R&amp;D/INNOVATION POLICY:</b> <ul style="list-style-type: none"> <li>• Indirect subsidies to education research &amp; productivity enhancing infrastructure</li> </ul>	<b>R&amp;D POLICY</b> <ul style="list-style-type: none"> <li>• Direct subsidies to encourage skills development</li> </ul> <b>TRADE POLICY:</b> <ul style="list-style-type: none"> <li>• Intervene to reduce domestic content rules in other countries</li> </ul>	<b>INDUSTRIAL/R&amp;D POLICY</b> <ul style="list-style-type: none"> <li>• Strategic analysis &amp; targeting of strategic industries</li> <li>• Subsidies and grants for pre-competitive research through cooperative R&amp;D consortia</li> </ul>
DIRECT	<b>TRADE POLICY:</b> <ul style="list-style-type: none"> <li>• Foreign exchange controls</li> <li>• Tariffs, quotas, standards</li> <li>• National procurement</li> <li>• Purchasing restrictions</li> </ul> <b>FOREIGN INVESTMENT POLICY:</b> <ul style="list-style-type: none"> <li>• Targeted restrictions to protect favoured industries</li> </ul>		<b>MACROECONOMIC &amp; SOCIAL POLICY:</b> <ul style="list-style-type: none"> <li>• Employ taxation &amp; public expenditure to directly invest in populations skills</li> </ul>	<b>TRADE POLICY:</b> <ul style="list-style-type: none"> <li>• Aggressive unilateralism</li> <li>• Managed trade (voluntary import agreements)</li> <li>• (1) Voluntary export restrictions (VER), (2) Counter vailing duties (CVD), (3) Counter vailing subsidies (CVS)</li> </ul> <b>FOREIGN INVESTMENT POLICY:</b> <ul style="list-style-type: none"> <li>• Review</li> <li>• Favour "national solution"</li> </ul>

complex R&D bureaucracy which, in its approach to administering science and technology expenditure, may in fact adopt directly interventionist practices. Certainly the practise of industrial targeting provides for this possibility. Reich's position on R&D policy is more problematic as the target of expenditure is not firms but people. Although, he calls for the state to directly "invest" in R&D by a vaguely defined system of corporate subsidies, the goal of these policies is to develop the

skills of the nation's citizens. The essence of Reich's R&D policy may be better contained in his call for the state to redistribute government assistance to the people away from firms through macroeconomic and social policies. Conversely, Porter calls for public expenditure to support R&D but only in an extremely indirect, and limited fashion. He maintains that the best solution to fostering investment in R&D is a conservative macroeconomic policy, which enhances the supply of capital available for investment, and a liberal competition policy, which encourages firms to invest themselves.

## **5. Conclusions**

Our analysis of the new theories of competitiveness in this chapter reveals that competitive advantage depends upon the capacity of firms and workers to innovate and produce higher value-added goods and services faster and cheaper than those located in other economies. Far from relying on the invisible hand of the free market, these theories support our central argument that the capacity of firms and people to innovate is very much affected by the visible interventionist hand of the state and its institutions. Moreover, our analysis reveals several broad policy areas within which the state may employ policy instruments to foster competitive advantage. These are research and development and innovation policy, foreign investment policy, trade policy, macroeconomic policy, competition policy, privatization and deregulation, industrial policy and social policy. Our review of the literature also reveals a lack of consensus as to which of these policy areas the state should pursue and whether they should comprise a liberal, direct or moderate interventionist program. In the course of our survey, we identified two extremes - Porter as an advocate of a liberal program of

intervention and STT economists, such as Tyson, as advocates of direct programs of state intervention. The role of the state according to Porter is to establish an economic framework which channels the market's forces towards upgrading, innovation and productivity. The role of the state according to Tyson is to protect and promote strategic firms and industries.

Our survey in this chapter compares and synthesizes the theorizing and policy prescriptions of four leading American political or business economists who have passed their analyses on the concrete experience of the United States, Japan and, in Porter's case, 10 countries across Europe and Asia, including the United States during the 1980's. From this survey and the resulting typology, we contend that while the state in industrial countries should intervene to foster competitiveness in the new world economy, the policy means to accomplish this goal and the degree to which intervention should be employed are varied. Focusing now on Canadian experience in order to test the hypothesis that the Conservative government intervened to promote competitiveness, we will analyze the Mulroney government policies, assessing the means of state intervention employed to promote competitive advantage for Canadian firms in three high value-added, innovative, knowledge-intensive industries.

## CHAPTER THREE

### Case Studies: Connaught Laboratories & De Havilland Canada

#### **1. Introduction**

Despite the consensus surrounding the need for state intervention to support and foster innovation, Chapter One indicated that the federal Conservatives came to power in 1984 pledging to foster Canadian economic competitiveness through free-market, liberal economic reforms. Our analysis will now focus on the one major policy area on this agenda - privatization. Consistent with its ideological drive to strengthen the market at the expense of the state, the Conservative government fully privatized key firms which could have been considered Canadian "national champions" in the biotechnology, telecommunications and aerospace industries. Each of these are classified as high-technology industries (Appendix E) defined by Tyson as those "in which knowledge is a prime source of competitive advantage for producers who in turn make large investments in knowledge creation." Firms in these industries are associated with higher than average productivity, wages and skills. As well, high technology firms may foster innovation throughout the economy by rendering knowledge-intensive spillovers, outcomes which create value beyond original investment. As a result, high-technology industries are regarded by many economists as "strategic" to national economic prosperity and it is in these industries where global competition is most intense and where governments are often directly interventionist.<sup>1</sup> In Chapters

Three and Four, we will develop micro-level case studies of firms in each industry - Connaught Laboratories, de Havilland Canada and Teleglobe Canada - in order to determine whether neoconservative ideology provided a sufficient basis for national economic competitiveness.

In this chapter, after a brief review of the privatization program, we shall examine the cases of Connaught and de Havilland which involved the divestiture of commercial assets. We will devote Chapter Four to the case of Teleglobe Canada which involved the divestiture of a Crown-owned monopoly in the federally regulated telecommunications industry. In each case we will distinguish two phases: the initial privatization and the post-privatization period. In each phase, we will ask whether or not the Conservative government intervened in the market and if so, how, for what purpose, and with what policy instruments. Consistent with Jeanne Laux' overall analysis of the Conservative government's privatization program, the case studies will clearly demonstrate that the government disregarded its ideological commitment to neoconservatism and employed state intervention to regulate each firm's behaviour following privatization. At the end of each case study, we will transpose the means of intervention onto the typology developed in Chapter Two. These findings will be used later in the study to support our central argument that free market, neoconservative economic policies are an insufficient response to the imperatives of global competition and that state intervention is required to ensure competitive advantage in the new world economy.

## 2. The Mulroney Government's Privatization Program

The first definitive policy statement on privatization appeared in the May 1985 federal Budget. In his speech, the Finance Minister unequivocally stated that "Crown Corporations with a commercial value but no ongoing public policy purpose will be sold."<sup>2</sup> In so doing, "the government will return to the private sector activities that more properly belong there."<sup>3</sup> The new Progressive Conservative government believed that privatization would reduce the size of government in the economy and make room for private sector initiative by reducing political and bureaucratic impediments.<sup>4</sup> To implement this agenda, the 1985 Budget also created a special Ministerial Task Force chaired by the President of the Treasury Board and charged with developing a "comprehensive privatization action plan." Specifically, the Task Force was given a series of principles to guide its review of Crown holdings and "recommend to the government a privatization plan for those corporations where no convincing public policy reason exists to retain them in the public sector." Amongst the principles listed was one which stated that, in recognition of the diverse nature of the various corporate holdings, all issues concerning the method of sale, domestic and foreign ownership restrictions and government obligations and commitments "will be examined on a case by case basis, rather than being subject to a general approach."<sup>5</sup>

In June of 1986, the privatization process was further centralized by the creation of a Minister of State responsible for Privatization and Regulatory Affairs. In addition, the Minister, Barbara McDougall, would chair the new Cabinet Committee on Privatization, Regulatory Affairs and Operations. The effect of institutionalizing the privatization process in the form of the

Ministerial Task Force and the successor Ministry of State was to subject all Crown Corporations and responsible Ministers to the public policy test. In essence, each holding was a candidate for privatization and the onus was on responsible Ministers to demonstrate why a particular asset should *not* be privatized.<sup>6</sup>

The government had established a succinct policy for privatization and what would appear as the necessary bureaucracy to implement it. However, as late as May of 1987 after 11 privatizations had already been completed,<sup>7</sup> the Conservatives had not yet clearly stated their rationale for privatization. Besides the general ideological and pragmatic motives already described, the Minister for Privatization listed five specific reasons in a May 1987 speech:

- i. *The changing economic environment:* The public policy objective of the Crown Corporation is no longer relevant and other instruments such as taxation and spending are available to meet public policy goals.
- ii. *Effectiveness:* The corporation will be more efficient under the "test of the market place."
- iii. *Public funds:* Crown Corporations are a drain on the public treasury and the accountability measures required to oversee the infusion of funds are not in place. Moreover, the funds required to finance a competitive corporation do not exist.
- iv. *Management styles:* The management structure of a Crown Corporation does not foster risk taking and does not foster adaptability to rapid changes in markets and technologies.
- v. *Fairness and Equity:* Crown Corporations often compete against private firms in the same market sector. Firms therefore see their tax dollars being used to compete against themselves. This is hardly fair or conducive to a free enterprise system.<sup>8</sup>

The Conservatives appeared to believe that privatization would reduce some of the federal government's fiscal burden and increase efficiency and the viability of the free market in Canada.

McDougall's 1987 speech reveals that these conclusions were apparently based on two important premises. The first is a belief that governments can not, and should not be expected, to "do

everything." More importantly, according to the Minister, the development of Canada's social and economic infrastructure was complete thus rendering several Crown Corporations of little continued public utility. To ignore each of these facts and not curtail the growth of Crown Corporations would increase the budget deficit and restrain the private sector, "the engine of growth in the economy." McDougall did not completely rule out a continued role for Crown Corporations and concluded in her speech that the privatization program "is based on the belief that there has to be a proper balance and relationship between the private and the public sectors."<sup>9</sup> In 1989, McDougall's successor, John McDermid, said privatization "very simply... is a matter of good management." This statement is premised on conditions similar to McDougall's, the essential one being that Canada's public infrastructure is now mature and direct ownership of resources by the State is no longer required. Instead, future growth and prosperity depends upon cutting the budget deficit, and, as we argued in chapter one, thereby limiting the role of the state.<sup>10</sup>

Measured by these statements, policy initiatives and this process of subjecting Crown corporations to the sweeping test of public policy relevancy, the Conservatives appeared extremely committed to privatization as a means of withdrawing the Canadian state from direct intervention in the market and as a practical means of reducing the federal deficit. Moreover, privatization was linked to other crucial policy objectives identified in chapter one ( deregulation, free trade and deficit reduction) which the government presented as means of "laying the foundation" for economic competitiveness in the 1990's.<sup>11</sup> The Conservative government matched the rhetoric with action. At the end of their first administration, Tupper and Doern conclude that "the Mulroney Conservatives have more seriously scrutinized the Federal stable of Crown

enterprises than any previous government."<sup>12</sup> Jeanne Laux concludes that "the [privatization] program had radically redefined the public sector in Canada." Laux bases her conclusions on research which shows that by 1991, the Conservatives divested state ownership of eight wholly-owned Crown corporations -- including Connaught, de Havilland and Teleglobe -- and other government investments with book value assets over \$9 billion; implemented legislation authorizing the sale of other firms, including Petro-Canada; and wound up various inactive Crown corporations.<sup>13</sup>

The results of the Conservative government's privatization program between 1984 and 1993 are ironic given the free market objectives they were meant to satisfy and the interventionist means used to achieve them. Laux also observes that the Conservatives could not have achieved the outcomes listed above without altering program policy and structuring divestitures so as to increase the legitimacy and acceptance of privatization in the eyes of Canadian voters and business sectors.<sup>14</sup> This required a disregard for the *laissez-faire* maxims of open competition and free market entry and exit in favour of market concentration, foreign ownership restrictions and legislated behaviour following divestiture. Given these findings, Laux concludes that the privatization experience in Canada under the Conservative government is no different from the experience in other nations because, "state involvement in the affairs of privatized companies, before during and after their sale is habitual."<sup>15</sup> The subject for our analysis is to determine to what extent neoconservatism, in the form of the Conservative government's privatization program provided a sufficient basis for economic competitiveness in Canada. We will now begin to focus on the cases of Connaught Laboratories and de Havilland Canada both during and following divestiture.

### 3. Connaught Laboratories

#### A. INTRODUCTION

In 1985, the Conservative government began liquidating the federal state's interest in the Canada Development Corporation (CDC). In so doing, it indirectly privatized Connaught Laboratories and consequently disposed of the federal government's equity in the global biotechnology industry. This case study will first review phase I, the liquidation of the CDC and Connaught, a task entrusted to the CDC's successor the Canada Development Investment Corporation (CDIC); and then turn to phase II to focus on the post-privatization actions of the Conservative government when faced with attempts by two foreign-owned companies to purchase a controlling interest in Canada's leading biotechnology firm. In each phase we will see that the government intervened directly through legislation and Investment Canada, a federal agency which we will review in this study.

#### B. EXITING A HOLDING PATTERN: FROM CDC TO CDIC

Connaught Biosciences, previously Connaught Laboratories, is one of the world's foremost developers and producers of vaccines making it Canada's biotechnology champion. Its history and achievements are a source of Canadian pride. In 1914 at the University of Toronto, physicist John Fitzgerald produced vaccines to combat a rising incidence of diphtheria and in 1917, the laboratories were named after Canada's Governor General at the time, the Duke of Connaught. In 1921, the research team of Frederick Banting, Bert Collins, John MacLeod and Banting's student, Charles Best, won the Nobel Peace Prize for what probably remains the laboratories'

most renowned achievement: the discovery of hormone insulin. In 1922, Connaught became the first manufacturer of insulin.

Connaught continued to be a leader in its field. In the 1940's it fostered the large scale production of penicillin in glass-lined steel tanks and in the 1950's developed and produced the serum which Dr. Jonas Salk would employ to eventually eradicate the polio virus. Its success gained international attention. In 1966 the World Health Organization launched a campaign to eradicate the more than ten million reported cases of smallpox worldwide. Connaught was designated as one of the two world smallpox Vaccine Centres. As a "leading" contributor to WHO programs such as the Expanded Program for Immunization, Connaught supplied more than 100 million doses of vaccine every year from its Toronto operations.<sup>16</sup> Connaught was indeed Canada's biotechnology champion and in order to ensure that it remained in domestic hands, the Liberal government of Pierre Trudeau, through the CDC, purchased it in 1972.<sup>17</sup>

The CDC was a mixed (government and private sector) holding corporation created by federal statute in 1971 in response to increasing fears over foreign, predominantly American, ownership in key Canadian economic sectors, such as natural resources. Following the federal budget of Liberal Finance Minister, Walter Gordon, economic nationalists sought means to finance Canadian economic sovereignty, a role the CDC was expected to play.<sup>18</sup> The choice of a mixed-enterprise to realize this policy objective became increasingly problematic. By 1981 the newly-elected Trudeau government was not content with the CDC as an instrument of industrial policy and decided to divest the Crown's interest in the corporation.<sup>19</sup>

In order to manage the divestiture of its CDC shares, the Trudeau government created a new holding company, the Canada Development Investment Corporation (CDIC) . Besides this

initial function, the CDIC's origins result from the federal government's plan to engage in a more active and directed investment policy and, conversely, the failure of the CDC to act as a suitable instrument for this objective. The company's broad policy objectives were to participate in the development of business or industry in Canada, or to invest in any enterprise, provided these actions were "related to the economic interests of Canada" or "likely to benefit Canada." The CDIC was designated as a Crown Corporation which the government would completely own and would be subject to Cabinet directives. All of these measures were intended to ensure the government's control over its investment policy. By autumn of 1982, the holding company was responsible for over 2 billion dollars in assets, mainly as a result of Cabinet directive. Besides its remaining shares in the CDC, the CDIC also held the government's holdings in Canadair and de Havilland, Teleglobe and its shares in Massey-Ferguson amongst others.<sup>20</sup>

### C. PRIVATIZATION

The CDIC acted neither as an instrument for a coherent investment or divestment strategy<sup>21</sup> and in October of 1984, Sinclair Stevens, the Conservative Minister of Regional Industrial Expansion responsible for the CDIC announced that "most" of the CDIC's assets were to be privatized. On the block were the government's holdings in the CDC and in other commercial interests such as Teleglobe Canada, the overseas communications company, and the two aerospace manufacturers Canadair and de Havilland. Also up for sale were Eldorado Nuclear and the government's shares in Massey-Ferguson. Announcing the sale, Stevens said that it is not an indicator of a "blanket policy" of privatization on the part of new government. Rather, touching on what would become the Rosetta stone of the Tory privatization program, the original mandate

of the companies, according to Stevens, had been fulfilled "and other situations dictate changed responses by the government." The Minister implied that the privatizations were consistent with what the Conservatives perceived as its role "to support the private sector by setting the right atmosphere for business ... We wish to make these companies above all accountable to the Canadian people through the mechanism of the private market."<sup>22</sup>

The Conservatives' plan to divest the government's 47 per cent interest in the CDC was intended to be a simple affair, given that the decision to do so had already been made by the previous Liberal government. Appearing before the Parliamentary Committee studying the divestiture bill, the Industry Minister claimed that the CDC will be properly placed in the private sector and more open to investors both domestic and foreign, freeing it from the artificial constraints of public ownership, enabling it to "respond quickly and efficiently to the demands of the market place." At the same time, however, the post-privatization ownership structure contained in the bill would preserve Canadian ownership by a ratio of three to one while protecting the corporation from undue corporate concentration.<sup>23</sup> The legislation governing the divestiture limited foreign ownership to a maximum of 10 per cent per non-resident and a non-resident aggregate maximum of 25 percent. The legislation also limited domestic ownership to 25 per cent of the company by residents and their "associates." An associate is defined in the *CDC Act* as an affiliated concern of a purchaser, in which the purchaser owned a 50 percent or more interest.<sup>24</sup>

The Chief Executive Officer of the CDC, Anthony Hampson also appeared before the Committee and asked it to consider five amendments to the government's bill. One would have ensured that the ownership restrictions proposed by the government would apply to any CDC

successor corporation. According to Mr. Hampson, the bill would not prevent a CDC successor, or for that matter the present directors, from transferring control of the CDC's assets to an unregulated subsidiary and by-passing the domestic and foreign ownership restrictions. Regardless, the CDC's Chief Executive made it clear that his amendment did not apply to any decision of the CDC to dispose of assets in the "normal course of business." Prophetically, (for this study's purpose) an NDP Member on the Committee, Michael Cassidy, asked Hampson, "Therefore, in the ordinary course of business, would there be anything to prevent your firm from, let us say, selling off Polysar in 1986..., the AES office equipment group in 1988 and Connaught Laboratories in 1989?" In response, the CEO said "No, there would not be anything to stop that in a legal sense. No, there would not."<sup>25</sup>

The NDP supported Hampson's amendments but the Conservatives did not and the bill passed untouched. The federal government divested its equity in the CDC between 1984 and 1987 and in those same years the CDC divested its controlling interest in Connaught, a decision which was therefore not an act of government but to use a phrase conjured in the Parliamentary hearings, an act of a private concern "in the normal course of business." Amongst the company's largest shareholders at this time was Institut-Mérieux SA of France, a French state-owned competitor with a 12.5 per cent interest.<sup>26</sup>

#### D. POST PRIVATIZATION: IN SEARCH OF CRITICAL MASS

As a private corporation, Connaught maintained its status as a world leader in the production of human vaccines. Leadership translated into financial success. In 1988, the firm reported revenues of 200 million and its value was estimated at 700 million.<sup>27</sup> Moreover, the firm

was not laden with debt and it possessed a solid presence in the American biotechnology market through its operations in Swiftwater, Pennsylvania.<sup>28</sup> In 1988, Connaught invested 14.5 percent of its revenues into research and development (R&D). Although, according to Connaught Chairman, Brian King, the actual dollar figure spent in R&D, 28 million, was minuscule compared to the expenditures of such industry giants like Merck and Co. which spends USD 470 million per year. Despite Connaught's success, King argued that survival relied upon having the resources to engage in more R&D in order to stay competitive in an increasingly global market. King referred to these resources as a "critical mass", without which little companies like Connaught would disappear and the big biotechnology companies would get bigger.<sup>29</sup>

On March 6, 1989, by virtue of its commercial attractiveness and its need for additional resources, Connaught and Institut Mérieux-Pasteur (Mérieux) of France announced that they had agreed to a merger. The proposed merger would see the two companies swap shares such that Mérieux would possess a 51 percent interest in a combined biotechnology concern in Holland. The reasons for the merger appeared rational enough. For example, Mérieux and Connaught overlapped on 70 percent of all R&D projects. Given the rationalization of R&D resources that would ensue and given each other's respective access to the European and North-American markets, King estimated that the merger would increase threefold the firm's collective market size and would "create a critical mass of long-term research." Regardless, soon after the merger was announced, commentators declared the loss of Connaught as a damaging blow to Canada's technology base and given Connaught's history, a damaging blow to the nation's industrial pride.<sup>30</sup>

The University of Toronto was not content to simply express its concern but acted on it, indicating that it might take legal measures to block the sale. The University claimed that the merger violated the 1972 purchase agreement it had with the CDC, which transferred control of Connaught to the federal government. That agreement, the University argued, provided that the CDC could not sell any part of Connaught to a foreign-owned firm, or transfer control of Connaught to a foreign-owned firm. We will recall that the legislation authorizing the government's divestiture of the CDC did not provide for these constraints. At issue were the "millions of dollars" worth of R&D contracts between the two parties. The University was concerned that its research would become the property of a foreign-owned company, depriving the Canadian academic community of any benefits derived from its research projects.<sup>31</sup> Another academic, Robert Church, who taught and researched at the University of Calgary, was reportedly attempting to gather the estimated \$700 million required to purchase Connaught and keep it in Canadian hands.<sup>32</sup>

Academics and nationalists were not the only ones cool to the deal. The value of a Connaught share, which had risen to 29 dollars on rumours of a bidding war from the entry of Church's group, fell to 27 5/8 by June 4, when it became evident that a competing bid would not be entered. The negative reaction amongst shareholders and investors was partly due to the complicated method in which the two companies' shares would be transferred in order to maintain Canadian tax breaks. Despite a resolution to these technicalities, it appeared that shareholders were generally uncertain about the proposed benefits of the merger.<sup>33</sup> The uncertainty was exacerbated in July when the University of Toronto formally filed suit in the Ontario Supreme Court to block the deal.<sup>34</sup>

The merger continued to face more obstacles. On July 31, just before the shareholders were to vote on the offer, the Supreme Court of Ontario ruled that fully two-thirds of all shareholders must approve the deal and fifty percent of all "disinterested" shareholders must do so as well for it to succeed. The federal government demanded these conditions in light of a possible conflict of interest between Mérioux and the Caisse de dépôt et de placement du Québec. In 1988 Mérioux agreed to pay the Caisse a premium for an option on the latter's 20 percent interest in the company. That agreement between the two companies was still in place rendering the Caisse a vested interested in the Mérioux takeover bid.<sup>35</sup>

One hurdle which many expected to present little difficulty was the required approval from the federal investment screening agency Investment Canada. Despite the fact that the University of Toronto would submit a brief detailing the severe consequences of losing national control over such an important firm, opponents of the sale were hardly confident that it would be blocked given that Investment Canada had not blocked one foreign takeover of a Canadian owned firm since its creation in 1984. Therefore, despite the rocky road the merger had travelled to this point, Connaught and Mérioux confidently expected shareholders to vote for it, given that it was the only deal on the table. However, this too would change.

On September 11, 1989, JV Vax, a consortium of Ciba-Geigy of Switzerland and Chiron Corp. of California, made a \$30 per share cash offer for control of Connaught (we'll refer to this as the Ciba bid or Ciba for short). Ciba noted that the value of Connaught's stock had dropped to \$25 per share heading into the shareholders annual general meeting. It concluded that shareholders were dissatisfied with the Mérioux plan and were waiting for something better. Besides the superior monetary offer, the Ciba bid offered other benefits. First, Connaught would

be maintained as an independent entity in Toronto. Ciba would also give the marketing link to Europe so sought after by King. No rationalization of Connaught's efforts would be required since Ciba and Connaught did not compete in the same markets. Quite the contrary, Connaught's R&D base would increase as Ciba agreed to transfer Chiron Corporation's, its partner, recombinant DNA technology. Besides avoiding a scale down of its operations, Ciba declared that the transfer of this technology would allow Connaught to produce "safer, more effective vaccines."<sup>36</sup> Recognizing that the Ciba bid was viewed by shareholders as superior to the merger plan, Mériex upped the ante and counter-offered \$37 per share on September 25, 1989. At the same time, the potential "Canadian" bid led by Robert Church never materialized.<sup>37</sup> Each proposal was then submitted to Investment Canada for approval. Given its unexpected importance as an instrument of policy following privatization, we will now turn to a brief review of this agency.

#### E. INVESTMENT CANADA

Investment Canada (IC) was created on June 30, 1985 upon the proclamation of the *Investment Canada Act (IC Act)*. IC replaced the Foreign Investment Review Agency (FIRA), itself a product of the 1974 *Foreign Investment Review Act (FIR Act)*. Like the CDC, the *FIR Act* was conceived in the anxiety of increased foreign, always American ownership of Canadian assets in key economic sectors and the perceived dangers of increasing multinationalization on the nation's economic sovereignty. In order to address these concerns, the *FIR Act* sought to filter foreign investment into Canada from abroad and FIRA was the administrative tool used to accomplish this task. For example, under the terms of the *Fir Act*, any non-Canadians wishing

to establish a new business in Canada or invest in a Canadian-owned enterprise were obliged to submit a proposal to FIRA, regardless of the extent of the undertaking.<sup>38</sup>

Contrary to popular perception, Russell Deigan, an IC expert, asserts that FIRA's goal was neither to eradicate nor reduce nor discourage foreign investment in Canada, but to increase the benefits to the national economy resulting from the investment. Even if the former were FIRA's goals, the amount of investment coming into Canada over the course of its lifespan shows that it did not accomplish them.<sup>39</sup> Regardless, by the end of 1984 it appeared that the negative bias towards foreign investment inherent in the Act and in the agency's mandate was inconsistent with the newly elected Conservative government's "open for business" posture towards foreign investment. It also appeared that the *FIR Act* was unsuited to manage the transformation to a global economy in which industrial nations were now competing against each other to attract foreign investment into their economies.<sup>40</sup> Finally, the expansive authority of the agency angered the Reagan neoconservatives in Washington, a group of individuals the new Prime Minister was very eager to accommodate especially on the eve of the Free Trade Agreement (FTA) negotiations.<sup>41</sup>

The *Investment Canada Act* replaced the *FIR Act* and institutionalized a positive attitude and a more open policy towards foreign investment. For example, the preamble states:

Recognizing that increased capital and technology would benefit Canada, the purpose of this Act is to encourage investment in Canada by Canadians and non-Canadians that contributes to economic growth and employment opportunities and to provide for the review of significant investments in Canada by non-Canadians in order to ensure such benefit to Canada.<sup>42</sup>

Given its favourable disposition towards investment,<sup>43</sup> the *Act* conferred the Minister of Industry, Science and Technology with the new obligation of *promoting* investment in Canada by residents

and foreign residents alike. Conversely, the Minister is also obliged to limit his review authority to "significant" investments only. As a result of the reorientation towards a liberal Canadian foreign investment policy, the rules governing the Act's administrative agent, Investment Canada, are quite different than those which governed FIRA.

Relative to FIRA, the authority of IC is restrained by statute, the terms of which limit the agency's scope and define more precisely the conditions the agency must use to render decisions on foreign investment proposals.<sup>44</sup> Nowhere is this more evident than in the terms governing reviewable investments. Under the former Act, FIRA was permitted to review any foreign investment regardless of the amount of money and assets involved in the transaction. Under the *IC Act*, with the exception of cultural industries, IC is not even authorized to review new business proposals. In terms of investments in established Canadian businesses, IC must limit its review to "economically significant" transactions, significant being defined by the value of assets involved in the transaction.

The rules regarding asset thresholds are not the same for all foreign investors in all industries. Section eight of the *Act* defines five "sensitive" economic sectors (oil and petroleum, uranium, culture, financial services and transportation) in which any direct acquisition of a Canadian firm involving assets worth at least five million dollars or indirect acquisitions involving at least fifty million dollars in assets must be reviewed. Because of the FTA, the threshold for Americans directly investing in Canadian concerns outside of these industries is considerably relaxed. In 1989 the threshold was 25 million dollars, increasing to 50 million in 1990 and 100 million in 1991. As of 1992 the threshold is 150 million dollars, with indirect acquisitions no longer reviewable. Thereafter, the threshold for direct acquisition of Canadian assets by American firms or residents

will remain at 150 million measured in constant 1992 dollars.<sup>45</sup> Despite these limitations, the *Act* confers upon the federal cabinet a reserve review power. Section 15 states that notwithstanding the limits described above, an investment may be reviewable if in the opinion of the Governor-In-Council (the federal Cabinet), it is "related to Canada's cultural heritage or national identity."<sup>46</sup> Regardless, Deigan argues that by limiting the scope afforded to IC and making the rules tighter, the Conservative government accomplished its goal of preventing a future "regulatory creep" back to a more interventionist state of affairs.<sup>47</sup>

The *IC Act* also attempted to make the review process significantly more transparent and accountable than under the former Act. However, it is clear that the new review process still affords the agency and the responsible minister a significant amount of discretion. The review process is initiated once an application is submitted to the agency by the potential foreign investor. IC then begins a process of consultation at the federal level. This involves soliciting the advice of affected bureaucracies on the potential impact of the investment and taking into account all relevant federal economic, industrial and cultural policies. The minister is only obliged to take into "consideration" the same policies "enunciated" by provincial governments or their legislatures.

The federal Bureau of Competition Policy often assumes a significant role in the IC review process. The Bureau of Competition Policy is the administrative and investigative secretariat for the federal Competition Tribunal, a quasi-judicial body which has the authority under the 1986 *Competition Act* to review and adjudicate on criminal and non-criminal business practises which contravene the Act's stated purpose: "to maintain and encourage competition in Canada."<sup>48</sup> According to a discussion paper prepared by the federal Department of Consumer and Corporate Affairs, the department to which the Bureau was responsible during the Connaught and de Havilland

reviews, the *Competition Act's* goals are pursued with a view to "promoting economic competitiveness and facilitating the role of market forces in the economy."<sup>49</sup> In the case of foreign investment aimed at the merger or acquisition of Canadian assets, it is the Director of the Bureau's responsibility to recommend to the Competition Tribunal that such transactions be blocked or ordered dissolved if it is believed they will "prevent or lessen competition substantially."<sup>50</sup>

After receiving input from the Bureau of Competition Policy and other bureaucracies and after determining the relevant issues in each case, Investment Canada then approaches the investors "to discuss their plans, to obtain needed clarification and, when necessary, to identify concerns regarding assessment of the investment's benefit to Canada."<sup>51</sup> It should be noted that this process is applied to each proposal on its own merits and therefore not relative to the merits of other, competing proposals.<sup>52</sup> The agency then makes a recommendation to the Minister who must inform the investor within 45 days (75 with the investor's approval)<sup>53</sup> whether or not the investment will be of "net benefit" to Canada.<sup>54</sup>

The "net benefit" test is an amorphous concept, defined nowhere in the *Act*, but at the heart of the review process. Instead, Section 20 lists six factors which the minister must take into account when deciding whether or not an investment will be of benefit and therefore whether it should be approved or rejected. These six factors are as follows:

- i. "the effect of the investment on the level and nature of economic activity in Canada" including employment, resource processing, Canadian content and on exports from Canada;
- ii. "the degree and significance of participation by Canadians" in the proposed investment;
- iii. "the effect of the investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;"
- iv. "the effect of the investment on competition" within any industry;

- v. "the compatibility of the investment with national industrial, economic and cultural policies" and taking into "consideration" the same policies "enunciated by provincial governments and/or their legislatures; and
- vi. "the contribution of the investment to Canada's ability to compete in world markets."<sup>55</sup>

The net benefit test replaces the equally amorphous "significant benefit" test contained in the *FIR Act*. Yet the factors involved are similar in both cases with two exceptions. The first is the addition of cultural policies in the *IC Act* to the list of federal policies with which investments must be compatible. The second is the responsibility to take into account the affect of the investment on Canada's international competitiveness.<sup>56</sup> Nor are the six factors listed in Section 20 accorded any hierarchical preference. Instead, the relative weighting of each one is contingent upon the nature of the transaction and the particular circumstances at that time. As a result, the net benefit test is very fluid, allowing for a flexibility in the application of policy and affording the minister the ability to use it to address regional and other political concerns.<sup>57</sup>

A review of the legislation and regulations governing IC leads to the following conclusions relevant to this case study and the succeeding de Havilland case study. The first is that the capacity of the government to intervene in foreign investment decisions should have been restrained in keeping with market ideology by reducing the scope and increasing the transparency of IC. Yet, the fluidity of the net benefit test within a review process that provided for private negotiations suggests that the government could still intervene to extract commitments from the investor in the crucial areas of jobs, exports, Canadian control and participation, technological development and innovation all of which significantly affect Canada's competitiveness. Combined with the reserve review power in Section 15, the *IC Act* still affords the federal cabinet a considerable degree of latitude in intervening in foreign investment decisions. Secondly, despite the transparency of the review

process, any decision on a foreign takeover is political as it is ultimately the Minister's decision to make. Finally, the legislation and regulations are case specific. That is to say the legislation applies the "net benefit" test to each application on its own merits rather than qualitatively assessing competing bids to determine which one yields the "greatest" benefit. Despite the continued potential for state intervention, in the approximately five years from the date of the implementation of the *IC Act* to the time of the Connaught review, not one foreign investment proposal had been publicly rejected.

#### F. REINTERVENTION

On October 15, 1989, Acting on the agency's recommendation, the Industry minister surprised many observers and invoked Section 23 of the *IC Act* which gave him the authority to initially reject Mériex' bid as he was not satisfied that it would be of net benefit to Canada. Mériex was given 30 days to resubmit a more satisfactory bid. After renegotiating commitments from both Ciba and Mériex, Investment Canada submitted its recommendations to the Industry minister towards the middle of November.<sup>58</sup> By the end of November, Cabinet had not yet made a decision on whether the offers would be accepted or rejected. Reports revealed that ministers were divided over assuming an interventionist industrial policy role and letting the markets decide. On the one hand, the government faced pressure from the academic and scientific communities and from within the Industry Department to reject the Mériex bid in favour of the Ciba bid. These actors believed that the Ciba bid not only provided the necessary means for Connaught's survival, but would preserve its role as a Canadian biotechnology champion. Overall, the Ciba bid was viewed as more beneficial than the Mériex bid in terms of industrial development. On the other hand, the

Conservatives feared that by choosing one bid over the other, its credibility and that of Investment Canada would be damaged in the eyes of foreign investors. Generally, by intervening on the behalf of one bid over the other, the Tories' feared that their free market economic renewal agenda could be placed in jeopardy<sup>59</sup>

This debate over whether or not the government should intervene in the Connaught case was played out intensely in the business press. Peter Newman argued that to let Connaught fall into foreign hands would be tantamount to ruining any hopes of competing in the high-tech environment of the 21<sup>st</sup> century, leaving Canada "destined to remain an industrially marginal nation, stagnating on the northern periphery of the world's geography."<sup>60</sup> John Godfrey, a former editor of the *Financial Post*, later elected as a Liberal MP in the 1993 federal election, countered the claim that Canada's credibility would be tainted by intervening. According to him, Connaught's suitors knew the rules regarding Investment Canada's power to judge the merits of an investment application. Perhaps confounding his colleagues, he further argued that markets often ignore the national interest and that if Ottawa has targeted biotechnology as a strategic technology, then it should stick by its guns and exercise its legal right to choose the offer which would meet that goal.<sup>61</sup> Another columnist in the same paper declared that "seeking to develop home-grown industry by government is a colossal waste of time and money under any circumstances." Crossing his editor, he wrote if Ottawa intervenes, foreign investors simply will not be happy.<sup>62</sup> The *Globe and Mail* simply crystallized the question, "Does the Cabinet permit Connaught's shareholders to choose between two reasonable, attractive bids, or does it allow only the bid it considers more clearly in Canada's interests?" Egging the Tories on, the editorial continued, "The markets are waiting, Connaught is waiting, the bidders are waiting."<sup>63</sup>

On December 13, 1989, the Conservative Minister of Industry, Science and Technology, Harvie Andre, announced that he had approved both competing bids, leaving shareholders to decide Connaught's fate. Offering seven dollars more per share than Ciba, Connaught became a part of Institut Mérieux shortly thereafter.<sup>64</sup> In making the announcement, Andre stressed that a Canadian partner could not be found for Connaught and, in light of this fact, the Minister stated that Cabinet's decision was "the result of the most comprehensive and rigorous analysis and review to ensure that each proposal is likely to be of net benefit to Canada . . . ." The Minister concluded his statement saying that Investment Canada secured "extensive legal undertakings" from each of the applicants in order to ensure Connaught's Canadian identity and its function as an independent biotechnology manufacturer. A fact sheet accompanying the announcement lists these undertakings which involve commitments mainly in the areas of capital expenditure and employment, a world product mandate (WPM) for Connaught's products, R&D and product innovation, and a series of commitments guaranteeing Canadian control, participation and identity. Some of the more significant measures include:

- i. Connaught's share of the total R&D budget of the combined enterprise will not be less than 36 per cent. Connaught will spend an aggregate of not less than \$160 million on R&D in Canada during the five years following the transaction.
- ii. Mérieux will make available to Connaught its proprietary production technology.
- iii. Mérieux will build a Biotechnology Centre at Connaught's Willowdale (Toronto) site, requiring estimated capital expenditures of 30 to 40 million dollars and will employ 125 people when completed and create a total of approximately 30 to 50 new permanent positions.
- iv. "Connaught will retain its name, a strong Canadian identity, its head quarters, all key corporate functions and a full range of activities in Canada."

- v. Connaught will be maintained "and developed as world-class company in the vaccine, biotechnology and health care products industries, with the mandate and resources to vie for the position of a leading worldwide vaccine producer."
- vi. Connaught will have a WPM for every new and existing product.<sup>65</sup>

#### F. CONNAUGHT: A TYPOLOGY OF STATE INTERVENTION

In the wake of the Connaught decision, one columnist aptly wrote that the affair "provides a fascinating glimpse into making of industrial policy in the Mulroney era."<sup>66</sup> We witness a government loath to intervene in the market willingly do so through legislation and through the power to review, reject and alter foreign investment decisions. In the CDC case, while the government intoned the necessity and the benefits of placing the corporation in the hands of the free market, the Minister of Regional Industrial Expansion also legislated foreign ownership restrictions on the purchase of shares for the expressed purpose of retaining Canadian control and participation of the corporation. In the Connaught case, when Andre was asked why he had refused to select the Ciba bid over the Mérioux bid, he replied that to have made a qualitative judgment would have violated the Mulroney government's policies of privatization and liberalization and this is "exactly the kind of action we're trying to get away from."<sup>67</sup> Regardless of the rhetoric, the Minister of Industry, Science and Technology employed his powers under the *IC Act* to review foreign investment proposals and intervene to alter them, in this case for the purpose of maintaining a strategic Canadian firm in a globally competitive industry. As some have suggested, the role played by Investment Canada in the Connaught case established the agency and not the federal Department of Industry, Science and Technology as the Conservatives' preferred tool of industrial development.<sup>68</sup> Through this policy instrument, the minister ensured that the French buyers would maintain

Figure 3.1

## A Typology of State Intervention for Competitive Advantage: CDC/Connaught

TYPE	BEST STRATEGIC INDUSTRIAL POLICY	PORTER NEO-RICARDIANISM	REICH POSITIVE ECONOMIC NATIONALISM	TYSON (STT) CAUTIOUS ACTIVISM
NEO-LIBERAL				
MODER-ATE				
DIRECT	<p><i>Canada Development Corp.</i></p> <p><b>TRADE &amp; FOREIGN INVESTMENT POLICY:</b> Acted to maintain Canadian control over CDC</p> <p><b>STATE INSTRUMENTS:</b></p> <ul style="list-style-type: none"> <li>• <i>CDC Reorganization Act:</i> Legislated foreign ownership restrictions</li> </ul> <p><b>STATE ACTORS:</b></p> <ul style="list-style-type: none"> <li>• Minister of Regional Industrial Expansion</li> </ul>			<p><i>Connaught Laboratories</i></p> <p><b>TRADE &amp; FOREIGN INVESTMENT POLICY:</b> Extracted commitments in the areas of Canadian control and participation, product development, innovation and exports</p> <p><b>STATE INSTRUMENTS</b></p> <ul style="list-style-type: none"> <li>• <i>Investment Canada Act:</i> Reviewed and blocked foreign investment proposal to extract economic commitments</li> </ul> <p><b>STATE ACTORS:</b></p> <ul style="list-style-type: none"> <li>• Federal Cabinet</li> <li>• Minister of Industry, Science and Technology</li> <li>• Investment Canada</li> </ul>

Connaught in Canada as an independent manufacturer of vaccines and similar products and that this capacity would be enhanced through capital investment commitments, product development and innovation targets, technology transfers and a world product mandate.

In the CDC privatization and the Connaught takeover the Conservative government engaged in a foreign investment policy that in rhetoric appeared to be liberal but in practice was directly interventionist. Figure 3.1 transposes the Conservatives' interventions in this case and the actors associated with them onto the typology developed in the previous chapter and reveals an approach to foreign investment policy consistent with the prescriptions of Michael Best and Strategic Trade Theory. In the CDC case, legislating foreign ownership restrictions constitutes an interventionist extreme of strategic industrial policy as practised in nations such as Japan. In the Connaught case, while the Minister in consultation with the Conservative cabinet did not block the sale to a foreign company, one partly owned by a foreign government, he intervened through Investment Canada for the purpose of achieving a "national" solution consistent with the foreign investment policy prescriptions contained in Tyson's Strategic Trade Policy agenda.

## 4. DE HAVILLAND CANADA

### A. INTRODUCTION

Unlike the Connaught case, the privatization of de Havilland involved a direct transfer of ownership from the Crown to a private corporation. We will focus on the Conservatives' 1984 decision to sell de Havilland Canada (DHC) to the American aerospace manufacturer Boeing Corporation (Boeing) and the government's actions at the time of Boeing's proposed resale of DHC to a European aerospace consortium. This analysis will show that the government structured the divestiture and later, intervened through a number of policy instruments, including Investment Canada, to realize its stated goal of making de Havilland a strategic cornerstone of a Canadian controlled and internationally competitive aerospace industry.<sup>69</sup>

### B. THE AVRO SHADOW

Federal policy in the Canadian aerospace industry has historically been shaped by several factors. The first is a small number of core manufacturers<sup>70</sup> rendering Canadian production highly specialized, primarily serving a demand for components and inputs as opposed to value-added product design and development. The lack of product development is exacerbated by a heavy amount of foreign ownership amongst Canadian core manufacturers and a corresponding lack of world product mandates for these manufacturers. Also, Canada's proximity to the United States and the relatively giant American aerospace industry inhibits the development of domestic core firms and provides an incentive to supply American ones. Thirdly, survival in the global aerospace industry requires continuous new product development, an activity which requires significant high-

risk, front-end investment putting constant demands on public treasuries as private markets are not willing to bear this risk.<sup>71</sup> Governments, including Canadian governments, have traditionally been willing to assume financial risk because of the strategic benefits associated with the industry. For example, 75% of Ontario's aerospace output is manufactured for export; skilled production workers account for 55% of the Canadian industry's workforce; 13% of the Canadian industry's sales, approximately \$8 billion in 1992, are put back into R&D; and the sector renders strategic spillovers through linkages with other research and knowledge-intensive industries such as computer software, telecommunications and materials. Finally, approximately 90% of the domestic industries 64,000 workers are employed in Ontario and Quebec.<sup>72</sup> All of the above have made political activity and state intervention another fundamental characteristic of the Canadian aerospace industry.<sup>73</sup>

However, the 1959 decision by John Diefenbaker's Conservative government to cancel support for the A.V. Roe (AVRO) Arrow has perhaps stood alone as an influence on the federal government's contemporary policy in this industry. This decision led to the closure of one of Canada's three core aerospace manufacturing firms, pulled the plug on what was regarded as the most technologically advanced aerospace project of its time and, finally, caused an exodus of skilled and talented engineers, mostly to the United States. The impact on the Canadian industry was so severe that since that time, "no government has wanted to be responsible for the failure of another core firm or project." Quite the opposite, Doern and Atherton suggest that federal support for this sector has been extensive. De Havilland, as one of the two core firms left, continues to be a beneficiary of this support.<sup>74</sup>

De Havilland is a company shrouded in symbolism for Canadians and closely connected to the nation's development. Incorporated in 1925, it began as a parts supplier for its English parent

corporation, evolving into a core manufacturer after the second World War. The company produced training aircraft for the Canadian government's war efforts and is greatly associated with blazing Canada's northern wilderness, producing such famous models as the *Beaver* and the *Twin Otter*. In the mid to late 1960's, the company, then owned by the British firm Hawker-Siddeley, developed propeller-driven aircraft capable of taking off and landing in very short distances. This technology, known as STOL, is widely acknowledged as a Canadian feat which restored the stature of the Canadian aerospace industry in the aftermath of Arrow debacle.<sup>75</sup>

By the 1970's, it was apparent to de Havilland that STOL technology could be applied more profitably to the civilian commuter aircraft market and it produced designs for a four engine turbo-propeller aircraft, the DASH-7. Hawker-Siddeley did not have as much faith in the new series and refused to finance the development. As a result, the Liberal government became heavily involved in the financing of the DASH-7. After failing to find a Canadian investor in 1974, the Liberal government negotiated the purchase of de Havilland for 40.8 million dollars.<sup>76</sup> Reacting perhaps to the AVRO shadow, nationalization was an attempt by the Liberal government to preserve one of the two remaining Canadian core aerospace firms and preserve an integrated domestic industry. The government did not intend to do this through continuous ownership and clearly stated its intentions to restructure the firm and return it to the private sector. The nationalization of de Havilland, the Industry minister at the time declared, was strictly an "interim measure."<sup>77</sup>

The government did not realize its intentions for a number of reasons, chief amongst which were the lack of a Canadian core firms to absorb de Havilland and a depressed civilian aircraft market. As a result, de Havilland became a de facto Crown Corporation which, by 1983, had amassed a debt of 285.9 million dollars financed by government loan guarantees. The large sums

of money involved in financing the firm drew public criticism and in order to avoid further controversy, the Liberal government transferred the firm to the Canada Development Investment Corporation in 1982, whereupon the CDIC wrote off 265 million dollars in deferred research and development expenditures. De Havilland still carried large long term debts because of earlier government financing decisions and the government made infusions of equity, approximately 775 million dollars total by 1985, to improve the debt-equity ratio in lead up to privatization which was announced in the same year.<sup>78</sup> By the time the Progressive Conservative government came to power in 1984, the focus of media and government attention on the alleged mismanagement of the firm's affairs reduced public support for the company and strengthened the consensus on privatization.<sup>79</sup>

### C. PRIVATIZATION

On October 31, 1984, the Minister of Regional Industrial Expansion, Sinclair Stevens, announced that de Havilland, along with the other holdings of the Canada Development Investment Corporation (CDIC) would be sold to the private sector. The CDIC, under new president Paul Marshall, was instructed to manage the divestiture.

#### i. *CDIC Analysis:*

After the initial public distribution of information, the CDIC hired a team of financial advisers and selected 134 interested parties whose initial bids were considered serious enough to warrant further attention. After further negotiations, this number was reduced to twenty-four. At this time, the American aerospace giant Boeing Co. of Seattle indicated that it was prepared to negotiate the purchase of de Havilland and signed a Letter of Intent. According to the CDIC, it then offered two other groups the opportunity to present their acquisition proposals. Of these two groups,

one was led by the German Justus Dornier and the other was a consortium called Rimgate Holdings, combining disparate Canadian investors and the Dutch aerospace firm N.V. Fokker. The latter produced the Fokker-50, a direct competitor to the de Havilland DASH-8 series of aircraft. Upon completion of his assessment, the president of the CDIC advised the Industry Minister that the Boeing plan is superior to the other two offers. This recommendation was based on a combination of criteria, namely the price being offered and concessions demanded, the feasibility of the business plans and the bidders' intentions.<sup>80</sup>

Before going ahead with the privatization, the CDIC was also asked to analyze the comparative costs of maintaining de Havilland under government ownership and the cost of winding the firm down. The CDIC pegged the cost of maintaining government ownership at 197.4 million dollars. Arthur Andersen and Co., hired as consultants, pegged the cost of liquidating the firm at 365 million dollars.<sup>81</sup> In light of these options, it appeared advantageous for the government to simply give the firm away. Given the price received for the company, many critics would later allege that this in fact was what the Conservatives did. Not surprisingly, the President of the CDIC wrote to Stevens, the "CDIC endorses the recommendations of our financial advisers ... that the Boeing Company offer be accepted as being superior to the other submission received and far preferable to continuing de Havilland under government control or winding it up." He advised Stevens that an agreement to sell de Havilland to Boeing based on the latter's Letter of Intent be negotiated with goal of arriving at a deal by the "end of 1985."<sup>82</sup>

ii. *The Letter of Intent*

The Letter of Intent (LOI) consists of two separate agreements. The first of these agreements is the acquisition agreement which enumerates the terms and conditions governing the transfer of

ownership. The second is the Memorandum of Understanding, or MOU, which defines a voluntary relationship between the company and the Crown after divestiture. In the case of the de Havilland privatization, the Conservatives structured each of the documents to ensure that the company would remain in Canada as a core manufacturer in an internationally competitive aerospace industry. The MOU is more explicit in defining this relationship.<sup>53</sup> A review of the documents' contents demonstrate this.

- **The Acquisition Agreement:**

- *Location:* De Havilland would remain in Ontario.
- *World Product Mandate:* de Havilland will have a WPM under Boeing ownership for the ongoing design, development, production and marketing of DHC's products and derivatives. Licensing and third-party production agreements are permitted subject to ministerial review and approval.
- *Tax Limitation Agreement:* As of December 31, 1984, DHC possessed losses carried forward of 198 million dollars and investment tax credits of 13 million, all of which would expire over the period 1985-1991. Under Canadian law, Boeing would be able to apply these concessions to its own operations. Instead, Boeing agreed to forego the use of DHC's pre-1985 tax losses in return for a deal which would see Boeing raise capital through a preferred share offering, the dividends on which would be tax deductible. The capital raised through the share offering would be loaned to a Canadian leasing entity who in turn would loan money to Canadian aerospace firms at concessionary rates for the purpose of purchasing DHC products.
- *Price:* The total sale price was \$155 million dollars, 90 million paid in cash by Boeing. The remaining 65 million would be paid through deferred payments over a thirty year period, or Boeing could choose to deduct 20% of the value added from the purchase of Canadian goods and services from the outstanding balance. Therefore, 325 million in new Canadian business would eliminate deferred payments.<sup>54</sup>

- **The MOU**

Ironically the MOU is at the heart of the government's industrial policy objectives concerning the privatization yet its terms are completely voluntary. In the case of de Havilland, the MOU

described "the good faith intention of Boeing relative to accommodating Canadian industrial policy interests, within the constraints of normal commercial business considerations ...."<sup>85</sup> The industrial policy interests were as follows:

- to maintain and increase the levels of Canadian content in DHC products;
- to increase the amount of R&D at DHC "to enhance the existing pool of aerospace expertise found there";
- to modernize DHC's production facilities; to improve the DASH-8 model and to develop a 50 seat stretch version of the DASH-8; and
- to "enhance Canadian industrial capabilities to meet national defense requirements... consistent with the government's objectives of... establishing a base to pursue more effectively export opportunities."<sup>86</sup>

In order to realize these objectives, the federal government intended to employ a series of financial inducements through procurement, the Defense Industry Productivity Program (DIPP), the Enterprise Development Program (EDP) and through a Crown corporation, the Export Development Corporation (EDC). Jeanne Laux concludes that the Mulroney Conservative government used these policy instruments to selectively intervene in the market to improve Canada's competitive position in the aerospace industry while remaining consistent with its broader neoliberal approach to economic restructuring.<sup>87</sup> The de Havilland privatization appears to conform to this hypothesis. For example, the MOU stipulated the following:

- *Procurement Contracts:* Recognizing the "significant economic and technological benefits to Canada and Canadian industry," it is the government's "wish" that de Havilland participate in the bidding for national and international defense contracts. Boeing promised to position DHC in order to pursue such contracts, "especially defense contracts in the United States."
- *DIPP:* Through this program, the federal government committed itself to 46 of the 105 million dollars required to modernize the Downsview (Toronto) production facilities, upgrade the DASH-7 and DASH-8 and to develop the stretch version of the DASH-8. In this

last case the government committed itself to 50 per cent of the development costs up to a maximum of \$30 million.

- *EDC*: Export products manufactured by DHC "shall be eligible for EDC sales financing support and assistance." This financing will be made available at internationally defined consensus rates. However, in the case where the EDC considers the risk of the purchasing agent unacceptable or where a competitor is receiving financing below consensus rates, the government may consider making export financing available through its own account.<sup>88</sup>
- *EDP*: In addition to EDC financing, DASH-7 and DASH-8 products manufactured in Canada and sold in U.S. markets "shall be eligible for EDP financing assistance" so long as the company meets acceptable Canadian content and "benefit to Canada" criteria.<sup>89</sup>

According to Robert De Cotrêt, the Minister responsible, the sale would provide a competitive stimulus to the firm's development. De Cotrêt premised this conclusion in light of the commitments solicited from Boeing and in light of the aerospace giant's global marketing and management expertise. Overall, the Minister concluded, "the sale will assure Canada of a strong, long-term and internationally competitive aerospace sector" and simultaneously relieve taxpayers of the "burden of past levels of support."<sup>90</sup> In a letter to Members of Parliament, the Minister noted that despite the 775 million dollars the federal government had invested in de Havilland up to that point, its product line had dwindled to two products (the DASH-7 and DASH-8 models), employment had varied dramatically and, overall, the firm remained a very small player in a cut-throat international market. Ottawa would not risk the taxpayers money in reviving the company to a solid competitive position. He estimated that immediate cash and equity needs were in the order of 200 million dollars. Rather, in order to compete in the global and domestic aerospace markets, de Havilland required the management, global marketing and financial skills that "could only be met by a private sector investor" in the aerospace business.<sup>91</sup>

The reaction to the sale was immediate and swift. "arousing the ire of nationalists, the two opposition parties, and the friends of an activist government industrial policy to create jobs in high-tech industry."<sup>92</sup> Reacting to pressure from all sides, the Tories relented and permitted a Parliamentary enquiry during which the opposition concentrated on hammering the government for its "obsession" with selling de Havilland to a foreign buyer and the apparently low price for which it was sold.<sup>93</sup> The government was not swayed. In the House of Commons, De Cotrêt repeated that the sale to an international giant like Boeing was the only way to save de Havilland and strengthen the Canadian aerospace industry, given the lack of available investment capital. It was also consistent with the government's overall privatization program of which De Cotrêt said, "We on this side of the House recognize the reality of the market place. We recognize that by reducing the bureaucratic and political impediments, there will be a more efficient market economy." The only problem with the market-based approach was posed by the Minister himself who said: "If the purchase of de Havilland turns out to be a good deal for Boeing shareholders ... it will also turn out to be a good deal for Canada."<sup>94</sup>

The converse could just as well be true. However, Richard Albrecht, Chairman of Boeing Canada, sought to reassure the committee investigating the sale: ". . . we are confident that de Havilland of Canada has the potential to become a profitable and more viable operation . . . . We believe Boeing has the unique capability to bring that strength and growth to pass. I assure you we will do our utmost to make that happen."<sup>95</sup> In fact, the confidence expressed by Boeing in de Havilland began to erode almost as soon as the transfer of ownership took place.

#### D. THE PROPOSED RESALE

In July of 1990, Boeing announced that it was planning to sell de Havilland to Aerospatiale SA of France and Aeritalia SpA of Italy, principals in a consortium called Avions de transport régional (ATR). The two aerospace manufacturers were owned by their respective governments, and in the case of Aerospatiale, assumed a traditionally strategic role in the French government's defence and economic policies.<sup>96</sup> Despite investing 400 million dollars into the company, laying off 700 workers in February of 1989, receiving an additional 161 million dollar grant from the federal government one year later and an extensive order backlog and robust sales of the DASH-8, Boeing had not been able to realize a profit on its de Havilland operations and had decided by this time to get out.<sup>97</sup>

The announcement caught Ottawa and other players by surprise and immediately put into question de Havilland's continued status as a Canadian core aerospace manufacturer. This status was no longer guaranteed, if it ever was, as the terms and conditions agreed to by Boeing in the original privatization agreement applied to de Havilland only under "Boeing ownership."<sup>98</sup> Moreover, the ATR consortium produced the ATR-42 and the ATR-72 aircraft, direct competitors to the DASH-8 series. The ATR-72 was a completed version of the stretch DASH-8 400 model still in the developmental stage.<sup>99</sup> The Canadian Auto Workers (CAW), the union representing de Havilland's workers, and many other commentators immediately began to speculate that should the company be purchased by the ATR group, it would be transformed into a sub-assembly operation or a parts supplier for the latter's European-developed products thus eliminating all technological expertise at the Downsview site and perhaps 2,000 jobs.<sup>100</sup>

Reacting to the announcement and speculation over de Havilland's fate, the then Minister of Industry, Benoit Bouchard, said that the federal government would insist that any new owners adhere to the conditions negotiated in the original privatization agreement so that the company will "continue to develop." Bouchard stated that any purchase proposal would have to be referred to Investment Canada which "would undertake a thorough review to ensure it is in the country's best interests."<sup>101</sup> On the agency's behalf, Allan Nymark said, "obviously, we will be looking at [the ATR proposal] very closely, given the importance of de Havilland to high-tech generally in Canada."<sup>102</sup>

In the months which followed the July announcement, ATR officials began to make it clear that any yet to be determined role for de Havilland in their operations was contingent upon financial assistance from both the federal and the Ontario provincial governments. The reasons for this were simple enough. Governments in Europe and all over the world finance aerospace firms due to the strategic benefits associated with this industry. As one ATR official reasoned, how could French and Italian taxpayers be expected to pay for such work in Canada?<sup>103</sup> The CAW and the newly-elected NDP government in Ontario demanded that guarantees protecting the design and development capacities of de Havilland be included before any public financial assistance were committed. Bob Rae, the new Ontario Premier, stated unequivocally that de Havilland was critical to the province's R&D base and in January 1991 formed a labour, government and private sector task force to study alternatives for the company.<sup>104</sup> CAW president Robert White suggested to the federal government that one of those options was to repatriate the company in whole or in part which the industry minister rejected but indicated that "Ottawa would be open to considering some kind of support for new owners such as tax breaks or loan guarantees."<sup>105</sup> Regardless, on April 10, 1991 Boeing and ATR announced that they had formally reached an agreement to transfer ownership of

de Havilland. Contingent upon as yet an unspecified amount of assistance from Ottawa and Ontario, ATR proposed to invest one billion dollars in de Havilland over the next 10 years during which the company reportedly would:

- i. remain a full-fledged aircraft manufacturer;
- ii. develop components for two new passenger airliners planned by the consortium partners;
- iii. develop components under contract for other aerospace manufacturers; and
- iv. participate on equal footing with the ATR partners in the development of a 80-100 seat successor aircraft to the ATR-72. This would occur in coordination with the German aircraft manufacturer Deutsch Aerospace which would invest 50 per cent and receive the majority of research and final assembly contracts.<sup>106</sup>

The irony of the proposed sale was not lost on then president of the Canadian Auto Workers' Union who extolled the folly of the Conservatives' original drive to sever de Havilland from Canadian government ownership only to see it perhaps end up in the hands of foreign governments.<sup>107</sup> Regardless, the government remained adamant about its original decision. For example, on the day Boeing and ATR announced their agreement, the opposition demanded that the Tories block the sale and consider repatriation or, at the least, subsidize de Havilland. The Prime Minister replied: "I can tell you that faced with the choice of free competition and international investments that will guarantee jobs in Toronto and elsewhere and charging it all to the national debt, we will choose international investment."<sup>108</sup> The Prime Minister apparently believed that any foreign investment transaction favoured Canada's economic interests. The Industry minister, in a less rhetorical fit, told the House of Commons on the same day that the proposed deal must first receive approval from Investment Canada and that the government would issue an official statement at that time.<sup>109</sup>

The time lag between the announced sale and the submission of a business plan to Investment Canada, together with a lack of direction by the federal government, all combined to create a policy void and allowed the players to dig in their heels. The ATR group began to cite a figure of 500 million dollars which would be required in the form of grants, loan guarantees, procurement contracts, training schools and research facilities in order to maintain de Havilland as a core aerospace manufacturer. These requirements soon developed into what seemed to be outright blackmail. For example, the chairman of Aeritalia, now renamed Alenia, openly asked, "does Canada want to have a vibrant aerospace industry or just an assembly operation?" The CAW demanded that Investment Canada block the sale, stating that the money requested by ATR was too much without a Canadian partner in the deal or a guarantee that job levels would be maintained. Again, the union had cause for concern. Displaying his real lack of confidence in de Havilland's potential, the chief executive of Aerospatiale stated that the reason no Canadian investor could be found is "because everyone knows this company is a money loser." Bob Rae stated flat-out that Ontario would not contribute any assistance to the European consortium unless job and investment guarantees were made and commitments to expanding the current Canadian-made product line as well. In concert with the employees' unions, he viewed a Canadian partner as a necessary guarantee for these demands.<sup>110</sup>

Two separate developments occurred during this impasse which would ultimately affect the fate of de Havilland. The first was the suggestion that Canadair, de Havilland's privatized twin, might participate in the purchase group. Politicians in Ottawa and at Queen's Park believed this to be an attractive goal and therefore met with Laurent Beaudoin, president of Canadair's parent Bombardier. The ATR group, already connected with Beaudoin through Canadair's contract to

supply components for the European Airbus 330 and 340 aircraft, did likewise.<sup>111</sup> Secondly, in June 1991, the European Economic Community, now the European Union (EU), through its executive, the Commission, launched an anti-competition probe into the proposed purchase. The purpose of this action was to determine whether or not the acquisition of de Havilland by the ATR group would limit competition in the European aerospace industry and amongst aerospace manufacturers in the twelve nation EU.<sup>112</sup>

## E. REINTERVENTION

### i. *Investment Canada*

In May of 1991, ATR submitted its investment proposal to IC. We will recall from our analysis in the Connaught case that Section 23 of the *Investment Canada Act* empowers the Industry minister to review "economically significant" foreign investment proposals and reject those which are not found to be of "net benefit" to Canada. We will also recall that net benefit is not defined in the *Act* although, when applying this test, the minister must consider the effect the investment may have on jobs, product innovation and development, Canadian control and participation, Canada's international competitiveness in the industry concerned and a number of other strategic factors.

By the middle of June, 1991, Investment Canada had finished its review of ATR's business plans and had made its recommendation to the newly-appointed Industry minister, Michael Wilson. On June 20, Wilson announced that he was rejecting ATR's initial proposal. Echoing the interventionist statements made by labour and the Ontario NDP, Wilson said that the money required by ATR from government sources was too high and the guarantees of maintaining de Havilland as a centre of Canadian aerospace design and development too little. The Department of

Industry, Science and Technology and Investment Canada estimated that the ATR plan would require one billion dollars from Canadian taxpayers, far in excess of the \$500 million originally cited by consortium officials. Departing from the open-for-business rhetoric of the Prime Minister on the subject, the Industry Minister said, "This is quite an important application . . . . This industry is a strategic industry for Canada . . . and we want to see it and de Havilland strengthened." The Minister and IC officials wanted solid guarantees that de Havilland would remain a core manufacturer after being bought and that the takeover would strengthen the overall Canadian aerospace industry. Specifically, the minister wanted to see a Canadian company take an equity stake in the takeover and should one not come forward, better guarantees "regarding Canadian participation in the management of de Havilland and on its board of directors."<sup>113</sup>

Wilson's insistence on a Canadian partner led to frantic efforts by Ottawa, Ontario and ATR to include Bombardier in any new plan. These efforts came to no avail and on September 9, 1991 the Ontario government announced that it intended to take an equity position in the aircraft manufacturer and assume the role of a Canadian partner. According to Ontario's Industry Minister, the future of de Havilland and all of its intended benefits for Canada could not be left in the hands of the French and Italian governments. The Minister said: "If you look at the aerospace industry throughout the world, governments have invested in it . . . . We believe that not only the industry, but all the spin-off industries that come from it justify our participating."<sup>114</sup> On the same day, Ottawa announced that the deadline for ATR to submit a revised proposal to Investment Canada had been extended another 30 days. This grace period became meaningless as the EU Commission vetoed the takeover on October 2, 1991. This decision was the result of the anti-competition investigation commenced in June and was the first time the EU had blocked a merger or acquisition since

legislating its competition policy in 1989. According to the EU Commissioner responsible for Competition Policy at the time, Sir Leon Brittain, ATR's purchase of de Havilland would give the group a formidable position in the world market for commuter aircraft. Their combined position would be detrimental to competition amongst other European competitors, namely British Aerospace and Fokker, N.V. and would therefore be detrimental to customers in Europe and elsewhere.<sup>115</sup>

In Canada, the EU's decision was greeted with confusion and anxiety. Michael Wilson said the decision was "unwelcome." Despite the Prime Minister's assurances to the Ontario Premier that the federal government attaches a great deal of importance to de Havilland, the Industry minister stressed that his government would not issue any new capital for it. At the same time, Wilson did not prevent state intervention at another level of government, saying that it was now up to Boeing, the ATR consortium and the Ontario government to figure out a solution.<sup>116</sup> The Ontario Premier said he was "extremely confused" by the EU's decision and promised to battle "on all fronts" to save the company which by this time was reportedly close to financial collapse.<sup>117</sup> In light of the company's desperate plight, the Prime Minister to no avail lobbied Jacques Delors then President of the European Commission to revise the decision on the occasion of his G7 trip to Paris. At this point, Bob Rae continued to actively regroup his government, Ottawa, Aerospatiale and finally, Bombardier, to salvage one of Canada's two remaining core aerospace manufacturers.<sup>118</sup>

ii. *Bailout*

On March 10, 1992, Bombardier President Laurent Beaudoin, Ontario Premier Bob Rae and the federal Industry minister announced a rescue plan. Bombardier would purchase a 51 per cent interest in de Havilland for 51 million dollars; the government of Ontario a 49 per cent stake for 49 million, and this venture would be backed by millions of dollars from Ottawa. The trilateral talks

leading to this agreement began in earnest in October when Aerospatiale the last of the two original ATR partners declined any further involvement so as to not interfere with "a Canadian solution."<sup>119</sup> What was the Canadian solution? Besides its equity position, Ontario granted Bombardier \$200 million in shareholder loans. The federal government also made commitments of 170 to 200 million dollars in export promotion, R&D subsidies and restructuring funds through the DIPP. As well, Ottawa agreed to contribute to a reserve fund administered in coordination with Ontario to protect Bombardier from financial loss over the first four years of the plan. All told, the amount of money committed by the federal and Ontario provincial governments to Bombardier to make de Havilland viable was estimated at \$600 million.<sup>120</sup>

#### E. DE HAVILLAND: A TYPOLOGY OF STATE INTERVENTION

The privatization of de Havilland was premised on the Tories' faith in the market as a primary means of achieving industrial policy objectives. Yet at the time of privatization and later when it came time to put their faith to the test, the Mulroney government intervened through a variety of policy instruments to maintain de Havilland as a strategic cornerstone of a Canadian controlled and internationally competitive domestic aerospace industry. In 1986, the Tories argued that de Havilland could not remain viable under state ownership and that the only way to restore the company's competitive health was to subject it to the rigour of the market and the expertise of private ownership. Our analysis of the divestiture shows that far from relying on the market, the Conservatives employed a number of indirect interventions to realize its policy objectives. First the government charged the CDIC to undertake a strategic analysis of which firm would be most capable of advancing its policy goals. The decision to sell de Havilland to Boeing was not a result of free

market forces such as, for example, either a public share issue or a competitive bid for assets based strictly on price. It was motivated by Boeing's capacity to strategically integrate DHC into its global financial and marketing orbit.

Secondly, the Tories attached conditions to the sale to ensure de Havilland's compatibility with the government's aerospace industry objectives after privatization. The acquisition agreement bound Boeing to maintain the company in Ontario, to grant it a world product mandate and to use tax concessions to integrate Canadian aerospace component suppliers and users into the company's manufacturing network. Finally, in the MOU, the Tories pledged to spend millions of dollars and to use policy instruments such as procurement, the DIPP, the EDP and a Crown corporation, the EDC to realize specific targets in the areas of Canadian control and participation, R&D, product innovation, exports, jobs and international competitiveness. Recall for example, the government's commitment to spend 30 million dollars through interest free DIPP loans to develop a 50 seat stretch version of the DASH-8.

The proposed resale of de Havilland to the ATR consortium revealed the folly of the Conservatives' agenda to rely on private sector companies to ensure competitive advantage for Canada in the global aerospace industry. As the federal government stood idly by in the wake of the June 1990 announcement, the Ontario NDP had concluded that should the proposed deal go through, de Havilland would end up serving the interests of a European aerospace agenda, an agenda largely directed by state policy. After forming the government later that year, it immediately signalled its intentions to intervene in favour of a Canadian solution. The federal Conservative government later arrived at the same conclusion. Ottawa now deemed DHC to be a strategic firm in a strategic industry as opposed to a continuing fiscal drain. The Industry minister employed the *IC Act* and

exploited the vagueness of the net benefit test to extract from ATR better guarantees in the areas of Canadian control and participation, product development and product innovation. The EU veto of the purchase plan put an end to further IC review and truncated the federal agency's affect on de Havilland's future similar to its direct and lasting impact on Connaught.

The EU veto also put de Havilland in the midst of financial collapse as Boeing by this time had abdicated all responsibility for the company's development. In the aftermath of the ruling, the Industry Minister began a process of downgrading expectations for further federal involvement and downloading the pressure to save the company onto the Ontario NDP government.<sup>121</sup> The Ontario government responded to this challenge by purchasing a minority equity position in coordination with Bombardier's majority stake. Yet this arrangement could not have occurred without the active participation of the federal government. Despite its blustering to the contrary, Ottawa leveraged the Ontario-Bombardier purchase by intensifying its financial involvement, committing itself to more than 200 million dollars for export promotion, R&D and corporate restructuring. These inducements were to be channelled through actors similar to those employed at the time of privatization, namely the DIPP and the EDC.

After transposing these interventions onto our typology, figure 3.2 suggests that the Conservative government implemented research and development and foreign investment policies consistent with strategic trade policy and strategic industrial policy. During both phases of our study, the federal Conservative government employed inducements through several actors to finance the development of de Havilland's products and promote their export. In an era where governments must reconcile the urgencies of economic competitiveness with the constraints of self-imposed neoliberal economic strategies, Laux accurately concludes that "the Canadian state pursues its

Figure 3.2

## A Typology of State Intervention for Competitive Advantage: De Havilland

TYPE	BEST STRATEGIC INDUSTRIAL POLICY	PORTER NEO-RICARDIANISM	REICH POSITIVE ECONOMIC NATIONALISM	TYSON (STT) CAUTIOUS ACTIVISM
NEO-LIBERAL				
MODER-ATE	<p><b>R&amp;D POLICY:</b></p> <p>Financial support for aerospace research, product development and export:</p> <p><b>STATE INSTRUMENTS:</b></p> <p>Federal Loans, Grants &amp; Subsidies through:</p> <ul style="list-style-type: none"> <li>• Acquisition Agreement/MOU</li> <li>• DIPP, EDP</li> <li>• Trilateral Purchase Plan</li> </ul> <p><b>STATE ACTORS:</b></p> <ul style="list-style-type: none"> <li>• Minister of Regional Industrial Expansion</li> <li>• EDC, CDIC</li> </ul>			<p><b>R&amp;D POLICY:</b></p> <p>Financial support for aerospace research, product development and export:</p> <p><b>STATE INSTRUMENTS:</b></p> <p>Federal Loans, Grants &amp; Subsidies through:</p> <ul style="list-style-type: none"> <li>• Acquisition Agreement/MOU</li> <li>• DIPP, EDP</li> <li>• Trilateral Purchase Plan</li> </ul> <p><b>STATE ACTORS:</b></p> <ul style="list-style-type: none"> <li>• Minister of Regional Industrial Expansion</li> <li>• EDC, CDIC</li> </ul>
DIRECT				<p><b>TRADE &amp; FOREIGN INVESTMENT POLICY:</b></p> <p>Reviewed and blocked foreign investment proposal by state controlled agents in favour of "national solution".</p> <p><b>STATE INSTRUMENTS:</b></p> <ul style="list-style-type: none"> <li>• <i>Investment Canada Act</i></li> </ul> <p><b>STATE ACTORS:</b></p> <ul style="list-style-type: none"> <li>• Federal Cabinet</li> <li>• Minister of Industry, Science and Technology</li> <li>• Investment Canada</li> </ul>

concerns for economic security in the high-technology aerospace industry through inducements rather than through restrictions."<sup>122</sup> In the DHC case, the actions of the Conservatives went beyond financial inducements and included an interventionist foreign investment policy. Boeing's proposed sale of de Havilland to the ATR group presented a scenario in which foreign governments, in this case France and Italy, employ state-owned agents to pursue national economic interests, which may include encouraging economic competitiveness.<sup>123</sup> This is a scenario which, at one extreme of STT, Tyson argues should be reviewed and, if necessary, blocked in favour of a "national solution." In the de Havilland case, the Conservative government appeared to have acted consistent with Tyson's recommendations.

## **5. Conclusions**

The Connaught and de Havilland case studies reveal that the Conservative government disregarded its *laissez-faire* principles and intervened in the market both during and after privatization. By privatizing each firm, the government pursued its ideological agenda to strengthen the market at the expense of the state. The crucial observation for our analysis is that at some point between divestiture and reintervention, the government determined that its ideological commitments to neoconservatism would not provide a sufficient basis for competitiveness in each industry. Instead the Conservatives used moderate and direct state interventions to protect and promote Canadian national champions in the global biotechnology and aerospace industries.

The case studies revealed state interventions in the form of legislative, administrative and financial tools designed to restrict foreign investment, protect jobs and encourage exports and

innovation. The Conservative government also relied on a variety of state actors to intervene in both cases. Prominent amongst these actors were the federal Minister of Industry, Science and Technology, his department and its agency, Investment Canada. In both the Connaught and de Havilland reintervention phases, the Industry Minister used the latitude of the *Investment Canada Act* to review and reject foreign investment proposals which were contrary to what the government determined were Canada's strategic economic interests in the global biotechnology and aerospace industries. The typologies from each case suggest that these interventions were consistent with R&D, foreign investment and trade policies contained in Best's strategic industrial policy model and Tyson's "cautiously activist" strategic trade theory model. We will recall from chapter two that both of these policy programs aim to promote competitive advantage through moderate and direct state interventions

While privatization, intervention and reintervention were designed to accomplish several policy and short-term political objectives, namely reducing government expenditure and saving jobs, our investigation and typologies show that state intervention was also designed to protect and promote Canadian competitiveness in each industry. We will now turn to a study of the Teleglobe privatization and assess whether or not the Conservatives' actions in that case are consistent with the observations drawn from this chapter's case studies.

## CHAPTER FOUR

### Case Study: Teleglobe Canada

#### **1. Introduction**

Our last case study focuses on the actions of the Conservative government in the affairs of Teleglobe Canada Incorporated, the "Crown jewel" of Canadian public-sector enterprises and Canada's only supplier of overseas telecommunications services. This analysis will situate Teleglobe within the transformation occurring in the global telecommunications industry and the challenges this is presenting for state policy. Besides the carriage of voice telephony services, telecommunications is increasingly about the technology of manipulating information in an interactive, automated fashion on the burgeoning, albeit amorphous "information highway."<sup>1</sup> The pace of technological innovation and the blurring of industrial lines means that telecommunications is strongly associated with knowledge-intensive investment, high-technology spillovers, high productivity and highly skilled jobs, all of the strategic possibilities which make it a globally competitive industry. As a result, states are confronted with an intriguing policy dilemma of how to foster competitive domestic telecommunications industries: through the market or through strategic intervention?

The current debate on the appropriate means of state policy in telecommunications amongst industry analysts, bureaucrats, economists and entrepreneurs pits those dedicated to the market

against those whom advocate strategic intervention. The market position is represented, for example, by two Canadian academics and industry analysts H.N. Janisch and R.J. Schultz both of whom advocate privatization of state monopolies and industry deregulation. Their argument is premised on the notion that telecommunications is an "enabling" industry which produces multiple services that firms must integrate into their corporate infrastructures as a means of competing against rivals with access to equally vast and multiple services. Therefore, firms must be allowed to possess the freedom and flexibility to choose and configure which services they require. To undermine this freedom through excessive regulation or monopoly supply is to undermine the firm's competitive position and therefore, it follows, the nation's economic competitiveness.<sup>2</sup>

An example of strategic state intervention is the European Union's ESPRIT programme, an evolving series of strategic alliances and partnerships that Lynn Krieger Mytelka argues have effectively established a European state supported telecommunications and information technology national champion.<sup>3</sup> In Canada, the former Ontario NDP government identified telecommunications as a strategic source of technological innovation and competitiveness:

Increasing productivity depends on expanding innovative activity throughout the economy. Changes in the international division of labour in the global economy create the possibility of, and needs for, a reorientation of production in Ontario toward activities that rely on continuous innovation. Comparative advantage in the past has often relied on physical endowments such as the country's resource base. By contrast, comparative advantage in technology-intensive activities can be created by firms and governments.<sup>4</sup>

Support for strategic intervention is not restricted to governments. Phil Lind, the Vice-Chairman of Rogers Communications, the Toronto-based cable television and telecommunications empire, said that the Canadian Radio-Television and Telecommunications Commission (CRTC) must grant speedy regulatory approval of its spring 1994 takeover bid for Toronto industry rival

Maclean Hunter Ltd. in order to battle "the 'menacing competition' of big phone companies, foreign multimedia conglomerates like Time Warner and so-called U.S. 'death stars' that promise hundreds of satellite channels..." In short, the Vice-Chairman of the immensely profitable but well-regulated firm said, "we need Canadian national champions."<sup>5</sup>

This chapter will analyze the privatization of Teleglobe Canada and the Conservative government's reinterventions after privatization. Similar to the case studies in the previous chapter, the goal for analysis in this case study is to determine whether or not the government's ideological commitment to neoconservatism provided a sufficient basis for competitive advantage. To identify the official view of the appropriate role of the state in fostering competitiveness in this industry, we will situate both phases of our study within the Conservative government's overall telecommunications policy. Our analysis will reveal that the government intended Teleglobe to remain a national champion and a pillar of a Canadian controlled telecommunications infrastructure and intervened through several policy instruments and state actors to accomplish this objective. A brief survey of federal policy in this industry during the Mulroney administrations will reveal that these interventions were consistent with the Conservative governments' other actions to maintain Teleglobe and other core domestic telecommunications carriers<sup>6</sup> as the strategic pillars of a Canadian owned and globally competitive telecommunications industry.

## **2. From Cash Cow to Crown Jewel**

Teleglobe began operations as the Canadian Overseas Telecommunications Corporation (COTC), a product of the 1945 Commonwealth Telecommunications Conference. Held in the

aftermath of the Second World War, as Britain took its last gasp as a colonial empire, the Conference sought to enhance telecommunications links between the members of the Commonwealth nations for both reasons of security and of averting American dominance in the provision of services. It was agreed that each member nation would acquire direct ownership of its overseas telecommunications services by means of expropriation and place the assets under the aegis of either a government department or a Crown corporation. The Liberal government of Louis St. Laurent chose the latter option and passed legislation in 1949 authorizing the COTC to purchase the Canadian assets of the Cable and Wireless, Ltd. and Canadian Marconi Ltd., both British firms.<sup>7</sup> The mandate of the COTC as contained in the original legislation was "to establish, maintain and operate in Canada and elsewhere external telecommunications services for the conduct of public communications." Although the company evolved as a de facto monopoly, this was never intended to occur. Rather, the company's monopoly evolved primarily as the result of a "gentlemen's agreement" with the domestic carriers, collectively known as the Trans Canada Telephone System (TCTS). Despite the COTC's mandate to provide telecommunications services between Canada and "elsewhere", this agreement gave the COTC the "overseas" market while the TCTS retained the lucrative North American market, thanks to the latter's long established links with American giants such as the American Telephone and Telegraph company (AT&T).<sup>8</sup> After the one other Canadian firm dropped out of the overseas market, the COTC's monopoly in this market was confirmed.<sup>9</sup>

The COTC was characterized by Schultz as a "stolid" profit maker in the initial period following its inception. The sleepy overseas market, to which the domestic carriers had relegated the COTC, changed dramatically in 1956 when TAT-1, the first long-distance multipurpose (telephone, telegraph, telex) coaxial submarine cable was laid across the floor of the Atlantic Ocean

between Scotland and Newfoundland. Competition in this market was minimal due to the structure of overseas facilities, which required agreements between two international partners to complete an international connection. These arrangements precluded any single carrier from unilateral rate cutting. These factors, combined with growing demand for international telecommunications services, created a very successful business environment for the firm. Between 1956 and 1965, the COTC's revenues increased by 900 percent.<sup>10</sup>

The subsequent period between the late 1960's and the early 1980's witnessed the advent of telecommunications satellites. When the International Telecommunications Satellite Organization (INTELSAT) was established to operate a global system, the COTC was designated as the Canadian signatory to INTELSAT's operating agreement. Schultz describes this period of technological change and growing affluence within Canadian society as one in which the COTC, renamed Teleglobe in 1975, evolved from a stolid profit maker to a veritable "cash cow." For example, in 1986, an information circular published by the Department of Communications estimated Teleglobe's annual revenues at 240.5 million dollars. Its annual profits in 1986, before privatization were estimated at 50 million dollars on an asset base of 300 million dollars with 1300 employees.<sup>11</sup>

Despite its robust performance, Teleglobe spent most of its existence as a Crown corporation unnoticed by successive governments. For example, Schultz estimates that between 1949 and 1984, MP's posed less than one question per year in the House of Commons regarding the company. Essentially, the Crown corporation remained autonomous from its political masters in Ottawa. The autonomy was never greatly challenged, even when political responsibility for the firm was transferred from the Department of Transportation to the newly created Department of Communications in 1968. In 1977, the Liberal government introduced a national

telecommunications bill which would have subjected Teleglobe to regulation by the CRTC, granted such authority in 1976.<sup>12</sup> For the first time, Teleglobe actively defended its autonomy from direct government intervention. This petition became moot as the Liberal government of the day could not get the bill past first reading in the House of Commons on three different occasions, after which it eventually died as did the Department of Communications' concern for Teleglobe.<sup>13</sup>

The degree of autonomy from government possessed by Teleglobe relative to other Crown firms is unique. The fact that it earned substantial profits and was unencumbered by the cross-subsidizing requirements of its regulated counterparts meant that the carrier could finance growth and expansion without calling upon the federal treasury. The fact that it adapted to technological change and satisfied consumer demands only reinforced this position. Ironically, it is the company's financial performance which eventually attracted the government's attention. Although Teleglobe had ceased to cause concern amongst officials at the Department of Communications, the Treasury Board of Cabinet began to argue that it was inappropriate for Teleglobe to earn substantial profits while retaining exclusive control over their use and that it no longer possessed any public policy purpose other than fulfilling the treaty obligations of a defunct international organization. In response to mounting criticism, Teleglobe began to pay a dividend of 3.8 million dollars to the federal government, and did so annually from 1980 until 1984 when the CDIC, to which Teleglobe became a subsidiary in 1983, opted against a dividend as the money would have gone to the government's coffers at the expense of the Crown holding company. Regardless, instead of keeping the so-called Crown jewel on display, the new Conservative government decided to get what it could for it.<sup>14</sup>

### 3. Privatization

#### A. 1985 POLICY ASSUMPTIONS AND GUIDELINES

The October 1984 announcement that Teleglobe, along with the other assets of the Canada Development Investment Corporation (CDIC), would be privatized was followed by intense jockeying within the new Cabinet for control over this case and of the Tories' privatization program itself. This is largely attributed to the intentions of the Minister then responsible for the CDIC, Sinclair Stevens. It is widely alleged that Stevens' goal in announcing the divestiture of the CDIC so soon after the Conservatives came to power was to preempt control of the privatization agenda from his Cabinet colleagues. Nonetheless, other players, notably the Minister of Communications, Marcel Masse, and the Bureau of Competition Policy, became quite involved in Teleglobe's privatization process. Each of these actors and their bureaucratic constituents possessed strong policy positions concerning the sale and debate ensued within Cabinet.

On August 1, 1985, almost a year after the original announcement, the government announced that it was "proceeding immediately with the privatization of Teleglobe Canada" and called for "final proposals" from prospective purchasers. A set of "Policy Assumptions and Guidelines" setting out "the general direction for government policy with respect to Teleglobe" accompanied the announcement. These guidelines contained the following provisions:

- i. Teleglobe would remain a separate entity from its shareholders.
- ii. CRTC approval will be required for the subsequent transfers of control and/or future disposition of the substantive assets or business undertakings of Teleglobe.
- iii. Non-resident ownership will be restricted to a minority position (e.g. 20 percent) with the CRTC empowered ... " to approve or disallow the transfer of effective control to foreign interests."

- iv. Single Interface Policy: Teleglobe will continue to be the only carrier to receive cable landing and earth station licenses for the purpose of Canadian-overseas telecommunications. This policy would be in effect for five years.<sup>15</sup>

Critics charge that the preliminary guidelines did not satisfy any outstanding policy issues. With regard to Teleglobe's monopoly status, the five year "single interface policy" did not provide any clear direction as to the government's long term intentions. More importantly, the Tories gave no indication as to whether the temporary monopoly status meant that domestic carriers would be compelled to route their overseas traffic directly through Teleglobe. The absence of direction in this area of concern raised serious questions amongst bidders as the domestic carriers were essentially Teleglobe's only customers. Secondly, if Teleglobe were to remain a monopoly for however long, it would require some form of rate regulation. The guidelines did not indicate what format regulation would take. They simply noted that subsequent regulation would be commandeered by the CRTC and asked those interested to submit bids based on a traditional rate base/rate of return format and on a price regulation not tied to return on equity scenario. With regard to the role of the domestic carriers, the August 1985 guidelines provided no guidance at all.<sup>16</sup>

The contents of the 1985 guidelines and the debates which ensued are evidence of a struggle between two visions within the Conservative government concerning industrial policy in the telecommunications sector.<sup>17</sup> The first, championed by the Industry Minister, envisioned open competition. The second, strongly supported by the Department of Communications, envisioned a Canadian-owned and controlled telecommunications sector. These positions are best exemplified in the debates over Teleglobe's monopoly status and over ownership. With regard to the monopoly and regulation issues, Stevens and the federal Bureau of Competition Policy did not consider

regulation necessary as it was assumed that Teleglobe would naturally lose its de facto monopoly in what would be a competitive market for external telecommunications services. The only question which loomed large in Stevens' opinion was that of domestic ownership. Supported by the Competition Bureau, he argued that ownership by domestic carriers must be blocked in order to reduce corporate concentration and increase competition.<sup>18</sup> The Department of Communications (DOC) in the person of Marcel Masse launched a counter-assault on the monopoly question. Masse argued that a monopoly backed by control measures must be maintained in order to prevent domestic carriers from by-passing Teleglobe and rerouting overseas services through other, namely American, carriers and facilities. To this extent, the DOC argued that ownership by the domestic carriers was necessary to provide them with the economic incentive to respect Teleglobe's monopoly. The decision to extend Teleglobe's monopoly or "single interface" policy was therefore a compromise. However, it was a compromise to which Stevens had to accede as it became evident that if competition in the Canadian overseas market were allowed and the phone companies were able to go elsewhere, Teleglobe could be reduced from a cash cow to a "white elephant."<sup>19</sup>

The August 1985 guidelines intended that the privatization would be completed by the end of the year. However the issues of domestic and foreign ownership lodged the Cabinet in a quagmire until November, 1986. With regard to domestic ownership, the respective positions were clear. Stevens and the Bureau of Competition favoured as little as possible while Masse and the DOC, according to Schultz, "almost single-mindedly" advocated for Telecom Canada to acquire effective control of Teleglobe. The question of foreign ownership appeared equally problematic. While there appeared to be a consensus on the degree to which non-residents could participate (up to 20 percent), the same could not be said for foreign *carriers*. In coordination with his Canadian control position,

Schultz describes how Masse was furious over the Cabinet's apparent willingness to treat bids from foreign-owned companies as equal to those of the domestic companies. In order to press his point, Masse enlisted the support of his provincial colleagues who in turn expressed serious concerns over the possibility of a foreign owned Teleglobe. In order to press his point further, Masse engaged in a number of stalling tactics which, combined with general dissatisfaction for the bids received, delayed the privatization of the company even further.<sup>20</sup> At an impasse, the Mulroney Cabinet underwent a significant reorganization. Sinclair Stevens succumbed to conflict of interest allegations and resigned his post while Flora MacDonald replaced Marcel Masse as Communications Minister.<sup>21</sup> Meanwhile, the earlier confusion surrounding the administration of the government's privatization program had been resolved somewhat with the appointment of Barbara McDougall the Minister of State Responsible for Privatization and Regulatory Affairs.<sup>22</sup>

## B. 1986 POLICY GUIDELINES AND DIRECTIVES

With new ministers in place and the government bogged down in the questions of monopoly, regulation, domestic and foreign ownership restrictions, a new set of policy guidelines were developed and new bids called for. On November 19, 1986, the Privatization and Communications Ministers announced that "the Government of Canada will be proceeding with the final bidding stage in the privatization of Teleglobe Canada"<sup>23</sup> and released two more documents listing the terms and conditions of sale which bidders were required to meet and live with. Neither of these directives appeared to resolve the ongoing policy debate in cabinet concerning the relevancy of the market versus the state as the primary agent of industry organization. On the one hand, the two ministers declared that "Crown ownership of Teleglobe was no longer necessary to achieve a public policy

purpose" and that private ownership would mean that "Canadian taxpayers will benefit through the government's ability to free-up taxpayers' capital for priority initiatives." The ministers also concluded that privatization would also mean that "Teleglobe will be better positioned to sustain and expand its status as a world-class Canadian-owned telecommunications company."<sup>24</sup> On the other hand, the same documents also declared that "Teleglobe occupies a position of strategic importance within the Canadian telecommunications industry, providing our principal communications links with the world outside North America." Therefore, "it is in Canada's national interest that telecommunications services between locations in Canada and from Canada to other locations shall, to greatest extent feasible, be provided over Canadian owned and controlled facilities."<sup>25</sup> The conditions governing the sale and the behaviour the government expected of Teleglobe under private sector ownership appear to reflect the state control arguments championed by Marcel Masse. For example, the policy document informs bidders that government will exercise its existing powers under the *Radio Act* and the *Telegraphs Act* to ensure Teleglobe's initial five year "exclusive mandate", or monopoly. The policy document also confirms that once privatized, Teleglobe would be designated as a company within the meaning of the *Railway Act* and the *National Transportation Act*, thus subjecting it to direct regulation by the CRTC. The government would rely on the regulatory authority of the Commission, specifically its authority to approve carrier connecting agreements, to ensure that "consistent with the government's long standing policy favouring the carriage of Canadian domestic and international telecommunications traffic on Canadian facilities, overseas services originating or terminating in Canada are routed via Teleglobe facilities. . . ." In other words, the domestic carriers would not be able to by-pass Teleglobe without the CRTC's approval. In the off-chance the Commission did not tow the line, the government drew bidders

attention to section 64.1 of the *National Transportation Act* which granted the Governor-in-Council, the federal cabinet, the authority to vary or rescind any CRTC order or decision. These powers, the government stated in the document, will be used "to ensure that regulatory decisions affecting the mandate or responsibilities of the company are consistent with government policy."<sup>26</sup>

The conditions governing the firm's post-privatization ownership structure reflected a compromise between the two competing visions but tilted decidedly in favour of the state control option. Restrictions were placed on both domestic and foreign ownership. Domestic carriers would be permitted to purchase up to 40 percent of the company which would be reduced to 33 1/3 percent after an initial share offering. The government declared that domestic ownership will be restricted "to prevent [Telecom Canada carriers] from having effective control now or in the future." With regard to foreign ownership, non-resident ownership would remain at a twenty percent maximum while non-resident carriers "will be excluded from Teleglobe's ownership now or in the future." In addition, CRTC approval would be required to transfer effective control of the company's substantive assets. Finally, the government informed potential bidders that "Teleglobe cannot be amalgamated or wound up without legislative approval."<sup>27</sup> In summary, these documents confirm that the Conservative government intended Teleglobe to assume an economic policy role after privatization. This role was a strategic link in a Canadian-owned, internationally competitive telecommunications infrastructure. It is also clear that the Tories structured the privatization to effectively ensure that the state could intervene, directly or indirectly, to realize this policy objective.

On February 11, 1987, two years and four months after the original announcement, Barbara McDougall announced that a letter of Intent had been signed between the government and the heretofore little known Memotec Data Inc. of Montreal. Memotec was an international data

communications and data processing company which designed and manufactured hardware and software for transmitting information between computers over telecommunications lines. The firm was controlled by venture capitalist Gordon Baker, founder of Memotec's original parent, Innocan Inc., and more notably, Altamira Capital Corporation. Laux' research reveals that Memotec's investors also included federal and provincial Crown corporations: Air Canada (since privatized), Canadian National Railways, the CBC, Ontario Hydro, the Caisse de Dépôt and the Société générale de financement (SGF), each acting through their pension funds.<sup>28</sup> After Baker took a controlling interest in Memotec in 1984, it established a pattern of swallowing firms in the same industries much larger than itself and, according to industry analysts, managing their growth successfully. Memotec's pursuit and purchase of Teleglobe is a case in point. For example, in 1986 Memotec earned only \$11 million on revenues of \$57 million, while, for the same year, Teleglobe had earnings alone of \$63 million on revenues of \$813 million.<sup>29</sup>

The competitors Memotec went up against and ultimately beat included the carriers of Telecom Canada, Power Corporation, First City Financial Corp., Inter-City Gas Corporation, a joint Spar Aerospace and Caisse de dépôt et de placement du Québec bid and a bid backed by Gordon Capital of Toronto. Regardless, backed by the National Bank of Canada and Bay Street investment firms, Baker convinced CDIC president Paul Marshall that Memotec could leverage what turned out to be the highest bid. Memotec agreed to pay a total of 608.3 million, of which 488.3 was cash, 102 million in accumulated cash in Teleglobe, and a special dividend payable at December 31, 1987.<sup>30</sup> Announcing the sale, the privatization Minister said "the Memotec-Teleglobe alliance will result in an exciting, new Canadian-owned telecommunications company" and then committed the government to enacting the necessary divestiture legislation.<sup>31</sup> Bill C-38, the legislation governing

the reorganization and divestiture of the Crown's interest in Teleglobe institutionalized each of the 1986 conditions of sale, with the notable exception of the company's monopoly status, and received Royal Assent on April 1st 1987. The legislation also conferred upon Cabinet the extraordinary authority to issue "a directive to the new corporation with respect to any matter relating to the security, the foreign policy or the international telecommunications policy of Canada."<sup>32</sup> Although privatization formally shifted ownership from the public to the private sector it did not promote market competition in the international telecommunications market as the as the government allowed the company to maintain its monopoly status for at least five more years. Rather, the privatization policies and legislation confirmed Teleglobe's role as a pillar of a Canadian-owned and controlled telecommunications infrastructure.<sup>33</sup>

### **3. Post Privatization: Industry Transformation and Deregulation**

Now a privatized monopoly, Teleglobe had to contend with a number of new challenges, namely corporate infighting<sup>34</sup> and, for the first time in its forty year history, direct regulation by the CRTC.<sup>35</sup> Yet technological transformation within an increasing environment of industry deregulation presented the largest challenges following privatization. Innovation and deregulation were caused by, and in turn fostered, lowering prices, vicious competition and tremendous growth in international markets amongst a host of competing firms in products and services, particularly in the provision of public long-distance services, estimated to be worth 450 billion dollars in 1991.<sup>36</sup> By 1992, many nations had fully embraced competition and deregulation in their telecommunications sectors, eschewing stated owned monopolies. Privatization and deregulation

commenced in the U.S. and the U.K. inspired similar moves in Sweden, New Zealand and Australia. On June 12, 1992 the CRTC decided in favour of Unitel Communications' application to compete against Bell and the British Columbia Telephone Company (B.C. Tel) opening the Canadian domestic public long-distance market to competition.<sup>37</sup> However, a brief review of Conservative telecommunications policy reveals that, similar to federal policy in the airline industry,<sup>38</sup> limited deregulation occurred only after policy decisions guaranteed a Canadian-owned and internationally-competitive infrastructure in which Teleglobe and the other core carriers would play an intrinsic role.<sup>39</sup>

Upon coming to power in 1985 and most significantly under the tenure of Marcel Masse as federal Minister of Communications, the Conservatives' telecommunications policy is marked by a commitment to the principles of universal access to affordable telephone services and a concern for regional interests in the formulation of federal policy. In both June of 1985 and October 1986, the Minister and his provincial counterparts "agreed to give priority to maintaining universal access to affordable telephone services for all Canadian consumers."<sup>40</sup> At the same time, however, federal communications policy makers were being pushed by other bureaucratic and industry actors to move away from social outcomes and begin focusing on efficiency and competitiveness outcomes. For example, in August of 1985, the CRTC rejected CNCP Telecommunications' application to compete against Bell and B.C. Tel in the public long distance market. This decision simultaneously ruled out competition in the immediate future, but opened the door to a discussion of the possible benefits that competition could bring. The Commission wrote that competition would offer greater customer choice, greater supplier responsiveness and accelerate the diffusion of new technology. The CRTC appeared to believe that competition would lower consumer rates compelling suppliers to increase

productivity and reduce costs which would further cause rates to decrease. These effects in turn "would have a positive impact on the performance on the Canadian economy as a whole." The Commission simply decided that CNCP's proposal at that time "would not yield the expected benefits."<sup>41</sup>

In July of 1987, Communications Minister Flora MacDonald released a document entitled "A Policy Framework for Telecommunications in Canada." The policy paper addressed the rapidly changing technological environment, caused in large part by the merging of telecommunications and computer, digital-based technologies. Information technology was radically altering the way businesses operated and competed around the globe and was evolving quicker than the capacities of regulated monopolies to adapt. The Communications Minister stated that the "fundamental objective" of federal communications policy and regulation was to: "Ensure that an efficient, internationally competitive telecommunications infrastructure exists in all areas of Canada sufficient to support the economic and social development of Canada and its regions." In order to sustain these objectives the federal government had to reform its regulatory policies. The paper also indicated that regulatory reform in search of industrial innovation and economic growth would be consistent with the federal government's "longstanding view that domestic ownership of Canada's telecommunications infrastructure is essential to national sovereignty and security."<sup>42</sup>

The policy framework's regulatory reform proposals focused on two thrusts: creating a dynamic national market for suppliers of telecommunications services and equipment; and fostering a cost-effective network infrastructure to deliver these services. To this extent, the Minister proposed that carriers be classified as either Type I or Type II carriers. Type I carriers were the large companies such as Bell, which owned network infrastructure and offered the most lucrative and

advanced services. Type II carriers were the resellers or "middlemen" which leased or purchased bulk lines and specialty services from the Type I carriers and sold them to customers at discount rates. The government proposed that competition amongst Type II carriers should be enhanced while existing Type I monopolies should be maintained for the present time. The Minister also proposed that "effective Canadian ownership and control" of no less than 80 percent of Type I carriers was central to any policy of deregulation and competition of this sector in the future. According to the Minister of Communications, "the implementation of these measures is intended to encourage the rapid growth of innovative and competitive new telecommunications services . . . and to ensure that such services are implemented. . ." through the network facilities of domestically owned and controlled Type I carriers.<sup>43</sup>

The 1987 policy statement's strategic thrusts were transcribed into the *Telecommunications Act* which Parliament passed on June 23, 1993 and came into force on October 25, 1993.<sup>44</sup> The *Act's* primary objective is to modernize the legal and regulatory framework for all federally-regulated telecommunications carriers.<sup>45</sup> Besides modernization, the *Act* aims to reduce the role of regulation in the market. For example, one of the *Act's* stated objectives as listed in section seven is "to foster the increased reliance on market forces for the provision of telecommunications and to ensure that regulation, *where required* [author's italics], is efficient and effective." Secondly, as much as the *Act* grants the CRTC "a full range of regulatory powers of an independent, quasi-judicial regulatory agency"<sup>46</sup>, section 34 also instructs the Commission to forbear from regulation where it determines it to not be necessary. The Minister of Communications believed that a more coherent and flexible regulatory framework would support the 1987 priorities of equity and accessibility, economic competitiveness and regional economic and social development.<sup>47</sup>

Besides regulatory flexibility, the Act also aims to promote telecommunications as a strategic industry. Reminiscent of Marcel Masse's Canadian solution for Teleglobe six years earlier, Perrin Beatty said in 1992 that the goal of Bill C-62 was:

To maintain and increase the competitiveness of Canadian telecommunications, domestically and internationally, to promote Canadian ownership and control of telecommunications common carriers, and to guarantee Canadians access to reliable and affordable telecommunications services.<sup>48</sup>

Each of these goals are policy objectives guiding the application of the *Act*.<sup>49</sup> For example, section 7(c) states that one objective is "to enhance the efficiency and competitiveness, at the national and international levels, of Canadian telecommunications". In addition to less regulation, sections seven (d) and (e) also commits the cabinet to "promote the ownership and control of Canadian carriers by Canadians" and to "promote the use of Canadian transmission facilities for telecommunications within Canada and between Canada and points outside Canada."<sup>50</sup> Consistent with the 1987 policy statement, section 16 of the *Act* states that a common carrier (Type I carriers) is eligible to operate in Canada if it is a Canadian-owned and Canadian-controlled corporation. These criteria are defined in section 16(3) as no less than 80% of Canadians on the company's board of directors and no less than 80% of the company's voting shares owned by Canadians and that "the corporation is not otherwise controlled by persons that are not Canadians."

The CRTC is not authorized to grant a company a Canadian operating license unless the Canadian ownership and control conditions listed above in section 16(3) are met. Section nine of the *Act*, however, newly empowers the CRTC to exempt any company from the statute's application. As a check on this authority, section eight grants the federal cabinet the authority to order directives to the CRTC on "broad policy matters with respect to the Canadian telecommunications policy

objectives". Just to make sure, the cabinet retains its authority, by order, under section 12, to "vary or rescind the decision or refer it back to the Commission for reconsideration. . . ."

The *Telecommunications Act* consolidates the Canadian state's authority to directly intervene in the market to ensure, amongst other policy objectives, competitiveness and Canadian ownership and control of domestic telecommunications facilities.<sup>51</sup> Our analysis up to this point is meant to indicate that the Conservative government structured the Teleglobe privatization consistent with these evolving policy objectives. By allowing the firm to maintain its monopoly on the provision of overseas long distance services for five years and by legislating foreign ownership restrictions, CRTC regulatory authority and retaining Cabinet's authority to issue directives to both the firm and the Commission, the government aimed to position Teleglobe as a strategic pillar in a globally competitive, Canadian owned and controlled telecommunications industry. For example, the increasing availability of competitive services from American and British telecommunication carriers provided an incentive for Canadian resellers to reroute overseas traffic through American facilities, and therefore indirectly benefit from international competition and deregulation. This practice clearly contravened the exclusive mandate policy conferred upon Teleglobe and was exactly what the Tories had sought to prevent when designing privatization legislation. The CRTC, empowered by the government to enforce the exclusive mandate, ordered resellers to stop routing customers' overseas calls through American facilities or face the possibility of losing their connections and compensating Teleglobe for lost revenue. As a result, resellers considered that it was "no longer in their interest" to bypass Teleglobe, even though it might mean higher consumer prices.<sup>52</sup>

#### 4. Reintervention

Regulation, policy guidelines and legislation ultimately provided Teleglobe the protection it required to become an efficient and lucrative national champion. Between 1987 and 1992 the company cut its rates by 40 per cent. In 1991 it established the GlobeDirect service which not only improved customer service but reduced the cost of an overseas call from \$1.45/minute to \$1.05. In March of 1992, Teleglobe aggressively expanded this service, adding eight more cities to its "points of presence" network, further eliminating Bell and other designated carriers from the overseas revenue stream and passing the savings on to the consumer.<sup>53</sup> Teleglobe was also able to compete against international carriers in order to retain its share in the lucrative cross-country market. It did this by entering into negotiations with Call-Net Communications Ltd. of Toronto, in order to recapture "transit traffic" from American carriers on a price competitive basis. Transit traffic is the North American portion of a call that originates in Germany, for example, and terminates in Japan. The revenue from this service is crucial to Teleglobe. In 1990, it accounted for approximately 12 percent of Teleglobe Inc.'s revenues growing at 7 percent annually, slightly faster than the firm's total revenues.<sup>54</sup> In 1991 Teleglobe Inc. posted solid earnings of 25.7 million, partly due to "unexpectedly strong profits from subsidiary Teleglobe Canada Inc." This figure tripled the previous year's figure but was well below the 48 million achieved in 1987 when Teleglobe was unregulated. Finally, the firm planned to invest 830 million between 1992 and 1995 in its network infrastructure, contributing greatly to Canadian research and development.<sup>55</sup> These facts and figures suggest that Teleglobe was an efficient, competitive monopoly.

Nonetheless, in anticipation of the approaching five year deadline, the battle to end Teleglobe's monopoly had been engaged. In a brief presented to the CRTC hearings investigating Teleglobe's future regulatory status in 1991, the Canadian Business Telecommunications Alliance argued unequivocally that the company's monopoly status must go. Instead, the CBTA argued that Teleglobe should "welcome the challenge to performance and pricing that comes with increased competition and should concentrate on expanding its customer base by competing fairly through better service and price".<sup>56</sup> Bell's parent, Bell Canada Enterprises argued that Teleglobe was not big enough to service Canadian demand in the overseas market competitively. Advising the CRTC that BCE had been approached to take part in joint ventures for undersea cables, Jean Monty, then Chief Executive, told the Commission, "Teleglobe is not strong enough as a company and is not large enough to take part."<sup>57</sup>

For its part, Teleglobe challenged the arguments for deregulation by citing the improvements it had made in services and the rate reductions which had occurred since it was privatized. In regard to BCE's position, Teleglobe argued that a fragmented Canadian market would not provide any benefit to Canadian consumers due to the high costs of maintaining a network and infrastructure. Rather, perhaps for the very reasons cited by its antagonist, BCE, Teleglobe argued that Canada requires a strong monopoly which can invest in network infrastructure and be in a dominant position to negotiate competitive rates amongst its overseas counterparts, and therefore pass the savings along to consumers. Terrence Corcoran, the dogmatic business columnist for the *Globe and Mail*, characteristically rejected Teleglobe's position. He wrote that the strong monopoly argument is an industrial policy "snow job" and argued that Canadians would prefer open competition, which provides benefits today rather than a strategy which will allow the teleccmmunications companies

to compete "in some mythical environment in the year 2005."<sup>58</sup> Thus, as the government contemplated Teleglobe's status in winter 1992, it was once again confronted with two distinct visions of the state and its role in fostering economic competitiveness: to either let the market decide or to intervene.

On March 18, 1992 the Minister of Communications, Perrin Beatty, announced that the Government decided to extend Teleglobe's "single interface policy" and exclusive mandate for another five years, subject to review after 3 years. In his speech to Teleglobe employees in Montreal, the Minister said:

Telecommunications is one of the major sectors in the Canadian economy . . . . In the present context, it seems absolutely necessary to maintain Teleglobe's exclusivity for overseas communications, both to preserve Canada's position in the world market and to support economic recovery in the Montreal Area.

Consistent with their revised telecommunications industrial policy, the Conservatives' decision to extend the monopoly recognized Teleglobe as a strategic tool for economic development. For example, Beatty noted that the company had committed 200 million in R&D to be carried out in Quebec over five years. Secondly, Canadian sovereignty in telecommunications could not be ensured unless Canada maintained nationally owned and operated facilities. Specifically, the Minister said that the present "high level of competition in the world market" required one dominant player to negotiate with foreign administrations to provide efficient and effective services. To not extend the monopoly, the Minister explained, would be to fragment the Canadian market for overseas services and to sacrifice the goals cited above.<sup>59</sup> Finally, the Minister said, "the only way Canada can be strong in the international telecommunications market is to have one company sending Canadian phone signals to Europe, Asia and other parts of the world."<sup>60</sup> According to

Beatty, extending Teleglobe's monopoly was "essential for Canadian sovereignty and to enable Canadian players to compete internationally."<sup>61</sup>

For his part, Charles Sirois had trouble deciding how he was happiest. Said the President of Teleglobe, "I am most satisfied by today's decision as a businessman, an employee, a major investor in Teleglobe, a Canadian, a Québécois and a Montrealer." Multiple identities aside, Sirois said the extension will allow Teleglobe to go ahead and invest in its network and therefore offer lower prices and meet the competition emanating from everywhere, but especially from the U.S. Specifically, the extension will permit Teleglobe to lower its international communications rates, "boost service and gain an edge in a world market that is becoming more deregulated and, as a result, more competitive."<sup>62</sup>

## **5. Teleglobe: A Typology of State Intervention**

Consistent with our findings in the Connaught and de Havilland case studies, our review of the Teleglobe privatization shows that the government intended to regulate the company's behaviour following divestiture and intervened through a number of instruments and actors to accomplish policy objectives. Using the typology developed in chapter two, figure 4.1 summarizes the means of intervention observed in this case study. During the privatization phase, Cabinet directives and legislation were used to protect the privatized company from any domestic or international competition, primarily through imposing restrictions on foreign ownership, maintaining the firm as

Figure 4.1

## A Typology of State Intervention for Competitive Advantage: Teleglobe Canada

TYPE	BEST STRATEGIC INDUSTRIAL POLICY	PORTER NEO-RICARDIANISM	REICH POSITIVE ECONOMIC NATIONALISM	TYSON (STT) CAUTIOUS ACTIVISM
NEO-LIBERAL				
MODERATE				
DIRECT	<p><b>TRADE &amp; FOREIGN INVESTMENT POLICY:</b> Protected and promoted Teleglobe and Canadian telecommunications industry through federal legislation, regulation and Cabinet directive and perogative</p> <p><b>STATE INSTRUMENTS</b></p> <ul style="list-style-type: none"> <li>• <i>Teleglobe Reorganization Act</i></li> <li>• <i>Telecommunications Act</i></li> <li>• <i>National Transportation Act</i></li> <li>• <i>Radio and Telegraphs Act</i></li> <li>• 1985 &amp; 1986: Cabinet Policy Guidelines and Directives</li> <li>• 1992: Cabinet/Ministerial Perogative on monopoly</li> </ul> <p><b>STATE ACTORS</b></p> <ul style="list-style-type: none"> <li>• Federal Cabinet</li> <li>• Minister &amp; Dept. of Communications</li> <li>• Minister of Regional Industrial Expansion</li> <li>• Minister Responsible for Privatization &amp; Regulatory Affairs</li> <li>• CRTC</li> </ul>			

a monopoly, and by subjecting it to CRTC regulatory authority to enforce the monopoly. In 1992, the Cabinet and Minister of Communications used executive discretion to extend Teleglobe's monopoly for another five years. Finally, the *Telecommunications Act*, passed in 1993, consolidated the federal government's ability to use state intervention to accomplish stated policy objectives, including Canadian competitiveness in the telecommunications industry. Each of these interventions correspond to Best's concept of strategic industrial policy which provides for a program of state intervention designed to protect and promote strategic industries.

## **6. Conclusions**

Consistent with our findings in Chapter Three, the Teleglobe case study shows that the Conservative government ignored its ideological commitment to *laissez-faire* market competition and intervened in the market both during and following privatization. Once again, the decision to privatize Teleglobe reflects the government's stated faith in the market as the principle means to realize economic policy objectives. The policies designed to protect the firm following privatization concede an apparent belief on the Conservatives' part that state intervention was required to promote national competitiveness in the strategic telecommunications industry, despite ideological commitments to the contrary. The decision to extend Teleglobe's monopoly in the provision of overseas telecommunications industry confirms that the company had evolved from being a Crown corporation void of any reasonable public policy purpose to a strategic link in an internationally competitive and Canadian-owned and controlled industry. If the company was apparently so crucial to the nation's economic health, why was it privatized in the first place? We conclude that the

response to this paradox resides in the government's struggle between ideological faith in the free market and the imperatives of global competition. We have argued that when confronted with the latter, the free market will not help national government's create competitive advantage in innovation-driven industries and that state intervention is required to achieve this objective. In the case of Teleglobe, our study reveals that consistent with its overall policy to create competitive advantage in the telecommunications industry, the Conservative government intervened in the market during and after privatization, to maintain Teleglobe as a strategic element in a Canadian-owned and globally competitive telecommunications industry. We will now assess whether or not these findings and the findings from the case studies in chapter three support our central argument.

## CHAPTER FIVE

### Conclusions: Beyond Competitiveness

#### **1. Introduction**

This thesis has been devoted to investigating the role of the state in the new world economy. We set out to demonstrate that neoconservatism, and in particular, ideological adherence to the free market, is not a sufficient basis for economic competitiveness and that state intervention is required to ensure competitive advantage. After relying upon leading new theories of competitiveness to support the central hypothesis, we applied it to Canada under the neoconservative administrations of Brian Mulroney and the Progressive Conservative Party from 1984 to 1993. We examined the Conservative government's policies with specific reference to three case studies involving innovation-industries. In the course of our analyses, we observed that despite an ideological commitment to a *laissez-faire*, neoliberal agenda, the government intervened during privatization and after in an effort to ensure Canada's economic competitiveness in each of the industries concerned. In this chapter we will summarize the previous four chapters' observations. This review will lead us to confirm the study's hypothesis concerning the role of the state in the global economy.

## 2. A Positive State in the New World Economy

In Chapter One, we broadly surveyed the transition from the liberal international economy to the new world economy and established our argument concerning the role of the state in this new order. We observed that globalization and technological innovation increasingly challenged fordist/Keynesian economic development strategies and forced governments in the industrial West throughout the 1970's and 1980's to reassess state interventions in pursuit of prosperity. In response to the crisis which accompanied this period of transition, we argued that neoconservative regimes in industrial democracies aimed to retrench the state in the economy rather than readjust state interventions in a manner consistent with the new realities of global competition. In opposition to the neoconservative ideology of free markets and *laissez faire* capitalism, we argued in chapter one that globalization requires states to pursue competitive advantage and that state intervention may help governments to achieve this objective.

Selecting Canada as our state of reference, we used chapter one to demonstrate that the federal Conservative governments of Brian Mulroney sought to implement a neoconservative agenda in Canada throughout the 1980's and into the 1990's. We cited the government's commitment to deficit reduction, liberalized trade, deregulation, the institution of a liberal foreign investment regime, federal tax reform and a program to privatize federal Crown corporations. While we observed that the government was forced to reexamine state interventions in the face of a growing fiscal crisis, we cited the government's own words to demonstrate that each of these initiatives were consistent with prevailing reliance upon free markets as opposed to a non-doctrinaire program to retain the viability and legitimacy of the Canadian state. Our survey of the Conservative

government's agenda from 1984 to 1993 led us to conclude that it aimed to strengthen the market at the expense of the state and ensure the centrality of the free market as the driving force behind Canada's economic competitiveness.

We devoted chapter two to a survey of classical comparative advantage theory and four leading theories of competitiveness to establish support for the main hypothesis. This survey revealed that national economic specialization in the new world economy resides in competitive advantage and that contrary to classical comparative advantage theory, the state can intervene in the market to achieve competitive advantage. After a brief survey of classical comparative advantage theory, we employed Schumpeter's theory of "creative destruction" to counter the notion of production, trade and commerce as a function of the price mechanism, subject to the classical law of marginal costs. Schumpeter's analysis provided us with enough evidence to suggest that firm production and specialization do not necessarily reside within the market but in the capacity to coordinate strategic resources. Drawing upon Schumpeter's analysis, our survey of the new competitive theories provided a theoretical basis on which to argue that national economic specialization does not result from a comparative factor cost advantage but from the economy's capacity to support innovation in order to make its firms and workers more competitive than firms and workers in other economies. All four theories of competitiveness argued that innovation does not adhere to the laws of the market, but relies upon strategy and coordination, processes which to varying degrees require state intervention.

Besides the consensus on the intent of state intervention to develop competitive advantage, the survey revealed that each of the theories differed on the means of intervention to accomplish this goal. In chapter two we developed a typology of state intervention to capture the differing economic

policy agendas and match them against our analysis of the Canadian government's privatizations. The typology revealed several areas of policy governments may employ to foster competitive advantage including research and development and innovation policies, foreign investment policy, trade policy, macroeconomic policy, competition policy, privatization and deregulation, industrial policy and social policy. The typology revealed variations concerning which of the broad policy instruments governments should assemble and the degree to which they should be employed. For example, Porter's competitive advantage program included a liberal foreign investment policy, a conservative macroeconomic policy, a relatively moderate R&D policy and a liberal competition policy which included privatization and deregulation. Reich concurred with Porter that free markets will promote national and global prosperity so long as nations' citizens possess the capacity to add value to global markets. Contrary to Porter, Reich therefore proposed a series of moderate interventions accompanied by a directly interventionist program of public investment. Best's strategic industrial policy program and Tyson's strategic trade theory program rejected Porter's neo-Ricardian tendencies and argued that the state must protect and promote national industries and firms to foster competitive advantage. These latter two programs included a moderate R&D policy and directly interventionist trade and foreign investment policies. The theoretical survey and typology developed in chapter two supported our argument that state intervention is required to either create or protect competitive advantage in the new world economy. In chapters three and four, we set out to test our general hypothesis.

The next two chapters proceeded to observe the actions of a government ideologically committed to neoconservatism in response to the challenges posed by globalization through an analysis of one particular area of neoconservative policy -- privatization. In particular, we analyzed

the Conservative government's privatizations and subsequent interventions into the affairs of Connaught Laboratories and by consequence its holding company, the Canada Development Corporation, as well as de Havilland Canada and Teleglobe Canada. Each of these firms and industries possessed different characteristics. For example, Teleglobe provides an example of federal regulation to achieve industrial policy objectives; de Havilland was directly owned by the Crown as was Teleglobe while Connaught was indirectly owned and involved state holding companies. However, each of the three firms possessed similar characteristics directly relevant to this study's investigation. Each of these firms was once a federal Crown corporation and is in a globally competitive industry -- respectively, biotechnology, aerospace and telecommunications. Each of these industries and the firms within them are associated with knowledge-intensive investment, high productivity, highly skilled jobs and render technologically innovative economic spillovers. The privatization of each firm was consistent with the government's plan to create competitiveness by strengthening the market at the expense of the state in Canada. The analyses therefore provided a broad opportunity to test whether or not the Conservatives' ideological commitment to neoconservatism provided a sufficient basis for economic competitiveness. In each of the three case studies, we observed that the federal government disregarded its commitment to a *laissez-faire*, neoliberal economic agenda and chose to intervene in the market both upon privatization and after.

In each of the case studies, it is possible that intervention may have responded to immediate political circumstances and the nature of the industry concerned rather than strategic policy goals. For example, the decision to renew Teleglobe's monopoly in March of 1992 may have been motivated by the Mulroney government's wish to appease Montreal and Quebec voters in the

aftermath of the failed Meech Lake Constitutional Accord and in the run-up to a national referendum on the Charlottetown Constitutional Accord. Nonetheless, our case studies reveal a consistent pattern which suggests that the Conservative government was compelled to react to the imperatives of global competition and intervened with the intention of securing competitive advantage in each of the industries concerned. The typology of state intervention employed in each case study revealed that the Conservative government employed R&D, foreign investment and trade policies consistent with Best's strategic industrial policy program and Tyson's strategic trade theory program of "cautious activism."

These interventions were designed to protect and promote strategic Canadian firms in innovation-driven, knowledge-intensive globally competitive industries. In the Teleglobe and Connaught cases, the federal government enacted legislation to restrict foreign ownership of corporate assets. In the Connaught and de Havilland cases, the federal cabinet employed its authority under the Investment Canada Act to intervene after privatization to extract commitments from foreign-owned purchasers concerning world product mandates, R&D, jobs, product innovation, investment and Canadian control and participation. In the de Havilland case, the Conservatives also employed strategic analysis, legal and voluntary agreements, millions of dollars in procurement arrangements, tax incentives, financial leverage and bail-outs to ensure its strategic objectives in the aerospace industry both upon and after privatization. Whereas the government's actions in the Connaught and de Havilland cases were intended to manipulate the market, the Teleglobe study showed that the government chose to suppress the Canadian overseas long-distance telecommunications services market altogether. In this case, the Conservatives employed cabinet policy guidelines and directives, federal regulation and direct ministerial intervention to ensure that

Teleglobe would remain, at least for the duration of the government's administration, Canada's monopoly supplier of overseas telecommunications services.<sup>1</sup>

The case studies revealed that a variable set of state actors served to accomplish strategic industrial policy initiatives. The actors ranged from the Cabinet and Ministerial levels down through the bureaucratic machinery of the Canadian federal government. While the Minister and Department of Industry, Science and Technology played a prominent role in both the Connaught and de Havilland cases, the Minister and Department of Communications as well as the Minister of State Responsible for Privatization were the government's Teleglobe interventionist architects. The de Havilland privatization illustrates the range of program levers at the federal government's disposal to finance strategic industrial initiatives. We noted in particular the Defense Industry Productivity Program and the Export Development Program. The government, perhaps ironically, also relied upon Crown corporations to pursue its de Havilland policy initiatives. The Export Development Corporation and the Canada Development Investment Corporation were prominent actors in this case.

Rounding off the series of state actors involved in each case were arms-length government agencies, specifically Investment Canada (IC) and the Canadian Radio-Television and Telecommunications Commission (CRTC). IC provides an excellent example of the Conservative government's grey zone concerning the market versus state means of fostering competitiveness. Consistent with the government's neoliberal program for economic renewal upon coming to office in 1984, the Tories repealed the *Foreign Investment Review Act* and replaced the Foreign Investment Review Agency with IC to liberalize Canada's foreign investment regime. The Connaught and de Havilland cases studies revealed that regardless of intent, IC and the *Investment Canada Act* remain

potent interventionist tools which the Industry Minister and federal cabinet may employ to pursue both strategic policy initiatives and reduce the effect that foreign ownership may have upon these initiatives.

The important role of the CRTC as an economic policy agent can be supported from three observations from chapter four. Firstly, the Conservative government employed CRTC regulation to enforce Teleglobe's government-regulated monopoly. Secondly, the Conservative government structured the *Telecommunications Act* to ensure that the Commission's decisions remained subject to Cabinet review and direction. Thirdly, the *Telecommunications Act* also required the Commission to regulate consistent with the Conservative government's policy of a Canadian owned and operated internationally competitive telecommunications infrastructure. More study on the economic role of the CRTC and its impact on Canada's economic development in telecommunications and information technology is definitely required. Regardless, we can conclude from our observations in chapter four that under the Mulroney Conservative administrations, the Commission increasingly became an instrument to realize explicit policy objectives in the economically critical information technology sectors.

Chapters three and four confirmed our expectation that the federal Conservative government would intervene in the market and that these interventions were aimed at supporting economic competitiveness in each of the three industries concerned. At the same time, our case studies also reveal that the government accomplished these interventions using a fragmented and disparate set of political and bureaucratic actors. The seemingly ad hoc method of intervention, especially when contrasted to the rational system established to execute the government's privatization agenda raises a key question: do these interventions indicate a strategic trade or industrial policy agenda? Or was

intervention in each case reactive -- dictated more by circumstances than by strategy? Between 1984 and 1993, it is unlikely that the Conservative government was guided by a strategic trade or industrial policy agenda. On the contrary, our survey of the Conservatives' economic agenda in chapter one revealed that the government appeared to respect the relatively liberal prescriptions of Michael Porter's Neo-Ricardian approach to competitive advantage. This interpretation is strengthened by the fact that it was Porter to whom the Conservatives, in concert with the national corporate lobby, the Business Council on National Issues, turned in 1991 to guide the development of the prosperity initiative, the Tory's competitiveness strategy. In the report which followed, entitled *Canada at the Crossroads: The Reality of a New Competitive Environment*, Porter concluded that in order to meet the challenges posed by the "new competitive realities," the Canadian economy must be driven by a new approach to economic development, one inspired by the goals of innovation and productivity.<sup>2</sup> Porter advised the government to intensify its pursuit of liberal framework policies such as deregulation, privatization, liberal competition, trade and foreign investment policies, indirect contributions to R&D and above all, a deficit reducing fiscal policy.<sup>3</sup>

It is clear that the Conservative government ideologically opposed state intervention, favouring a neoliberal, laissez-faire approach to economic competitiveness. The interventions identified in chapters three and four were not intended therefore to comprise a strategically interventionist policy in pursuit of competitiveness. Instead, our study, like Porter's, suggests that the Conservative governments were presented with the common dilemma identified in chapter one -- how to ensure national economic security in the face of challenges posed by globalization and the transformation to the new world economy? As part of their response to this dilemma, the Conservatives attempted to pursue competitive advantage in the innovation-driven industries

surveyed in chapters three and four. Central to our investigation, the case studies also revealed that the government pursued this objective through state intervention designed to protect and promote strategic firms in strategic industries, despite a broader ideological commitment to *laissez-faire*, free market economic policies. Chapters three and four confirm our argument that neoconservatism and free market economic policies were not a sufficient basis for the Conservative government's pursuit of economic competitiveness in each of the industries surveyed. These findings support the study's central argument that neoconservatism is not a sufficient basis for economic competitiveness in the new world economy and that state intervention is required to create and protect competitive advantage.

### **3. Postlogue: Beyond Competitiveness**

These conclusions supporting a positive economic role for the state have never been more relevant than in the new era of right-wing North American politics. The North American political scene in the early part of the 1990's reveals a rejuvenation of neoconservative ideology and an even more intense scrutiny of the state's role in the economy than in the 1980's. In the United States, the Republican Party's victory in the 1994 American Congressional elections marks a watershed in the emergence of a radical right dedicated to eradicating the welfare state.<sup>4</sup> The radical right is also setting the agenda in Canada in the mid-1990's, converting the federal Liberal government and gaining almost universal support by the provincial governments in english-speaking Canada.<sup>5</sup> The "revolutionary" posture of North America's new right wing parties is tempered by the fact that they continue to chant the mantra of deficit reduction and less government as the only means to restore

prosperity and competitiveness.<sup>6</sup> What appears to distinguish these parties from their relatively moderate right wing predecessors of the 1980's is the apparent commitment to scaling back government. For example, after pledging in 1984 to make the federal fiscal house the priority "for this year and for each year of our mandate," Canada's national debt more than doubled under the Mulroney administrations to \$466 Billion in 1993 from \$206.3 Billion in 1985, while the budget deficit at the end of the 1993 fiscal year was \$41 Billion, higher than the previous record \$38.5 Billion in 1985 when the Conservatives took office.<sup>7</sup> Contrast this with the Ontario Progressive Conservative government which, after being in office for just two weeks in July 1995, moved faster than any government in Canadian history and announced \$1.9 Billion in spending cuts for the 1994-1995 fiscal year only, leaving little doubt that it intends to deliver on the core promises of its "Common Sense Revolution," balancing the province's budget by the year 2000, cutting government spending by 20 per cent or \$6 Billion by 1999 and reducing provincial income taxes 30 per cent by 1999.<sup>8</sup>

As we proceed into the 21st Century, a neoconservative determinism is taking root in North America which aims to render the state powerless within the realm of the private economy. We devoted this thesis to debunking such determinism as ideological myth and proved to the contrary that the state may successfully intervene in the market to ensure national economic security through competitive advantage. Our research concerning the Canadian state under the federal Progressive Conservative governments from 1984 to 1993 supported the hypothesis that, when faced with choosing between a doctrinal commitment to neoconservative ideology and adjusting policies to ensure economic security in the face of global economic imperatives, national governments will most likely employ the visible hand of state intervention to protect and promote competitive

advantage in knowledge-intensive, innovation-driven and export-focused industries. Despite these general conclusions and the possibilities for a post-fordist approach to intervention which they support<sup>9</sup>, this chapter's brief survey of contemporary North American politics suggests that the degree to which the state and its institutions are utilized for competitiveness and other policy objectives is ultimately a political choice. Political choice, however, is increasingly affected by the changing balance of forces within industrial democratic nation-states, including Canada and the United States.

Economic globalization and the pursuit of national and corporate competitiveness have transformed capital accumulation and pushed the state's capacity to underwrite an equitable relations of production to the limit. The unravelling of the post-war compromise in industrial democracies therefore presents a possible crisis of state sovereignty and political cohesion. Leslie Pal argues that this crisis is particularly acute in Canada, where, exacerbated by a continuous preoccupation with national unity, political cohesion may not be possible within the current structure of Canadian federalism.<sup>10</sup> In the United States, Reich decries the secession of the highly skilled and therefore highly-paid, wealthy Americans from the American economy and, it follows, social responsibility, while other observers of the American scene are writing off the unravelling consensus as a "revolt" of the wealthy who increasingly refuse to contribute to the current political state as it is or no direct benefit for them to do so.<sup>11</sup>

Ultimately state intervention by democratic, responsible governments depends upon the response of the electorate to one fundamental question: "to what end?" Self-interest over citizenship? Negligent ideology over responsible pragmatism? Increasing disparity and consequentially, decreasing opportunity between the skilled and the unskilled? To what end the

resultant division, polarization and discord between those who have, those who have not and those who are increasingly losing what they had? Do we want to return to a world so uncompromising, uncompassionate and harsh, a world already described in real detail by Dickens, Zola and other harbingers of the social consequences of lettered capitalism? These are the questions citizens of industrial democracies must now ponder as we move into the Twenty-First century. As President Clinton said on the eve of the Republican party's 1994 Congressional victory, "it is critical that people understand there are clear choices between going forward and going back. . . ." We in Canada must choose to go forward. By supporting a positive economic role for the state in the new world economy, this thesis' contribution is to demonstrate that a progressive choice is possible, now and in the future.

## ENDNOTES

## Endnotes for Chapter One

1. The concept of the world economy is elaborated in Charles Albert Michalet, "Strategic Partnerships and the Changing Internationalization Process," in *Strategic Partnerships: States, Firms and International Competition*, ed. Lynn Krieger Mytelka (London: Printer Publishers, 1991), 35-50. Michael Howlett and M. Ramesh define the study of political economy as an investigation into the specific state and market institutions found within nation-states and international political economy as an investigation into the specific mix of state and market institutions that exist between nation-states. Michael Howlett and M. Ramesh, *The Political Economy of Canada: An Introduction* (Toronto: McClelland and Stewart, 1992), 10.
2. John Kenneth Galbraith, "Revolution by John Maynard Keynes," chap. in *A Journey Through Economic Time: A Firsthand View* (Boston, New York: Houghton Mifflin Company, 1994), 96-105; Abba P. Lerner, "The General Theory & Keynesian Economics in the 1960's," in *Keynes' General Theory: Reports of Three Decades*, ed. Robert Lekachman (New York, London: St. Martin's Press, 1964), 203-222.
3. Reg Whitaker, "Neoconservatism and the State" *The Socialist Register* (1987): 1-31.
4. Jeanne Kirk Laux, "The Changing World Economy: States in Competition," in *International Conflict and Conflict Management*, 2nd ed., ed. Robert O. Matthews, Arthur G. Rubinoff and Janice Gross Stein (Scarborough, Ont: Prentice-Hall Canada Inc, 1989), 353-362.
5. Carlos Ominami, *Le tiers-monde dans la crise* (Paris: Maspero, 1986), 22. The French School of Regulation includes observers of world political economy such as Alain Lipietz. See for example, the following references: Robert Boyer, préface to *Politique et Régulation: Modèle de développement et trajectoire canadienne*, ed. Gérard Boismenu and Daniel Drache (Montreal: Editions du Méridien, 1990), 7-24; and, Robert Boyer, *The Regulation School: A Critical Introduction*, trans. Craig Charney (New York: Columbia University Press, 1990). This chapter will draw heavily upon the regulation school's observations.
6. Alain Lipietz, "The Globalization of the General Crisis of Fordism, 1967-1984," in *Frontyard Backyard: The Americas in Crisis*, ed. John Holmes, Colin Leys (Toronto: Between the Lines, 1987), 28; *Ibid.*; Galbraith. *A Journey Through Economic Time*, 96-105.
7. Productivity is cited in regulationist, Keynesian, neoconservative and new competitiveness literature as a standard, if not the ultimate, indicator of prosperity and competitiveness. The underlying premise is that rising output from labour and capital is socially beneficial as it facilitates private accumulation and therefore, the basis for further investment and productivity expansion. This thesis does not set out to challenge the

accumulation of capital as the basis for competitiveness but the role of the state in the process. Nonetheless, we should note that there are possibly other indicators of an economy's competitiveness and prosperity such as rates of income distribution and social welfare. Private accumulation need not be the sole measure.

8. Daniel Drache and Marc Gertler, eds., "The World Economy and the Nation-State: The New International Order," chap. in *The New Era of Global Competition: State Policy and Market Power* (Montreal and Kingston: McGill-Queen's University Press, 1991), 15; Charles Albert Michalet, "Crise mondiale ou crise internationale ?", in *Natinoalisations et Internationalisations*, ed. C.A. Michalet *et al.* (Paris: Maspero, 1983), 13-40.
9. Lipietz, "Crisis of Fordism", 32.
10. *Ibid.*, 31.
11. Michalet, "Crise mondiale ou crise internationale," 21.
12. The ensuing period of economic crisis in the industrialized world is often perceived as a consequence of the 1973 and 1979 oil shocks imposed by OPEC, the Organization of Petroleum Exporting Countries. Recession, rising unemployment and inflation appeared as early as 1967 in the United States and other industrial economies rendering the so-called shock thesis chronologically invalid. *Ibid.*, 23-24.
13. *Ibid.*, 355.
14. Michalet, "The Changing Internationalization Process," 40.
15. Michalet, "The Changing Internationalization Process," 41-44.
16. This is a synthesis of the new competitive theories which will be studied in more detail in Chapter Two. For a direct interpretation of the process of multinationalization, see Laux, "States in Competition," 350.
17. Ankie Hoogvelt and Masae Yuasa, "Going Lean or Going Native? The Social Regulation of 'Lean' Production Systems," *Review of International Political Economy* 1, 2 (Summer 1994): 285-289.
18. The "techno-economic paradigm" concept was developed by Freeman and Perez. Following Freeman and Perez, a techno-economic paradigm is defined as "a cluster of interrelated technical, organizational and managerial innovations, whose advantages are to be found not only in a new range of products and systems, but most of all in the dynamics of the relative cost-structure of all possible inputs to production." The word 'paradigm' indicates a dominance of technological style whose "common sense and rules of thumb affect the entire economy." C. Freeman, Preface to Part II, "Evolution, Technology and Institutions," in *Technical Change and Economic Theory* (London and

- New York: Pinter Publishers, 1988), 10; quoted in Hoogvelt and Yuasa. "Going Lean or Going Native?" 287.
19. *Ibid.*, 286; Daniel Leborgne and Alain Lipietz, "L'Après-Fordisme et son espace," *Les Temps Modernes* 43, 501 (April 1988): 75-110.
  20. *Ibid.*
  21. Lipietz, "Crisis of Fordism," 48.
  22. Michalet, "The Changing Internationalization Process", 40.
  23. *Ibid.*, 357.
  24. Laux, "States in Competition," 360.
  25. Ben Fine and Laurence Harris, "Ideology and Markets: Economic Theory and the 'New Right'" *The Socialist Register* (1987): 369. Fine and Harris refer to the "New Right" as the school of thought which has sought to justify neoconservatism intellectually.
  26. Lynn Krieger Mytelka, "States, Strategic Alliances and International Oligopolies: The European ESPRIT programme," in *Strategic Partnerships: States, Firms and International Competition* (London, Printer Publishers, 1991), 182-210. See also, Lynn Krieger Mytelka, "Crisis, Technological Change and the Strategic Alliance," in *Strategic Partnerships: States, Firms and International Competition* (London: Printer Publishers, 1991), 7-34.
  27. Jeanne Kirk Laux, "Limits to Liberalism," *International Journal* 46 (Winter 1990-91): 113-116
  28. Parliament, House of Commons, *Debates*, 6th Session, 19th Parliament, Vol. 245 [in Whole Series], 1945 (19 March, 1945 - 16 April, 1945), 808-810.
  29. David Wolfe, "The Rise and Demise of the Keynesian Era in Canada: Economic Policy, 1930-1982," in *Modern Canada 1930-1980's*, Vol. 5, Readings in Canadian Social History, ed. Michael Cross and Gregory Kealy (Toronto: McClelland and Stewart, 1984), 52.
  30. *Ibid.*
  31. Parliament, House of Commons, *Debates*, 6th Session, 19th Parliament, vol. 245 [in whole series], 1945 (19 March, 1945 - 16 April, 1945), 808-810.
  32. The staples theory as developed by H.A. Innis, and later elaborated by Glen Williams, considers that Canada's economic development is a result of an overreliance on the extraction of natural resource commodities for export at the expense of an export-oriented domestic manufacturing industry. Williams concludes that this approach to economic

development was consolidated the particular mode of insertion of Canada's economy into the international system. Originating with the National Policy of Sir John A. MacDonald in 1879, economic development was premised upon a model of import substitution industrialization (ISI) in which manufacturing for export was rejected in favour of natural resource exports, primarily to Britain and within the British Empire. The domestic manufacturing industry was encouraged to produce for the domestic market only and was protected by high tariff walls, supported by government investment in transportation and infrastructure and was dependent upon foreign technology and importing capital goods.

Please see, Glen Williams, "Canada in the International Political Economy," in *The New Canadian Political Economy*, ed. Wallace Clement and Glen Williams (Kingston: McGill-Queen's University Press, 1990), 117-121; Glen Williams, *Not For Export: Towards a Political Economy of Canada's Arrested Industrialization*, updated ed., Canada in Transition Series (Toronto: McClelland and Stewart Limited, 1986), 1-15, 103-151. The latter is further updated in Glen Williams, *Not for Export: The International Competitiveness of Canadian Manufacturing*, 3rd ed. (Toronto: McClelland and Stewart, 1994).

33. Wolfe, "The Keynesian Era in Canada," 48-49.
34. Francois Houle, "L'état canadien et le capitalisme mondial: stratégies d'insertion," *Canadian Journal of Political Science* 20, 3 (September, 1987): 490.
35. OECD, *Economic Surveys 1975-1976, Canada* (Paris: OECD, 1976), 25.
36. OECD, *Economic Surveys 1981-1982, Canada* (Paris: OECD, 1982), 7.
37. *Ibid.*, 17.
38. Williams, *Not for Export*, 137-150.
39. Privy Council Office, *Foreign Ownership and the Structure of Canadian Industry [Report of the Task Force on the Structure of Canadian Industry]*, by Melville H. Watkins, Chairman (Ottawa: Privy Council Office, 1968); Canada, *Foreign Direct Investment in Canada [The Gray Report]*, by Herb Gray, M.P., P.C. (Ottawa: Canada, 1972).
40. Williams, *Not for Export*, 137-150.
41. *Ibid.*, 162.
42. *Ibid.*, 166.
43. Department of Finance, *A New Direction for Canada: An Agenda for Economic Renewal* (Ottawa: Department of Finance, 1984), 83.
44. *Ibid.*, 6.

45. Department of Finance, *The Budget Speech* (Ottawa: Department of Finance, 1985), 1.
46. *Ibid.*
47. Department of Finance, *The Budget Speech* (Ottawa: Department of Finance, 1986), 1.
48. *Ibid.*, 10. Chapter three will examine the Conservatives' privatization agenda in more detail.
49. *Ibid.*, 18.
50. Department of Finance, *The Budget Speech* (Ottawa: Department of Finance, 1987), 3.
51. Department of External Affairs, *The Canada-U.S. Free Trade Agreement* (Ottawa: Department of External Affairs, 1988); Department of Finance, *The Canada-United States Free Trade Agreement: An Economic Assessment* (Ottawa: Department of Finance, 1988); Department of Finance, *The Budget Speech* (Ottawa: Department of Finance, 1988), 4-5.
52. Parliament, House of Commons, *Debates*, 2nd Session, 34th Parliament, Vol. 1, 1989 (3 April, 1989 - 5 May, 1989), 2.
53. *World Competitiveness Report 1993* (Geneva: IMD International and the World Economic Forum, 1993), 30. The WCR basis of study of each nation covered on eight factors of competitiveness which are composed of 371 criteria, determined relevant on the basis of economic theory founded on specific principles (Appendix O).
54. Canada, Prosperity Secretariat, *Consultation Paper: Prosperity Through Competitiveness* (Ottawa: Minister of Supply and Services, 1991), iii.
55. Michael Porter, *Canada at the Crossroads: The Reality of a New Competitive Environment* (Ottawa: Business Council on National Issues and Minister of Supply and Services, 1991).
56. Canada, *Prosperity Through Competitiveness*, 2.
57. Keith Banting, "Neoconservatism in an Open Economy: The Social Role of the Canadian State," *International Political Science Review* 13, 2 (1990): 149-170.
58. *Ibid.*, 166-167. Others concur with Banting that it is problematic for an internally fractious state such as Canada to implement a neoconservative agenda similar to those pursued by the U.S. and the U.K. under the Reagan and Thatcher years. For example, Fine and Harris conclude that the consistent preoccupation with national unity in the face of

linguistic division inhibits the development of a coherent nationalism which neoconservative regimes in the U.S. and the U.K. have used to justify the implementation of their programmes. Instead, "surreptitious nibbling at the corners of social programmes is about as far as this government has gone. . . ." Contrary to the neoconservative creed of limited government intervention, Aucoin writes that fostering national unity "may be at odds with the neo-conservative credo, for regional interests often are perceived as requiring an interventionist state if the spatial dimensions of public policy are given consideration in the formulation of public policy." Therefore, Aucoin takes Banting's argument one step further, concluding that not only does federalism in Canada prevent Ottawa from withdrawing its interventions, instead it may cause it to increase its involvement in the economy corresponding to the degree of unity at any given time.

See, Ben Fine and Laurence Harris, "Ideology and Markets: Economic Theory and the 'New Right'," *The Socialist Register* (1987): 365-392; Peter Aucoin, "The Mulroney Government, 1984-1988: Priorities, Positional Policy and Power," in *Canada Under Mulroney: An End of Term Report*, ed. Andrew B. Gollner and Daniel Salée (Montreal: Véhicule Press, 1988), 335-356.

59. Andrew B. Gollner and Daniel Salée, eds. "Introduction: A Turn to the Right? Canada in the Post Trudeau Era," chap. in *Canada Under Mulroney: An End of Term Report* (Montreal: Véhicule Press, 1988), 19.
60. William T. Stanbury, "Privatization and the Mulroney Government, 1984-1988," in *Canada Under Mulroney: An End of Term Report*, ed. Andrew B. Gollner and Daniel Salée (Montreal: Véhicule Press, 1988), 135-136.
61. Michael J. Prince, "The Mulroney Agenda: A Right Turn for Ottawa?," in *How Ottawa Spends 1986-1987: Tracking the Tories* (Toronto: Methuen, 1986), 1-60.
62. *Ibid.*, 15.
63. Robert M. Campbell, "The Conservatives and the Unemployed." in *How Ottawa Spends 1992-1993: The Politics of Competitiveness*, ed. Francis Abele (Ottawa: Carleton University Press, 1992), 23-55.
64. Department of Finance, *The Budget Speech* (Ottawa: Department of Finance, 1985), 11.
65. *Ibid.*, 17.
66. Prince, "The Mulroney Agenda".
67. Jeanne K. Laux, "Limits to Liberalism," *International Journal* 46, 1 (Winter 1990-91): 113-136. In this article, Laux concludes that the problematic of neoliberalism and

economic competitiveness may be conflicting in their consequences for state policy. The former provokes the state to disengage from traditional interventions as public ownership, protectionism and procurement; the latter has in fact obliged the state to remain engaged in these policy areas, albeit more selectively.

68. We will review comparative advantage theory in more detail in chapter two.
69. The relevance of the territorial sovereign state is increasingly questioned as the centrifugal forces of economic dislocation, dissidence and the diffusion of ideas and symbols through heretofore unassumed telecommunications technologies are empowering diverse groups, nations and identities to rally from above and below state sovereignty under the banner of "civil society" and challenging the state's continued capacity to coerce allegiance to a unitary social and economic structure. See, Michael Walzer, "Between Nation and World," *The Economist* [Survey], 11 September, 1993, 49-52.

## Endnotes for Chapter Two

1. Richard Simeon, "Studying Public Policy," *Canadian Journal of Political Science* 9, 4 (December 1976): 561. Simeon defines means of intervention as the instruments by which "governments make and enforce policy choices."
2. Michael Howlett and M. Ramesh, *The Political Economy of Canada* (McClelland and Stewart, 1992), 27.
3. *Ibid.*, 27-28.
4. Arthur I. Bloomfield, "Adam Smith and the Theory of International Trade," in *Essays on Adam Smith*, ed. Andrew S. Skinner and Thomas Wilson (Oxford: Clarendon Press, 1975), 457.
5. Ricardo's labour cost theory of production introduced a higher level of analysis to the basis of trade and economic specialization between regions relative to Smith's model of absolute advantage. According to Bloomfield, Smith's justification for differences in absolute real costs of production between regions "lies mainly in differences in climate, qualities of soil, and other natural or acquired advantages." *Ibid.*, 458.
6. Ricardo used the hypothetical production of wine and cloth in England and Portugal with the following labour units to justify comparative advantage theory:

	England	Portugal
Cloth	100	90
Wine	120	80

Clearly, it costs England less to produce cloth relative to wine and vice-versa in Portugal. In the absence of trade with England, a unit of Portuguese wine could only obtain  $\frac{8}{9}$  a unit of domestic cloth, while that same unit of wine would be worth 1.2 units of English textiles. Likewise, one unit of English cloth would fetch only  $\frac{4}{5}$  a unit of domestic wine whereas if England entered into commerce with Portugal, that same unit of cloth could purchase 1.2 units of Portuguese wine. Under this scenario, both countries will gain from specializing in goods in which it has a comparative advantage, even though Portugal possesses an absolute advantage in both products. See, Donald Rutherford, *Dictionary of Economics* (London and New York: Routledge, 1992), 84; *The McGraw-Hill Dictionary of Modern Economics: A Handbook of Terms and Organizations*, 3rd edition (New York: McGraw-Hill Book Company, 1983), 88-89.

7. Samuel Hollander, *The Economics of David Ricardo* (Toronto, Buffalo: The University of Toronto Press, 1979), 465. See also, Mark Blaug, "What Ricardo Said and What Ricardo Meant," in *The Legacy of Ricardo*, ed. Giovanni A. Caravale (New York;

- Oxford: Basil Blackwell Ltd., 1985), 3-12..
8. Bertil Ohlin, *Interregional and International Trade*, Harvard Economic Studies, Vol. 39 (Cambridge, MA: Harvard University Press, 1933; repr., 1935), 29.
  9. J.L. Ford, "The Ohlin-Heckscher Theory of the Basis of Commodity Trade," *The Economic Journal* (September 1963): 463. The validity of the free trade will be addressed in our review of strategic trade theory and Michael Best's New Competition theory, respectively.
  10. Joseph Schumpeter, *Capitalism, Socialism and Democracy*, 2nd ed. (New York, London: Harper and Brothers Publishers, 1947), 77-78.
  11. *Ibid.*, 78.
  12. *Ibid.*, 79.
  13. *Ibid.*, 83.
  14. *Ibid.*, 84.
  15. Technological innovation is at the core of new economic growth theory developed by a school of economists including Paul Romer (Berkeley), Pierre Fortin (UQAM), and Richard Lipsey (Simon Fraser) and supported by institutions such as the Canadian Institute for Advanced Research. Lipsey narrows the study of technological innovation to four specific subjects: the products we make and consume; the processes we employ to make these products; the organizations we use to coordinate our economic activity; and the institutions that provide the background structure to economic activity. Lipsey's analysis suggests that, along with the private actions of firms, public infrastructure also plays a role in creating technological innovation. See, Richard G. Lipsey, "Globalisation, Technological Change and Economic Growth," CIAR Program in Economic Growth and Policy, Reprint Series, Number 4.
  16. Charles Albert Michalet, "Introduction: Pour une nouvelle approche de la spécialisation internationale," in *L'intégration de l'économie française dans l'économie mondiale*, ed. Charles Albert Michalet (Paris: Editions Economica, 1984), 5-26. Michalet observes that national economic specialization is contingent upon the presence of competitive firms within national frontiers. However, this does not render the state powerless in the face of oligopolistic competition. Instead, Michalet contends that the state must adjust its policy programme to meet the new competitive challenges. This requires an analysis of the national economy's "competitive advantages" or the dominant forms of specialization created as a result of competition between firms resident in the economy and outside of it and subsequently tailoring interventions to foster these areas of specialization. Michalet refers to this economic policy approach as Néointerventionisme.

17. Michael Porter. *The Competitive Advantage of Nations* (New York: The Free Press, 1990).
18. *Ibid.*, 173.
19. *Ibid.*, 1.
20. *Ibid.*, 129.
21. *Ibid.*, 71.
22. *Ibid.*, 149.
23. *Ibid.*
24. *Ibid.*, 618.
25. *Ibid.*, 662
26. Paul Krugman, ed., "Introduction: New Thinking About Trade Policy," chap. in *Strategic Trade Policy and the New International Economics* (Cambridge, MA: MIT Press, 1986), 1-22.
27. *Ibid.* Backtracking from this previous research, Krugman, like Porter, now argues that national specialization is determined largely by productivity, writing, "competitiveness is a meaningless word when applied to national economies. And the obsession with competitiveness is both wrong and dangerous." Thus, economic policies which thwart the composition of comparative advantage, namely protection, managed trade, industrial targeting and promotion, will cause national and the international economies more harm than good. Krugman merely repeats the mantra of comparative advantage, a theory which we challenge as incapable of guiding economic policy in the new world economy. Paul Krugman, "Competitiveness: A Dangerous Obsession," *Foreign Affairs* 73, 2 (March-April 1994): 28-44. The debate between Krugman and American Strategic Trade Theorists continues in *Foreign Affairs*, "The Fight Over Competitiveness," 73, 4 (July-August 1994): 187-203.
28. Laura D'Andrea Tyson, *Who's Bashing Whom? Trade Conflict in High-Technology Industries* (Washington, D.C.: Institute for International Economics, 1992), 18.
29. *Ibid.*, 32-39.
30. Michael H. Best, *The New Competition: Institutions of Industrial Restructuring* (Cambridge, MA: Harvard University Press, 1990), 13-15.

31. According to Best, production in the Taylorist firm is organized according to the principles of scientific management as developed by Frederick Taylor in the 1930's. Scientific management of work sought to maximize labour productivity through the perfection of a continuous method of production. Continuity in turn relied upon a standard and never changing product. Continuity is not compatible with innovation and by consequence the Taylorist firm is not compatible with the *New Competition*. *Ibid.*, 11-14.
32. *Ibid.*, 144. Best concludes that the Japanese firm embodies the spirit of the entrepreneurial firm. The goal of the Japanese firm is not to maximize profits for a given material, product, process or organizational method, but to seek a competitive advantage by continuously upgrading product process and organization through continuous improvement. This vision has produced renowned production practices namely, an emphasis on process versus operational efficiency, just-in-time inventory control, automation and an obsession with product quality, all of which are interrelated.
33. *Ibid.*, 13-15.
34. *Ibid.*, 17.
35. *Ibid.*, 130.
36. *Ibid.*, 19.
37. *Ibid.*, 266.
38. *ibid.*, 168.
39. *Ibid.*, 188.
40. *Ibid.*, 188.
41. Robert B. Reich. *The Work of Nations: Preparing Ourselves for Twenty-First Century Capitalism* (New York: Knopfler, 1992).
42. *Ibid.*, 168-170.
43. *Ibid.*, 131.
44. *Ibid.*, 133.
45. *Ibid.*, 163
46. *Ibid.*, 311.
47. *Ibid.*, 309.

48. Tyson, *Who's Bashing Whom ?*, 258.
49. *Ibid.*, 264.
50. *Ibid.*, 285.
51. *Ibid.*, 253-296.
52. This distinction by Tyson is questionable given her overall thesis that high-technology firms invariably receive some form of public assistance either through protection or promotion. Therefore, public equity positions or outright state ownership may be considered as only one form of structural assistance for the national economy. In essence then, high-technology firms within the rubric of strategic trade theory may be considered in one way or another "public policy companies." For more on this concept see Chalmers Johnson *Japan's Public Policy Companies* (Washington D.C. and Stanford, CA: AEI - Hoover Institution, 1978).
53. Tyson, *Who's Bashing Whom ?*, 43-44.
54. Best, *The New Competition*, 265-269.
55. David B. Audretsch, *The Market and the State: Government Policy Towards Business in Europe, Japan and the United States* (New York: Harvester Wheatsheaf, 1989). See chapters 7 and 8, pages 181-214 and 275-296, respectively.
56. H. Uneo, "The Conception and Evaluation of Japanese Industrial Policy." in *Industry and Business in Japan*, ed. K. Sato (White Plains, NY: M.E. Sharpe, 1980); quoted in Audretsch, *The Market and the State*, 182-183.
57. Audretsch, *The Market and the State*, 118.
58. *Ibid.*, 193.
59. *Ibid.*, 271.
60. *Ibid.*, 277-284.
61. *Ibid.*, 278.
62. *Ibid.*, 280.
63. Or does it? There is a large school of thought which contends that Japan's economic competitiveness is due to efficient capital accumulation and a thriving small private-enterprise sector rather than heavy-handed policies to promote strategic industries. This school points to failed MITI-initiatives such as proposals to nationalise the domestic auto

industry, targeted support for aerospace and dominance in superconductivity as examples of the flaws of state intervention. Regardless, Japanese industrial policy has been successful in several other areas through a variety of protectionist and nurturing interventions. For more on this debate, see, "A Survey of the Japanese Economy: Turning Point," *The Economist* [Survey], 6 March 1993; "MITI's Identity Crisis," *The Economist*, 22 January 1994, 65-66.

64. Porter, *The Competitive Advantage of Nations*, 30.
65. *Ibid.*, 662.
66. *Ibid.*, 658-669.
67. Ironically, both Tyson and Porter agree that the state should intervene in foreign acquisitions which reduce competition and increase concentration. The similarity of their positions belies the differences upon which they are based. According to strategic trade theory, foreign ownership is to be feared because of a vision of the world economy in which neomercantilist agents receive the required aid of the state to roam the globe and capture market share at each other's expense. Therefore, the foreign acquisition of a national firm is not beneficial to domestic economic welfare in terms of fostering jobs, training, etc . . . . Rather, it is harmful in that the nation's representative in the given industry has been squeezed out and the potential for benefits to the national economy eliminated to the degree that the acquiring nation's has been increased. Thus strategic trade policy is inherently a zero-sum game in which nations either win or lose. The loss or death of a national champion is a sign of defeat and must be avoided through a series of directly active means.
68. *Ibid.*, 670-671.
69. *Ibid.*, 627.
70. *Ibid.*, 634.
71. *Ibid.*, 639.
72. *Ibid.*, 638.
73. Reich, *The Work of Nations*, 157.
74. *Ibid.*, 152.
75. *Ibid.*, 159.
76. *Ibid.*, 160. The standard microprocessor or "chip" architecture for any computer platform is currently 32K, or 32 million bits of data, travelling at up to speeds of 100 mhz

and increasing daily.

77. *Ibid.*, 163.

78. *Ibid.*, 164.

79. *Ibid.*, 165.

80. *Ibid.*, 113.

81. *Ibid.*, 311-314.

82. The ideology of Porter's argument is justified in conventional macroeconomic theory which holds that national income is linked to the rate of national savings and that all public expenditure is inherently "consumption" of national savings. In this scenario, public expenditure must be restrained lest it consume the supply of capital available to the private sector which in turn must be induced to choose productive investment over private consumption. This is most often accomplished through reducing the private sector's tax burden.

Reich, however, argues that in the previous, high volume era in which prosperity was directly linked to the success of national firms, excessive public expenditure would have raised interest rates and would have put the nation's national champions at a competitive disadvantage against national champions from more reserved economies. However, by the 1990's, "the savings of many nations were combining into a vast pool which sloshed across national borders in search of highest returns" (page 263). Just as it has become problematic to identify national firms in the presence of global webs, so has it become problematic to identify national savings amidst the unimpeded movement of global capital.

The consequence of this transformation in global finance is that the heretofore assumed connection between the rate of national savings and the cost of capital is becoming less pronounced. It follows that reductions in public spending and increased tax breaks in the United States have had little effect on the amount of investment Americans have undertaken in their factories, people and research and development. On the other hand, Reich argues that there is a growing connection between the amount, and kind, of investment that the public sector undertakes to develop the skills of its citizens and their ability to attract global capital. *Ibid.*, 262-264.

### Endnotes for Chapter Three

1. Laura D'Andrea Tyson, *Who's Bashing Whom? Trade Conflict in High-Technology Industries* (Washington, D.C.: Institute for International Economics, 1992), 18.
2. Department of Finance, *Budget Speech* (Ottawa: Department of Finance, May 19 1985), 10. The "public policy test" has consistently remained the central feature of the Conservative's privatization policy. See, See Alain Toulin, "Big Crown Selloff to Cut Deficit," *Financial Post*, 1-3 February 1992, 1.
3. Department of Finance, *Budget Papers* (Ottawa: Department of Finance, 1985), 56.
4. *Ibid.*, 26-27.
5. Department of Finance, *Budget Papers* (Ottawa: Department of Finance, 1985), 26-28.
6. Jeanne Kirk Laux and Maureen Appel Molot, *State Capitalism: Public Enterprise in Canada* (Ithaca, NY: Cornell University Press, 1988), 192.
7. William T. Stanbury, "Privatization and the Mulroney Government, 1984-1988," in *Canada Under Mulroney: An End of Term Report*, ed. Andrew B. Gollner and Daniel Salée (Montreal: Véhicule Press, 1988), 131.
8. Hon. Barbara McDougall, "Excerpts From Statements Made by the Hon. Barbara McDougall on the Reasons for Privatization" (Ottawa: Minister of State [Privatization] and Minister Responsible for Regulatory Affairs, May 1, 1987).
9. *Ibid.*
10. Hon. John McDermid, "Privatization: A Matter of Good Management [Notes for a Speech by the Hon. John McDermid]" (Ottawa: Office of Privatization and Regulatory Affairs, May 18, 1989).
11. Canada, Prosperity Secretariat, *Consultation Paper: Prosperity Through Competitiveness* (Ottawa: Minister of Supply and Services, 1991.), 4.
12. Allan Tupper and G. Bruce Doern, "Canadian Public Enterprise and Privatization," in *Privatization, Public Policy and Public Corporations in Canada*, ed. Allan Tupper and G. Bruce Doern (Halifax, N.S.: The Institute for Research on Public Policy, 1988), 26.

13. Jeanne Kirk Laux, "How Private is Privatization?" *Canadian Public Policy* 19(4): 398.
14. *Ibid.*
15. *Ibid.*, 399. Laux' analysis significantly improves earlier assessments of the Conservative government's privatization program. For example, William Stanbury, in his review of the Mulroney government's first administration, argued that the government's program was significant for what it didn't do (i.e. large assets left untouched) as opposed to what it did. Obviously, Stanbury's earlier analysis must be noted with caution given the Tories' subsequent privatization of Air Canada and, as Laux notes, initiating the state's divestiture of Petro Canada. See, Stanbury, "Privatization and the Mulroney Government," 147.
16. Institut Mériex, "Biology Without Boundaries," Annual Report (NP: Institut Mériex, 1991). See information sheet on Connaught accompanying Annual Report.
17. Peter Newman, "Lament for a Cherished Asset," *Maclean's*, 16 October 1989, 51.
18. Stephen Brooks, "The State as Entrepreneur: From CDC to CDIC," *Canadian Public Administration* 26, 4 (Winter 1983): 527.
19. Laux and Molot, *State Capitalism*, 96-97.
20. Privy Council Office, PC 1982-2843 (Ottawa: Privy Council Office, September 15, 1982); quoted in Laux and Molot, *State Capitalism*, 134.
21. In fact, the financial crisis at Canadair and de Havilland and the need to restructure the two aerospace firms occupied the bulk of the CDIC's affairs at this time. Secondly, the CDIC exerted a great deal of effort to a public relations role. Heading into the 1984 general election, the Liberal government sought to reassure the public that large cash infusions like the ones witnessed with de Havilland and Canadair were not the wave of the future. Rather the CDIC was portrayed as part of a rationalization strategy which would lead to "a new, more business-like management of government to act as a private shareholder but as a vehicle for privatization, ready to engage in divestiture as well." The Liberal government was not able to see this plan through because it lost the September election to Brian Mulroney and the Progressive Conservative Party. See, Laux and Molot, *State Capitalism*, 134-135.
22. James Rusk, "CDIC Told to Sell Off Crown Firms", *Globe and Mail*, 31 October 1984, A1, A2.

23. Parliament, House of Commons, *Minutes of Proceedings and Evidence of the Legislative Committee on Bill C-66, An Act respecting the reorganization of the Canada Development Corporation*, 1st Session, 33rd Parliament(1984-1985), 1:23-24.
24. *Acts of the Parliament of Canada*, 1985, 33-34 Elizabeth II, c.49 [*Canada Development Corporation Act*] (Ottawa: Queen's Printer for Canada, 1987). See Sections 5(a),(b),(c).
25. *Ibid.*, 3:12.
26. Geoffrey Rowan, "U of T Files Suit to Prevent Connaught and Mérieux Deal," *Globe and Mail*, 14 July 1989, B1, B2.
27. Unless otherwise noted, all figures are cited in Canadian dollars.
28. Stevie Cameron, "U of T Contract Could Quash Connaught Merger," *Globe and Mail*, 11 April 1989, B1, B2.
29. Richard Siklos, "Mérieux-Connaught's Marriage of Necessity," *Financial Times of Canada*, 30 March 1989, 10-11.
30. Stevie Cameron, "Connaught Slipping Into Foreign Hands," *Globe and Mail*, 30 March 1992, A2.
31. Stevie Cameron, "U of T Contract Could Quash Connaught Merger".
32. Stevie Cameron, "U of T Contract Could Quash Connaught Merger,"; Oliver Bertin, "Canadian Group to Bid for Connaught," *Globe and Mail*, 24 May 1989, B1, B4.
33. Karen Benzing, "Connaught Merger Passes Through First Crucial Checkpoint," *Financial Post*, 5 June 1989, 5.
34. Geoffrey Rowan, "U of T Files Suit to Prevent Connaught and Mérieux Deal".
35. Geoffrey Rowan, "Court Agrees to Terms for Connaught Approval," *Globe and Mail*, 4 August 1989, D8. The Caisse de dépôt et de placement du Québec is the provincial public sector pension fund which has been used by the provincial government to invest in several Quebec-based companies, rendering it the moniker "Québec Inc.", a symbol of the government's tendency towards an activist, *dirigiste* industrial policy.
36. Karen Benzing, "Review Process a New Front in the Battle for Connaught," *Financial Post*, 27 November 1989, 5; Ann Shortell, "Connaught Ponders a New Prescription," *Financial Times of Canada*, 18 September 1991.

37. Richard Siklos, "France Raises the Flag on a Canadian Biotech Landmark," *Financial Times of Canada*, 18 December 1989, 7; "Quest for Canada's top vaccine maker," *Financial Post*, 14 December 1989, 5.
38. Russell Deigan, *Investing in Canada: The Pursuit and Regulation of Foreign Investment* (Toronto: Thomas Professional Publishing Canada, 1991), 1-9.
39. Unreasonable delays in proposal reviews had engendered a significant amount of hostility towards FIRA in foreign capitals, most importantly in Washington D.C. In response, the Trudeau government in June of 1982 implemented a number of administrative changes to the *FIR Act* to streamline the agency's review process. However, these were not enough to halt the agency's eventual demise. *Ibid.*, 5-6.
40. Arpad Abonyi, "Government Participation in Investment Development," in *Canada Under Mulroney: An End of Term Report*, ed. Andrew B. Gollner and Daniel Salée (Montreal: Véhicule Press, 1988), 159-162.
41. Deigan, *Investing in Canada*, 12.
42. Parliament, House of Commons, *Office Consolidation* [Investment Canada Act, Regulations, Interpretation Notes and Guidelines] (Ottawa: Canada, March 1991). See section two.
43. Abonyi, "Government Participation in Investment Development", 169.
44. For example, the *IC Act* changes the definition of a Canadian controlled corporation to one in which Canadians own a majority of voting shares. This is very different from the subjective and arbitrary "de facto control" test in the *FIR Act*. Deigan, *Investing in Canada*, 38-43.
45. Parliament, *Office Consolidation* [Investment Canada Act]. See sections 8, 14, 14.1(2).
46. *Ibid.*, section 15.
47. Deigan, *Investing in Canada*, 43.
48. *Statutes of Canada*, 1986, 34-35 Elizabeth II, c.26 [*Competition Act*], Part II, section 1.1.
49. Consumer and Corporate Affairs Canada, Bureau of Competition Policy, "Canadian Competition Policy: Its Interface With Other Economic and Social Policies A Framework for Discussion," (Ottawa: Bureau of Competition Policy, 1989), 1-3.

50. *Statutes of Canada, [Competition Act]*. Part II, section 64(1). There are, however, exceptions to every rule. With regard to subsidies and other industrial promotion interventions, "a number of provisions of the *Competition Act* serve to facilitate efficiency-enhancing structural adjustments . . . even where such adjustments could on the surface be perceived as limiting competition." For example, sections 67 and 68 directs the Competition Tribunal to allow mergers where they are aimed at establishing R&D joint ventures or where the merger is likely to bring about "gains in efficiency that will be greater than . . . the effects of any lessening of competition that will result," may result or would not have otherwise resulted. There is even a limited exception from the Act's criminal conspiracy provisions, or the authority to establish approved industry specialization cartels.

Federal documents prepared during the Conservative government's administration proclaim the consistency of the *Investment Canada Act* and the *Competition Act* in that their objective is to increase the role of the market and reduce the role of the state in the Canadian domestic economy. However, the Conservative government also made provisions for state intervention where national economic interests can either be supported or adversely affected. See, Consumer and Corporate Affairs Canada, Bureau of Competition Policy, "Canadian Competition Policy: Its Interface With Other Economic and Social Policies A Framework for Discussion," (Ottawa: Bureau of Competition Policy, 1989), 24-25.

51. Investment Canada, *Annual Report: 1991-1992* (Ottawa: Minister of Supply and Services, 1992).
52. Deigan, *Investing in Canada*, 220.
53. Under the *FIR Act*, the initial time period allotted for review was 60 days but could be, and according to most observers, often was unilaterally extended for an indefinite period of time. See Deigan, *Investing in Canada*, 38-43.
54. Parliament, *Office Consolidation [Investment Canada Act]*. Section 21.
55. *Ibid.*, Section 20.
56. Abonyi, "Government Participation in Investment Development", 171-172.
57. Deigan, *Investing in Canada*, 220-221.
58. Although no details were released, each of the firms attempted to sway public opinion by offering to transfer technology to Connaught, increase R&D expenditures, production and employment; both companies signed research agreements with the University of Toronto. Karen Benzing, "Takeover Body Close to Ruling on Connaught Offers," *Financial Post*, 13 November 1989, 8. See also, Benzing, "Review Process New

Front".

59. James Rusk, "Cabinet Dithers Over a Decision on Competing Connaught Bids," *Globe and Mail*, 29 November 1989, B1, B4; Ann Walmsley, "Connaught's Foreign Sale," *Maclean's*, 25 December 1989, 44-45.
60. Peter C. Newman, "Lament for a Cherished Asset".
61. John Godfrey, "The Connaught Deal: Should Market Decide?," *Financial Post*, 8 December 1989, 9.
62. Patrick Bloomfield, "Ottawa Wrong-Headed in its Stance in Connaught Affair," *Financial Post*, 12 December 1989, 23.
63. "Deciding Who may Buy Connaught," editorial, *Globe and Mail*, 1 December 1989, A6.
64. Karen Benzig, "Connaught Falls to Mérioux as Ottawa Approves Both Bids," *Financial Post*, 14 December 1989, 5; Richard Siklos, "France Raises the Flag on a Canadian Biotech Landmark.,"; Ann Walmsley, "Connaught's Foreign Sale."
65. Investment Canada, "Summary of Key Undertakings by Institut Mérioux," *Release* (Ottawa: Investment Canada, December 13, 1989).
66. Giles Gherson, "Tory Softball on Industrial Policy," *Financial Post*, 18 December 1989, 8.
67. Richard Siklos, "France Raises the Flag on a Canadian Biotech Landmark".
68. Giles Gherson, "Tory Softball on Industrial Policy,"
69. According to G. Bruce Doern and John Atherton, the aerospace industry sector "includes all those firms which are substantially involved in the production of goods for both civilian and military requirements, which includes aircraft and satellite manufacturing and all other space related products. G. Bruce Doern and John Atherton, "The Tories and the Crowns: Restraining and Privatizing in a Political Minefield" in *How Ottawa Spends 1987-1988: Restraining the State*, ed. Michael J. Prince (Toronto: Methuen, 1987), 150.
70. The global aerospace industry is generally comprised of three tiers. The first-tier of core manufacturers consists of approximately a dozen firms -- *primes* -- that have integrated design, development, manufacturing, marketing and product support facilities for complete systems. These firms are supported by approximately 80 second-tier component suppliers such as manufacturers of airframe sub-assemblies, major aircraft components or subsystems, connectors and printed circuit boards. The third-tier consists of suppliers of services such as machining and electroplating. See, Department of

Industry, Science and Technology, *Consultation Paper: Industrial Competitiveness A Sectoral Perspective* (Ottawa: Minister of Supply and Services, 1991), 89-96.

First-tier aerospace manufacturers in Canada include de Havilland Inc. and Spar Aerospace while second-tier firms include McDonnell Douglas Canada, Comdev and Litton Systems Canada. Third-tier suppliers are usually small Canadian-owned enterprises located close to their customers. See, Ontario Aerospace Ministerial Advisory Committee, *Ontario Aerospace: People, Technology , Global Leadership [Ontario Aerospace Strategy]*, March 1994.

71. Industry, Science and Technology, *Industrial Competitiveness A Sectoral Perspective*, 89-96.
72. *Ontario Aerospace Strategy*, 23-24.
73. Doern and Atherton, "The Tories and the Crowns," 150-151.
74. *Ibid.*
75. W. A. Cram, "Clearance for Takeover: the Sellout of de Havilland," *Canadian Forum* 66, 762 (October 1986): 21.
76. Doern and Atherton, "The Tories and the Crowns", 152-153; Parliament, House of Commons, *Minutes of Proceedings and Evidence of the Standing Committee on Regional Development*, 1st Session, 33rd Parliament (1984-1986), 37A: 98.
77. Doern and Atherton, "The Tories and the Crowns," 152.
78. *Minutes and Proceedings of Evidence of the Standing Committee on Regional Development*, 37A: 15; Doren and Atherton, "The Tories and the Crowns," 154-155.
79. *Ibid.*, 154-155.
80. The CDIC questioned the intentions of the Rimgate bid given that its principle shareholder, Fokker, directly competed with de Havilland's chief product, the DASH-8. The President of the CDC wrote to the Industry Minister, "some concern must exist as to their real motivation in this regard." Parliament, *Minutes of Proceedings and Evidence of the Standing Committee on Regional Development*, 37A: 65.
81. *Ibid.*, 90-92.
82. *Ibid.*, 68.
83. *Ibid.*, 30.

84. *Ibid.*, 31-47.
85. *Ibid.*, 31.
86. *Ibid.*, 42-51.
87. Jeanne Kirk Laux, "Limits to Liberalism," *International Journal* 46, 1 (Winter 1990-1991): 113-136.
88. The essential function of the EDC is to subsidize credit for Canadian exporters. As Laux writes, "increased competition and impending recession in the 1970's prompted all [OECD governments] to engage in cut-throat financing to win major contracts. A series of agreements or 'consensus' rates sought to limit the damage..." The government account or Canada account according to Laux, "is earmarked for transactions deemed to be in the national interest by the federal cabinet." *Ibid.*, 130-131.
89. Parliament, *Minutes of Proceedings and Evidence of the Standing Committee on Regional Development*, 37A: 42-51. These criteria are listed in the MOU-Appendix B.
90. *Ibid.*, 4-12.
91. *Ibid.*, 15-16.
92. W. T. Stanbury, "Privatization and the Mulroney Government: 1984-1988," in *Canada Under Mulroney: An End of Term Report*, eds. Andrew B. Gollner and Daniel Salée (Montreal: Véhicule Press, 1985), 126.
93. Doern and Atherton conclude that neither the price nor nationality were primary issues in the sale and that the "emphasis appears to have been in the post-privatization conduct of the buyers." Doern and Atherton, "The Tories and the Crowns", 158.
94. Parliament, House of Commons, *Debates*, 1st Session, 33rd Parliament, Vol. 6, 1985 (8 October-20 December), 9053-9067.
95. Parliament, *Minutes of Proceedings and Evidence of the Standing Committee on Regional Development*, 33: 1-8.
96. Aeritalia, later to be named Alenia, is a subsidiary of Italy's state owned holding company IRI. Aerospatiale is the product of state-sponsored mergers in France, most significantly in the 1970's, aimed at creating strong national champions in several industries including civilian aircraft. Significantly involved in strategic nuclear programs, arms exports, space programs and government-sponsored international joint ventures (i.e Airbus product development), Aerospatiale continued to receive considerable state support during the late 1980's despite the Chirac government's neoliberal commitment to privatize the French state's vast holdings. Jeanne Kirk Laux, "Privatization and France's Aerospace

- Industry: Limits to Liberalism," *French Politics and Society* 5, 4 (September 1987): 29-32.
97. Bob Papoe, "Aircraft Firm Had Been Taxpayer Drain," *Toronto Star*, 21 July 1990, C1, C2.
  98. Parliament, *Minutes of Proceedings and Evidence of the Standing Committee on Regional Development*, 37A: 31.
  99. Susan Smith, "De Havilland Deal Stirs Hot Debate," *Financial Post* 18 March 1991, 1,5.
  100. James Daw, "Boeing Eyes De Havilland Sale," *Toronto Star*, 21 July 1990, C1, C2.
  101. *Ibid.*
  102. Allan Nymark is the same individual whose name appeared on IC's Connaught announcements. Gonophore Lanthier and Cecil Foster, "De Havilland Set to be Sold," *Financial Post* 23 July 1990, 1, 5.
  103. James Daw, "Tax Money Needed to Keep Work at De Havilland, Plant Bidder Says," *Toronto Star*, 16 November 1990, B1, B5.
  104. James Daw, "De Havilland Bidders Seek Federal Money," *Toronto Star*, 5 February 1991, D3.
  105. Susan Smith, "De Havilland Deal Stirs Hot Debate".
  106. James Daw, "Bidders Flexible on Canadian Aid for de Havilland," *Toronto Star*, 6 February 1991, C2; James Daw, "Europeans to Buy de Havilland," *Toronto Star*, 11 April 1991, C1, C7; Drew Fagan, Virginia Galt, Ken Romain, "PM won't block de Havilland deal," *Globe and Mail*, 11 April 1991, A1, A2.
  107. Robert White, "Irony in Aerospace," *Globe and Mail*, 2 November 1990, A13.
  108. Parliament, House of Commons, *Debates*, 2nd Session, 34th Parliament, Vol. 14, 1991 (12 March-8 May), 19,273-19,274. See also, James Daw, "Europeans to Buy de Havilland," *Toronto Star* 11 April 1991), C1, C7; Drew Fagan, *et. al.*, PM Won't Block de Havilland Deal," *Globe and Mail*, 11 April 1991, A1, A2.
  109. Parliament, House of Commons, *Debates*, 2nd Session, 34th Parliament, Vol. 14, 1991 (12 March- 8 May), 19,271-19,272.

110. Drew Fagan, "De Havilland Bidders Seek Aid," *Globe and Mail*, 11 May 1991, A1, A2; Robert Hearn, "Ontario Wants Canadian Partner As Condition in De Havilland Deal" *Globe and Mail*, 13 May 1991, A1, A2; Susan Smith, "de Havilland 500 Million Aid Plea," *Financial Post*, 13 May 1991, 1.
111. James Daw, "De Havilland Fate in the Balance," *Toronto Star*, 21 May 1991, E1, E10.
112. James Daw, "De Havilland Faces New Probe," *Toronto Star*, 13 June 1991, C1.
113. Drew Fagan, Virginia Galt, "Ottawa Opposed Offer for de Havilland," *Globe and Mail*, 21 June 1991, A1, A2; Shawn McCarthy, "Aircraft firm's Sale is Rejected by Ottawa," *Toronto Star*, 21 June 1991, A1.
114. Matt Maychak, "Ontario Makes Bid for Troubled De Havilland," *Toronto Star*, 10 September 1991, A1, A22.
115. The decision exacerbated the constant debate within the twelve nation European Union between those committed to a European State with all of the corresponding trappings, including an aggressive industrial policy, and those committed to simply a free-trade area where competition is essential. See George Ross, "De Havilland's EC Courtship," *Canadian Forum* 70, 807 (March 1992): 8-9.
116. Catherine Leconte, "La CEE met son veto sur la vente de De Havilland," *Le Devoir*, 3 October 1991, A5; Madelaine Drohan *et al*, "De Havilland at Risk as EC Reject Merger," *Globe and Mail*, 3 October 1991, A1, A2.
117. On October fourth, Boeing announced that it was forced to lay off 1,270 people or one quarter of de Havilland's workforce and cut DASH-8 production in half. Company officials said that this decision was unrelated to the merger veto and was simply a result of a slumping commuter aircraft market and deepening economic recession. Geoffrey Rowan, "De Havilland Lays Off 1,270, Cuts Plane Production in half," *Globe and Mail*, 5 October 1991, B1, B2.
118. Patrick Doyle, "PM, Rae Fight to Save De Havilland," *Globe and Mail*, 18 November 1991, A10.
119. Laura Fowlie, "Taxpayer on the Hook for de Havilland-Mulroney," *Financial Post*, 2 December 1991, 1; Suzanne Danseran, "Bombardier et l'Ontario négocient l'achat de De Havilland," *Le Devoir*, 31 October 1991, A5.
120. Jeanne Laux, "De Havilland Takes Off, Again," *Canadian Forum* 70, 807 (March 1992): 7-11; Barry Came, "Getting Things Cheap," *Macleans* 27 January 1992, 32-33.

121. The Conservatives could afford to do this due to the politics involved. By the Summer of 1991, the newly elected NDP government in Ontario was anxious over the possibility of seeing Metro Toronto's largest employer go under, especially considering that each of the 4,500 jobs at risk were members of the CAW, to whom the NDP was beholden for its victory in the 1990 Ontario election. Bob White, the president of the CAW, an intimate friend of the Premier and the individual leading the charge to save those jobs, most likely reminded Bob Rae of this daily.
122. Laux, "Limits to Liberalism", 123.
123. *Ibid.* Because of the aerospace industry's strategic importance to national economic competitiveness, Laux writes (p. 115) that it is "an industry which offers neomercantilist temptations to many member-governments of the Organization for Economic Co-operation and Development." In the case of earlier research on France, Laux writes that "The Right's apparent reluctance to extend the principles of neo-liberalism to the aircraft industry can best be explained by reference to the longstanding state involvement in this industry, an involvement that crosses political party lines within a broader consensus that state ownership is necessary to national independence for both reasons of defense and . . . for reasons of technology." When confronted with these self-defined interests, national governments arrive at "the limits to liberalism," including full-scale privatization. See, Laux, "Privatization and France's Aerospace Industry: Limits to Liberalism," 28-29.

## Endnotes for Chapter Four

1. The Advisory Committee on a Telecommunications Strategy for the Province of Ontario defines telecommunications as "the input, processing, storage, transmission and output technologies - and associated software and services - that enable electromagnetic communications of information. This broad definition reflects the growing convergence of traditional telecommunications with computing on the one hand and the industries which provide information on the other." *Telecommunications: Enabling Ontario's Future* [The Report of the Advisory Committee on a Telecommunications Strategy for the Province of Ontario] (Toronto: Ministry of Culture and Communications, 1992), 9.
2. H.N. Janisch and R.J. Schultz, *Exploiting the Information Revolution: Telecommunications Issues and Options for Canada* (Montreal: Royal Bank of Canada, 1989).
3. Lynn Krieger Mytelka, "States, Strategic Alliances and International Oligopolies: The European ESPKIT Programme," in *Strategic Partnerships: State, Firms and International Competition*, ed. Lynn K. Mytelka (London: Pinter Publishers, 1993), 182-210.
4. Ministry of Treasury and Economics, "Investing in Tomorrow's Jobs: Effective Investment and Economic Renewal," *1992 Ontario Budget* [Supplementary Paper] (Toronto: Ministry of Treasury and Economics, 1992), 11, 14; quoted in *Telecommunications: Enabling Ontario's Future*, 25.
5. Robert Brehl, "Rogers Outlines its \$100 Million Pledge," *Toronto Star*, 23 July 1994, C3.
6. Core domestic telecommunications carriers will refer to common carriers under federal jurisdiction who own and operate transmission facilities. These include national carriers such as Telesat, Teleglobe, Unitel, Sprint, independent telephone companies and all but one of the ten STENTOR group of Canadian "phone companies" (Sask Tel). The latter include Bell Canada and B.C. Tel. By far the largest of these carriers is Bell which serves the greater part of Ontario and Quebec and accounts for 46% of the Canadian telecommunications service industry's revenues. See, Industry Canada, *The Canadian Telecommunications Service Industries: An Overview [Part 1: The Domestic Situation]*, 1994/1995 edition (Ottawa: Industry Canada, November 1994), 16, 56.
7. Department of Communications, "Teleglobe Canada: An Overview" *Communications Fact Sheet FS-86-3848E* (Ottawa: Department of Communications, Information Services, 1986); Charles M. Dalfen, "Deregulation and Privatization in the Canadian Telecommunications Sector: The Case of Teleglobe Canada," in *Privatization and Deregulation in Canada and Britain: Proceedings of a Canada-UK Colloquium held in*

*Gleneagles, Scotland, November 1987*, ed. Jeremy J. Richardson (Aldershot, England and Halifax, N.S.: Dartmouth and IRPP, 1990), 78-93

8. The TCTS, formed in 1931, became Telecom Canada in 1983 and subsequently regrouped under the banner of Stentor in 1992. Given the time period in which the privatization occurred, this study will refer to Telecom Canada. As mentioned in note six, the alliance is comprised of the nine federally-regulated phone companies (the privatized monopoly satellite service provider, Telesat, is the tenth member) which provide public local, long-distance and private value-added services. Industry Canada notes: "With estimated revenues topping \$13.5 billion, Stentor accounts for 78% of all telecommunications service revenues, estimated at 17.4 billion for 1993." Again, Bell dominates the alliance, accounting for 52.6% of STENTOR'S 1993 revenues.
 

Stentor is comprised of three entities which service the R&D, network management, marketing development and lobbying efforts of Canada's telephone companies. Its primary function is to coordinate telecommunications traffic inter-provincially and with U.S. phone companies. Through this alliance, "Canada's telecommunications industry seeks the same type of economic efficiencies the U.S. industry has enjoyed for years." See, Industry Canada, *The Canadian Telecommunications Service Industries*, 16; Stentor, *The Telecommunications Service Industry in Canada [An overview of legal, regulatory and industry structures in Canadian telecommunications markets.]*, revised edition (Ottawa: Stentor Telecom Policy Inc., May 1993), 6-7.
9. While Parliament and the Cabinet possessed the power to issue directives and other control measures such as audits, the COTC remained an unregulated Crown-owned monopoly. This is due in part to the fact that the British legislation required to initiate the Canadian legislation establishing a regulatory regime was never passed at Westminster. Richard Schultz, "Teleglobe Canada", in *Privatization, Public Policy and Public Corporations in Canada*, ed. Allan Tupper and G. Bruce Doern (Halifax, N.S.: IRPP, 1988), 331-32.
10. Department of Communications, "Teleglobe Canada: An Overview," 3-4.
11. Dalfen, "The Case of Teleglobe Canada," 81.
12. The CRTC regulates the operations of the phone companies which fall under federal jurisdiction, including the Telecom Canada/Stentor group of companies. The Commission is empowered to administer the *Telecommunications Act*. Often the CRTC is called upon to review telecommunication carriers' and cable companies' requests to increase customer fees for services and equipment.

CRTC regulation, however, does not occur in a policy vacuum. Decisions affect the composition and direction of the nation's electronic infrastructure and in the course of issuing decisions, the CRTC has established itself, directly and indirectly, as a powerful

agent of contemporary Canadian economic development. This is most evident in the 1990's when the Commission deregulated the domestic market for public long distance services, permitting Unitel to compete against Bell Canada and sending business and consumer rates plummeting. The CRTC also approved the takeover of media empire MacLean Hunter in December 1994 by the evidently larger Rogers Communications empire, thus permitting the creation, we will recall, of a Canadian "national champion" able to take on all electronic global competitors.

Perhaps the most crucial CRTC decision in recent history is *Telecom Decision 94-19*. This document, titled innocuously, has irreparably transformed the Canadian electronic infrastructure in preparation for the coming age of the "information highway" complete with high speed networks able to transmit *terabytes* (a billion bytes) of information in seconds. In this decision, the Commission completely opened the telecommunications services market, including local service, to competition by cable-TV service providers and others. In turn, the phone companies were permitted to invest in content services (i.e. movies) and broadcast them, as carriers, on behalf of licensees to the consumer's home (i.e. movies on demand). In other words, the CRTC approved the convergence of sound, data and image transmission technologies in Canada. See, Industry Canada, *The Canadian Telecommunications Service Industries*, 62-68; Stentor, *The Telecommunications Service Industry in Canada*, 3-4; CRTC, "CRTC Telecom Decision CRTC 94-19: Review of Regulatory Framework," September 16, 1994.

13. Schultz, "Teleglobe Canada," 338.
14. *Ibid.*, 331-339.
15. *Ibid.*, 343-344; Dalfen, "The Case of Teleglobe Canada," 81.
16. Dalfen, "The Case of Teleglobe Canada," 82-83.
17. Schultz, "Teleglobe Canada," 351. Schultz disagrees with this analysis and concludes that the insulated environment in which bureaucratic actors debated the sale meant that the process was largely driven by a concern "over who should be allowed to purchase Teleglobe rather than a concentration on policy principles and priorities." In an isolated sense, Schultz is most likely correct. However, the Conservatives' decisions concerning the privatization will appear more calculated when viewed within their overall approach to telecommunications industrial policy.
18. Although not directly related to the Teleglobe privatization, remarks by the Director of the Bureau of Competition Policy in March 1994 provide a relevant indication of the Bureau's vision of the Canadian telecommunications industry's within the context of the *Competition Act*. Speaking to an audience in Toronto, George N. Addy said, "... I think it is important to remind you that the promotion of competition in Canadian telecommunications markets has been a Bureau of Competition Policy priority for at least

20 years. The Director's office has made numerous interventions over the years to the CRTC and other regulatory bodies. It has advocated liberalized competition with respect to . . . public long distance service. The Director has strenuously and consistently represented the benefits of competition in provision of telecommunications services . . . . I intend to continue to make the issue of competition in the telecommunications one of our major priorities." See, Industry Canada, "The Competition Act and the Canadian Telecommunications Industry," Address by George N. Addy to Institute for International Research Telecommunications Conference, Toronto, March 29, 1994 (Ottawa: Industry Canada, 1994).

19. *Ibid.*, 345.
20. *Ibid.*, 346.
21. The creation of the Minister of State (Privatization) and responsible for Regulatory Affairs also reduced the priority of the Teleglobe divestiture as the new Ministers required time to establish order in the Tory privatization agenda and come up to speed with its initiatives. *Ibid.*, 346.
22. Please see section on privatization in Chapter Three.
23. Government of Canada, "Government Announces Final Bidding Stage for Teleglobe Canada" *News Release* (Ottawa: Canada, November 19, 1986).
24. *Ibid.*
25. Department of Communications, "Statement of Telecommunications Policy Respecting Teleglobe Canada" (Ottawa: Department of Communications, November, 1986).
26. *Ibid.* The legislation governing the regulatory framework surrounding Teleglobe and the other federally-regulated carriers was consolidated into the *Telecommunications Act* in June of 1993. We will discuss this Act later in the chapter.
27. Government of Canada, "Divestiture of Teleglobe Canada: Conditions and Process of Sale" (Ottawa: Canada, November, 1986). The domestic carriers were not satisfied with these conditions. Already guaranteed first refusal on 40% of the initial share offering, they argued that it was preposterous to buy a minority interest in a company without knowing who would possess the controlling interest. Telecom Canada decided to ignore the conditions and submitted a bid on the last day possible that would have given them effective control over the company, which the government promptly rejected. Rebuffed, the domestic carriers and the government engaged in a series of threats and counter threats that indicated a struggle between the domestic carriers, the government and Memotec Data Inc. for control of Teleglobe, a struggle that would continue well into Teleglobe's post privatization period. See, Schultz, "Teleglobe Canada," 348-349.

28. Laux writes that Teleglobe "provides an example of Ottawa's willingness to allow indirect government ownership of an ostensibly privatized Crown corporation," supporting her conclusion that the Conservative government disregarded market principles, in this case open competition, in order to get the job done (see section on privatization in Chapter three). Jeanne Kirk Laux, "How Private is Privatization?" *Canadian Public Policy* 19, 4: 403.
29. Minister of State Privatization and Minister Responsible for Regulatory Affairs, "Teleglobe Canada to be sold to Memotec Data Inc.," *News Release* (Ottawa: Minister of State Privatization and Minister Responsible for Regulatory Affairs, February 11, 1987); Patricia Best, Wayne Lilley and Jennifer Wells, "How Gordon Capital was Humiliated," *Financial Times of Canada*, 20 May 1991, 16-19.
30. *Ibid.*
31. Minister of State Privatization, "Teleglobe Canada to be Sold to Memotec Data Inc."
32. *Statutes of Canada*, 1987, 35-36 Elizabeth II, c. 12 [An Act Respecting the Reorganization and Divestiture of Teleglobe Canada] (Ottawa: Queen's Printer for Canada, 1988; quoted in Jeanne Kirk Laux, "How Private is Privatization?" *Canadian Public Policy* 19, 4: 407.
33. *Teleglobe Reorganization and Divestiture Act*, 1987.
34. Bell Canada Enterprises was determined to control the company. Right after Bill C-38 was given Royal Assent on April 1, 1987 and the sale officially closed on April 3, BCE slipped in and purchased 30 percent interest in Memotec and, therefore, Teleglobe. Restricted to holding only four seats on the board of directors, BCE constantly engaged in an intercene struggle with Memotec management for control of Teleglobe's agenda. At the heart of the matter was BCE's opposition to Memotec's strategy to diversify into the data communications equipment and software market, primarily for the insurance industry, rather than concentrating solely on telecommunications. BCE had grave concerns as well over the management of the firm, particularly with Memotec President William McKenzie. In light of a flagging performance caused in part by some questionable acquisitions, BCE did not attempt to block a hostile takeover bid orchestrated by Gordon Capital in 1991. When this effort failed, the struggle continued until February of 1992, at which time BCE succeeded in removing McKenzie as president and appointing Charles Sirois, a prominent Québec businessman.

See, Patricia Best et. al, "How Gordon Capital was humiliated,"; Mike Urlocker, "Memotec Board Members Facing Overthrow," *Financial Post*, 13 May 1991, 5; Mike Urlocker, "Bell-Teleglobe War Hits the Courtroom," *Financial Post*, 3 February 1992, 3; Mike Urlocker, "Teleglobe's Profits Triples," *Financial Post*, 17 February 1992, 11.

35. The Commission made an impact on Teleglobe's rates, services and operations. For example, it is estimated the Teleglobe's international rates decreased by 40 percent between privatization and March 1992. On the core issue of regulation, the company was ordered to lower its rates by an average of 6.9 percent and decided on rate of return of 13.75 percent, down from 14.5 percent. It was reported that Teleglobe requested 15.5 percent.

The CRTC also expressed serious concerns about methods of financing between Teleglobe and its parent, now called Teleglobe Inc. Essentially, the parent had used 135 million from Teleglobe to finance the former's unregulated computer, data and software enterprises. This money represented 40 percent of Teleglobe's net book value. Obviously, if the parent were to default on these debts, then the value of Teleglobe's stock could be seriously and adversely affected, putting creditors and equity holders at risk. The subsidiary was ordered to retrieve the cash from its parent or provide a guaranteed letter of credit from a bank.

See, James Bagnall, "Teleglobe tries Bell's patience," *Financial Times of Canada*, 9 March 1992, 8; Canadian Radio-Television and telecommunications Commission (CRTC), *Annual Report, 1990-1991* (Ottawa: Minister of Supply and Services, 1991), 38. See also Mike Urlocker, "Memotec's Musclemen," *Financial Post*, 24 June 1991, 14; Mike Urlocker, "Teleglobe Shocked by Tough CRTC Ruling," *Financial Post*, 30 December 1991, 3.

36. Lawrence Surtees, "Phone Companies Seek Long Distance Affairs," *Globe and Mail*, 14 November 1992, B1, B6.
37. Unitel is the successor to CNCP Telecommunications and is jointly owned by Canadian Pacific and Rogers Communications Inc. Frances Misutka, "Romancing the Phone," *Canadian Business*, 14 November 1992; Michael Urlocker, "Telephone Wars: CRTC Opens Up \$7.5B Long Distance Phone Market," *Financial Post*, 13-15 June, 1992; CRTC, "Telecom Decision CRTC 92-12: Competition in the Provision of Public Long Distance Voice Telephone Services and Related Resale Sharing Issues," June 12, 1992.
38. To ensure the commercial viability of the Canadian national airline industry in the late 1970's and 1980's, the Liberal government deregulated internal restrictions in favour of enabling selected Canadian carriers (i.e. Air Canada) to compete in increasingly internationally competitive markets. In his study of federal airline policy, Mathieu Arès observes that the federal government pursued deregulation only after ensuring a duopoly of national champions - Air Canada and Canadian International Airlines. In order to support federal policy objectives of strong, globally competitive firms and an internal air transport infrastructure, the Canadian state protected and promoted these carriers by keeping the domestic market closed to competition and permitting them to subsidize international business through domestic operations. Similar to our study of Teleglobe and the Canadian telecommunications industry, Arès concludes that "la politique aérienne canadienne . . . correspond au point de vue des partisans de la théorie du commerce stratégique." Mathieu

Arès, "La Déréglementation une forme d'intervention de l'état: Le Cas du transport aérien au Canada" (M.A. thesis, University of Ottawa, 1992), 140-150.

39. Stanbury concludes in his 1985 analysis that in the interplay between competition (efficiency) and redistribution and accessibility, Canadian federal telecommunications policy will sacrifice the former in the preference of the latter. Furthermore, the federal government will employ economic regulation to achieve these social goals. Our analysis in this chapter has shown that Stanbury's conclusions are no longer accurate. The emphasis of federal telecommunications policy during the Conservatives' tenure has shifted from social goals such as accessibility to the economic goal of ensuring an international competitive telecommunications infrastructure. W. T. Stanbury, "Decision Making in Telecommunications: The Interplay of Distributional and Efficiency Considerations," in *Telecommunications Policy and Regulation*, ed. W. T. Stanbury (Halifax, N.S.: IRPP, 1986), 481-516.
40. *Ibid.*, 506.
41. CRTC, "CRTC Telecom Decision 85-19: Interexchange Competition and Related Issues," August 25, 1989, 1660. The same decision in fact opened the market for resale and line sharing services to greater competition. In Telecom Decision 85-19, the CRTC defined "resale" as the subsequent sale or lease on a commercial basis, with or without adding value, of communications services or facilities leased from a carrier. Sharing was defined as the use by two or more persons in an arrangement not involving resale, of communications services or facilities leased from a carrier.
42. Department of Communications, "A Policy Framework for Telecommunications in Canada," 27 July 1987, 2-3. The 1987 discussion paper was the culmination of a federal communications policy review which began shortly after the Conservatives took office in 1984. In it, the Minister states: "The vast majority of [review submissions /consultations] called on the federal government to establish a national policy for telecommunications in Canada that would apply across provincial and jurisdictional boundaries." In April of 1987, a meeting of federal and provincial communications ministers in Edmonton produced six principles which were "intended to guide the formulation of government policies and regulation in the telecommunications industry." These principles endorsed a nationalist response to technological evolution, equity and access, maintenance of international competitiveness and "fair an balanced" regional development. See pages 3-4.
43. *Ibid.*
44. *Statutes of Canada*, 1993, 41-42 Elizabeth II, c.38 [Telecommunications Act] (Ottawa: Queen's Printer for Canada, 1993).
45. The *Telecommunications Act* overhauled and centralized federal legislation affecting the administration of telecommunications, including the so-called *Special Acts*

relating to Bell Canada and Teleglobe Canada. The new Act repeals the *National Telecommunications Powers and Procedures Act* (formerly the *National Transportation Act*) and the *Telegraphs Act*, and those sections of the *Railway Act* which formerly dealt with Telecommunications.

46. Industry Canada, *The Canadian Telecommunications Service Industries*, 57.
47. Department of Communications, "Beatty Tables Bill to Modernize Regulation of Canada's Telecommunications System." *News Release* (Ottawa: Department of Communications, February 27, 1992). Please see accompanying background on Bill C-62.
48. *Ibid.*
49. Section 7(c) of the *Act* states that one of its objectives is to "enhance the efficiency and competitiveness, at the national and international levels, of Canadian telecommunicatic .."
50. This last objective directly applies to our study of Teleglobe's overseas monopoly and 80% Canadian ownership rules. The *Act* (sections 17-21) also forbids any person from operating an international submarine cable or constructing or operating "any works or facilities for the purpose of operating an international submarine cable."
51. *Statutes of Canada*, 1993, 41-42 Elizabeth II, c.38 [Telecommunications Act] (Ottawa: Queen's printer for Canada, 1993).
52. Bruce Gates, "Teleglobe Overseas Long Distance Monopoly on the Line," *Financial Post*, 9 September 1991, 33.
53. James Bagnall, "Teleglobe Tries Bell's Patience," *Financial Times of Canada*, 9 March 1992, 8; CRTC, *Annual Report, 1990-1991*, 38. See also Mike Urlocker, "Memotec's Musclemen".
54. James Bagnall, "Teleglobe Tries Bell's Patience".
55. Bruce Gates, "Teleglobe Overseas Long-Distance Monopoly"; Mike Urlocker, "Teleglobe's Profit Triples".
56. *Ibid.*
57. Mike Urlocker, "Memotec's Musclemen".
58. Terrence Corcoran, "Stop the Teleglobe Monopoly Now," *Globe and Mail*, 5 February 1992, B2.

59. Department of Communications. "Teleglobe." *Speaking Notes for the Hon. Perrin Beatty* (Ottawa: Department of Communications, March 18, 1992). See Appendix F for full text of the Minister's speech. See also, "Teleglobe Wins 5 Year Monopoly in Overseas Calls," *Toronto Star*, 19 March 1992, D11.
60. Jan Ravensbergen. "Ottawa Extends Teleglobe's Monopoly For Five Years." *Montreal Gazette*, 19 March 1992, C1,C3.
61. Ann Gibbon. "Teleglobe Retains Monopoly." *Toronto Star*, 19 March 1992, B2.
62. *Ibid.*

## Endnotes for Chapter Five

1. Consistent with the March 18, 1992 statement extending Teleglobe's monopoly for another five year period with a review after three years, on July 12, 1995, Industry Canada invited comment on "various issues related to the carriage of telecommunications between Canada and countries overseas . . ." and "in particular. . . Teleglobe's future role." In addition to questions on market competition, traffic routing considerations, international considerations (eg. Teleglobe's role in INTELSAT and INMARSAT) and ownership considerations, Industry Canada invited public comment on the this general question: "Which measures or policies should be implemented to insure that the Canadian-based, overseas service market grows and achieves the necessary economies of scale to sustain long-term domestic and international competitiveness?"

Teleglobe submitted its response to Industry Canada on October 27, 1995 in which it indicated its intent to not seek a renewal of its mandate and support for "sustainable competition." Teleglobe's proposals for Sustainable competition included regulatory reform to increase Teleglobe's price flexibility vis-a-vis international competitors; "delaying" the entry of Stentor carriers into the overseas market, in recognition of Teleglobe's investment in an extensive overseas network; reciprocal access to the U.S. market; and enforcing the current policy regarding by-pass of Canadian facilities until a rules-based, integrated North American market is established. Finally, in order to be a globally competitive carrier in an unregulated market, Teleglobe argued that it must have access to global sources of capital and the flexibility to form alliances with foreign carriers. The company's response called for the federal government to repeal the *Teleglobe Act*, and subject the firm, like all other Canadian carriers, to the *Telecommunications Act* thus eliminating Teleglobe's unique foreign ownership restrictions, which included a prohibition on any foreign carriers holding stock in the company. Moreover, Teleglobe called for the federal government to raise the *Telecommunications Act's* ceiling on foreign carrier investment in Canadian carriers from 20% to 49%.

See, Industry Canada, "Notice No. DGTP-00X-95 (July 1995) Review of Canadian Overseas Telecommunications and Specifically Teleglobe Canada's Role," July 12, 1995 (Canada Gazette Notice accessed through World Wide Web); Teleglobe Canada Incorporated, "Submission in Response to Canada Gazette, Part 1, 22 July 1995, Notice DGTP-008-95 Review of Canadian Overseas Telecommunications and Specifically Teleglobe Canada's Role," 27 October 1995.

2. Michael Porter, *Canada at the Crossroads: The Reality of a New Competitive Environment* (Ottawa: BCNI and Minister of Supply and Services, 1991), 350.

3. *Ibid.*, 359-362, 379. For example, in regard to foreign investment policy, Porter advised his clients that the traditional Canadian concern over foreign ownership must be replaced by the goal to transform foreign subsidiaries into home bases for the most innovative and therefore productive undertakings. The reason why foreign-owned Canadian subsidiaries are predominantly multinational marketing arms or raw material sourcing agents is due to the Canadian economy's inability to foster an environment conducive to innovation and productivity. Thus, state intervention, Porter advised the government, can not remedy the pervasive and unproductive pattern of foreign investment in Canada. On the contrary, the solution to this issue ultimately depends upon the economy's capacity to foster robust industry diamonds in which the federal government's economic role is to establish an economic framework in which the market's competitive pressures will come to bear.

We will recall from our observations in chapter one that the Conservative government pursued Porter's advice as the foundation underlying the prosperity initiative. The "Action Plan" which resulted from the prosperity initiative consultations confirms Porter's prescriptions as the agenda the Conservative government planned to follow to develop Canada's economic competitiveness into the next millennium. See, Steering Group on Prosperity, *Inventing Our Future: An Action Plan for Canada's Prosperity* (Ottawa: Minister of Supply and Services, 1992), 9.

4. "Republicans Stand to Transform the Agenda," *New York Times*, 11 November 1994, A1; "New Majority's Agenda: "Substantial Changes may be Ahead," *New York Times*, 11 November 1994, A10; "Allegro Furioso," *The Economist*, 19 November 1994, 27-28; "The Republican Congress the Evolution of a Revolution," *The Economist*, 4 November 1995, 23-25.
5. After defeating the Progressive Conservative Party (then led by Kim Campbell) in the 1993 federal election on a positive economic platform and declaring in its first Throne Speech that it "attaches the highest priority to job creation and economic growth in the short and long term," the Liberal government of Prime Minister Jean Chrétien has instead dedicated its administration to reducing the budget deficit and rolling back the state. Reacting to business press hysteria over an approaching "debt wall" the Finance Minister, Paul Martin Jr. swore leading up to the 1995 budget that the Liberal government will meet its deficit reduction target of 3 per cent of GDP, or \$25 Billion, "come hell or high water." Martin proceeded to introduce a budget plan that calls for cuts in federal expenditure of \$15.6 Billion over three years and aims to almost half the budget deficit (including debt charges) from \$42 Billion in 1993-1994 to \$24.3 Billion in 1996-1997, which in the Minister's own words are "the largest set of actions in any Canadian budget since demobilisation after the Second World War."

However, the provincial governments in the nine english-speaking provinces have been the most active deficit cutters. The February 1995 Alberta budget included legislation making balanced budgets after 1995-1996 and orderly debt retirement after 1996-1997 the

law. Spending in Saskatchewan, Manitoba and the Atlantic provinces are at or below 1990-1991 levels resulting in massive cuts to education, health and welfare. In Ontario, the Progressive Conservative government is on course to balance the province's budget by 2001 and cut provincial income taxes by 30 per cent (see note eight).

Parliament, House of Commons, *Debates*, 1st Session, 35th Parliament, Vol. 134 (18 January 1994), 9-11; Liberal Party of Canada, *Creating Opportunity: The Liberal Plan for Canada* (Ottawa: Liberal Party of Canada, 1993); Department of Finance, *Budget in Brief and Budget Speech* (Ottawa: Department of Finance, February 27 1995). For an analysis of the Liberal government's deviation to the right, see Duncan Cameron, "Right Turn," *Canadian Forum* (January/February 1995), 5. For the provinces, see "Alberta Budget Highlights: 1995-1996," KPMG Centre for Government, KPMG On-Line, 1995; Shawn McCarthy, "The New Austerity," *Toronto Star* 22 July 1995, B1, B4.

6. In 1985, the federal Conservative Finance Minister said his government's economic growth strategy was to "remove obstacles to growth, cut waste, improve effectiveness, and make better use of limited resources." In 1995, the Ontario Conservative government's Economic Development Minister said "our approach (to job creation) involves action on two fronts. On the one hand, we must eliminate government waste and balance our budget . . . . And on the other hand, we must unshackle business, give them the room to create wealth and employment. . . ." Secondly, both government's upon their arrival to power proudly proclaimed their jurisdictions "open for business." Finally, it is no surprise that the Ontario Conservatives immediately raised the possibility of privatizing Provincial Crown assets after winning the 1995 Ontario election. Shortly after taking office, the new economic development minister said, "everything's on the table," citing in particular Ontario's 49% stake in de Havilland Canada.

Department of Finance, *The Budget Speech* (Ottawa: Department of Finance, 1985); Remarks for the Honourable William Saunderson Minister of Economic Development, Trade and Tourism at the Institute of Chartered Accountants of Ontario, October 16, 1995; James Walker, "Everything on the Table as Ontario Privatizes," *Financial Post*, 23 October 1995, 20.

7. Brian Mulroney announced his resignation on February 24, 1995. In the last two years of his second administration, the Conservative government lost control of the budget deficit, missing reduction targets substantially for the 1991-1992 and 1992-1993 fiscal years and sending the deficit to record highs. Receiver General of Canada, *Public Accounts of Canada 1994*, Volume 1, Summary Report and Financial Statements (Ottawa: Minister of Supply and Services, 1994), Statements on pages 1.6 and 1.7. See also Drew Fagan, "Deficit Balloons to \$34.6 Billion This Year," *Globe and Mail*, 20 November 1992, B1, B2; Alan Freeman, "Major Economic Reform Mulroney Legacy," *Globe and Mail*, 25 February 1993, A4.

8. Ontario Progressive Conservative Party, "The Common Sense Revolution" May 3, 1994; Legislative Assembly of Ontario, *Debates*, 1st Session, 36th Parliament 27 September 1995), 3-7; Ontario, Ministry of Finance, "Finance Minister Outlines \$1.9 Billion in Spending Cuts; Government Outlines Spending Cuts, Audits, Accounting Review," July 21, 1995.
  
9. These conclusions support the increasing body of new economic growth theory, theory which may provide the basis of a post-fordist mode of regulation or at the least, a new theory of state intervention in response to the challenges of global competition. The economists, such as Paul Romer, who comprise this school of thought argue that technological innovation and knowledge are the most important sources of economic growth, productivity and employment in the new world economy and the state should support innovation to foster prosperity and competitiveness. Applying new economic growth theory to public policy, Romer and Canadian economic journalists like David Crane strongly support state intervention in the areas of skills development, science and technology and the development of an innovation infrastructure. Crane argues that these policies should form the foundation of a Canadian industrial strategy to build a competitive economy into the next millennium.
 

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10. Leslie A. Pal, "The Role of the State: Canada and the Contradictions of Political Cohesion," in *Un Etat Réduit?/A Down-Sized State?*, ed. Robert Bernier and James Iain Gow (Sainte-Foy, PQ: Presses de l'Université du Québec, 1994), 389-407.
  
11. Christopher Lasch, *The Revolt of the Elites and the Betrayal of Democracy* (New York: W.W. Norton, 1995). Mr. Lasch, long a critic of the American right, died shortly before this book was published.

## APPENDICES

APPENDIX A

Post World War II Industrial Growth:

Canada and OECD Countries

Labour Productivity Growth in Five Countries:  
Aggregate and Manufacturing, 1950-1984 (avg. annual percentage change).

Growth of GDP per hour worked	France	West Germany	Japan	UK	USA
1950-73	5.01	5.83	7.41	3.15	2.44
1973-9	3.83	3.91	3.40	2.18	0.80
1979-84	3.24	1.88	3.06	2.95	1.09
Growth of manufacturing output per hour					
1950-73	5.63	6.31	9.48	3.21	2.62
1973-9	4.90	4.22	5.39	1.15	1.37
1979-84	3.50	2.78	5.46	4.28	3.10

*Source:* Lynn Krieger Mytelka, "Crisis, Technological Change and the Strategic Alliance," in *Strategic Partnerships: States, Firms and International Competition*, ed. Lynn Krieger Mytelka (London: Printer Publishers, 1991), 22, Table 1.5.

Total Industrial Production:  
OECD 1960 - 1975 (1970 = 100)

## O.E.C.D.-TOTAL

1970 = 100

	Total industrial production S.I.C. 2, 3, 4101, and 4102					Production industrielle totale C.I.T.I. 2, 3, 4101 et 4102											
	Year	Q.1	Q.2	Q.3	Q.4	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
1960	96	96	97	95	97	96	97	97	97	97	97	96	95	97	95	98	96
1961	98	98	99	97	92	95	96	97	98	98	98	96	96	99	92	92	91
1962	97	97	93	91	98	99	91	93	93	93	96	99	99	96	95	95	93
1963	97	98	97	95	75	92	94	96	96	97	98	93	92	94	73	71	99
1964	72	76	73	70	75	65	71	72	72	73	73	67	67	74	75	75	76
1965	77	76	77	76	80	73	75	76	76	77	78	72	71	79	91	91	79
1966	82	80	83	80	85	78	81	83	83	83	85	76	77	85	88	88	86
1967	84	85	85	82	98	81	86	89	85	85	76	80	79	88	89	90	89
1968	91	89	91	89	96	85	89	91	90	90	93	86	85	94	96	98	95
1969	98	96	99	95	101	92	96	99	98	99	101	93	92	101	102	103	99
1970	100	100	102	97	101	96	101	102	102	102	103	95	93	102	102	102	100
1971	101	101	103	98	106	98	101	102	102	102	104	96	93	103	109	109	101
1972	104	104	109	105	115	101	104	104	106	108	110	101	100	113	115	116	116
1973	118	119	120	119	123	111	117	119	118	119	122	112	110	123	126	129	126
1974	118	120	122	115	117	116	120	122	121	142	126	113	109	141	121	118	111
1975	109	108	108	105	114	105	109	108	108	108	110	102	100	113	118	115	112

Source: OECD, *Industrial Production: Historical Statistics: 1960-1975* (Paris: OECD, 1976), 234.

Growth of Real GNP, Employment and Productivity:  
Canada, 1961-1975

Table 4 Growth of Real GNP, Employment and Productivity

	Real GNP	Employment	Productivity
1961	2.8	1.5	1.3
1962	6.8	2.8	3.9
1963	5.2	2.4	2.7
1964	6.7	3.7	2.9
1965	6.7	3.8	2.8
1966	6.9	4.2	2.6
1967	3.3	3.2	0.1
1968	5.8	2.1	3.6
1969	5.3	3.2	2.0
1970	2.5	1.3	1.2
1971	5.7	2.5	3.1
1972	6.0	3.1	2.8
1973	6.9	5.2	1.6
1974	2.8	4.3	-1.4
1975	0.2	1.9	-1.7

Source: National Income and Expenditure Accounts and Bank of Canada Review.

Source: OECD, *Economic Surveys, 1975-1976: Canada* (Paris, OECD, 1976), 14, Table 4.

Growth of Real GNP:  
OECD Area, 1972-1975 (percentage changes)

	Average 1959-60 to 1972-73	From previous year		1973 to 1975
		1974	1975	
Canada	5.1	2.8	0.2	3.0
United States	4.2	-1.8	-2.0	-3.8
Japan	10.9	-1.3	2.1	0.8
France	5.9	3.9	-2.4	1.5
Germany	4.9	0.4	-3.4	-3.0
Italy	5.6	3.4	-3.7	-0.3
United Kingdom	3.3	0.1	-1.6	-1.
Other OECD countries	5.5	3.1	-0.6	2.5
Total OECD	5.5	0.2	-1.4	-1.2

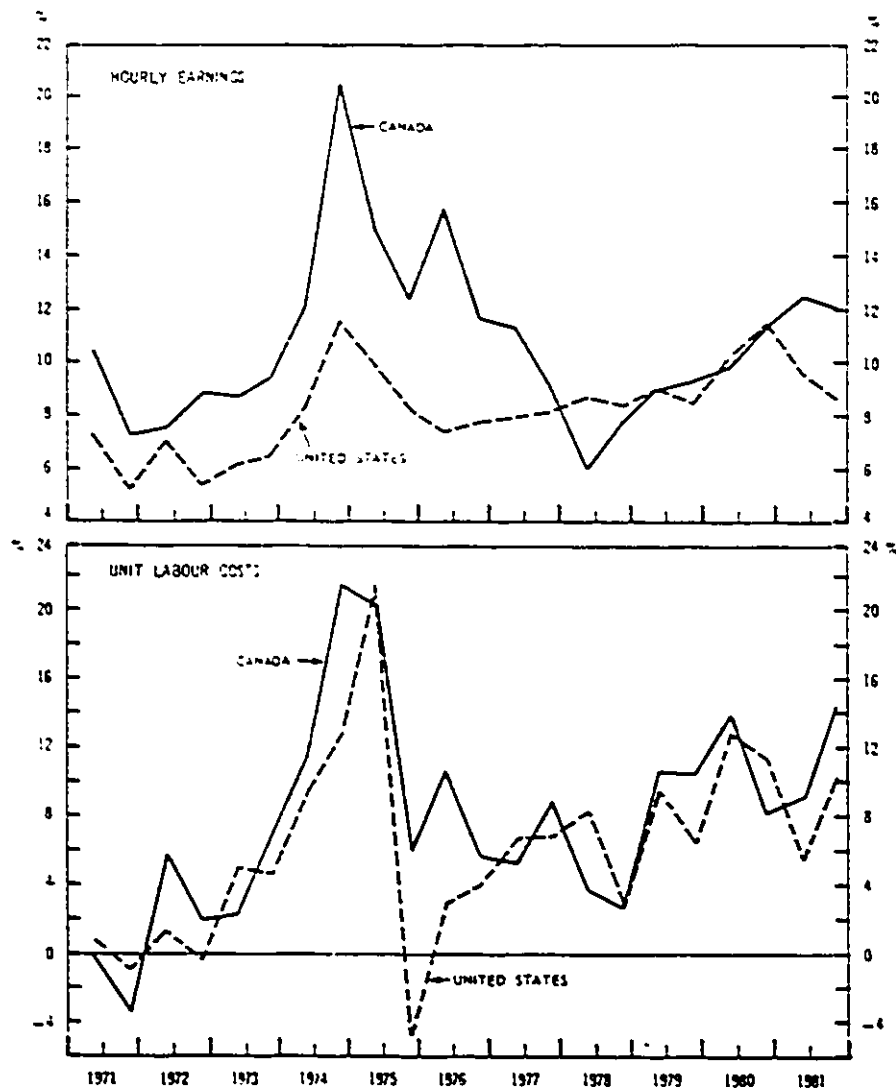
Source: OECD

Source: OECD, *Economic Surveys, 1975-1976: Canada* (Paris: OECD, 1976), 6, Table 1.

APPENDIX B

Selected Canadian Economic Competitiveness Indicators,

1950-1983

Manufacturing Costs, 1971-1981<sup>1</sup>

1. Seasonally-adjusted annual percentage rate of increase on preceding half-year.  
 Source: OECD, *Main Economic Indicators*.

Source: OECD, *Economic Surveys, 1981-1982: Canada* (Paris: OECD, 1982), 16, Diagram 4.

Composition of Canadian Imports and Exports:  
 Import and Export Volumes by Commodity Classification, 1968-1975

	Weight in total 1972, per cent	1968/1971	1972/1974	1975
<i>Exports</i>				
Fish and farm products	11.6	13.3	3.1	6.0
Forest products	13.3	3.4	2.6	-21.9
Metals and minerals	24.5	4.1	4.6	13.9
Motor vehicles and parts	23.4	13.6	4.7	4.5
Other manufactured goods	17.4	6.5	-4.9	-6.0
<i>Imports</i>				
Industrial materials	20.6	9.4	7.9	-15.3
Construction materials	2.5	3.5	29.7	-18.0
Producers equipment	21.4	6.8	16.7	-0.8
Food	6.6	1.4	-1.0	-0.3
Other consumer goods	11.9	8.3	11.8	-6.2
Motor vehicles and parts	..	9.4	10.6	-1.1

Source: Bank of Canada Review.

22 In fact, the trade balance improved in value terms between the two halves of the year but not sufficiently to outweigh the usual deterioration in the service account.

Source: OECD, *Economic Surveys, 1975-1976: Canada* (Paris: OECD, 1976), 22, Table 9.

Balance of Payments:  
Canada, 1963-1972 (OECD basis, US\$ million)

	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972
<i>Current account:</i>										
Exports	7 004	8 114	8 600	10 085	11 030	13 143	14 415	16 793	18 478	21 035
Imports	6 243	7 131	8 156	9 778	10 384	11 709	13 461	13 739	15 887	19 298
Trade balance	761	983	444	307	646	1 434	954	3 054	2 591	1 737
Services, net	-1101	-1 215 <sup>1</sup>	-1 347 <sup>1</sup>	-1 245	-973	-1 493 <sup>1</sup>	-1 753	-1 931	-2 116	-2 262
Balance on goods and services	-340	-232	-903	-938	-327	-59	-799	1 123	445	-525
Private transfers, net	-83	-79	-42	13	33	100	49	84	116	166
Official transfers, net	-60	-64	-86	-154	-169	-123	-132	-194	-200	-225
Current account balance	-483	-375	-1 031	-1 079	-463	-81	-882	1 013	391	-584
<i>Capital account:</i>										
Long-term capital	591	777 <sup>1</sup>	818 <sup>1</sup>	1 083	1 256	1 551 <sup>1</sup>	2 166	710	391	1 790
(a) Private	281	364	659	910	467	553	1 260	693	493	966
(b) Official	310	413	159	173	789	998	906	17	-101	824
Basic balance	108	402	-213	4	793	1 470	1 284	1 723	782	1 206
Short-term non-monetary capital and unrecorded	136	219	-28	139	-453	-995	-735	-29	-1 385	-1 760
Balance on non-monetary transactions	244	621	-241	143	340	475	549	1 694	-603	-554
Private monetary institutions short-term capital	-115	-249	413	-423	-312	-305	-495	-86	1 380	727
Assets	-466	-681	610	-205	-554	-751	-2 103	-1 370	509	-1 241
Liabilities	351	432	-197	-218	242	446	1 608	1 284	871	1 968
Balance on official settlements	129	372	172	-280	28	170	54	1 608	777	168
Use of IMF credit	-79	-59	-	-	-	-	-	-	-	-
Special transactions	-	-35 <sup>2</sup>	-35 <sup>2</sup>	-	-	-35	-	-	-	-
Miscellaneous official accounts	3	-2	11	-54	-15	193	6	-159	-4	54
Allocation of SDR's	-	-	-	-	-	-	-	124	118	126
Change in reserves (+ = increase)	52	276	148	-334	13	328	60	1 573	891	318
(a) Gold	108	209	125	-105	-31	-152	9	-81	1	-28
(b) Currency assets	-56	-130	-133	-325	60	709	-221	1 280	1 038	293
(c) Reserve positions in the IMF	-	197	156	96	-16	-227	272	192	-338	-18
(d) Special Drawings Rights	-	-	-	-	-	-	-	182	190	101

<sup>1</sup> Data are adjusted to include debt obligations payable by the United Kingdom, but waived.

<sup>2</sup> See footnote 1.

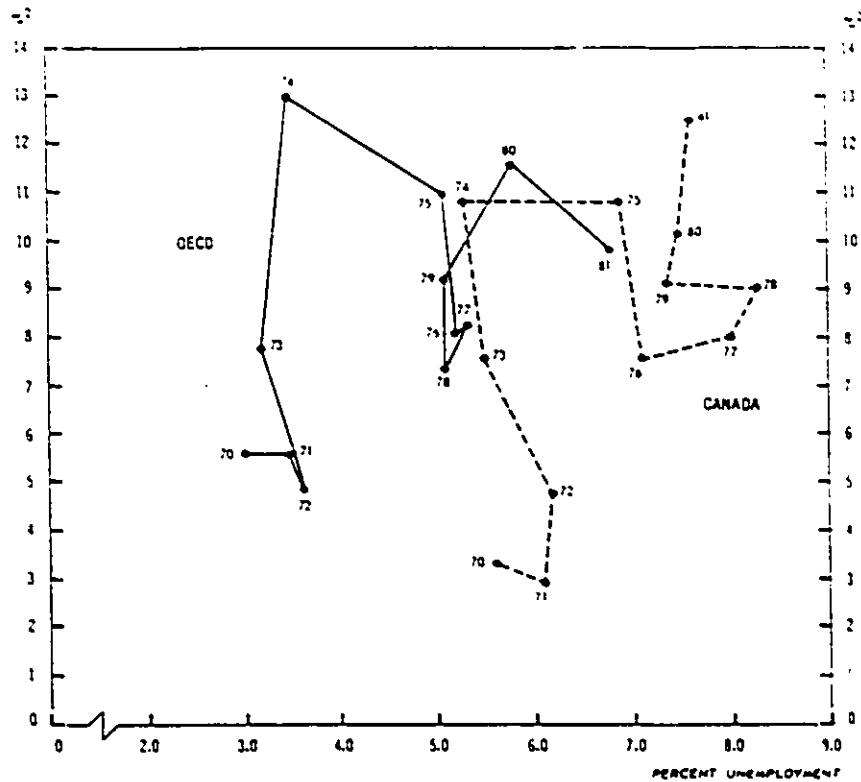
NOTE: Detail may not add due to rounding.

SOURCE: The Canadian Balance of International Payments, Canadian submission to the OECD and Secretariat adjustments.

Source:

OECD, *Economic Surveys, 1973: Canada* (Paris: OECD, 1973), 46.

Inflation and Unemployment:  
Canada and other OECD, 1970-1981 (percent)



Source: OECD, *Economic Surveys, 1981-1982: Canada* (Paris: OECD, 1982), 29, Diagram 6.

Balance of Payments:  
Canada, 1973-1982 (US\$ million)

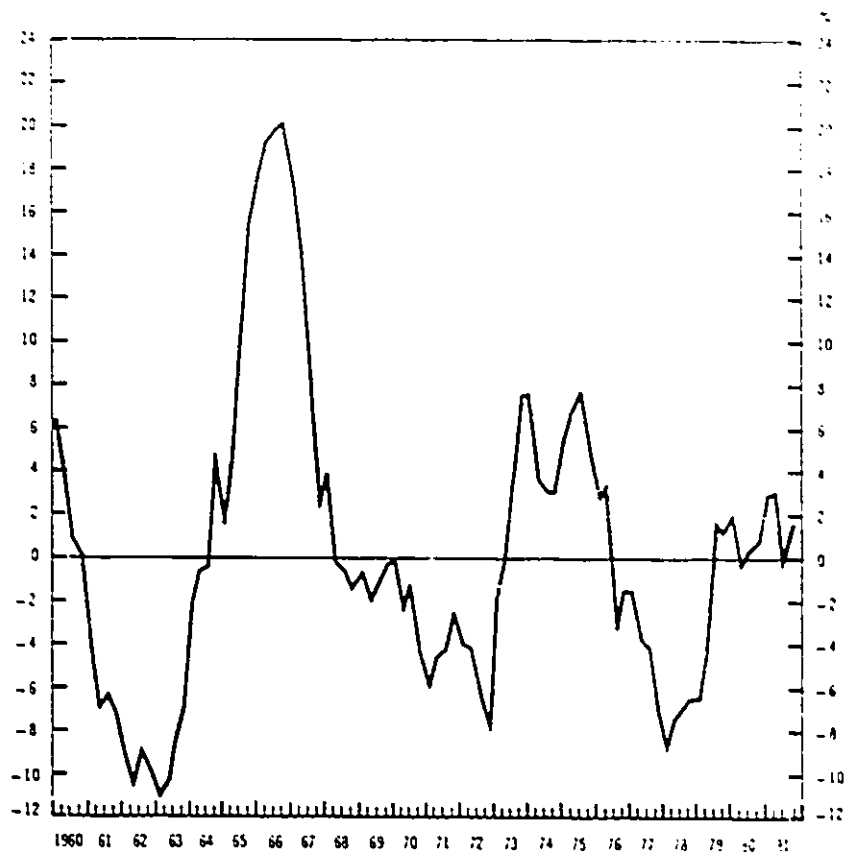
	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982
<b>Current account:</b>										
Merchandise exports	26 370	34 338	33 922	39 840	42 949	47 939	57 403	67 582	72 276	70 446
Merchandise imports	23 377	32 400	34 652	38 137	40 000	44 020	53 480	59 802	65 665	55 424
Trade balance	2 992	1 938	-730	1 703	2 949	3 913	3 923	7 780	6 611	15 022
Services, net	-2 906	-3 561	-3 864	-5 627	-6 582	-7 773	-8 084	-8 933	-11 447	-13 057
Travel, net	-1 742	2 023	2 506	3 166	3 447	3 581	3 377	3 914	4 067	4 559
Interest and dividends, net	-1 260	-1 588	-1 921	-2 534	-3 427	-4 117	-4 476	-4 604	-5 401	-7 543
Other services, net	-3 388	-3 996	-4 443	-6 259	-6 902	-7 237	-6 985	-8 243	-10 113	-9 573
Transfers, net	22	130	-83	26	-110	-467	-77	216	376	199
Private, net	275	469	421	488	397	331	474	797	975	911
Official, net	-253	-339	-504	-462	-507	-798	-551	-582	-599	-712
Current account balance	108	-1 493	-4 677	-3 897	-4 043	-4 327	-4 237	-937	-4 459	2 163
<b>Capital account:</b>										
Long-term capital, net	620	1 065	3 869	8 122	3 966	5 431	-570	1 407	-405	6 964
Private - Direct	59	36	-187	-902	-249	-1 810	-1 431	-2 194	-8 758	-993
Portfolio	127	157	802	3 276	1 964	539	395	2 094	2 022	1 656
Other	316	-62	290	888	-166	1 223	1 576	90	1 621	995
Public - Portfolio	534	1 655	3 600	5 498	3 050	3 739	2 444	2 212	6 762	7 489
Other official <sup>1</sup>	-416	-721	-636	-637	-965	1 741	-3 554	-795	-2 052	-2 182
Short-term capital, net	1 189	398	450	-3 754	-566	1 597	3 866	-1 091	4 929	-9 644
Private non-monetary	-499	2 038	620	913	-1 144	1 412	1 499	-1 986	-3 695	-3 651
Private monetary institutions	-117	-759	1 017	-909	1 602	2 487	4 061	1 243	16 051	-3 934
Official non-monetary	77	46	-4	7	162	48	185	146	137	-21
Miscellaneous official accounts <sup>2</sup>	-7	54	-40	54	123	-39	21	-28	79	-24
Allocation of SDRs	-	-	-	-	-	-	187	186	175	-
Errors and omissions	-650	-887	-1 183	-3 765	-1 186	-2 350	-1 879	-494	-7 564	-2 038
Change in reserves	-467	24	-397	524	-1 219	-161	-733	-464	318	-540

1. Including drawings on standby credit facilities. Excludes special transactions.

2. Including Bank of Canada liabilities towards foreign central banks.

Source: Statistics Canada, OECD Secretariat.

Source: OECD, *Economic Surveys, 1982-1983: Canada* (Paris: OECD, 1983), 58, Table D.

Business Non-Residential Investment, Canada<sup>1</sup>:

1. Percentage deviation of volume outlays from 1960-1981 trend.

Source: Secretariat estimates.

Source: OECD, *Economic Surveys, 1981-1982: Canada* (Paris: OECD, 1982), 12, Diagram 1.

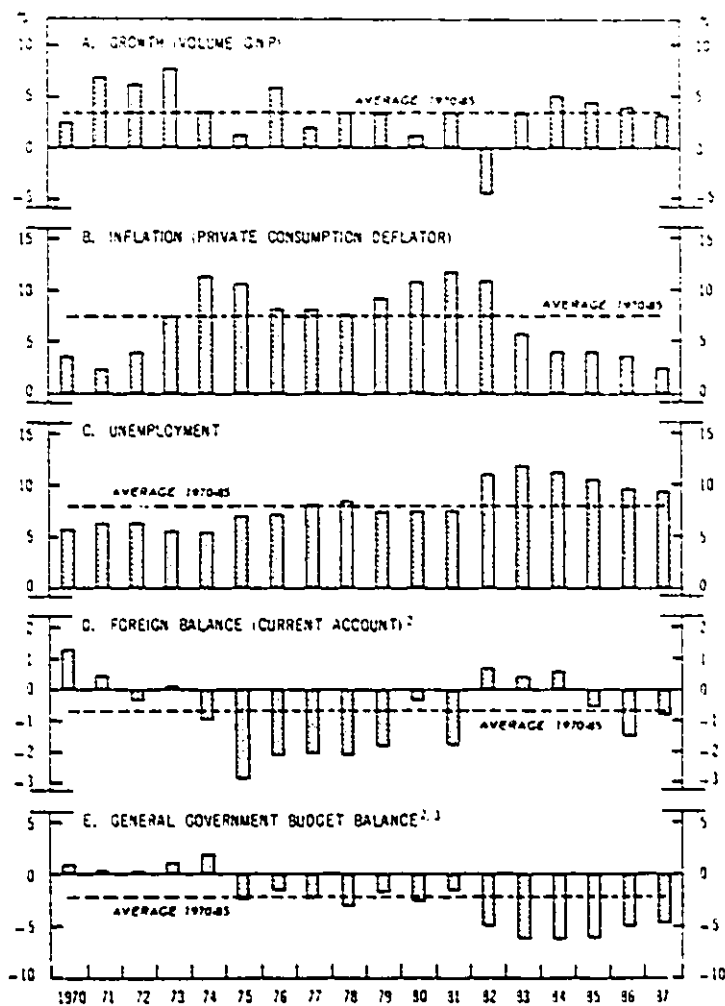
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APPENDIX C

Selected Canadian Economic Indicators,

1984-1993

Macroeconomic Performance Indicators:  
Canada, 1970-1987 (percent)<sup>1</sup>



1. Data for 1986 and 1987 are OECD Secretariat forecasts.

2. Percent of GNP.

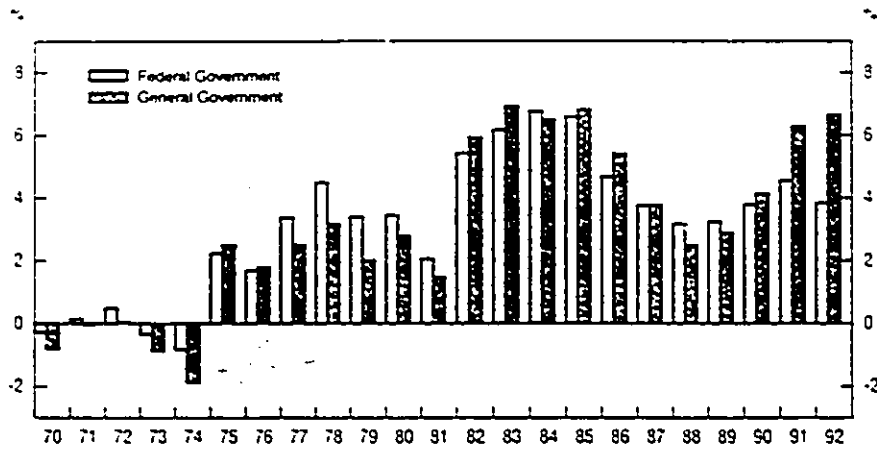
3. National accounts basis.

Sources: Statistics Canada, *National income and expenditure accounts*; OECD.

Source:

OECD, *Economic Surveys, 1985-1986: Canada* (Paris: OECD, 1986), 21, Diagram 7.

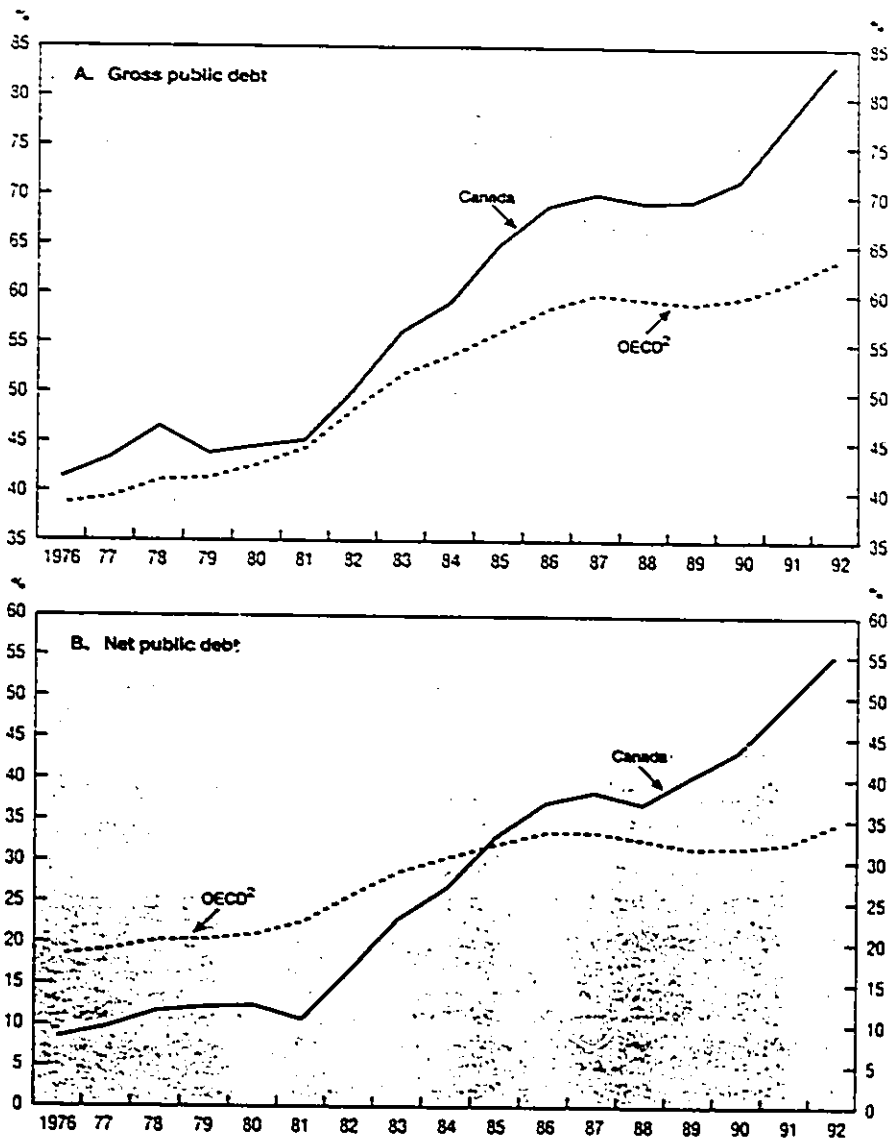
Federal and General Government Deficits:  
Canada, 1970-1992 (as a percentage of GNP)



Sources: CANSIM - Statistics Canada; OECD, *National Accounts*.

Source: OECD, *Economic Surveys, 1992-1993: Canada* (Paris: OECD, 1993), 39, Diagram 11.

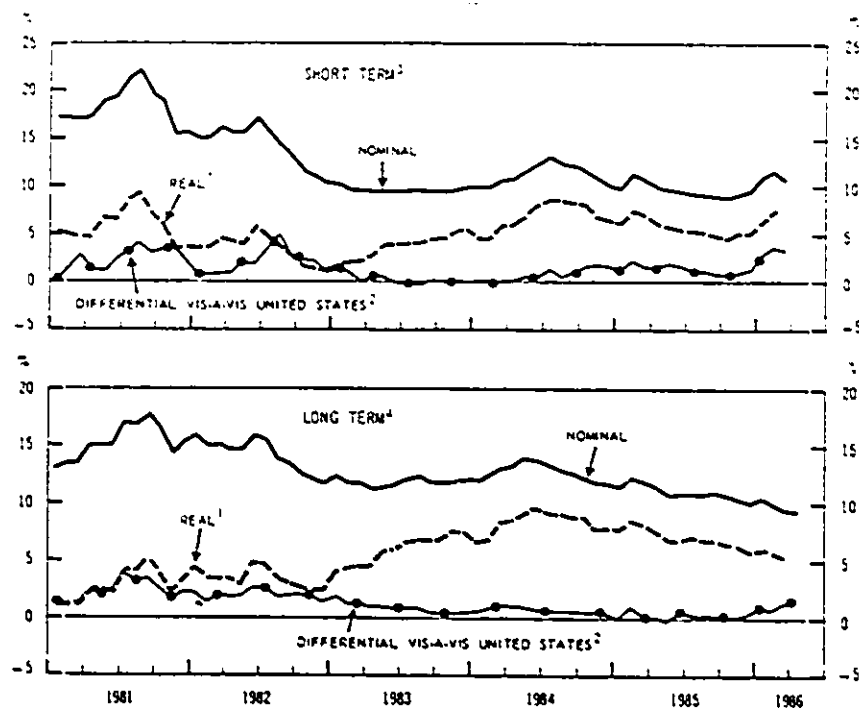
Public Debt:  
Canada, 1976-1992 (as a percentage of GNP)



1. General government; national accounts definitions.
  2. Weighted average of 17 countries (1987 GDP weights and exchange rates).
- Source: OECD, *National Accounts*; Secretariat estimates.

Source: OECD, *Economic Surveys, 1992-1993: Canada* (Paris: OECD, 1993), 42, Diagram 13.

## Interest Rates: Canada, 1981-1986



1. Deflated by year-on-year CPI growth rate.
2. Canadian less United States rates.
3. Yield on 90-day commercial paper.
4. Yield on government bonds of over 10 years to maturity.

Sources: OECD; Bank of Canada, *Review*.

Source: OECD, *Economic Surveys, 1985-1986: Canada* (Paris: OECD, 1986), 26, Diagram 10.

Productivity Growth in Selected Industries<sup>1</sup>:  
Canada, 1954-1981 (percentage change)

Industry	1954 to 1974	1974 to 1979	1974 to 1981
Mining	6.1	-3.3	-4.9
Metals	3.6	-2.7	..
Oil and gas	7.3	-9.6	..
Manufacturing	4.0	2.6	1.1
Wood	2.4	3.5	1.7
Pulp and paper	2.5	2.6	0.7
Primary metals <sup>2</sup>	3.9	2.5	0.6
Non-metallic mineral products	3.6	3.1	..
Petroleum and coal products	5.7	-9.7	..

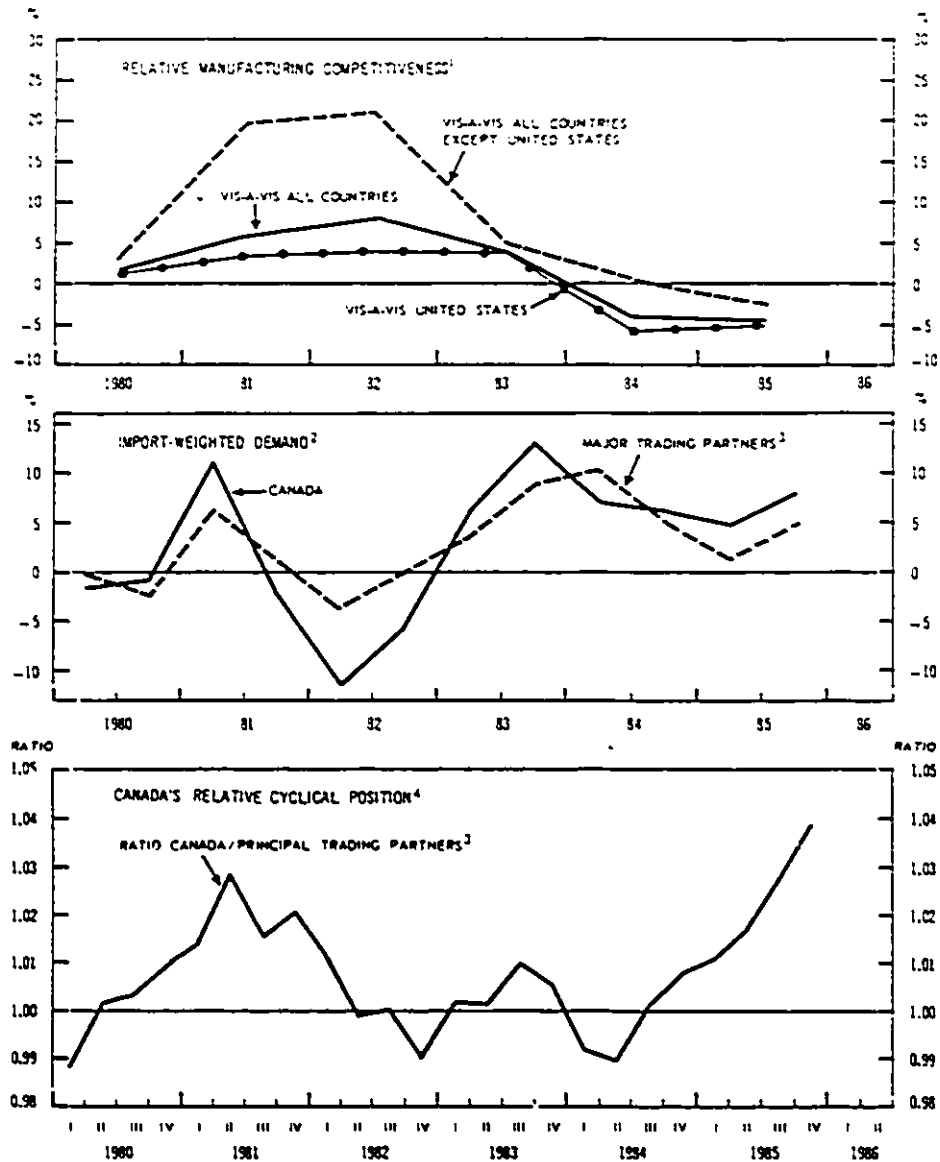
1. Estimated in terms of volume output per man.

2. Except for 1974 to 1981 primary metals and metal fabrication.

Sources: Gerard Stuber: *A note on productivity developments at the industrial level*, Bank of Canada Review, January 1982 (periods 1954 to 1974 and 1974 to 1979); Statistics Canada, *Manufacturing Industries of Canada: National and Provincial Areas and Gross Domestic Product by Industry*.

Source: OECD, *Economic Surveys, 1983-1984: Canada* (Paris: OECD, 1984), 33, Table 10.

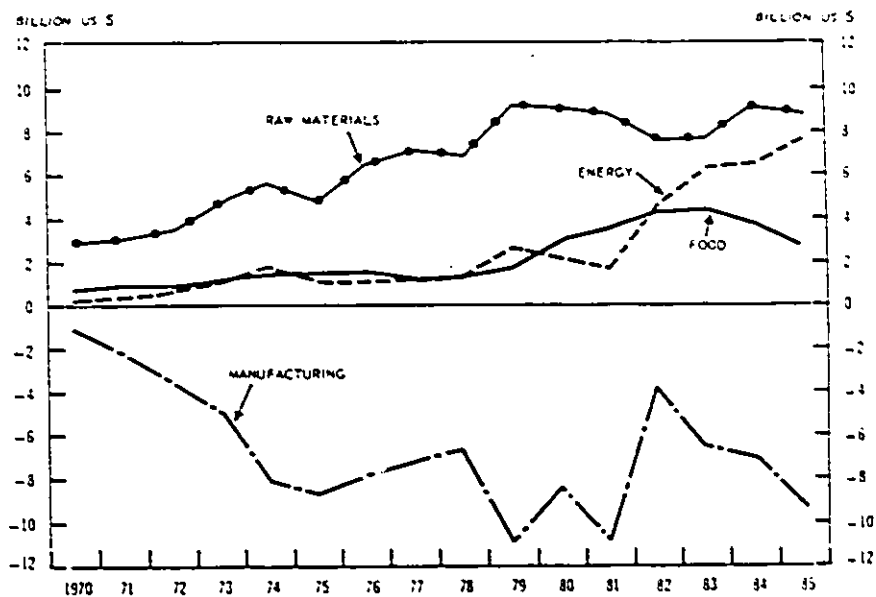
### Determinants of Foreign Trade Performance: Canada, 1980-1986



1. Percentage change in relative manufacturing unit labour costs measured in United States dollars.
2. Percentage change on preceding period (s.a.a.r.)
3. United States, Japan, Germany and United Kingdom; weighted average according to 1984 share in Canadian exports.
4. Ratio of volume GNP to phase-average trend for Canada, divided by the corresponding ratio for Canada's major trading partners.

Source: OECD, *Economic Surveys, 1985-1986: Canada* (Paris: OECD, 1986), 17, Diagram 5.

Commodity Structure of Canadian Trade Balance:  
(US\$ billion, custom basis)



Source: OECD.

Source: OECD, *Economic Surveys, 1985-1986: Canada* (Paris: OECD, 1986), 19, Diagram 6.

APPENDIX D

World Competitiveness Report:

Criteria for Competitiveness Measurements

## Principles Used in the Analysis of World Competitiveness

### *I Domestic Economy*

1. Productivity reflects value-added in short-term.
2. Long-term competitiveness requires capital formation.
3. Prosperity of a country reflects its past economic performance.
4. Competition governed by market forces improves the economic performance of a country.
5. The more competition there is in the domestic economy, the more competitive the domestic firms are likely to be abroad.

### *II Internationalization*

1. A country's success in international trade reflects competitiveness of its domestic economy (provided there are no trade barriers).
2. Openness for international economic activities increases a country's economic performance.
3. International investment allocates economic resources more efficiently worldwide.
4. Export-led competitiveness often is associated with growth-orientation in the domestic economy.
5. Maintaining a high living standard requires integration with the international economy.

### *III Government*

1. The state intervention on business activities should be minimized apart from creating competitive conditions for enterprises.
2. Government should however provide macroeconomic and social conditions that are predictable and thus minimize the external risks for economic enterprise.
3. Government should be flexible in adapting its economic policies to a changing international environment.

### *IV Finance*

1. Finance facilitates value-adding activity.
2. A well-developed, internationally integrated financial sector in a country supports its international competitiveness.

### *V Infrastructure*

1. A well-developed infrastructure including the availability of natural resources and functional business systems supports economic activity.
2. The state must care for infrastructure if no private arrangement exists.

### *VI Management*

1. A competitive price/quality-ratio of products reflect managerial ability in a country.
2. Long-term orientation of management increases competitiveness over time.
3. Efficiency in economic activity together with ability to adapt to changes in the competitive environment are managerial attributes crucial for enterprise competitiveness.
4. Entrepreneurship is crucial for economic activity in its start-up phase.
5. In more mature business, corporate management requires skill for integration and differentiation of business activities.

### *VII Science and Technology*

1. Competitive advantage can be built on efficient and innovative application of existing technologies.
2. Investment in basic research and innovative activity creating new knowledge is crucial for a country in a more mature stage of economic development.
3. Long-term investment in R&D is likely to increase competitiveness of a firm.
4. Non-defense private/business investment in R&D is likely to increase competitiveness of a country more than public investment in defense R&D.

### *VIII People*

1. Skilled labour force increases a country's competitiveness.
2. Attitude of the workforce affects competitiveness of a country.
3. Competitiveness tends to increase the level of expectations for the quality of life.

Source:

*World Competitiveness Report, 1993* (Geneva: IMD International and the World Economic Forum, 1993), 31, Table 2.

APPENDIX E

Alternative Classification Schemes  
for High-Technology Industries

Classification scheme	Categories identified as high technology
Organization for Economic Cooperation and Development (OECD), International Standard Industrial Classification (ISIC) <sup>a</sup>	Drugs and medicines (ISIC 3522) Office machinery and computers (ISIC 3825) Electrical machinery (ISIC 383, but excluding 3832) Electronic components (ISIC 3832) Aerospace (ISIC 3845) Scientific instruments (ISIC 385)
US Department of Commerce, Standard Industrial Classification (SIC)	Guided missiles and spacecraft (SIC 376) Communications equipment and electronic components (SIC 365 and 366) Aircraft and parts (SIC 372) Office, computing and accounting machines (SIC 282) Ordnance and accessories (SIC 348) Drugs and medicines (SIC 283) Industrial organic chemicals (SIC 351) Plastic materials, synthetic resins, rubber and fibers (SIC 282)
Guerrieri and Milana <sup>b</sup>	Chemicals: Synthetic organic coloring Products for agriculture Radioactive materials Polymers and plastics Pharmaceuticals: Antibiotics and selected other products Power-generating machinery: Turbines Piston engines Electrical: Power machinery and selected apparatus Data processing: Machines, Processing and storage units, Parts Electronic office machines: Photocopying apparatus Other Telecommunications: Telephone, telegraphy, and transmission apparatus Selected equipment, parts and accessories Electronic components: Integrated circuits and microassemblies Semiconductors Television picture tubes Selected parts Aircraft: Aircraft, Helicopters, Spacecraft Reaction engines Scientific instruments: Electronic measuring and controlling instruments Particle accelerators Optical instruments

*continued . . .*

- <sup>a</sup> OECD data in these ISIC categories was 96 percent coextensive with data in the US Department of Commerce categories in 1980, and 100 percent in 1986.
- <sup>b</sup> The Guerrieri-Milana classification scheme is a refinement of the OECD scheme. The authors use data on world trade flows at the five-digit SITC level to classify certain industrial products within the OECD high-technology industrial classification schemes as "high-technology" products. They base their classification decisions on experts' and analysts' judgments. This "subjective" approach to identifying high-technology trade is now used by the US Bureau of the Census to calculate high-technology trade balances for the US. A recent paper by Abbot discusses the advantages and disadvantages of this approach and contrasts it with the more traditional OECD and Commerce approaches. *Sources:* Paolo Guerrieri and Carlo Milana, "Technological and Trade Competition in High-Tech Products" *BRJE Working Papers* 54 (Berkeley: University of California, Berkeley), October 1991; T.A. Abbot, "Measuring High-Technology Trade: Contrasting International Trade Administration and Bureau of Census Methodologies and Results," *Journal of Economic and Social Measurement* 17:17-44, 1991.

**Source:** Cited in Laura D'Andrea Tyson, *Who's Bashing Whom: Trade Conflict in High Technology Industries* (Washington: Institute for International Economics, 1992), 20-21, Table 2.1.

APPENDIX F

Speaking Notes for Perrin Beatty on Teleglobe

Montreal, March 18 1992

Mayor Jean Doré, Dear Colleague, Mr. Sirois  
Ladies and gentlemen,

One of the rewards of political life is sometimes to be the bearer of good news. I have good news for you today.

The Government of Canada has decided to renew, for a period of five years, Teleglobe's mandate as exclusive supplier of overseas telecommunications services in Canada.

This is good news -- first, for Teleglobe and its staff, who honour us today with their presence here in great numbers. The goal of this initiative is clearly to strengthen the industry and to consolidate jobs. I believe that by preserving the integrity of Teleglobe's internal market and by creating an opening for new, external markets, we will meet our objective.

This is good news for Quebec, too -- the Montreal area, in particular -- and Canada as a whole.

I am sure that this news will please officials of the City of Montreal and members of the region's business community. They have been asking for several months, and rightly so, for the continuation of Teleglobe as sole provider of telecommunications services.

My colleague, the Honourable Jean Corbeil, will speak to you in more detail about the implications of this decision for the region.

You may be assured, however, that the Government of Canada did not make this decision simply to be agreeable. We have good reasons -- both of public and economic interest -- to renew Teleglobe's mandate.

On the national political level, the decision reflects the primary objective of the telecommunications bill. With this legislation, we want to establish a coherent telecommunications policy which is sensitive to the interests of the regions and provinces -- a policy which recognizes the importance of telecommunications as a tool for economic development.

On the social level, this decision was necessary to preserve Canada's sovereignty in the telecommunications sector. It recognizes that our economic leadership cannot be ensured unless we own our telecommunications facilities, and unless the points of arrival and departure for our overseas communications are situated in Canada. Any fragmentation of our market would threaten both in the short term.

First, the decision recognizes that, with the present high level of competition in the world market, our domestic market is too small to make room for other operators of overseas telecommunications services. Exclusivity enables Teleglobe to negotiate with foreign administrations from a position of strength.

An event of few weeks ago provides another striking example of the importance of being able to negotiate from a position of strength with other countries. Against all expectations, the Canadian delegation at the World Administrative Radio Conference in Spain succeeded in obtaining new radio frequency allocations which will permit Teleglobe to improve its services.

Canada attended this conference with a certain degree of uneasiness. We knew that the United States and Europe were resolved to take control of these available spaces on the spectrum. Under such circumstances, we had very little chance of fulfilling our needs.

But the Canadian delegation, led by Communications Canada and made up of a strong contingent from the private sector, including representatives from Teleglobe, were persistent and ended up winning the cause for us. This is a remarkable success, which demonstrates the importance of valuing our interests on the international scene, and underscores the need for solidarity in our internal policies. This success will give us the raw material, in terms of radio frequencies, for the development of telecommunications services in Canada for years to come.

In other respects, telecommunications is undeniably a driving force behind economic development.

In October 1991, Teleglobe announced in Montreal a research and development program which would generate more than \$200 million in spending over five years. The bulk of these expenditures will be carried out in Quebec.

The program will lead to the creation of many jobs, most of which will be positions for engineers and scientists. These jobs will be in addition to the 2,500 jobs already provided by the telecommunications industry, which is one of the most promising in the Montreal area's high-technology sector.

When I met with the Mayor of Montreal to discuss the renewal of Teleglobe's exclusivity, he noted that Teleglobe is one of the focal points of the telecommunications industry in Montreal. Its investments in research will make an invaluable contribution to the area's economic recovery.

Financing and implementing Teleglobe's research program depend on the company's economic stability. Clearly, Teleglobe's projects would not be as favourably received by lenders if the agency were exposed to competition in its immediate market.

Moreover, it would be an inopportune moment to end Teleglobe's position as sole provider of telecommunications services. With the integration of North American and overseas telecommunications markets, Teleglobe is already facing stiff competition.

If the domestic market for overseas telecommunications were fragmented, there would be the risk that Teleglobe would be deprived of the most profitable part of its business and that its financial situation would be soon compromised. The major users of international communications might also be tempted to drop Teleglobe and the Canadian carriers in favour of the American network. Canada would thus lose some of its sovereignty in this leading sector.

Teleglobe has substantially met the government's expectations since it was privatized. It has also respected the commitments made by Memotec at the time of the transaction to keep the company's headquarters in Montreal and to renew the collective agreements in force with its employees.

To sum up, telecommunications is one of the major sectors in the Canadian economy. In 1990, they accounted for 2.7 percent of gross domestic product — a larger share than agriculture, forestry or mining.

In the present context, it seems absolutely necessary to maintain Teleglobe's exclusivity for overseas communications, both to preserve Canada's position on the world market and to support economic recovery in the Montreal area.

This is why we are convinced that this decision will contribute in a tangible way to the economy, whether in Quebec or in Canada as a whole.

Thank you.

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