ALLIANCE CAPITALISM, POLITICAL ECONOMY, AND THE MULTINATIONAL CORPORATION

A Theoretical and Empirical Investigation of Government-Business Relations in Canada 1971-1999

By

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A thesis submitted to the Department of Political Studies

in conformity with the requirements for

the degree of Doctor of Philosophy

Queen's University

Kingston, Ontario, Canada

September 1999

0-612-42941-5

Abstract

The process of economic globalisation has had a substantial impact on the fields of international relations and international political economy. The growing power of the integrated multinational corporation has mandated that governments adopt new approaches to the management of firm-state relations. This study examines such new approaches for the nation of Canada, and utilises a new theoretical tool – termed *alliance capitalism* – to outline the particular contours of firm-state relations in Canada. The empirical period examined is 1971- present, and examines the evolution of Canadian federal policy over that period. The basic tenets of alliance capitalism -- that government must work to attract business activity, and utilise partnerships with their primary economic constituents in order to accomplish this goal – are affirmed. The conclusion discusses the implications for Canadian policy that the advent of alliance capitalism holds.

Acknowledgements

The process of obtaining a Ph.D. is an ironic one – the writing of the thesis is a solitary activity, but it cannot be accomplished without the support of many individuals. First acknowledgment is always due to the supervisor, which in my case was Dr. Michael K. Hawes. Thank you for shepherding me through the process – for showing me what was fruitful and what was not, for sharpening what were often only vague ideas, and providing for timely and honest appraisals. The quality of the ensuing work is due largely to your effort and diligence, and I thank you for making my four years at the department of political studies such a positive experience. Thank you also for loaning me hockey equipment during those times when I was too lazy to get my own, and also for introducing me to the wondrous world of Japanese cuisine.

I also benefited from the accumulated academic expertise of many individuals. Dr. Charles Pentland guided me into theory of international relations and served as a constant source of academic balance and wisdom. Dr. Steve Page also provided strategic advice on managing the Ph.D. process, particularly in the latter stages of thesis panic. While I did not work as closely with Dr. David Haglund as I would have liked, we nevertheless had numerous contacts and conversations, from which I learned much. Dr. Douglas Bland, in the School of Policy Studies, is also due gratitude for encouraging me to publish and to continue my work in civil-military relations, which I plan to do. Because this thesis is interdisciplinary, I also benefited from my work with several professors who reside in the Queen's School of Business, including Dr. Brent Gallupe, Dr. Alan Richardson, and Dr. Lorna Wright.

Gratitude is also due to the numerous public servants of Canada who gave so generously of their time and knowledge for the empirical portion of this work. There is no more convincing evidence of how little a graduating Ph.D. candidate knows than to be confronted by an experienced government official. The list of interviewees is provided at the end of the thesis; to all of them, thank you. Also, to Dr. Brian Stevenson and his assistant Monique, thank you for arranging interviews and being so generous with your limited time.

The Royal Military College of Canada has also been a formative part of my academic experience. My work with three professors there has made me a sharper academic and a wiser person. Dr. James Finan introduced me to the wonderful world of operations research and applied methodologies for studying political phenomena, and I hope to continue working in that area for some time to come. He has also kindled an interest is Scotch and bagpipes that I sometimes over-indulge. Dr. Ron Haycock nurtured my interest in history and continues to show me friendship long after our paths began to diverge. Finally, one of the key turning points in my academic career came from Dr. Joel Sokolsky, who provided me with an opportunity to teach, who encouraged me to write, and who strongly supported my efforts to enter a Ph.D. program at a time when I was in doubt. I will not forget this generosity, and can only hope to repay it in kind some day.

I have been extremely fortunate to develop a network of friends in the Kingston area who provided me with appropriate doses of reality when needed. John and Cath, Graeme and Lisa, thank you. To Van, Richard, Rich, Kerry, and all the staff at the Kingston Brewing Company, thank you as well for teaching me how to relax. Thank you also to Micheal Parent and Devon Weedon, who proved to be great friends and mentors in the academic world. To my fellow doctoral students, thank you for your ideas and support.

No note of gratitude could be sufficient to thank Don and Lee Macnamara for all they have done over the past seven years. Don, you have guided, advised, consoled, illuminated, and inspired. While I have benefited from your academic and practical knowledge, it is in other domains that I have learned the most, particularly in the areas of leadership, integrity, and wisdom. Both you and Lee have showed Sarah and I so much; perhaps in ways you are not even aware of. I hope that in the future we can help others the ways you and Lee have helped us.

My last remarks are saved for my family. To my Mom, Dad, and brother who have supported me – thank you. To the Brantford crew – it looks like now I have a second hometown. Finally, to Sarah – without you this could not have been possible. The last 4 years have been wonderful; and I can hardly wait to start the rest. Let's go.

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> Canada depends on international capital to finance a significant proportion of its economic development ...The attraction of international business investment is, therefore, a core objective of Canada's foreign policy ... the Government of Canada has adopted a new investment strategy that seeks to increase Canada's share of foreign FDI ... This strategy consists of ... targeting specific multinational enterprises (MNE's) in priority sectors, to attract new investment, and to facilitate the retention and expansion of existing investments.[1]

Even a cursory glance at today's major news programs may lead one to conclude that the business of government is business. Governments seem preoccupied with the need to attract greater levels of foreign direct investment, to create infrastructure that will attract and retain business, and to promote educational programs that will ensure its citizens will have the necessary skills to adapt and thrive in what is becoming an increasingly global economy. Such actions are thought necessary to attract and retain investment, without which the prosperity of a nation's economy and population will slowly dwindle. There is nothing particularly new about this - creating a well-educated, technically literate population, and ensuring a thriving domestic manufacturing base have long been classical elements in the lexicon of power proposed by students of international relations.

Today, however the stakes and scope of such activities today arguably dwarf that of previous eras. The economic environment has become so competitive -- and the entity known as the multinational corporation (MNC) has become so powerful -- that states today have little choice but to fashion policies designed to enhance their economic attractiveness to these companies. Governments argue that if they do not enact such measures, they will quickly be usurped by competing governments who will, ultimately resulting in a loss of economic prosperity and national power.

Such realities have not escaped the attention of international relations (IR) scholars. In a field historically dominated by the study of the causes of war and peace – in which the subfield of international political economy played a supporting, rather then central, role -- the perceived link between economic matters and the central issues of war and peace has received increased scholarly attention. Contemporary international realities - the end of the Cold War, the lack of an external threat – have weakened the priority of security and diplomatic affairs on the IR agenda.[2] The major international issues today revolve as much around the nuances of trade and investment as they contribute to the broader questions of peace and security. The issues of today's global political economy – the trials and tribulations of emerging markets, the incorporation of the states of the former Soviet Union into a liberal global economic regime, the continuing concerns over a sometimes acrimonious trading relationship between Japan and the United States, the economic prospects of China, and the widening and deepening of regional economic associations that threaten to create self-contained trading blocs – ultimately involve concerns over security as well as economics. Indeed, there appears to be a general consensus that prevention of a renewal of great power conflict depends heavily on the success of international economic institutions and actors to provide an equitable and continued level of economic prosperity for the major powers.

The apparent influence of economic success on the maintenance of a stable international system dictates that greater academic attention be paid to the instruments of that success. The single most important example of a non-state economic entity that can shape the economic conditions of states and regions alike is the MNC. Susan Strange has argued that greater academic work needs to be directed at examining firm-state relations and their impact on the international political economy. She argues that the classical IR interpretation of the MNC - which viewed the corporation largely as a secondary actor that furthered the economic and ideological interests of its home nation -- is no longer accurate. She notes that the sheer size of the largest of today's multinationals eclipses all but the most advanced and developed nations in economic power. She argues that the ease with which the modern MNC can integrate its activities across borders makes the assumption that it serves the interests of any one state highly dubious, and that the economic effects of its major production decisions hold significant consequences for the countries involved. She argues that the agenda for the study of international political economy needs to be altered to reflect an accurate portrayal of the scope and power of the integrated multinational firm. She states that

> Governments must now bargain not only with other governments, but also with firms or enterprises, while firms now bargain both with governments and with one another. As a corollary of this, the nature of the competition between states has changed, so that macro-economic management and industrial policies may often be as or even more important for governments than conventional foreign policies as conventionally conceived.[3]

Such an agenda has become central to international political economy research. Study of the multinational corporation as an important actor in international affairs should consequently be a research priority of the discipline of international relations.

Situating the Thesis

The rise of the MNC in power and influence is both a product and an indication of the degree of structural change in the international system brought about by the end of the Cold War. True, large MNCs accumulated significant power and capability during the Cold War era, and received serious scholarly attention long before the fall of the Berlin Wall.[4] Yet the end of the Cold War provided conditions for a significant increase in the power and influence of the modern MNC. To begin, the breakdown of the system of bipolarity meant the loss of its accompanying virtues - stability and predictability being foremost among them.[5] Neither of the prominent superpowers involved in that struggle appears to have both the capability and the desire to maintain its prominent international leadership role into the post-Cold War era. The costs of Cold War leadership exacted heavy tolls on both the principal parties. Russia and its associated former eastern bloc nations are attempting to repair the damage wrought by decades of communist rule and economic mismanagement, a task that will likely require much time. The United States has repeatedly stated that it is no longer willing to automatically intervene or lend political stability in all areas of the globe.[6] The "declinist" debate that occupied IR scholars in the late 1980s - proponents of which argued that efforts of the Cold War were leading the United States into "strategic overstretch", in which the demands of its international commitments were eroding its domestic base of resources[7] – seems to have had an effect on policy makers. Post-Cold war American policy objectives have been primarily domestic - to rejuvenate the education system, re-tool and energise American industry, and to lower public debt and expenditure levels.[8] Such objectives have also mandated a significant reduction of foreign policy commitments and a sometimes reluctance to undertake leadership in foreign crises.

Such realities have allowed other nations to exert more international power and influence, to assume some of the leadership responsibilities shed by the superpowers. Contemporary IR scholars are reluctant to characterise the international system, feeling that such labels as "unipolar" and "multipolar" obscure contemporary realities as much as they illuminate them. Today the international system is characterised by one great power, many smaller but still significant powers, and features geopolitical conflicts and clashes that are spread throughout the globe. Calculation of state interests and likely courses of actions is immensely more difficult in such an environment, as areas of state collaboration and competition meld easily within the same geographic or issue areas. Finding a useful paradigm with which to view the international environment is a difficult - some may say irrelevant - task. All that can be said is that the present system is more complex, more fluid, and perhaps less intrinsically stable than the bipolar structure of the Cold War.

Not only are increasing numbers of states competing for international status, but there are also an increasing number of non-state entities that wield formidable economic, diplomatic and reputational influence. Inter-governmental and supranational organisations are steadily increasing the scope and range of their authority, imposing on national governments increasingly stringent regulations. Non-governmental organisations - of which the MNC is a prime example - are able to appeal to a broad class of people that transcends national boundaries, creating international support over particular issue areas. The dynamics of civilizational[9] and ethnic politics increasingly compete for the political loyalties of citizens, damaging the often-fragile coalitions of domestic governance. Not only must states compete with other states, but they are finding their authority increasingly challenged by organisations and movements which seek to erode their sovereignty.

Accompanying the structural changes in the international political system is the increasing liberalisation of the international economic system. While geopolitical calculation has become more complex, international economic competition has become more intense. An increasingly liberal trade and investment environment - featuring the progressive reduction of tariff and non-tariff barriers to trade, the widening and deepening of international economic institutions, and the wholesale acceptance of the economic doctrines of free market capitalism by former Communist nations - present new challenges for the international system. Corporations have much more freedom to explore new markets, have greater access to international capital, and can integrate production strategies across numerous countries. The economic benefits that they bring are in great demand, and countries now compete to draw foreign investment. The twin phenomena of economic liberalisation and interdependence are now structural elements of the international system.

There are many indicators of an increasingly globalised economic system. Free trade agreements now incorporate much of Central and all of North America. Europe marches closer to an ever-greater integration of markets, currencies, and monetary and fiscal policy. Asia is host to a variety of institutional arrangements that seek to heighten economic integration. From a regulatory perspective, the General Agreement on Tariffs and Trade (GATT) has succeeded in lowering if not eliminating many tariff and non-tariff barriers to trade, has instituted mechanisms to protect intellectual property rights, and has established the regulatory World Trade Organisation (WTO) to resolve trade disputes. Access to investment capital is now achieved through global rather than national money markets. Institutions and markets now reinforce each other in the creation and preservation of a truly global political economy.

The increasing liberalisation of the various elements of the international political economy is perhaps one of the clearest indicators of the present fluidity of the international system. Accompanying the conversion to liberal democracy in many former Communist countries has been an implicit acceptance of the ethos of market capitalism. Indeed, as the prominent economist Milton Friedman has argued, the two are inseparable - that the progress of one depends on the acceptance and promotion of the other.[10] The confluence of the values of democracy and the activities of capitalism has allowed both to flourish in an increasingly unstructured post-Cold War international environment.

Such dramatic changes in the economic environment of the international system have created many new opportunities for the multinational corporation. While there is nothing particularly new about the presence of large corporations that serve multiple national markets, the present combination of size, strategy, and structure of the modern multinational is indeed unprecedented. In terms of economic output, 8 of the top 20 GDP producers in the world are corporations, not countries. Moreover, the strategy and structure of these corporations differ markedly from their predecessors. Historically, the growth of large MNCs has followed a broadly consistent path. The firm, having satiated much of the demand of the home market, increasingly looked to foreign markets to increase economic rents and to provide increasing returns to scale.[11] Production remained based almost entirely in the home country; other markets were de facto labelled as foreign. Today, firms are likely to practice all the elements of their individual value chain across a wide spectrum of countries.[12] Research and development, production, marketing, after sales service - all depend on harnessing the particular advantages a company has created through its multinational activities. The idea of a national "home" which dominates a company's direction seems increasingly antiquated when only a dwindling percentage of a company's value-added activities continues to take place there.

Today, companies have little choice other than to compete in integrated markets and through an integrated structure. The competitive pressures that typify most modern industries - from auto production to pharmaceuticals to biotechnology – are too intense to be withstood by firms operating in single national markets. Massive research and development costs and product development and customisation, combined with continuous pressure by international competitors, result in mandatory large production runs to ensure profitable returns to scale. Increasing technological sophistication characterises both the production process itself and the final product, which necessitate high levels of factory productivity and extensive capacities for after sales service. Increasing research costs, technological sophistication, and competitive pressure all mandate that companies must exploit a truly global network of competitive advantages.[13]

Such realities often force national governments - in both the developed and the developing world – try to attract MNC investment, because MNCs provide considerable benefits to host countries and governments. They increase tax revenue and employment levels. They often introduce new production technology and management skills into the host country, upgrading both the technological literacy and managerial skill of the nation's workforce. They often provide high levels of worker training, which also acts to upgrade the quality of the workforce. They integrate local production sites within a global enterprise network that garners additional benefits in knowledge and investment. Indeed, integrated productions schemes may become so entrenched that it becomes impossible to delineate what are the true elements of a "national" economy. The reality of the benefits of such interdependence has meant that national governments must devote an increasing portion of their energy towards attracting and maintaining continued high levels of foreign investment.

The confluence of these realities - the end of bipolarity, the liberalisation of the international economy, the globalisation of business strategy – present important policy dilemmas for national governments. The priority of economic prosperity has risen to dominate post-Cold War domestic and international policy. The tenure of most governments is determined primarily by the national economic performance that occurs during their term in office. The provision of increasing levels of employment, the reduction in tax and debt levels, and a rising per capita income are now used as standards against which government performance is measured. To ensure such success, governments must craft policies designed to attract foreign direct investment. Indeed, for small powers such as Canada, such measures have become the very essence of foreign policy. As Eaton, Lipsey, and Safarian note, "for the United States, as a super power, trade policy has always been an instrument of foreign policy ... For small countries such as Canada, however, foreign policy is an instrument of trade policy".[14]

Although the influence of external structural factors provided the foundation for the globalisation of business, the specific national responses to that phenomenon are issues largely of domestic governance. The introduction of a policy agenda that amends traditional and long-accepted norms of state-firm relations holds particular policy dilemmas for both the executive and the bureaucratic elements of national governments. The executive level - responsible for the creation of new public policy – must have a clear vision of the implications such structural changes will have, and must craft appropriate responses to them. Its policies must not only be economically sound but must also be politically feasible. Sustaining a broad national base of support for embracing globalisation remains as much a governance challenge as is the creation of the policies themselves. For the bureaucracy - charged with administering the day-to-day specifics of government policy – difficulties also remain. Often having endured a series of budgetary and personnel cutbacks resulting from the privatisation of many programs during the past decade, career public servants may fear that adopting new policies in firm-state relations will entail further reductions in their departmental power and influence.[15] The inevitable competition between government departments to maintain influence over the legislative agenda will necessarily impact dramatically on government policy. New interpretations of firm-state relations must account for the particular contexts of national policy making structures and functions.

Any theoretical tool of firm-state relations must recognise and account for the nature of public policy-making process. This is no less true for Canada than it is for other industrial nations. Bruce Doern and Richard Phidd have developed a framework for analysing Canadian public policy that illustrates the internal conflicts between executive wish and bureaucratic execution. They demonstrate how the combination of ideas, structure, and process ensure that new policy agendas are filtered through a largely permanent process to create decidedly mixed policy outcomes.[16] Such a framework is indeed appropriate in modelling state industrial policies in Canada. The need to attract FDI -- motivated largely by the accepted wisdom of globalisation -- poses particular policy objectives for both the executive and bureaucratic ranks of the federal government. For the executive -- which includes the Prime Minister's office, Cabinet, and senior public servants at the rank of Deputy Minister -- they include the reshaping of organisational mandates and bureaucratic requirements in order to facilitate rather than hinder foreign investment in Canada. At the same time, the executive must convince the Canadian public that such policies bode well for Canada's future economic prosperity. For the bureaucracy, their objectives include the maintenance of policy jurisdictions and federal control over policy authority slowly being eroded by the executive's wish to de-regulate the investment process.

Such realities have also affected the formulation of Canadian public policy in the area of government business relations. The need to attract and retain foreign investment is well recognised by the federal government, and is reflected in many policy statements and initiatives that will be outlined in subsequent chapters. It is clear that the present government believes that foreign trade and investment garner benefits that are unobtainable through any other way. Yet critics charge that the desire to attract such investment has weakened the government's commitment to a broad based social support network that has been the hallmark of Canada's society.[17] They fear that present efforts to create a more attractive environment for business - loosening the regulatory environment and reducing public expenditure and debt levels -- come at the expense of social spending on health, welfare, and education. They charge that traditional government concerns over wealth distribution and equity have been sacrificed to the needs of international business, a bargain that benefits the Canadian economy but which will have devastating consequences for the Canadian polity.

Structure and Objectives of the Thesis

The primary goals of the thesis are threefold. The first is to review current theoretical models of firm-state relations that are well established in the research tradition of IPE scholarship, and to evaluate their utility as a descriptive and explanatory tool for the current Canadian economic environment. The second goal is to describe an evolutionary paradigm of firm-state relations that incorporates previous government policy initiatives but which has better analytic utility for the current economic environment. Drawing largely from the international business literature, such a paradigm features a collaborative relationship between state and firm interests and has several important policy imperatives for national governments. A third and final purpose is to assess the theoretical and public policy implications that such a paradigm holds for the study of international political economy, implications that will be outlined in the final chapter. By drawing on an interdisciplinary body of research, new insights can be developed into the effects of globalisation on national governments, and the policy responses governments can enact that preserve their public duties of preserving equity while simultaneously providing an attractive domestic environment for investment to occur.

The thesis will examine the present state of firm-state relations in Canada. Current policies emanating out the Department of Industry and the Department of Foreign Affairs and International Trade (DFAIT) reflect many of the trends already mentioned. Such policies are concerned primarily with creating jobs through the attraction of foreign direct investment, they attempt to expand and diversify Canadian trade and investment links throughout the globe, and is particularly attentive to the demands of business. The role of the Canadian state in regulating and promoting market activities will consequently receive close scrutiny. Ultimately the utility of the new paradigm will be tested to see if it is able to provide analytic clarity and utility to the Canadian situation.

The Collaborative Paradigm of Government Business Relations -- Alliance Capitalism

Some prominent writers have argued that the inclusion of the state in a general theory of international political economy is losing relevance in today's highly interdependent world. They argue that the state is steadily losing authority to regulate the effects of a world-wide market. Perhaps the most prominent of these writers is Kenichi Ohmae, whose argues that the rise of regional integrated economies is steadily supplanting the state as the primary unit of analysis in international political economy.[18] His analysis of the economic regions of Europe, the Far East, and North America leads him to conclude that individual nations within these regions have little power to control the economic forces that shape their prosperity. He emphasis on regions is supported by the work of Frankel and Kahler (1993) who provide additional academic arguments that support the regionalization of the world economy.[19] In their view, individual states are too weak to substantially influence the global financial, productive, and strategic reach of today's integrated MNC. According to this view, the state has little role to play beyond its traditional functions, and is indeed subject to continual threats of MNC relocation should its domestic policies fail to meet MNC desires. According to this view, a theory of political economy that remains rooted in the structure of the state is at best misguided and at worst irrelevant.

There exists, however, an equally prominent group of writers who argue that the role of the state is more, rather than less, important in an interdependent international economy. Perhaps the most famous of this group is business analyst Michael Porter, whose Competitive Advantage of Nations (1990) has influenced both policy-making and industrial circles alike. In it Porter argues that national economies still possess identifiable and distinct competitive advantages which are a partial product of government policies designed to promote and maintain those advantages. His concluding chapters outline very clear policy directives that he argues must be followed if national governments wish their industries to remain globally competitive. To Porter, government maintains a clear and vital role.

Porter is echoed by John Dunning, who is an equally strong supporter of the role of government in the global political economy. Dunning argues that governments have a key role to play in reducing the operational, organisational, and co-ordination costs of global business.[20] Dunning has concentrated his efforts on adumbrating the domestic policies governments need to enact in order to preserve and enhance their nation's attractiveness for foreign direct investment. He argues that educational, tax, and fiscal polices designed to provide a highly educated and trained workforce, a stable tax and regulatory environment, and a relatively open market structure are the ingredients for an effective domestic economic policy. In short, Dunning argues that government policy must be co-ordinated, selective, and work to aid in the transition of the domestic economy towards one that is primarily knowledge -- rather than resource -- based.

Later chapters will show that facilitating such a transition has become a stated policy goal for the current Liberal government. The historical dependence of the Canadian economy on successive development of its natural resources has been elucidated clearly by the Canadian economic historians H.A. Innis and Michael Bliss.[21] While Canada's natural endowments have proven a valuable and consistent source of economic prosperity, they also have reduced overt incentives to diversify the economy away from an overt reliance on resource development. Reducing that dependence by diversifying Canada's economic base – particularly in high-technology, knowledge-intensive industries - has become a general policy objective, one that the Liberal government believes can be aided through selective government policy initiatives in the industrial landscape.

Dunning offers a paradigm that outlines how these convictions have resulted in a new interpretation of government-business relations that he labels "alliance capitalism".[22] Alliance capitalism integrates elements of the classical liberal model of firm-state relations in a unique fashion that emphasises co-operation, rather than conflict, between national governments and the MNC. This paradigm, moreover, is evolutionary. It integrates and builds upon the policy decisions taken in previous eras in order to accommodate the realities of a more interdependent international economy within an activist government agenda. It also elucidates avenues for selective government policy action in an era when governments of developed states have limited resources to devote to public spending and are generally trying to reduce overall levels of government bureaucracy.

According to Dunning, national industrial and economic policy in the age of alliance capitalism should reflect some or all of the following:

1. A closer collaborative relationship between government and its domestic exporting firms than would be predicted under a more traditional models that emphasised state-firm separation.
2. A more deliberate government policy to participate in economic institutions that directly affect the operating environment of its domestic MNCs.
3. A more consistent government effort to encourage its own firms to
4. A generally higher policy priority accorded to matters of international trade, production, and finance.

The objective of the thesis research is to demonstrate whether – and to what degree – the alliance capitalism paradigm is a useful interpretative tool for analysing the current economic and industrial policies of the federal government of Canada. Evidence will be drawn from a variety of primary and secondary sources, economic surveys, and interviews with government policy makers and analysts. Because the argument is primarily one based on the evolution of firm-state relations, the industrial policy efforts of previous as well as the current federal governments will be described and analysed, and statistical evidence will be presented that describes the nature of Canada's participation in the global political economy. The thesis will argue that the paradigm offers considerable analytic utility for students of Canadian economic and industrial policy. The paradigm outlines characteristics of policy patterns that are very much in evidence in the current Canadian federal government.

The concluding chapter will discuss some of the implications of the alliance capitalism paradigm, focusing particularly on small and medium sized industrialised economies. Not all of these implications are necessarily positive; there are possibilities that the drive to increase Canadian participation in a knowledge-based international economy may compromise other policy priorities and objectives. The conclusion will also contain a critique of alliance capitalism, as well as a more theoretical discussion of the implications that alliance capitalism has for the study of international political economy, international business, and international relations.

Endnotes

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[1] Government of Canada, Department of Industry, Canada's International Business Strategy (Ottawa: Minister of Supply and Services, 1997) p. 2.

[2] It has not, of course, eliminated these issues from academic attention, as the beginning sections of chapter 2 will demonstrate.

[3] Susan Strange, "States. Firms and Diplomacy", International Affairs, 68(1), 1992. Pp 1-2.

[4] Raymond Vernon's classic Sovereignty At Bay (New York: Basic Books, 1971) is a case in point A more extensive review of state-firm literature is offered in chapter 2.

[5] The most eloquent statesman for the virtues of bipolarity is Kenneth Waltz, Theory of International Politics (Reading: Addison Wesley, 1979).

[6] As this thesis was being written the crises in Kosovo – in which the forced emigration of Albanians from a province of Serbia in which they were the prominent majority, accompanied by documented human rights abuses – was met with a unified NATO-led response. However, the alliance was only prepared to use air power, and doubts emanated from many circles as to the wisdom and ultimate efficacy of such an action. Such action only took place after protracted negotiations and after abuses had been fully documented. Such reluctant action indicates the degree of care with which the United States and its major allies currently approach armed intervention. However, American involvement in major international issues remains consistent, despite the domestic calls for greater isolationism.

[7] The most widely recognised author of the "declinist" school is Paul Kennedy, The Rise and Fall of the Great Powers (New York, Random House, 1988). For a more theoretical treatment, see Robert Gilpin, War and Change in World Politics (New York: Cambridge University Press, 1981).

[8] Such recommendations formed the basis of the report tabled by the President's Council for Economic Competitiveness, which sought to remedy the symptoms of supposed "declinism". See M. Dertouzos. et. al., Made in America: Regaining the Productive Edge (Cambridge: MIT Press, 1989).

[9] Samuel Huntington, The Clash of Civilisations and the Remaking of World Order (New York: Simon and Schuster, 1996).

[10] Milton Friedman, Capitalism and Freedom (Chicago: University of Chicago Press, 1962)

[11] Alfred D. Chandler, Strategy and Structure: Chapters in the History of the American Industrial Enterprise (Cambridge: MIT Press, 1962). The path of this development has not been uniform in the major industrial countries. For the American, German, and British experience, see Alfred D. Chandler, Scale and Scope: The Dynamics of Industrial Capitalism (Boston: Harvard University Press, 1990).

[12] The concept of the value chain as a tool of competitive analysis can be found in Michael Porter, Competitive Advantage: Creating and Sustaining Superior Performance (New York: Free Press, 1985). Chapter 2.

[13] Steven J. Kobrin, "An Empirical Analysis of the Determinants of Global Integration", Strategic Management Journal, 12(9), Special Issue, 1991. Pp. 17-31.

[14] Curtis Eaton, Richard Lipsey, and A.E. Safarian, "The Theory of Multinational Plant Location in a Regional Trading Area", in Lorraine Eden, ed., Multinationals in North America (Calgary: University of Calgary Press, 1994), p. 71.

[15] The standard reference for examining the departmental reluctance to relinquish budgetary or managerial control over government programs is Donald J. Savoie, The Politics of Public Spending In Canada (Toronto: University of Toronto Press, 1990). Numerous anecdotal evidence garnered from interviews indicates that a significant reduction in terms of public sector resources and personnel has indeed occurred over the preceding decade.

[16] C. Bruce Doern and Richard W. Phidd, Canadian Public Policy: Ideas, Structure, Process (Scarborough: Nelson Canada Limited, 1992).

[17] Recent books have emerged that are critical of the current Canadian desire to court foreign direct investment. One example is Maude Barlow and Tony Clarke, MAI: The Multilateral Agreement on Investment and the Threat to Canadian Soverignty, (Toronto: Stoddart Publishers, 1997).

[18] Kenichi Ohmae, The End of the Nation State: The Rise of Regional Economies (New York: Free Press, 1995).

[19] Jeffrey Frankel and Miles Kahler, Regionalism and Rivalry (Chicago: University of Chicago Press, 1993).

[20] John Dunning, edt., "Introduction" Governments, Globalization, and International Business, (Oxford: Oxford University Press, 1997), pp. 4-10.

[21] See H. A. Innis, Essays in Canadian Economic History (Toronto: University of Toronto Press, 1956), and Micheal Bliss, Northern Enterprise: Five Centuries of Canadian Business (Toronto: McClelland and Stewart, 1987).

[22] John Dunning, Alliance Capitalism and Global Business (New York: Routledge Press, 1997).

Chapter 2 – Literature Review: International Relations and International Political Economy

Understanding contemporary debates within the field of international relations often benefits from substantive study of several ancillary fields outside the mainstream of contemporary international relations literature. The thesis will contend that the field of international business - particularly the literature addressing the strategy, structure, and market power of the modern multinational corporation – suggests a new paradigm for government/business relations within the developed world. This is an argument based on two fundamental assertions. The first is that the dynamic evolution of the international system in the post-Cold War era – with the market gaining an increased degree of influence in its contest with state authority – has provided the necessary conditions for a increase in the MNCs power and influence. Second, the thesis argues that the present size, power, organisational and managerial capacity, and scope of the MNC has altered its status as an actor within the field of international relations. It has great capacity to influence state economic policy than ever before, and this reality encourages a new paradigm for the management of state-firm relations.

The chapter will draw upon two bodies of literature to define the research scope of the argument. It will explore the past and current debates within the field of international relations that deal specifically with the phenomenon of economic power and the MNC.

Such debates include concepts such as mercantilism, the hegemony thesis, the neorealism/neoliberalism debate, and the importance of non-state actors in the international system. The second section will outline how the study of international political economy has accounted for the major changes in political and economic structure that have arisen at the end of the cold war. These accounts have propelled the re-evaluation of fundamental debates within the discipline of international political economy, such as the conflict between state authority and market independence, as well as the concept of "national" economic power in a world increasingly characterised by regional and supranational economic institutions. These two areas - international relations and international political economy -- are the lenses through which the ensuing empirical material will be examined. [1]

International Relations

It is a contention of this thesis that the paradigms used to analyse the MNC in the field of international relations require modification. In itself this contention is not surprising, as it reflects the current dynamism that animates the field of international relations. The academic freedom and energy released by the fall of the Berlin Wall – freedom to explore new questions, expand old definitions, and widen the legitimate scope of international relations inquiry – has resulted in fresh approaches to traditional questions. The analysis of security, to use a brief example, has moved away from considering solely questions of "national" security to include more nebulous notions of "human" security, and similar examples could be found in other traditional areas.[2] Methodologies applied to the study of security, stability, and development have widened their analytic scope to include new units and propose new questions. Incorporating the MNC as a unit of separate analysis within the international system contributes to the ongoing effort to widen the scope of the field's inquiry. Yet, without a grounding in the theoretical traditions and major research approaches to the field, it would be difficult to demonstrate either how this analysis may be different or why such a new approach in necessary. Consequently, the bulk of this chapter will be concerned with the treatment of the MNC within the existing bodies of international relations and international political economy literature.

A history that integrates the evolution of the MNC and the structure of the international system during the Cold War would emphasise both conflict and co-operation between the entities of the state and the market. The objectives of both were initially complementary. The rapid post-war expansion of international economic activity reinforced the prevailing international structure established after World War II. It helped solidify American hegemony and leadership, integrated the Western alliance, and worked to secure the compliance of non-committed developing nations in the global struggle against the Soviet Union. The activities of the MNC contributed to all of these. Yet, the expansion of MNC size and power eventually began to erode the post-war political conditions that had allowed their initial expansion to take place. Integrated production networks, an independent research and development capacity, and the monopoly over proprietary technology and management experience allowed the MNC to exert significant influence over the policies of host nations. As this chapter will show overt investigations of such activities initially concentrated on the developed world. Later, scholars were concerned mainly with the MNCs effects on the less-developed countries (LDC), effects that are well explored in the dependency literature. Yet the current ability of the MNC to operate against or independent of the wishes of even the most powerful developed nations has been noted with some trepidation by Western analysts.[3] Its ability to do so has been both a product of and a contributor to the major structural shifts that have occurred within the international system.

Early international relations scholars could not have predicted this. The emergence of international relations as an independent field of academic inquiry - usually dated from the 1920s, although discourses on international relations can be traced back at least as far as Thucydides[4] – did not regard the MNC as an independent actor in the international system. The efforts of early scholars were devoted to detailing the accepted parameters of the field, establishing the major branches of legitimate inquiry, and developing an established lexicon of analytic terms. Historical experience conditioned the avenues of accepted inquiry. The writers who comprised the emerging realist school reacted against the aberrant state behaviour that had led to the Second World War. To them, the conflict was caused as much by the inappropriate inter-war foreign policies of the European allies as it was a product of the ambition of Hitler.[5] The purpose of the field, therefore, was to discover of the causes of war and peace and to establish the conditions under which a stable and peaceful international system could exist.

The defining characteristic of the international system was anarchy. The lack of an overarching authority imposed conditions of prudent and necessary behaviour on nation -states. Consequently, early scholars developed the foundational ideas of power, balance of power, and national interest, ideas that could serve to guide state policy making. The task of statesmanship was to identify and articulate legitimate national interests, to develop intrinsic sources of national power, and to accurately gauge the intentions and capabilities of potentially hostile neighbour states. Such principles formed the core of the realist school of international relations inquiry.

Samples of such scholarship include the following works. E.H. Carr's The Twenty Years Crisis[6] outlined a trenchant critique of inter-war European diplomacy, focused upon the importance of historical and moral forces, and provided a sound empirical justification for realist thought. Hans Morgenthau's Power Among Nations codified the previously amorphous concept of national power.[7] His overt and systematic ranking of the elements of national power – with the familiar placement of military power first, economic power following, and working down through the list of social, ideological, and geographic elements of power – quickly became the standard by which other writings were measured. Kenneth Waltz's Man, the State, and War defined the appropriate units of analysis for the study of international relations, units which would form the basis of much subsequent scholarship. He argued that the individual, the state, and the international system interacted to create conditions conducive to either the maintenance of peace or the outbreak of conflict.[8] Klaus Knorr's The Power of Nations[9] provided a guide with which to gauge a nation's reservoir of power. Finally, Henry Kissinger, whose study of Metternich and the diplomacy of post-Napoleonic Europe became a classic treatise on the concept of the balance of power, would utilise realist principles to guide his actions in government three decades later.[10] The work of these and other scholars defined the post World War II system and governed the study of the international relations for much of the ensuing two decades.

The work of these scholars established the objectives of the field and defined patterns of legitimate inquiry. Their principles created a rigorous and parsimonious paradigm into which almost all academic energy was funnelled. The specific concern with the problems of war and peace was best studied through the specific units of the individual, the state, and the international system. The distribution of power between the units of that system was vital to the preservation of stability. Power could be measured and articulated, and some elements counted more than others. National interests were permanent and could be assumed to collide; therefore the management of conflict became as important as the prevention of conflict. International organisations could never replace the primacy of the state in international relations, and reliance on their ability to ensure state security was foolhardy. The rapidity with which these ideas were absorbed in the West testified to their power to explain the historical wartime experience and contemporary Cold War reality of their progenitors.

Study of the MNC within this established paradigm was fragmented and cursory at best. Transnational and non-governmental organisations, while growing in number and areas of nominal authority as the Cold War progressed, could not wrest from the state the prerogatives of its sovereignty. Non-state actors were thought to hold only limited ability to influence state behaviour. Hedley Bull's The Anarchical Society, published in 1977 after witnessing the profound growth in multinational enterprise that occurred in the 1950's and 1960's, remained sceptical that such firms influenced the dynamic of realism to any substantial degree.[11] The MNC was a vital contributor to the economic fortunes of its home state, and a secondary contributor to the development of the host country, but it was not viewed as an independent actor. It was incorporated largely within the established research tradition of realism.

The early history of the Cold War enhanced the perception of the MNC as an element of national power, and as a supporter of the home nation's interests. It is well established that the United States endeavoured to create a post-war liberal international economic system that would integrate its most important allies. The economic system inaugurated at Bretton Woods - which established fixed exchange rates pegged to the US dollar, created the economic institutions of the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD), and called for a broad multilateral trading agreement that endeavoured to lower tariffs and trade barriers - established the international economic structure by which the Western World could be revitalised. The objectives of the United States in creating such a system were several. It immunised the areas of Japan and Western Europe against the ideological threat of communism. It would serve to thwart the economic protectionism that had augmented the trials of the 1930s depression. Finally, it would also establish in institutional form the hegemony of the United States at the end of the Second World War, and would work to protect the principles of liberal markets and free trade if and when that hegemony eroded.[12]

As the primary producers in the "arsenal of democracy", the rapidity with which American firms had converted wartime output into the production of civilian consumptive goods was astonishing. The dominance of world production enjoyed by American multinationals was unparalleled, and soon the post-war production capacity exceeded the initial absorptive capacity of the American market. This forced company executives to seek new markets that could absorb their excess product. The markets of Western Europe and Japan - recovering from the tribulations of war, and strengthened by the infusion of large amounts of US capital – began to import the products of American multinationals, further integrating them into the US led international economic system. The markets, raw materials, and low priced labour of the developing world beckoned as well. For two decades after the end of the Second World War, the national interests of the United States and the economic interests of its major firms were highly congruent and reinforced the original assertions of state-firm relations made by realist scholars.[13]

Scholars noted the rapidity with which large US multinational corporations (MNCs) moved to take advantage of the opportunities presented in the immediate post war period. One of the clearest illustrations of this school is Stephen Krasner's Defending the National Interest. Krasner argued that the post-war history of multinational activity reflected their capacity to act as agents for American foreign policy. He demonstrated that, despite the appearance of a relatively weak American state regulatory structure that could co-ordinate firm strategies and foreign policy, it was nevertheless evident that MNC activity was in general accordance with U.S. foreign policy objectives.[14] Robert Gilpin also noted such realities. His US Power and the Multinational Corporation described in detail the relationship between large American multinationals and the international interests of the US government. His arguments reinforced the traditional view of the corporation acting as a surrogate for and extension of national interests. He argued that the penetration of foreign markets by large MNCs was a key component in anchoring an American-led post-War economic system, and that American business activity in the developing world would play a vital role in securing third world allegiance to that system. Yet, he also uttered words of warning. He cautioned that not all MNC actions supported the international goals of the American government. Multinationals could at times display a powerful degree of independence from their home government; that tendency would only grow as they developed increasingly global economic networks of production. Gilpin concluded that the congruence of state and firm interests was welcome but could not be assumed; and that the relationship needed careful management if the two were not to come into conflict.[15]

The early decades of the Cold War provided little indication that the twin demands of state authority and market independence would eventually conflict. It was expected that the activities of major MNCs would continue to reinforce - rather than erode - the structure of the international system. U.S. multinationals augmented American political leadership and hegemony by creating an integrated production and marketing network. Such integration proved especially useful in securing the allegiance of uncommitted developing nations in the all-absorbing struggle with the Soviet Union. It solidified the adherence of the states of Western Europe and Japan into the economic domain of the American production system, reinforcing the security apparatus that had been created at the close of the Second World War.

The appearance of Robert Keohane's and Joseph Nye's Power and Interdependence in 1977 posed an alternate paradigm designed to supplement realism. They argued that the bulk of inter-state relations - particularly those between adjacent developed countries – could not be easily interpreted using realism. Such relations were characterised by an absence of military threat, were typically conducted either at low levels of government or by non-governmental agents, and featured a variety of cross-national contacts. Keohane and Nye demonstrated that the distribution of power between the two countries often held little relationship to the bargaining outcomes over disputes. Small, less powerful countries often achieved equitable if not favourable gains from such negotiations, even when their adversary held much more of the traditional elements of power. They presented a new model of international relations which, while not meaning to replace realism, was intended to explain the characteristics of what they termed "complex interdependence".[16]

Keohane and Nye portrayed the MNC as a largely independent actor that had in fact weakened, rather than strengthened, the realist paradigm. The MNC was a key element of this model because it fostered the international non-governmental links that were fundamental. Yet, the very success of the large MNC eventually created the conditions under which conflict between its economic aims and the foreign policy objectives of its home country might collide. Two emerging branches of IR literature - the theories surrounding integration, particularly in the European context, as well as the emerging body of scholarship surround the issues of development and dependence – illustrate that MNC success could erode the long term structure and stability of the international system.

Integration and Developmental Approaches to International Relations

In post war Europe, the infusion of American capital and the incipient processes of economic integration helped foster recovery. Building upon the foundation of functionalist theory originating in the inter-war period, integrationists believed that fostering such supranational institutions with broad authority over European production and investment would quell the economic nationalism that had led Europe into conflict.[17]

The specific "supranational state building" over specific issue areas resulted in a "steady expansion of the Community scope of activity and powers of its central institutions."[18] Such efforts regularised investment rules and created industrial policies over specific issue areas that were broadly consistent. While the initial proclivity of European based multinationals to take advantage of over such policy regulation within the European area appeared scant – and many European multinationals appeared to prefer national rather than European affinity[19] – the early effects of integration efforts laid the basis for a more integrated institutional framework that would follow in later years.

Stephen Krasner's work on regime theory provided a useful addition to the process of European integration. Regimes, as Krasner noted, "are defined as principles, norms, rules, and decision making procedures around which actors expectations converge in a given issues area."[20] Regulatory regimes that provide institutional contexts for the resolution of state conflict acted to absorb the regulatory function previously allocated to the hegemonic state power. The capacity of international organisations to regulate the international system became a subject of intense debate, as some scholars championed the "institutionalisation" of world politics, while others were sceptical and argued that such institutions held limited utility. [21] By regularising forums for inter-state co-operation, regime theory fostered the conditions for a resurgence of the European MNC.

The dependency literature, which seeking to analyse economic relations between the developed and the developing world, also paid substantial attention to the MNC. Integrating the developing nations into the Western capitalist system posed several challenges.[22] Albert O. Hirschman demonstrated the importance the international trade structure played in the progress of a national economy.[23] Hirschman explained the linkages between national goals and the structure of a nation's trade. While not directing his study at the developing nations directly, his ideas provided clarity to the relationship of the international trade structure and the apparently arrested development efforts. The lack of productive diversification or manufacturing knowledge present in much of the developing world often resulted in an overt reliance on the production of staple crops or commodities. Many nations became overly dependent on the corporations and markets of the developed world for the manufacturing and the sale of their primary produce. The hub and spoke paradigm - in which developed nations had access to numerous sources of supply for key commodities, while the developing nations that produced such commodities were dependent on the market - proved to be one of the most popular.[24]

Other work by James Goldgeier and Michael McFaul utilised the concept of "core" and "periphery" economic zones to help illuminate the dependency debate. The developed core used its institutional and historical dominance over the periphery to extract continued economic concessions. Additional examples of dependency scholarship include the work Fernando Henrique Cardoso, who introduced the theory of associated-dependent development. Cardoso argued that, in order to break out of the cycle of dependency, it was vital for developing nations to acquire foreign technology in order to eliminate the reliance on foreign knowledge for industrial expansion. This required crafting new relationships with the developed world's economic agents – including the multinational corporation. Dependency's analytic models often portrayed a structural imbalance between state authority and firm capability.

This apparent imbalance in economic capability prompted academics to focus on the problems of development. One apparent problem was national governments that, according to Marxist scholarship, were often nothing more than a conduit through which exploitative investment took place. The apparatus of the state only represented the interests of the elite; government officials and local businesspeople who stood to gain most from continued foreign investment. Developing nations had also become dependent on the continued transfer of capital and technology from the developed world, and the agent of transfer typically was the MNC. Such writers often claimed that the activities of the MNC left the host nations in a permanent state of arrested economic development, dependent on foreign corporate activity and possessing little capacity or desire to diversify their national economy. Such work further maintained that the developed world had an interest in maintaining such a system because it provided an abundant supply of cheap labour and commodities that would keep product prices down.

Theorists of dependence argued that, since the developed world had no interest in changing the status quo and in fact worked to maintain it, it was the duty of the developing nations to reclaim economic independence. Potential tools for such change included cartelisation of production, establishing quotas on the production of key raw materials in order to elevate prices, and the establishment of import substitution policies that would create an indigenous production capacity. All of these actions targeted the MNC, which was assumed to be an agent of economic subjugation. The resolution of conflict between the states of the developing world and the MNC depended upon an elaborate bargaining relationship. The firms' control over proprietary technology, access to capital, and management capability gave them enormous power; the state often could only reply with crude regulatory instruments. Yet the various state efforts to control the activities of the MNC were largely disappointing. The threat of nationalisation of key was weakened by the difficulty in establishing unanimity across the varied sources of supply, and the threat of product substitution limited the utility of a cartel for all but the most specialised raw materials. Internationally, the nations of the developing world collectively attempted to redress this imbalance through institutional means. The creation of the Group of 77 and their cumulative call for a New International Economic Order (NIEO) represented a unified response to the perceived exploitation wrought by the developed world's multinationals.[25] While achieving some influence at the United Nations, this effort to reshape world economic relations failed, largely due to the inability of the Group to maintain a united policy front. Equalising the bargaining power between the host nation and the multinational remained an elusive goal of development theory.

Some analysts argued that, as developing nations gained in economic capability and stature, they would be able to extract more bargaining concessions from the investing corporations. Raymond Vernon's <u>Sovereignty at Bay</u> argued that the perceived exploitation of its economic assets would encourage the developing world to re-assert their traditional prerogatives within their own borders. He envisioned a possible future in which corporate investment and relocation decisions would be subject to intense scrutiny - if not outright prevention - by the governments of the involved nations.[26] More recent scholarship has concurred with Vernon, and demonstrates that the states of the third world have steadily increased their bargaining capacity in relations with MNCs, and have garnered greater concessions as a result.[27] Typically, developing nations have established a pattern of policies designed to both attract and control foreign investment. The offering of tax incentives and low wage labour is countered by demands for the transfer of technology and the inclusion of local nationals at increasing levels of management of tax incentives and low wage labour is countered by demands for the transfer of technology and the inclusion of local nationals at increasing levels of management responsibility within the company. While early MNC dominance in the bargaining relationship allowed firms to enact maximum rent from their investments in the developing world, that advantage has decreased somewhat over time.

Hegemony and Its Discontents

The hegemony thesis - that the presence of a hegemon lends stability to the international system, and that its decline may herald a period of turbulence - has been a useful interpretative tool for explaining international post-war economic events. Charles Kindleberger[28] was one of the first to note how the power of a hegemon provided the leadership necessary for the "public goods" that allowed the international economy to function smoothly. Such powers acted as lenders and markets of last resort, established regulatory patterns for the transfer of capital, and worked to smooth the inevitable cycles of international production. The lack of a hegemon, according to Kindleberger, resulted in a turbulent and unpredictable economy in which national protectionism clogged trade arteries. His thesis proved prescient in describing the institutional role played by the United States in the immediate post-war world. Its dominance in trade and production allowed the United States to act as a system hegemon, regulating international economic activity and funding the reconstruction of the world economy.

The erosion of American power wrought by the continual provision of public goods was evinced by the 1971 decision by President Richard Nixon to abandon the Bretton Woods system and remove the U.S. dollar from the gold standard. The repudiation of Bretton Woods indicated a loss of American economic power, the occurrence of which became a key argument in the hegemonic decline thesis which peppered the IR literature in the 1980s and early 1990s. The erosion of American market predominance to its more nimble West German and Japanese competitors led many to argue that the United States was losing its economic status as a hegemon. Robert Gilpin and Paul Kennedy are perhaps the most widely known of those scholars who questioned the long-term ability of the United States to maintain its military, economic, and ideological dominance. Kennedy's Rise and Fall of the Great Powers provided an historical argument in which dominant states were subject to "imperial overstretch" which eventually weakened their economic base. Gilpin's trenchant War and Change in World Politics clarified the argument by offering a theoretical account of long term decline of hegemonic powers. He argued that the establishment of a hegemon, its period of dominance, and its eventual decline was a cyclical model that characterised the international system. He too voiced concern over the phenomenon of over-extension. He also argued that the agents of a nation's initial economic growth - its productive firms and industries – weakened over time, and often worked to transfer wealth producing knowledge and skills to neighbouring countries. The agents of such economic and technological transfer were often the hegemon's own corporations, as their foreign activities raised the economic capacity of rising international competitors. The activities of domestic economic agents actually contributed to the long-term decline of the dominant nation.[29]

Whether or not the decline of hegemony would result in increasing levels of discord or renewed attempts at co-operation became the focal point of IR scholarship in the late 1980s and early 1990s. Some argued that hegemonic decline would weaken international regulatory capability, but that this would be countered by the increased prospects for co-operation fostered by the growth of international institutions and regimes. Robert Keohane's After Hegemony argued that, although creating such institutions and regimes required the overarching power of a hegemon, maintaining them did not. Keohane argued that the increasing discord and conflict that accompanied the decline of a hegemon's power would provide more, rather than less, motivation for states to engage in co-operative behaviour. The framework provided by established international institutions created a forum where highly contentious and protracted bargaining between competing nations states could take place.[30]

Such scholarship also noted the threat to national economic power posed by the increasingly internationalisation of the world economy. The gain in industrial power enjoyed by America's competitors would inevitably translate into political power. The MNC was thought to be an important participant in that process. Its foreign operations transferred modern technology to industrial rivals for which the American polity received few tangible benefits in return. Increasingly international production networks were equated with an inevitable weakening of national economic strength, and a concern that the foreign operations of major American multinationals could be detrimental to the production powers of the nation.

MNCs acted as both protectors of the hegemonic system and as instruments of change. They reinforced the open liberal trading environment created by the institutionalisation of liberal international economic policies, and their rapid expansion furthered the interests of the dominant state within the international system. Yet the MNC also acted to erode the hegemonic structure by advancing the economic and technological capability of emerging rival states. Current debates within IR scholarship, therefore, contest whether the continued expansion of MNC activity will erode or aid systemic stability. Some analysts have warned that the decline in the hegemonic system will force major developed states to enact independent trade and investment polices. Such states will likely attempt fuse their familiarity with multilateral trading practice with an increased self-determination that places greater reliance on bilateral and regional trading policies. A revival of protectionist trading policies is also possible, though such tendencies may be countered by the increasing international dependence of domestic industry.[31] In short, by the end of the 1980 scholars were divided on the role of the MNC and its contribution – or detraction – from systemic stability. This would become an important component of the emerging neo-realist and neo-liberal debate.

Neo Realism and Neo Liberalism

The distribution of power across the units of the international system became the foundation for the theories of structural realism, whose foremost advocate is Kenneth Waltz. His Theory of International Politics argued that the stability of the international system depended upon both the clarity and the structure of power distribution within that system. He reiterated the traditional realist dictates by placing primary emphasis on the state as an actor in international relations, and re-affirmed the focus on the problems of war and peace. To Waltz, the structure of great power relations was the primary determinant of the stability of the system. The system of bipolarity present in the Cold War was the most stable due to its clarity, predictability, and elimination of the delicate balancing of many nation's interests that had been necessary under the previous systems of multipolarity.[32]

The arguments of structural realists -- whose members include Waltz, Joseph Grieco, and Robert Jervis, among others -- hold several common axioms. Anarchy and the distribution of power are the dominant constraints within the international system. States remain the predominant units. The prospects for co-operation between states is inherently limited, as states were more concerned with relative, rather than absolute, gains. While acknowledging that the degree of co-operation in the present system was indeed high, they stressed that examples of such behaviour were drawn from non-critical or non-vital interests. Such co-operation, they argued, would evaporate whenever conflictual issues arose over key national interests. Moreover, they were quick to point out that examples of co-operation were drawn almost invariably from the relations between developed industrialised nations. For the remaining states - which formed the vast numeric bulk of the international community – international relations remained primarily an exercise in competition, self-help, and the pursuit of national interest.[33]

Accompanying their emphasis on the primacy of the state was an intentional subordination of the other elements acting within the international system. They argued that international and supranational organisations, as well as non-state actors, could not challenge the predominance of the state because they lacked both sovereign legitimacy and the coercive power of force. Their effect on the international system was necessarily ancillary, and mattered only to the extent that their activities augmented or eroded the power of the major states. They argued that scholars who stressed the capacity for co-operation - whom they labelled neo-liberal institutionalists -- had over-estimated the capacity of international institutions to manage the international system. Joseph Grieco has reviewed the differences in positions adopted between structural realists and neo-liberal institutionalists[34], and announced clearly his preference for neo-realist theory.

Such a prognosis held little potential for the analysis of non-state actors. Scholars who wished to include non-state actors within the scope of IR inquiry quickly realised the limitations of realism, and endeavoured to create theoretical models which could encapsulate the role of non-state actors. The fundamental thrust of the neo-liberals' argument - that the institutional framework can mitigate the consequences of anarchy within the international system - quickly became a subject of great debate within the IR community. The advocates of the neo-liberal institutionalist school argued that the institutional context allowed for a greater degree of international co-operation than was previously possible. The characteristics promoted by regularised institutional contact between nations - including trust, reciprocity, openness, and transparency – could soften if not eliminate the suspicion which had historically clouded such relations. Neo-liberals argued that, at least in economic matters, states were more concerned with absolute rather than relative gain. They accepted that some of the fundamental assertions of realists and neo-realists – such as the condition of anarchy and the primacy of the state – but believed that the prospects for co-operation and institutional regulation were strong.

The debate between neo-liberal institutionalists and neo-realists – and the field of international relations in general - received a substantial shock both during and after the fall of the Soviet Union. The rapidity with which Mikhail Gorbachev's policies promoted change was staggering. The dismantling of the Soviet nuclear arsenal, the growing desire to join Western economic organisations, and the eventual liberation of the nations of Eastern Europe had been predicted by very few international scholars or policy makers. The collapse of bipolarity and the end of the Cold War nuclear threat necessitated a new paradigm for the management of the international system. It provided new opportunities for international relations scholarship, and posed new dilemmas and questions about the historical roots and future direction of the field.

One of the primary questions engendered by the collapse of bipolarity was whether realist and neo-realist scholarship held any continued utility. Simply put, the actions of the Soviet Union between the period 1989-1991 were not in accordance with - and often directly opposed - the actions that realist theory would predict.[35] The Soviet Union took few measures to prevent the collapse of its sphere of influence along its Western border. It offered only token resistance to the incorporation of these new states into the political and economic organisations of the West. It rapidly acquiesced to large cuts in both conventional and nuclear forces that were offered by the NATO alliance - cuts in the one element of national power that it still had in abundance. The states of the former Soviet Union rapidly embraced an ideological conversion to the principles of free market economics and liberal democracy. Such actions surprised and confounded realist scholars, because they involved the willing surrender of key elements of national power. Consequently, the continued relevance of realism as predictor and guide to state behaviour came under scrutiny. Even loyal realist scholars realised that their theories had to adapt and become more flexible if they were to remain relevant.[36]

Reforming realism required deciphering the new expressions of classical realist principles. One apparent principle that re- emerged at the end of the Cold War was that American leadership was still necessary, and that the United States was more than capable of providing such leadership. The United States still possessed many of the attributes of a hegemonic power.[37] Indeed, the end of the Cold War had allowed the United States to withdraw or scale down many of its foreign commitments and reinvest in its own industrial and educational foundations - precisely the actions recommended by those who hoped to reverse the apparent American decline. Discussion of the new American role ranged from Charles Krauthammer's "Unipolar Moment"[38] to the advent of neo-isolationist movements within the United States by those who had grown weary of American over-extension abroad. The need for American leadership in the international system was just as pronounced at the end of the Cold war as it was during the shaping of the post-World War II world.

Yet, as clear as the need for American leadership was, it was also obvious that the elements of that leadership had changed. The calculus of power that had provided a foundation for realist scholarship did not appear to adequately account for the changed post-Cold War world. The Soviet Union, while possessing large measures of military power, had crumbled because of a dysfunctional economy and a bankrupt political and social ideology. The triumph of the West, many analysts concluded, was mainly a consequence of a superior productive capacity that had allowed the American economy to withstand decades of Soviet challenge while still providing a high and rising standard of living for its citizens. The energy with which former communist states embraced democratic and market reforms indicated that such principles played a very strong role in the calculus of international power, and that they therefore a critical element of international leadership. Consequently, international relations scholars began to re-evaluate their interpretations of power. Joseph Nye's Bound to Lead [39] was one of the first to argue that the instruments of "soft" power - such as ideological appeal and the apparent attractiveness of domestic lifestyle – were also elements of international leadership. The power to shape perception and the entice other nations to subscribe to a form of political and economic leadership appeared to be just as important as was the raw ability to exert force.

The potential of the MNC to exert just such "soft" power was considerable. Not only were integrated multinationals formidable economic entities, but they were also powerful conveyors of the attractive social conditions supposedly characteristic of their home nation. Nye's work noted that not only did the MNC affect domestic economic conditions; it also influenced cultural mores and social philosophies to a comparable extent. Their activity became one of the key elements in the debates between global integration and local fragmentation that seemed to characterise post-Cold War international politics. The integrative capacity of large economic institutions and production networks came into conflict with the increasingly assertive politics of local culture and identity, which were often opposed to multinationals because they eroded social and religious affiliation.

Such scholarship began to emphasise how the workings of the international marketplace contributed to social and political transformation as well. It meant that scholars of international relations would begin to pay greater attention to the workings of that market and the implications it held for the state, power, and system stability – all of the root concepts and questions of the field. It led to a resurgence of the importance of international political economy, and it is to this that we now turn.

International Political Economy

Three dominant schools of thought have dominated the study of international political economy – liberalism, mercantilism, and Marxism. All three have staked out positions on the core questions of the field – the competition between and market and authority, and the domestic political implications of increasing international commerce. Robert Gilpin has outlined how international political economy research has concentrated on the three traditional approaches.[40] The first -- economic liberalism -- draws on the classical works of Adam Smith and David Ricardo. Domestically, this model assumes that individual consumers are rational economic maximizers, and that a free market in the trade of goods and services will result in the greatest good for the greatest many. Internationally, liberalism utilises the theory of comparative advantage in recommending that countries focus their industrial efforts in producing goods for which they are most suited. It argues that international trade should be free of restriction, save for those items deemed essential for national security. Modern descendants of Smith and Ricardo include Friedrich Hayek and Milton Friedman, who contend that their original conceptions are applicable today.[41] Their recipe for economic prosperity included the dismantling of state regulation and the privatisation of as much national industry as possible.

Such recommendations formed the intellectual foundation of the program of de-regulation that became prominent in both the Reagan and Thatcher administrations[42], programs that have been emulated in many additional states.[43] Liberalism argues that the state should interfere as little as possible with the market. Both Thatcher and Reagan were convinced that the economic stagnation they perceived in their nations was a product of an over-intrusive state that stifled industrial initiative and entrepreneurial drive. Their governments moved quickly to deregulate industries, to sell government corporations to the private sector, and to loosen regulatory requirements that supposedly impeded the flow of capital and the creation of new businesses. Such actions were credited with restoring the prosperity of the national economies of both the United States and Great Britain.

While this model does see a necessary role for national government - particularly in providing legitimate and predictable avenues for economic redress – that role is by implication limited. Its appeal in the post-War international system benefited both from the support of the United States and the memories of the economic nationalism that had contributed to the Great Depression. Its fundamental assertions were translated into policy by the economic institutions of the post-War world. The securing of IMF developmental assistance became contingent upon the adoption of non-interventionist forms of domestic governance. Admission to the GATT depended upon a national commitment to lower trade and investment barriers. The principles of comparative advantage were assumed to provide the most reliable and effective path to development; consequently developing nations concentrated on the production of primary resource products that were consumed largely by the industrialised world. This pattern of international economic management dominated much of the first two decades of the Cold War.

The assumed ubiquity of the liberal model contributed to the rapid expansion of the MNC in the early post-war years. Substantial reductions in tariff and trade barriers and the enhanced stability of foreign exchange levels encouraged the creation of foreign operations by many domestic firms. At first, such activity usually involved the export of finished goods for distribution in foreign markets; later, enhanced confidence in the stability of the trading system encouraged these corporations to make manufacturing investments abroad. The political effects of large MNCs were assumed to be at worst neutral and at best inherently positive to both home and host countries. They provided developing nations with enhanced employment opportunities and raised technological literacy and income levels. For the home country, international operations kept product prices down by reducing labour costs, and allowed firms to upgrade their domestic production unites into higher valued-added production processes. Continual investment and manufacturing abroad were assumed to be both economically necessary and politically beneficial.

The early initial successes of the MNC in rehabilitating Japan and Germany were however, countered by the inability to create similar effects in other areas of the globe. In many respects the progress of the world economy under a liberal trade and investment regime were quite positive. Trade had been re-invigorated, and the production processes within Western Europe and Japan rehabilitated. Yet, development in what came to be termed "the third world" had been less than expected. In the first three decades of the post-war period, many such nations were unable to translate their comparative advantages in the production of raw commodities into a steady progression of industrial upgrading. The attempt to try- under the liberal assumption that the best route to development lay in industrialisation – had eroded traditional social structures and inaugurated rapid urbanisation, without which local political authorities had few resources to cope.

Foreign multinationals had proven reluctant to transfer key technologies or production processes into foreign plants; and were reticent in incorporating local personnel into their overall management structure. MNCs quickly transferred much of the wealth garnered from foreign operations back to the home nation; comparably minor amounts were re-invested in the development of the host nation.[44] Host governments often endorsed production arrangements that enriched local business and governing elite while providing few worker benefits. The record of the MNC had not fulfilled the economic promise that liberalism predicted.[45]

Such realities prompted a revival of a model of political economy based on the ideas of Karl Marx. The experience of development mirrored many of the predictions and warning Marx had made about the perils of liberalism. Marx's argument - that liberalism created conflict between the economic interests of the owners of capital and the suppliers of labour - proved prophetic. His contention that the state was nothing more than a conduit for the flow of international capital seemed borne out by the collusive state-firm relations endemic in the Third World. His critique of capitalism – that the international structure was artificially constructed by nation-states competing desperately to acquire new markets and resources – found tangible proof in the inherent exploitation of the Third World. Because world economic resources were finite, that competition inevitably created conflict and outright armed hostility between nation-states. Within the developing world, competition for accumulation led to the exploitation of national resources and the creation of a social order plagued with class and material conflict. Such orders were unjust and ultimately self-defeating, as the growing tensions within the economic order proved unbearable and led to nationalisation or rebellion by the exploited class.

Such ideas formed the basis for the dependencia scholarship. Two intellectual descendants of Marxian scholarship include Theodore Moran and Robert Cox. Moran's study of the copper industry in Chile demonstrated that country's strong national desire to gain more sovereign control, first over its domestic mining operations, second over Chilean participation in the world economy. He argues that the economic nationalists in Chile focused primarily on wresting control from large mining multinationals, and only later did they concentrate on establishing overall Chilean economic independence.[46] He concluded that a more equitable pattern of control and a greater symmetry of power between host nation and MNC would work to ameliorate much of the inherent tension between the two.[47] Robert Cox has argued that current world production processes have engendered a certain structure of world order. As a self-described "historical materialist", he utilises the class struggle primarily "as a heuristic model for the understanding of structural change."[48] He identifies the historical progression of international political economy as a dynamic between social forces, world order, and ensuing forms of state. Certain models of production condition both the structure of the world order and the accepted realms for the exercise of state power.

Such interpretations argue that the MNC is an instrument of oppression and exploitation, not one of development and progress. The MNC attempts to expropriate and maintain control over the generation of wealth, and holds few other objectives other than the enhancement of its own economic power. It should therefore be regarded with as much suspicion as welcome; and the role of the state is to first divest itself from such collusive agreements and second to exert stronger control over its own domestic resources. This it can only do by first recognising the inherent tendency for exploitation, and then working diligently to equalise power relationships between the multinational firm and the developing nation. Awareness of that need would breed the capacity for action.

The third model that will be discussed here is the mercantilist or nationalist model of economic development. Mercantilism is often associated with the realist scholarship because both emphasise the accumulation and maximisation of state power. Europe's early mercantilist strategies have been well recorded by Jacob Viner.[49] Viner's historical accounts of 18th century Europe noted how the drive to accumulate gold specie dedicated the trade and production policies of the European powers. Primary intellectual expositions of the mercantilist school include Friedrich List. List's National System of Political Economy justified why national power objectives should dominate economic policy, and provided a methodology for achieving such power. To List, the purpose of economic activity was to enrich the power of the state; it was not to maximise individual welfare. States should strive to achieve rapid industrial and technological development until they could equal and surpass that of their competitors.

The principles that mercantilism advocates run as follows. First, the state should play an active - rather than a mere regulatory – role in shaping domestic market conditions and in aiding the progress of its indigenous firms. Relying on principles of comparative advantage to fulfil national economic needs would result in permanent economic subordination to stronger industrial powers. Economic activity should concentrate on building core industrial and technological capabilities, not on raising the standard of living of individuals. Trade barriers - particularly in fledgling industrial industries - should remain high until indigenous firms gain experience and manufacturing skill. Taxes on accumulated wealth should be heavy, to provide state revenue for further investment. After a state had gained strength in a particular industry, it could relax trade restrictions, and thereby endeavour to obtain more international market share. Such principles were thought to provide the surest and quickest route to economic power.

Under mercantilism, a market economy is utilised for day to day transactions but is deemed inappropriate to chart the economic course of the nation. The ideology of mercantilism holds strong conceptions of the role the state must play in fashioning economic success. Nations practising mercantilism must have a state apparatus with both the legitimacy and the capacity to intervene in the workings of the market. Government officials must work in co-operation with executives of industrial leaders, to ensure that economic plans are communicated and understood. The state works to foster domestic firms' success by protecting the home market from foreign competition, erecting regulatory investment regimes designed to ensure rapid transfer of foreign technology to home firms, and by ensuring that firms have assured long-term access to low-interest capital. Domestic competition is encouraged but regulated: rivalry between domestic firms is intense, yet the state works to prevent the establishment of monopoly by ensuring the survival of at least several firms in any one industry. Strong state structures and a public desire for national economic progress are prerequisites for the practice of mercantilism.

The revival of mercantilist interpretations of national economic activity resulted from the economic success of post-war Japan. The rapidity with which Japan rebuilt its war-shattered industry was unparalleled. Within twenty years Japan was competing with American producers in low-value consumer durables; by the 1980s, Japanese auto manufacturers were commanding increasingly large shares of the global automobile market. Initial accounts attributed such success to the infusion of American post-war monetary aid and the absorption capacity of the American domestic market. Yet, as American trade deficits with Japan grew - and were counted in the tens of billions of dollars per year – analysts began to note that the Japanese economic success was not a product of liberal economic principles. The Japanese home market remained largely closed to American imports, particularly in high tech manufacturing. Imports from Japan were often priced at artificially low levels, engendering accusation of trade dumping by American competitors. And the ferocity and resilience with which Japanese firms could compete led many to conclude that they were not relying solely on their market earnings. Japanese companies could apparently endure years of selling at below-cost prices in a long-term strategic effort to dominate market share. Such a strategy could only be built on profits garnered from sales in the domestic Japanese market. Finally, the groups of allied manufacturing firms that drew financing from a single bank - the now famous *keiretsu* of industrial groupings - allowed the exchange of information and the provision of low cost capital that was unmatched by liberal market structures.

Writers such as Chalmers Johnson, Lester Thurow, Clyde Prestowitz, James Fallows and Karel van Wolferen examined the patter of Japan' economic behaviour and drew largely similar conclusions. Fallows argued that historical and cultural experience had taught the Japanese leaders to equate technological capacity with national independence, and that therefore the desire to dominate high-tech industries was a strategy of national defence. Prestowitz recounts his experiences as a trade negotiator, and notes how domestic regulatory systems in Japan effectively eliminated foreign competition. He argued that Japanese leaders were surprised that Western nations did not erect similar domestic regulations to protect and enhance their own economies. Karel van Wolferen notes how the Japanese bureaucracy had effectively usurped power from elected state representatives. Consequently, the Japanese economy wielded the strength of consensus among business and government elite but lacked centres of power and accountability, which inhibited the ability to enact change. Wolferen noted that this was a source of long term weakness within the Japanese system. Thurow argued that the system of trade competition between the industrial economies would threaten the post war liberal trading system enacted by the United States. These authors attempt to illuminate the success of Japan and to provide reciprocal policy recommendation for the West.[50]

Many observers concluded that Japan's economic power could only be countered by selective government aid to industries thought to hold important strategic value. The debate over strategic trade policy - or the need for government support of industries that competed in especially expensive or strategic industries - populated academic and policy literature during the latter half of the 1980s and early 1990s. Economists such as Laura Tyson, Paul Krugman, and Michael Mastanduno[51] argued that the structural dynamics of particular industries – such as semiconductor production, steel, and the fabrication of civilian jetliners – mandated government participation. They argued that government support of these industries by industrial competitors created an uneven playing field upon which American firms could not compete. An example frequently cited was the Airbus consortium, in which the combined government support by Britain, France, and Germany enabled Europe to produce the Airbus civilian jet. None of the three European partners possessed sufficient economies of scale to produce such an aircraft; their consortium, however, allowed them to wrest vital market share from their primary competitor, Seattle-based Boeing aircraft. This example of European mercantilism engendered a series of reciprocal actions from the American government, proving that mercantilism theory remained alive and well is some of the most avowedly liberal industrial countries.

Mercantilism both fosters and depends upon a close working relationship between the policy apparatus of government and the management of large corporations. MNCs contribute to state aims by regularising production practices within their home nation. They often enact restrictive hiring and promotion practices designed to ensure that nationals retain control over major management decisions. The ownership of public stock is often controlled by large native financial institutions that do not trade or sell that stock. This frees companies from the shackles of quarterly profit results, and allows them to enact long term strategic practices. Company loyalty is encouraged and often becomes an institutional surrogate for expression of loyalty to the state. Production of high value-added research and production activities is concentrated in the home state; routine productive tasks are allocated to foreign plants. In return for such measures, the mercantilist MNC receives numerous state benefits. The state protects the domestic market from foreign competition and prevents the establishment of monopoly. State measures designed to induce high levels of personal savings create a large pool of investment funds that can finance new ventures. Long-term research and development is encouraged. Such advantages mitigate the dangers associated with unchecked market independence, and allow the state to retain a large measure of control over its domestic development.

The three traditional interpretative models prevalent in the theory of international political economy describe the MNC as an agent of economic efficiency, of exploitation, and of state power respectively. Liberal interpretations of the international economy focus upon the efficient productive capacity of the modern MNC as the best instrument for global economic development. The principles of this theory were infused into post-war economic institutions and the development practices those institutions encouraged. Multinationals, however, could also be seen as exploiters, whose control over resources, technology, and production put them in a position of advantage when bargaining for concessions from host states. Descriptions of such behaviour are well developed in the dependencia literature. Finally, mercantilism forms the economic philosophy that is the direct counterpart to political realism. It emphasises the achievement of state power through economic advantage. It prioritises the economic power of the state, not the economic welfare of the individual, and holds little faith in the regulatory capacity of free market mechanisms. International relations theory provides direct corresponding links to the three schools of international political economy research.

Regionalism Versus the Primacy of the State

The traditional focus on the state - a staple of theories of international political economy research - may be waning. Susan Strange, for one, has argued that ability of the state to regulate economic activity has been eroded by the activities of integrated MNCs and the expansion of bilateral and regional investment regimes. Her arguments - outlined most recently in The Retreat of The State[52] - question some of the fundamental assumptions of liberalism, mercantilism, and dependence. She argues that international economic production arrangements are too diffuse for any one state to control. Attempts to adopt overly-strict domestic state regulatory mechanisms discourage the inflow of foreign direct investment, investment that is critical in maintaining productive competitiveness with industrial rivals. She consequently shows how broader instruments of regulation are necessary to control the unfettered investment and production decisions enacted by integrated multinationals.

Because of the observations of analysts such as Strange, current branches of political economy research do not necessarily focus their analysis on the individual nation-state. The growth of trans-border trade and the increasingly integrated production networks that characterise modern enterprise has led to an intensive study of the political economy of regions. The most-developed example of the phenomenon of regionalism is the increasingly unified economy of Europe. As Brian Hanson notes,

> One of the most striking features of the international economy since the mid 1980s has been the proliferation and intensification of regional trading arrangements around the world. Among the most prominent developments, the European Union (EU) implemented a program to create the world's largest single market .. . and is contemplating the further addition of ten or more countries.[53]

The original political motives, which were the foundation of European post-war integration efforts, have been superseded by the realised and potential economic advantages of an integrated European market.

Regionalism has had different dynamics in North America. The largely political motives behind the European efforts have not been mirrored in North America. While economic unification in Europe was largely a product of efforts to curb nationalist economic rivalry, in North America the business reality of integration preceded regional political initiatives by a good margin. The Canada-US free trade agreement (CUFTA) and its North American Free Trade descendent (NAFTA) have been described as political agreements designed to reflect a long-standing business reality.[54] Initiators of the agreement argued that the sheer volume of Canada-US trade mandated the establishment of regional regulatory and institutional structures. The inclusion of Mexico and the potential inclusion of South American countries indicate that developing regional economic strategies continue to command policy priority.

In Asia , economic institutions are being created largely in order to facilitate trade. The goal of creating an integrated East Asian trading system is reflected in the continual efforts to lower trade barriers and increase production within the region. Although the regional dynamics of Asia differ substantially from its European or North American counterparts - primarily in their emphasis on fostering pure economic co-operation, with comparatively little emphasis placed on the development of regional political institutions – the economic potential of an integrated East-Asian economic system is enormous. Efforts to create transparent and predictable regulatory regimes have been a growing phenomenon in the post-war trading system, and often such efforts have political implications that challenge the economic sovereignty of the nation-state.

The Continuing Relevance of the State

The field of international political economy is characterised by a constant process of competition and adaptation between state regulation, non-state institutions and agreements, and the market mechanism. While acknowledging that the market requires a degree of freedom for capital, labour, and knowledge to migrate to profitable and competitive industries, the state also attempts to shape and regulate market outcomes such that they accord with national policy objectives. It utilises a variety of mechanisms to do so, including tax law, statutes on competition, environmental and labour standards, and other measures. The market is underpinned by a stated or assumed ideology which establishes the objectives and conditions of success. However, the task of regulation is hampered by the elusiveness of the agents and modes of transaction that comprise the market mechanism. Compared to the state, whose regulatory agencies and policy objectives are relatively clear and consistent, the market is the very epitome of fluidity. Market instruments vary in size, interest, and power, from the individual merchant through to large integrated MNCs. The market expands to accommodate new agents while shedding industrial functions deemed obsolete. It is organic, competitive, and unpredictable.

This complexity is compounded by the paradox of an increasingly international- and perhaps global - economy that relies upon state-based institutions for its management. Despite its apparent independence, the market remains a genuine social structure dependent on institutional and political support for its existence. Markets are not free; they exact costs in their creations, regulation, and maintenance, costs that are usually borne by the apparatus of the state. Markets require regulatory regimes, transparency and disclosure mechanisms, and policy consistencies, all of which require state involvement and generate state expense.

Modern developed economies have developed unique state instruments and industrial policy paradigms to enhance their ability to cope with such changes. Historical and contemporary experience have shaped the various forms of state industrial policy.

Peter Gourevitch[55] has added an important historical dimension to the debate over state industrial policy. He demonstrates how the particular forms of state have affected the long-term allocations of international capital within domestic markets. His examination of the allocative patterns of capital in France, Great Britain, and United States shows that it has differed quite markedly in times of depression and economic recession, reflecting different societal priorities. A more contemporary example includes the work of Bruce Kogut, who edited a volume detailing how the comparative industrial structures provide each nation with specialised competitive advantage. The collected works in the volume illustrate how particular state-society relations influence research and development methods, labour relations, and the specific methods of introducing new technology.[56] Industrial patterns are products both of historical experience and current policy priorities.

The particular governing structure in individual countries -- combined with historical patterns of state guidance over the evolution of the domestic economy -- impacts directly on a country's reaction to the phenomenon of economic globalisation. Jeffrey Hart's work on contemporary forms of competitive capitalism outlines some of the broad patterns of industrial behaviour found in the United States, Japan, and Western Europe.[57] He argues that the competitiveness of industries within industrial countries depends on particular structures of state-societal relationships. He examines the organisational structure of business, government, and labour organisations within these states, as well as the institutional linkages between them. He notes how Europe – and Germany in particular – has a form of state-industrial co-operation that is labelled corporatism, which features a loose, informal association between business and policy leaders who can set general industrial objectives. Nations espousing corporatism view national firms as serving both economic and social interests. Corporate governance standards concentrate on serving the interests of employees as well as shareholders. Preserving employment is rated as a high managerial priority.

Japan, by contrast, follows the particular organisational requirements of the developmental state model.[58] It is the domestic institutional expression of mercantilist political economy outlined earlier. The developmental state features similar co-operation as corporatism but features more government authority and direction. Political structures affect both the freedoms of business decision making and the ultimate goals economic activity is supposed to achieve. This system features intense collaboration between the instruments of the state, labour, and business, with the goal of achieving mutually acceptable industrial policy goals. Such a system depends heavily upon communication between its primary elements and an identifiable policy and business elite who interact easily with their counterparts in labour and business. Both the corporatist and the developmental patterns of industrial policy feature co-operative relations between states and national firms. They differ primarily in the predominance of the role of the state in industrial policy making. Yet they have broadly similar patterns of overall corporate governance, which are designed to pursue both economic and corporate objectives. Co-operation between major corporations and government policy makers ensure a broadly consistent and focused plan of industrial development.

More liberal states often do not feature such collaboration. Often their domestic governing structures are designed to foster competition and animosity between the elements of business and the state. The United States, for example, publicly shuns the very concept of state industrial policy as inherently contrary to a free enterprise system.[59]

The relationship between government and domestic firms is at best neutral and often hostile, and the government's role is often perceived as one of regulation, not collaboration. It is more concerned about preventing industrial monopolies than with influencing the goals and success of its domestic firms. A standard work detailing the relationship between the American state apparatus and the operation of its major domestic firms is Stephen Krasner's Defending the National Interest. He adopts a statist approach to the examination of American foreign policy towards the acquisition and control of raw materials. He notes that the American system provides few instruments for central decision makers to exert control over domestic actors, but argues that the state apparatus within the United States has nevertheless been able to significantly determine the actions of its raw materials firms abroad.[60]

Works by Judith Goldstein and Helen Milner demonstrate that American industrial policy is often a product of competing domestic and international economic interests. In the case of Milner, she argues that policy reactions to similar external economic challenges often differ across historical periods. In comparing protectionist sentiment in the United States during the 1920s and the 1970s, she notes that the latter period was less prone to protectionism, largely because of multinational patterns of international production and the greater interdependence of the American economy with the world economy.[61] Goldstein sees American industrial policy as a product of ideas, institutions, and interests, each of which holds significant input depending upon external and internal economic challenges. Neglecting any of the three results in a distorted and erroneous interpretation of the formation and execution of American trade policy.[62] Milner and Goldstein offer interpretations of American trade policy that illustrate both the impact of ideology and the confrontational structure of the American policy making apparatus.

State policy-making apparatuses, ideology, and history all continue to play a role in the formation of industrial policy. While this is particularly evident in examining the large developed economies, it is also clear when discussion moves to small and medium sized economies as well, as the next chapter will demonstrate. While the trends influencing the development of the international economy are broadly consistent, the filter of national policy making mechanisms will dictate how individual states react to those trends.

Conclusion

This chapter has attempted to trace the major post-war developments within the fields of international relations and international political economy. Moreover, it has attempted to outline the major interpretations of the MNC featured in the scholarship of the two fields. The MNC has been included as a traditional element of state power, contributing to the aims and welfare of its home nation. Yet its activities have had the ironic effect of weakening the ideological and productive powers of the hegemonic power, by transferring wealth, technology, and production expertise to industrial rivals. The MNC has also aided - perhaps even demanded - the creation of regional associations or trade blocs designed to harmonise investment policies across numerous countries. MNC activities have spurred the development of institutions and regimes designed to control and regulate investment activity. This has had the ancillary effect of purportedly weakening the autonomy of the state to control its domestic economy. The power and authority of the state has consequently been questioned, as the debate between neo-liberals and neo-realists demonstrates. The MNC has been at the centre of the major debates within the two fields, and will likely continue to remain there.

The challenges to the present international political economy are many. The perceived decline in the economic hegemony of the United States– demonstrated by the rise of industrial competitors – has been replaced by a surging American economy and renewed respect for American economic power. Yet it is unclear whether the United States can or should exert continued leadership over the international economy. In addition, the global trading system has had to adapt to a vast increase in the amount of international commerce and the number of states participating in it. Consequently, the growth of bilateral and regional agreements are rapidly usurping the authority of global multilateral trade rules, leading to fears that regional trade blocs are emerging which will stifle multilateralism. Integrating the states of the former Soviet Union into the global capitalist system has presented a daunting challenge. Finally, the growth in the power and influence of non-state actors - in particular the MNC – threatens state capacity to enact independent domestic economic policies.

The thesis will argue that solutions to such dilemmas necessitate a greater understanding of the management, strategy, and investment behaviour of the modern MNC. In the post-Cold war era of globalisation, the ability of these entities to affect domestic political behaviour is substantially greater than at any time in the post-war era. This is due primarily to the structural changes in the international system that now allow the MNC to operate a truly global production and sales network. That reality holds significant policy implications for national governments, and the specific reaction to that reality of each government will be conditioned by historical tradition, the state apparatus, and domestic ideology. For the purposes of this study, it will be necessary to outline those factors for the nation of Canada. Consequently, the next chapter will provide an overview of the literature surrounding the strategy and structure of the modern MNC, and will illustrate the particulars of the Canadian case in reacting to the MNCs growing power.

Endnotes

[1] There inevitably will be some overlap between this chapter and the next, especially when considering works that deal with both the multinational corporation and international political economy. For analytic distinction, works cited in this chapter view the MNC as a supporting and contributing element to the analysis of specific issues within international political economy. Works cited in the next chapter are those which concentrate on the strategy and structure of the MNC, irrespective of any contribution to international relations or international political economy research.

[2] Re-definitions of security expand the inter-state conflict paradigm that has dominated much of IR scholarship to include such issues as the environment, human security, and ethnic and civil conflict. Examples of environmental writings on security include Thomas F. Homer-Dixon, "On The Threshold: Environmental Changes as Acute Causes of Conflict", International Security, 16(2), 1991. See also Thomas F. Homer Dixon, "Environmental Scarcities and Violent Conflict: Evidence From Cases", International Security, 19(1), 1994, pp. 5-40. Refugee issues are covered thoroughly by such works as F. Stephen Larrabee, "Down and Out in Warsaw and Budapest: Eastern Europe and East-West Migration", International Security 16(4), 1992, and Myron Weiner, "Security, Stability, and International Migration", International Security, 17(3), 1992/1993, pp. 91-126. The most popular elucidation on the likelihood of ethnic and cultural conflicts include Samuel Huntington, The Clash of Civilisations and the Remaking of World Order (New York: Simon and Schuster, 1996) and Benjamin R. Barber, Jihad Vs. McWorld: How Globalism and Triabalism are Reshaping the World (New York: Ballantine Books, 1995).

[3] Examples of such literature include William Greider, One World, Ready or Not: The Manic Logic of Global Capitalism (New York: Simon & Schuster, 1997), and Daniel Yergin and Joseph Stanislaw, The Commanding Heights: The Battle Between Government and the Marketplace That Is Remaking the Modern World (New York: Simon And Schuster, 1998).

[4] Establishing a firm date for the supposed inauguration of the field of international relations is a controversial activity. Certainly scholars and students of political activity were detailing the characteristics of inter-state relations long before 1945. Classic works such as Thucydides The History of the Peloponnesian Wars, trans. Rex Warner (Harmondsworth: Penguin Books, 1954), and Niccolo Machiavelli The Prince and the Discourses (New York: Random House, 1940) form the antecedent basis for the modern school of realism, while the inter-war work of David Mitrany, A Working Peace System (Chicago: Quadrangel Books, 1966) was a prelude to the integration literature that was to follow the Second World War. The date of 1945 was chosen because of the rapid expansion of the number of scholars studying international relations, the rapid development of the ontological and epistemological scope of the field, and the formal recognition of international relations as a branch of independent inquiry within the field of political science.

[5] E. H. Carr, The Twenty Years' Crisis, 1919-1939: An Introduction to the Study of International Relations (London: Macmillan and Company Ltd., 1962).

[6] Carr, Twenty Years Crisis.

[7] Hans Morgenthau, Politics Among Nations: The Struggle for Power and Peace (New York: Alfred Knopf, 1967).

[8] Kenneth Waltz, Man, The State, and War: A Theoretical Analysis (New York: Columbia University Press, 1959).

[9] Klaus Knorr, The Power of Nations (New York: Columbia University Press, 1975).

[10] Henry Kissinger, A World Restored (New York: Grosset and Dunlap, 1964), White House Years (Boston: Little Brown and Company, 1979), Years of Upheaval, (Boston: Little Brown and Company, 1982), and Diplomacy (New York: Simon & Schuster, 1994).

[11] Hedley Bull, The Anarchical Society (New York: Columbia University Press, 1995). Pp. 261-263.

[12] The literature concerning post-War American foreign policy objectives -- and the role that international institutions would play in pursuing those objectives -- is indeed vast Some standard works include the following. Christopher Thorne, Allies of a Kind: The United States, Britain, and the War Against Japan 1941-1945 (New York: Simon & Schuster, 1979) details how differing visions of the post war world threatened to damage the unity of the Anglo-American alliance. The origins of Cold War American foreign policy are traced in John Lewis Gaddis, The United States and the Origins of the Cold War 1941-1947 (New York: Columbia University Press 1972), and its continual mutations are chronicled in John Lewis Gaddis, Strategies of Containment: A Critical Appraisal of Post-war American National Security Policy (Oxford: Oxford University Press, 1982). The standard reference for the origins, objectives, and evolution of post-war international economic institutions is Robert Gilpin, The Political Economy of International Relations (Princeton: Princeton University Press, 1987).

[13] On this congruence of interests, see Raymond Vernon, Sovereignty at Bay: The Multinational Spread of U.S. Enterprises (New York: Basic Books, 1971), Chapters 1-3.

[14] Stephen D. Krasner, Defending the National Interest (Princeton: Princeton University Press, 1978).

[15] Robert Gilpin, US Power and the Multinational Corporation: The Political Economy of Foreign Direct Investment (New York: Basic Books, 1975).

[16] Robert O. Keohane and Joseph S. Nye, Power and Interdependence: World Politics in Transition (Boston: Little, Brown Inc., 1977).

[17] Charles Pentland, "Integration, Interdependence, and Institutions: Approaches to International Order", David G. Haglund and Michael K. Hawes, editors, World Politics: Power, Interdependence, & Dependence (Toronto: Harcourt Brace, 1990), pp. 176-177.

[18] Ibid., p. 182.

[19] Charles Pentland, International Theory and European Integration (London: Faber and Faber Ltd., 1973), p. 88.

[20] Stephen Krasner, "Structural Changes and Regime Consequences: Regimes as Intervening Variables", International Organisation 36(2), 1982, p. 185.

[21] For samples of this debate, see Susan Strange, "Cave! Hic Dragones - A Critique of Regime Analysis", International Organisation, 36(2), pp. 479-496, Charles Lipson, "International Co-operation in Economic and Security Affairs", World Politics, 37(1), 1984, pp. 1-23, and Giulio M. Gallarotti, "The Limits of International Organisation: Systemic Failure in the Management of International Relations", International Organisation, 45(2), 1991, pp. 183-221.

[22] James M. Goldgeier and Michael McFaul, "A Tale of Two Worlds: Core and Periphery in the Post-Cold War Era", International Organisation, 46(2), 1992, pp. 467-491.

[23] Albert O. Hirschman, National Power and the Structure of Foreign Trade (Berkeley: University of California Press, 1975).

[24] Fernando Henrique Cardoso, "Associated-Dependent Development: Theoretical and Practical Implications", in Alfred Slepan, ed., Authoritarian Brazil: Origins, Policies, and Futures (New Haven: Yale University Press, 1973), pp. 142-178.

[25] Marianne H. Marchand, "The Political Economy of North-South Relations" Richard Stubbs and Geoffrey R. D. Underhill, Political Economy and the Changing Global Order (Toronto: McClelland & Stewart Inc., 1994), pp. 292-293.

[26] Raymond Vernon, Sovereignty At Bay: The Multinational Spread of US Enterprises (New York: Basic Books, 1971), pp. 282-284.

[27] Shah M. Tarzi, "Third World Governments and Multinational Corporations: Dynamics of Host's Bargaining Power", International Relations 10(3), 1991, pp. 237-249.

[28] Charles Kindleberger, The World in Depression 1929-1939 (Berkeley: University of California Press, 1973).

[29] The literature surrounding the apparent reality of American decline is substantial, and includes Paul Kennedy, The Rise and Fall of the Great Powers (New York: Random House, 1988); Robert Gilpin, War and Change in World Politics (Cambridge: Cambridge University Press, 1981), Ronald A. Morse and Clyde V Prestowitz. Jr., editors, Powernomics: Economics and Strategy After the Cold War (Washington: Economic Strategy Institute, 1991), and Joseph Nye, " The Misleading Metaphor of Decline", The Atlantic Monthly, 265(3), 1990, pp. 86-94.

[30] Robert Keohane, After Hegemony: Co-operation and Discord in the World Political Economy (Princeton: Princeton University Press, 1984), p. 240.

[31] Helen V. Milner, Resisting Protectionism: Global Industries and the Politics of International Trade (Princeton: Princeton University Press, 1988), pp. 18-25.

[32] Kenneth Waltz, Theory of International Politics (Reading: Addison Wesley, 1979).

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[34] Joseph Grieco, "Anarchy and the Limits of Co-operation: A Realist Critique of the Newest Liberal Institutionalism", International Organisation, 42(3), 1988, p. 503.

[35] Richard Ned Lebow, "The Long Peace, The End of the Cold War, and the Failure of Realism", International Organisation, 48(2), 1994, pp. 249-277. See also R. Harrison Wagner, "What Was Bipolarity?", International Organisation, 47(1), 1993, pp. 77-106, and John Lewis Gaddis, "International Relations Theory and the End of The Cold War", International Security, 17(1), pp. 5-58.

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knowledge – the United States still retained the elements of hegemony. Susan Strange, "The Persistent Myth of Lost Hegemony", International Organisation, 41(4), 1987, pp. 551-574.

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[45] Theodore H. Moran, Multinational Corporations and the Politics of Dependence (Princeton: Princeton University Press, 1974).

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[47] Ibid., pp. 254-257.

[48] Robert Cox, "Social Forces, States and World Orders: Beyond International Relations Theory" in David Baldwin, Neorealism and Neoliberalism: The Contemporary Debate (New York: Columbia University Press, 1993), p. 248.

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[55] Peter Gourevitch, Politics in Hard Times (Ithaca, Cornell University Press, 1986).

[56] Bruce Kogut, ed., Country Competitiveness: Technology and the Organising of Work (Oxford: Oxford University Press, 1993).

[57] Jeffrey A. Hart, Rival Capitalists: International Competitiveness in the United States, Japan, and Western Europe (London: Cornell University Press, 1992), p. 5.

[58] Johnson, MITI and the Japanese Miracle, Japan: Who Governs?

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Chapter 3 - The Multinational Corporation and Canadian Public Policy

The previous chapter detailed the evolution of international relations and international political economy research that has occurred in the post-war era. This evolution has reflected the structural changes that have occurred in both the international political and the international economic systems. Moreover, it has illustrated how the multinational corporation has contributed to the evolution of both fields, both in theoretical and in applied contexts. The thesis contends that the degree of integration that characterises today's multinational production networks has raised that governments place on acquiring foreign direct investment as a method of upgrading their economies. This in turn has altered traditional state-firm paradigms from an emphasis on confrontation to one of collaboration. This chapter builds the foundation of that argument in two specific ways. First, it will detail the evolution in MNC strategy and structure that have resulted in the modern production networks that characterise international business today. Secondly, the chapter will outline the major contributions to the literature of Canadian state-firm relations and MNC activity in Canada. This is in preparation for the theoretical discussion of "alliance capitalism" that will follow in chapter four. The utility of this model in the Canadian context will constitute the empirical work of the thesis, and will be demonstrated in chapters 5-6.

Corporate expansion into international markets is fraught with opportunities and constraints that are not faced by domestic businesses. The opportunity to market directly to foreign consumers - and to take advantage of the comparative advantages that foreign production sites often hold – are balanced by the constraints on firm activity enacted by host governments. The ability of the host government to halt, direct, or interfere with MNC activity remains a primary external management challenge of the modern MNC. A government's proclivity to do so is a product of domestic ideological demands, economic development objectives, and the institutionalised regulatory mechanisms entrenched in its state apparatus. Consequently, the generic models of firm-state relations outlined in the previous chapter must be adapted to the particular conditions of individual states.[1]

The second portion of this chapter will therefore detail the specific conditions of state-firm relations in Canada. The Canadian state – characterised by a varying combination of liberal values and fiscal conservatism, in which the government plays an overt but varying role in the workings of the market – features unique policy mechanisms and objectives. Government policy objectives are subject to fluctuation as different parties assume the mantle of power. Domestically, Canada's federal and provincial division of power necessitates the balancing of national and provincial economic objectives that do not always agree. Moreover, an increasingly regionalised national economy often places contradictory demands upon the federal governments in terms of fiscal, monetary, and taxation policy. Internationally, the increasingly interdependent economic relationship with the United States engenders economic benefit but also entails costs in terms of economic autonomy. The federal policy mechanisms are tasked with balancing the competing demands of these diverse influences on Canadian economic policy. Consequently, the structure of the Canadian state often intentionally diffuses power and limits state capacity to initiate industrial change.

Such fluctuations are reflected in an historical Canadian ambivalence towards the MNC. The economic benefits of its activities are recognised, but are often thought to erode or interfere with broader social policy and national objectives. This has spurred successive post-war Canadian federal administrations to adopt different policy objectives towards FDI, at times welcoming it, and in other cases regarding it with nationalist suspicions. Integrating economic objectives within a broader nationalist agenda has not surprisingly occupied much of the federal policy making approach to the MNC.

Defining the Multinational Corporation

One of the persistent difficulties plaguing discussions of the MNC is the lack of a widely accepted definition. While many business executives and academics have an intuitive understanding of the specialised features of the MNC, their characterisations often vary. Some argue that the mere presence abroad of domestic products constitutes evidence of multinational activity. Others argue that the criteria for multinationality are much more stringent. One base measure is the overall value of company assets located abroad, expressed as a percentage of overall company assets, a measure that indicates not only the penetration of foreign markets but also a willingness to locate productive assets outside of the home nation. Another measure includes managerial mindset – or, as Howard Perlmutter argues, the ability of managers to adopt a globally integrated perspective of the firm's operations.[2] Yair Aharoni adds yet another, noting that in addition to strictly performance measures, the national composition of top decision makers also indicates multinationality - that a geographically diverse cadre of senior managers indicates willingness to promote local managers and an ability to accommodate the needs of local markets.[3] He concludes "the proper definition to be used depends to a large extent on the problems discussed."[4]

Raymond Vernon made a significant contribution to the effort of defining and describing the MNC. His definition will provide the basic reference for this thesis. Vernon's work argues that several characteristics differentiate the MNC from purely domestic businesses– size, types of business activities, and patterns of management and control.[5] He demonstrates that most MNCs are relatively large companies with access to large amounts of liquid capital. He argues that such companies tend to operate in diverse industries with high barriers to entry; that they operate in a multitude of national markets and attempt to harness the competitive advantage of each, and have consequently adopted patterns of management and control designed to accommodate geographic and product diversity. He concludes that the MNC must continuously monitor its relationship with host governments, both in the developed and in the developing world, in order to ensure a stable business environment. Vernon accurately summarised the predominant policy issues surrounding the operation of the MNC prevailing at the time. His analysis – particularly on the relationship of the MNC to developing nations, with labour groups, and the shifting bargaining relationship between the state and the firm – remain pertinent and relevant today.[6]

Today, a combination of industry dynamics and the organisational structure of the firm itself determine a MNCs' "multinationality". While raw economic measures - such as book value of foreign assets, percentage of sales generated by international activity, or the number of foreign personnel employed – are all useful measures, they do not by themselves capture the essence of the modern global corporation. They do not provide any indication of the scale and direction of the political effects of MNC operations. They have difficulty encapsulating the synergy effects modern MNCs possess by taking full advantage of the inherent gains of an integrated productive network. Such benefits range from capturing the particular competitive advantage of a local workforce, to bridging innovative steps from country to country, to exploiting the scale economies of large markets. In order to evaluate these capabilities, other measures must be adopted which focus on the organisation and the dynamics of the industry. The following section will outline some of the historical contributions to that literature.

The Multinational Corporation: Evolution of Strategy and Structure

The internationalisation of the domestic enterprise is not a new phenomenon. Such internationalisation was often encouraged by governments as a method of augmenting state power. Earlier examples of European commercial expansion featured a race to acquire international ports, lands, and sources of raw materials. The industrial history of the nineteenth century is characterised by the domestic and international growth of the capitalist enterprise. Often such enterprises worked in conjunction with host governments to achieve local development objectives. The British East India company, for example, rapidly expanded its international operations to provide lumber, coal, and cotton for the expanding British empire. International expansion ensured that the colonising power would maintain access to the raw materials and resources that such areas held in abundance. Manufacturing and production were concentrated in the factories of the home nation, which endeavoured to retain primary control over technology and industrial development.

Later, such expansion was predicated on the concepts of comparative advantage associated with Adam Smith and David Ricardo. The creation of an integrated production network that took advantage of its country's endowed advantages – particularly in raw natural resources – provided intellectual explanation for the growth of the multinational corporation. Rapid technological advancement in communication and manufacturing technology steadily increased both the size of such enterprises and their ability to enact co-ordinated strategies across vast expanses of land. Concentration of manufacturing processes in technologically advanced nations increased the productive capacity of the world economy and led to industrial rivalry among the European powers and later with the United States.

The formal study of the practice of management was by comparison slow to appear. Much of the literature surrounding the effects of large production concentrated on the labour conditions on the working poor. The practice of management itself was not initially a target of analytic scrutiny. That changed with the publication of Frederick Taylor's Principles of Scientific Management in 1911.[7] Taylor's work formed the foundation for the study of the management of large production enterprises that continues to this day. His emphasis on measurement, individual work processes, and the necessities of managerial competence form the analytical basis of modern industrial practice. Disciples of Taylorism established rigorous measures of industrial activity that reduced waste, labour, and cost through the concept of the "one best way". This allowed managers to establish uniform expectations of performance for their subordinates, and provided a set of standards that could be integrated across many manufacturing plants. The principles of rational production enabled owners and managers to increase the size and integration of their production facilities without losing managerial control. Such principles also allowed managers to vastly increase factory output and to establish regularised management practices across scattered manufacturing networks.

Taylor's ideas rapidly became integrated into the productive processes of most major American corporations, and helped form the foundations of the vast increase in productive capacity that characterised American industry during the first half of the twentieth century. Buoyed by the artificial stimulus of world war, many such corporations were soon producing quantities of goods that far exceeded the absorptive capacities of the American domestic market. This increase in size and productive capacity had two implications for the study of management. The first – how to establish organisational structures that could maximise control over such large entities – became the subject of Alfred Chandler's attention. His Strategy and Structure [8] catalogued the organisational response of four major US firms to the evolution of their industry and economic environment. His analysis noted how such organisational forms were a reflection of both industry analysis and company production structure. The expanded production – combined with diverse lines of business that characterised such conglomerates – gave the post-war MNC tremendous economic power and influence. Chandler chronicled the evolution of the organisational structure of the large domestic – and later multinational – firm.

The second effect of this rapid expansion of domestic production was the increasingly obvious necessity for international expansion. Such expansion became an increasingly important source of post-war industrial revenue. Foreign direct investment began to usurp standard portfolio investment in the international operations of major companies, and the effect of growing foreign direct investment began to receive economic analysis. The work of Stephen Hymer[9] outlined some of the potential advantages that the establishment of foreign subsidiaries would hold. Hymer was one of the first to demonstrate how the theory of direct investment differed from the theory of portfolio investment. It was apparent to Hymer that a firm reaped economic benefit from manufacturing directly in foreign markets, rather than merely licensing production knowledge to foreign firms for use in those markets. The inevitable transaction costs that accompanied the process of licensing and joint ventures could be eliminated by direct expansion abroad. Hymer's work augmented earlier efforts by Raymond Vernon[10], whose analysis of the business and product cycle had become a standard reference for business economists. Vernon argued that the life-cycle of production creation, manufacture, and eventual obsolescence could account for the fortunes and difficulties of manufacturing firms. This cyclic pattern of business activity could help businesses predict future market returns and plan for product necessary product replacement. Hymer and Vernon presented important initial theories on the topic of international business behaviour.

Theories of internationalisation quickly became more elaborate and defined. The work of Stephen Buckley and Mark Casson reflected this elaboration. They argued that the increasing level of international production was motivated by a desire to reduce the transaction costs endemic in arms-length cross-border transactions. They argued that standard explanations of international production – which often emphasised the comparative productive advantages of individual countries, based on natural factor endowments – were important but incomplete. They pointed out that one key assumption of classical trade theory – that international markets could be efficient – was unrealistic in practice. They argued that international trade between two domestic firms was inevitably plagued by inefficiency due to the endemic barriers that raised costs - barriers such as language, capital transfer costs, and the integration of production knowledge into the practices of local firms. These costs could be overcome, they argued, if domestic firms expanded their operations abroad rather than relying on the transfer of productive capacity through licensing arrangements. Firms could extract more economic rent and raise profit margins by relying on their own abilities to satisfy international markets, and by incorporating particular country advantages into a multinational production network.[11]

Another explanation offered for the greater proclivity for firms to internationalise came from the emerging literature of competitive advantage. This literature argued that a firm's international success had less to do with its locational advantages- the standard explanation of comparative advantage in classical trade theory - and more to do with the advantages garnered through its own production process. The work of Michael Porter its perhaps the most well-known within the area of competitive advantage. Porter argued that firms competed primarily on the basis of cost, differentiation, or focus. He demonstrated that industry structure constrained firm choices and dictated firm strategies. He introduced the framework of the value chain; in which a firm's overall success depended on its ability to wrest greater efficiency and advantage across the entire production process, from the acquisition of raw material to the final sale and service of the end product. The value chain, therefore, demanded an efficient international production effort, particularly in industries depending on imported materials and exporting to foreign markets. Porter's work placed great emphasis on the internal abilities of firms to manage international operations, adding managerial skill as an equivalent to comparative advantage as an explanatory factor for industrial success.[12]

John Dunning argued that none of the existing theories – whether based on comparative or competitive advantage, or on transaction costs – was sufficient. He argued that international production required a theory that combined the competencies of specific firms, the dynamics of individual industries, and the comparative advantages of nations. He articulated such a theory in his "eclectic paradigm" of international production. This paradigm argued that international production could be explained only by a combination of specific ownership, location, and what he termed "internationalisation" advantages. Ownership advantages referred to the specific knowledge, productive capacity, and technological strength possessed by international firms. Location advantages were composed primarily of the comparative advantages of production sites located in different countries. Finally, internalisation referred to the specific advantages garnered through the internationalisation of individual industries. The eclectic theory of international production encompassed the particular policies and dynamics of countries, firms, and industries. Its comprehensiveness served a vital function in integrating the various strands of theory emerging around the topic of international production.[13]

The eclectic paradigm had various strengths and weaknesses. One strength lay in its ability to integrate competing approaches, offering an encompassing theory of international production. A second strength was its dynamism and flexibility. It provided room to incorporate the evolution of industry dynamics, firm strategy, as well as the effects of domestic governments' industrial policies. However, critics charged that its very comprehensiveness and flexibility was also a source of weakness. While the eclectic paradigm provided an explanatory foundation for the evolution of international production, it did not provide specific recommendations for firms and governments on how to shape and profit from international production. Its general explanatory ability was countered by an inability to predict the effects of government policy and business strategy. More specific theories were needed to aid governments and business to enhance domestic and international competitiveness.

Michael Porter attempted to satisfy the demand for greater specificity. He noted that a singular defining characteristic of today's MNC is its ability to integrate various sources of competitive advantage across the global spectrum of business activity. He had earlier provided a useful definition of both the global industry and the global firm, arguing that "a global industry is one in which the strategic positions of competitors in major geographic or national markets are fundamentally affected by their overall global positions."[14] He stated further that "an industry becomes a global industry because there are economic (or other) advantages to a firm competing in a co-ordinated way in many national markets."[15] To Porter, the modern multinational was distinguished by the active co-ordination of its operations to take full advantage of the benefits international markets bring.

Porter's 1990 work -- entitled The Competitive Advantage of Nations -- sought to uncover the basis of national economic success. His overall aim was stated succinctly: why do some nations succeed and others fail in international competition?[16] Porter was intrigued by the ability of individual nations to field groups of successful companies competing in a single industry. His research led Porter to propose an explanatory theoretical framework based on the metaphor of the national "diamond" of competitive advantage. The corners of the diamond were meant to illustrate the factors required for competitive success. They included the presence of domestic factor supplies, sufficient domestic demand conditions, the presence of rival competing firms in individual industries, and the proximity of related and supporting industries. The presence of all four were prerequisites for international competitive success.

Porter's framework also provided specific recommendations for national governments. He argued that, rather than acting as a surrogate for, or protector of, national industry, it was government's role to foster the conditions under which all four corners of the diamond could flourish. Government played an important but supporting role. It could aid industrial success by deregulating industries, encouraging international expansion, and by investing in infrastructure and training. Greater action than this, however, would risk damaging the competitive dynamics that were key to success. The conclusion of his book listed specific recommendations for each of the ten countries that were the subjects of his study. The Competitive Advantage of Nations received corporate and government attention as a guide for business strategy and national economic policy.

Porter's work attempted to explain the dynamics of international competitiveness through the economic capabilities of individual nations. His conclusions – both as recommendations for the individual countries studied and as axioms for industrial policy in general – were meant primarily for national policy makers and business executives. He argued that industrial competition meant primarily market competition; that government and public regulatory instruments, while important, played primarily a supporting role in fostering domestic competitiveness. He also defended his decision for using the nation as the proper unit of analysis. He argued that the dynamics of industrial competition could only be measured and compared in a national context. His attempt to provide a comprehensive explanation for national competitiveness mirrored in many respects Dunning's work on explaining international production. It attempted to blend theories of industrial economics and comparative advantage into an integrated whole.

Porter's efforts also received rapid and extensive commentary from the academic community. Not all of it was positive. John Dunning argued that Porter's emphasis on national economic policies did not account sufficiently for the increasing globalisation of business. He argued that modern industrial structures that spanned global production networks could not be adequately interpreted by examining only national economic conditions or national economic policies.[17] Alan Rugman and Joseph D'Cruz also offered a critique. They argued that, while Porter's framework may have had analytic utility for large developed economies, it did not have sufficient nuance for the particular industrial dynamics of smaller industrialised economies, particularly those that had an interdependent relationship with a larger developed economy. To prove their point, Rugman and D'Cruz extended Porter's diamond framework in an analysis of the Canadian industrial relationship with the United States. They proposed a "double diamond" framework in which the North American – rather than the sole Canadian - market was the unit of analysis. They demonstrated that industrial production in Canada centred upon the network of subsidiaries surrounding flagship firms whose production sites spanned the Canadian and American border. While the corporate headquarters of these firms usually rested in the United States, their operations entailed significant benefits for the Canadian economy and held implications for Canadian policy. Their critique noted that, in an economy increasingly characterised by integrated production networks, purely national models of competitive advantage were of only partial utility.[18]

Other writers quickly began contesting Porter's findings and his assumptions. Some argued that Porter's decision to use a national framework did not reflect current economic realities. Kenichi Ohmae, for one, argued that the nation state was no longer an appropriate unit of analysis for international trade.[19] Ohmae pointed out how the growth of trade between geographically adjacent regions of many countries exhibited quite different characteristics than did the whole of a country's trade. Quite often these regions contained all the competitive elements of the diamond, yet were not controlled by any one nation. He argued that the integrated production networks that characterised European industrial output, or the increasingly integrated industrial network between Canada and the United States, simply could not be analysed through a national policy or industrial structure framework. According to Ohmae, the use of the nation as the unit of analysis no longer reflected the structure of international trade, the competitive dynamics of international industries, or the integrated strategies of global firms.

Other analysts took issue with Porter's argument that government played a supporting, rather than a central, role in crafting industrial success. The rise of Japan and the concept of the "developmental state" provided evidence that government could indeed play a central – rather than a supporting -- role in industrial development. [20] Others argued that government played a key role even in the more avowedly "market" economies. Stephanie Ann Lenway and Thomas Murtha, for example, noted how the state was an element in competitive strategy not only for the overtly centralised corporatist states, but also for the pluralistic United States. The American system -- which supposedly featured few instruments of government control and many diverse groups competing for political influence – nevertheless held important industrial strengths in terms of transparency, openness, and predictability. They argued that a state's capacity to pursue broadly predictable and consistent industrial policies, its ability to create and maintained stable institutions for transactional governance, and its regulation of public and private property rights all impacted greatly on its long-term industrial success. Stating that they offered "a framework for understanding states that has common intellectual lineage with the academic discourse on firms"[21] they argued that the state's role needed greater emphasis than Porter had provided.

Others also argued that the relationship between industrial success and national political actions and institutions needed more elaboration than that provided by Porter. Thomas Brewer provided an issue-area approach to the analysis of MNE-Government relations. He reviewed the traditional schools of literature of government-business relations, and argued that they did not possess sufficient nuance to account for modern realities of corporate success. He argued that more effective interpretative analysis would include the concept of issue-areas that could account for the various levels of analysis, competing political groups, and diverse determinants of MNC power.[22] His plea for a more subtle interpretation of government-business interaction was echoed by Kent Miller, who concurred that the vagaries of government policy needed to be incorporated into any sophisticated model of risk analysis for international business.[23] These authors represent a sampling of those who believe that greater linkage between international business research and political studies needs to be forged.

Other authors argued that industrial analysis of individual countries did not reflect the realities of industrial competition. Bruce Kogut and Steven Kobrin each offered empirical investigations on the determination of global integration and the particular characteristics of international competition. Kobrin's work cast serious doubt upon the analytic utility of concentrating analysis upon individual states. Truly global companies were often able to leverage the particular comparative advantages of several countries into an integrated global production network. Such integration provided efficient economies of both scale and scope and provided flexibility and bargaining strength through the exploitation of a multinational network. He argued that the magnitude of intra-firm trade flows – or flows of finished and semi-finished goods between affiliates of a single company – made national comparisons of trade in finished goods incomplete and misleading. He developed a robust methodology for measuring the global characteristics of industries based largely on the measurements of intra-firm trade flows. He also argued that the technological intensity of many industries- and associated increasing costs in research and development – precluded unimarket firms from competing in such industries. He stated that "at some point it becomes impossible for even the dominant firm in the dominant market to remain in the industry on a uninational basis. Companies must integrate transnationally.."[24] Kobrin concluded by acknowledging the continued importance of the nation-state as a unit of economic analysis, but that it needed to be augmented by measures adapted specifically for global industries.

Bruce Kogut also contributed to the study of country capabilities for global industries. He noted how the enduring organisational and institutional capacities of states impacted greatly on their ability to upgrade manufacturing practice. He demonstrated that the transfer of supposedly "best practice" manufacturing techniques from one country to another was rarely successful; that productivity levels in the recipient country still lagged behind those of the transferring country. He showed that the local intensiveness of research and development efforts was a more accurate indicator of productivity improvement than was the ability to import technologies and practices from abroad. To Kogut, country borders remained largely impermeable to manufacturing practices and techniques developed elsewhere. Such techniques depended upon the presence of legal, organisational, and institutional factors that may not be present in other nations attempting to incorporate them. He concluded that manufacturing and service activities in global industries had to recognise and adapt to the practices of individual nations. Recognising these particular organisational strengths and integrating them into global strategy would become the determinant of global success.[25]

That debate chronicled thus far has centred upon the industrial characteristics of individual nations, the globalisation of particular industries, and the long-term ability of home and host governments to affect industrial development. The inherent attractiveness of the Porter model in its analytic capacity for a single state needs to be balanced by the overt reality of interdependent national economies which may not independently control all the elements of Porter's framework. Moreover, the model is static, and takes little account of the inherent dynamic nature of a firm's strategy and organisation.

Interdependent, small and medium sized domestic economies find little policy utility in the literal application of the Porter framework.

Many authors have outlined general government policy objectives and goals that are designed to enhance a nation's ability to compete in the international marketplace. Most acknowledged that governments play a vital role in industrial development, but few agree on the specifics of such a role. The next section will deal with the debate about government intervention and the need for appropriate organisational responses. A later section will detail the literature dealing with the specifics of the Canadian case, which attempt to incorporate such general frameworks into the particular dynamics and realities of the Canadian economy.

Government and Industry

The ability of individual governments to affect local industrial operations of MNCs cannot be overestimated. Consequently, global companies need to account for host government preferences in their management plans. The integration of government activity into global strategic planning received intensive debate in the political risk literature that populated management texts in the 1970s and early 1980s.[26] The vulnerability of international industries to changes in government policy was revealed by the impact of the Iranian revolution on the operations of oil companies in Iran. Such investments typically totalled tens if not hundreds of millions of dollars, and were completed over time frames that were measured in decades. Suddenly the assertiveness of host governments – governments which often viewed MNC behaviour as exploitative at best – posed a threat to the continued operation and profitability of foreign operations. While the threat of outright expropriation remained the most drastic, managing other, more mundane, concerns – including changes in tax regulations, import/export restrictions, and conditions of local hiring and management participation – became management priorities in the global company.

A sampling of academics who turned their attention to the problems of political risk include Thomas Brewer, Stefan Robock, and Frederick Stapenhurst.[27] They drew attention to particular methodologies for evaluating political risk, the sources of information and analysis available for companies to make better international decisions, and the importance of calculating local government interests in overall management decisions. Companies could respond to the inherent political risks of international operations by limiting exposures to individual countries, developing multiple manufacturing points in different countries, and by instituting contractual clauses in agreements with local governments which limited the state's capacity to influence firm operations. The evaluation of government as an element of risk in international strategy became an integrated facet of global strategic management.

Maximising the advantages of international operations and minimising the inherent risks quickly became a managerial issue for the MNC. Management theorists realised quickly that the methods of organisation that suited domestic business units were unsuitable for managing an international business. Two theorists – William Thompson and Howard Perlmutter – were particularly influential in influencing the course of organisational development of the MNC. Thompson's Organisations in Action defined the scope of appropriate corporate activity.[28] Thompson argued that large corporations would attempt to internalise the factors of key operations as much as possible. This included key supplier and customer relationships, as well as manufacturing processes that converted raw material to finished product. The desire to wrest maximum control of productive processes from the overall business environment motivated firms to expand their operations and impose their own managerial processes. Internationally, this implied that firms were more comfortable in providing their own locally managed subsidiaries to service local markets and to provide locally available raw materials. Indigenous partners and suppliers were often viewed as less reliable than wholly owned subsidiaries of the parent firm. Thompson's work on organisational control held key analytic value for explaining the expanded scope of operations for many MNCs.

Howard Perlmutter was one of the first management theorists to confront the managerial challenges of the MNC. Perlmutter focused his analysis on the roles and mindset of the individual manager in the global firm. His article "The Tortuous Evolution of the Multinational Corporation" described a series of three progressively integrated visions that were associated with companies according to their international experience.[29] The ethnocentric mind set indicated a young company with little international experience, whose managers assumed that home country methods were the most effective and were easily applicable across diverse national markets. Two successive attitudes – the polycentric and then geocentric -- indicated a progressively greater willingness to incorporate local managerial expertise and product knowledge into the management of the global firm. The final geocentric mindset was composed of managers who held a global vision of the company's strategy, and worked to integrate local managers and subsidisers into a global production network. This evolution was a product of both the experience of the firm and the maturity of the industry. As the firm gained international experience the need for local adaptation and specialised knowledge would increase. Perlmutter was confident that eventually most managers of international firms would adopt the third mind set as inherently the most productive.

Sumantra Ghoshal provided a model to integrate the evolving literature on global strategic management. He argued that the most competitive international companies maximised the competitive advantages of international operations to achieve the strategic objectives of the firm. The motivations for expansion into foreign markets centred on three sources of competitive advantage. The first and second were to achieve economies of scale and scope. Economies of scale were about size – the creation of a large enough productive capacity to service new and growing markets, in order to recover the rising costs of developing and marketing new products. Economies of scope allowed companies to spread the costs of investment across different products and business lines, reaping maximum synergy from diverse production units. The third benefit was reaping the specific comparative advantages of producing in various countries and products. Companies could leverage product and marketing knowledge garnered in one country to their operations in others. By spreading operations across many countries, integrated MNCs could take advantage of the specific manufacturing and service strengths of each. The integrated management of the global company allowed MNCs to manage risks, increase their efficiency, and benefit from the possession of an integrated network of innovation and learning. This framework of balancing strategic objectives and sources of competitive advantage served to integrate much of the previous work on global strategic management.[30]

C.K. Prahalad and Yves Doz offered a second framework for global strategic management.[31] They argued that managing a global company involved balancing the objectives of a global vision with the needs of local markets. They presented a framework in which the task of top management was to integrate economic, political, and organisational imperatives into a coherent strategy. The particular characteristics of that strategy would depend upon the structure of the industry as well as the organisational characteristics of the corporation. They argued that multinational businesses could be mapped on an integration-responsiveness grid in which local differentiation could be balanced against global integration. They presented a model of the ideal domestic MNC that balanced competing local and global demands through multiple advocacy processes, a fluid power structure, and an organisational structure that legitimised dissent and resolved conflicting points of view. Only by encouraging the sharing and debate of new knowledge could a firm maximise the advantages of operating in diverse markets. Balancing the local and the global became and remains a key strategic imperative for the MNC.

Yet, just as overt headquarters control often stifled local entrepreneurial spirit and the development of local managers, local strategies concentrated along business or functional lines also had drawbacks. Country managers often jealously guarded their independence. Senior executives habitually compared operations and profitability levels across country divisions. As a result, competition between country managers of the same firm often proved every bit as intense as the rivalry with other firms. Country managers often proved unwilling to share market and operating knowledge with other country units, for fear of losing internal advantage. Redundant systems of information flow did not facilitate communication, and ensured large overhead and operating costs. Finally, such structures did not facilitate strategic direction from senior executives, who could not hope to integrate such insular operations into an overall global strategy. The role of senior management often degenerated into one of mediator between competing factions, leaving little time or energy for strategic planning or implementation. Too much subsidiary freedom often proved as destructive to corporate health as too little.

The evolution of global corporate activity depended upon an effective management of both strategy and structure. Academic work often concentrates on the debate between the primacy of strategy and structure in the establishment of international business units. Companies often faced a choice of organisational structures to suit their objective needs. Stopford and Wells demonstrated that many companies necessarily evolved their international structures in order to adapt to a more integrated marketplace. Companies often first adopted functional and divisional lines of authority across international operations, often resulted in autonomous subsidiaries run by an independent country manager.[32] This evolution continued in the adoption of truly global structures that integrate headquarters and local subsidiaries. George Yip, by contrast, placed company strategy at the forefront. He argued that globalisation efforts were attempts to integrate and leverage value-creating drivers across the international marketplace. He presented a thorough list of marketing, production, operational and competitive drivers that benefited from international expansion.[33] While acknowledging the importance of organisational structure, Yip believed structure needed to be complemented by an integration of company culture, management processes, and human resources into an integrated assessment of global corporate strategy.[34]

The challenges faced by a global company often mandated that it adopt particular forms of organisational structure. As global operations began to account for an increasing share of a company's operating revenue, they required greater executive attention and the cultivation of local talent. The overt reliance on expatriate managers and the infusion of domestic management practice was no longer sufficient to function in more sophisticated international markets. Creating local management personnel that could integrate established business practices with the needs of local markets became a management priority. Many companies established structures that concentrated authority in country managers who were responsible for the performance of all product lines in a single nation. Other companies adopted a country or regional focus along functional business – rather than product – lines. International responsibilities were often divided among managers specialising in finance, marketing, or international operations management. Decisions between the two were based on a combination of industry dynamics and the historical pattern of a company's activities. The growing importance of international markets motivated firms to adopt strategies and organisational forms to maximise their return on such investments.[35]

Sumantra Ghoshal and Christopher Bartlett recognised the disadvantages of both forms of traditional multinational structure, and proposed a new organisational framework that combined their strengths while eliminating their weaknesses. They argued that the adoption of a transnational organisational structure would reap maximal advantage from international operations. They pointed out that structures based on either cost advantages or product differentiation alone were necessary but not sufficient for long term international competitive success. Companies also needed to leverage their global learning and innovative capacities between geographic units and across business lines. They argued that the only sustainable international advantage was the creation and communication of market and product knowledge. Their specific recommendations for achieving the transnational solution included increasing the international exposure of their managers by rotating them through several international assignments; and the creation of avenues for cross-functional communication of acquired market knowledge. Their framework could be described as an integrated web in which the lines connecting operations carried much of the responsibility for creating new company advantage.[36]

Bruce Kogut has provided a strong contribution to the literature surrounding the multinationalisation of enterprise. He argues that two principal questions determine international strategy. Firms must decide what parts of the value added chain should be separated across borders and in what functional activities they should concentrate their resources.[37] He argues that such activity can be viewed as a desire to maximise the competitive advantages of the firm and the comparative advantages of foreign production sites. He demonstrates that multinational activity often results from combining the cost advantages of capital and labour to exploit the particular strengths of foreign markets, and provides an analytic matrix by which the particular advantages of country and market can be judged. In a companion article, Kogut demonstrates that the benefits of internationalisation include operational flexibility.[38] Having a diverse network of production sites allows companies to hedge financial and political risks inherent in inflationary developing markets. Global operations allow companies to leverage global co-ordination and information flow, and to provide comparable performance incentives across their business lines. To Kogut, global business strategy involves balancing advantages and risks.

Strategic alliances also often play a key role in the strategy of the MNC. The characteristics of modern global competition mandate that businesses shed superfluous activities and concentrate on core capabilities and strengths. The large investment in technology and research and development characterising many industries is too large for all but the most dedicated and specialised firms to consider. Consequently, businesses have come to rely on strategic alliances with other global firms as a primary tool of their corporate strategy. Such activity provides firms with access to key skills and technologies that they may not possess, while allowing them to concentrate on developing their firm-specific competitive advantages. Alliances provide specialised benefits in learning, the development of new businesses, and the co-specialisation of complementary skills.[39] By partnering with local firms, MNCs can obtain access to previously restricted markets. Many industries today are characterised by networks of integrated production, which include formal or informal agreements among many competing firms. Such realities pose difficult challenges to government efforts to regulate industry, as it becomes difficult to separate the operations of foreign and domestic firms.

The realities of global strategic management have mandated that firms take a more proactive stance towards their relationship with home and host governments. Effective strategies included measures designed to predict and if possible influence the policy making process within those governments. Utilisation of effective government relations can be a source of competitive advantage. Earlier works on global strategic management include sections on the regulatory impact of government, and portray such measures as inherently restricting the freedom of global corporations. The evolution of such literature, however, demonstrates how firms can adopt a more sophisticated position on the role of government in their strategic decisions. The movement away from confrontation and towards interdependence and co-operation can be traced through the literature, and culminates in the alliance capitalism paradigm, detailed in chapter 4.

Policy and Regulatory Responses to the Integrated MNC

Yves Doz demonstrates that a government's response to a company's international strategic decisions depends upon the degree of local responsiveness or global integration that the firm exhibits. He argues that multinational integration creates a dilemma for host governments: that "it may be possible to achieve international competitiveness or to preserve national responsiveness, but not both. Government officials prefer control, but can they strive for control at the expense of jobs?" For governments, imposing regulations on MNCs in an attempt to maintain local job levels inhibits the corporation from taking measures to ensure long-term competitiveness. If firms are prevented from making strategic decision that involve job losses, they will eventually become less competitive and prone to ultimate failure. Doz argues that it is possible for governments and firms to balance the competitive demands of the present and the future. Such a balance requires an accurate industrial, competitive, and regulatory analysis, which will then provide the basis for both government regulation and corporate strategy.[40] Government, according to Doz, needs to craft policies appropriate to industry structure, which will then allow local and integrated firms to compete effectively in their marketplace.

Alan Rugman and Alain Verbeke also argue that appropriate trade strategies can complement policies designed to enhance domestic industrial structure. They contend that trade policies designed to shelter domestic firms from international competition perpetuate management inefficiencies which erode the long-term competitiveness of the firm. They note that "government trade policy becomes a substitute instead of a complement for the company's firm-specific advantages."[41] They present several matrices designed to encapsulate both government policy objectives and appropriate company strategic responses. Their work focuses primarily upon the strategic options of Canadian firms that compete in an integrated North American marketplace and are facing rising protectionism within the United States. They conclude with both normative and practical policy prescriptions. They argue that it is in the interests of both firms and governments to develop policies designed to enhance efficiency-based activities. Governments should encourage the generic competitive strategies of cost, differentiation, and focus by deregulating industries and reducing avenues for industrial shelter. Such measures are imperative to maintaining industrial strength and competitiveness.[42]

Several facts about multinational operations need to be addressed in order for governments to make adequate policy choices. The first is the evolution of ownership structure adopted by corporations as they gain international management experience. There is a direct correlation between international business experience and the type of ownership structure adopted. Companies often begin their internationalisation efforts through limited control arrangements such as joint ventures and partnerships with locally owned companies that have the necessary market expertise. Such patterns of control limit liability and allow fledgling international companies to gain necessary market knowledge. As companies gain experience, they are often willing to take more direct ownership of operations in foreign countries, and usually jettison the limited arrangements in favour of those that provide complete control. Large corporations today may have decades of operating experience in their key foreign markets, and are as skilled in those markets as any local competitor. The evolution of multinational investment activity implies that, in many of today's developed and developing markets, companies are now operating wholly owned subsidiaries and are managing them accordingly. This provides companies with greater leverage and bargaining power with host nations.

In conclusion it is important to reiterate some of the main effects that the growth of investment activity and greater MNC integration have had for matters of public policy. The first is that the international institutional framework governing investment activity is relatively poorly developed, particularly in comparison with the institutionalisation of international trade policy.[43] Consequently, national governments still play a powerful contributing role to the process, aims, and direction of foreign direct investment and the direction and composition of inter-state trade. How individual governments perform such activities is a powerful continuing element of national sovereignty. Examining the interrelationship between Canadian public policy and foreign direct investment is therefore a necessary foundation for the examination of alliance capitalism.

The Multinational Corporation and Canadian Public Policy

The relationship between multinational business enterprises and the apparatus of the state differs markedly between developed states. While many nations espouse loyalty to broadly similar industrial and political ideologies, their methods for directing and controlling corporate behaviour differ both in means and ends. The last chapter noted some important differences in business-government relations that characterise the large industrial powers of the United States, Germany, and Japan, and noted that the degree of co-operation between leaders of business and government policy makers differs widely. The institutional state structure – the division of power between various societal actors and the policy communities through which industrial and investment policy is filtered – channels and limits the effects of foreign direct investment. A critical examination of the particulars of the Canadian case will provide the framework into which the concept of alliance capitalism can be placed.

The vast majority of analytic attention has been focused upon the industrial structures of the major developed economies. However, smaller countries which surround large industrialised states also have policy concerns that are unique, and that often centre upon maintaining some degree of political or economic independence from their much stronger neighbours. This section will explore how Canadian public policy has faced the challenges of regionalism and its own domestic constraints.

Industrial Policy in Canada

Different states have different governing structures, which result in varied policy outcomes. These outcomes emanate from an integrative policy process that considers domestic social and cultural ideology, government interests, and a normative position on the appropriate relationship between business and the state. Moreover, the importance of these outcomes can be measured not only by their domestic effects, but also by the ancillary economic repercussions felt by smaller surrounding nations. Growing interdependence between the economies of the developed world -- particularly at the regional level – implies that smaller countries have additional difficulties in creating independent economic policies, especially if such policies differ substantially from those Of their more powerful regional neighbour. This is particularly true at the regional level, where smaller national economies are featuring greater integration with the central economic powers of Germany, Japan, and the United States. Consequently, issues of national development, independence, and autonomy play a large role in the formation of such policies.

The post-World War II history of Canadian trade and investment policy fits into the post-war dilemma of Canadian foreign policy in general. This dilemma is easily articulated, if not easily managed. Canadian policy makers believed in and contributed to the establishment and maintenance of a post-war security, economic, and political order that depended on the United States for leadership. To that end, Canada participated in and contributed to the international institutions and regimes that permitted such leadership, such as participating in the North Atlantic Treaty Organisation (NATO) or supporting free-trade initiatives as successive negotiating rounds of the General Agreement on Tariffs and Trade. Yet that participation entailed ever wider and deeper links with the United States across the entire foreign policy spectrum -- in political, economic, security, and cultural policies. So deep and strong did the bilateral relationship become that, by the third post-war decade, many Canadian policy makers began to fear that Canada's sovereignty and capacity to take policy decisions independent of the United States had eroded, if not evaporated. Balancing the obvious benefits garnered from a productive Canadian-U.S. bilateral relationship with the necessity to protect Canadian independence has been the principal dilemma of post-war Canadian foreign and economic policy.

The overt centralisation of Canadian economic production that had proved so successful during World War II continued into the post-war era. The federal government, confident of its ability to centrally manage the national economy, assumed greater prominence in national economic decision making. Moreover, Canada supported the more visible international economic efforts of the United States in the immediate post-war period, including supporting a series of multilateral tariff reduction negotiating rounds of the incipient GATT process. In this Canada was in general economic agreement with its more powerful southern neighbour.

While general economic harmony between Canada and the United States remained strong into the 1970s; however, some disputes also arose. Domestically, the Canadian federal government had begun to de-centralised many of its economic powers onto the provinces, resulting in a weakened central economic policy making capacity and contributing to the increasing regionalisation and provincialisation of the Canadian economy. General progress on bilateral and multilateral trade issues had been impressive – Canada had contributed to overall initiatives to lower trade barriers world-wide, and had been generally agreeable to measures designed to facilitate trade between the two countries. The foreign investment climate remained comparably open. The signing of the Auto Pact in 1965 signalled a long-term commitment to greater economic rationalisation of productive capacity within this vital sector of both national economies. Economic exchange between the two countries – in trade and investment – grew remarkably in the post-war era.

Over time, the general progress in reducing trade barriers and providing greater avenues for foreign direct investment engendered concern in Canada that too much of its industrial capacity was owned and operated by foreign – principally American – firms.[44] The initial two decades of the post-war era had witnessed a large increase in the level of

American foreign investment, particularly in the strategically significant natural resource industries, and policy makers grew uncomfortable about the sway American firms held over this vital sector. A series of parliamentary reports drew attention and concern to this issue. For example the government of Lester Pearson commissioned what came to be known as the Watkins report, which was tasked to evaluate the nature of foreign investment in Canada. Reporting in 1968, it concluded by recommending the establishment of a state-trading agency and a national-venture capital development corporation.[45] Subsequent additional reports included the Wahn report, published two years later, and the Gray Report, published in 1972. The Gray report – probably the most comprehensive review of foreign investment in Canada up until that time -- recommended the establishment of a screening agency to monitor the performance of foreign direct investment in the Canadian economy.[46] It was becoming abundantly clear that the sheer volume of American direct investment in Canada posed policy concerns for Canadian control over its domestic industries concerns that needed to be addressed through federal intervention.

Regulation of the MNC in Canada is a product of state institutions, government ideology, and the crafting of a consensus among the business and policy elite. Edward Safarian has provided a detailed overview of the particular patterns of state regulation of industry that occur in smaller developed countries. His analysis of Canada concentrates on examining the motives, processes, and effects of the long-term operation of the Foreign Investment Review Agency (FIRA). He notes how Canadian legislative protection over key industries – such as banking and energy production – is more extensive than most other economies of similar size. He argues that in Canada the different ideological motivations of successive administrations result in an unpredictable pattern of investment regulation. Some governments have attempted to use such review as an instrument of control; while others have opted to use mechanisms of investment review primarily as a conduit through which new investment can take place.[47] That Canada has an ambivalent ideology on its economic relations with the United States can be seen by the alternating mandates of investment review agencies.

This ambivalence is not surprising to those who have studied Canadian investment policy, a primary example of which is the work of Claire Sjolander, whose doctoral dissertation interpreted the imposition of FIRA from the perspective of a more assertive Canadian state.[48] Another significant work detailing the politics of industrial policy making in Canada is Michael M. Atkinson and William D. Coleman's <u>The State, Business, and Industrial Change in Canada</u>. They argue that the decentralised nature of Canadian federalism – combined with a federal governing structure that intentionally divides power across lines and departments – inhibits the creation of a consistent industrial policy. They note that "a weak state tradition means that officials at the centre of the state apparatus are both unwilling and unable to spearhead any particular vision of industrial development."[49] They divide Canadian industrial policy initiatives into two broad categories – anticipatory and reactive. They argue that the relative autonomy between the departments of finance, industry, and development "create a significant barrier for the kinds of state interventions associated with anticipatory industrial policy."[50] Consequently, such policies are often purely reactive; they are initiatives penned in response to an external occurrence over which the Canadian government can exert little control.

Explanations of Canadian industrial policy often focus on the development of the Canadian economy as a whole. Some argue that, at least historically, state industrial policy is actually more coherent and powerful than it initially appears. Tom Traves has noted two primary realities that have conditioned industrial policy making as Canada. The first is the increasing centralisation of economic prosperity in specific regions and provinces, with an accompanying persistent regional underdevelopment in other, less fortunate regions. The second is the "the integration of the country's industrial leadership into the established commercial and financial elite which has long dominated the Canadian economic and political system."[51] Spurred primarily by the integrative economic effort of the world wars, centralised control over the Canadian economy has historically been considerable, but has not always been achieved through formal structures of state power. The formal federal centralisation of power present in the 1950s and 1960s has given way to more informal networks of industrial and political leaders, whose interaction allows for an additional degree of policy co-ordination that supplements the industrial policy structure of the federal state.

Due in part to the gradual relinquishment of power by the federal government, the utilisation of partnerships between the public and private sector to secure mutual goals has become a standard practice in the Canadian government. Indeed, the idea of government partnership with elements of the private sector in the service of public administration has become quite common and widespread across a spectrum of government departments. For example, by 1993 Environment Canada boasted a total of over 2000 partnerships with other governments, departments, and countries.[52] In fact, explicit cultivation of such partnerships became a codified goal of the public service. The federal government's *Public Service 2000* report noted that

> Partnership between the various elements of the private sector and the different levels of the public sector is becoming more common. And so it should be, given the need for broadly-based input to problem solving and the limited resources and capacities of the public sector.[53]

Cultivating partnerships has an established tradition in the execution of Canadian public policy. That tradition will receive greater analytic attention in the chapters that follow, due to the prevalence of partnership arrangements under the alliance capitalism paradigm.

Creating and executing industrial policy in Canada has therefore been largely a matter of crafting a consensus among the elite of business and policy executives. Such a consensus has depended upon balancing regional development needs and general employment, infrastructure, and other policy goals. The MNCs increasing structural and economic power often appears to pose a threat to that delicate balance. Multinationals domesticated and experienced in larger economic markets appear to wield resources that may overwhelm Canadian domestic competitors. Consequently, the domestic regulatory environment has attempted to compensate for the relatively small power of the Canadian market. Such regulation at times appears rigid for an avowedly liberal state. Yet it reflects the caution of a fragile domestic consensus on the overall effects of foreign direct investment.

Concern that powerful MNCs might overwhelm Canadian social independence and policy autonomy is certainly nothing new. The Canadian Marxist and leftist schools have attacked the multinational. Patricia Marchak has produced an in-depth critique of the MNC. She argues that the pliant Canadian public is too ready to assume that free trade and corporate freedom primarily engenders benefits for the Canadian citizen. Marchak is particularly stringent on this point. She argues that the prevalence and power of American investment has engendered an intrusive federal government essentially unable to produce policy independent of large corporate interests. Her analysis leads her to conclude "the Canadian state has unequivocally joined American capitalism, using public money for the purpose, to exploit Canadian resources in the interests of the dominant class."[54] Her conclusions provide powerful warnings against corporate dominance of the Canadian economic landscape.

Today, the debate over the costs and benefits of greater foreign MNC activity in the Canadian economy continues to rage. A recent critic of the MNC is Maude Barlow. She argues that the federal government needs to regulate foreign investment to a far greater degree than presently exists. She centres her argument on the need for Canada to dissociate itself from any proposed Multilateral Agreement on Foreign Investment (MAI). She contends that such an agreement would remove what few controls and restraints that the Canadian government still wields in controlling the nature of foreign investment in Canada. Most troubling to her is the spectre of a MNC effectively taking the Canadian government to court if its domestic laws violate provisions of the MAI. She perceives the multinational not merely as an economic entity, but rather as an agent of foreign domination working to erode the independent sovereignty of the Canadian state. The Canadian response, she concludes, should be much stricter controls on FDI, an abstention from any proposed MAI, and a renewed and strengthened investment review apparatus.[55]

Lorraine Eden, by contrast, portrays FDI and the activities of the MNC in a much more positive light. After reviewing the history of Canadian foreign investment policy – which she argues remains deadlocked between the objectives of promoting and regulating FDI – Eden proposes a new approach to the policy problems of the MNC. She encapsulates her views on the MNC in the following simple statement: "we recommend a new focus on multinational enterprises as investment bridges to the global economy and as agents of change within the Canadian economy."[56] She points out that foreign investors find Canada attractive but are wary of the historical tendency to regulate investment. She also argues that, in an integrated world in which businesses can operate on a global scale, Canada must compete for the foreign investment dollars of large multinationals. Doing so requires a movement away from confrontation to co-operation with large multinationals, and the adoption of a "strategic" investment policy which attempts to lure multinationals that will contribute to and build upon Canada's established competitive strengths.[57] Maintaining and increasing access to the American market is an economic and a political interest. The cultivation of MNC investment to Eden is not optional – it is the foundation of continued Canadian economic prosperity.

The contemporary debate in Canada over the process of globalisation and the activities of the MNC has not abated. While this debate reflects long-established themes of Canadian economic and foreign policy, it has received new vigour as the march of multinational business activity continues. Crafting a new relationship between the Canadian state and the multinational corporation implies the necessity of new theoretical tools. Alliance capitalism, as the next chapter will argue, is one such tool.

Conclusion – The Multinational Corporation and Canadian Public Policy

The post-war history of Canadian foreign economic policy – and its consequent estimation of the MNC – has displayed several consistent themes. Support of the American post-war economic plan has been tempered by a desire to maintain full policy autonomy and sovereignty in domestic economic matters. The policies taken toward FDI in particular have generally matched the social and political priorities of the day. For investors, an unpredictable and ambivalent political environment has at times countered the attractiveness of the Canadian market. Today's emphasis on broadening free trade links and encouraging FDI are balanced by a vocal group of critics who argue that the economic gains from such measured do not compensate Canadians for the loss in cultural independence and policy autonomy.

The domestic policy apparatus is designed to accommodate such shifts in perception. While the overt tools of influencing national economic policy lie with the federal government, there is also a host of lesser informal relationships that help to shape business and economic policy in Canada. Business and government officials interact informally to exchange views. Lobby groups are increasingly active on Parliament hill, as are trade and union association groups. Canada's policy network in comprised of diverse groups competing for legislative influence, and is subject to all of the domestic policy implications of a liberal, multiparty state. This informal network buttresses the state's centralised administrative structure; actual policy decisions often are a product of a general policy consensus based on compromise from these affiliated groups. Alliance capitalism builds on the reality of these co-operative relationships, and integrates them more formally into theory, and also notes the particular strategic evolution of the modern multinational corporation. It integrates the fields of multinational strategic management and domestic policy practices. The next chapter will be devoted to elucidating that integration.

Endnotes

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[4] Ibid., p. 36.

[5] Raymond Vernon, Storm Over the Multinationals (Boston: Harvard University Press, 1977), p. 19.

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[18] Alan M. Rugman and Joseph R. D'Cruz, "The "Double Diamond" Model of International Competitiveness: The Canadian Experience", Management International Review , 33(2), 1993, pp. 17-39. See also Alan M. Rugman and Alain Verbeke, "Foreign Subsidiaries and Multinational Strategic Management: An Extension and Correction of Porter's Single Diamond Framework", Management International Review, 33(2), pp. 71-84.

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[34] Ibid., p. 29.

[35] John Stopford and Louis T. Wells, Managing the Multinational Enterprise (New York: Basic Books, 1972).

[36] Christopher Bartlett and Sumantra Ghoshal, Managing Across Borders: The Transnational Solution (Boston: Harvard Business School Press, 1989).

[37] Bruce Kogut, "Designing Global Strategies: Comparative and Competitive Value-Added Chains", Sloan Management Review, 26(4), 1985. P. 15.

[38] Bruce Kogut, "Designing Global Strategies: Profiting From Operational Flexibility", Sloan Management Review, 27(1), 1985, pp. 27-38.

[39] Yves L. Doz and Gary Hamel, Alliance Advantage: The Art of Creating Value Through Partnering, (Boston: Harvard Business School Press, 1998), pp. 4-5.

[40] Yves Doz, Strategic Management in Multinational Companies (New York: Pergamon Press, 1986). Chapter 2.

[41] Alan Rugman and Alain Verbeke, Global Corporate Strategy and Trade Policy (New York: Routledge Press, 1990), p. 8.

[42] Ibid., p. 140-141.

[43] Thomas L. Brewer and Stephen Young, The Multilateral Investment System and Multinational Enterprises (Oxford: Oxford University Press, 1998).

[44] Concern over foreign ownership over Canadian industries, as well as foreign citizens sitting on companies incorporated in Canada, was well established at this point. By 1957, amendments had been made to Canadian insurance companies act to ensure that the majority of board members were Canadian. Similar restrictive and controlling measures were adopted to protect Canadian cultural industries, as well as banks, trusts, and eventually natural resource exploration industry. For a summary of such policies see Department of Foreign Affairs and International Trade, "The Impact of Investment Rule Making and Liberalisation: The Case of Canada", Internal Research Paper, Appendix, P. 67.

[45] Stephen Clarkson, Canada and the Reagan Challenge, (Toronto: James Lorimer & Company, 1982), p. 12.

[46] Ibid

[47] The various governments headed by Pierre Elliot Trudeau, for example, were often critical or hostile to foreign investment. The Conservative government of Brian Mulroney, by contrast, declared Canada "open

for business" and changed the mandate of FIRA away from review and towards the role of conduit for direct foreign investment. This process will be outlined in detail in the ensuing chapters.

[48] Claire Turenne Sjolander, Foreign Investment Policy Making: The Canadian State in the Global Economy (Ottawa: Carleton University, Unpublished PhD dissertation, 1989). Sjolander argues that the particular forms of state in Canada have influenced the formation of foreign investment policy. She argues that the perceived hegemonic control of capital flow effectively withdrew conceptions of the state from the formulation of such policy. Drawing largely on the work of Robert Cox, she examined how FIRA was an indication of a more assertive Canadian state strucuture in the formation of investment policy, which ultimately was ineffective due to a antiquated view of the motives of foreign direct investment.

[49] Michael T. Atkinson and William D. Coleman, The State, Business, and Industrial Change in Canada, (Toronto: University of Toronto Press, 1989). P. 8.

[50] Ibid., p. 39.

[51] Tom Traves, The State and Enterprise: Canadian Manufacturers and the Federal Government 1917-1931 (Toronto: University of Toronto Press, 1979). P. 5.

[52] Kenneth Kernaghan, "Partnerships and Public Administration: Conceptual and Practical Considerations", Canadian Public Administration, 36(1), 1993, p. 58.

[53] Public Service 2000, The Renewal of the Public Service of Canada, (Ottawa: Supply and Services, 1990), p. 53.

[54] Patricia Marchak, In Whose Interests: An Essay on Multinational Corporations in a Canadian Context, (Toronto: McClelland and Stewart, 1979), p.270.

[55] Maude Barlow and Tony Clarke, MAI: The Multilateral Agreement on Foreign Investment and the Threat to Canadian Sovereignty, (Toronto: Stoddart Publishers, 1997). In addition to the MAI, the Canada-U.S. Free Trade Agreement and later the North American Free Trade Agreement also have substantial provisions regarding foreign direct investment. They will be dicusssed in greater detail in chapters 5 and 6.

[56] Lorraine Eden, Multinationals As Agents of Change: Setting A New Canadian Policy on Foreign Direct Investment, (Ottawa: Industry Canada, Discussion Paper #1, 1994), p. 31.

[57] Ibid., pp. 31-35.

Chapter 4 - The Theoretical Basis of Alliance Capitalism

Alliance capitalism at its core is a new paradigm for interpreting the production of wealth. It argues that the restructuring of global economic activity that has occurred in the past two decades can no longer be adequately interpreted by traditional paradigms emanating from the fields of industrial economics or comparative political economy. The dynamics of industrial production now involve both the specialisation of economic activity within national borders and the integration of that economic activity across them. Alliance capitalism explains contemporary economic reality through a paradigm that emphasises collaboration, rather than competition, between the constituent elements of the wealth-generation process. John Dunning outlines the distinctive characteristics of alliance capitalism as follows:

> the distinctive features (of alliance capitalism) will be the extent to which, in order to achieve their respective economic and social objectives while meeting the dictates of the domestic and international market place, the main constituents, or stakeholders, in the wealth-creating process will need to co-operate more explicitly with each other.[1]

This paradigm offers a valuable contribution to the field of international political economy. Dunning's quote illustrates some of the central preoccupations with contemporary international political economy research. In order to be sustainable, industrial activity within the nation state must respect the demands of the international economy while preserving local demands for equitable distribution. The quote also recognises the concept of stakeholders - that national economic prosperity requires the cumulative efforts of all economic agents. The express need for co-operation - both for corporate strategy and government policy – reflects the integral roles that the state and the firm continue to play in modern economic development.

Alliance capitalism differs from earlier interpretations of economic activity in several fundamental ways. It argues that the phenomenon of globalisation – the increasingly integrated network of international production that characterises the most advanced MNCs – rests upon a combination of political, economic, and technological revolutions that is fundamentally new. This combination has created new freedom for the MNC, and demands that host governments re-evaluate their relationship with this economic entity. Although the term "globalisation" is often over-used and poorly defined[2], its prevalence in the literature suggests that it has very real implications for the way governments craft investment, trade, and industrial policies.

The purposes of this chapter are first to outline the business practices and strategic goals that characterize current MNC production strategies. The second purpose is to oultine the traditional economic policy instruments that national governments have used to attract and affect MNC activity, and to outline their efficacy in the age of globalisation. The third purpose is to adumbrate the characteristics of the alliance capitalism paradigm in greater detail, and to demonstrate how it will contribute to the analysis of both MNC strategy and government policy. This will prepare the reader for the empirical examination of alliance capitalism detailed in chapters 5 and 6.

MNC Strategy and Globalisation -- Firm Collaboration and Strategic Clusters

Alliance capitalism argues that the combination of truly global MNC strategies and the necessity for host governments to cultivate Foreign Direct Investment (FDI) has fundamentally altered the relationship between the MNC and the state. Today's modern MNC has crafted strategic and organisational responses to an increasingly competitive environment that place new demands on regulatory agents. Such strategies emphasise the cultivation of specific competitive advantage and the integration of the individual strengths featured in a global production network. Perhaps the key indicator is the MNCs' participation in a network of production clusters that possess the elements necessary for competitive success. The state's ability to create advantages within its borders that can attract and maintain participation in such clusters will be a key factor in national economic success.

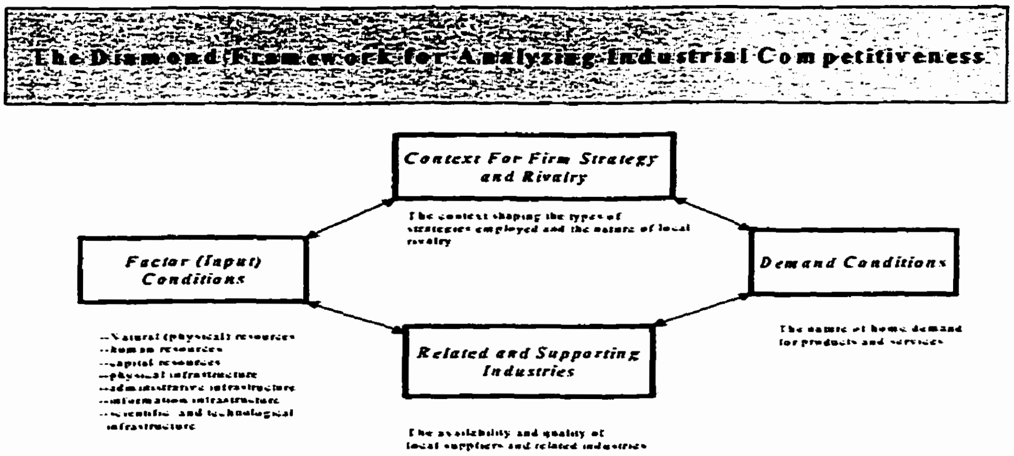
This concentration on core competitive strength and the increasingly demanding competitive environment has had two primary effects on global firm operations. First, large firms are acquiring other firms on a massive scale, in order to take advantage of the specialised knowledge and skills that smaller firms possess. A large percentage of the FDI involves the purchase of local companies who hold specific knowledge advantages. Merger and acquisition activity has increased enormously in the last 5-10 years. In some cases – such as the automotive and financial services industry – such mergers are designed to reap economies of scale in providing a full range of products and services across a global marketplace. In other industries, however, such activity is designed to acquire the specialised service, customer base, and knowledge capability of foreign firms directly, rather than attempting to build such capacities in- house. A more discriminating global customer base demands that global companies rapidly innovate and acquire needed capabilities. Often the best method of achieving these goals is to purchase an existing company that possesses them.

The growing importance of strategic alliances has also proven particularly important in the analysis of competitive industries. The concept of strategic networks has had a full development in the analysis of the competitive success of many Far Eastern firms, but largely from a cultural basis. The most famous examples are the Japanese *keiritsu* and the Korean *chaebol*. Both terms refer to a closely integrated group or "cluster" of companies that often share a high degree of mutual ownership and reciprocal trade and investment relationships. These networks have an intense social and political -- as well as economic – function. They create and establish an accepted pattern of organisational authority. They allow the firms within the network to create joint strategic planning efforts that work to mutual advantage. They provide a reservoir of financial and technological assets that can be drawn upon in times of economic recession. Finally, such organisations assure a foundation of assured suppliers and customers that can be utilised as a base for forays into international competition. Much of the post-war economic success of the Far East is attributed to the mutual strengths present in the networked family of firms. [3]

The concept of "clusters" has also been used to describe relations among firms that are based purely on a competitive – rather than a cultural – foundation. Instead of detailing the activities of discrete independent firms producing a standard array of products, analysts are now employing the metaphors of "network" and "cluster" to demonstrate the pure dynamics of industrial innovation. Michael Porter's work on clusters appears in his "diamond" framework, first published in 1990.[4] He notes how specific industries often cluster around geographic areas that possess the appropriate contributing and supporting industries and facilities. Perhaps the most famous of these is Silicon Valley in California; others include the pharmaceutical industry in New Jersey and the automotive industry in the Detroit-Windsor area. Such economic "clusters" feature a group of world class firms that both compete and collaborate in the provision of certain categories of goods. The cluster also enjoys related industries, higher education facilities, and transport capacities that supply the industry with an educated workforce, transport infrastructure, and associated services.

The following diagram indicates the composition of the competitive diamond. Included are the following. First, factory, or input, conditions, must be present. These include natural and physical resources, infrastructure, information and scientific input, and human and capital resources. The second is a group of related or supporting industries whose quality and availability help determine the overall cluster performance. The third component is demand conditions, which requires a sophisticated and discerning customer base that demands and appreciates continued product innovation. These three factors set the context for firm strategy and rivalry, the fourth element of the diamond. This is composed of a group of competing firms whose geographic proximity ensures constant competition for industrial leadership. Mapping specific industries according to the diamond framework provides an explanation for the clustering phenomenon that characterises many of today's industries.

Diagram #1 – The Diamond Framework



Michael E. Porter, "The Microeconomic Foundations of Economic Development", Global Competitiveness Report 1998, p. 44.

The concept of "clusters" also has implications for international business, since such clusters are not necessarily confined to the landmass of a single country. While Porter confined and based his analysis on competitive industries that operate in individual countries, others have noted that clusters can also span multinational networks. In fact, in the case of small, open, developed economies, participating in a multinational cluster may be the key to assuring economic competitiveness. Such economies are typically too small – and their industrial capability is too limited – to support an indigenous cluster with all of the diamond's elements.

Alan Rugman and Joseph D'Cruz have extended and modified Porter's cluster framework for the case of Canada. They argue that the increasing phenomenon of regionalism and the greater interdependence of medium-sized economies with the larger triad nations places great demands on local industry to integrate with the larger cluster networks. Furthermore, clusters that span national borders place greater demand on national governments to create policies designed to enhance the industrial power of the network. Their analysis of American FDI into Canada leads Rugman and D'Cruz to conclude that the diamond framework requires extensive modification for small open economies that are heavily interdependent with larger national economies. In the case of Canada, the strong interdependence with the US industrial economy centres upon the concept of "flagship firms", usually domiciled in the US, which create transborder networks of supporting and related industries. They argue that Canadian prosperity demands the support of, and participation in, these networks. The authors go so far as to argue that, in the case of these flagship firms in clustered industries, "Canadian governments and the public at large, must show that they are willing to treat these foreign investments as if they were "domestic" to Canada."[5]

Rugman argues that participation in such "North American" clusters garners as much economic benefit to Canada as that provided by completely indigenous firms. He has demonstrated that the largest 20 U.S. subsidiaries in Canada export virtually as much as they import.[6] He argues that, in terms of import/export behaviour, research and development, and technological capacity of manufacturing facilities, there is little analytic difference in the activities conducted by Canadian subsidiaries of large US multinationals and large domestic Canadian firms. Such subsidiaries are not simple branch plants that are meant to serve the Canadian market alone, but are rather integral components of a general North American production network. Rugman concludes in a later piece that "foreign owned firms act and play as significant a role as do the domestic owned Canadian corporations."[7] The model of purely national economic industries and firms is not an appropriate one for small open economies such as Canada's.

The preceding arguments indicate a composite picture of the spatial organisation of economic activity that characterises alliance capitalism. The growth, direction, and nature of contemporary FDI flows indicate strategic asset-seeking by the world's largest MNCs. Much of the contemporary form of FDI involves mergers, acquisitions, and alliance arrangements. The prosperity of the firms participating in major industries depends upon the twin concepts of "networks" and "clusters", both of which indicate a group of related business activities working interdependently. The leadership of such clusters often centres on "flagship firms", which set the overall industrial direction but which rely upon a network of supporting manufacturers and service suppliers. For Canada, such industrial realities are of particular importance to government policy-makers due to the proximity and Canadian interdependence with the American economy.

The Theory of Alliance Capitalism

The table on the following page adumbrates the evolution of the global political economy. It notes the specific factors that differentiate "alliance capitalism" from previous economic forms, most notably the age of hierarchical capitalism. It also illustrates the vital effects of the evolution of the international political structure, and how that relates to the international production function.

Table 1 – Successive Phases of Industrial Capitalism

	Phase 1: Entrepreneurial Capitalism (1770-1875)	Phase 2: Hierarchical Capitalism (1875-1980)	Phase 3: Alliance or Flexible Capitalism (1980-?)
Markets	Small and fragmentary: local and national: mainly competitive	National or international: increasingly oligopolistic	Regional and global: dynamic and more competitive
Specialisation	Simple and modest, based mainly on distribution of natural assets	Becoming more complex: both national and international	Extensive and interdependent: the paradox of and increasing global division of labour based on location of created assets, together with the subnational specialised clusters of economic activity
Key resources	Natural assets, e.g. fruits of the land and relatively unskilled labour	Physical and some knowledge capital	Tangible assets, e.g. infrastructure and technological capacity Intangible Assets, e.g. human competence and knowledge formation, organisational and learning capability
Mobility of Assets	Little except for finance capital, and some emigration	Gradually increasing via MNE operations	Substantial mobility of firm specific created assets. But less mobility of some location specific assets
Organisation	Factory, small firms	Large integrated corporate hierarchies	More inter-firm alliances, single firm heterarchies, corporate networks
Production System	D form, batch	M form, mass or scale	Innovation driven: flexible
Government Role	Limited involvement: active role confined to provision of public utilities, fiscal policy and social welfare	Growing intervention: growth in welfare providing services. In interwar years considerable protectionism	More systemic and market enabling: less regulation of individual markets
Government structure	Local/national legislation	National legislation, limited supra-national institutions	Greater plurality of governmental forms, especially at sub-national and supra-national levels
International Activities	Classical trade, very little foreign production	market and natural resource seeking FDI: growth of intra-industry trade	Substantial efficiency and strategic asset-seeking FDI: more cross hauling of FDI and growth of cross-border strategic alliances
Cross-border integration	Of product and finance markets	Fluctuating: c.f. inter war years with early post-Second-World-War period	Increasing, through corporate and regional integration
Hegemonic Power	UK	USA	No single country

Table sourced from John Dunning, "Governments and the Macro-Organisation of Economic Activity: A Historical and Spatial Perspective", in John Dunning, ed., Governments, Globalisation, and International Business (Oxford: Oxford University Press, 1997), pp. 33-34.

As the table demonstrates, perhaps the central conclusion of the theory of alliance capitalism is that domestic governments still matter. Only they can enact policies designed to create the specific economic advantages needed to draw FDI. The general absence of international institutions that govern the mode and conduct of investment activity implies that state and national governments still retain a measure of control. Moreover, because the motivation behind current FDI patterns has changed - away from purely market or resource seeking investment and towards the acquisition of created and knowledge-based assets – governments' role in alliance capitalism is more rather than less important. Governments can do little to affect their natural factor endowments, the primart explanatory variable employed in Ricardian-based theories of FDI. Market-seeking theories of FDI cannot adequately explain FDI in the developed world, whose markets have been relatively open for much of the preceding three decades. Governments can enact policies that significantly impact on both their indigenous knowledge and innovation based assets, and can enact policies designed to create and retain the clusters of industrial activity that are the source of much innovation.

Globalisation – Implications for National Governments

It is ironic that, as the literature on international business strategy integrates political theories of the state in more sophisticated ways, much of the international relations literature raises concerns of the continued relevance of the state at all in international business activity. Susan Strange argues that

> The impersonal forces of world markets are now more powerful than the states to whom ultimate political authority over society and economy is supposed to belong. Where states were once the masters of markets, now

> it is the markets which, on many crucial issues, are the masters over the governments of states.[8]

Others argue that the globalisation of production has engendered threats to state democratic systems. Often the logic of enlarging economic units to encompass regional arrangements removes sovereign authority, with dangerous implications for domestic democratic legitimacy. One analyst argues that

> By dissolving sovereign statehood, globalising capitalism has made the traditional models of democracy impractical. Transborder production, markets, monies and business associations readily evade most democratic controls that might be attempted through a state.[9]

Clearly, globalisation has led many analysts to be sceptical that the state can still exert meaningful influence on its own domestic economic development.

The phenomenon of globalisation affects national policy autonomy in three specific ways. The first is the multinationalisation of production. Integrated MNC production networks have steadily removed the capacity of national governments to enact industrial strategies based on either resource or wage advantages. Worldwide production networks imply that MNCs invest in order to gain strategic assets, based primarily on unique knowledge and production capabilities, rather than resource or wage advantages. The second implication of globalisation for national governments is that they will be pressured continuously to upgrade their national trade competitiveness – by raising worker productivity levels, infrastructure capacities, and tax and wage incentives to business. The third element that concerns national governments is the global integration of financial markets. The flow of capital today is largely free from the shackles of state interference, and operates largely bereft of regulatory apparatus. These three factors have created new challenges to national government that cannot be solved by traditional policy prescriptions and avenues.

Traditional policy tools and frameworks require modification in the age of globalisation. Governments are considering an increasingly wide range of policy options that affect the domestic attractiveness of their state as a host for FDI. So strong has the competition for such investment become that governments are forced to evaluate the entire range of their economic policies in terms of their encouragement or discouragement of FDI. Policies that determine FDI attractiveness have consisted of both specific policies designed to loosen the regulatory framework for FDI as well as more general economic policies that affect the national economic environment as a whole. Some examples of these policies include the following.

Traditional FDI Policies (Policy initiatives designed specifically to attract and control the type, amount and direction of FDI inflow:

- policies that introduce market distortions designed to make certain types of investment more or less attractive. This includes erecting artificial barriers to entry, local content requirements on manufactured goods, and the granting of specialised subsidies to national firms.

- policies that encourage equitable standards of treatment for both foreign and domestic firms. Such policies include the granting of most favoured nation status (MFN), the creation of transparency in national accounting standards, affording "national treatment" to foreign firms, and erecting proper supervisory mechanisms for market transactions.

- policies that liberalise the general investment framework by removing sectoral and amount restrictions on the types of foreign investment that can take place.

Macroeconomic Policies (Policies that are not directly concerned with FDI per se but which have an important effect on the overall national economic attractiveness to foreign firms). These include:

- Monetary and fiscal policies designed to reduce overall debt levels while maintaining predictable and low inflation levels. Such policies directly affect the cost of capital for investing countries, and ensure that tax levels will remain stable and hopefully decrease.

- Exchange rate policies designed to encourage stability of local currency. Such policies affect the prices of host country assets and the value of transferred profits from national activity.

Macro-Organisational Policies (Policies that affect the patterns of resource allocation within the state as well as the structure and organisation of economic activities). These include:

- Structural policies influencing the spatial concentration of economic activities (such as regional development policies), research and development policies, technology transfer policies, and industrial composition policies which attempt to move the national economy away from "sunset" industries and towards "sunrise" industries.

- policies determining the functions of factor markets, such as labour market policies

- factors which affect the supply and quality of productive resources in a host country, such as educational and health policies that raise the overall quality of human capital.[10]

Alliance capitalism argues that this third category of policies - those determining the macro-organisational capacities of the nation – is the most important in determining overall national attractiveness to FDI. Building such capacities depends upon crafting a co-operative relationship between governments that create and manage such policies, and the corporations that utilise the improved domestic human and industrial capabilities in the production of wealth.

International relations theory is not at present well equipped to provide an interpretative framework for the political implications of alliance capitalism. Perhaps the most significant previous attempt emerged from the scholarship of the associated dependency development schools, whose primary members included Fernando Henrique Cardoso, Enzo Falleto, and Peter Evans. Cardoso and Falletto examined the problems of development for various Latin American states, and concluded that some form of alliance between the state apparatus and the MNC was necessary in order for development to proceed. They argued that it was necessary for the state to take a direct participatory role in profitable domestic sectors, lest those sectors be dominated by the purely economic motives of the MNC. They advocated the creation of a sector of "public entrepreneurs" who could protect state interests while maintaining an efficient administration of business practices.[11] They cautioned that the political problem was to equip the state with a set of entrepreneurial skills – which would allows both international and national capital accumulation – while maintaining overall state allegiance and economic direction.[12] They argued that a more explicit and co-operative working relationship between the instruments of the MNC and the state apparatus would ensure continued economic growth and development progress.

Peter Evans' work – entitled Dependent Development – focused on the developmental efforts of Brazil. He argued that state needed to deliberately foster ties with the purveyors of international capital, most specifically large MNCs. He argued that although the global strategies of investing MNCs and the development objectives of local governments were often in conflict, such conflict was resolvable by a concentrated bargaining effort. He posited that a state owned industrial apparatus was best positioned to extract both economic rent and to encourage overall economic development. He noted that the "state does have an external constituency interested in development and it must be responsive the this constituency."[13] He argued that state owned and operated industrial concerns were consistent with the overall strategy of increasing political and economic centralisation. His model of development that concentrated on the relationships among multinationals, local capital, and the state had been substantiated by a close examination of the progress of Brazilian development.[14]

These examples of developmental literature indicate that scholars have advocated an alliance strategy between the interests of the MNC and the state for quite some time. However, their formulation of how such an alliance might work – specifically through the cultivation of an entrepreneurial public sector, with an extensive system of state-run industries – holds little attractiveness for the developed world. There is considerable scepticism that state-run industrial concerns can ever match private firms in terms of efficiency and productivity. Moreover, such schemes are thought to engender a bloated civil administrative structure that raises governing costs and which is incapable of responding rapidly to emerging economic and market trends. Today's version of alliance capitalism depends upon a fluid investment environment, elaborate networks of interrelated production activity, and productive assets that emphasise knowledge over resource-based endowments. Such structures demand a different measure of state-firm relations than that advocated by the associated dependency school.

The evolution of multinational production in the age of alliance capitalism differs from previous eras due to the political composition of the international economy. The twin components of economic regulation that characterised most of the post-World War II era - the presence of an economic hegemon, combined with an ever more elaborate and entrenched system of regimes and international institutions – are not present. Such entities provided much of the regulatory public goods apparatus of the international economy in the post-war era. Their absence implies a current lack of authority in the management of international investment behaviour. This section will illustrate the current international relations contribution to the phenomenon of globalisation, and will outline a framework from which more substantive theoretical efforts may be built.

The realities of globalisation are main contributors to the current "crisis in embedded liberalism" that today occupies the governments of many developed states.[15] The work of John Ruggie is often associated with the concept of embedded liberalism, and he provides a framework for interpreting its gradual decay. Ruggie notes how the post-war Bretton Woods economic order emphasised trade liberalisation, with clear methods of domestic capital control. This system preserved the economic benefits of an open international trading environment while instilling an element of predictability in international monetary relations. The United States assured overall regulatory direction by providing the public goods functions that were thought necessary in preserving a stable international economy. It acted as lender[16] and market of last resort. Moreover, the United States created and maintained a series of international institutions and regimes that served to ensure the relative permanence and widespread acceptance of the doctrines of economic liberalism, even after the hegemonic power of the United States began to decline.[17]

Due to the strength of its initial leadership, The United States was also able to infuse the international system with a set of norms and regimes designed to regulate international economic behaviour. Institutions such as the International Bank for Reconstruction and Development (IBRD) and the International Monetary Fund (IMF) were designed to enhance and to put into practice the economic ideals possessed by the hegemonic power. Stephen Krasner argues that regimes moderate the causal variables and related outcomes that are endemic to relations between states in an anarchic international system.[18] Post-war regimes in trade, monetary relations, and a host of environmental and social issues illustrated the utility of regimes and their ability to moderate international economic relations.

The decline and eventual abolishing of the Bretton Woods system – signified by the American abandonment of fixed exchange rates and the nominal gold standard in 1971 -- signalled both a decline in American leadership and a significant weakening of a rule-based international system. John Ruggie's work dissects the processes and preservation of multilateral institutional norms, and he demonstrates that -- in the trade regime in particular -- multilateralism was able to survive the decline of the United States. He notes that traditional international relations theory – which attributes outcomes to the distribution of power relationships within the international system – cannot account for the persistence and power of the multilateral norms governing the international trading regime.[19] Multilateralism offers explanatory capability by noting the practices of co-operation and mutual adjustment that have characterised many aspects of international economic exchange in the post-Bretton Woods system.[20]

The success of regimes and multilateral co-operation, however, was not ubiquitous. Scepticism existed that questioned whether states were willing to continue ceding sovereign authority, especially when the retention of that authority created clear benefit. Susan Strange's trenchant critique of regimes questioned many of the fundamental assumptions of regime theorists. She argued that there did not exist any accepted definition of regimes, and that the inherent bias and value association with the term would likely prevent any emergence of one. She also questioned whether there could be a permanent locus of power and authority in the international system, a critical component to maintaining the permanence of established regimes. Finally, she concluded that contemporary theories of regimes were too static and ignored the overwhelming state-centeredness that characterised power and authority relations in the international system. Her arguments re-emphasised some of the traditional components of international relations scholarship.[21]

Strange's criticisms are particularly relevant for the case of MNC investment. In contrast to its more successful trade and monetary institutions, efforts to create an effective investment regime that can moderate the international activity of the MNC have, as Raymond Vernon notes, proceeded at a glacial pace.[22] Earlier efforts to codify international standards of MNC behaviour – most notably by the Organisation of Economic and Community Development (OECD) and the United Nations (UN)[23] – did not establish the expected convergence of behavioural norms that is necessary. Vernon argues that such attempts have been hobbled by the state's desire to maintain regulatory control over MNC activity within its borders. The unique structural characteristics and economic benefits derived from the MNC result in a persistent desire of both home and host nations to retain as much political control over its operations as possible. Vernon notes that national governments have pursued contradictory policies toward MNCs in the past – attempting to control the subsidiaries of foreign multinationals operating on their soil, while also expecting to garner the majority of tax and knowledge based advantages reaped from the foreign operations of their indigenous MNCs. He points out that such dualism cannot form the basis of an effective international regime, and that any international arrangement would depend on national governments relinquishing some of the powers they currently enjoy.

Pre-requisites for an effective regime on investment would include – in addition to a generous dose of political will – a recognition of the differing rights and obligations between the operations of subsidiaries and the operations of the MNC network as a whole. Vernon is pessimistic that an effective regime can ever emerge, and any regime that does emerge will be the product of a "long period of experimentation and travail."[24] The desire to retain political control over the operations of MNCs has resulted in the lack of effective international institutions that can regulate their behaviour. Attempts by the OECD to introduce an agreement on multilateral investment in 1998 marked the first serious attempt to create an institutional structure for the regulation of investment. The MAI was designed to increase the regulatory and dispute resolution framework that surrounds investment issues. It would conceivably "improve the enabling environment for FDI, to the extent that it would contribute to greater security for investors and greater stability, predictability, and transparency in investment polices and rules."[25] Its initial rejection indicates the fear of a sceptical and suspicious electorate that such institutional measures may erode a government's ability to control investment behaviour within its own territory. Further efforts to introduce such a multilateral agreement will have to allay public concern over the perceived loss of economic sovereignty.

Consequently, regulatory responses to the increased globalisation of MNC activity will remain state-based. National responses to capital de-regulation and globalisation have varied according to domestic state structures and societal demands. The United States is perhaps one of the poorest equipped states to do so. The logic of investment liberalism accepts the short-term economic costs caused by the free flow of economic capital in order to reap long-term gain. Yet, the economic structure created by the American political process "push politicians to seek short term solutions that effectively ignore long term costs."[26] European states – by and large characterised by a corporatist investment climate –are thought better able to manage the process of adapting to footloose capital.[27] The conclusion of such analysis indicates that states are not powerless to direct and control foreign investment, even after the removal of most capital controls. Doing so, however, depends upon crafting a broad consensus among the state's major economic constituents on the scope and direction such investment should take.

These two central transformations of the international political economy – the weakening of a leadership-based hegemonic system, and the lowering and elimination of capital controls by much of the developed and developing world – have resulted in the unpredictable pattern and immense volume of capital movements occurring today. The triumph of liberalism in the arena of global monetary relations has come at the expense of domestic monetary autonomy. Moreover, in the absence of a well-developed institutional forum for investment, multilateral regimes cannot fill the regulatory void. Scholars have long noted that that the economic advantages of free markets need to be balanced with the regulatory capacity of political institutions to soften the short- term economic dislocations engendered by the free movement of goods, services, and capital. Yet the increasing enthusiasm with which free markets have been adopted has steadily eroded the state's ability to provide such regulation in the realm of investment, and present international institutions do not have the capability to replace the regulatory capacity of the state. As Geoffrey Garrett notes,

> The distinctive feature of this scholarship was the recognition that the short-run political dynamics of exposure to trade ... are very different. Openness increased social dislocations and inequality and hence heightens political pressures for dampening these effects. If protectionism ... is to be avoided, government must redistribute market allocations of wealth and risk.[28]

Many analysts have concluded that national governments in the age of globalisation are simply no longer able to adequately protect such concerns over distribution and equity. Robert Reich has argued that the phenomenon of globalisation works to separate citizens in individual countries according to categories of economic power. Overt macroeconomic interference in the workings of the domestic economy – such as the imposition of wage, health, and safety standards, too heavy a tax burden, or other industrial policy regulations – cannot be countenanced, as they simply engender capital and production flight to more hospitable investment climates. He concludes that the very idea of a national economic system is meaningless in today's global economy.[29] Other critics of globalisation fear that it engenders a "race to the bottom", forcing governments to jettison concerns over wealth distribution and labour and environmental standards in order to create a more attractive domestic investment environment. The competitive drive to acquire investment in capital and production overwhelms the national concerns over equity, distribution, and social justice. [30]

Other analysts argue that the loss of sovereign state economic power will be replaced by the growing autonomy of regional-based economic institutions. Each of the major regions of North America, Europe, and the Far East has established supranational political and economic arrangements designed to facilitate trade and investment activity. As regional arrangements grow and mature --a process entailing the admission of new members, and the assumption of ever-greater amounts of economic authority -- they will increasingly usurp state authority. They point to the widening institutional legitimacy of the North American Free Trade Agreement and the continued economic integration within Europe as indicators of the continued removal of economic authority away from state-based institutions and towards wider political arrangements. Advocating an investment model that places at its core the policy-making capacity of the state seems antiquated in the global trend towards integrated regional economic arrangements.[31]

In the face of such evidence - the continued erosion of state authority, the increasing integration of regions – some have argued that the boundaries of political and economic analysis do not necessarily coincide. The attempt to interpret the economic performance of the nation-state is misguided because the state is a political rather than an economic unit. Stephen Kobrin notes that it is not necessary for political and economic analysis to concentrate on similar geographic units, and that the contemporary tendency to focus both on the nation state is nothing more than a historical accident.[32] The diffusion of sovereign economic authority away from the nation state and towards non-state entities implies that state-based theories of economic development are wrong.

The challenge for national autonomy in the age of globalisation is relatively simple to articulate, if difficult to practice. Can an avowed liberal state craft indigenous policy responses that both encourage progressive MNC investment and also protect traditional governmental concerns over wealth distribution, equity, and social justice? The theory of alliance capitalism argues that this is possible, but requires more collaborative efforts among the major wealth creating constituents of domestic society. The form of alliance capitalism will differ in the case of individual states, depending upon their industrial structure, proximity and degree of interdependence with other major economies, and state/societal patterns. In the particular case of Canada, the conditions for that collaboration will be outlined in the following chapters. Now it is necessary to outline some of the major trends in FDI and corporate behaviour that are occurring, and the necessity of adopting alliance capitalism in the face of such trends.

Globalisation and the Theory of Multinational Production

The study of the internationalisation of firm activity – of why firms choose to expand their value-adding activities across borders – is a relatively recent phenomenon. Initial efforts by Stephen Hymer[33] and Raymond Vernon[34] offered primarily economic rationales for the expansion of such activity, and focused on maximising rents and on the technological evolution of the product cycle. Subsequently, a variety of explanations were offered that attempted to explain international business activity. By the mid 1970s, many theories of multinational production had been offered, and could be grouped into one of four categories – market seeking, efficiency seeking, resource seeking, and strategic asset acquisition.[35] Economic analysis tended to focus on one of the four areas to the exclusion of the other three, and the insight gained from such specialisation was often outweighed by a specific theory's inability to explain other aspects of multinational firm behaviour. What appeared necessary was a robust interpretation of international production that could incorporate a wide range of firm motivations and which could account for the technological and market evolution of specific industries.

John Dunning attempted to provide such a theory with the publication of the eclectic paradigm of international production, which first appeared in 1980.[36] Dunning was careful to note that he offered a paradigm, or a set of assumptions and observations from which more specific theories of international production could be drawn. The eclectic paradigm combined the foundations of previous economic analysis within a robust framework that had generalised explanatory capability. The eclectic paradigm integrated elements of classical trade theory, the market dynamics of international industries, and the specific production dynamics of the individual firm. The result, Dunning hoped, would provide scholars with a broad framework in which to analyse the activities of the MNC.

There are three constituent elements in the eclectic paradigm. The first element incorporates the specific advantages that an individual firm garners through its own internal activities. Dunning termed these ownership (O) advantages. They included proprietary patents on products, production and marketing knowledge, established brand production and distribution channels, and overall managerial knowledge and experience. Economists had long argued that firms could garner larger economic rents from such advantages through an international network of controlled subsidiaries. Such a network was preferable to licensing accumulated knowledge to foreign firms. Licensing engendered transaction costs due to international market failure – arms-length transactions suffered from inefficiencies due to incomplete transfer and absorption of knowledge. Any theory of international production had to incorporate the firm's desire to maintain control over its accumulated ownership advantages.

The second element in the eclectic paradigm incorporated advantages accrued by operating in specific locations. Not surprisingly, such advantages were coined location-specific (L) advantages. The roots of such advantages were lodged in classical trade theory, and centred upon the concept of national comparative. Such advantages were particularly important for MNCs operating in the primary extractive industries that depended upon secure sources of natural raw materials for their operation. Yet, L-advantages encompassed much more than just natural resource endowments—they also included created advantages, such as infrastructure networks, the predictability and stability of government policy and practice, and the general educational and literacy levels of the local workforce. The actions of nations and governments to upgrade their attractiveness to MNC investment could be incorporated into the eclectic paradigm.

The final component of the eclectic paradigm included elements of internalisation (I) of the production function. This element attempted to explain the phenomenon of vertical integration that had become characteristic of the MNC. Just as there were transaction costs that accompanied the licensing of ownership advantages to foreign firms, there were also transaction costs associated with relying on other firms for intermediate products. Rather than engage in arms-length transactions to acquire necessary production inputs, MNCs preferred to expand their operations to include all necessary functions along the value chain. Internalising such productive processes could eliminate the market failure associated with arms-length transactions. This element of the eclectic paradigm proved especially useful in explaining the high and growing rates of intra-firm trade that composed a significant portion of international trade in general. Firms attempted to vertically integrate in order to internalise the productive function as much as possible, thereby extracting maximum economic rent.

The combination of the three factors – ownership, location, and internalisation (OLI) – formed a robust paradigm into which various theories could be fit. The eclectic paradigm offered the most significant integrative effort theory of multinational production. Its integrative capacity served as a basis for interpreting MNC behaviour for over two decades. Yet, in the wake of the economic changes brought by the phenomenon of globalisation, even Dunning has had to conclude that modifications of the eclectic paradigm are indeed necessary. The modern corporation's main source of competitive advantage has changed in the era of globalisation, and therefore the emphasis placed on the three constituent elements of the eclectic paradigm must be re-evaluated in the wake of those changes.

Globalisation and Corporate Strategy

The nature of competitive strategic advantage enjoyed by the successful MNC has changed as a result of globalisation. Factors such as economies of scale and scope, access to secure sources of raw materials and the utilisation of accumulated proprietary knowledge still play a role. Yet the source of true advantage of today's global firm lies primarily in its ability to create unique knowledge capabilities and to diffuse those capabilities. In part, this is a matter of organisational skill and involves integrating teams that can garner the specialised knowledge gained in local markets and diffuse it throughout a global network. Yet it is also a matter of recognising the value of tapping into the unique knowledge and productivity capabilities of individual foreign markets, and investing in those markets to access those capabilities. Simple branch plant models of foreign production – in which high value-added research and primary manufacturing are carried out in a firm's home state, and foreign subsidiaries carry out prefabricated assembly – do not in fact accurately depict the operations of the most successful global companies. Foreign plants are today as great a source of innovation and knowledge as are home-based facilities, and leveraging local advantages and knowledge across a global manufacturing network in a prime component of successful global strategy.

Today's' MNCs rely upon their ability to innovate and create knowledge-based assets in order to compete in today's international marketplace. This has had important effects on MNC strategy. One clear example of such strategic change is in how firms chose to integrate their cumulative operations, either vertically or horizontally. Historically, the clearest examples of MNCs that vertically integrated their operations were those that concentrated on raw materials processing – such as mining, petroleum, and forestry companies. Such firms vertically integrated their operations in order to encompass all steps in the value chain. By contrast, companies that produced standardised products with a low or medium technology component often adopted horizontal integration. This involved the creation of branch plants and the accompanying administrative structure in major markets, plants that would then operate with a high degree of independence from the home nation. Headquarters monopolised research and development functions; heads of country operations enjoyed a great deal of managerial autonomy. Such a strategy mandated that the firm has a core of relatively standardised products that can appeal to customers across diverse cultural and political backgrounds.

An innovation-based strategy, however, depends on accessing new customers and market while continuously improving products and services offered to existing customers. Consequently, neither the overtly centralised headquarters-based structure, nor the diversified network of essentially independent country operations, will maintain firm competitiveness. Today's most successful global firms have adopted a "transnational" organisational model that integrates its global operations into a cohesive role. Under this role. Under this model, headquarters sets direction but still provides considerable freedom to company subsidiaries. This freedom allows the firm to gain local market, product, and innovation knowledge that is rapidly diffused throughout the network. Successful global MNCs are both locally responsive and globally integrated.[37]

Such companies, moreover, are becoming much more selective in the activities that they perform and those for which they rely on outside partners. MNCs depend upon continued improvement in product technologies and capabilities in order to maintain competitiveness. Assuring continued improvement often mandates that firms identify their "core" skills and competencies, those activities that differentiate them from their competitors. An increasingly competitive environment mandates that firms concentrate completely on those specific skill sets, and partner with other firms to provide additional necessary manufacturing capacities. There has been a marked increase in the collaborative behaviour between leading global MNCs and smaller firms that provide such specific niche expertise. Often termed strategic alliances, such collaborative efforts recognise the inherent value of combining specialised skills and attributes, and the virtual impossibility that one firm can possess all of the necessary skills and technologies in producing competitive products.

When analysing FDI data, it is important to note that the nature of such investment often is not directly in the creation of new enterprises and greenfield investment. It is often in the form of purchasing already existing companies that have significant advantages to offer in the provision of specific products. The modern competitive MNC is enmeshed in a network of collaborative arrangements that provide it with the necessary specialised expertise. Firms participate in strategic alliance to acquire added strategic advantage. Doz and Hamel argue that there are three primary purposes to engaging in an alliance – co-option of potential competitors into allies, co-specialisation of complementary assets, and as an avenue for learning and internalising new skills.[38] Alliances are crucial to MNC success. It is apparent that no one firm can provide all the necessary skills in the value-added process; even the largest MNCs engage in alliance behaviour. The example of IBM – whose company culture initially proved reluctant to engage in alliance activity – found that the competitive environment was too severe to maintain that outlook. By 1992 IBM was engaged in over 20000 alliance-style engagements, including 400 equity investments.[39] Such figures indicate that even the most technologically advanced MNCs require additional capabilities acquired from outside sources.

The adoption of particular organisational patterns to facilitate industrial competitiveness, it has been argued, is nevertheless highly cultural-specific. Mitchell Bernard's work on post-Fordist capitalist structures is a case in point. Barnard argues that the particular industrial form of Fordism – with massed production lines and legions of unionised workers performing repetitive manufacturing tasks – arose due to the particular social and economic conditions present in the United States at the turn of the century. He argues that the rise of Japanese economic power in the past few decades has been the result of an intentional rejection of Fordism in favour of uniquely Japanese production processes. Such practices included the adoption of just-in-time manufacturing, a co-operative union-management working relationship, and a production process that could rapidly adapt to innovation. These practices, moreover, also contributed to an increasingly integrated regional production scheme that called into questions the practice of evaluating economic activity from a purely national perspective. Bernard's work emphasised that production and innovation practices were highly cultural-specific.[40]

The cultural component of industrial practices may cause some to question whether any one type of MNC production structure or practice could be deemed ubiquitous. Yet cultural practices are complementary – not opposed – to the global strategic practices of the modern MNC. Such firms have long recognised that production and labour processes needed to be adapted to local conditions. Such adaptation has been perceived as a source of, rather than detracting from, firm competitiveness, as innovations created in one national market can be integrated into the practices of another. Global MNCs attempt to reap advantages that, while products of a particular social context, can also be applied elsewhere.

The most attractive assets to the modern MNC that a country can possess are those that are created, rather than those that rely on natural factor endowment. The location-specific advantages – particularly of knowledge or innovation assets – of countries are absolutely vital to the maintenance of this network. MNCs understand the importance of cultivating the appropriate location-specific advantages of their foreign markets. The retention of exclusive rights to knowledge-based and knowledge-creating assets remains a key to continued competitiveness.

The attraction and retention of foreign direct investment are vital because it ensures the continual upgrading of the industrial capabilities of the nation's workers. Sustainable economic development results from continually increasing levels of productivity within the national workforce. Such productivity maintains and increases

FDI within the country. Today's developed economies depend upon a continual process of innovation in their industrial processes and upgrading of their manufacturing capacities. Alliance capitalism argues that the only true elements of economic competitive advantage for the state lie in the organisational skills, knowledge, and technological capacity of indigenous production facilities, and that the primary agent through which such skills are transferred and created is the MNC.

Corporate Strategy and the State – The Perspective of the Firm

Scholars have long noted the potential for both home and host governments to affect – if not dictate – certain aspects of international business activity. Early explorative efforts of government business relations emphasised the necessity for global managers to understand local government objectives and to craft appropriate business strategies. Under certain circumstances host governments could become hostile to foreign business activity, depending on the local perception and effects of such activity. The literature focusing on the phenomenon of political risk consistently emphasised the dangers posed by host government intervention.[41] Often host governments were assumed to have divergent interests from investing MNCs; it was the firm's responsibility to understand and account for such objectives. The early political risk literature emphasised the potential dangers of host governments acting in confrontation, rather than co-operation, with investing firms.

Managers and academics alike soon realised that understanding the motivations – and therefore the policy decisions – of host governments was an important part of global business strategy. Greater incorporation of such knowledge into strategic planning efforts became part of the planning process of increasingly global firm. Yet, much of this literature continued to emphasise the potential conflict inherent in global business-government relations. Jean Boddewyn and Etienne Cracco, for example, offered an analytic framework that centred host government imperatives on issues of national interest, national sovereignty, and national identity. They noted that developing bargaining skills with local governments and understanding political developments were necessary elements of global business planning.[42] They also argued that managers who viewed global business activity purely in terms of market activity would not understand – and still less be able to cope – with host government domestic intervention designed to further domestic economic development objectives.

One of the first seminal works that integrated host government policy into global strategy was Yves Doz and C. K. Prahalad, The Multinational Mission. This work provided a strategic framework for global companies that balanced the benefits of global integration with the need for local responsiveness. They argued that, although governments by necessity limited the scope for truly global integration, they also offered avenues for MNC exploitation by modifying competitive condition in their favour.[43] They noted that the potential for collaboration between host governments and investing firms did indeed exist, particularly where location-specific advantages matched the core competitive advantages of the firm.[44] They concluded "from relatively minor investments to major strategic direction choices, a first guiding principle for action has to be mutuality of interest." [45] That such mutuality could exist – indeed, that it could become the basis for the strategic planning of the MNC – is a constituent element of alliance capitalism.

Further developments in the literature of global strategy featured a more exacting integrative effort to bridge the theory of the state and international business strategy.

The work of Murtha and Lenway incorporated extensive discussion of the political economy objectives of the state. They argued that the state was an independent element, and that individual structures of political authority, conflict resolution, and bargaining avenues would dictate appropriate local business strategies. They noted that "states embody country-specific governance capabilities that, together with national factor endowments, influence the international economic strategies that firms can implement."[46] In a separate article, the authors provided a framework demonstrating how governments' organisational capabilities and countries' political institutional structures affected MNC strategies and organisation structures.[47] Their framework emphasised the combination of property rights, transactional governance, and policy credibility as contributing to the efficacy of state industrial strategy capabilities. A more explicit view of states' interests, and the willingness to accommodate them in production and investment decisions, was a necessary part of successful MNC strategy.

Thomas Brewer continued to question the view of the state that emphasised the inherent tendency for conflict with the MNC. He and Jean Boddewyn argued that scholars needed to challenge the fundamental assumption that "governments and other political actors constitute constraints or givens rather than a factor of production or a set of agents that international firms may want to control or create for strategic purposes."[48] In another article Brewer argued that the relationship between the MNC and government was complex, differing along levels of analysis, issue areas, and degree of MNC power.[49] He argued that a greater understanding of government behaviour – garnered primarily through the study of public and foreign policy literature – held important insights for the study of international business. Particular issue-areas demanded the adoption of specific models of MNC-firm interaction. A greater understanding of the political process would improve a multinational's ability to operate in foreign environments, primarily through utilising the potential for collaborative rather than competitive behaviour.

The integration of government policy and international business strategy has become an important reality for governments and firms alike. As FDI increasingly becomes dependent on strategic asset seeking – rather than the market or resource models that have driven MNC expansion for most of this century – government's ability to foster the conditions for creating those assets becomes critical. Such investment is intended to acquire specific skills developed by indigenous firms. Countries that fail to produce such specific advantages will inevitably receive a smaller portion of worldwide FDI flows.

The global strategy literature has made increasing efforts to integrate the concept of "government as partner" into the strategic planning process, taking particular account of government economic and political interests. What remains necessary is an examination of government polices that reflect a greater understanding of MNC strategy and which demonstrate the model of "government as collaborator" that is key to the concept of alliance capitalism. As Thomas Brewer and Stephen Young note:

> ...the need to replace bureaucratic and authoritarian regimes of hierarchical governance applies as much to governments as it does to enterprises. And relationships between the public and private sectors require changing from confrontation to co-operation and partnerships.... Since the locational options of firms are widened, action by governments to ensure that the economic environment is conducive to promoting competitiveness becomes critical. [50]

Of the elements outlined in the eclectic paradigm, host governments can work to directly influence their locational (L) advantages. It is not sufficient for governments to enact broadly permissive investment policies. The trend towards investment liberalisation implies that many potential investment sites are competing for a limited supply of foreign investment funds. Of the 151 FDI policy changes enacted world wide between 1991-1997, 94 per cent contributed to creating more favourable conditions for FDI.[51] This has led to the following realisation:

> Competing fiercely with one another for FDI and finding that liberal policies are no longer enough, host countries have increasingly come to realise the importance of adopting proactive measures to facilitate business transactions by foreign investors and of improving the economic determinants of FDI.[52]

Such policies need to be accompanied by complementary trade, tax, and regulatory frameworks that work in unison to create an attractive investment environment. Alliance capitalism demands the creation of a bundle of monetary, fiscal, industrial, and employment policies designed to attract and retain knowledge-based FDI.

The theory of alliance capitalism acknowledges that the MNCs search for competitiveness is increasingly responsible for current patterns of FDI. Yet it argues that states must and do play an increasingly co-operative role in facilitating such investment. The advantages firms require in order to remain internationally competitive are exactly those that national governments would wish to foster. Developed economies must compete on their indigenous knowledge base, as does the modern MNC. Consequently, governments also note that not all FDI is equal; some investment contributes more to the country's knowledge base and chosen competitive clusters than does investment motivated purely by resource or market-seeking desires. Government has considerable policy freedom both to enact policies designed to cultivate specific local assets and industries and to attract particularised FDI that utilises and renews those assets and industries.

There are several areas of contention within the model of alliance capitalism. Critics argue that such efforts at firm-state co-operation exact a price. They note that, because firms possess considerable investment freedom, they can choose to withdraw much of their value-adding activity from any individual country quickly. Should this happen, governments would have few legal or regulatory avenues of recourse. Any model of industrial activity based on such co-operation – and not on legal or confrontational approaches designed to reduce the firm's freedom to divest its assets and discontinue investment -- would lack the relative permanence and stability featured by endowment or resource-based investment. Critics also argue that, under alliance capitalism, states run considerably more economic risk than do firms. Without constraining the MNCs' ability to relocate investment activity, the state does not have a sufficient "stick" to offset the considerable carrots offered in the collaborative model. Finally, the model of alliance capitalism seems applicable only in the developed world, which possesses the infrastructure, knowledge and research resources that are required to collaborate effectively with the modern MNC. Countries that do not possess these advantages run even greater risks in the collaborative model, because their ability to generate innovation in industrial practices is constrained. Developing countries often must base their investment policies on the belief that most FDI in their region is market or resource based. A model based on strategic asset acquisition, therefore, would have little relevance for their industrial policies.

These scenarios can, however, be mitigated by adroit policy decisions. The appearance of large numbers of mergers, acquisitions, and strategic alliances gives an appearance of fluidity to the international economy that is not entirely accurate. The underlying purpose of such economic behaviour is to acquire economic and production assets that are necessary to remain competitive. Such assets can be created by the appropriate collaboration between firms and governments. Moreover, firms and nations that have made strategic investments in clusters of industries would be reluctant to divest them, because the particular advantages of the cluster are not easily replicated elsewhere. Specific investments in knowledge creation and specialised production capability are often unique. The management of an established cluster or network exacts less managerial effort and retains more economic rent than does the creation of a new one. While MNCs possess the appearance of mobility, that freedom is constrained considerably in the case of knowledge and innovation based investment.

Conclusion

International business scholars now recognize the importance of bringing a sophisticated view of firm-govememnt relations into their analysis of global business strategy. Just as host governments are attempting to craft a new relationship with the MNC as a method of upgrading their indigenous economic resources, MNCs are looking at more creative means of integrating host government concerns into their overall strategy. Such realisations have created the conditions under which alliance capitalism - the co-operative venture between firm and state – can flourish.

The combined effects of technology, rapid capital movement, and the diffusion of knowledge have altered traditional models of economic development. Classical interpretations based largely on theories of national competitive advantage need extensive modification – if not complete replacement – in order to account for the contemporary reality of economic development. Today, sustainable competitive advantage is not drawn from possessing clear natural endowments in primary materials or low-wage labour costs. Industrial polices based on an assumed permanence of such advantages will not succeed in building a sustainable competitive economy, because such advantages are transitory. Today, there are numerous national sources for raw materials – many countries compete with each other to market their endowed resources, and it is unlikely that a manufacturing firm can be deprived of access to needed raw materials. Nor can a country rely on its supply of low-wage labour as a long-range strategy to attract investment. First, other countries will continually attempt to undercut such wage levels. Second, increasing investment and production within a single country has had a tendency to drive wage levels up. This destroys the initial cost advantage, which then must be compensated by gains in productivity. Neither natural endowments nor low-wage labour are sustainable sources of competitive advantage. Only the specific assets created in the model of alliance capitalism are sustainable and will provide increasing sources of economic advancement. The following chapters will demonstrate how these realisations have become part of the Canadian governing agenda.

Endnotes

[1] John Dunning, Alliance Capitalism and Global Business, (London: Routledge Press, 1997), pp. 13-14.

[2] For the purposes of this thesis the term "globalisation" will refer to the creation and maintenance of an integrated world-wide production structure that is featured in the most advanced MNCs.

[3] On the importance of networks in fostering regional integration in the Far East, see Peter J. Katzenstein and Takashi Shiraishi, Network Power: Japan and Asia (Ithaca: Cornell University Press, 1996). In particular, see the essay by Richard F. Donner, "Japan in East Asia: Institutions and Regional Leadership", pp. 197-234. See also Chalmers Johnson, "Comparative Capitalism: The Japanese Difference", in Japan: Who Governs? The Rise of the Developmental State (New York: W.W. Norton & Company, 1995), pp. 51-68. As an example of freedom from excessive shareholder demand, Johnson notes that "chosen shareholders are a firm's domestic competitors, intermediated by its financial partners; together they hold approximately 70 percent of the share of each other's firms, thereby preventing take-overs by keeping the numbers of tradable shares below a controlling interest. The shares that a company holds in its competitors' firms are never sold, regardless of price." P. 63.

[4] Michael Porter, The Competitive Advantage of Nations, (New York: Free Press, 1990).

[5] Alan Rugman and Joseph R. D'Cruz, "The Double Diamond Model of International Competitiveness: the Canadian Experience", Management International Review, 33(2), Special Issue, 1993, p. 35.

[6] Alan Rugman, Multinationals and Canada-United States Free Trade, (Columbia: University of South Carolina Press, 1990), pp. 100-104.

[7] Alan Rugman and Joseph R. D'Cruz, "The Double Diamond Model of International Competitiveness: The Canadian Experience", Management International Review 33(2), Special Issue, 1993, p. 25.

[8] Susan Strange, The Retreat of the State, (1996), p. 4.

[9] Jan Aart Scholte, "Global Capitalism and the State", International Affairs, 73(3), 1997, p. 451.

[10] This synopsis of policy responses to the demands of FDI is taken from the following source: UNCTC, World Investment Report 1998: Trends and Directions (Geneva 1998), pp. 96-99.

[11] Fernando Henrique Cardoso and Enzo Faletto, Dependency and Development in Latin America (Berkley: University of California Press, 1971), p. 210.

[12] Ibid., p. 212.

[13] Peter Evans, Dependent Development: The Alliance of Multinational, State, and Local Capital in Brazil (Princeton: Princeton University Press, 1979), p. 215.

[14] Ibid., p. 275.

[15] Geoffrey Garrett, "Global Markets and National Politics: Collision Course or Virtuous Cycle?", International Organisation, 52(4), 1998, pp. 796-797.

[16] Barry Eichengreen, "Hegemonic Stability Theories of the International Monetary System", in Jeffry A. Frieden and David A. Lake, International Political Economy: Perspectives on Power and Wealth, 3rd edition, (New York: St. Martin's Press, 1995), pp.230-254.

[17] Arthur A. Stein, "The Hegemon's Dilemma: Great Britain, the United States, and the International Economic Order", International Organisation, 38 (Spring 1984), pp. 355-386; Duncan Snidal, "The Limits of Hegemonic Stability Theory", International Organisation, 39(Autumn 1985), pp. 579-614.

[18] Ibid., pp. 11-19. See the discussion in chapter 2.

[19] John Gerard Ruggie, "Multilateralism—The Anatomy of an Institution", International Organisation, 46(3), 1992, p. 564. See also Ruggie, Multilateralism Matters: The Theory and Practice of an Institutional Form (New York: Columbia Press, 1993).

[20] Robert O. Keohane, After Hegemony: Co-operation and Discord in the World Political Economy (Princeton: Princeton University Press 1984). Keohane argues that multilateral regimes provide regularised mechanism for dispute settlement, which generally lower conflict in the international system.

[21] Susan Strange, "*Cave! Hic dragones:* A Critique of Regime Analysis", International Organisation, 36(2), 1982, pp. 337-354.

[22] Raymond Vernon, "Codes on Transnationals: Ingredients For An Effective International Regime", in John H. Dunning and Mikoto Usui, edts., Structural Change, Economic Interdependence and World Development, (London: Macmillan Press Ltd., 1987), pp. 227-242.

[23] OECD, International Investment in Multinational Enterprises: Responsibility of Parent Companies for Subsidiaries (Paris: OECD, 1980). UNESCO, Proposed Text of the Draft Code of Conduct on Transnational Corporations, presented in John Dunning, Multinational Enterprises and the Global Economy, (London: Addison-Wesley, 1993), pp, 588-596.

[24] Vernon, "Codes On Transnationals", p. 238,

[25] UNCTC, World Investment Report 1998, p. 129.

[26] Simon Reich, "Roads to Follow: Regulating Foreign Direct Investment", International Organisation, 43(3), 1989, p. 544. Much of the literature surrounding the Japan-United States trade disputes focuses on the purported greater ability of the Japanese state to direct investment capital into industries deemed of national importance. The contrasting American system – which often features distrust and conflict between government and major capital importing firms – could not compete. On this point see John Zysman and Laura Tyson, American Industry In International Competition: Government Policies and Corporate Strategies (Ithaca: Cornell University Press, 1983).

[27] Ibid., p. 548. See also Peter Katzenstein, Small States in World Markets: Comparative Responses to International Economic Crises (Ithaca: Cornell University Press, 1986).

[28] Garrett, "Global Markets and National Politics", p. 796.

[29] Robert Reich, The Work of Nations, (New York: Vintage Books, 1992). Reich argues that most within most developed nations, three primary economic classes have emerged – symbolic analysts, who possess specific skills to thrive in the global economy, in-person services, and routine production services. He argues that the increasing disparity of income between the three classes has resulted in very separate sets of economic concerns, and argues that such realities hold dangerous implications for the idea of national unity and the concept of national citizenship.

[30] William Greider, One World Ready or Not, (New York: Simon and Schuster, 1997).

[31] Kenichi Ohmae, The End of the Nation-State: The Rise of Regional Economies (New York: Free Press, 1995).

[32] Stephen J. Kobrin, "The Architecture of Globalisation", in Dunning, Governments, Globalisation, and International Business, p. 160.

[33] Stephen Hymer, The International Operations of National Firms: A Study of Direct Investment (PhD Thesis, MIT Press, 1976).

[34] Raymond Vernon, "International Investment and International Trade in the Product Cycle" Quarterly Journal of Economics, 80, pp. 190-207.

[35] For an elaboration of this taxonomy, see Jack Behrman, The Role of International Companies in Latin America: Autos and Petrochemicals (Lexington: Lexington Books, 1972).

[36] John H. Dunning, "Towards An Eclectic Theory of International Production: Some Empirical Tests", Journal of International Business Studies, 11(1), 1980, pp. 9-31.

[37] Christopher Bartlett and Sumantra Ghoshal, Managing Across Borders: The Transnational Solution, (Boston: Harvard Business School Press, 1989).

[38] Yves L. Doz and Gary Hamel, Alliance Advantage: The Art of Creating Value Through Partnering, (Boston: Harvard Business School Press, 1997), pp. 4-5.

[39] Michael Yoshino and U. Srinivasa Rangan, Strategic Alliances: An Entrepreneurial Approach to Globalisation, (Harvard: Harvard Business School Press, 1995), p. 9.

[40] Mitchell Bernard, "Post-Fordism, Transnational Production, and the Changing Global Political Economy", in Richard Stubbs and Geoffrey R.D. Underhill, Political Economy and the Changing Global Order, (Toronto: McClelland & Stewart Inc., 1994), pp. 216-229. The emphasis on culture as a determining variable in the produciton process is hardly new. Alfred Chandler's Scale and Scope (Boston: Harvard University Press, 1990), and Bruce Kogut, ed., Country Competitiveness: Technology and the Organisation of Work (New York: Oxford University Press, 1993) are other examples of such literature. While such analysis is a vital component of the globalisation process, this thesis argues that the modern MNC has both adapted its production process to the particular host country conditions and has created mechanism to disperse best practice knowledge and technology throughout its global network. As a response to Bernard, it is clear that many European and American plants have adopted Japanese production processes reasonably successfully, indicating that production processes are adaptable.

[41] The political risk literature is indeed vast, spurred primarily by well-publicised cases of local expropriation of business assets. Some of the early works include Antoine W. Van Agtmael, "How Business Has Dealt With Political Risk", The Financial Executive, 44, January 1976, pp. 26-30; Robert T. Green, "Political Structures as a Predictor of Radical Political Change", Columbia Journal of World Business, 9, Spring 1974, pp. 28-36; R.J. Rummel and David A. Heenan, "How Multinationals Analyse Political Risk", Harvard Business Review, 56, Jan-Feb 1978, pp. 67-76; and Robert J. Stobaugh, Jr., "How to Analyse Foreign Investment Climates", Harvard Business Review, 47, Sept-Oct 1969, pp. 100-108.

[42] Jean Boddewyn and Etienne F. Cracco, "The Political Game in World Business", Columbia Journal of World Business, 7, Jan-Feb 1972, pp. 45-56.

[43] C. K. Prahalad and Yves Doz, The Multinational Mission: Balancing Local Demands and Global Vision, (New York: The Free Press, 1987), p. 68.

[44] Ibid., p. 77.

[45] Ibid., p. 99.

[46] Stefanie Ann Lenway and Thomas P Murtha, "The State As Strategist in International Business Research". Journal of International Business Studies, 39(1), 1994, p. 514.

[47] Thomas P. Murtha and Stefanie Ann Lenway, "Country Capabilities and the Strategic State: How National Political Institutions Affect Multinational Corporations' Strategies", Strategic Management Journal, 15(Special Issue), 1994, p. 113.

[48] Jean J. Boddewyn and Thomas Brewer, "International Business Political Behaviour: New Theoretical Directions", Academy of Management Review, 19(1), 1994, p. 123.

[49] Thomas Brewer, "An Issue-Area Approach to the Analysis of MNE-Government Relations", Journal of International Business Studies, 23(2), 1992, pp. 304-305.

[50] Thomas L Brewer and Stephen Young, The Multilateral Investment System and Multinational Enterprises, (Oxford: Oxford University Press, 1998), p. 22.

[51] United Nations, World Investment Report 1998: Trends and Directions (UNCTC, New York, 1998), p. 93.

[52] Ibid., p. 97

Chapter 5 -- Foreign Direct Investment in Canada 1971-1993

The fundamental tenet of alliance capitalism is that the power of the modern MNC – and its importance to the maintenance of national economic strength – necessitate a new public policy framework that emphasises co-operation between the firm and the state. Nations can adapt to a global economic environment only by providing knowledge assets that will attract foreign direct investment. For Canada, which has historically depended upon the MNC for the exploitation of its natural resources, such a public policy framework is even more vital for the transition towards a knowledge-based economy. In order to demonstrate that the alliance capitalism paradigm is indeed new, it is necessary to account for Canada's investment policy framework before the Liberal victory of 1993. The provision of a broad overview of the investment patterns that have occurred in Canada will provide a template against which the unique characteristics of the alliance capitalism paradigm can be compared.

The purposes of this chapter are straightforward. The first objective is to outline the amount, direction, and overall effect of investment flows into Canada that have occurred over time, and to adumbrate the government policies that have been designed to regulate those flows. A second purpose is to demonstrate the change globalisation has brought for trade and investment flows for both Canada and the world. Consequently, the chapter contains a section with numerous charts and statistics to illustrate the historical patterns of FDI in Canada, and general global investment and trade flows. The period under examination is that of the tenure of the Liberal government of Pierre Elliott Trudeau and later the Conservative government headed by Brian Mulroney. Both governments viewed the issue of foreign direct investment primarily in terms of its effects on domestic policy, and both crafted investment regulations designed to protect domestic policy interests. Both also crafted investment policies that were largely in keeping with the economic tenor of the times. However, for both governments other, more pressing economic issues made the issues of FDI less central. In neither case did the government make the attraction of FDI a specific priority of their economic policy and, in the case of Trudeau, measures were actually taken to restrict and control such FDI. Yet the process of global economic liberalisation had by the early 1990s brought important changes to the Canadian economic landscape. By the time of the Conservative defeat in 1993, many of the basic elements of alliance capitalism were in place, and the Conservatives had taken some preliminary steps in reforming their economic and investment policies. It would fall to the Liberal government of Jean Chrétien to complete that task.

The Inherited Legacy of FDI Policies in Canada

Much of Canada's investment policy outlook during the 1970s was coloured by the massive restructuring of the international economy that occurred in 1971. The effect of Nixonomics -- President Richard Nixon's economic program that eliminated the link between gold and the US dollar -- signalled the beginning of the end of U.S. post-war between gold and the US dollar -- signalled the beginning of the end of U.S. post-war economic hegemony. The voluntary relinquishment of American leadership over the international monetary system signalled an end to the predictable and stable financial architecture that formed the foundation of the post-war international economic system. The turbulence created by Nixon's policies was exacerbated by the 1973 and 1979 oil shocks, created by the increase in crude oil price by the Organisation of Petroleum Exporting Countries (OPEC). The rapid rise in oil prices threatened the developed world with economic "stagflation", and heightened the reliance on the Middle East for secure supplies of oil. This became an issue debated in national security terms. Adjusting to these twin economic shocks would occupy the efforts of most Western governments for the bulk of the ensuing decade.

The Canadian economy was not exempt from the need to adjust its economic doctrine. The burden of doing so largely fell to the Liberal government of Pierre Elliott Trudeau, which held power for nearly all of the fifteen-year period between 1970-1984. Trudeau's economic policy formed a key part of his overall governing vision, which stressed independence both in Canada's domestic and foreign affairs. Domestically, Trudeau believed that a strong and activist federal government was necessary to combat the increasingly regional and parochial political movements emanating from Quebec and sectors of the Western Provinces. Internationally, he followed an independent Canadian foreign policy. While Trudeau valued Canada's important international relationships, he also believed it necessary that Canada maintain the ability and willingness to take policy decisions that might be opposed the wishes of major allies, the United States and Great Britain. It was a belief that he quickly demonstrated.[1]

Trudeau was especially concerned with Canada's relationship with the United States. The growing interdependence[2] of the Canadian and American economies, while creating significant benefit, also held considerable risk for Canada, largely because the size of the American economy threatened to overwhelm Canada's economic independence and policy-making autonomy. The effects of the oil shocks and Nixonomics made this possibility particularly worrisome. The United States had shown willingness to take increasingly unilateral measures aimed at enhancing domestic economic interest, despite the potential international disruption. Trudeau perceived that an increasingly isolationist United States pursuing its unilateral economic interest would inevitably endeavour to cultivate diverse – and preferably nearby – sources of natural resources. Governing a resource-rich economy, Trudeau knew, would prove increasingly difficult in the face of American expansionist pressure.

This concern – combined with the desires for a strong and activist federal government – could be seen in Trudeau's policies towards foreign direct investment and the role it played in the Canadian economy. Upon assuming office, Trudeau assumed stewardship of a resource-dependent economy whose endowments were of increasing interest to its southern neighbour. As later tables will show, FDI in Canada during the 1970s was concentrated in the natural-resources sector. Foreign companies were particularly active in the pulp and paper, mining, agriculture, and oil and gas exploration industries in Canada, and their size and economic influence continued to grow. In an era in which continued economic prosperity appeared almost completely dependent on secure access to basic raw materials, the strategic base of Canada's resource endowments played an increasingly large role in government deliberations. Maintaining ultimate national control over Canada's strategic resource base became a policy priority in the early 1970s, as the strategic importance of oil supplies became imprinted on the economic policy of the developed nations.

Concern over the level of foreign involvement in the extraction of Canadian resources certainly did not begin with Trudeau. Such concerns had been expressed in the preceding decades. Two particular government inquiries into the nature of foreign involvement in the Canadian economy stand out. The first was the Report of the Task Force on the Structure of Canadian Industry, entitled "Foreign Ownership and the Strucuture of Canadian Industry." Informally known as the Watkins[3] report, it was commissioned by the Government of Canada in to review of the nature and scope of FDI in Canada, and released its report in 1968. The report noted the rapid increase in the level of foreign ownership and control of corporations operating in Canada, particularly in the manufacturing, petroleum, mining, and smelting industries.[4] It also demonstrated that the level of foreign indebtedness and foreign control of Canadian manufacturing assets had also risen considerably since the end of the Second World War. The report also noted with some alarm that

> the tendency inherent in direct investment to shift decision-making power in the private sector outside Canada has posed serious problems of those responsible for formulating Canadian policy, and has created widespread unease among Canadians as to the continuing viability of Canada as an independent nation state.[5]

The report included several policy recommendations that balanced Canadian competitiveness with the preservation of national autonomy. Moreover, it recognised that, in order for Canada to remain competitive, it needed to take continuous measures to improve its factors of production, such as improved management education and higher levels of R&D.[6] It argued that a special agency needed to be created that could co-ordinate existing government policies towards the MNC. It called for the strengthening of anti-monopoly measures and for fuller public disclosure of accounting information. It encouraged the government to "take positive steps to encourage Canadian ownership of economic activity", in ways that would "facilitate greater national independence and continuing economic growth."[7]

This document was followed four years later by another document that provided a critical examination of foreign direct investment in Canada. Informally labelled the Gray Report[8], it took particular note of the "miniature branch plant" characteristics of Canadian manufacturing subsidiaries. In this model, companies produce in their Canadian plants "most or all of the product range and the varied models as their parent, and which carry out these production activities using the same production techniques as the parent."[9] It provided a comprehensive analysis of the effects of FDI on Canadian industrial output, culture, and overall levels of economic activity.[10] It also offered a similar range of policy prescriptions. It noted that any policy initiatives providing for Canadian ownership across all or large parts of the economy would not "advance the broad objectives of the country." It argued that a "more effective means" of dealing with remaining problems "would be through flexible administrative intervention on a case-by-case basis", which would "be restricted to foreign controlled firms", and would be carried out "within the framework of well-defined industrial strategy."[11]

The conclusion of these reports served as warning against an overt reliance on foreign multinationals in the Canadian resource industry. The theoretical basis of such warnings was simple: the reports argued that MNCs controlled significant economic power in Canada, and that it was possible for host government policies to successfully extract associated economic rent and/or induce changes in MNC behaviour that would benefit the host country. The reports also concluded that much of the economic rent from such company operations was returned to head office coffers, and that Canada garnered comparatively little in return. Companies devoted almost no resources to research and development in Canadian plants, and their operations were geared almost solely to servicing the relatively limited demands of the Canadian market. Finally, the reports warned that the companies enjoyed a too-permissive policy framework that allowed them to operate with virtual impunity, reducing Canadian economic autonomy.

Trudeau's government took such economic advice to heart, and began to craft strategies that reduced overall company autonomy and increased the interventionist role of the federal government. Perhaps the two most significant policies were the establishment of the Foreign Investment Review Agency (FIRA) in April of 1974, and the inauguration of the National Energy Program (NEP) in 1980. FIRA instilled a critical review process on proposed investments, and placed strict limits on the terms of foreign take-overs of Canadian businesses and governance practices. It also placed maximum allowable ownership ratios on non-resident investors. FIRA established an agency that reviewed all acquisitions of Canadian assets by foreign companies and for every establishment of a new business in Canada by foreign-controlled entities. In the process of such review, agents of FIRA judged applicants according to the simple maxim of whether their proposed investment plan offered "significant benefit to Canada."

FIRA installed a consultation process with proposed investors in order to suggest ways in which potential investments could meet with regulatory requirements while still achieving profitability and return requirements. Broad criteria were established in order to guide FIRA regulators. These included an evaluation of the effect of the acquisition or investment on the level and nature of economic activity in Canada, the effect on competition among indigenous firms, and the acquisition's compatibility with the overall national industrial and economic polices of the federal government. As one report noted, "the negotiations surrounding the review process were ostensibly used by the government to try to leverage from foreign investors undertakings that would constitute benefits to Canada without necessarily making the investment unprofitable."[12] FIRA established a pattern of Canadian government interference in the foreign investment process.[13]

The National Energy Program marked the federal attempt to instil control over the strategic industries of oil and natural gas production. Three overall goals were established for the NEP. The first was to achieve at least a 50 percent Canadian ownership level of oil and gas production in Canada by 1990. The second was to increase Canadian control of a significant number of larger oil and gas firms. The third goal was to increase in the share of the oil and gas sector owned by the Government of Canada. Specific measures taken to achieve these goals included the changing of land rules on frontier regions that made Petro-Canada or another Crown Agency a 25 percent partner in oil and gas developments on such lands. A minimum of 50 percent Canadian participation was mandated from any production on Canada Lands. A new petroleum and gas revenue tax was introduced, and Petro-Canada was instructed to begin discussions with industry to negotiate the takeover of several foreign-controlled firms.[14]

The creation of program had a variety of motivations. It represented a strategic response of a major oil-producing nation to establish control over its energy reserves, which had assumed vital importance after the establishment of the OPEC cartel and the successive energy crises of the 1970s. Establishing increased Canadian control over energy in a turbulent international environment commanded broad public support that ensured the passage of the measure. It also signified the centralising tendencies of the Trudeau administration that desired greater overall federal control over national economic policy making. The provisions of the NEP were designed to increase Canadian control over the productive resources in the energy sector over the long term. Canada's major oil export market and most important strategic partner, the United States, did not warmly greet the NEP, and criticism of the NEP flowed from both business and political circles.[15] While there is no doubt that establishing the NEP was meant to enhance the domestic political goals of the Trudeau administration[16], its macroeconomic policy implications on the natural-resource based Canadian economy were certainly noted by potential foreign investors.

The establishment and continuation of such measures – FIRA in particular – led to several systematic attempts to clarify the net effect that the measures had on the level of FDI that occurred in Canada. Such investigations sought to determine how stringently were the investment criteria applied and whether nationalist investment policies deterred investment that otherwise would have occurred. Globerman and Shapiro's analysis – drawing on data provided in a series of FIRA annual reports -- illustrated that between 1976 and 1982, an average of 80 percent of the investments reviewed were eventually allowed.[17] Globerman also notes that the imposition of FIRA induced some potential investors to withdraw their application for review in the anticipated liklihood of it being rejected. While providing accurate figures on such withdrawals is difficult, Globerman and Shapiro estimate that 40 percent of the withdrawals in FIRA's early years were made in expectation of a disallowance.[18]

Economic analysis on whether FIRA substantially altered the pattern of FDI flow into Canada is decidedly mixed. An analysis by Globerman and Shapiro "found no evidence that FIRA affected capital flows in the aggregate."[19] They concluded that although FIRA may have discouraged some FDI projects, the overall impact was relatively modest. Moreover, it is not clear that the FIRA was able to extract significant economic rent from the investments that did occur. Their overall conclusion is that public policy attempts to extract favourable economic rent from FDI should be treated with a healthy scepticism, since "the determinants of inward FDI, as well as the net benefits at the margin, vary too much to allow policy makers to act efficiently as rent maximizers in either direction."[20] A second analysis by Kudrle that examined FDI inflows into Canada from the United States also found that the investment requirements of FIRA did not substantially alter investment patterns. He concluded that

> Those fearful that screening would deter substantial amounts of FDI would find some grounds for optimism. Performance requirements for foreign investors might be met without a substantial impact on the overall volume of FDI.[21]

Economic analysis that surrounded FIRA showed that its impact on the actual amount of FDI flow into Canada was relatively modest, but that Canada rarely accrued the economic benefits the FIRA was supposed to generate.

FIRA and the NEP, however, did generate considerable costs, primarily in the overall "chilling" of the investment atmosphere in Canada. The very existence of the NEP and FIRA increased transaction costs for investing firms and raised fears that even more stringent investment requirements would be set by an increasingly interventionist federal government. One spokesman for the American government stated the issue very clearly when he said, "the very existence of FIRA undoubtedly discourages many would-be investors".[22] The raising of uncertainty and political risk emanating from the policy decisions of the Canadian government could only be compensated by some other economic benefit, such as the potential for higher stock return or access to low-cost capital.[23] The effect of the uncertain investment climate is difficult to measure; it involves attempting to determine the extent and pattern of FDI flow had the restrictive policy measures not been in place. Nevertheless, it is clear that the perception of an increasingly restrictive investment policy "may have had a much greater impact on Canada's popular image as a host to FDI than on either the volume or profitability of investment."[24]

Foreign investment in Canada during the 1970s was characterised by several factors that induced suspicion of the MNC in the federal government. Most of the investment in Canada was either of the branch plant variety or was directely involved in extracting natural resources. Comparatively little R&D was done in these facilities, and mcuh of the economic rent garnered from such investment left Canada. Successive government studies had argued that MNC investment would garner additional benefit for Canada with the judicious use of government review. Moreover, the economic importance of oil and petroleum reserves had been demonstrated by the successive oil crises; consequently, maintaining sovereign control over these resources became a strategic priority that outweighed the particular economic benfits garnered from increased FDI. These characteristics convinced the Liberal government that investing MNCs deserved more suspicion than trust, and they enacted policies reflecting that belief. It was a perception that the Conservative government was determined to change upon taking power in 1984.

The Mulroney Administration – Investment Canada and Free Trade

The chain of events inaugurated by Brian Mulroney after his election victory in 1983 provided the Canadian basis for alliance capitalism. The creation of a North American regional trading arrangement through the successive free trade deals augmented the pattern of corporate rationalisation program that were slowly gaining momentum.[25] The free-trade agreements further encouraged firms to change their overall production strategies. By the end of Mulroney's tenure, the 'branch plant" interpretation of the Canadian economy no longer was valid; and Canadian subsidiaries found themselves competing for regional and global product mandates. The difficult adjustments required by the global economy augmented the severe economic recession in the early 1990s, which contributed heavily to Conservative electoral defeat in 1993. The economic re-structuring also eroded Canada's historic concern over sovereignty and cultural autonomy associated with high foreign participation level in the Canadian economy, to the point where explicit government cultivation of private sector partnership became both politically palatable and fiscally expedient. Such realities laid the foundation for the more explicit public and private sector co-operation featured in the alliance capitalism model; a foundation utilised later by the incoming Liberal government.

The Conservative government of Brian Mulroney began the initial process that transformed the Canadian investment climate from one of hostility to one of openness.

Mulroney inaugurated policy, procedural, and organisational changes within the machinery of the federal government that were conducive to the inflow of foreign investment. He would reiterate the importance of reducing trade barriers and increasing Canada's international economic interdependence. Federal funding for science and technology would increase, and monetary and fiscal policies were designed primarily to encourage investment and reinforce business activity.[26] Yet his government avoided any explicit arrangement of partnerships with large multinationals, largely because such partnerships engendered political cost and because they were thought unnecessary.

Mulroney's economic agenda is revealed through a reading of his government's successive Throne Speeches. Initially, there was little indication that investment issues would play a central role in Mulroney's economic policy. The first speech, delivered on 5 November 1984, outlined a three -pronged storage for economic renewal. The first was a commitment to reduce deficit spending. The second included a strategy designed to "improve the efficiency and flexibility of our capital markets ... and to increase investment in research and development to improve our productivity." The final commitment was to introduce "proposals to enhance risk taking, innovation, and reward among entrepreneurs, especially in the small and medium sized sector." Moreover, Mulroney stated that these goals required that Canada "stimulate both domestic and foreign investment", and that "My government is determined to regain Canada's reputation as a reliable and profitable place to do business." [27]

Economic priorities outlined in the Throne Speech of October 1, 1986 centred upon lowering trade and tariff barriers and the continued emphasis of Canada's legacy as a trading nation. Reiterating the generally positive economic conditions that existed at the time, the speech emphasised the need for prudent fiscal management, the need to reduce regional economic disparities within Canada, and a particular concern to lower interest rates and inflation. No direct reference to investment issues was made in the speech, save a brief reference stating the need to control "the increasing concentration of foreign enterprises" which utilised take-over and merger strategies "without creating new jobs or stimulating economic growth in Canada." One prelude to alliance capitalism was the announced intention to "forge a partnership with the provinces, with the scientific and educational communities, and with business and labour in an effort to stimulate increased technological development in Canada." The need to increase Canadian technological capability was recognised by the proposed creation of a National Advisory Board for Industrial Technology, comprised of leading industrialists, scientists, and public service officers. The Board's responsibility was to assess Canadian technological capacity with a view to increasing industrial competitiveness. Technological development appeared to be a crucial economic issue in 1986, one which demanded federal leadership and private and public-sector partnership.[28]

Mulroney's early efforts concentrated on erasing Canada's poor image as a host for FDI in particular and business in general. His prime objective was to reassure primarily the American business community that Canada was not only ready, but also willing, to court increased economic interchange between the two countries. Shortly after his election in 1984 Mulroney travelled to New York City, where in an address to the Economic Club of New York he stated

> The maturity and self-confidence of our country make it possible for us now to confront issues in a realistic manner, and to examine operations that a few years ago produced emotional reflexes that made rational

> discussion difficult. Nowhere is this truer than in the subject of our bilateral relations with the United States.[29]

A part of this economic maturity included the confidence that Canada could court increasing economic interdependence with the United States without risking its domestic sovereign authority or cultural autonomy. Increasing economic links involved lowering barriers to trade and increasing avenues for the promotion of FDI. Mulroney moved rapidly to do both.

Mulroney was particularly displeased with the international community's perception of Canada as an unpredictable host for foreign investment. In 1984 the World Economic Forum had ranked Canada last on its annual scorecard of competitiveness, and its survey of twenty-two advanced industrialised countries ranked Canada as the least hospitable to foreign investment.[30] Mulroney attributed this unimpressive ranking to the imposition of FIRA and the associated perceived uncertainty of the Canadian investment environment. In response, he proposed to overhaul Canada's investment review process, with a view to increasing foreign investment levels and to eliminate the negative international impressions of Canada.

The first indication of the Conservatives' intention to increase levels of FDI in Canada was the wholesale revamping of the Foreign Investment Review Agency. FIRA was renamed Investment Canada (IC) in June of 1985; and the changes made to the organisation were more than titular. Investment Canada's new mandate was to act as a conduit - rather than a hurdle - for the passage of FDI. While still nominally charged with reviewing investment proposals, the criteria by which those proposals were judged were altered, as was the established threshold that would trigger the review process.

Wording was changed. Potential investments no longer had to demonstrate a "significant" benefit to the economic fortunes of Canada, but merely had to show a "net" benefit. The act establishing IC raised threshold limits for members of this and other trade-liberalising organisations in which Canada was also a party. Previously, investments that involved the acquisition of a Canadian company with over $5 million dollars in assets was subject to review; now that limit was raised to $160 million. Investments falling below this limit merely had to file a notice of acquisition form. As one legal interpretation commented, "one of the stated purposes of the IC is to encourage investment in Canada by non-Canadians that contributes to economic growth and employment opportunities."[31] Such a statement indicates a strong re-orientation of the priority placed on investment that had been previously attached to FIRA.

Investment Canada remedied other FIRA shortcomings. Administrative costs and waiting periods for companies considering investment were shortened considerably. Under FIRA, there was no pre-set time limitation for the review of investment, and every case reviewed by FIRA was brought for cabinet approval. The process could literally take months, and generated an enormous administrative cost. Under Investment Canada, review of an investment proposal had to occur within 45 days of its submission. Rules of what constituted a "foreign investor" were simplified, and took greater account of the extent of Canadian ownership. The overall organisation of Investment Canada was revamped in order to pursue the objectives of increasing and promoting FDI in Canada, assessing the performance and conformance of investing companies, and reducing administration costs. Improving the perception and the reality of the Canadian attractiveness for FDI were integral parts of Mulroney's economic strategy.

The replacement of FIRA with Investment Canada marked a "watershed" in Canada's relations with foreign investors.[32] It indicated a realisation that continued foreign investment in Canada could no longer be assumed, and that it was necessary to compete for such funds. Much of Canada's investment history had been relatively stable; investment flowed primarily from American companies and was directed at the resource-intensive industries in which Canada held competitive advantage. The very predictability in the source and target of foreign investment had aided the creation of FIRA. The strategic nature of these industries -- particularly oil -- made it palatable to exert a measure of government control over their production. Moreover, the American dominance of the investment total meant that measures aimed primarily at limiting American power in the Canadian market held little risk of offending other potential investors in Canada. Yet, by 1985, those conditions had begun to erode. The cessation of the oil crises had weakened security arguments, and an increasingly international investment market – in which the American share still dominated, but was eroding – made the apparent economic costs of maintaining a review agency too great too bear.[33] The passing of the Investment Canada Act "went beyond minor adjustments and fine tuning. It marked a philosophical transformation about the relationship of foreign investment to the economy."[34]

Reaction from American investors to the passage and operation of Investment Canada was generally positive, but many American investors still held reservations about the investment climate in Canada. The scrapping of FIRA was greeted with applause, but many hindrances and uncertainties appeared to remain. Many American investors expressed continued reservations about the remaining provisions for investment screening, including the possible imposition of performance requirements that would hinder a firm's decision making independence in terms of employment, suppliers, exports, and research and development expenditures. Further concerns were expressed that the "investment policies of Ottawa and the provinces distort trade flows between the two nations."[35] For example, Canadian investment funds to foreign automakers were charged with distorting auto-investment flows.[36] Provincial trade barriers were cited as a remaining impediment to investment flow. Washington contended that further progress on trade liberalisation would depend on progress in these areas, but that the establishment of Investment Canada was a positive step.[37]

The Throne Speech delivered on April 3, 1989 indicated both the continuation of previous policies and further indications of the shift towards alliance capitalism. Continued emphasis was placed on efforts to reduce tariff and trade barriers. The need to emphasise Canadian exports – particularly to Europe and the Asia/Pacific region – was reiterated, as was the commitment to regional development through regional economic agencies. The Advisory Board on Science and Technology had made several policy recommendations, and a commitment was made to turn those recommendations into practice. One such commitment was the creation of a "centres of excellence" program, "for the development of strategic technologies such as biotechnology, advanced industrial materials, and information technology." The emphasis on such technologies indicated a desire to shift Canada' industrial base towards industries requiring a high skill and knowledge base.[38] Once again, no direct reference was made to issues of investment; however, it was noted that an increasingly liberal trade environment had allowed companies to create "world-scale plants" to take advantage of larger regional and global markets.

By 1991 the necessary policy responses to the realities of a global economy were beginning to emerge. Tentative steps had been taken to increase the level of collaborative federal partnerships with primary wealth-producing constituents. The reality of the need to compete globally on knowledge – rather than on a resource-intensive – basis had been acknowledged, and measures had been proposed to make the necessary adjustments. Mulroney's government implemented some of the actions recommended by alliance capitalism. Yet there was still a considerable amount of evolution to occur. Government co-operation in the field of science and technology had been assured, but there was no direct emphasis on partnership with the private sector. Economic policies remained tied to the need to reduce interest rates and control inflation; courting investment meant changing aspects of the regulatory regime and little else. However, the primary economic achievement of the Mulroney government – the inauguration of the free-trade negotiation process, which eventually led to the Canada-U.S. free-trade agreement (CUFTA), the precursor to the North American Free Trade Agreement (NAFTA) – would engender great change in the Canadian industrial landscape. Adapting to those changes would be the primary economic task of the Liberal government, a task for which alliance capitalism was well suited.

The Free Trade Agreements

The drive to increase Canadian economic interdependence with foreign investors - in particular the United States – continued with Mulroney's efforts to negotiate a free-trade agreement between Canada and the US.[39] Initiating and concluding a free trade-agreement with the United States rapidly become the centrepiece of the Conservative economic and foreign policies. Despite bilateral trade figures that dwarfed those of any other two-country relationship in the world, the Canada-U.S. trade regulatory environment still suffered from considerable tariff and regulatory barriers. Reducing such barriers – preferably in a comprehensive, trade agreement – would contribute to the interests of both countries.[40] In Canada, such an agreement would be in keeping with the "gradual movement by successive Canadian governments towards free trade."[41] For the United States, such an agreement might serve to reaffirm its long-term commitment to the principles of free trade, a commitment that would prove useful in the emerging U.S.-Japan trade disputes occurring at the time.

For the Mulroney administration, the decision to press for a free trade agreement with the United States emanated from the conclusions of the Macdonald Commission, which had undertaken a massive study of the present state and future prospects of Canadian economic development. The Commission had concluded that pursuing an increasingly open trading relationship with the U.S. would garner considerable economic benefits for Canada and was in fact necessary if Canada was going to maintain its economic strength. The Commission also recommended that Canada continue to press for multilateral tariff reductions through the successive negotiating rounds of the General Agreement on Tariffs and Trade. It rejected the use of import substitution policies or the imposition of excessive tariffs to protect Canadian industry. Finally, it also recommended that "the Government of Canada .... Open negotiations with the Government of the United States to reach an agreement on a substantial reduction of barriers, tariff and non-tariff, between Canada and the United States."[42] The commission encouraged the continued liberalisation of the Canadian economy.

The Conservative government believed that the creation of a free-trade agreement would serve Canada's interests in several ways. The institutionalisation of bilateral free-trade rules would reinforce Canada's long-standing commitment to a liberal trading environment. The dispute settlement mechanism that the document would inevitable contain would mitigate some of the effects of the overwhelming U.S. economic power. It would help in eliminating the "boardroom prejudices" of many U.S. corporations, which resulted in tendencies to automatically utilise American partners for their shipping, marketing, and service needs. Finally, it would force the upgrading of many sectors of Canadian industry that had up until that point competed in a Canadian environment that was sheltered by high tariffs. While it was acknowledged that some sectors of the Canadian economy might not withstand American competitive pressure, it was thought that exposure to such pressure would force Canadian industry to upgrade.[43]

The nominal thrust of the free-trade effort was to lower the remaining trade barriers that still existed between the two countries, thereby facilitating greater economic flows. While the agreement did not focus on investment, it was widely acknowledged that lowering trade barriers would have significant implications for Canada's net investment position. Investment theory had argued that firms often use direct investment in a foreign market to circumvent trade barriers.[44] However, this action engenders transaction costs that must be compensated in terms of a higher profit and return potential emanating from the foreign market. Theoretically, lowering trade barriers may reduce investment, as indigenous US companies would prefer to export domestically produced products rather than manufacture them in Canada. However, it was also expected that a free-trade agreement would engender more robust economic growth over the long term; as GDP increased, so would the available capital for foreign investment. Consequently, free trade was expected to raise overall American investment levels in Canada.

The investment provisions that were part of the CUFTA and NAFTA agreements focused primarily on ensuring national treatment for foreign investors. Chapter 16 of the CUFTA agreement, for example, stated that "except as otherwise provided ... each Party shall accord to investors of the other Party treatment no less favourable than that accorded in like circumstances to its investors ..." This provision applied primarily to the establishment of new enterprises, as well as the acquisition, conduct, and sale of current enterprises.[45] The ability to impose minimum equity participation by nationals or to demand national participation at senior management levels or on governance boards was also prohibited. Eliminated also was the mandate to impose performance requirements on investing firms. In effect, investors could no longer be required to source a certain percentage of their components from domestic firms, nor could governments mandate that any percentage of production be earmarked for export[46], and, in the case of disputes, a binational arbitration panel was established.

Canada did retain some of its regulatory capacities for reviewing foreign investment. The mandate of Investment Canada, for example, remained unchanged, although reviewable limits of investment and acquisitions were raised. Article 1608 of the CUFTA stated that "a decision by Canada following a review under the Investment Canada Act .... shall not be subject to the dispute settlement provisions."[47] The review thresholds for Investment Canada were raised: review for a direct acquisition of a Canada business for the first year after the commencing of the agreement was triggered at the $25 million (Cdn,) threshold, the second year threshold was $50 million, the third $100 million, and the fourth $150 million.[48] Review thresholds for indirect acquisitions of Canadian businesses were eliminated over a four-year time frame. The agreement also explicitly stated that "nothing in this Chapter shall affect the rights and obligations of either Party under the *General Agreement on Tariffs and Trade*"[49], indicating that the signatories wished the agreement to be seen as a regional complement to a global free trade and investment regime. The signing of the agreement was thought to be part of the wider objective of further liberalising international trade and investment flows.

The NAFTA agreement followed suit in many respects. Chapter 11 of the NAFTA continued to extend no less favourable treatment to non-national investors; the prohibition of performance requirements, national equity ratios, and governance requirements were extended to the NAFTA agreement. In effect, under the NAFTA investment regime the participating countries could not as a rule legally distinguish between foreign and national business operations. Canada's capacities to review investment remained present in the NAFTA accord with the same schedules and provisions.[50] Some restrictions remained in the agreement, restrictions designed to recognise the particular industrial concerns for each country. For Canada, restrictions remained on investment in the transport, cultural, and social service industries, while the national-security concerns of the United States, and Mexico's desires to retain sovereign control over petroleum, were also recognised.[51]

U.S. legislators scrutinised the investment provisions of the NAFTA agreement with greater attention then they had those of CUFTA. They feared that the expansion of the agreement to include Mexico would induce a number of productive enterprises to flee the U.S. in search of comparatively low-cost Mexican labour. They also insisted that the agreement contain stern rules-of-origin provisions, in order to prevent non-signatories from evading U.S. tariff schedules by establishing plants in Mexico that merely assembled parts prefabricated outside the North American region.[52] The regulatory requirements, however, remained largely similar to those established in the earlier CUFTA agreement.

Both the CUFTA and NAFTA trade agreements would hold-long term and irreversible implications for the North American economic environment. They created a region-wide free trade area that facilitated the relatively free flow of goods and services across the participants' borders. Many tariff and duty measures were reduced if not eliminated. While important restrictions on trade and investment remained even after the ratification of the agreements, the overall effect was nevertheless extraordinary, particularly in the fields of multinational strategic management and government policy towards industrial development. The CUFTA agreement in particular would have very different implications for Canadian-based multinationals in comparison with their American counterparts, especially combined with the effects of an increasingly global economy.

For Canadian multinationals, the creation of the free-trade agreements necessitated strategic changes in which the cultivation of the American market received top priority.[53] The strategy of relying on a protected Canadian base – which had been become increasingly untenable since the conclusion of the Tokyo round of tariff negotiations -- now had been rendered bankrupt. No longer could such firms depend upon an established Canadian base that was largely protected from American competition, from which to finance their own international efforts. Competition in Canada would become more intense, as larger American companies could bring their scale advantages to bear on the servicing of the Canadian market. Conversely, only an aggressive entry into the American market would spell the key to Canadian MNCs continued prosperity. Competing successfully in the American market would necessitate the development of a "national responsiveness"[54] capability, requiring the adaptation of products designed specifically for the needs of the American market and cultivating appropriate distribution and marketing channels. For American multinationals – who had accumulated experience about operating in Canada through the earlier management of "branch" plants designed solely to service the Canadian market – the free-trade agreements allowed them to integrate their respective production sites into a cohesive regional production network. This placed additional competitive demands on their Canadian facilities, which were charged with improving their competitive and productive level to that commensurate with the most advanced American production plants. The need for such firms to develop a national-responsiveness strategy for the Canadian market was less pervasive, due to the inherent size discrepancies of the two national markets. The CUFTA and NAFTA agreements mandated strategic changes in Canadian multinationals and raised the overall competitiveness of the North American region.

Commentators on the CUFTA agreements and its NAFTA follow-on speculated on the effect they would have on MNC strategy, particularly in the areas of plant location and production mandate. Raymond Vernon focused his commentary on the locational decisions of U.S. based multinationals, and noted that "with the introduction of the

NAFTA ... many U.S. based multinationals can be expected to consider whether to alter the existing functions of a Canadian or a Mexican subsidiary". Such alternations would likely involve "abandoning the production of some product lines in the subsidiary or by expanding its output at the expense of other production units in the network."[55] The inauguration of the free-trade agreements allowed firms to adopt production strategies to take increasing advantage of economies of scale. Investments made in either Canada or Mexico that were designed primarily to evade tariff walls and service the local market would be in danger of closure once tariff barriers were removed. Plant locations would be evaluated almost entirely in terms of business cost; the evaluation of the risk of government intervention would drop in the MNCs decision calculus.

Other economic evaluations of the free trade agreements indicated that specific agglomerations of business activity - the "clustering" phenomenon - would be more likely to occur, and that participation in such clusters would depend upon specific competitive advantages. The development of knowledge-based technologies was noted to have particular effects on the investment patterns of medium sized developed economies such as Canada. Companies within these countries could enact prosperous niche strategies that utilised specific human capital capabilities.[56] Moreover, trade liberalising agreements contributed to the decentralisation of research and development, and the specialised demands of local markets, the geographic availability of human capital, and the need for product development capacity near customers all contributed to the decentralisation of product development.[57] Eaton, Lipsey, and Safarian argue that government policy in such an environment should focus on getting "background conditions right", including policies that emphasised human capital, competitive factor prices, and favourable tax regimes. After creating this background, government should then let industry determine specific trade and investment flows.[58]

Further recommendations for Canadian economic adaptation emanated from the academic community. In 1991 the Canadian government commissioned Michael Porter to analyse the Canadian competitive environment, and his conclusions would have significant impact on the economic thinking of the Mulroney government.[59] Porter's recommendations were largely similar to the ones that he had put forth in his seminal work The Competitive Advantage of Nations and some of his earlier works. He argued that Canadian firms needed to concentrate on the development of cost, differentiation, or product niche strategies based on the Canadian competitive "diamond" outlined in chapter four. He noted that Canada possessed many intrinsic economic advantages – including cheap access to plentiful natural resources, a well-educated populace, and a strong industrial base – but that these advantages would be eroded unless specific policy steps were taken to nurture them. His report had many recommendations and warnings, including the following:

> Freer trade and greater globalisation of competition will cause multinationals to re-examine their Canadian operations. Branch plants whose sole *raison d'être* has been to serve the Canadian market will relocate if their productivity does not match or exceed operations elsewhere. Multinationals will also face choices about where to make investments in new skills, new technologies, and new product lines that will be governed by whether or not the Canadian environment is conducive to innovation and productivity growth.[60]

The Throne Speech delivered on May 13, 1991 indicated that Porter's recommendations had made an impact. Investment was praised as a creator of jobs, and the cultivation of it was announced as a partial remedy to the lingering recession. The speech linked Canadian economic prosperity directly to the successful participation in a global economy. Such participation demanded capabilities that could "compete with the best, by giving ourselves the economic conditions we need to be competitive and by making world markets accessible to our products." For Canada, successful competition in the global economy was becoming "more and more a factor of knowledge, skills, and innovation", and primary competitive risk was "not to be undercut by developing countries with low-wage economies but to be outperformed by technologically advanced countries with highly paid, skilled workers." Successful competition demanded increased productivity, and that in turn required "the collaborative efforts of governments, business, labour, and individual Canadians in all regions." The Throne Speech outlined the intention to create a national strategy for learning, to enhance skill and knowledge levels at all levels, arguing that "the time has come to reach a national consensus on performance, goals, partnerships, and priorities for learning."[61] Emphasis on investment, competitiveness, and partnerships could be found in the public statements emerging from the latter stages of the Mulroney government.

A second indication of Mulroney's increasing willingness to work in co-operation with the private sector was the institutionalisation of private sector consultations through the establishment of the Sectoral Advisory Groups on International Trade (SAGIT). Such groups were composed of industrial representatives from various sectors who worked in an advisory capacity with the federal government by providing industrial trend and market analysis, technology recommendations, and general industrial expertise. While such sectoral consultations had in fact existed in ad hoc form for many years, their increasing relevance to Canadian economic policy led the Mulroney government to institutionalise the consultative arrangements.[62] A second example was the establishment of the International Trade Advisory Committee in the spring of 1992. ITAC was designed to provide the formal trade policy bureaucracy with outside analysis and briefing documents which outlined some of the broader challenges Canadian trade policy would face after the conclusion of the Uruguay negotiating round of the General Agreement on Tariffs and Trade. Contributors to the ITAC were drawn from academia, the government, and industry.[63] The wide range of expertise consulted indicated the degree to which trade policy could potentially affect other areas of Canadian economic and social policy.

Alan Rugman provided additional analysis. Rugman disagreed with some key characteristics of Porter's model. He argued that the Canadian marketplace was too small for an indigenous diamond; consequently Canadian firms needed to integrate their efforts with larger American networks in a bi-national "double-diamond" approach. However, Rugman agreed with Porter in emphasising that Canadian firms could no longer rely on strategies based on maintaining a sheltered Canadian base. Not only did the specific provisions of CUFTA and NAFTA prohibit such national sheltering, but such a strategy was also debilitating over the long term because it prevented firm from taking the organisational and innovative measures necessary to stay competitive globally.[64] Rugman went on to argue that competitive success for Canadian firms depends upon developing firm-specific advantages that are not limited to the Canadian market but can be readily adapted to the American market. He noted that, despite the comprehensive free-trade agreement, important restrictions still applied to Canadian firms operating in specific sectors in the American market, particularly those in defence and security-related industries. Overcoming these restrictions required direct investment into the United States. Rugman bluntly concluded that

> to remain internationally competitive Canadian firms need to have access to the U.S. market, and if their access by exports is threatened they must achieve access by foreign direct investment and maintain the viability of such U.S. operations by an on-going strategy of national responsiveness.[65]

Meeting those competitive challenges would not prove an easy task. The industrial restructuring that took place in the Canadian economy in the late 1980s and early 1990s shattered traditional operating paradigms in Canada. A much more competitive domestic and global operating environment forced firms to re-evaluate their overall production processes with the goals of reducing inefficient practices, focusing on core competitive strengths, and contracting out non-core and supporting activities. The techniques utilised to make these competitive changes – such as "downsizing", "re-engineering", and "total quality management" – resulted in reduced overall bureaucracy and middle-management levels while raising demand for workers engaged in information-technology. In Canada, such re-structuring efforts were particularly prevalent in the service-related industries such as finance, insurance, and real estate[66], while manufacturing re-structuring efforts were comparably less prevalent.[67] These efforts engendered considerable demands on the Canadian workforce to upgrade its primary skills capabilities in an effort to raise overall firm productivity.

Lorraine Eden concurred that, in the wake of the NAFTA agreement, country-specific advantages (CSAs) would become more important in the attraction and retention of MNC activity. She believed that the wholesale flight of manufacturing operations to low-wage Mexico was unlikely because the wage component of manufacturing costs was decreasing. Firms were increasingly attracted to particular CSAs that emphasised knowledge and technological sophistication. She also argued that large U.S multinationals were best positioned to take advantage of the liberalised trade and investment regime created by the CUFTA and the NAFTA.[68] She noted that a combination of industrial and firm specific advantages – combined with the strategic decisions of large MNCs to develop a network strategy within the three regional economic blocs -- meant that such firms had the most freedom to relocate and re-configure their operations. She noted further that NAFTA would "induce substantial rationalisation and possibly some downsizing of U.S. majority owned foreign affiliates both inside and outside North America."[69]

Such conclusions would have important implications for Canadian federal industrial policy. The scope for the Canadian government to place restrictions of foreign firms operating in the Canadian market had been considerably reduced by the CUFTA/NAFTA agreements. Moreover, academic evidence argued that such restrictions ultimately hurt Canadian prosperity because they encouraged archaic business practices in indigenous firms, and the restructuring of industrial practices, however painful, was necessary to induce competitive upgrading of indigenous skills and capabilities. Moreover, government had a new and different role to play in the North American -- and increasingly global -- economic environment. Instead of sheltering industries, government's role was to craft policies designed to aid firms in making necessary competitive adaptations and to help create a technologically skilled workforce. Such competitive recommendations would play an important role in the waning years of Mulroney's government.

Those policies, however, had not engendered the economic prosperity that Conservatives had hoped. The economic situation in Canada in between 1990-1993 was at best recessionary, and it hit the manufacturing sector particularly hard. Growth in gross domestic product was slow: in 1989 it measured 650.75 billion dollars (Cdn.), in 1990 670.95, 1991 675.93, and 1992 688.54.[70] Production in crude steel, commercial vehicles, and passenger cars all dropped between 1989-1992; production of crude oil and natural gas – mainstays of the country's resource sector – were up only marginally.[71] Federal deficit spending continued and federal debt levels rose; the latter topped $500 billion dollars by the time of the 1993 election. Most importantly, the unemployment rate had risen steadily during the entire previous 4-year period: measuring 7.5 percent in 1989, 8.1 percent in 1990, 10.3 percent in 1991, and 11.3 percent in 1992.[72] While these mediocre economic statistics could be partially ascribed to the long-term adjustments costs of the free-trade agreements – and were even predicted as inevitable by some of the agreement's biggest enthusiasts -- that alone could not prevent a scathing judgement from the Canadian electorate over the Conservative management of the national economy.

The Liberal Election Victory of 1993

"Jobs, Jobs, Jobs." It was by this relatively simple mantra that the federal Liberal Party of Canada, led by Jean Chrétien, defeated the incumbent Conservative government of Kim Campbell in 1993. Simple or not, the objective of improving Canada's economic conditions became the primary test by which all ensuing federal government action would be judged. Moreover, it was hardly a secret; the Liberals had made the improvement of economic conditions their primary policy tool for recruiting undecided voters in the election. The famous "Red Book', the policy document issued by the Liberal party that purported to outline what the party would do with the reins of power, had stated quite plainly that "a strong economy is the essence of a strong society. A Liberal government will put jobs and economic growth at the forefront of its objectives."[73] Part of the strategy was to establish a governmental role in economic policy that mirrored the recommendations of alliance capitalism:

> The role of government policy is twofold: to establish the overall framework, which included monetary and fiscal policy, federal-provincial fiscal relations, and trade policy; and to work in partnership with provincial governments, business, labour, and non-governmental institutions to achieve national economic objectives.[74]

Partnership and economic renewal were the platforms of Liberal electoral success in 1993; they resulted in an eventual overwhelming Liberal victory and reduced the previous governing party's share of seats in the House of Commons from 153 to 2.

The Liberal challengers, however, had their own image issues to deal with. While sensing that the weak Canadian economic performance would lessen the Conservative's chances for re-election, the Liberals realised that they were still perceived as a party that would increase tax and expenditure levels far beyond even the current unsustainable rates. Combating this perception became a key element in pre-campaign and election strategy. Consequently, they rapidly adopted a public stance calling for "an activist government in an era of limited resources", one which could "strike a balance between fiscal responsibility and social activism."[75] One of the first public commitments was to introduce a three year deficit reduction target of 3 per cent of Gross Domestic Product (GDP), and one observer noted how much of Chrétien's pre-election strategy consisted of "slamming on the spending brakes" on new expenditures.[76] Deficit reduction strategies -

publicly palatable as the size of the federal debt continued to expand - became an important campaign issue.

Despite the obvious commitment to deficit and spending reductions, early campaign releases indicated that the Liberals intended to play a larger role in the national economy than had the Conservatives. Proposed policies along this line included the creation of a special fund for infrastructure development, as well as easing credit restrictions for small businesses, particularly those working in emerging and high technology industries.[77] Most importantly, an elected Liberal government would create an investment fund that would work in partnership with banks and other lending institutions to increase the access to capital for high technology industries.[78] Finally, as early as August 17, 1993 Paul Martin stated bluntly that "the driving purpose of the national government is, first to create jobs and, second, to change the economic culture of Canada. We need to make the transition to an innovation-driven economy."[79] The Liberals clearly envisioned an activist stance in encouraging specific types of industries and technologies within Canada.

Incumbent Prime Minister Kim Campbell responded with a painful economic prognosis that did not contain electoral appeal. She publicly reiterated her commitments to a zero deficit, no new taxes, and low inflation[80], and argued that the maintenance of such polices would eventually engender the much-needed jobs. However, she accompanied this policy platform with warnings that Canadians could not expect too much too fast, and that she predicted that the jobless rate would not drop significantly before the end of the century.[81] Her criticism that Chrétien's program represented nothing more than the traditional – and expensive – Liberal proclivity for government interventionism -- did not resonate. She did not offer any immediate solutions or programs designed to lower the unemployment rate, while the Liberals promised the inauguration of a national infrastructure program that, however expensive, would nevertheless create thousands of jobs. Campbell vowed she would continue to encourage the Bank of Canada to maintain an anti-inflationary monetary policy; this compared poorly with Chrétien's promise to change that policy to one more directed at creating jobs.[82] The promise of jobs aided the Liberal victory. Such comparisons did not bode well for the Conservative leader.

The Conservative government had made fundamental changes to the Canadian policy frameworks that were designed to encourage business development and investment. Such measures – combined with the larger global economic liberalisation discussed in earlier chapters – brought painful change to the Canadian economy. The degree of these changes can only be evaluated by examining the broad patterns of investment, trade, and corporate activity occurring during the previous 15 years. The following section is designed to provide the reader just such an overview.

Trade and Investment Patterns, Canada and the World, 1980-1998

The thesis contends that the process of economic globalisation has altered the relationship between the firm and the state. Globalisation features structural changes in the international economy that accord more freedom to the MNC and which demand different actions from host governments. These realities have caused shifts in the pattern and type of industrial production which, when combined with the ensuing strategic choices of large multinational corporations, have meant that government must adopt a more collaborative relationship with their domestic economic constituents. This relationship is one that emphasizes partnership and collaboration in the pursuit of overall industrial objectives. In order to substantiate this argument, it is necessary to document some of the major trends in global trade, investment, and production that are statistical indicators of the globalisation process. This section will draw upon trade and investment date to demonstrate both the particularities of the Canadian case as well as the generalities of the global condition. Statistical sources are noted either at the bottom of the table or in accompanying endnotes.

Global Investment Patterns

The single most striking characteristic of global FDI flows is the increase in absolute dollar figures occurring over the past decade. Between 1986-1990, the annual increase in total global FDI flow averaged 23.6 percent; between 1991-1996, average annual inflow of global FDI grew at a rate of 20.1 percent. FDI outflows for the same periods also showed impressive growth. FDI outflow between 1986-1990 averaged 27.1 percent; and between 1991-1995, it averaged 15.1 percent. Absolute levels of FDI inflow totaled $338 billion (U.S.) in 1996 and $400 billion in 1997, while absolute levels of FDI outflow measured $333 billion in 1996 and $424 billion in 1997.[83] The following table indicates the level and degree of increase of total FDI flow:

Table #2 -- Total Global FDI Inflows, Outflows, Selected Years ($Billion U.S.)

Year	1983-1987	1988-1992	1993	1994	1995	1996	1997	1998
FDI Inflow	77.1	177.3	207.9	225.7	314.9	338	400	430-440*
FDI Outflow	76.8	208.5	225.5	230.0	317.8	333	424	430-440*

Source: UNCTC, World Investment Report (New York: United Nations, Various Annual Issues).
**-- projected.*

The growing levels of FDI are accompanied by a greater MNC dependence on the activities of its foreign affiliates. The differences between FDI inflow and outflow totals is accounted for by the phenomenon of reinvested earnings, many MNCs are electing not to repatriate the profits of such affiliates but are instead reinvesting them in the local market to expand and upgrade operations. Sales of goods and services by foreign affiliates -- estimated at $9.5 trillion in 1997 -- are growing at a faster rate than are worldwide exports of goods and services, which amounted to $6.4 trillion in 1997. During the early 1980s the ratio of sales of foreign affiliates to world exports was 1.1; in 1990 it was 1.2, and by 1997 the ratio was 1.5.[84] Firms are increasingly servicing foreign markets through foreign affiliates rather than by country to country trade.

The model of a "branch plant" subsidiary, moreover, is no longer accurate. Today's foreign affiliates do much more than simply replicate established manufacturing practices and product lines from the home base. They are, rather, integral components of a firm's global technology network: they are as likely to export research and product development to the head office as they are to receive it. Central head offices, moreover, expect each node of their international production network to contribute to product development, particularly in design and production modifications needed for the local market. Receipts and payments for royalties and technology licensing fees are an admittedly imperfect measure of the level of technology import by foreign affiliates – yet their value is nevertheless increasing at double-digit rates, and intra-firm technology transfers dominate such transfers. Such technology transfer has become a primary method of upgrading the technological capacity of a nation's economy, because

> Transnational linkages between firms have become more important in acquiring and upgrading technology over the years because foreign affiliates have, at least in principle, access to their parent companies' R&D facilities and indeed to those of their entire corporate networks.[85]

Moreover, technology transfers have not been limited to intra-firm transfers alone. Technology transfers between independent firms are also growing. Agreements to share technological developments or production knowledge have increased from an average figure of around 300 in the early 1980s to over 600 in the mid 1990s. Roughly 650 such agreements were recorded in 1996.[86] Firms are more willing to exchange technological developments with their affiliates and with their strategic partners.

The patterns of technological transfer and technological partnership are due mainly to the competitive challenges accompanying the process of globalisation. More demanding customers and an increasingly liberal environment ensures that even local firms will face global competition. In response, many firms are choosing to concentrate their activities in a few areas in which they possess unique capabilities. After defining these "core competencies" such firms become increasingly reliant on cultivating a strategic network of associated firms which can supply the needed expertise at other stages in the value chain. Often they enter into strategic alliances with such firms that often include provisions to share technology or product development knowledge.[87]

Other strategic practices have accompanied the process of globalisation. For example, the human resource strategies of the most advanced global firms also act to facilitate knowledge transfer. Many such firms sponsor informal seminars and regular firm conferences designed to facilitate knowledge transfer between diverse production networks. Such firms also have invested heavily in management information systems that allow the rapid transfer of data. In a global firm, senior managers often must have several international assignments before they achieve executive level, which heightens their awareness of the strategic problems of international business. Product development teams are drawn together from diverse production sites to share knowledge and innovation practices. One of the central competitive advantages of the modern MNC is its ability to rapidly diffuse production, marketing, or innovation capabilities rapidly throughout its network. Firms that cannot tap the advantages of their global network are at a competitive disadvantage to firms that can.[88]

Not surprisingly, national governments have become more eager to cultivate additional FDI, largely to accrue the technological benefits it often brings. The intentional liberalisation of the domestic investment regime has been a consistent trend in most states, especially with the conversion to liberal economic practice in former Communist states. The following table demonstrates the current drive to liberalise domestic national economies.

Table #3 – Regulatory Changes in National Investment Policy, 1991-1996

Year	1991	1992	1993	1994	1995	1996
Number of countries introducing changes in investment regimes	35	43	57	49	64	65
Number of changes in direction of liberalization	80	79	101	108	106	98
Number of changes in the direction of control	2	-	1	2	6	16

Source: UNCTC, World Investment Report (New York: United Nations, Various Issues).

Trade Patterns – Canada

The overall statistical economic pattern of Canadian trade over the past decade and a half is in general agreement with the processes of globalisation and alliance capitalism. In absolute terms the level of Canadian trade, and its relevance to the Canadian economy as a whole, have risen substantially. In 1985 Canada's total exports were valued at $136 billion; in 1990 that number reached $174 billion, and by 1997 it reached $345 billion, almost doubling its 1990 value. The following table demonstrates the overall pattern of Canadian exports in goods and services since 1990:

Table 4 – Canadian Exports and Imports of Goods And Services ($ Billions)

	1990	1996	1997
Goods:			
Exports	152	280	301
Imports	141	238	277
Balance	11	42	24
Services:			
Exports	22	40	42
Imports	33	49	40
Balance	-11	-9	-8
Goods & Services:			
Balance		33	16

Source: Statistics Canada.

The share of Canada's GDP that is dependent upon trade has also increased. In 1990, exports of goods and services were measured at 25.9 percent of Gross Domestic Product (GDP); that percentage rose to 40.2 percent by 1997. The importance of imports also rose dramatically; in 1990, overall imports measured 25.8 percent of GDP, and by 1997 that figure had climbed to 38.5 percent. The overall importance of trade to the Canadian economy is demonstrated by comparing these figures with those of the United States and the cumulative average of all the Group of Seven (G-7) industrialized countries. In 1990, exports and imports comprised 9.7 percent of the U.S. GDP and an average of 15.4 percent for the G-7 nations; in 1997 those figures measured 11.9 percent and 17.6 percent respectively. Imports told a similar story; in 1990 imports totaled 10.9 percent of the U.S. GDP and 15.5 percent of the G-7; by 1997 those figures had risen only marginally to 13.1 percent and 17.2 percent respectively. The importance of trade to the Canadian economy – especially when compared specifically with the United States and generally with the G-7 – is hard to overstate.[89]

The composition of Canadian trade has reflected the overall industrial restructuring occurring in Canada since the mid-1980s. Overall percentages of specific industry exports revealed a movement away from natural resource processing. The following table reveals some of the percentage changes in particular export industries:

Table 5 – Distribution of Canada's Exports By Industry (Percentage: Selected Years)

	1985	1990	1997
Services	19	13	12
Automobiles	24	20	20
Machinery & Equipment	13	17	20
Forestry	11	12	10
Crude Petroleum and Other Energy	12	8	8
All Metal	9	10	8
Agriculture and Fishing	7	7	7
Others	14	14	16

Source: Industry Canada, Micro-Economic Analysis Branch, A Report Card on Canada's Trade and Investment Record, Volume 5, (Special Issue), 1999, p. 5.

A recent study by Industry Canada, noted that the combined high-value added industries – such as computer equipment and pharmaceuticals – are composing a larger percentage of the Canadian economy, while the percentages in the natural resource sector are generally decreasing. The study subsequently concludes that "Canada's industrial structure is becoming increasingly knowledge-based and technology-intensive, with its competitive advantage rooted in innovation and ideas".[90] According to Industry Canada, Canadian trade composition has mirrored that trend. They argue that "Canada's exports have moved up the value added chain"[91] and that, especially over the 1990s, Canada's export structure has shifted toward high value-added items. They argue that overall trade balances in particular industries demonstrate this point. Raw materials and semi-finished goods processing, for example, continue to post increasingly positive trade balances but compose a smaller portion of the overall trade figures. In trade areas in which Canada has traditionally run a deficit – particularly in the service sector – deficit levels have either stabilized or have been reduced. According to Industry Canada this implies "a consolidation of the industrial structure of merchandise trade balances: sectors traditionally enjoying trade surpluses have run increasingly large surpluses, while the reverse is true for sectors generally showing trade deficits."[92]

The direction of Canada's exports and imports remains overwhelmingly dominated by its relationship with the United States. Overall trade with the United States as a percentage of total trade levels has steadily increased over the preceding fifteen years, and between 1990-1997, the annual amount of Canada's exported goods and services that were bound for the United States increased seven percentage points to reach roughly 80 percent. The U.S. share of Canada's total imports rose from 69 percent in 1990 to 74 percent in 1997. Canada's share of G7 exports to the U.S. market rose from 33 percent in 1987 to 41 percent in 1995. Moreover, much of this increased growth has focused on high growth sectors that have a significant component of high-technology value added. Such sectors include the more traditional resource-based products such as wood and paper products, but also include such sectors as road vehicles, aerospace and defence products, and agriculture and agri-food products.[93]

Industry Canada argues that the increasing Canadian reliance on the American economy is a product of three events: the surging U.S. economy, the depreciation of the Canadian currency, and the increasingly liberal trading architecture wrought by the CUFTA and later NAFTA. They note that the increasing two-way trade between the two countries reflects "increased product specialization and rising integration of production by multinational enterprises." Canadian exports remain dominated by a few large exporters. In 1995, Canada's top 5 exporting firms accounted for 21.1 percent of Canada's exports: the next 45 exporters accounted for an additional 26.9 percent.[94] This statistic is in accordance with the overwhelming role of intra-corporate trade in the Canadian marketplace. Almost 50 percent of Canada's trade relationship with the United States is composed of goods traveling within the production structure of integrated firms. The degree of intra-corporate transfers and the increasing product specialization demanded from production sites are prime characteristics of the process of industrial globalisation noted in earlier chapters.

Canadian trade patterns reflect an increasing integration at the level of the firm. The large amount of trade that is composed of intra-firm exchange indicates a high degree of interdependence between Canadian subsidiaries and their American counterparts. Absolute trade levels are rising; moreover, the importance of raw materials processing in overall Canadian trade figures continues to decrease. Canadian provision of services and relatively high value-added goods continues to increase. Such trends are in keeping with a more interdependent global economy.

Investment In Canada

Patterns of foreign direct investment (FDI) in Canada reveal some consistent trends, and also indicate Canada's response to the phenomenon of globalisation. Canada has historically enjoyed a stable level of foreign direct investment. The following table indicates the amount of investment Canada received during the period 1974-1990. It reveals that Canada has enjoyed relatively stable and predictable increases in FDI levels over that 15-year period.

Table 6 -- Investment in Canada, 1974-1990 ($ Millions CDN)

Year	Direct Investment in Canada	Amount of Increase	Percentage Increase
1974	37 557	----------	----------
1975	38 728	+ 1171	+3.1
1976	41 623	+2895	+7.4
1977	45 132	+3509	+8.4
1978	50 089	+4957	+10.9
1979	56 785	+6696	+13.3
1980	64 708	+7923	+13.9
1981	70 327	+5619	+8.7
1982	72 814	+2487	+3.5
1983	77 413	+4599	+6.3
1984	83 385	+5972	+7.7
1985	87 226	+3841	+4.6
1986	92 401	+5175	+5.9
1987	101 843	+9442	+10.2
1988	110 545	+8702	+8.5
1989	118 958	+8413	+7.6
1990	126 588	+7930	+6.7

Source: Statistics Canada, Canada's International Investment Position: Historical Statistics 1926-1992 (Ottawa: Minster of Industry, Science and Technology, 1993), p. 54.

Not surprisingly, Canada's foreign investment levels have risen considerably in the years between 1990-1998. The table below indicates total FDI levels into Canada, the amount of FDI emanating from the United States, as well as the Canadian levels of investment in the United States for that period.

Table 7 -- : Net and USA Investment Flows for Canada 1993-1997

Year	Total FDI into Canada ($ Billion Cdn.)	FDI into Canada from U.S.A. ($ Billion Cdn.)	Canadian Direct Investment Abroad ($ Billion Cdn.)	Canadian Direct Investment to U.S.A. ($ Billion Cdn.)
1991	135	86	109	63
1992	138	88	112	65
1993	146	90	122	68
1994	148	103	146	78
1995	168	113	164	88
1996	180	120	181	95
1997	188	132	206	102
1998	217	147	240	126

Source: Statistics Canada, Canada's International Investment Position (Ottawa, Ministry of Industry, Science, and Technology, 1998), p. 32., 42. (Figures rounded to nearest billion.)

The overall importance of the American market – both as a source of FDI and a target for Canadian investment – has continued to increase.

While the growth of inbound and outbound investment in Canada has been particularly impressive over the past 5 years, it has not kept pace with the overall global flows of foreign investment. Canada's comparative stature as a host for FDI has in fact dwindled in percentage terms from comparable G-7 countries; between 1985 and 1996 Canada's share of inward G-7 FDI stock shrank by nearly half. Moreover, in percentage terms Canada's share of US investment abroad has also been reduced - in 1985 Canada enjoyed 39 percent of outbound American investment; by 1996 that percentage had dropped to 26 percent. Globally, Canada's share of foreign investment has also dropped. In the mid-1980's Canada received roughly 11 percent of the total global flow of FDI; in 1998 it received approximately 4 percent.[95]

Both the growth and the direction of FDI into Canada reveal an increasing reliance on the North American market and an increasing consolidation of industries. The American share of Canadian FDI has increased steadily over the last decade, while that enjoyed by other traditional investors – such as the United Kingdom and other OECD countries – has shrunk. Industry Canada estimates that between the period 1982-1989 the United States was responsible for 30 percent of the cumulative net FDI inflows into Canada; the United Kingdom was responsible for 27 percent, Japan 11 percent, and other OECD countries 11 percent, the remainder coming from EU and other countries. By contrast, in the period 1990-1997, the United States was responsible for over 70 percent of the cumulative net inflows of FDI into Canada. The U.K.' s portion in this period dropped to 0.5 percent, Japan's to 5.3 percent, other OECD countries 1.9 percent, and other EU and additional countries 22 percent.[96]

The sectoral distribution of investment in Canada reveals the traditional avenues of national resource exploitation, but also shows a growing degree of investment in the service, manufacturing, and high-technology industries. Foreign-controlled firms are concentrated mainly in high knowledge - and high technology – industries. The importance of resource-based investments has diminished by 10 percent since the mid-1980's; percentages in the service and manufacturing sector have increased. In 1998 the percentage distribution of various FDI recipient sectors ran as follows: energy and metals received 18 percent of inbound FDI, finance received 19 percent, machinery and transportation equipment 14 percent, services and retailing 10 percent, and wood and paper 8 percent. The following table translates actual FDI levels in specific sectors into dollar terms:

Table 8 -- Amount of Total FDI by Sector, Selected Years ($Millions CDN)

Year	Wood and Paper	Energy and Metallic Minerals	Machinery/ Transport Equipment	Finance and Insurance	Services and Retailing	Others.
1988	5452	29773	16641	20041	8607	33661
1989	7308	29298	18032	22435	9643	35948
1990	7599	31581	18431	24766	9780	38776
1991	7902	31706	18212	25939	10363	41112
1992	8895	30062	18496	26873	10807	42785
1993	9109	30846	20641	26685	11010	43203
1994	9598	29959	24638	28119	14417	47864
1995	10167	28923	25978	28855	16757	57674
1996	9919	30802	26726	33062	18047	60959
1997	13508	32836	29205	38590	19723	62851
1998	16467	39839	30940	41610	20917	67280

Source: Statistics Canada. Canada's International Investment Position (Ottawa: Minister of Supply and Services, 1998), p. 42.

Investment Abroad

Canadian foreign investment abroad, while still targeting the United States market to a large degree, is rapidly diversifying both in terms of geography and in types of investment. It is also growing; for the past several years Canada has been a net exporter of capital, investing more abroad than the amount it receives. Earlier tables document the amount of that investment; Canadian investment abroad totaled almost $240 billion in 1998 alone, compared to the $217 billion it received. 53 percent of that investment total was directed at the United States; the United Kingdom received 9 percent, Japan 5 percent, other EU countries 10 percent, and the remaining 23 percent[97] was distributed to all other countries. The gradually decreasing importance of the American investment market is a clear historical trend; between 1982-1989, 68 percent of Canadian investment abroad went to the United States; between 1990-1997 that overall average dropped to approximately 40 percent.[98]

The pattern of this investment reveals traits consistent with continued economic globalisation. For example, Canada's investors are active in merger and acquisition – in 1997, acquisitions of foreign companies by Canadian-based corporations totaled $6.4 billion, a new record. Such companies often provide local knowledge and product development capabilities necessary for operating in their indigenous market. Canadian investment in services continues to rise; the percentage of Canadian investment directed at services climbed 18 percentage points between 1985 and 1997. Canadian companies continue to invest less in percentage terms in the United States; overall investment in the United States has amounted to only two-fifths of Canada's total foreign investment in the 1990s. Non-OECD countries, particularly those in the Latin-American and Asia-Pacific

Regions, are increasingly popular targets for Canadian investment. They have more than doubled their share of Canada's outward FDI stock, from 14 to 31 percent in the 1990s. Canadian investment in becoming increasingly global.

The integration with the United States in terms of investment continues to increase. Canadian exporters still overwhelmingly target the United States, which is also the source of the bulk of the investment Canada receives. Canadian firms, moreover, are increasingly global investors that are investing substantial amounts. Much of this capital is greenfield investment; however, previous investments are beginning to show dividends in the form of reinvested earnings, which indicate an increasing involvement with the local economy. Canadian efforts at acquiring foreign local companies are expanding through Canadian expenditure on mergers and acquisitions. The sectoral distribution of investment into Canada is becoming concentrated in high-technology and high value added industries; and Canadian subsidiaries of foreign firms are receiving regional and worldwide product mandates.

Implications and Conclusions

The Mulroney administration inaugurated policies during the 1980s that were in keeping with the general conservative movements occurring in Margaret Thatcher's Great Britain and Ronald Reagan's United States. Those policies continued into the early 1990s and were defended by Mulroney's successor, Kim Campbell. Such policies emphasised the steady withdrawal of government activity within the private workings of the economy, the sale and privatisation of many public corporations, and an obsession with controlling the spectre of inflation through the manipulation of interest rates. Earlier attempts to control public spending and reduce deficit spending had met with widespread public disapproval, limiting the federal government's ability to curtail the growing federal debt. The free trade agreement with the United States had been approved in 1987 and was expanded to include Mexico in 1990, thereby creating the North American Free Trade Agreement. Economic policy under the Conservative tenure remained broadly consistent, but was limited by the scope and pressures of public opinion.

That policy, however, could not adapt quickly enough to the industrial restructuring of Canada wrought by the phenomenon of globalisation. Firms were quickly transformed, and moved away from the branch plant model and toward one of a participant in an integrated regional production system that sought world product mandates. Emphasis placed on Canada's indigenous resources was actually seen to be counterproductive by many economists, who recommended instead that Canada develop its capabilities in knowledge-intensive sectors. The recession plaguing Canada in the early 1990s made traditional Conservative policy prescriptions increasingly unpalatable, while the Liberal promise of immediate job creation and an emphasis on knowledge based-industries aided their election victory. Their 1993 mandate provided an opportunity to enact polices that reflected the dictates of an increasingly global economy.

The preceding sections indicate several important conclusions that would affect the investment policy of the Chrétien administration. First, it is difficult to separate and measure the various impacts that individual policy decisions make; investment patterns are a product of several factors, and stated public policy is only one. A nominally stringent review policy established under FIRA did not deter determined investors; the high approval rate established under FIRA's tenure indicates a generally permissive environment. The Investment Canada Act, by contrast, did not radically increase investment levels. While it aided investment levels - and also attempted to change Canada's reputation for hostility towards investment that had been established under the NEP – it was not sufficient to raise investment levels to a significant degree.

This chapter offers a longitudinal examination of the pattern of investment flows in and out of Canada for the period 1974-1990. The data were drawn primarily from Statistics Canada's annual publication Canada's International Investment Position. It reveals several interesting facts. First, the flow of investment within Canada during this period remained relatively stable, despite vast public policy changes in between the NEP, FIRA, and ICA and CUFTA. Sectoral investment also remained stable, as did the percentage of investment emanating from various countries. Investment in Canada remained concentrated in the hands of a few relatively large multinationals; most investment occurred in extractive resource industries, engineering, and communications services. Overall, investment patterns within Canada remained roughly stable throughout the Trudeau and Mulroney years.

Such conclusions raise at least some doubt on the efficacy of individual public policy measures to affect investment levels. It raised doubts that specific investment-control or investment-inducing policy regimes were by themselves sufficient to draw the type of high-value added investment that Canada desired. The simple provision of a liberal investment environment was not sufficient and could easily be matched by other competitors. More was needed, the specifics of which will be detailed in the next chapter.

A second conclusion from this section is that decisions regarding investment and trade in general have important domestic and foreign policy implications for the Canadian government. Typically, they are part of an overall government agenda that establishes public policy priorities. The NEP during the Trudeau administration represented an activist and centralist federal government that wished to take an increasingly independent policy stance in foreign economic policy. Such measures incurred the wrath of the domestic constituency that suffered from the transfer of economic authority to Ottawa, and also resulted in considerable criticism from the United States. The Conservative attempts to reverse such tendencies – to regionalise economic development and to increase Canadian economic and political ties with the international community, in particular the United States – became centrepieces of Canadian domestic and foreign policy for the latter half of the 1980s and the beginning of the 1990s. This is hardly surprising in a country whose GDP depends to such a great extent on the international economy in general and the United States in particular. The priority placed on such matters would continue with the incoming Liberal administration of 1993, but with a new approach to the treatment of the multinational corporation.

A third conclusion is that small and medium sized developed economies must work within the overall investment and trading environment that exists in the global economy. They possess comparatively small markets and limited domestic investment capital; limited resources ensure that they cannot take policy decisions that are counter to these broader trends. The Trudeau administration could only implement investment control measures under the assumption that Canada's domestic resources endowments would induce firms to submit to an additional regulatory process. If alternate sources of such raw materials are available, the policy independence of a resource-based economy is jeopardised. The Conservative emphasis on liberalising the trade regime and increasing

Canada's economic interdependence with the United States recognised that Canada needed to compete for foreign investment. It also reflected a belief that the route to successful competitiveness was through the reduction of government size, providing enhanced regional independence, controlling inflation, the liberalising of the trade and investment regulatory regimes, and a removal of government from the workings of the market.

The Liberal government of Jean Chrétien would acknowledge these realities and take steps to accommodate them in its governing agenda, which they began to implement in January of 1994. They too recognised that Canada could not independently resist the pressures of a global market, and must instead prepare its economic resources for successful competition in that market. Such preparation, moreover, would have to be conducted under a period of severe fiscal restraint. That governing agenda would both recognise the importance of a national economic strategy and would use the paradigm of alliance capitalism to build one. Partnerships and the cultivation of country specific advantages would be at the forefront of the Liberal's economic agenda, as would the emphasis on knowledge-based industries and the cultivation of strategic networks. The next chapter provides evidence of the inauguration of alliance capitalism within the Canadian government.

Endnotes

[1] Trudeau's willingness to alter Canadian policy towards NATO is a case in point. He lessened Canada's overall commitment to the alliance and created an airborne brigade that was actually to serve as a reserve – rather than a front-line – unit against possible Soviet attack.

[2] Joseph Nye and Robert Keohane, Power and Interdependence (Boston: Little Brown, 1977).

[3] Melville H. Watkins chaired the task force. Other members included Bernard Bonin, Stephen H. Hymer, Claude Masson, Gideon Rosenbluth, Abraham Rotstein, A.E. Safarian, and Willima J. Woodfine. The Report was submitted on 12 January 1968.

[4] Privy Council Office, Foreign Ownership and the Structure of Canadian Industry: Report of the Task Force on the Structure of Canadian Industry (Ottawa: Information Canada, 1968), p. 11.

[5] Ibid, p. 21.

[6] Ibid., p. 404.

[7] Ibid., p. 394.

[8] The report was a product of a working group chaired by the Honorable Herb Gray. Its formal reference is The Government of Canada, Foreign Direct Investment in Canada (Ottawa: Government Printing Office, 1972).

[9] Ibid p. 409.

[10] Ibid. p. 420.

[11] Ibid, p. 432.

[12]Steven Globerman and Daniel Shapiro, "Canadian Government Policies Toward Inward Foreign Direct Investment", Working Paper Number 24 (Ottawa: Industry Canada, September 1998), p. 20.

[13] Specific requirements established by the FIRA act included the following: the act required that proposed takeovers be subject to review if it involved Canadian businesses with gross assets of $250 000 or more, or "gross revenues of $3 million or more by "non-eligible persons." The second phase of the act, which came into effect on October 15 1975, covered the establishment of new businesses in Canada and established limits on non-Canadian ownership of both private and public companies. A review of the provisions of FIRA - as well as a synopsis of the major criteria by which foreign investments would be judged to hold "significant net benefit to Canada" –can be found in Steven Globerman, "Canada's Foreign Investment Review Agency and the Direct Investment Process in Canada" Canadian Public Administration 27(3), 1984, p. 316.

[14] Globerman and Shapiro, "Canadian Government Policies Toward Inward Foreign Direct Investment", pg. 30.

[15] American executives of multinational oil companies objected to the measure, fearing that it might be applied retroactively and used to usurp American assets in Canada that were products of previous investments. Moreover, they argued that the establishment of the NEP was a violation of the "national treatments" provisions enshrined in a series of post-war trade agreements to which Canada had been a signatory. See Stephen Clarkson, Canada and the Reagan Challenge, (Toronto: James Lorimer &

Company, 1982), pp. 60-78. On the diplomatic front, establishment of such a unilateral measure angered American policy makers who had advocated increasing economic interdependence (which had depended upon abundant supplies of relatively cheap energy). American policy makers had hoped that a relatively coherent multilateral policy response on the part of the major oil consumers that would confront the oil producing countries with a unified bloc of resistance. See Henry Kissinger, Years of Upheaval, (Boston: Little, Brown and Company, 1982), chapters 19, 20.

[16] The NEP provoked domestic controversy as well. The primary oil-producing province of Alberta regarded the NEP as nothing more than a federal intrusion on provincial economic activity designed solely to increase federal revenues. It was a further indication of Trudeau's penchant for concentrating economic power in Ottawa.

[17] Globerman revealed the following: of the total resolved cases in 1976, the percentage of cases that were eventually allowed was 81 percent. Figures for ensuing years run as follows: 1977-89 percent, 1978-86 percent, 1979-87 percent, 1980-85 percent, 1981-71 percent, 1982-64 percent. Globerman, "Canada's Foreign Investment Review Agency..." p. 318.

[18] Globeman and Shapiro, "Foreign Ownership Policies in Canada", pg. 20.

[19] Ibid., p. 62.

[20] Ibid., p. 75.

[21] Robert Thomas Kudrle, "Canada's Foreign Investment Review Agency and United States Direct Investment In Canada", Transnational Corporations, 4(2) 1995, p. 87.

[22] Robert Hormats, assistant secretary of state for international economic policy, U.S. Department of Commerce, Statement before the Subcommittee on International Economic Policy of the Senate Committee on Foreign Relations, October 28, 1981, p. 2. Quoted in Clarkson, Canada and the Reagan Challenge, p. 92.

[23] On this point see John Dunning, Multinational Enterprises and the Global Economy, (London: Addison-Wesley Publishers Ltd., 1993), pp. 559-567, and Edward Safarian, Multinational Enterprise and Public Policy: A Study of the Industrial Countries (Aldershot: Edward Elgar Publishing), p. 147.

[24] Kudrle, "Canada's Foreign Investment Review Agency ...", p. 87.

[25] The implementation of the tariff reductions agreed to at the conclusion of the Tokyo round of GATT negotiations had encouraged firms to begin their corporate rationalization process. The provisions of that round of talks allowed firms to sell their products competitively without maintaining a strong Canadian presence.

[26] Interview with Mr. Michael Wilson, former finance minister in the Mulroney government; currently Vice-President RBC Dominion Securities, 18 June 1999.

[27] References in this paragraph are from Canada, House of Commons, Debates: Speech From the Throne, 5 November 1984, p. 6.

[28] Government of Canada, House of Commons, Debates: Speech From the Throne, 1 October 1986. Pp. 1-15.

[29] Brian Mulroney, address to the Economic Club of New York, 10 December 1984.

[30] Survey quoted in Arpad Abonyi, "Government Participation in Investment Development", in Andrew B. Gollner & Daniel Saleé, editors, Canada Under Mulroney: An End of Term Report, (Toronto: University of Toronto Press, 1988), p. 161.

[31] Legal Firm McCarthy Tetrault, Highlights of Investment Canada Act, p. 1.

[32] Interview with Mr. Zulfie Sadeque, Deputy Director, Investment, Science and Technology Division (TBE), Department of Foreign Affairs and International Trade, 13 May 1999.

[33] Ibid.

[34] Abonyi, "Government Participation in Investment Development", p. 168.

[35] Earl H. Fry, "Investment Relations in North America: The U.S. Perspective", The American Review of Canadian Studies, 17(2), 1987, p. 135.

[36] Such a charge, of course, could be leveled at either country. Fry notes that the combined Ottawa-Quebec investment package offered to Hyundai motors was worth over $100 million (Cdn.). He also noted that the Commonwealth of Pennsylvania offered Volkswagen an $80 million (U.S.) package to operate a facility in New Stanton, while Kentucky offered $120 million to Toyota for the construction of a new plant. Ibid., pp. 136-137.

[37] Despite these initial steps, it was nevertheless clear that there remained significant domestic opposition to the further liberalisation of the Canadian investment regime. One clear example of this resistance occurred when the Mulroney administration attempted to alter Canadian patent protection for domestically developed pharmaceutical products. The pharmaceutical industry had long been perceived as an attractive industry in which Canada should develop its expertise. It was a consistent provider of high wage jobs, was inherently science and technology based, and provided long-term real returns on indigenous products. Yet major pharmaceutical firms were reluctant to engage in significant research and development efforts in Canada. Canadian patent law extended protection to domestically developed drugs only for a period of 24 months, at which time these compounds could face competition from generic compounds. Generics posed a threat because their producers did not assume the significant research and development costs required to develop and test the new compounds. Consequently, generics could be sold at a lower cost than the original drug, lowering overall profits and making it difficult for pharmaceutical firms to recover their initial development costs. Conducting research and development in Canada under such conditions did not make economic sense.. However, amending Canadian patent law proved no easy feat. Comparable OECD countries typically extended patent protection for 15 or 20 years to new compounds, and moving Canadian standards to similar levels appeared to be a necessary competitive action. Yet the bill to do so engendered considerable opposition from both opposition parties and the Senate. Such an overt change in Canadian law appeared to be too accommodating to large pharmaceutical firms. It was feared that creating a more liberal pharmaceutical investment environment would result in large firms investing rapidly in acquiring Canadian science and technology assets and appropriating them for use in the firm's home country. Opponents charged that such action would result in large multinationals stripping Canada of its knowledge and science resources. The passing of the amendment required personal attention by the Prime Minister, who spent considerable political capital on the pharmaceutical issue. The difficulty in passing the patent law change indicated the degree of suspicion in which many multinationals were held. Source : Interview with Mr. Hugh Segal, Former Chief of Staff to Brian Mulroney, May 21 1999.

[38] Government of Canada, House of Commons, Debates: Speech From the Throne, 3 April 1989, pp. 1-5.

[39] This work will intentionally limit its discussion of the Canada-US Free Trade Agreement (CUFTA) and the North American Free Trade Agreement (NAFTA) to those provisions that concerning issues of foreign

direct investment. For comprehensive bibliographic reviews of the entire economic scope of the negotiations and the final agreement, see the bibliographic essay in Michael Hart, Bill Dymond, et. al Decision at Midnight Inside the Canada-US Free Trade Negotiations (Vancouver: UBC Press, 1994): pp. 431-439.

[40] David Leyton-Brown, "The Canada-U.S. Free Trade Agreement", in Andrew B. Gollner and Daniel Saleé, editors, Canada Under Mulroney: An End of Term Report, (Toronto: University of Toronto Press, 1988), pp. 104-108.

[41] Department of External Affairs, Canadian Trade Policy for the 1980s, (Ottawa, Minister of Supply and Services, 1983), p. 45.

[42] Government of Canada, Report of the Royal Commission on the Economic Union and Development Prospects for Canada (Ottawa: Minister of Supply and Services, 1985), p. 382.

[43] Interview with Michael Hart, Former Senior Trade Policy Advisor, Department of Foreign Affairs and International Trade, 9 June 1999.

[44] John Dunning, Multinational Enterprises and the Global Economy, p. 58.

[45] Canada, Department of External Affairs, The Canada-U.S. Free Trade Agreement, Chapter Sixteen, Article 1602: "National Treatment".

[46] Ibid., Article 1603.

[47] Ibid., Article 1608.

[48] Ibid.

[49] Ibid, Article 1608, paragraph 3.

[50] For the regulatory provisions of the NAFTA agreement, see the following: Ottawa: Minister of Supply and Services, North American Free Trade Agreement (Ottawa: Canada Communication Group, 1992), Chapter 11.

[51] A complete detailing of the industries exempt from the liberalising provisions of the NAFTA agreement can be found in Alan M. Rugman and Michael Gestrin, "NAFTA's Treatment of Foreign Investment", in Alan M. Rugman, editor, Foreign Investment and NAFTA (Columbia: University of South Carolina Press, 1994, pp. 67-78.

[52] This concern is well chronicled by Raymond Vernon, "Multinationals and Governments: Key Actors in the NAFTA", in Lorraine Eden, editor, Multinationals in North America, (Ottawa: Minister of Supply and Services, 1994), p. 35.

[53] Alan Rugman, Multinationals and Canada-United States Free Trade (Columbia: University of South Carolina Press, 1990), and Rugman and Verbeke, Global Corporate Strategy and Trade Policy (London: Routledge Press, 1990).

[54] C.K. Prahalad and Yves L. Doz, The Multinational Mission: Balancing Local Demands and Global Vision (New York: The Free Press, 1987), pp. 91-93.

[55] Raymond Vernon, "Multinationals and Governments: Key Actors in the NAFTA", in Lorraine Eden, editor, Multinationals in North America (Ottawa: Minister of Supply and Services, 1994), p. 28.

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[56] B. Curtis Eaton, Richard G. Lipsey and A Edward Safarian, "The Theory of Multinational Plant Location: Agglomeration and Disagglomerations", in Lorraine Eden, editor, Multinationals in North America (Ottawa: Minister of Supply and Services, 1994), p. 98.

[57] Ibid., p. 99.

[58] Ibid.

[59] Interview with Mr. Hugh Segal, former Chief of Staff to Brian Mulroney. 21 May 1999.

[60] Michael E. Porter, Canada At the Crossroads: The Reality of A New Competitive Environment (Monitor Consulting Company, 1991), p. 361.

[61] Government of Canada, House of Commons, Debates: Speech From the Throne, 13 May 1991, pp. 1-5.

[62] Interview with Michael Hart, Former Senior Advisor Trade Policy Studies, Department of Foreign Affairs and International Trade, 9 June 1999.

[63] The ITAC briefing membership included such trade luminaries as Richard Lipsey, Sylvia Ostry, Bill Davidson, Michael Piore, David Runnalls, Howard Wetston, and Geza Feketekuty. Marshall A. Cohen, "Foreword", In Michael Hart, What's Next: Canada, the Global Economy, and the New Trade Policy (Ottawa: Centre For Trade Policy and Law, Carleton University, 1994), p. vii.

[64] Alan Rugman, "Strategic Management and Canadian Multinationals", in Steven Globerman, editor, Canadian-Based Multinationals (Calgary: University of Calgary Press, 1994), p. 249. See also Alan Rugman and Alain Verbeke, Global Corporate Strategy and Trade Policy (London: Routledge Press, 1990).

[65] Ibid., p. 257.

[66] Sunder Magun, Working Paper #23: Restructuring in Canadian Industries: A Micro Analysis, (Ottawa Industry Canada, 1998), p. 26. This work provides a comprehensive analysis of the origin, motivation, and ultimate economic results of the re-structuring efforts of Canadian firms.

[67] Ibid., p. 27.

[68] Lorraine Eden, "Who Does What After NAFTA?" , in Lorraine Eden, editor, Multinationals In North America (Calgary: University of Calgary Press, 1994), p. 233. She notes the applicability of the "network" paradigm by to North American MNC production by quoting the UNCTC World Investment Report (New York: United Nations, 1991), which states that "regionally integrated, independently sustainable networks of overseas investments [are] centered on a Triad Member." (p. 42).

[69] Ibid., p. 245.

[70] OECD, Main Economic Indicators (Statistics Directorate: Paris), November 1993, p.92.

[71] The figures for these particular industries are as follows: crude steel production dropped from 1289 thousand tons (monthly average), in 1989, to 1011 in 1990, 1082 in 1991, and 1161 in 1992. Crude petroleum increased, but only marginally: 6.86 million tons in 1989, 6.82 million tons in 1990, 6.82 in 1991, and 7.11 in 1992. Yearly figures for natural gas production (billion cubic meters) ran as follows: 1989-11.23, 1990-11.36, 1991-11.87, 1992-12.95. Output of commercial vehicles and passenger cars

(thousands per month) ran as follows: 79.1 for commercial vehicles, 82.0 for passenger vehicles in 1989, 67.3 and 78.4 for 1990, 65.8 and 74.2 for 1991, and 75.1 and 75.1 for 1992. Ibid.

[72] Ibid., p. 94.

[73] Liberal Party of Canada, Creating Opportunity: The Liberal Plan for Canada, 1993, p. 3.

[74] Ibid.

[75] The Globe and Mail, 16 September 1993, p. A1.

[76] Giles Gherson, "The Chrétien Caper: Scooping the Tories' Economic Agenda", The Globe and Mail, 24 September 1994.

[77] The Globe and Mail, 17 August 1993, p. A1.

[78] Ibid., p. A2.

[79] The Globe and Mail, 17 August 1993, p. A2.

[80] The Globe and Mail, 28 August 1993, p. A1.

[81] The Globe and Mail, 9 September 1993, p. A6.

[82] The Globe and Mail, 2 September 1993, p. A1.

[83] UNCTC, World Investment Report 1998: Trends and Direction (New York: United Nations, 1998), p. 2.

[84] Ibid., p. 5.

[85] Ibid., p. 6.

[86] Ibid., p. 23.

[87] On the phenomenon of strategic alliances, see Yves Doz and Gary Hamel, Alliance Advantage: The Art of Creating Value Through Partnering (Boston: Harvard Business School Press, 1998).

[88] Braxton Associates, Deloitte and Touche Consulting, Innovative Leaders in Globalisation (Deloitte and Touche Consulting and the World Economic Forum, Geneva, 1999).

[89] Industry Canada, Micro-Economic Policy Analysis Brand, A Report Card on Canada's Trade and Investment Record, Volume 5 (Special Issues), 1999, p. 4.

[90] Surendra Gera, Industry Canada, and Kurt Mang, Department of Finance, "The Knowledge-Based Economy: Shifts In Industrial Output" Industry Canada, Working Paper #15, (Ottawa: Government Printing Offices, January 1997), p. 53.

[91] Ibid., p. 6.

[92] Ibid., p. 6.

[93] Data draws from Statistics Canada and Industry Canada publications. See also Ibid., pp. 6-9.

[94] Industry Canada, Data on Trade and Investment in Canada, (Handout prepared by the International Business Branch and Micro-Economic Policy Analysis Brand, Industry Canada).

[95] Interview with Dr. Someshwar Rao, Director, Strategic Investment Analysis, Industry Canada.

[96] Industry Canada, A Report Card on Canada's Trade and Investment Record, p. 10.

[97] Ibid., p. 17.

[98] Industry Canada, A Report Card on Canada's Trade and Investment, p. 12.

Chapter 6 -- The Politics of Alliance Capitalism—the Canadian Case

For the sake of clarity, it is beneficial to restate the general components of the alliance capitalism paradigm that were outlined in chapter one. Alliance capitalism argues that national economic policy will reflect some or all of the following characteristics:

1) A closer collaborative relationship between government and its domestic exporing firms than would be predicted under a more traditional model tht emphasised state-firm separation.
2) A more deliberate government policy to participate in economic institutions that directly affect the operating environment of its domestic MNCs.
3) A more consistent government effort to encourage its own firms to export
4) A generally higher policy priority accorded to matters of international trade, production, and finance.

The theory of alliance capitalism is both general and parsimonious. While it proposes a general set of principles for industrial development, it also recognises that the execution of these principles will be highly state-specific. Individual state expressions of the paradigm will be a product of history, previous combinations of OLI advantages, and the particular policy-making procedures present in a specific state. Consequently, any description of government behaviour within the alliance capitalism framework must be founded upon a specific examination of the state's unique characteristics. This chapter will empirically illustrate the actions of the Canadian government during the Chrétien administration in the realm of broad industrial and economic policy. It will argue that such polices reflect the paradigm of alliance capitalism. Evidence will be drawn from the policy programs of the Department of Foreign Affairs and International Trade, the Department of Industry, and various interdepartmental efforts.

The paradigm of alliance capitalism provides direction for national policy making efforts. The state wields considerable influence in the location and direction of continued FDI, but only if its efforts are co-ordinated from the highest levels of government. Therefore, the first necessary element for the governance of alliance capitalism is federal recognition of the importance of FDI for overall national economic health. The priority national governments place on issues of trade, investment, and industrial development -- and their overall commitment to innovation-led growth -- demonstrates such recognition. Such an administration would recognise that reliance on location specific factor endowments would not suffice in the globalisation era, and that the cultivation of knowledge-based assets is needed to supplant an overt reliance on factor resources.

Such direction would also serve to provide a reasonable of policy co-ordination between the major departments within government. In the case of Canada, primary responsibilities for issues related to FDI and internal economic developments are divided between the Departments of Finance, of Foreign Affairs and International Trade, and the Department of Industry. Ensuring co-operative policy efforts among these three departments is rarely a simple matter, and often the policy initiatives of one may directly clash with the efforts of another. The broad characteristics of alliance capitalism helps to mediate such conflict by providing a broad set of criteria towards which different policies can be directed. Moreover, in the case of Canada under the Liberal government of 1993, the importance of FDI to economic development – and the priority placed on economic development as an overall government objective – emanated from the head of the government, imposing further policy discipline. The provision of such direction allowed further policy focus and consistency across separate departments.

Under alliance capitalism, governments recognise the importance of strategic clusters of economic activity and create infrastructure and investment programs designed to facilitate them. This involves channelling government spending in the forms of infrastructure and industrial assistance to industries deemed to be part of a larger industrial network. It implies that governments will cultivate investment and industrial activity in those sectors in which the nation possesses a specific competitive advantage. For Canada, the centre of such networks may often be located in the United States, yet Canadian participation in the supporting and related industries within those networks acquires significant technological and economic benefit. The Canadian creation of a sectoral investment and industry strategy would provide further evidence for the adoption of alliance capitalism.

A final indication of alliance capitalism is the concentrated emphasis on partnerships, both within government and between government and the private sector. In order to demonstrate the utility of alliance capitalism, the use of such partnerships must be in accordance with overall industrial objectives and therefore must fulfil certain criteria. First, such partnerships should contribute to the overall consistency of government action, so that there is reasonable harmony between departments and between elements of foreign and domestic policy. The partnerships must also be participatory: members drawn from non-federal or private sector groups must play an active role in the policy process. Partnerships should also be selective, and must contribute to the sectoral and industry-specific industrial strategy that are key to the clustering framework. Finally, they need to be cost effective – they must provide real benefit to the industrial development process and are not used merely as surrogate policy instruments by a government determined to cut expenditure. As later sections of this chapter will demonstrate, the present use of partnerships by the federal government fulfils these criteria.

The Economic Priorities of the Liberal Government

Interdependent changes in both the global and the national economy in the early 1990s encouraged the Liberal government adopt new strategies to attract FDI. Domestically, the ratification and operation of both the CUFTA and NAFTA agreements had removed most of the existing trade and tariff barriers between the three North American countries. While important exceptions remained, it was still clear that the movement of goods and capital across North American borders was practically unhindered. Internationally, the fall of the Soviet Union and the end of the Cold War wrought economic changes outlined in previous chapters. Numerous countries – some holding considerable domestic competitive advantages in terms of low wage, relatively skilled labour – now clamoured for the foreign funds denied them during the Cold War decades. Their rapid adoption of liberal economic policies posed both risks and opportunities for Canada's economic prosperity that required careful government management.

The incoming Liberal government professed a belief that government could indeed play a facilitation – rather than merely a regulatory -- role in facilitating its domestic economic transition to a knowledge-based economy. They indicated that the Conservative policies -- of investment deregulation, of promoting greater domestic competition via free trade, and of pursuing an enhanced multilateral trading regime – were necessary, but not sufficient, measures in inducing this transition.[1] Additional measures were necessary to adapt to the process of globalisation, and the Liberal government moved quickly to inaugurate programs and policy directions designed to raise Canada's investment profile and economic capability.

The Liberal government's priorities could not have been clearer. There were two primary objectives that would dictate Canadian economic policy for the ensuing years. The first and most publicised priority was to reduce overall levels of federal government spending and to take constructive steps towards a balanced budget. Both the initial Speech From the Throne and the inaugural budget emphasised the need to control expenditures and improve Canada's fiscal position. The 1994 address noted that "the Government will pursue the fiscal discipline necessary for sustained economic growth ... (the budget) will include measures to bring the federal debt and deficit under control."[2] The initial budget, delivered almost exactly a month later by Finance Minister Paul Martin, reiterated a commitment to fiscal prudence. Martin's budget forecast a reduction in deficit spending from $45.7 billion in fiscal year 1993-1994, to $39.7 billion in 1994-1995, and to $32.7 billion the year afterward.[3] Martin committed the government to reducing deficit spending to a target of 3 percent of GDP within three years, and he reduced the operating budgets of government departments by $400 million in 1994-1995 alone.[4] No department was spared budgetary cuts; and the tone of Martin's budget echoed Chrétien's campaign promises that departmental proposals for new spending would not be welcome.

The government's economic priorities, however, extended far beyond efforts at spending reduction. The second overall economic objective was to aid in the transformation of the nature of the Canadian economy, away from reliance on primary resources and towards effective participation in the global knowledge-based economy. The priority placed on overhauling Canada's "architecture for government and for the economy" also received emphasis in the Budget of 1994. Martin stated that the Liberal governments' approach to aiding the transformation of the economy would learn from the mistakes of previous efforts; in the budget Martin argued that it was "not the principle of industrial strategy that is wrong. It has been the practice." He emphasised that "innovation and ideas are essential for jobs today and in the future. They are our country's new natural resources."[5] Despite the emphasis on deficit reduction, Martin nevertheless found room to initiate new programs designed to increase co-operation between the public and private sector in high technology industries. He noted that there was "a major research and development shortfall in Canada", and he proposed measures to remedy that shortcoming. Such measures included an $800 million investment in Canada's space technologies, the inauguration of a national research and development strategy, and the creation of a Technology Partnership Program designed to link universities and government laboratories to aid in the creation and dissemination of knowledge. Finally he noted that the Minister of Industry -- John Manley -- would table papers that would "set the stage for an intense national dialogue on the challenge that is required to take existing resources and redirect them toward the creation of a national system of innovation."[6]

Manley fulfilled Martin's commitment by examining the state of Canada's industrial development in his inaugural Ministerial address to the House of Commons. He reemphasised the importance the Red Book had placed on job creation and economic growth, the need to control government spending and reduce debt levels, and to restore a measure of economic hope to the recession-plagued Canadian economy. He proposed a simple remedy:

> It is the kinds of partnerships we can build with the private sector, business organisations, labour organisations, and others that are going to enable us to overcome obstacles and build on some of our strengths.[7]

Other remedies he proposed included special partnerships with banks and lending institutions to make capital available for small businesses working in knowledge industries, as well as a restructuring of the tax and regulatory environment to ease bureaucratic impediments to business investment. He also noted that Canadian reliance on the natural resources sector and traditional manufacturing faced increasing foreign competition and needed revamping to meet the competitive environment. Finally, he declared that his "objective as Minister of Industry is to make the Canadian business sector synonymous with quality and innovation."[8] Creating jobs through investment and the selective support of small and medium businesses did indeed become the "driving purpose" of the Chrétien government upon assuming power. It would be difficult to find a policy initiative that was as strongly supported by the senior members of the government.

It quickly became clear that the cultivation of foreign direct investment would play an integral role in the economic strategy of the Liberal government. That Canada did in fact need to compete for such investment was not lost; and the Liberal government gave evidence that it intended to fight vigorously for it. The investment flow patterns outlined in the previous chapter indicated that Canada was receiving a lower percentage of the global boom in FDI than it had enjoyed before 1985, and global investment indicators implied that maintaining the share it did receive could not be assumed. Documentary and academic evidence on the benefits of foreign direct investment -- in terms of job creation, the absorption of high technology manufacturing processes, and increasing wage levels -- had been accumulating since the mid-1980s. Consequently, by the time the Liberals gained power there was little internal government debate on the need to attract FDI.[9] Maintaining and increasing FDI levels would be a key factor in ensuring national economic success, and the increasingly competitive international economic environment mandated a pro-active government approach to increasing Canada's share of global investment. Doing so required creating government policies that increased the propensity of firms to invest in Canada.

Overall government action in the area of investment centred upon several core objectives. The first was to raise international awareness of the benefits that companies would enjoy by investing in Canada.[10] It was apparent to Liberal policy makers that Canada had not shed its image as a resource-based economy, and altering this view among firms competing in knowledge-based industries was a top priority. The second objective was to craft an interdepartmental policy approach that would work co-operatively to attract FDI to Canada. The third priority was to enlist the aid of firms, industry associations, provincial governments, and municipalities in ensuring an integrative, collaborative approach to building the knowledge-intensive skills and resources necessary for the knowledge-based economy. Such policies mandated that the federal government possess a clear conception of the necessary role it needed to play in industrial development and of the long term Canadian economic interest in cultivating investment links abroad.

As the previous chapter argued, many of the ensuing economic actions taken by the Chrétien government had been outlined in policy statements and news bulletins released before the election. Moreover, the harmony among and between the Prime Minister and his senior Ministers indicated that the Liberals had possessed a clear and cohesive economic strategy before taking office. Implementing that strategy required a robust framework into which efforts at attracting FDI could be made that fit within the overall goals of debt reduction and the furthering of Canadian economic interests. The strategy had to be cheap, effective, and needed to show rapid results. At the forefront of the implementation would be the Department of Industry.

The Department of Industry

Within a year of taking office the Liberal government had proposed a bill which would amalgamate the Ministries of Industry, Science and Technology, and Communications and Consumer and Corporate Affairs. The House of Commons' debates over the bill commenced in the fall of 1994 and Bill C-46 –which created the new amalgamated Department of Industry – was passed on March 16, 1995. In introducing the bill Mr. Dennis J. Mills, Parliamentary Secretary to the Minister of Industry, emphasised the need to produce a "streamlined, organised, and comprehensive approach" to the Department's activities, one which united various policy instruments that had been spread over several departments.[11] In part, the amalgamation of several departments into one fulfilled the Liberals' election promise of reducing the overall size and number of government departments, promises that had been well outlined in the Red Book. However, the specific mandate for the Department empowered the Minister in specific ways.

Bill C-46 allocated to the Minister a comprehensive mandate to pursue an active industrial strategy. Its most prominent features included measures designed to strengthen the national economy, increase the competitiveness of Canadian goods and services, foster and promote science and technology, and to strengthen the framework for the development and efficiency of the Canadian marketplace.[12] It enabled the Minister – in this case John Manley -- to "develop and implement programs and projects of special assistance to industries" when it was deemed in the national interest.[13] The introduction of the bill received intense criticism by the opposition parties. The Reform Party saw it as pure Liberal economic interventionism, and accused the Chrétien government of assuming decision-making powers that were best left to the marketplace. Criticism from the Bloc Quebecois focused on the perceived federal intrusion on provision economic development authority.[14] By creating the Department, the Liberal government reaffirmed its belief that the federal government had a necessary role to play in directing the evolution of the Canadian economy. This Manley was determined to do.

The Department of Industry proclaimed several departmental priorities to achieve this goal over the first governing year. The first priority was to reduce interprovincial trade barriers and increase overall levels of internal trade. The emphasis on reducing business regulation and to increase SME access to capital was continued. A third priority was to increase the capabilities of Canadian infrastructure – both physical and intellectual – from which business could draw. Measures included a national infrastructure program, as well as continued investment in information technology designed to increase communicative links between industry, government, and academia. Finally, the fourth strategic priority was to emphasise the role of science and technology in building a strong economy. Manley justified this emphasis in simple terms:

> Virtually all product innovation is science-based, the result of research and development. And nothing is more important than product innovation for businesses to maintain and improve market share, thus contributing to economic growth and productivity.[15]

Manley realised, however, that his policy decisions could not involve the spending of vast amounts of money. The Department of Industry received substantial budget cuts with Martin's first budget that precluded large public expenditures. However, Manley was undeterred, and two days after the budget speech of 1994 he outlined how he planned to create a national system of innovation. He noted that his government had a responsibility to help transform the Canadian economy "into one premised on the need for growth based on knowledge, skills, innovation, and the use of technology".[16] He also argued that the world economy was moving from one based on commodity exports and assembly line production to a knowledge-based economy that valued innovation above all else. Such an environment required new policy approaches, and demanded that governments be "innovative and strategic" in the use of their resources and in "the direction sought for the economy of the nation." His vision for Canadian policy was to help Canadian individual and firms adapt to new economic realities. He emphasised the need for continued education and skills upgrading, the simplification of tax and regulatory structures, the adaptation to technological advancement, and the enhancement of government support to encourage small and medium sized enterprises (SMEs) to export.[17]

Manley made specific policy recommendations to achieve this goal. He committed $15 million in 1994 to the creation of a Canadian technology network, designed to provide small businesses with the latest market information. He announced a technology partnerships program designed to "promote the growth of technology partnerships" by turning basic research into new products, a program which will be discussed in greater detail later. He built upon Martin's announcement of a 10-year, $800 million dollar effort to improve Canada's indigenous capacity in space technologies by announcing a space plan that would build on established Canadian strengths in earth observation, remote sensing, and satellite communications.[18] He concluded that "with the co-operation of industry and of government we can build toward a better Canada and a better world."

Manley also emphasised the need for the federal government to work in partnership with Canadian small and medium-sized enterprises in order to increase their competitive strengths. Subsequent studies done by the Department of Industry had demonstrated that such companies were far more likely to take advantage of government programs and assistance than were large integrated multinational corporations.[19] Manley would continually quote the development of SMEs as a solution to the job crises, often stating that such firms were responsible for the bulk of the new job growth in Canada. He announced his intention to introduce legislation designed to improve high tech SMEs access to capital[20], and to break down interprovincial trade barriers.[21] Finally, he emphasised the government's strategic priority in building an innovative economy through science and technology, and made the cultivation of such one of the cornerstones of sustainable economic development.

Manley's approach attempted to avoid the difficulties that industrial policy efforts in the past had experienced. Failed past industrial policy efforts had featured individual policy initiatives that often worked in opposition – rather than in concert- with each other. For example, Manley's emphasis on the development of Canada's SMEs, particularly those competing in the high-technology sector, was not new. His efforts had policy forbearers that reached back decades, and Isaiah Litvak's chronicling of such efforts held decidedly mixed conclusions about their effectiveness.[22] Litvak surveyed 29 SMEs competing in the high technology sector, following their progress from 1970 until 1990. He concluded that government aid acted as often as a hindrance than as an aid to the success of these companies. Of the original companies surveyed, by 1991 only 10 had survived as independent entities, the rest having gone bankrupt or being absorbed by large US or European multinationals. [23]

Litvak listed several factors that contributed to the high attrition rate, ranging from poor company management to government bureaucrats that insisted that companies develop technologies that resulted in little marketplace attractiveness. Most importantly, Litvak noted, was that selective industrial support required in turn a comprehensive and consistent federal approach to industrial policy, which was rarely forthcoming. It made little sense, for example, to aid SMEs while maintaining high tariff walls in high tech industries, which would result in a sheltered domestic operating environment that discouraged the continual innovation necessary for global competition. Litvak concluded, "for small and medium-sized technology-based firms the importance of well-defined government research and development and procurement policies cannot be overstated." He noted that "to succeed, government assistance must be market-driven, free of excessive red-tape, and not dependent on political whims." The Canadian government needed to develop a "constructive relationship" with SMEs "as an ally in the battle for global competitiveness."[24] Industrial policy had to be created as a comprehensive whole, rather than through individual efforts that often resulted in contradictory policy outcomes.

Manley's Department of Industry was aware of such previous errors and was determined to avoid them. The relative scarcity of Departmental funds enforced a measure of fiscal discipline on collaborative projects; such projects had to pass severe criteria in terms of market profitability and potential.[25] Yet the regulatory measures introduced were in keeping with an overall strategy of facilitating industrial upgrading. Later sections will outline in greater detail the more specific policies and programs that composed the overall strategy. At this point it is necessary to demonstrate that Manley's Department of Industry had allies in its quest for greater Canadian competitiveness in knowledge-based industries. Partners in this strategy included the Ministers responsible for Canada's foreign economic and trade policy.

Canada's Economic Relations Abroad

The need to spur job creation through investment also became a central tenet for Canadian foreign affairs. The incoming Minister for International Trade, Roy MacLaren, reiterated the government's commitment to improving the Canadian economic environment from his earliest public statements. At the annual meeting of the World Economic Forum in Davos, Switzerland, MacLaren made the following statement to the Canadian luncheon:

> Canada's ability to continue to attract the high skill, high value-added industries and jobs of the future will depend directly on how we position ourselves in this emerging global economy. Or, stated alternatively, any domestic growth strategy must, almost by definition, be an export-orientated strategy. [26]

The economic priorities of the Liberal governing agenda found expression in foreign policy pronouncements. The Liberals initial Speech From the Throne -- delivered in January of 1994 – had included a government commitment to undertake a comprehensive Parliamentary review of Canada's foreign and defence policy.[27] This Chrétien's government subsequently did, commissioning a wide range of experts to report on Canada's foreign policy priorities for the foreseeable future. In his testimony before the Parliamentary Review Committee, MacLaren noted that, for a country as dependent on trade as Canada, "any meaningful domestic growth strategy must, almost by definition, be export-led."[28] The Report issued as the end of this review process reflected MacLaren's emphasis on exports. It listed the creation of a prosperous and open trading environment as Canada's number one foreign policy priority, one that even outranked commitments to international peace and security or the promotion of Canadian values abroad. The economic agenda topped Canada's list of foreign policy priorities.

MacLaren continued to reiterate similar themes in his public statements throughout the bulk of 1994 and into 1995. He noted with particular vigour the difficulty of enacting independent policy decisions for domestic and foreign policy, arguing that "jurisdictions and policy areas that have long been considered to be quintessentially domestic are now increasingly subject to international negotiation and rule making."[29] He, too, noted that the government intended to pursue "a much closer and more active partnership with the provincial governments and the private sector".[30] He continued to reiterate the need for a rules-based international trading system, and hinted that international investment issues would also benefit from a more pronounced multilateral regulatory framework.[31] Emphasising interdepartmental unity, he noted that

> Canada's international trade policy and market development programs are fully integrated into the federal government's comprehensive initiatives aimed at re-engineering the domestic business climate. The process is ongoing and accelerating.[32]

The public link between trade, industrial, and foreign policies appeared to be well established early in the Liberals tenure. MacLaren worked extensively with Manley on Trade and Investment issues, and in March of 1994 they made a joint announcement of the creation of Canada's "International Trade Business Plan", which emphasised the need for "greater partnership between public and private sectors."[33] Creating and maintaining an established international business plan for each of the world's primary regions became an interdepartmental project that has been maintained and expanded since 1994.[34]

MacLaren also continued the commitment to reducing trade barriers on both the multilateral and bilateral fronts, re-emphasising Canada's support of the principles of the WTO and NAFTA while simultaneously increasing bilateral co-operation with the emerging economies of the Far East.[35] He noted that Canada's industrial and economic development depended upon a stable rules-based international trade regime. Not only would such a regime help protect Canadian interests in trade disputes with larger economic powers, but it would also enhance Canadian investment and trading opportunities in developing and regional markets. Traditional trade policy mechanisms were certainly not ignored in the early years of the Liberal government.

Such mechanisms, however, were not the only tools of Canadian trade policy. Co-operation with other departments in joint initiatives also played a central role. MacLaren continued to emphasise similar themes throughout his tenure as Minister for International Trade, which ended in January of 1996. The interrelationship between foreign and domestic policy, the need for continued co-operation between various levels of government and between government and business, and the reference to the transformed global economy found constant repetition in his public statements. Particular emphasis was placed on co-operation in the creation of the "Team Canada" trading efforts (which will be elaborated upon later) as well as the crafting of an international business strategy for Canada. In a speech to the Canadian Exporters' Association he noted how the federal government, "together with the provinces and the private sector" were attempting to craft "a more coherent, integrated approach to international business development." In the same speech he extolled the creation of Canada's export strategy, entitled *Canada's International Trade Business Plan*, which was a product of cooperation

> Among 19 federal departments, the provinces, the International Trade Advisory Committee, (ITAC), and the Sectoral Advisory Groups on International Trade (SAGITs), numerous vertical and horizontal industry associations, such as the Canadian Exporters Association, as well as individual companies.[36]

Such consistency in the public statements and actions of senior officials of an incoming administration gave strong evidence that industrial strategy enjoyed a high priority. Moreover, in their public statements, senior government ministers continued to profess that unanimity throughout the first year of the Liberal administration. Statements emanating from the Departments of Foreign Affairs, Industry, and Finance continued to reiterate central themes. The emphasis on deficit and eventually debt reduction remained paramount. Yet there was also clear emphasis in supporting SMEs to grow and to export. On the foreign front there appeared succeeding policy statements and speeches rededicating Canada to the mandate of increasing trade and investment and to reducing barriers to international economic flow. Guiding all of these priorities was an additional acknowledgement that the process must be supported by both business and labour groups. As John Manley stated succinctly, "what is required is decisive action by government, wise investment by business and labour, and a new model of co-operation and partnership."[37]

The "Team Canada" Trade Initiative

One of the Liberal government's earliest – and most notable – efforts to spur increased Canadian participation in the global economy was the "Team Canada" trade missions project. The concept was simple – the federal government of Canada, combined with representatives from each of the provinces, would lead trade missions to various global locations with which Canada wished to increase trade. Quite early on in the process it was decided that the Prime Minister would head each delegation, and that the provincial representatives would be the individual provincial Premiers. The delegation would be comprised of business people from both small and large corporations, representatives from educational institutions, members of Canadian based non-governmental organisations, and associated media personnel. The delegation would meet a complementary group of local business and government personnel in targeted geographic areas. The overall economic objectives would be to raise awareness of possible economic partnerships between Canadian-based industry and their complements in regions of the globe in which Canadian international economic activity required improvement.[38]

The missions are politically directed, but allow the participants considerable freedom and input into the actual mission's progress. Planning for the mission involves first an overall economic and industrial analysis of the targeted region, in order to determine what sectors of the Canadian economy would likely benefit most from exposure to the trip. A preliminary list of Canadian economic agents is drawn up, which includes representatives from businesses, major educational institutions, industry associations, and other economic stakeholders[39], and invitations are forwarded. Canadian SMEs are particularly targeted, and over 80 percent of the participants in the missions have thus far fallen into the SME category.[40] Participation on the mission is relegated to a strict first-come first-serve basis, and the program is also run on a cost-recovery basis. Consequently, a wide spectrum of business views and objectives are typically represented.

The current director of the Team Canada missions, Peter McGovern, notes that the idea for this trade initiative emanated directly from the Prime Minister's office.[41] There is no doubt that the impetus for the missions derives from a variety of motives, and they were to serve a variety of economic and political interests, both old and new. The first goal was increased trade diversification. Increasing Canadian business exposure abroad was part of the Liberal's electoral agenda, especially is some of the more dynamic developing regions of the global economy. The inclusion of the provinces in an international trade mission also helped bolster the image of a unified Canada and aided federal efforts to combat the drive for sovereignty in Quebec.[42] The missions serve a variety of interests, both political and economic.

They do, however, also represent the characteristics of alliance capitalism. The central characteristics of the missions – politically led but economically motivated, designed to represent a variety of Canadian stakeholders – are constituent components of alliance captialism. The federal government's role in the program is primarily one of facilitation. It works with industry to identify the opportunities for partnering that exist in the designated area, and extends invitations to those local entities via Canadian embassies and trade missions abroad. The actual missions provide venues where business representatives can exchange information and ellicit potential contracts while expressing industrial views to Canada's senior political leadership. Business representatives receive no direction from political representatives, and are free to conduct business as they wish. Moreover, the federal government does not track the success or failure of individual arrangements, nor has it made an overt attempt to catalogue the overall success rate of previous missions[43], and is content to let market developments unfold.

Current planning efforts for the next Team Canada mission are underway, which will target Australia and Japan.[44] This mission differs from previous missions in two primary ways. To begin, it will be the first mission to target directly a country that is already a major trading and investment partner for Canada – Japan. Secondly, the mission will include specific attempts to cultivate venture capital investors to provide funds for Canadian high-tech SMEs. These points are complementary. The emphasis on investment over trade indicates a primary Liberal objective to encourage brownfield (investment in already-established plants and industries) investment in Canadian SMEs, particularly in the high-tech knowledge intensive industries that are central to the overall industrial strategy. These objectives indicate a general drive to continue to cultivate investment as well as trade. Indeed, the Team Canada approach appears to make little distinction between the two; and agreements that result in Canadian direct investment abroad are as lauded as agreements that draw investment inward. Greater overall Canadian participation in the international economy remains the central priority.

The Team Canada missions were one of the earliest trade and public policy initiatives inaugurated by the Chrétien government.[45] Its evolution – to different areas of the global economy, and towards the inclusion of investment as well as trade agreements – indicates a degree of adaptability and a continued contribution to a co-ordinated economic strategy. Elements of that evolution include an emphasis on attracting new investment in key sectors, and the creation of an industrial assistance program. It is to these that we now turn.

The Strategy of 1996

In 1996 the Liberal government began to reformulate current policies designed to attract FDI. As the previous chapter demonstrated, overall percentages of global FDI flows directed at Canada had been dropping consistently. In 1980 Canada enjoyed 11 percent of global FDI funds; by 1996 that percentage had dropped to 4 percent. Moreover, two-thirds of Canada's total was comprised of brownfield investment – the reinvested earnings of MNCs already possessing significant subsidiary operations in

Canada. Greenfield investment – essentially new investment by companies not possessing a significant operating presence in Canada – made up the remaining one third.[46] These figures enticed the Liberal government to enact a two-pronged strategy. First, it was necessary to raise the overall Canadian economic profile to encourage already existing MNCs to entrust their Canadian subsidiaries with a world product mandate. Second, significant effort was necessary to encourage other MNCs to make greenfield investments in Canada. Doing so would require an integrated public and private sector effort.

In 1996 the Liberal Cabinet approved an aide-memoir that outlined an integrated government-wide strategy to the cultivation of foreign direct investment.[47] The document adumbrated five key priorities:

a) The need to advertise Canada's capabilities in knowledge-based industries to foreign investors who still perceived Canada as primarily a resource based economy;

b) To target MNCs operating in specific sectors, and to make particular government efforts to encourage them to invest in Canada;

c) To address at the company level the specific corporate concerns that hinder investment – such as tax, regulatory, and training issues;

d) To help Canada SMEs achieve greater expansion opportunities through partnering;

e) To develop a Team Canada approach that integrates the investment efforts at all levels of government and with the private sector.

An elaboration of each of these key elements will further illustrate the adoption of a co-operative model of business-government relations.

Shifting the international perception of Canada away from its traditional resource strengths and towards its capabilities in knowledge-intensive industries became the key initial step. Governmental efforts to achieve this goal involved senior Ministers and even the Prime Minister himself. The Prime Minister's participation in the World Economic Forum in the winter of 1998/1999 was repeatedly cited in interviews as an attempt to promote Canada's image as a knowledge-based economy to global investors.[48] The ministers of Trade and Industry have placed a priority on meeting with senior executives at major corporations to outline the virtues of the Canadian investment climate. Buttressing these efforts from senior Ministers was an elaborate marketing and education campaign created and delivered by the civil service. Brochures, pamphlets, and booklets were produced and distributed internationally, detailing Canada's investment advantages. Investment staff have been added to many of Canada's missions abroad, who are directed to make contact with potential local investors and to advertise Canada's potential for their investment. Foreign executives recently posted to Canada are encouraged to give speeches in their home countries about the positive experiences they have garnered in Canada.[49] All such efforts are directed at enhancing Canada's image as an investment location.

The efforts at raising awareness reflected the realities of the global political economy. The promotional campaign efforts do not advocate investment on the basis of serving the Canadian market alone. They are based instead on the creation of a Canadian-based North American investment platform that can serve the American and emerging Mexican markets as well. It is clear that the Canadian government regards the inherent attraction and strength of the American market as the primary inhibitor to investment in Canada. Canadian officials' conversations with private executives have indicated that the ability to serve the American market from a Canadian base is not well understood, and that this reflects the attraction of the strong American market, and not the weakness of the Canadian one. Advertisement and continuous contact with potential foreign investors is the perceived remedy to counteract the perceptions inhibiting foreign investment in Canada.

The second priority was to make particular efforts to attract investment from targeted companies operating in specific sectors. The sectoral and "cluster" strategy form the foundation of several current government programs, about which more will be said later. It was clear from the 1996 aide-memoire that not all foreign investment was equal; that investment that built upon Canada's emerging strengths in knowledge-based industries was to receive particular government attention. The aide-memoire outlined the following knowledge based industries as key to Canada's economic future: information and communication technology, life sciences, agri-food, aerospace, automotive, speciality chemical, mining, and forestry products.[50] Involved in this strategy is the targeting of particular MNCs operating in those sectors. Analysis is performed of a company's current operation, and then a business case is developed and presented to executives from the targeted company, detailing arguments about the business benefits of investing in Canada. This strategy demands a constant monitoring of major MNCs strategic decisions and an aggressive cultivation of their investment dollars by the Canadian government.[51]

The third element of the investment strategy involves addressing the specific concerns that multinationals express when they consider Canada as an investment site. Government efforts are made to contact specific firms to find out the source of their trepidation, which usually centres upon tax, regulatory, or training issues that increase the perceived costs of doing business in Canada.[52] Often such concerns were found to be based on misperceptions – companies often professed concern with Canada's high tax rates, but are also often found to be ignorant of the degree of public service and infrastructure provided by the various levels of government. Other misperceptions result from ignorance of the specific programs available to companies operating in Canada, such as compensatory programs and tax incentives for training and research and development expenditures incurred in Canada. Curing such misperceptions became a government wide priority.

It was necessary to achieve a government consensus on that priority, because correcting such misperceptions requires a collaborative government effort. It is apparent that global businesses require detailed information on a wide spectrum of investment issues before making their investment decisions; and they demand rapid and easy access to that information. Much of the Canadian investment strategy, therefore, has been information based. It includes the creation of integrated publications, internet sites, and the publication of online industrial and statistical information that allows exporters and investors to rapidly accumulate the necessary information.[53] No single government department possesses all the relevant expertise. Providing that information requires a collaborative government wide response.

The 1996 aide memoir placed a fourth priority on developing Canada's SMEs through the strategic use of partnerships with potential investing firms. The government recognises that such firms often have unique needs that could be well served by selective government support. To begin, such firms often need to expand internationally to grow, having satiated the Canadian market potential. Yet they lack the specific in-house expertise and experience in penetrating and operating in a foreign market. Moreover, firms operating in the high-technology industries – which are typically small, and possess exciting but unproven technologically advanced products – would benefit by having their capabilities revealed to foreign investing and partnering firms. Expansion abroad for such firms often depends on establishing reliable domestic partners who can provide the associated local distribution and marketing expertise. Larger multinationals may also integrate the newer technology products into their production networks. Cultivating international awareness of the technological capabilities of Canadian SMEs remains a government priority.

The Government of Canada recognises that it can aid the facilitation of such partnerships in several ways. It can establish a readily accessible and comprehensive market information system designed to provide exporters with the information they need to expand abroad. This the Liberal government has done, enacting a widespread public-information campaign composed of integrative websites, marketing brochures, and the compilation of sector and regional specific data. The government also sees its role as one of facilitator. For example it regularly sponsors venture financing partnership seminars in selected markets, particularly for companies operating in the information technology (IT) sector. Such seminars are designed to introduce representatives of Canadian high-tech firms to foreign venture capital companies.[54] The federal government also works in partnership with the provincial and municipal levels to sponsor similar events in Canada. Such efforts indicate a government committed to the facilitation of SME success abroad.

Such activities aimed at cultivating partnerships with firms and with different levels of government were a key component of the fifth and final priority outlined in the 1996 aide-memoir. The cultivation of a "Team Canada" approach to cultivating foreign investment – in which all levels of Canadian government played a role alongside private sector elements – has become a central priority. It also demanded that government experts from different department collaborate, that provincial and municipal governments are actively involved, and that consultation with the private sector in program and policy planning is encouraged. Finally, the idea of partnerships needed to become the guiding mandate for new economic programs and government organisations. One key example is the aptly named Investment Partnerships Canada.

Investment Partnerships Canada

In 1996 the Government of Canada publicised an investment strategy intended to reverse the decreasing percentage of FDI into Canada. The strategy held several key aspects that were outlined in the following government statement:

> The strategy includes more focussed marketing campaigns in the world's top five investment source countries, strategic campaigns targeting specific multinational enterprises, helping small businesses establish investment partnerships, and improving the investment climate within Canada.[55]

An integral part of this strategy was the creation of Investment Partnerships Canada (IPC), created in December of 1996. IPC's very title indicated collaboration. IPC was to be an organisation comprised of individuals from both DFAIT and the Department of Industry, whose mandate was to "secure high profile, strategic investments in key growth sectors, and to retain strategic investments where they are at risk." [56] IPC has four central objectives: first, to identify potential opportunities to retain, expand, and attract new international investment from multinational enterprises (MNEs). Its second objective is to select the best of those opportunities and to promote the Canadian case via the presentation of an established business case to potential investors. Third, IPC establishes investment strategies for each of the selected opportunities, concentrating on the central sectors outlined earlier. Finally, IPC "draws on the resources of Industry Canada, Foreign Affairs and International Trade Canada, other federal departments, embassies, and business networks abroad to implement the strategies."[57] IPC is an interdepartmental investment program.

Translating these overall goals into operational terms requires the efforts of some 40 people under the overall leadership of a senior director.[58] These personnel are charged with targeting specific corporations that operate in strategic sectors, and to provide those corporations with analysis and recommendations on why they should invest in Canada. Many of the corporations have already established operations in Canada, in which case IPC attempts to convince them to maintain those operations and develop them into a region-spanning production centre. Other efforts are directed at companies that are not involved in Canada but which may be induced to make such investments. IPC targets corporations acting in specific industries and from specific home countries. The traditional sources of foreign investment are emphasised – companies domiciled in the United States, Great Britain, France, Germany, and Japan. Companies domiciled in lesser but emerging investing countries are also targeted, though with less intensity.[59] The overall effort is designed to emphasise Canada's specific strengths and match them to the perceived investment needs of MNEs.

IPC operates under a clear perception of the realities of the international business environment and the challenges that Canada must meet in order to compete successfully. The communication function is one of IPC's central tasks. IPC commissions studies and issues reports designed to illustrate the attractiveness of Canadian municipalities for investment, especially in comparison with possible American investment alternatives.[60] It creates actual business case costings of investment in Canada and presents them to the executives of large multinationals contemplating investment. Often such multinationals have no experience operating in Canada; consequently, much of the business analysis includes a description of available public programs that encourage investment, research and development, and worker training. Cultivating the simple awareness of Canada as a potential investment site for serving the American market remains the top priority for the organisation. Canada's investment attractiveness depends upon its ability to provide a competitive manufacturing platform for servicing the North American market.

IPC's operations involve teams of government officials, spanning several departments and holding differing lines of responsibilities. Members of the team are selected to provide the specific industrial and policy expertise needed to provide information to potential investors. Often such teams include representatives from Foreign Affairs, Industry Canada, Revenue Canada and the Department of Justice. These representatives possess the specific tax, legal, and regulatory knowledge required to address company concerns. The teams also include various industrial specialists who have a thorough knowledge of both the company and the industry. Such specialists are charged with monitoring companies operating in the strategic sectors in which Canada wishes to obtain investment. Indications that a company is considering foreign investment are met with an immediate response from the investment teams, who rapidly develop a business case that illustrates why Canada should receive that investment. The aggressive marketing of Canada as an investment site requires a collaborative, integrative, and immediate government response.

IPC also fosters communication and partnership with municipal and provincial governments. This is critical. IPC's director, David Adam, notes that ultimately foreign investment decisions are based on the attractiveness of the individual municipality as an investment site, rather than on the overall national economic environment.[61] Consequently, IPC works with local municipalities in trumpeting investment advantages. Moreover, IPC recognises that the main hindrance to increased investment in Canada is the economic pull generated by the United States. Mr. Adam bluntly stated that "nobody would come to Canada to invest for the purpose of the Canadian market. They come to invest in Canada for access to the United States."[62] Competing successfully requires that IPC continually reiterate Canada's strength as an investment site for high-technology knowledge-intensive industries.

IPC's goals are sectoral specific. Not all investment is viewed equally; investment from companies operating in key strategic sectors are particularly prized. The strategic sectors outlined earlier – particularly aerospace, communications and information technology – are targeted directly. IPC maintains a strategic list of approximately 100 companies from which Canada hopes to attract investment[63], and most if not all of these companies operate in these sectors. Much of the organisation's analytical work is devoted to monitoring the strategic direction of the industry in general and the more specific decisions of the leading companies operating in the sector. Contact with industry executives and administrators from industry associations is a daily occurrence for IPC personnel, and their input provides information vital to IPC's efforts to attract investment. Current knowledge of industrial evolution and constant contact with the private sector allows IPC's personnel to stay current.

Adam was quick to note that support for the overall investment strategy and the particular efforts at IPC was nearly unanimous throughout the government, and that support also extended from the private business community and even labour groups. He noted that labour groups recognise the importance of FDI in job creation and support the overall government objective of attracting more foreign investment. IPC serves the objectives of job creation, sectoral development, and the facilitation of greater investment into Canada. It trumpets Canadian abilities in the high technology sectors. This task is made easier by a second Liberal government program, also inaugurated in 1996, the object of which is to increase Canadian competitiveness is specific knowledge-based industries. That program is entitled Technology Partnerships Canada.

Technology Partnerships Canada

In the fall of 1997, the Liberal government delivered a Speech From the Throne that emphasised its commitment to building a knowledge-based economy possessing advantage in high-technology innovation. The primary features of alliance capitalism could be found within the text – an emphasis on partnerships, a recognition of the reality of business networks, and a realisation that knowledge had replaced resources as the key sustainable base for Canadian economic development. It noted that "the revolution in the knowledge and information economy is transforming all sectors of the economy." While proclaiming that "Canada is well positioned to be a world-leader in the global knowledge-based economy", the Speech also asserted that leadership depended upon active government support. The government was determined to provide that leadership through building "creative partnerships between the private and public sectors to accelerate the adoption of innovative technologies." The government reiterated its "targeted growth strategy" in sectors in which Canada held a perceived advantage, such as "aerospace, biopharmaceuticals, biotechnology, ... and the environmental, information, and telecommunication technologies."[64] A sectoral-based innovation strategy that emphasised partnership with the private sector became a stated government priority.

The Technology Partnerships Canada (TPC) program, chartered on December 2, 1996 became the instrument through which the government pursued that policy. TPC is an industrial assistance program provided by the Federal government which loans federal funds to companies operating in the latter stages of product development in specific industries. Its Charter allows it to assume up to a 33 percent (extendible to 50 percent in a few specialised cases) of the projected costs of individual projects. Loans are repayable subject to the commercial success of individual projects; repaid funds remain under TPC's control and are not returned into general government revenue. TPC's investments are focussed on the "near market end of the R&D spectrum and on quality companies with high-risk, high potential projects in identified markets."[65] Companies applying for TPC aid require extra funding to develop high-tech products to market, after investing the bulk of the resources needed for basic product research.

TPC is designed to fill specific industrial needs. One primary purpose is to replace the Defense Industry Productivity Program, which had been designated specifically as a government program to aid the aerospace industry.[66] TPC's mandate is somewhat broader; it operates in three specific areas – environmental technologies, enabling technologies, and aerospace and defence. A second and more strategic goal is to provide financial assistance to SMEs in the latter product development stages, in order to facilitate their bringing products to market. Such firms often enact niche strategies within overall high-technology business networks; they also typically offer only a few products designed to fill very specific customer needs. Often such firms are unable to secure development funds from traditional financing sources.[67] The development of such products entails high development costs; financing these costs through traditional lending agents often proved difficult as many SMEs held little in the way of physical collateral. TPC is designed to solve the financing problem.

TPC's mandate is clear:

> TPC is mandated to make high risk, repayable investments in near market product and process technology development to stimulate economic growth and create jobs in Canada. It is to provide investments to build the industries of the future in the environmental and enabling technologies by supporting the development and diffusion of these technologies to the rest of Canadian industry....[68]

TPC is a professional organisation "dedicated to working in close partnership with other parts of the federal government and the private sector, capable of making strategic high-risk investments..."[69] Overall objectives are several. TPC is to advance and support other government initiatives, such as the Jobs and Growth Agenda, "within the context of fiscal restraint and globalised competition in an increasingly knowledge-based economy." It is to aid in economic growth and to support sustainable development by encouraging Canada's industrial skill base and by aiding competitive SMEs in all the regions of

Canada. Some of its guiding principles include an explicit emphasis on SMEs and on cultivating partnerships with other government departments and with members of the private sector.[70] The tenets of alliance capitalism are found in the origins and mandate of TPC.

The Charter of TPC outlines methods for achieving these objectives. In the area of environmental technologies, innovative technologies are to be introduced through the "encouragement of strategic alliances of producers and users." The "Enabling Technologies" component is aimed to "enhance the international competitiveness of industry through the development, application, and infusion of technologies." It supports "Canadian firms as well as alliances which may include foreign firms, universities, or research institutes that pool resources on high risk projects." Finally, the Aerospace and Defence component emphasises the key role this industry plays in the technology development of Canada. TPC is to help specific firms to adapt to the defence conversion process through the selective support of "dual use" technologies. The Charter committed TPC to direct projects that built on existing technological capabilities and that encouraged the employment and export base of the aerospace sector.

Partnerships within the government and between TPC and the private sector are not only encouraged, but are vital to the program's operation.[71] At the operational level, each proposed case is evaluated through a team approach that includes government members from diverse departments who possess needed industrial expertise. Industry Canada partners included Sector Branches (SBs) personnel who provide specific expertise in evaluating proposed business cases. At the administrative and executive levels, TPC in controlled by an Interdepartmental Advisory Committee that includes among others representatives from Environment Canada, the Department of National Defence, the National Research Council, and the Canadian Space Agency. Finally, employees at TPC are in daily contact with representatives of the relevant industries, which allows them to maintain an up-to-date awareness of industry development. Partnership is a vital component to TPC's operation.

In a speech describing TPC, Industry Minister John Manley noted the apparent success of the partnership between government and the aerospace sector, which he argues "contributed to building an industry that is world competitive."[72] In the same speech he noted that "the Government of Canada does recognise the need to partner with the private sector to make the critical investments needed to keep the aerospace industry competitive."[73] Industry commentary was also generally positive. The Financial Post noted that the introduction of TPC "should sharpen priority at the cabinet level. With its stress on private-sector commercialisation and partnership opportunities, it also brings a needed market-focused approach."[74] The success in terms of applications is apparent. By the winter of 1998 TPC had already committed its yearly budget, yet Manley noted that "we had 40 or so investment quality projects sitting in the queue that we couldn't fund," a reality that led him to press Paul Martin for an additional $100 million in funding.[75] Martin responded by increasing TPC annual allotment by $50 million annually, to a current total of $300 million a year. In terms of program expansion, TPC became successful quickly.[76]

The members of TPC do not view the program as a strategy of "picking industrial winners", a function that they acknowledge is best left to the private business ventures and the workings of the market. They are quick to note that the products they support have been developed almost entirely beforehand by the private sector. Members of each case analysis team have extensive industrial experience in the particularly technologies, expertise developed through experiences in various government departments. They have tied government participation in the program to expected returns; preliminary returns indicate that most projects will have a positive cash flow with a relatively low risk of default. The primary program advantages for industry is a preferential loan schedule and a solid base of funding for knowledge industries. These conditions, they argue, indicate an appropriate level of government support, carefully targeted, and which fulfils the overall government concern for fiscal prudence.

Other Current Government Efforts

Current policy efforts from the Department of Industry reflect a continued priority for partnerships, sectoral strategies, and continued investment in knowledge-based industries. Industry Canada's 1998-1999 Report on Plans and Priorities outlines five key challenges that Canadian industrial policy currently faces. The first is to encourage productivity growth. Canadian productivity levels lag behind those of its main competitors, particularly the United States. The second priority is to close the "innovation gap" in research and development and technology adoption. The third is to continually improve Canadian human-resource capabilities. The final two priorities involve trade and investment. Canadian efforts to encourage more firms to conduct more trade in more sectors in diverse markets will continue. The final Industry Canada priority is "to attract and retain more global knowledge-based multinational enterprises."[77] This demonstrates a large shift in Liberal attitudes towards the MNC that has occurred since the era of Pierre Trudeau and the Foreign Investment Review Agency.

The current Department of Industry views industrial strategy as a recipe of three complementary ingredients. The first is detailed micro-economic policy that combines leading-edge research on Canadian economic issues, which can be incorporated meaningfully into the associated trade and investment policies. The second component involves industrial sector development, which includes increasing the number of participating firms, attracting and retaining new sectoral investment, and encouraging technological innovation. The final component is the creation and maintenance of an effective system of marketplace rules and services. This involves the creation and sustainment of an effective system of standards and regulations, effective administration and enforcement of those regulations, and the encouragement of international acceptance of Canadian marketplace standards.[78]

Included in the overall industrial strategy is the continued support of a sectoral strategis for various industries. On 3 December 1998, Industry Canada outlined the current plans and future prospects of the Canadian biotechnology sector, which involved extensive consultations with industrial and academic researchers and which identified key competitive advantages of the Canadian biotechnology strategy.[79] Similar sectoral and promotional efforts have been undertaken in the automotive and aerospace industries, among others.[80] The similar themes throughout such strategies are a government commitment to identifying and promoting Canadian strengths, as well as promoting those strengths to the international marketplace. In each of these sectors government's role as a facilitator is emphasised. The biotechnology strategy notes that "a strong message was received from the overall consultation process that the federal government cannot and should not act unilaterally on biotechnology issues." It concluded that "by acting as a catalyst rather than a sole agent, the federal government can play a positive role in facilitating advances in biotechnology." [81] The sectoral, partnering strategy remains a powerful one in the Federal government's industrial policy.

The Proposed Multilateral Agreement on Investment

In the summer of 1997, international delegates from various developed and developing nations met to discuss the possibility of the creations of a Multilateral Agreement on Investment (MAI). The MAI was supposed to model the process that had been so successful in liberalising the world trade regime. It recognised that the global boom in foreign direct investment now had great implications for the global economy that would benefit from greater institutionalisation of regulation. Preliminary discussion focused on the need to codify and regulate a set of general rules that governed MNC investment into the participating countries. Measures discussed included the provision of a dispute settlement mechanism and codified investment provisions. Other measures intentionally limited the type of investment-limiting or investment-controlling legislation that domestic governments could enact.

Canada agreed to take part in the preliminary discussions, but it was apparent quite early on that the Liberal government would have difficulty ratifying it. Canada's preoccupation with cultural protection in investment matters – which had found expression in various provisions of both the CUFTA and NAFTA agreements – has been well established. Yet it had become clear in preliminary discussions that imbedding similar protective measures in the MAI would be difficult, if not impossible, to achieve.[82] Moreover, the possibility of the agreement raised intense public opposition in Canada. Spearheaded by Maude Barlow, head of the Council of Canadians, such opposition argued that an increasingly liberal investment agreement would destroy Canada's ability to defend its own culture and interests from those of large multinational corporations. Opponents of the MAI inaugurated a vigorous and co-ordinated opposition plan that many credit with forcing Canada to abandon support of the MAI in its current form.[83]

Implications --The Politics of Partnership

Kenneth Kernaghan offers a comprehensive outline of both the types of partnerships public service personnel can pursue and the conditions necessary to ensure their success. He notes that the degree of co-operation between elements of the public and private sectors can vary across a wide spectrum, from acts of mere consultation to the explicit endorsement of private sector entities to fulfil public functions.[84] He notes that successful partnerships provide several benefits, including reduced bureaucracy, more harmonious labour-management relations, and an enhanced governmental understanding of client needs. Finally, Kernaghan outlines the conditions that facilitate successful partnerships. Such conditions include an inclusion of all stakeholders "whose contribution is necessary for achieving the partnership's goals", a high degree of mutual dependence and pooling of resources between the partnership's constituent elements, and the statement of limited, formalised objectives that the partnership is meant to accomplish. Kernaghan also notes that the onset of globalisation has made private and public co-operation central to economic success, arguing that "global competition, economic recession, and public unhappiness with conflict between business and government provide powerful arguments for more harmonious business-government relations." He concludes with the following; "the synergistic effect of successful business-government partnerships enables the two sectors to achieve objectives that otherwise would be unattainable."[85]

It is precisely this "synergistic effect" which is the distinguishing characteristic of alliance capitalism, and it is an apt description of the Liberals' use of such partnerships in economic policy. This chapter has argued that the use of such partnerships has been both central and strategic in the Liberals' overall economic agenda. It has been central both because of the overall commitment to fiscal prudence and because the government realises that there are clear limits to its ability to direct and influence the marketplace. It has been strategic in the sense that the selective use of partnerships is thought to be the best method of encouraging the development of the knowledge- based economy, and in particular the specific industrial sector strategies.

The characteristics of the federal economic strategy have been largely consistent. Much of the government's effort has concentrated solely on promotion – simply raising the international awareness of Canadian capacities in knowledge-based industries has consumed a large portion of the government's attention. Shedding Canada's international image as purely a resource-based economy remains an ongoing priority, as shown by the continuing Trade Canada missions. Secondarily, the government has concentrated on enhancing industrial capacities by selectively supporting certain types of industrial development and by encouraging particular firms to invest in certain sectors. Support has been limited to the product development stage and is expected to become fully cost-recoverable, while IPC has concentrated on a select group of firms whose investment would encourage Canadian economic development.

The paradigm of alliance capitalism emphasises consistency across government departments and the utilisation of existing resources in a co-operative fashion. The teamwork exhibited by the Department of Foreign Affairs, the Department of Industry, other government groups, and other general stakeholders in the Canadian economy is testimony to that consistency. Several interviewees noted that the degree of co-operation in forwarding the Team Canada trade and overall Liberal investment strategy has been consistent, even when such co-operation often intrudes into several departments' areas of responsibility.[86] Enforcing policy discipline on the various departments has been for the most part a manageable task.

Alliance capitalism in Canada marks an increasing interrelationship between foreign and domestic policy. The Chrétien government continues to pursue an open, rules-based bilateral and multilateral trading system that had been the centrepiece of the Conservatives' foreign economic policy. Yet in its judgement the federal government needs to do more. It can serve Canadian economic interests by acting as a facilitator for greater Canadian participation in the world economy. It can shape the domestic economy by enacting polices designed to give impetus to the transition to the knowledge-based economy. It can build upon established Canadian sectoral strengths. Finally, it can utilise partnerships with other Canadian economic stakeholders in the pursuit of all these goals. This the Chrétien government has done and, by all indications, will continue to do for the remainder of its governing tenure.

Endnotes

[1] Despite campaign promises to re-open the NAFTA agreement negotiations, the Chrétien government made no serious attempt to do so upon achieving office. Moreover, Canada's membership in the World Trade Association – the institutional expression of the GATT commitment to create a multilateral regulatory trade organization – was quickly ratified. Interview and anecdotal evidence indicates that refuting these agreements did not receive serious policy consideration from the Liberal government.

[2] Canada, House of Commons, Debates, "Speech From the Throne", 18 January 1994, p. 10.

[3] Canada, House of Commons, Debates, "The Budget", delivered 22 February 1994, p. 1708.

[4] Ibid., p. 1712.

[5] Ibid., p. 1710.

[6] Ibid., pp. 1708-1714.

[7] John Manley, Minister of Industry, Address to the House of Commons, Canada, 21 January 1994, p. 162.

[8] Ibid, p. 163.

[9] Interview with Dr. Someshwar Rao, Director, Strategic Investment Analysis, Industry Canada, 5 May 1999.

[10] Interview with Zulfie Sadeque, Deputy Director, Investment, Science and Technology Division, Department of Foreign Affairs and International Trade, May 13 1999.

[11] Mr. Dennis J. Mills, Parliamentary Secretary to Minister of Industry, Introducing the Department of Industry Act. Canada, House of Commons, Debates,, 26 September 1994, pp. 6116.

[12] Government of Canada, Bill C-46, "Department of Industry Act", 16 March 1995, Part I Section 5.

[13] Ibid, Part IV, section 13.

[14] Canada, House of Commons, Debates, 26 September 1994, pp. 6119-6131.

[15] Ibid, p. 8640.

[16] Hon, John Manley, Minister of Industry, Canada, House of Commons, Debates, 24 February 1994, p. 1775.

[17] Ibid, pp. 1775-1776.

[18] Ibid, p. 1777.

[19] Gilles Mcdougall and David Swimmer, Industry Canada, Working Paper #16, Business Strategies of SMEs and Large Firms in Canada, (Ottawa: Micro -Economic Policy Analysis, 1997).

[20] Hon. John Manley, Speech From the Throne, 21 January 1994. House of Commons, Debates, p. 163.

[21] John Manley, House of Commons, Debates, 5 December 1994, p. 8640.

[22] Isaiah A. Litvak, "Public Policy and High Technology SMEs: The Government Embrace", Canadian Public Administration, 35(1), 1992, pp. 22-38.

[23] There is some anecdotal evidence that such absorption into a larger US network is in fact the primary goal of many SME start-ups. Such absorption typically involves a high sale price and reaps large rewards for successful entrepreneurs.

[24] Ibid, pp. 37-38.

[25] For an elaboration, refer to the later section in this chapter on Technology Partnerships Canada.

[26] Notes for an Address by The Honorable Roy MacLaren, Minister for International Trade, At the Canadian Luncheon, Davos, Switzerland. Canada, Department of Foreign Affairs and International Trade, Statements, 1994.

[27] Canada, House of Commons, Debates: The Speech From the Throne, 18 January 1994, p. 10.

[28] Address by Roy MacLaren, Minster for International Trade, to the Parliamentary Debate on Canada's Foreign Policy Review. 15 March 1994. Canada, Department of Foreign Affairs and International Trade, Statements, 1994.

[29] Hon. Roy MacLaren, Minster for International Trade, "An Address to the Parliamentary Debate on Canada's Foreign Policy Review", 15 march 1994, p. 3. Canada, Department of Foreign Affairs and International Trade, Statements, 1994.

[30] Ibid., p. 5.

[31] Hon. Roy MacLaren, Minister for International Trade, Deutsche Bank Dinner, 21 July 1994, p. 1. Canada, Department of Foreign Affairs and International Trade, Statements, 1994. In this statement MacLaren noted that "Efforts to bring investment under the discipline of the international trading system have so far been limited essentially to regional agreements; and only preliminary work has been done to build bridges between these groupings or, more globally, to develop an international agreed set of rules governing investment." He then noted that investment was one of the "the most practical market penetration techniques between regional economic groupings such as North America and Europe".

[32] Hon. Roy MacLaren, Minister for International Trade, Address to the International Trade Committee of the Board of Trade and Metropolitan Toronto, 26 September 1994, p. 2. Ibid.

[33] News Release, Government of Canada, "MacLaren and Manley Launch the 1994-1995 International Trade Business Plan", 18 March 1994.

[34] See the various Government of Canada publications, Canada's International Business Strategy (Updated annually; selected Regions).

[35] Address by Roy MacLaren, Minster for International Trade, to the Standing Committee on Foreign Affairs and International Trade, 8 March 1994. Canada, Department of Foreign Affairs and International Trade, Statements, 1994.

[36] Hon. Roy MacLaren, Minister for International Trade, Address to the Canadian Exporters' Association, 22 February 1995, pp. 3,5. Ibid, 1995.

[37]Hon. John Manley, Minster of Industry, Speech to the House of Commons, "Job Creation and Economic Growth", 5 December 1994. Canada, House of Commons, Debates,, 1994, p. 8639.

[38] The Team Canada missions have emphasized regions in which Canadian trading activity has been underrepresented. To date, the missions have gone to selective countries of the Far East, to China, and to Latin America. In the fall of 1999 a further mission is planned for Australia and Japan. These areas represent potentially high economic growth, and the Team Canada missions are designed to diversify Canada's trade reliance on the United States and Western Europe.

[39] During the interview Mr. McGovern made repeated reference to the concept of "stakeholders" as participants in the mission. He noted that the government considered that all wealth-generation agents – industrial, educational, and political – were considered equally important to the missions success. He noted that the Prime Minister based the "Team Canada" approach as exactly one that was inclusive of all aspects of Canadian society.

[40] Interview with Peter McGovern, Director, Team Canada Department of Foreign Affairs and International Trade, 9 May 1999.

[41] Ibid

[42] According to McGovern, the missions served to help heal some of the damage in federal provincial relations emanating from the wake of the failed Charlottetown accord initiative. Inclusion of the provincial premiers was a very clear initial priority for the federal government.

[43] McGovern noted that this lack of follow-up is intentional for tow reasons. First, tracking the success and spin-offs from each mission would be time consuming and would drain the Department of resources. Secondly, he noted that such follow up might be interpreted as a government effort at overt direction and industrial "shepherding" of the business community, which he stressed the government wished to avoid.

[44] The points in this paragraph are currently under discussion at DFAIT, but the likelihood of their fruition is quite high. Ibid.

[45] There is considerable debate about the ultimate efficacy of the Trade Missions. Supporters argue that the collaborative international approach gives Canadian businesses valuable exposure to international markets, and important contact with policy makers. Critics contend that the missions are designed to project an image of Canadian unity abroad. They also argue that the success of the missions in increasing trade levels is hard to measure since no follow-up studies are recorded. For an examination of the debate, see article in The Globe and Mail, 10 September 1999. P. A1.

[46] Interview with Dr. Someshwar Rao, Director, Strategic Investment Analysis, Industry Canada, 26 April 1999.

[47] The aide-memoir itself had not been made public. The author was made aware of its contents through an interview with Mr. Zulfie Sadeque, Deputy Director, Investment, Science and Technology Division, DFAIT, May 13, 1999. The description of the contents of the document are also drawn from that interview.

[48] Interviews with Mr. David Adam, Director, Investment Partnerships Canada, and with Mr. Zulfie Sadeque, May 13 1999.

[49] Interview with Zulfie Sadeque, who used as an example a German expatriate whose positive experience in Canada encouraged him to make numerous speeches upon his return to Germany. Such positive endorsements from practicing managers, according to Mr. Sadeque, is invaluable as an investment

promotional tool, and holds more credibility to potential investors than does the government's promotional efforts.

[50] Ibid.

[51] This point was made with particular strength by Zulfie Sadeque in an interview on 13 May 1999. Sadeque noted that the Canadian investment attraction team is able to move quickly to convince an MNC that is considering investment to look seriously at Canada. He noted that this demands rapid response time and a thorough knowledge of company strategies and operations garnered beforehand.

[52] Interview with Zulfie Sadeque, 13 May 1999. In an effort to correct misperceptions of the Canadian investment climate, the government commissioned accounting firm KPMG to conduct a study detailing the business costs associated with Canada. The study concluded that such costs were not significantly higher than those incurred in competing OECD countries, and were in several instances substantially lower. See KPMG,

[53] The creation and maintenance of the Industry Canada website *Strategis* involves a massive compilation of industrial, sectoral, and economic data. Yet its very comprehensiveness makes it an invaluable business analysis tool for both foreign based and Canadian businesses alike.

[54] Peter Sutherland, Director General, Trade Commissionr Service, DFAIT, "Investment Promotion: The Federal Government's Strategy and Priorities", Presentation made at Montréal International, 04 June 1998, p.24.

[55] Government of Canada, The Investment Strategy and Investment Partnerships Canada, (Ottawa: Minister of Supply and Services, 1996), p. 1.

[56] Ibid., p. 7.

[57] Ibid., p. 8.

[58] At the time of this writing that director was Mr. David Adam.

[59] Interview with Zulfie Sadeque, 13 May 1999. Sadeque noted that sources of foreign investment were grouped into Priority A countries- the traditional sources of the U.S.A., U.K., France, Germany, and Japan – and Priority B countries Switzerland, Sweden, The Netherlands, and Italy, and in the Asia Pacific Region Australia, Korea, and Hong Kong and Taiwan.

[60] A recent example of such a report is a study commissioned by IPC and carried out by KPMG, a global accounting and consulting firm. The report contains overall analysis of various Canadian municipalities as sites for investment, and make direct comparisons with business costs in the United States, Europe, and Japan. KPMG, The Competitive Alternatives: A Comparison of Business Costs In North America, Europe, and Japan, (KPMG: Vancouver, 1999).

[61] Interview with Mr. David Adam, Director, Investment Partnerships Canada, 13 May 1999.

[62] Ibid.

[63] Ibid.

[64] Government of Canada, Speech From the Throne, 23 September 1997.

[65] Technology Partnerships Canada, Special Operating Agency (SOA) Framework Document, p. 16.

[66] The DIIP program was deemed a Cold-War relic, largely because of its pure focus on the defense-related industries. The Liberals wished a broader program whose emphasis was on the development of commercial and marketable – rather than purely defense-orientated – technology.

[67] Reasons for the lack of "finishing" capital include a general reluctance by banks to lend money to such ventures. Often high tech firms lack necessary physical capital to secure such loans. They also are often unwilling to loan money for cutting edge technological products whose function they do not fully understand and for a market that may not yet exist.

[68] Technology Partnerships Canada, Charter, 2 December 1996, p. 3.

[69] Ibid.

[70] Ibid., pp. 3-5.

[71] Interview with Mr. Walter Simms, Senior Analyst, Technology Partnerships Canada, 13 May 1999.

[72] John Manley, Minister of Industry, Speech to the Aerospace Industries Association of Canada, 3 April 1998.

[73] Ibid.

[74] Neville Nankivell, "National Strategy See Potential for Job Growth", The Financial Post, 12 March 1996, p. 15.

[75] Alan Toulin, "Research Factions Vie For Money", The National Post, 21 February 1998, p. 10.

[76] TPC also invoked the ire of Canada's international competitors in the aerospace industry. TPC's close association with the aerospace arm of Bombardier engendered charges of illegal subsidization from Bombardier's primary competitor in the regional-jet market, Brazilian-based Embraer. The Brazilian firm argued that TPC extended illegal subsidies to facilitate an export-orientated industry, in contravention to World Trade Organisation (WTO) conventions. In February 1999, the WTO ruled that TPC did indeed constitute an illegal subsidy program, despite Canadian arguments that such subsidies are commonplace among it major competitors, although they are usually cloaked under defense spending programs. The case at the time of writing was under appeal, although Industry Minister John Manley was quick to say that Canada would fix the TPC program according to WTO regulation. What this entails is not clear as yet. The Globe and Mail, 23 February 1999, p. B4.

[77] Industry Canada, 1998-1999 Estimates: A Report on Plans and Priorities (Ottawa: Government Printing Office, 1998), p. 3.

[78] Ibid., section III, p. 2.

[79] Bio Industries Branch, Industry Canada, Building the Canadian Biotechnology Strategy, (Ottawa: Industry Canada, 3 December 1998).

[80] See documents, Industry Canada, Canada's Aerospace & Defence Industry: World Class Capabilities, Internationally Focused, (October 1998), and Marc Angers, Why Invest In Canada's Automotive Industry? (Ottawa: Industry Canada, December 2 1999).

[81] Building the Canadian Biotechnology Branch, p. 5.

[82] Interview with Peter McGovern, Director, Team Canada Inc., Department of Foreign Affairs and International Trade, 9 May 1999.

[83] Government officials are not so generous and argue that, as previously indicated, Canada was unlikely to support the agreement in any event. They also admit, however, that they underestimated both the strength and the organisational capability of the anti-MAI sector of the Canadian public.

[84] Kernaghan notes that the central characteristic of partnerships is the intentional sharing of decision-making power between or among the partners. This can range from mere consultative arrangements, in which private elements are allowed input into the policy process, to collaborative partnerships which "involve the pooling of resources such as money, information, and labor to meet shared or compatible objectives." He also notes the presence of "operational" partnerships, which involve a sharing of work rather than decision-making power. This typology of partnerships, which involves a considerable amount of classificatory overlap, encompasses most of the public/private sector partnerships in use today. Kernaghan, "Partnerships and Public Administration", pp. 60-65.

[85] Ibid., p. 71.

[86] David Adam in particular noted that, in his experience there was almost no internal opposition to the general government strategy of attracting FDI, and that the public opposition to the strategy has become increasingly marginalised. For an explanation of why interdepartmental cooperation is often so difficult to achieve, see Donald J. Savoie, The Politics of Public Spending in Canada (Toronto: University of Toronto Press, 1990).

Chapter 7 – Conclusion and Implications

It is important to note that the characteristics of alliance capitalism are found in other countries as well as Canada. Similar measures are being taken in other developed nations. The emphasis on balanced budgets and debt reduction are found in most Western European states and the United States as well. Moreover, the selective cultivation of knowledge based created assets is a policy that Great Britain, among others, has also adopted.[1] The trends of the global economy have forced national governments to adopt broadly similar policies – including an emphasis on innovation and knowledge, the cultivation of FDI, and the selective support of country-specific assets. However, the particulars of alliance capitalism will vary according to the characteristics of specific states, and the success governments have in coping with the conflict between the tides of globalisation and the rocks of domestic governance tradition.

Contrary to some depictions of globalisation[2], alliance capitalism argues that national governments are today every bit as important – if not more – than they were in an era of greater restriction on global commerce. Today, the necessity for the effective provision of public goods – measures which ensure equity, fair competition, and effective dispute settlement mechanisms – is an even more vital function of domestic governments. Moreover, it seems accepted that the market mechanism will not alone facilitate the creation of knowledge based assets; selective government support can be a vital component of a successful economic policy.[3]

This thesis has argued that there is a direct link between the international economic environment and the present state of government-business relations in Canada. An increasingly open trading and investment environment – a product of the structural changes in the international system occurring at the end of the Cold War – allowed multinational corporations to make significant strategic changes in their production networks. Access to raw materials has become relatively easy; investment decisions now depend more upon on acquiring specific country-specific knowledge assets. National governments, moreover, view such investment as a key component of their economic development strategies because it adds to a state's technological capabilities, upgrades its workforce, and aids in the transformation of its industrial base. Attracting the investment, consequently, is a major government priority.

Traditional strategies of business government relations were often based on the premise of conflicting interests, with host governments seeking to regulate firm behaviour in order to increase their share of economic rent, while corporations sought to evade such instruments of regulation. Today such strategies are increasingly more difficult, and garner fewer benefits. Firms can easily circumvent such strategies by choosing alternate investment sites. Moreover, such policies also engender considerable costs; in terms of international perception of the risk associated with the host government, and an overall "chilling" of the investment climate. Anecdotal and documentary evidence indicate that the perceived risk and the associated chilling that occurred with the imposition of the Foreign Investment Review Agency in Canada was substantial. In an era when natural resources could form the basis of economic prosperity, such costs could be borne. That is increasingly less tenable today.

The Mulroney government attempted to remedy the problems associated with FIRA by enhancing Canada's support for a rules-based multilateral trading system and by easing the domestic regulations that had hindered investment. Mirrors of his policies could be found in other, often larger, industrial democracies of his day. They generally focused on a monetary policy designed to control inflation, the privatisation of public sector corporations, and a general loosening of the regulatory environment in order to ease the establishment and maintenance of private businesses. Government's role in the economy was thought to be a structural one. Governments were thought best suited to particular tasks falling in their purview; negotiating international treaties with other governments and international organisations; and ensuring a proper domestic regulatory system that safeguarded fair competitive conditions. Their role was not thought to extend beyond this. Market forces would then direct investment towards the specific advantages a nation held.

The Liberal government of Jean Chrétien seems to believe that government has a greater role to play. It built on the Conservative agenda but took additional constructive steps to enhance Canada's economic attractiveness for investment. It initiated the Team Canada trade missions, a partnership-based public policy initiative that included a broad spectrum of Canadian economic stakeholders. It made the cultivation of foreign direct investment a government-wide economic priority that enjoyed the unified support of Cabinet. It extended government funds to aid industry in final product development in knowledge-based, sectorally-specific industries. Finally, it pronounced a government-wide strategy designed to transform the Canadian economy away from its overt reliance on natural resource production and toward indigenous capabilities in knowledge- based industries. The Liberals enacted an activist, but focused, approach to industrial policy.

Alliance capitalism is an appropriate paradigm with which to interpret that policy. Alliance capitalism is a model designed to capture the essence of current government-business relations, an essence composed of partnership with major economic stakeholders, an emphasis on sectors, and an integrated policy approach to addressing the problems that limit multinational investment. Canadian federal public policy has exhibited all of these trends. This model has been a product of a transformed international economy and a progression of government activism that has encouraged the transition of the Canadian economy.

That transition, however, has not been without difficulty. There remains a significant component of the Canadian populace that is opposed to the general process of globalisation. The vigour of this opposition indicates that there remains a politically potent sector of the Canadian populace that is strongly suspicious of the effects of investment and the general phenomenon of globalisation. Much of their opposition rests on social, rather than purely economic, arguments: they argue that any claims to greater economic efficiency have been more than outweighed by the damage done to Canadian social fabric. They point to greater wage discrepancies between the highest and lowest paid workers; the increasing amounts of job losses in traditional industries, a persistently high unemployment rate, and the erosion of federal government activism in the realm of social welfare as evidence of the damage globalisation can do. They argue that greater assertions of governing authority combined with efforts to rebuild a more civil and equitable society are necessary to safeguard the nation.

Opponents of globalisation are unlikely to endorse the paradigm of alliance capitalism. They see their objectives as incompatible with those of the model's present form. While they are likely to support the idea of co-operation between economic stakeholders, they disagree on the ends towards which this co-operation should be directed. They argue that such co-operation should be directed at increasing overall economic equity, ensuring adequate distribution, and promoting social welfare through an established social agenda. Co-operation under alliance capitalism, by contrast, is a means of increasing domestic competitiveness and safeguarding future economic prosperity by building the country knowledge-based specific assets that investing firms need. Without these, alliance capitalism argues, economic prosperity for all sectors becomes questionable. Supporters of alliance capitalism argue that no effective social program can be created without an economic engine that can afford the inevitable costs of such a program.

A Critique of Canadian Investment Policy and Alliance Capitalism

If Canada's economic condition continues to improve, it will be vital to observe the eventual policy modifications of alliance capitalism that may occur. It is clear that improving the national economy topped the list of the Liberals' governing agenda in 1993; no other priority seriously challenged that mandate. However, several issues will need continuous management. First, it will be important to prevent industrial assistance programs such as TPC from becoming tools for sheltering uncompetitive products for political reasons, as other programs have in the past. The federal government must also recognise that some of its sectoral strategies may fail the test of the markets, and should be prepared to let poorly performing companies exit the marketplace. Finally, the federal government must also ensure that it remains a partner, rather than a captive, of its economic constituents.

The charge of catering to economic over social interests will become increasingly harder to deflect if national economic performance continues to improve. There also lingers considerable suspicion of the operations of the large multinational, both in terms of the implied erosion of sovereign authority and in questioning the actual benefits such companies bring to the Canadian economic landscape. Moreover, within the government itself there will always remain competing priorities that clash with the priority of FDI attraction, and the current government has attempted to balance such competing priorities.

The previous chapters have argued that the key federal government ministries that control the execution of alliance capitalism are the Departments of Finance, of Industry, and of Foreign Affairs and International Trade. Extensive sections were developed detailing the actions of the latter; however, little mention was made of the third, other than the general policy pronouncements made by Finance Minister Paul Martin. An important counter argument to the theory of alliance capitalism is the point that marginal corporate and individual tax rates –especially for those with above-average income – have not been altered substantially and remain quite high. In fact, the perception of Canada as a high-tax environment dampens company enthusiasm for investing in Canada. It is noted as the single greatest inhibitor by multinationals considering Canadian investment, and it is an image that the Canadian government is working hard to rectify.[4]

The maintenance of the present tax scheme is explained by the current government's initial concern with the legacy of deficit spending practices and accumulated debt. Quite simply, Paul Martin -- and Jean Chrétien -- were not willing to substantially reduce incoming tax revenue while the federal government remained in a deficit situation. Today the budget has been balanced; in fact a small but growing surplus exists.[5] Despite the accumulated debt levels that remain, departmental clamours for new spending projects are becoming more difficult to shut out, as is the Canadian public's demand for tax relief. The Liberal government has promised to allocate any surplus revenue according to a simple formula. One half of any accumulated surplus will be allocated to new spending (targeting health and education transfers to the provinces), and the other half will be put towards a combination of debt and tax reduction. Martin himself has made his preference on new spending for post-secondary education well known[6], and restoring funding to provincial health care budgets will also become a top priority. Tax cuts will not play a central priority for the immediate future.

The maintenance of tax levels as continued sources of government revenue indicates that traditional pressures of Canadian governance remain alive and well, and do not fall within the alliance capitalism framework. Federal policy making is reached primarily by forging a consensus among diverse departmental interest. Such a consensus depends at any one time on core ideas and governance philosophy, overall government priorities, the skill of individual ministers and their associated deputies, and the personal views of the Prime Minister.[7] The emphasis placed on the campaign promises of debt reduction carried over into the governing agenda, took top policy priority, and remains a central commitment of the federal government. Clearly, not all public sector priorities follow the alliance capitalism framework.

A critique of alliance capitalism can be found in the very language used to describe its characteristics. Because it concentrates on the evolution of general government policies, the paradigm provides little utility for analysing specific instances of government decision and policy making. For students of Canadian public policy, the paradigm's emphasis on general policy trends and overall direction does not aid is the analysis of day-to-day policy formulation. The paradigm, consequently, offers little aid in resolving some of the key questions of Canadian public policy making. This thesis has argued that there has been a solid consensus within the Chretién government on the need to attract greater levels of FDI; evidence was garnered primarily from the public statements and interviews of relatively senior officials. Yet, despite such appearances of unanimity, there can be little doubt that there was bureaucratic struggle between various competing departments for the right to create and administer the general programs outlined in earlier chapters. Such competition has been a consistent trend in federal public policy making, which has a well-established research tradition.[8] Alliance capitalism lends little analytic utility to those who study how such conflicts are conducted and resolved. It is a tool for analysing broad policy direction, not specific policy formulation.

Because its focus is so broad, it is possible to interpret the current set of investment, trade, and industrial policies as merely outcomes of specific economic realities that are subject to change. As previously noted, Canada is not unique in its emphasis on a knowledge-based economy, and could be expected to create policies designed to enhance that capability. Moreover, its desire to work in partnership with the private sector may simply be a matter of government retrenchment in an era of scant resources; such partnerships may be the only alternative in establishing new programs. In sum, there are other significant factors that can motivate coincident actions that are consistent with the alliance capitalism paradigm, giving an appearance of overall policy co-ordination that is exaggerated.

Consequently, the durability of alliance capitalism also remains unproven. Its adoption in Canada has been aided by the perception that Canada's economic performance has lagged behind that of its competitors and that greater attraction of corporate activity will help improve Canada's economic condition. The apparent unanimity of senior officials of the overwhelming need – both politically and practically – to improve Canada's investment position helped spur the adoption of alliance capitalism through the programs and steps noted earlier. If and when Canada's economic position improves significantly, that relative policy cohesion may come under increased strain. As governments gradually escape from the burdens of debt and deficit spending and lagging productivity, they may then re-evaluate the need – and even the wisdom - of working too closely with firms and integrated MNCs, and may even adopt a more aggressive and independent posture in domestic state-firm relations.

Summary and Implications

The thesis argued that one of the first realities with which the Liberals had to contend was that an increasingly interdependent world economy fundamentally altered MNC strategies for operating in Canada. Large multinationals dominated the bulk of investment flowing into and out of Canada. Yet previous interpretations of their activities had focused on the "branch plant" model, in which large multinationals enacted fabrication plants in Canada whose sole purpose was to service the Canadian market. The purpose of such investment, according to standard investment theory, was to evade the tariff and trade barriers that hampered the supply of the Canadian market through exports, and to locate plants near natural resources.

Such a model no longer held true by the early 1990s. The removal of trade barriers had made it economically feasible to supply the Canadian market by export. In addition, the general global removal of trade and investment barriers meant that remaining Canadian subsidiaries were expected to participate in an integrated global production network, rather than acting as independent entities serving a closed market. Consequently, large multinationals no longer judged the performance of their Canadian plants on the basis of national economic needs, but rather evaluated their contribution to the global network as a whole.[9] This required that such plants had to re-evaluate their roles, structure, and function. Instead of providing generalised production, such plants now had to become increasingly specialised in manufacturing products that were globally competitive. Individual plants within the same MNC network had to compete for world product mandates; Canadian plants could no longer rely on a monopoly hold on the national market. For Canadian firms -- too small to operate with global economies of scale in general production -- specialisation in product design and production allowed such firms to regain scope economies for a smaller number of more specialised products. Independent research and development capacity – particularly in the area of global product development – became vital to a subsidiary's success.

The switch from a domestic to a global perspective in company strategies had a profound effect on the Canadian political and economic landscape. The increasing economic regionalisation of North America meant that Canadian industry had to be capable of competing in a market of 380, rather than 30, million potential customers. Higher competitive demands forced companies to re-evaluate their production patterns and to initiate the painful industrial restructuring that was prevalent in the late 1980s and early 1990s. Production runs became more focused, products more specialised, and uncompetitive operations jettisoned. Such domestic adaptation appeared necessary to ensure survival in a global economy. Moreover, for potential foreign investors, investment sites were evaluated on the basis of serving the regional, rather than the national market. While the CUFTA and NAFTA agreements had served to lower economic barriers within the region, they also ensured that the countries within the region would now have to compete to attract investment.

One indication of the growing influence of the increasingly regional character of the Canadian economy is the growing importance of North-South – versus East-West – trade flows. Simply put, each province in Canada now depends more upon its trade relations with bordering U.S. states than it does on trade relations with its fellow Canadian provinces. Thomas Courchene notes is a recent work that the shift in trade flows that occurred between 1981 and 1994 demonstrates the growing integration of the American and Canadian economies. Perhaps the most dramatic example of such integration has occurred in the province of Ontario. In 1981, for example, Ontario traded $47 billion dollars of goods and services with the rest of Canada; its total trade of similar goods and service with the rest of the world measured $45 billion dollars. By 1994, Ontario traded $54 billion of goods and services with the rest of Canada, and a whopping $ 117 (1986$) billion dollars with the rest of the world.[10] Similar increases could be cited for the other Canadian provinces; although none shows the amount of growth featured in Ontario. The increasing bilateral trade levels between Canada and the United States account for almost all of this increase. The Canadian economy is becoming increasingly dependent on its relations with other nations for its economic prosperity, and the trade dominance of the United States continued to grow.

Regional economic diversity has always posed governance challenges for Canada. Various policies have been enacted to increase provincial economic equity, including transfer payments, subsidies, and other equalisation schemes. Yet international realities often work against the intentions of the federal government. The health of many of the provincial economies depends on the general economic conditions prevalent in the areas in which their interdependence has grown. Ontario's recent economic revival is due in large measure to the general economic strength of the U.S. economy, with which Ontario's firms do the bulk of their exporting. British Columbia's current economic difficulties are due in part to the general malaise affecting the economies of the Far East, with which B.C.'s firms are intertwined. Crafting a national economic policy is a considerable challenge in Canada; solutions designed to alleviate current difficulties in one province may induce economic difficulties in another. Alliance capitalism holds implications for other governing priorities within the Canadian state.

Scope for Further Research

Additional research questions emanating out of the thesis research include a deeper examination of federal-provincial economic relations. This work has argued that greater harmony has existed in those relations in terms of the Team Canada trade missions. Evidence garnered in interviews indicates that the federal government acknowledges that its own role has strict limits. Working with provincial governments and with municipal leaders is a vital component of the current government's strategy; and there have been relatively few federal-provincial economic conflicts during the tenure of the present government. Exploring the depth and breadth of that co-operation – and gauging its difference with that of previous governments – is a natural extension of this present stream of research.

A second important branch of this body of research would be an examination of the actual strategic decisions of major multinational corporations operating in Canada during the Liberal mandate. This thesis has focused on government policy, and has cited primarily government sources indicating that such corporations have indeed made deep strategic changes in their Canadian subsidiaries. It has also outlined the specific government policies designed to attract foreign direct investment and build Canada's sectoral capability. Further research is necessary to demonstrate how and in what ways these policies have affected MNC decisions, and would involve the direct examination of company files and interviews with company personnel. Certain realities indicate that some time must pass before such research is done; some of the current government programs have only been in existence for at most 3 years; and the entire tenure of the Liberal government has measured less than six. The ultimate effects of these polices will require several years before revealing themselves.

The labour question also requires further examination. The fundamental change from a resource-based to a knowledge-based economy has significant implications for the structure, pattern, and custom of general labour practice in Canada. Government interviews and studies indicate labour's broad support for the general direction of the current federal policies. Yet significant labour concerns remain. The employees of small and medium-sized enterprises are unlikely to possess union membership and remain difficult to integrate within the general labour groups. In fact, they may perceive such membership as inhibiting their freedom action and independent decision-making capacity within their own firms. Moreover, labour groups may see the government's broad agenda of encouraging MNC investment to imply the support of lowering labour wage rates and protective legislation. Suspicions remain that, as a general drive to increase competitiveness and investment attractiveness, labour interests may be compromised federally.

A goal of alliance capitalism is to increase high value-added products. Achieving this will ensure gains in national productivity, which will allow Canadian plants and industries to compete more effectively internationally. The benefits of greater competitive strength over the long term include increased GDP per capita and ultimately a higher standard of living for Canadians. Such a vision is inclusive for labour groups; continual upgrading in the workforce's capability is the primary source of added productivity. Consequently, labour groups are primary stakeholders in the Canadian economy, and are therefore an important constituent of the strategy of alliance capitalism.

Not surprisingly, government representatives deny any anti-labour bias, and in fact argue that their agenda is remarkably pro-labour. They argue that, without the government's efforts to direct and shape the knowledge-based economy, Canada would steadily lose competitiveness in those industries. Such industries, they maintain, are the source of the high-wage, high skill level jobs that Canadian job seekers require. Moreover, government officials argue that the so-called traditional manufacturing industries are not able to create the required number or type of new jobs to maintain strong employment levels. They are also quick to note that labour groups are among the economic "stakeholders" that are free to participate in government-led initiatives. While some suspicion remains, it is clear that the alliance capitalism model has attempted to build bridges with the labour movement, with some preliminary indications of success.[11]

A comparative study of the particulars of alliance capitalism in Canada with other, larger developed economies is also a needed extension of this research. Such a study will be able to demonstrate the particular modifications that the paradigm holds for smaller developed economies, whose industrial base is often quite small and, in the case of Canada, highly interlinked with a more powerful economy. The paradigm of alliance capitalism as it stands does not offer sufficient nuance for the policy dilemmas of smaller economies, whose scope for independent action may already be limited. A comparative study will extend the paradigms' constructs and offer a richer interpretative capability.

Further research and time are necessary before these identified weaknesses of the paradigm can be effectively analysed. As mentioned previously, it takes a great deal of time for MNCs to alter their investment patterns to a significant degree, and establishing links from specific government policies to those changing investment patterns will require ongoing research. Moreover, if the Canadian economic situation continues to improve – as current economic statistics seem to indicate – then the proclivity and desire to maintain a public-policy framework of alliance capitalism may come under increasing strain. Governing in the age of surplus will likely erode such a consensus and may require a new statement of overall governing priorities. Further and continued research on the topics central to this thesis remains key.

Implications for Theory

This thesis has been interdisciplinary in nature. It has argued that a theory of government-business relations has emerged from the international business literature that needs to be incorporated into the research agenda of scholars of international relations and international political economy. It has attempted to establish connections between various phenomena – including the changed structure of the international system, the strategic practices of multinational corporations, and the policy practices of the Government of Canada. Consequently, the adoption of alliance capitalism will have theoretical implications for both the international relations and the international business literature, which a continuing research agenda will need to explore. Some of these implications will be outlined in the following paragraphs.

The field of international business will benefit from an enhanced understanding of the foundations and motives of government investment and trade policy. The state still wields considerable influence over the economic fundamentals that form the basis of corporate success. In a global economy in which knowledge and innovation are the main competitive advantages, both the firm and the state must co-operate in nurturing those advantages. Firm success will increasingly rest on identifying and exploiting the particular economic advantages that national governments have cultivated. Moreover, international institutions are also playing a wider and deeper regulatory role in the workings of the international economy. As such institutions continue to assume levels of authority previously monopolised by the state, they will increasingly impact on the operations of global firms. This thesis has only tangentially referred to the operations of these institutions. Yet they will continue to impact greatly on the strategic freedom of large multinationals.

For scholars of international relations, it will be important to adopt a more sophisticated view of the multinational corporation in order to integrate it into the traditional and contemporary debates of the field. Statistical evidence indicates that there are more large multinationals today that are wielding ever-greater amounts of economic power. Yet significant constraints on their operations remain. National governments and international organisations continue to wield regulatory powers that limit strategic decision making freedom. Moreover, such corporations are in reality networks rather than hub and spokes, relying upon their foreign affiliates and alliances with local firms to spur the innovation that is necessary for competitiveness. That reality poses both risks and opportunities for theory development. Large multinationals appear to contribute to increasing global economic interdependence; they spur increasing liberal trade and investment agreements, draw upon the advantages of various countries, and facilitate the cross-border movement of goods and services. Yet large MNCs also contribute to the national power of those nations that are successful in integrating their domestic economy into the production structures of advanced MNCs. Integrating these two realities will pose a major theoretical challenge for international relations theory.

A simple pendulum metaphor illustrates some of this theoretical evolution in the literature. Firm-state relations have been characterised by oscillation; early literature of the 1960s and 1970s emphasised state efforts to control MNC operations, while the literature of the 1980s reveals a greater trend towards liberalisation and MNC freedom. Today the globalisation debate often centres upon whether states have ceded too much authority to the MNC; and whether they have any realistic chance of reclaiming that surrendered sovereignty. Efforts to reclaim regulatory authority involve the greater legitimisation of international institutions designed to control MNC behaviour. For example, future multilateral trade negotiations are thought likely to concentrate on investment-controlling -- rather than purely trade liberalisation -- measures.[12] Consequently, scholars concentrating on international institutions and building a greater international regulatory regime will likely be heartened by such developments.

It is also possible, however, to integrate alliance capitalism into a state-based, power-centred framework. Countries that are successful in cultivating their created assets in knowledge, skills, and innovatory capacity will be as indispensable – if not more -- to the modern multinational as are countries that possess raw natural resources.[13] Realist scholars have long acknowledged that cultivating indigenous production skills and technological capacity are important elements of national power; they may argue with some merit that alliance capitalism represents the latest manifestation of that truth. Yet important subtleties remain. Alliance capitalism represents a co-operative ideal of government sharing – rather than providing – economic direction. It is focused on intangible production skills – rather than the measured economic assets – as the key element of economic power. Alliance capitalism does not argue that countries must be the home nation of a group of multinationals in order to remain prosperous. Smaller developed economies can also be attractive hosts, not through the concessions that they relinquish but through the added value their workforce provides. That value is a source of continued influence and economic sovereignty.

Alliance capitalism also contributes to the current research about the major questions of international political economy. The emphasis on regional integration and the accompanying governance challenges address the fundamental concerns of international political economy research -- the relationship between the market and authority. This relationship has unique characteristics when small and medium-sized developed countries are under examination. They are often too small to exert significant influence on the international system. Their stock of economic assets – both natural and created – is by implication limited, as is the size of their overall market potential. Consequently, they face strong international competition to attract corporate investment, yet they still must fulfil the governing responsibilities of preserving sovereignty, equity, and social justice.

Preserving the balance between the investment freedom that economic efficiency demands and the somewhat disorderly demands of democratic governance will remain an ongoing challenge. Alliance capitalism aids in meeting that challenge by creating a framework in which the domestic economic constituents can recognise their complementary interests. Regulatory instruments designed to limit, control, and direct firm activities in Canada remain in several key sectors; the federal government has given little indication of any willingness to change those restrictions. Yet it has also taken positive steps to build on the specific knowledge assets Canada possesses and to raise Canada's overall investment profile. They have repeatedly emphasised that industrial policy can only be effective if designed to aid Canadian businesses to meet global competition; it is not designed to shelter those businesses from such competition. Alliance capitalism will likely remain at the core of Canadian economic strategy – a strategy designed to enhance domestic economic prosperity while meeting the diverse governance challenges of the Canadian state.

Endnotes

[1] Presentations made by Mr. Andrew Fraser, Chief Executive Officer, Invest in Britain Bureau, at the Canadian High Commission in London, 10 March 1999, as well as Pat Langford, Department of Trade & Industry, Government of Great Britain, "British Competitiveness in a Knowledge-Based Economy", Canadian High Commission, London, 10 March 1999.

[2] Examples of some of the more alarmist literature arguing that globalisation holds more perils than benefits included David C. Korten, When Corporations Rule the World (West Hartford: Sierre Books, 1994), and Jerry Mander and Edward Goldsmith, editors, The Case Against the Global Economy (San Francisco: Sierra Club Books, 1996).

[3] Commercial banks in particular are reluctant to lend money to companies working in high technology industries because the commercial potential of the product or technology remains unproven. Interview with Walter Simms, Technology Partnerships Canada, 13 May 1999.

[4] The KPMG study commissioned by the Canadian government addressed the tax issue by noting that the degree of infrastructure provided by the tax revenue – in terms of transport facilities, general health care, pension adjustments, and other benefits – more than compensate investing companies. The study even argues that Canada is actually a relatively low-cost country to do business.

[5] Most estimates today put the accumulated surplus at a minimum of $3 billion, while some estimates range as high as $15 billion.

[6] Note the Introduction of the Millennium Scholarship program, introduced by Martin himself in his budget speech of 1997.

[7] The standard works on the Canadian federal public policy making process are Donald J. Savoie, The Politics of Public Spending In Canada (Toronto: University of Toronto Press, 1990), and G. Bruce Doern and Richard W. Phidd, Canadian Public Policy: Ideas, Structure, Process (Scarborough: Nelson Canada, 1992).

[8] See Donald J. Savoie, The Politics of Public Spending in Canada. For a historical and contemporary analysis of the effects of bureaucratic competition in Canada's formulation of state capitalism, see Jeanne Kirk Laux and Maureen Appel Molot, State Capitalism: Public Enterprise in Canada (Ithaca: Cornell University Press, 1988). For a classic international relations work on the "bureaucratic" model of decision making, see Graham Allison, Essence of Decision (Boston: Little Brown & Co. 1971).

[9] Interview with Zulfie Sadeque, 13 May 1999.

[10] Thomas J. Courchene, From Heartland to North American Region State: The Social, Fiscal, and Federal Evolution of Ontario (Toronto: Centre for Public Management, University of Toronto, 1998), p. 279. It is impossible to overstate the effects of the Autopact on these figures; the vast bulk of the composition of such trade was in automobiles and parts. The importance of the Autopact remains key to overall Canadian trade statistics; space limitations limit any extensive discussion of the Autopact in this work.

[11] David Adam, for example, notes that Investment Partnerships Canada regularly consults with labour groups, and finds that their support is usually quite strong for the investment attracting efforts. He notes that they usually recognise that such investment creates jobs and is a positive step for labour interests.

[12] Peter McGovern refers to these issues as the "trade-ands" – such as trade and labour policy, trade and environmental policy, and the like. These involve setting conditions on local business practices that

impede firm freedom but protect state responsibilities. Interview with Peter McGovern, Director, Team Canada, Department of Foreign Affairs and International Trade, 9 May 1999.

[13] Ireland is perhaps the best contemporary example. Ireland has been able, through a judicious use of tax, education, and transport policies, been able to transform its formerly weak economy to one that is thriving as a base for European production. Its success has inspired emulation.

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