In Canada Among Nations: The Challenge of Change
ed. by MA Molot and F. Hampson. Ottawa: Carleton
University Press, 1990 pp 135-62.

9 Two Steps Forward, One Step Back: Into the 1990s[1]

Lorraine Eden

The image of the year has to be one of thousands of East and West Germans on the Berlin Wall, symbolizing the major relaxation of Communist domination of Eastern Europe in October 1989. Germans pouring through the wall, the removal of party officials, free elections in several East European countries, increased ethnic tensions within the U.S.S.R., Gorbachev meeting the new non-Communist leader in Poland: these events confounded Western spectators and kept us glued to our television sets. Each night the television brings more news of reforms in Eastern Europe, reforms that most commentators a month earlier denied could ever happen.

More sobering, and in direct contrast to the relaxation of East-West tensions, was the Chinese military massacre of thousands of students in Tiananmen Square in June. The brutal repression in the People's Republic of China reminds us that rapid movements of the general population toward democracy can easily be derailed by the return of authoritarianism.

The easing of tensions between Eastern and Western Europe, the self-marginalization and retrenchment of the Soviet Union, the looming spectre of German reunification, the clampdown in China, all will have spillovers into the international economy in the 1990s. It is too early to conclude that the Cold War is forever ended, or that China has permanently closed its doors. The challenge of these political changes for trade and finance, as well as diplomacy and strategy, will keep policymakers busy for years.

It was already clear at the end of 1989 that an economic slowdown of the U.S. and Canadian economies had started. The landing appears to be a soft one, but the length and depth of the slowdown are uncertain. The global economy may face only a one-to-two year slowdown before growth resumes. However, there still are significant financial imbalances within the developed market economies (DMEs) and continuing debt problems face the less developed countries (LDCs). A failure to contain the U.S. "terrible twins", the budget and balance of payments deficits, could lead to significantly higher U.S. interest rates and increased protectionism, adversely affecting DMEs and LDCs.

A more encouraging factor is the strong potential for a global upswing. The combination of rapid technological change, coupled with lower trade and regulatory barriers and the increased globalization of production, could result in a marked increase in potential world income and welfare in the 1990s. However, if the imbalances noted above actually result in a hard landing in 1990-91, the subsequent recession will likely derail this potential long-run upswing. The problem facing policymakers is that of steering a tight course by reducing deficits and debt levels without unduly slowing a global economy already in the midst of significant political and structural change.

Political events colour our analysis of the economic changes that face the global economy as it moves into the last decade of this century. The purpose of this chapter is to examine key changes in the international economy in the 1980s and to flag likely routes into the 1990s. The analytical framework of the chapter is based on the concept of tension between the state and the market, as policy changes impact on market forces and vice versa. The first section looks at the health of the global economy from 1985 to forecasts for 1990, concentrating on macroeconomic variables and policies for the G-7 and the net debtor developing countries, and the growth in trade. The second section highlights the tension between state and market with an analysis of three key market forces that are changing the role of states in the global economy. First is the ongoing shift to multipolarity among the developed market economies; second is the growing importance of technology in the production process; and third is the increased globalization of firms and markets. The next section examines three key policy changes in the process of implementation by states that will profoundly affect domestic and international markets: one is multilateral (the Uruguay Round), one regional (1992 in Western Europe) and one unilateral (the 1988 trade bill in the United States). The last section of the chapter looks at implications for Canada.

The Global Economy in 1989

The Developed Market Economies

(a) 1985-88 for the DMEs in Review

The year 1985 was a key year in macroeconomic policy terms. After President Reagan assumed office in 1981, he introduced an economic package of tax cuts, increased defence spending and deregulation, designed to increase economic efficiency and spur supply-side growth (Eden 1989). As a result, in 1980-85 the U.S. gross domestic product (GDP) grew, the dollar rose, and the U.S. balance of payments and fiscal budgetary (FB) deficits widened. A large FB deficit crowded out private domestic investment spending, which coupled with high interest rates, caused large foreign portfolio capital inflows and put upward pressure on the dollar. As the dollar rose, U.S. products became less competitive on world markets and the U.S. current account (CA) went even further into deficit, increasing domestic calls for protectionism.

In 1985, for the first time in forty years, the U.S. capital account moved into surplus as capital inflows exceeded outflows. Domestic public reaction to the United States becoming an international debtor forced the Congress to face the terrible deficit twins and to acknowledge that the FB deficit could be affecting the CA deficit. Congress passed the Gramm-Rudman Act, setting budgetary limits on government spending. The Federal Reserve Board relaxed its control over the money supply, helping the dollar to fall in the hope that devaluation would lessen the CA deficit. The U.S. government was forced to recognize that the dollar was overvalued, due, at least in part, to the FB deficit, and that international coordination of monetary and fiscal policies would be necessary to solve the budgetary and payments imbalances.

As a result, 1985 marked an historic turning point in U.S. domestic policy management when the G-5 countries (the United States, West Germany, Japan, the United Kingdom and France) signed the Plaza Accord. The G-5 agreed to coordinate their macroeconomic policies and, in particular, to use central bank intervention to push the dollar down in foreign exchange markets. By the fall of 1986, the U.S. trade deficit had started to improve.

In 1987 the G-7 countries (the G-5 plus Canada and Italy) signed the Louvre Accord. Fourteen years of floating exchange rates effectively ended when the G-7 agreed to hold the dollar at its current level, by central bank intervention if necessary. However, rising U.S. interest rates widened the gap between the returns on equities and bonds, tipping stock markets into the October 1987 crash. The G-7 central banks were forced to intervene heavily in foreign exchange markets to support the dollar. A global recession in 1988 was avoided by this quick action, albeit at substantial cost to the G-7 treasuries. The dollar was then allowed to drift downwards, and the U.S. economy continued to grow.

In 1988, the increased domestic demands for protectionism resulted in the passage of the U.S. Omnibus Trade and Competitiveness Act. While the Act in its final form, was scaled down in relation to the initial draft proposals, it still represented a major shift towards unilateral neoprotectionism. In November 1988, when George Bush was elected President, U.S. economists asserted the economy had reached full employment. Since Bush had promised not to raise taxes, the fiscal policy apparatus in the United States was stalemated; the Republican executive branch refused to raise taxes while the Democratic House refused to cut expenditures.

Tables 9-1 and 9-2 provide some statistics on the performance of the G-7 countries between 1985 and (forecasted) 1990, based on statistics from the International Monetary Fund (IMF 1989). The first row in Table 9-1 for each country is the general government FB deficit or surplus, taxes (T) minus government spending (G) as a percent of GNP. A minus (plus) sign indicates a budgetary deficit (surplus). The second row is the current account (CA) deficit or surplus, exports (X) minus imports (M) as a percent of GNP. A minus (plus) sign indicates a CA deficit (surplus). Row three is the short-term nominal interest rate (i), from which the expected inflation rate for the year (P^e) is subtracted to give the real interest rate (r) in the fourth row.[2] The fifth row is the unemployment rate. Sixth is the foreign exchange rate; what it costs in Canadian dollars to buy one unit of foreign currency.

The statistics show clearly how large U.S. and Canadian FB and CA deficits are in comparison to those of to Japan, West Germany and the United Kingdom, although by 1988 the U.S. FB deficit had dropped to 1.8 percent, and the CA deficit to 2.8 percent, of GNP. Throughout 1985-88 real interest rates and unemployment rates were highest in Canada and the United Kingdom. Note the marked increase in the yen, mark and pound over the period.

Table 9-1
Indicators of Economic Performance for the G-7 Countries, 1985-90

					Forecast	Forecast
	1985	1986	1987	1988	1989	1990
CANADA						
FB as % GNP	-7.0%	-5.5%	-4.6%	-3.1%	-4.4%	-3.8%
CA as % GNP	-0.4	-2.1	-1.9	-1.9	-2.6	-2.9
Interest rate	9.6	9.2	8.4	9.6	11.7	NA
$r = i - P^e$	6.7	6.7	4.1	5.4	7.4	NA
Unemployment rate	10.5	9.5	8.8	7.8	8.0	8.0
UNITED STATES						
FB as % GNP	-3.3	-3.4	-2.3	-1.8	-2.2	-1.7
CA as % GNP	-2.9	-3.3	-3.4	-2.8	-2.7	-2.8
Interest rate	8.0	6.5	6.9	7.7	9.5	NA
$r = i - P^e$	5.0	3.8	3.6	4.3	4.8	NA
Unemployment rate	7.2	7.0	6.2	5.5	5.3	5.3
Exch. Rate ($Cdn)	1.37	1.39	1.33	1.23	1.19	NA
JAPAN						
FB as % GNP	-0.8	-0.9	0.6	1.1	1.6	2.0
CA as % GNP	3.7	4.3	3.6	2.8	2.7	2.8
Interest rate	6.7	5.1	3.9	4.1	4.6	NA
$r = i - P^e$	5.1	3.3	4.1	3.6	3.2	NA
Unemployment rate	2.6	2.8	2.8	2.5	2.4	2.4
Exch. Rate ($Cdn)	0.0058	0.0083	0.0092	0.0096	0.0087	NA
WEST GERMANY						
FB as % GNP	-1.1	-1.3	-1.8	-2.0	-0.6	-1.2
CA as % GNP	2.6	4.4	4.0	4.0	4.1	3.9
Interest rate	5.4	4.6	4.0	4.3	6.4	NA
$r = i - P^e$	3.2	1.5	2.0	2.8	3.9	NA
Unemployment rate	8.2	7.9	7.9	7.7	7.5	7.3
Exch. Rate ($ Cdn)	0.47	0.64	0.74	0.70	0.63	NA
UNITED KINGDOM						
FB as % GNP	-2.9	-2.4	-1.4	0.5	1.7	1.9
CA as % GNP	0.9	0.0	-0.6	-3.2	-3.4	-2.7
Interest rate	12.2	10.9	9.6	10.3	13.0	NA
$r = i - P^e$	6.3	7.3	4.7	4.3	6.4	NA
Unemployment rate	11.2	11.3	10.2	8.2	7.3	7.5
Exch. Rate ($ Cdn)	1.77	2.04	2.17	2.19	1.95	NA
ALL G-7 COUNTRIES						
FB as % GNP	-3.3	-3.3	-2.3	-1.7	-1.5	- 1.2
CA as % GNP	-0.6	-0.2	-0.4	-0.4	-0.5	-0.5
Interest rate	10.0	6.9	6.6	7.1	8.5	NA
$r = i - P^e$	6.6	3.8	3.9	4.2	4.7	NA
Unemployment rate	7.4	7.3	7.0	6.4	6.1	6.1

Sources: Calculations based on IMF (1989: 129, 134, 140, 142 and 157), and *Report on the Nation* (1989: 80).

Table 9-2
Growth Rates for the G-7 Countries, 1985-90

	1985	1986	1987	1988	Forecast 1989	Forecast 1990
	(in percentages)					
CANADA						
Real GNP growth	4.6	3.2	4.0	4.5	2.9	2.5
% chg.real GNP/POP	3.8	2.4	2.9	3.6	2.0	1.6
Real I Impulse	3.6	1.8	5.6	8.0	3.0	2.6
Fiscal Impulse	1.5	-1.1	-0.7	-0.7	1.3	-0.7
Monetary Impulse	1.9	3.0	1.8	1.4	NA	NA
UNITED STATES						
Real GNP growth	3.4	2.8	3.4	3.9	3.1	2.5
% chg.real GNP/POP	2.4	1.9	2.4	2.9	2.2	1.5
Real I Impulse	2.0	-2.8	-1.5	2.1	0.7	1.4
Fiscal Impulse	0.7	0.2	-0.8	-0.1	0.6	-0.6
Monetary Impulse	2.5	2.8	-0.1	-2.2	NA	NA
JAPAN						
Real GNP growth	4.8	2.5	4.5	5.7	4.5	4.4
% chg.real GNP/POP	4.3	1.8	3.9	5.1	3.9	3.8
Real I Impulse	3.3	0.5	5.8	7.6	2.2	1.3
Fiscal Impulse	-0.9	-0.3	-1.4	-0.1	-0.4	-0.2
Monetary Impulse	2.0	4.4	6.1	5.0	NA	NA
WEST GERMANY						
Real GNP growth	1.9	2.3	1.8	3.4	2.4	2.9
% chg.real GNP/POP	2.2	2.3	1.6	3.1	2.0	2.6
Real I Impulse	-1.8	1.0	0.7	2.4	0.3	1.0
Fiscal Impulse	-0.9	0.3	0.1	0.6	-1.6	0.8
Monetary Impulse	0.8	0.4	3.3	1.5	NA	NA
UNITED KINGDOM						
Real GNP growth	3.7	3.2	4.6	4.4	3.3	2.1
% chg.real GNP/POP	3.3	3.0	4.1	4.2	3.3	1.7
Real I Impulse	-0.7	-2.3	1.0	7.0	3.9	-0.9
Fiscal Impulse	-0.5	-0.1	-0.1	-0.7	-0.7	-0.4
Monetary Impulse	4.3	11.7	11.6	10.2	NA	NA
ALL G-7 COUNTRIES						
Real GNP growth	3.4	2.7	3.4	4.2	3.4	3.0
% chg.real GNP/POP	2.7	2.0	2.8	3.5	2.7	2.3
Real I Impulse	1.1	-0.8	1.0	4.0	1.4	1.4
Fiscal Impulse	0.2	0.0	-0.7	0.0	0.0	-0.3
Monetary Impulse	2.0	2.9	2.2	0.5	NA	NA

Sources: Calculations based on and taken from IMF (1989: 126, 127, 129, 134, 139, 142).

In Table 9-2 we look at macroeconomic performance in terms of growth rates. The first two lines in Table 9-2 for each country show the percentage change in real GNP (i.e. nominal GNP divided by the GNP price deflator), and real GNP per capita (GNP/POP). The third line is the real investment impulse, defined as the gap between the percentage change in real private investment expenditures and the percentage change in real GNP. Investment impulse gives some indication of the extent to which the private sector in each economy is productively investing in future growth. Real GNP and GNP per capita rose steadily over the 1985-88 period for the G-7 members. The investment impulse, however, is uneven and occasionally negative, suggesting that something, perhaps the fiscal budget deficit (see Table 9-1), was crowding out private investment in this period.

Lines four and five show the mismatch between the macroeconomic policies of the G-7 as measured by the "fiscal impulse" and "monetary impulse" of their government policies. Fiscal impulse is defined as the gap between the percentage change in FB and the percentage change in nominal GNP. If the gap is positive (negative), the budget deficit is growing faster (slower) than GNP and has an expansionary (contractionary) impact on the economy. Monetary impulse is similarly defined as the gap between the percentage change in broad money supply and the percentage change in nominal GNP. If the money supply is growing faster (slower) than GNP, the monetary impulse is positive (negative) and expansionary (contractionary). Therefore negative numbers in the table are contractionary; positive ones, expansionary. Throughout the period most G-7 governments ran conflicting policies: contractionary fiscal policies, as governments tried to reduce the size of their fiscal deficits, but expansionary monetary policies (note especially the United Kingdom), partly as a consequence of having to prop up the U.S. dollar under the Louvre Accord.

(b) 1989: a Soft Landing?

U.S. real interest rates have risen slightly over the year, with a forecasted 1989 real rate of 4.8 percent. Rising interest rates probably reflect targeting of inflation by the Federal Reserve Board, along with G-7 coordination of macroeconomic policies. The positive impact of the 1987-88 falling dollar has petered out and the forecasted current account deficit as a percent of GNP is basically unchanged from 1988. The FB deficit is expected to increase from 1.8 to 2.2 percent of GNP.

(See Table 9-1.) In Canada, both the FB and CA deficits are expected to rise as a percent of GNP. As a group the G-7 members are expected to have both FB and CA deficits. Real interest rates are higher in all member countries except Japan. Unemployment and inflation rates are expected to hold steady, except in Canada where both are rising.

As Table 9-2 shows, real GNP growth slowed in the G-7 from 4.2 percent in 1988 to an estimated 3.4 percent in 1989. The large investment impulse recorded in 1988 in Canada, Japan and the United Kingdom is also subsiding, with a forecasted real investment impulse for the G-7 of 1.4 percent. The enormous monetary increases in the United Kingdom (and their probable inflationary impact) should be noted. The U.S. economy is apparently headed for a soft landing, as output growth, auto sales and industrial production continue to slow (*Business Review* 1989). Unemployment and inflation are, however, holding steady at 5.3 and 4.5 percent, respectively.

Canada ran a moderately expansionary fiscal policy in 1989, as is shown by its larger FB deficit in Table 9-1. However, the only fiscal growth was in debt servicing due to high interest rates. Discretionary tax and expenditure changes in the April 1989 budget combined to take the steam out of the economy. The Wilson budget contained several tax increases and some spending cuts, notably cuts to defence and official development aid. The major tax increase was expected to come from the Goods and Services Tax (GST) which is to be in place by January 1991. Monetary policy was tight, with Bank Governor John Crow holding interest rates several points above those in the United States. As a result, the Canadian dollar rose steadily over the year.

Due to strong opposition to the Goods and Services Tax from business, labour and provincial government groups, the Finance Department has been forced to concentrate its resources on selling the tax to Canadians. External Affairs has been preoccupied with implementation of the Canada-U.S. free trade agreement and negotiations under the Uruguay Round. In 1989, large numbers of mergers and acquisitions made the headlines, along with their accompanying layoffs and movements either north or south across the Canada-U.S. border. Since big gains in investment and jobs were predicted to occur after free trade, their absence has been used by the media to condemn the agreement. Job losses, high interest rates and the expected GST made the Conservative government's job in 1989 a difficult one.

(c) *Forecast for 1990: Uncertainties Ahead*

The forecast for 1990 very much depends on events in the United States. If the U.S. economy continues its moderate slowdown, unemployment should rise and pressure on inflation ease. Improvements in the U.S. CA depend on changes in the FB deficit and the value of the dollar. If it remains at the present level and nothing substantial is done about the FB deficit by the U.S. Congress, portfolio capital inflows are likely to continue, because of the relatively high U.S. real interest rates. As a result, the CA deficit may again start to rise.

In addition, the U.S. CA deficit may also rise in 1990 due to lags between national business cycles. Since the North American economy is already slowing down, while the European economies are still growing, American exports are being pulled abroad by strong demand overseas while import growth is depressed by our slowing economies. If the European and Japanese economies move into this slowdown over the next year, the North American CA and balance of payments (BOP) deficits should widen further.

The IMF (see Tables 9-1 and 9-2) is forecasting smaller FB and CA deficits, slower growth, and unchanged inflation and unemployment rates for most G-7 countries. However, there are still reasons to fear a hard landing for the United States in 1990-91 (Feldstein 1989). Since the positive impact on the U.S. CA deficit has stopped now that the dollar is no longer falling, further reductions in the CA deficit must come from reduced domestic expenditure or increased saving (i.e. from cutting the FB deficit). With the Congressional election in 1990 and the Presidential one in 1992, it is unlikely that the political will exists to make substantial cuts in the FB deficit. The attempts to shift the savings and loan bailout to off-budget items so that the Gramm-Rudman targets would be officially met does not suggest any real commitment to deal with the problem. The potential peace dividend associated with relaxation of Cold War tensions is also an unlikely solution since it is seen by many in Congress as a way to finance and expand social programs rather than as a means to deal with the FB deficit problem. The most likely scenario is that the United States will continue to muddle through until after the 1992 Presidential election.

The Less Developed Countries

The 1980s have not been a good decade for the less developed countries, particularly since the onset of the debt crisis in 1982.[3] However, the economic effects have varied sharply between the newly industrializing economies (NIEs) which experienced substantial growth increases, the oil-exporting countries with fortunes tied to stagnant oil prices, and the net debtor LDCs which suffered from high interest rates and slow domestic growth. In addition, there are substantial regional variations, e.g. between Africa and Latin America. We concentrate our attention in this chapter on the net debtor LDCs (ND-LDCs).

Table 9-3
Indicators of Economic Performance, Net Debtor Developing Countries, 1985-90

					Forecast	**Forecast**
	1985	**1986**	**1987**	**1988**	**1989**	**1990**
		(in percentages)				
% chg. real GDP	4.6	4.6	4.0	4.5	3.3	4.3
% chg. real GDP/POP	2.7	2.5	2.0	2.9	1.1	2.5
Inflation (wt.avg)	46.4	34.4	45.3	77.1	51.7	19.5
% chg. broad money	51.6	39.1	55.9	81.3	NA	NA
Central FB as % GDP	-3.9	-4.8	-5.0	-4.6	-3.7	NA
% chg. terms of trade	-2.1	-12.8	0.1	-1.7	-0.6	-0.7
Debt service as % of exports	26.0	27.2	24.0	22.9	22.2	20.6
External debt as % of GDP	39.8	41.5	41.1	38.7	36.6	35.2
% chg. priv. lending	1.6	0.7	-0.9	1.5	1.5	2.7
% chg. offic.lending	12.1	10.8	10.9	5.2	7.1	6.0

Note: Net debtor countries include 126 developing countries which are net debtors in terms of their stocks of external assets and liabilities. The net debtors category can be further subdivided according to predominant type of creditor (market, official, diversified) and/or by experience with respect to debt servicing (with or without difficulty). For more information see IMF 1989:117-22.
Sources: IMF (1989: 47, 131, 136, 143, 144, 154, 186, 193).

Some statistics on the ND-LDCs, taken from IMF (1989), are provided in Table 9-3 for the period 1985 to forecasted 1990. Real growth rates since 1985 have hovered around 4 percent per year, with real GNP per capita growing about 2 percent per year. Inflation rates have been much higher than in the DMEs, averaging between 34 and 77 percent, about the same rate of increase as that of broad monetary aggregates in these economies. Average central government FB deficits have stabilized around 4 percent of GDP. The terms of trade of the ND-LDCs fell steadily throughout the period, with a large drop in 1986 as natural resource prices fell. The cost of servicing their external debt as a percent of exports has fallen slowly over the period from 26 percent in 1985 to 22 percent in 1989. The stock of external debt has also fallen slowly as a percent of GDP, from 40 to 37 percent. Private lending has hardly grown at all over the period, while official lending has slowed markedly from a 12 percent annual growth rate to 7 percent.

Sustained growth over the 1980s in the DMEs has had a positive impact on exports from the ND-LDCs. However, the unwillingness of private lenders to finance more debt relief has meant increasing reliance by the ND-LDCs on official lending sources. At the same time there has been a move towards structural adjustment and liberalization of domestic economies, as part of the conditions attached to official funding. In some countries, like Mexico, the reforms have been moderately successful in lowering inflation and encouraging growth and trade. Others, Brazil and Argentina for example, are enduring hyperinflation, capital flight and severe recession. The average inflation rate for Latin America in 1989 is expected to be 1,200 percent (*Business Review* 1989: 7).

Given the apparent failure of the U.S. Brady Plan as a solution to the debt crisis, due to the unwillingness of private banks to finance more loans to the ND-LDCs, the situation in the early 1990s depends very much on conditions in the DMEs. As they move into a slowdown, growth in the ND-LDCs should also slow. If interest rates start rising as central banks try to contain domestic inflationary pressures and prop up domestic currencies, the effect will be felt most negatively by the ND-LDCs. Their best hope is for a mild global slowdown, falling interest rates and substantial liberalization of trade under the Uruguay Round.

The Growth of International Trade

World merchandise trade volume grew 8.5 percent in 1988 and is expected to continue to grow by 7 percent in 1989. Trade growth is outstripping world output growth by almost two to one. There are at least nine possible explanations for this rapid trade growth, according to the Secretariat of the General Agreement on Trade and Tariffs (GATT 1989: 1,4), four of which are due to basic economic forces and five due to policy changes:

- technological innovations are widening the scope of traded goods and services;
- the real cost of petroleum has fallen by half since its peak in 1980;

- the share of manufactures in world trade in value terms has risen by one third since the 1980s and is now 73 percent of the value of world merchandise trade and half of the value of the exports of LDCs;
- the numbers of international joint ventures and mergers have been growing rapidly, along with the increasing interdependence of financial markets;
- market improvements have resulted from deregulation and denationalization;
- investors and consumers have shown confidence in the ability and willingness of the DME central banks to prevent inflation;
- capital flows have been liberalized;
- economic reforms are taking place in Eastern Europe and the U.S.S.R.; and
- the Uruguay Round, together with regional and bilateral trade policy reforms, implies a commitment to a new liberalized trade policy.

This list offers a basis for a positive perception of a global economy moving towards more open markets and liberalized economies. This trend should lead to an expansion of the global capital stock, faster economic growth and more employment in the 1990s. However, the road to good times is not an easy one, and for every two steps forward, there is one step back. The global economy is in the midst of state and market changes that will have significant long-run impacts on current global trade and investment patterns and on economic growth. Three key market forces are the diffusion of economic power, rapid technological change and the globalization of markets. Three key state policy changes, one multilateral (the Uruguay Round), one regional (1992 in Western Europe) and one unilateral (the 1988 U.S. trade bill), also pose their own challenges and suggest opportunities for the 1990s. The next two sections of this chapter examine the tensions between these state and market forces.

Two Steps Forward, One Step Back: Markets in the Global Economy

The Diffusion of Economic Power

In 1945, the United States stood alone as the undisputed hegemon, due to its commanding share of the world's economic and military resources. International institutions were weak or new, and nonstate actors such as multinational enterprises (MNEs) were just beginning to reach across international borders to set up affiliates.

Today, the situation is very different. As Gilpin (1987) and Hoffman (1989b) argue, most countries at the end of the 1980s are closely linked and interdependent, through their reliance on trade, investment, finance and production flows. The per capita income of the Triad countries (North America, the EC and Japan) is now roughly equivalent (Morris 1989). As Ohmae (1985, 1989) argues, these Triadic consumers represent a new democratization of consumer tastes on a global basis. The EC now has 320 million people in one market, compared to 250 million in the United States (Lees 1989). Small countries with regional influence, the so-called regional influentials such as Indonesia, are also more important in political economy terms (Thornton 1989). International institutions such as the GATT, IMF and World Bank have more political and economic power (although perhaps less so than in the 1960s and early 1970s). Plans are underway to form a new organization of the Pacific Rim economies. MNEs now straddle the globe and many have sales and assets several times larger than national incomes of the smaller LDCs (United Nations 1988).

The United States still remains a hegemon in terms of economic size. In 1988, its per capita GDP was the largest in terms of purchasing power parities; although in terms of current exchange rates, per capita incomes in several countries, such as Switzerland, Japan and Sweden were higher than in the United States (*Economist* 1989: 123). In 1986, at $4,444 billion, the U.S. GNP was the largest share, approximately 23 percent, of world GNP (Japan 1988). As several authors have argued (Gilpin 1987; Hoffman 1989b; Tonelson 1989), the increased diffusion of economic power, in some sense, was inevitable once the Western allies regained their economic strength after the Second World War. There are grounds for arguing that the current diffusion of power is simply a return to the historical norm, and that the 1945-80 period was an abberation in history.

However, even if the United States is still "the only 'complete' great power" (Hoffman 1989b: 88), its ability to lead the Western alliance is now severely constrained by market forces, in particular by the U.S. reliance on foreign borrowing, and the rise of regional blocs with markets larger than that of the U.S. Deficits make it less likely that the United States can afford to defend the Alliance (this may be a dated concept), and more likely that U.S. contributions to foreign aid and international institutions will be reduced in order to fund domestic programs. Multipolarity is a much-used word, but it does describe the market forces which are reducing the United States to the status of first among equals, a leader instead of a ruler (Eden 1989; Hampson 1989).

Japan remains the enigmatic power behind the U.S. throne. The top twenty-five banks are headquartered in Japan, which now has one-tenth of world GNP (Japan 1988). Japan now holds 50 percent of global patents, finances the bulk of the U.S. budget deficit, and in 1989 became the world's largest aid donor (McMillan 1989). Its present foreign policy is designed to ensure a continuation of postwar strategic and economic relationships between itself and the United States (Japan 1988; Okita 1989). Faced with a hostile U.S. Congress, a wary group of Pacific Rim neighbours and a eager crowd of ND-LDC borrowers, Japan contemplates its "quiet strength" in the 1990s.

As events in 1989 demonstrate, the Soviet Union's empire is apparently collapsing. The ability of the United States to exercise economic clout in Eastern Europe is uncertain. As Stern (1989) clearly shows, the use of economic leverage through threats of sanctions has had little effect on the U.S.S.R. Its economic fortunes are driven more by oil and gold prices and the success or failure of the wheat crop. Given the enormous short-run dislocation costs of *perestroika*, the U.S.S.R., like the U.S. is losing economic clout relative to other nations. As the two Germanies move closer together, there is the potential in the 1990s for a four-sided hegemonic power game: the United States, Russia, Germany and Japan, each with its own sphere of interests.

The Importance of Knowledge-Based Production

The global economy is in the midst of a third technological revolution based on microelectronics (Eden 1989). Through such new technology tools as CAD-CAM, microsoftware, flexible automation and information networking systems, a firm can be linked with its key operations, customers, suppliers and procurement officers worldwide. The start-up costs of this automation are extremely high, necessitating external markets so that the firm can reap economies of scale and scope (Levitt 1983). Product innovations have a higher knowledge content, and new processing methods such as just-in-time inventories and flexible automation have led to reduced wastage and substitution among materials (Fleck and D'Cruz 1987; van Tulder and Junne 1989).

Information technology is also being used as a tool to downsize and flatten the corporation. U.S. firms have shed more than one million managers and professional staff since 1979 (Applegate et al. 1988). Information technology can also be used to relocate production back from developing countries to the DMEs. The 1970s and 1980s shift to offshore processing as a way to cut costs may no longer be necessary with rapid automation at home. The ability of the NIEs to retain their offshore platforms in the 1990s will depend on their labour costs, political stability and the speed at which they can automate relative to the DMEs.[4]

Globalization of Markets and Firms

The joining of computers and telecommunications has revolutionized communications, changing the concept of a market from a geographic location to a network of computers linked by telephone lines. Just as the railroad revolutionized transportation of goods within and between national markets by lowering transportation costs to its downstream industries, so too is the computer revolutionizing transportation of services within and between markets. The railroad affected transportation in terms of both carriage and content, carriage through the use of freight cars and content in terms of bulk freight goods. The computer is changing transportation again in terms of carriage (airways, telephone lines, cables) and content (voice, data and video services).[5] Just as lower transport costs overcame tariff barriers, linking markets and increasing trade in goods, so also are lower communications costs overcoming regulatory and other non-tariff barriers, making previously untraded goods and services tradeable. By 1990, there will be one billion telephones in the world, all able to dial each other directly (Hax 1989). Trade in commercial services grew faster than in trade in goods between 1980 and 1988. World exports of commercial services in 1988 were estimated at U.S. $560 billion or about 20 percent of total world exports (GATT 1989).

Technology affects not only the globalization of trade in services, but also the overall volume of trade, since many goods have a high service content. GATT (1989: 3) concludes that the "greater the availability and the lower the costs of the needed services, the faster [is] the pace of globalization of markets," and that access to competitively priced producer services is a key determinant of a firm's ability to complete in global markets.

Almost all industries now have global markets, competitors, customers and suppliers. Ohmae (1985, 1989) argues that the Triad is the critical framework for MNEs thinking about global competition. Each multinational should have a position in each of the three leading blocs in order to be a "true insider" in that market. At the same time, each firm should develop "lead country models", products tailored to the dominant markets, which can be minimally tailored for smaller markets.

The globalization of markets is forcing multinationals to juggle simultaneously the goals of economic efficiency, national responsiveness and world-wide learning, according to Bartlett and Ghoshal (1987a, 1987b). They argue that three important intrafirm trade flows are at the centre of the emerging new global corporation: (1) product interdependence: flows of components and finished goods; (2) resource interdependence: flows of funds, skills and other scarce resources; and (3) knowledge interdependence: flows of intelligence, ideas and knowledge personnel. At the same time, MNEs are turning to partnerships, joint ventures and other co-operative arrangements as a way of spreading the high overhead costs of technological innovation; they are linking with firms with complementary skills and resources, and achieving "insider" status (United Nations 1988).

Implications of Market Changes for State Policies

The diffusion of economic power, the technological revolution and the globalization of firms and markets have faced governments with a major policy problem: how to ensure that their firms remain competitive in an increasingly competitive world. Globalization of markets is also encouraged by state policies such as deregulation, the liberalization of trade and the integration of financial and capital markets through the G-7 and the European Monetary System. The perception that technology is key to good trade performance and economic competitiveness has led governments to subsidize and protect their high-tech industries, and to encourage the production of high-skilled labour (van Tulder and Junne 1989; McMillan 1989).

What is international competitiveness? The World Competitiveness Report summarized in *European Affairs* (1989: 116) defines competitiveness as: "the ability of entrepreneurs to design, produce and market goods and services, the price and non-price qualities of which form a more attractive package than that of competitors." Competitiveness comes from two sources: the internal efficiency of the firm and the national environment. The report focuses on the impact of national environments on firms operating within domestic borders.

Of the twenty-two DMEs surveyed in the report the leader this year, as last year, was Japan, followed by Switzerland. Canada's position improved from sixth to fourth place, due mostly to the implementation of the free trade agreement. The ranking of the G-7 countries is summarized in Table 9-4. Japan has the current lead in process technology while the United States leads in product technology (McMillan 1989). Since product innovations can be rapidly duplicated, while process innovations are difficult to transfer, Japan's advantage may be more sustainable in the long run than that of the U.S. Canada's worrisome performance in terms of financial dynamism, and outward and innovative forward orientation should be noted.

Table 9-4
Competitiveness of the G-7 Countries, 1989
(rank out of 22 developed market economies)

	CAN	U.S.	JAPAN	F.R.G.	U.K.	FRANCE	ITALY
Dynamism of economy	3	2	1	4	11	13	19
Industrial efficiency	4	3	1	5	10	12	13
Market orientation	4	1	3	5	12	11	17
Financial dynamism	11	6	2	3	8	10	17
Human resources	2	1	3	12	15	11	19
State interference	3	2	5	7	8	17	20
Natural endowments	2	9	13	10	5	8	19
Outward orientation	14	9	2	4	6	12	17
Innovative forward Orientation	15	6	1	3	12	8	18
Socio-political stability	6	3	2	5	15	17	16

Source: "The World Competitiveness Report", *European Affairs* (1989: 117).

Two Steps Forward, One Step Back: States in the Global Economy

Multilateral State Initiatives: the Uruguay Round

The GATT is now forty-two years old. Its membership includes 96 countries that account for over 85 percent of world trade (Kelly et al. 1988: 29). In September 1986 the Uruguay Round of Multilateral Trade Negotiations (MTN) was launched at Punta del Este, Uruguay. The purpose of this round is broader than earlier MTN rounds because it includes both trade in goods and services. However services are being treated separately and any services accord is unlikely to be binding on all members. The goods negotiations are divided into fourteen negotiating groups covering tariffs, non-tariff barriers (NTBs), safeguards, various product categories, subsidies and countervailing duties, trade-related intellectual property rights (TRIPS) and trade-related investment measures (TRIMS) (Kelly et al. 1988; *Canada Export* 1989).

Since the negotiations were launched, individual countries have been discussing the breadth of issues that can be covered by each committee and tabling position papers. In December 1988, the mid-term review of the Uruguay Round was held in Montreal. At this meeting, the so-called "Montreal principles" of national treatment, nondiscrimination, market access, progressive liberalization and transparency were proposed for services, TRIMs and TRIPs. Eleven negotiating papers were tabled and tentatively approved. The mid-term review process reached an impasse, however, largely due to U.S.-European Community conflicts over agricultural reform, and reconvened in Geneva in April 1989.

The April 1989 meeting tabled draft negotiating papers setting out the objectives and timetables for completion of the Uruguay Round by the end of 1990. More than 100 countries ratified these papers, along with the ones passed at the 1988 Montreal meeting. The major points agreed upon at the April 1989 meeting, including those agreed upon in Montreal, were the following:

- agreement on an overall cut of 30-40 percent in tariffs;
- reductions, to begin in 1991, of support (read: EC) and protection (read: U.S.) to agriculture;
- the initiation of negotiations to bring textiles trade into the GATT after the Multi-Fibre Agreement expires in 1991;
- agreement to negotiate standards, rules and dispute settlement mechanisms for TRIPS;
- agreement to liberalize NTBs, trade in natural resources; and
- agreement to bring trade in business services into the GATT.

By August 1990, the delegations are to have reached broad agreement in each group so that, by November, the agreements can be finalized and legal documents prepared. The final meeting is to be held at Brussels in December 1990.

If the Round is successful it will substantially broaden the issues covered by the GATT and address the new realities of the global economy. As Preeg has recently argued: "The great irony in world trade is that just as actual trade relations are becoming truly globalized, the credibility of the GATT multilateral trading system has been in decline" (1989: 201). The growth of regional and bilateral trade, the increasing use of non-tariff barriers, the omission of major traded commodities such as agriculture, textiles and services, have all damaged the GATT's ability to manage the international trading system. The outcome will depend on the success of the Uruguay Round in broadening the issues covered by the GATT, as evidenced by the number of serious policy measures passed, the number of signatories to those measures and the speed with which the measures are implemented.

Regional State Initiatives: On the Road to 1992

The GATT needs a broadening both of issues and geography. Preferential trading arrangements fall under Article 24 of the GATT and were, in 1947, expected to represent exceptions to the rule of multilateral trade. However, the exception has become the rule, as preferential trading areas exist in all corners of the world. The most prominent of these, of course, have been the European Community, the Canada-U.S. free trade agreement and COMECON.[6]

In March 1985, the European Council passed a resolution to move to a single market ending the current maze of border controls, subsidies, regulations and preferential procurement policies. In June the Commission, the executive branch of the EC, published a White Paper listing three hundred areas where controls on capital, labour, goods and services flows needed to be liberalized, and setting a deadline of 1992 for passing the necessary legislation (Hoffman 1989a).

The EC Commission has estimated a once-and-for-all gain of 2 to 3 percent in Community GDP from the removal of border controls alone, and another 2 to 3 percent from improvements in competitiveness (Giersch 1989; Kelly et al. 1988: 88-105). Thus there could be a one-time gain of 5 percent in actual GDP due to liberalization under 1992. However, Giersch argues that this may underestimate the true gain if increased productivity due to decontrol and liberalization raises the potential level of GDP. A gain in potential GDP is a permanent gain, as compared to a one-time gain. Giersch observes that inflation in the EC is low, oil prices and wage demands are stable, investment is high and rising as is foreign direct investment. In addition, faster technological innovation, increased knowledge-intensity of production, and the spread of Europe-wide sourcing by EC multinationals is accelerating growth within the Community.

While the output gain to the EC may be clear, the impact on nonmembers is more worrisome. The 1992 liberalization is a regional initiative and, as such, can be a "building bloc" or catalyst for further multilateral liberalization, or an inward-looking bloc and a force for protectionism. Under Jacques Delors, head of the EC Commission, the pressure has been to harmonize legislation and set common standards across the twelve member countries. U.K. Prime Minister Margaret Thatcher, however, has been pressing for mutual recognition of each member's standards, allowing harmonization to come from competition rather than bureaucrats. (This conflict between upper-and-lower tier governments is a tension that Canadians know well). It is clear that the easiest harmonization has already occurred and that the 1992 deadline will not be met for all 300 directives. However, the hundreds of mergers and acquisitions taking place as firms position themselves within the Community suggest that economic restructuring is sufficiently advanced that it would be difficult to stop.

Schmieding (1989) argues that the trade diversion effects of 1992, particularly for the COMECON countries, may be larger than expected. Not only will outsiders will be at a disadvantage, since suppliers from member states enjoy easier access to partners' markets than do third country suppliers, but harmonization can accentuate this trade diversion. Over 70 percent of the 130 directives passed so far provide for harmonization. These uniform norms set by the EC bureaucracy can be misused as barriers to entry. For example, the new local content rule to the effect that any European good must not embody more than a fixed share of imported inputs is clearly discriminatory. In addition, Schmieding asserts that harmonizing social systems and labour laws will generate cost-push pressures of such a kind that the EC will increase its common external tariff.

As a result of the move to 1992, the members of the European Free Trade Area (EFTA) are deciding whether to apply for membership in the EC or, if they remain in EFTA, how to restructure the EC-EFTA relationship after 1992. The EFTA members generally are high-income, liberalized economies, and have their own long-run, preferential access to the EC. The key problem is the European neutrals in EFTA which would have to give up their neutrality to join the EC: Austria, Switzerland and Finland. If some of the members of EFTA join the EC, the longevity of EFTA may be problematic. A possible solution may be found in a new arrangement between the EC and EFTA that takes account of the changed political and economic situation in Europe.

An additional challenge and opportunity is the opening of Eastern Europe, which now looks to Western Europe for investment, goods and aid. The talk is of a new Marshall Plan for Eastern Europe and of a "common European home" in which the Community would be the centrepiece. The potential hegemonic dominance of Germany within Europe is unmistakable, and reflected in the booming West German stock market at the end of 1989. West German economic strength is likely to grow significantly in 1990s, as the country reaps the largest share of the gains from 1992.

The recent political and economic upheavals in Eastern Europe and the Soviet Union may well lead to requests from that quarter to join the GATT and/or the EC. The lack of convertible currencies and markets, and the low per capita incomes, will make it difficult to accept these countries into the GATT, and yet their omission has been one of its major holes. It is perhaps more likely that the East Europeans will turn first to the EC and seek preferential access. The Community, in the middle of 1992 reforms, is likely to agree to short-term limited access and to negotiations for a long-term permanent relationship.

Unilateral State Initiatives: U.S. Punitive Reciprocity

William Niskanen recently labelled the United States as the "new bully of international trade" (1989). While the increasing protectionism of the U.S. government may simply be a return to its pre-1935 hostility to free trade (see Gilpin 1987), it is clear that successive trade bills since the 1984 Trade and Tariff Act have become more and more protectionist. Over the 1980-87 period, the U.S. government initiated 411 antidumping, 283 countervailing and 60 safeguard investigations, according to Kelly et al. (1988: 11). The United States has unilaterally moved away from its postwar position of supporting multilateral trade access under generally agreed upon rules to a new (or renewed) position of permanent bilateral negotiation over market access.

This shift is most clearly spelled out in the 1988 Omnibus Trade and Competitiveness Act. As Ludlow notes, "If the act does not guarantee illiberal behaviour, it will certainly facilitate it." (1989: 157) Section 301 or "Super 301" of the Act requires the U.S. Trade Representative (USTR) to identify which countries and practices most limit U.S. exports and to demand negotiations with those countries to open their markets. If negotiations fail, the USTR can impose punitive tariffs on imports from the offending country.

The 1988 Act also authorizes private litigation that was impossible under the old U.S. trading rules. Super 301 allows any U.S. firm to claim as an unfair trade practice any foreign country's policies that do not correspond to U.S. trade, labour relations and antitrust legislation. Under the GATT unfair trade is defined as a trade practice inconsistent with the rules to which each affected party has agreed. Super 301, however, ignores international rules in its definition of unfair trade. Even if the United States already engages in the same offending practice, this fact can be ignored by the USTR if the practice is perceived as harming U.S. interests. American economic clout can be used to harass foreign governments with the threat of heavy tariffs on their exports unless they open their markets to U.S. exports. Because any firm, large or small, that wants to bring an action can do so, and claim it is justified under section 301, there is enormous potential for harassment of foreign firms. The president or the USTR can reject the suits, but any firm still has the right to bring one forward. It may well be that, as Feldstein (1989) has argued, that private 301 cases will be the dominant protectionist force in the 1990s.

In May 1989, the USTR, Carla Hills, cited Japan, Brazil and India under Super 301 as three countries which have erected significant barriers to U.S. exports (Niskanen 1989). While the average level of tariffs in Japan is about 2 percent, it is 37 percent in Brazil and 138 percent in India. The USTR claimed Japan discriminated against foreign-manufactured space satellites, supercomputers and lumber (through its building and fire codes). All three practices have their U.S. counterparts, and under the GATT would not be considered unfair trade. Although both parties are discussing these issues at the so-called "structural impediments initiatives" talks, no resolution had been achieved by the end of 1989.[7]

Milner and Yoffie (1989) argue that the U.S. shift to forcing foreign governments to open their markets to U.S. goods, and to retaliating by closing the U.S. door in the event that negotiations prove unsatisfactory, is a new form of strategic trade policy. The use of U.S. rules and definitions to mount a unilateral threat on perceived unfair trade practices abroad is also a perverse form of reciprocity. Reciprocity normally refers to the mutual lowering of trade barriers and increased market access that occurs during multilateral, regional or bilateral trade negotiations. The new U.S. tack is "punitive reciprocity" which threatens to raise U.S. barriers if other countries do not lower their barriers (as defined by the USTR, despite the fact that often similar barriers exist in the United States).

States and Markets: Implications for Canada

The ongoing changes in states and markets outlined in the sections above are both an opportunity and a worry for Canada, a small economy, highly dependent on access to the U.S. markets for Canadian raw material and automotive exports. Its fiscal budget and current account deficits are proportionately larger than those of the U.S., and inflation and unemployment rates are higher. The need to "get our house in order" is clear. Further expenditure cuts in the February 1990 budget are widely anticipated. Coupled with implementation of the Goods and Services Tax in 1991, these cuts should lessen the FB deficit. Continuing high interest rates, however, suggest that the current account deficit will persist in the near future.

The shift of economic power away from the United States, and the subsequent use by that country of neoprotectionism to shift the adjustment costs to outsiders, were major reasons for the Canadian government's push for the free trade agreement (to get in "before the doors closed"). As a result of spending our policy energies tying our economy to the United States, we have done little to encourage links with the emerging power centres of Western Europe and the Pacific Rim. Our firms have been slower to adapt to, and diffuse, the new product and process technologies. The impact of globalization on the Canadian market and firms has perhaps been stronger than in the United States, due to the more open nature of our economy. Some greenfield foreign investments have occurred due to the free trade agreement, but most Canadians have focused on the rash of mergers, plant closures and layoffs.

The international policy shift to comparative advantage engineered by nation states jockeying for competitiveness is also a worrisome trend for a small country like Canada. In an era of fiscal restraint there will be few tax dollars to spend on engineering our own comparative advantage. UNCTAD (1989) argues that the successful countries in the 1980s, in terms of international competitiveness, were those countries which moved into sectors of high demand, especially those with high R&D content, and/or applied advanced technological processes to generate increased exports in less dynamic sectors. Given Canada's poor rating in terms of outward orientation and innovative forward orientation policies (see Table 9-4), it is critically important that Canadian policymakers devise a long-run strategy that addresses these deficiencies.

Given our small number of domestic high-tech firms, one way to do this could be to encourage technological diffusion to the more numerous medium-tech and low-tech firms. Technological spillovers from foreign investments in Canada could also be a significant factor. Human resource development, particularly in the scientific and technical areas, should also be a priority, given Canada's poor standing in worldwide mathematics competitions and the high dropout rate from our schools. This is not a call for an activist industrial strategy, but rather a reflection of the need to assess and remedy areas of long-run weakness in Canada's human and technological resources.

Conclusions

The end of the 1980s has been a time of rapid technological, economic, political, strategic and institutional change. Uncertainty offers both opportunities and potential pitfalls for the global economy. As the Soviet Union and Eastern Europe move towards a new rapprochement with the West, and the United States and Japan sort out their relative positions in a world of diffused power, new strategies will be needed.

The tension between state and market is the crucial dynamic of which policymakers must take account. Our analysis of key market forces and state policy initiatives leads us to conclude that state and market have become more intertwined in the late 1980s. How countries handle the tension between political sovereignty and global interdependence will determine their relative national positions in the international competitiveness sweepstakes. Canada will need to step carefully to ensure it does not get left behind as we move two steps forward, one step backward into the 1990s.

Notes

[1] I thank Judith van Walsum for her research assistance. Helpful comments were provided by David Malone at External Affairs, Christopher Maule and the editors. The responsibility for all views and any remaining errors is mine.

[2] The implicit assumption is that the expected rate can be proxied by the actual inflation rate.

[3] For a short summary of the debt crisis see IMF (1989, 49-57 and 61-7). An excellent compendium of papers on the debt crisis can be found in Sachs (1989).

[4] For opposing views on offshore processing, see UNCTAD 1989, Grunwald and Flamm 1985, and Markides and Berg 1988.

[5] I am indebted to Christopher Maule for this analogy.

[6] See Curtis and McMillan in this volume. The free trade agreement includes a schedule for bilateral removal of tariffs, new rules of origin, freer cross-border movement for services, investment flows and professionals, binational dispute settlement, and new institutions (a trade commission, secretariat and ad hoc working groups on subsidies, antidumping and others). See *Canada Export* (1988: 1,6) for a brief outline.

[7] Interestingly, the USTR argued that the EC also had unfair trade barriers. However, the United States did not launch an aggressive attack on the Europeans, perhaps because the EC refused to negotiate in response to a Super 301 charge whereas the Japanese were willing to discuss the issue.

References

Applegate, Lynda, James Cash and D. Quinn Mills. 1988. "Information Technology and Tomorrow's Manager." *Harvard Business Review* (Nov.-Dec.):128-36.

Bartlett, Christopher and Sumantra Ghoshal. 1987a. "Managing Across Borders: New Strategic Requirements." *Sloan Management Review* 28 (Summer): 7-17.

Bartlett, Christopher and Sumantra Ghoshal. 1987b. "Managing Across Borders: New Organizational Responses." *Sloan Management Review* 29 (Fall): 43-53.

Business Review. 1989. No. 89/3 (July-Aug.-Sept.) Toronto: Bank of Montreal.

Canada Export. 1989 (May 15). Ottawa: External Affairs Canada.

Economist. 1989. New York: The Economist Newspaper, NA, Inc.: Nov. 4-10.

Eden, Lorraine. 1989. "Choices for the Global Economy." In *Canada Among Nations, 1988: The Tory Record*, edited by Brian W. Tomlin and Maureen Appel Molot. Toronto: James Lorimer and Co.: 83-106.

Feldstein, Martin. 1989. "US Protectionism on the Rise." *European Affairs* 3 (Autumn):108-13.

Financial Post, 1989. *Report on the Nation: The 1990s: Gloom or Glory?* (Winter).

Fleck, James and Joseph D'Cruz. 1987. "The Globalization of Manufacturing." *Business Quarterly* (Winter): 42-51.

General Agreement on Tariffs and Trade. 1989. *Focus: GATT Newsletter* 65 (October): 1, 4.

Giersch, Herbert. 1989. "EC 1992: Competition is the Clue." *European Affairs* 3 (Autumn): 10-17.

Gilpin, Robert. 1987. *The Political Economy of International Relations.* Princeton, N.J.: Princeton University Press.

Grunwald, Joseph and Kenneth Flamm. 1985. *The Global Factory: Foreign Assembly in International Trade.* Washington, D.C.: The Brookings Institution.

Hampson, Fen. 1989. "A Post-Modernist World: The Changing International Politico-Security System." In *Canada Among Nations, 1988: The Tory Record*, edited by Brian W. Tomlin and Maureen Appel Molot. Toronto: James Lorimer and Co.: 41-59.

Hax, Arnoldo C. 1989. "Building the Firm of the Future." *Sloan Management Review 30* (Spring): 75-82.

Hoffmann, Stanley. 1989a. "The European Community and 1992." *Foreign Affairs* 68, no.4 (Fall): 27-47.

Hoffman, Stanley. 1989b. "What Should We Do in the World?" *The Atlantic Monthly* (Oct.): 84-96.

International Monetary Fund. 1989. *World Economic Outlook* April 1989. Washington, D.C.: IMF.

Japan. 1988. *Diplomatic Bluebook: 1988 Japan's Diplomatic Activities.* Tokyo: Ministry of Foreign Affairs.

Kelly, Margaret et al. 1988. *Issues and Developments in International Trade Policy.* Washington, D.C.: IMF.

Kirkland, Richard I. Jr. 1989. "Entering a New Age of Boundless Competition." *Fortune* (March 14): 40-47.

Lees, Martin. 1989. "The Impact of Europe 1992 on the Atlantic Partnership." *The Washington Quarterly* 12, no.4 (Autumn): 171-82.

Levitt, Theodore. 1983. "The Globalization of Markets." *Harvard Business Review* (May/June): 92-102.

Ludlow, Peter. 1989. "The Future of the International Trading System." *The Washington Quarterly* 12, no.4 (Autumn): 157-69.

Markides, Constantinos and Norman Berg. 1988. "Manufacturing Offshore Is Bad Business." *Harvard Business Review* (Sept./Oct.): 113-20.

McMillan, Charles J. 1989. *Investing in Tomorrow: Japan's Science and Technology Organization and Strategies.* Ottawa: Canada-Japan Trade Council.

Milner, Helen and David Yoffie. 1989. "Between Free Trade and Protectionism: Strategic Trade Policy and a Theory of Corporate Trade Demands". *International Organization* 43, no.2 (Spring): 239-72.

Morris, Charles R. 1989. "The Coming Global Boom." *The Atlantic Monthly* (Oct.): 51-64.

Niskanen, William A. 1989. "The Bully of World Trade." *Orbis* 33, no.4 (Fall): 531-38.

Ohmae, Kenichi. 1985. *Triad Power: The Coming Shape of Global Competition.* New York: The Free Press, Macmillan.

Ohmae, Kenichi. 1989. "Managing in a Borderless World." *Harvard Business Review* (May-June): 152-61.

Okita, Saburo. 1989. "Japan's Quiet Strength." *Foreign Policy* 75 (Summer): 128-45.

Preeg, Ernest H. 1989. "The GATT Trading System in Transition: An Analytic Survey of Recent Literature." *The Washington Quarterly* 12, no.4 (Autumn): 201-13.

Sachs, Jeffrey, ed. 1989. *Developing Country Debt and the World Economy.* National Bureau of Economic Research. Chicago: University of Chicago Press.

Schmieding, Holger. 1989. "A Concept for a Pan-European Economic Integration." *European Affairs* 3 (Autumn): 33-8.

Stern, Paula. 1989. "U.S.-Soviet Trade: The Question of Leverage." *The Washington Quarterly* 12, no.4 (Autumn): 183-97.

Thornton, Thomas Perry. 1989. "The Regional Influentials: Perception and Reality." *SAIS Review* 9, no.2 (Summer-Fall): 247- 60.

Tonelson, Alan. 1989. "America in a Multipolar World—Whatever That Is." *SAIS Review* 9, no.2 (Summer-Fall): 45-59.

United Nations. 1988. *Transnational Corporations in World Development.* New York: United Nations.

UNCTAD. 1989. "The Impact of Technological Change on World Trade Patterns." *UNCTAD Bulletin* 252 (May): 3-6.

"World Competitiveness Report 1989." 1989 *European Affairs* 3 (Autumn): 114-26.

Van Tulder, Rob and Gerd Junne. 1989. *European Multinationals in Core Technologies*. New York and Toronto: John Wiley and Sons.

Canada Among Nations

1989
The Challenge of Change

Edited by
MAUREEN APPEL MOLOT
and
FEN OSLER HAMPSON

THE NORMAN PATERSON SCHOOL OF INTERNATIONAL AFFAIRS

CARLETON UNIVERSITY PRESS
Ottawa, Canada
1990

© Carleton University Press Inc. 1990

ISBN 0-88629-106-2 paperback
0-88629-112-7 casebound

Printed and bound in Canada

Carleton Public Policy Series #2
The National Library of Canada has catalogued this publication as follows:

Canada among nations
1984-
Annual.
Each vol. has also a distinctive title.
1984-1988 eds. edited by Brian W. Tomlin and Maureen Appel Molot;
1989- edited by Maureen Appel Molot and Fen Osler Hampson.
1984-1988 eds. published by J. Lorimer; 1989- published by Carleton University Press.
Produced by the Norman Paterson School of International Affairs at Carleton University.
Includes bibliographical references.
ISSN 0832-0683
1. Canada—Foreign relations—1945- —Periodicals. 2. Canada—Politics and government—1980-1984—Periodicals. 3. Canada—Politics and government—1984- —Periodicals. I. Tomlin, Brian W., 1944- II. Molot, Maureen Appel, 1941- III. Norman Paterson School of International Affairs.

FC242.C345 327.71 C86-31285-2 rev.

Distributed by: Oxford University Press Canada
70 Wynford Drive
Don Mills, Ontario
Canada M3C 1J9
(416) 441-2941

Cover design: Y Graphic Design

Cover photo: Courtesy of Bill McCarthy, P.M.O.
Brian Mulroney and Mikhail Gorbachev
meeting in The Kremlin, Nov. 21, 1989.

Acknowledgement
Carleton University Press gratefully acknowledges the support extended to its publishing programme by the Canada Council and the Ontario Arts Council.

Table of Contents

Preface

List of Contributors

1 The Challenge of Change
Maureen Appel Molot and Fen Osler Hampson 1

2 The Soviet Union and Eastern Europe in Transition: Trends and Implications for Canada
Lenard J. Cohen 19

3 Rude Awakening: Canada and China Following Tiananmen
Jeremy T. Paltiel 43

4 Canada's Response to the "New Détente" in East-West Economic Relations
Carl H. McMillan 59

5 Strategic Arms Control
Tariq Rauf 79

6 Conventional Arms Control
Roger Hill 93

7 The North in Canada's International Relations
Ron Purver 105

8 Canadian Defence Policy: An Uncertain Transition
Dan W. Middlemiss 119

9 Two Steps Forward, One Step Back: Into the 1990s
Lorraine Eden 135

10 The Trade Policy Response: Negotiating with the United States and the World
John M. Curtis 163

11 Pollution Across Borders: Canada's International Environmental Agenda
Fen Osler Hampson 175