Canada's National Policies: Reflections on 125 Years

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Alors que la Nation canadienne célèbre ses 125 ans, un examen des politiques nationales passées semble opportun. Le terme 'politique nationale' est défini ici comme une politique adoptée par les différents gouvernements fédéraux qui se sont succédés et visant sciemment à construire la nation canadienne. Le texte défend l'idée qu'il y a eu trois politiques nationales au Canada: *l'expansionnisme défensif* de 1867 à 1940, le *libéralisme compensatoire* de 1941 à 1981 et le *libéralisme de marché* à partir de 1982. La phase d'expansionnisme défensif est liée à l'adoption de tarifs, la construction du chemin de fer et la colonisation qui ont permis la construction du pays. La seconde politique nationale a été marquée par un engagement envers la philosophie de libéralisation des échanges du GATT prévalant après la Deuxième Guerre, les politiques macroéconomiques Keynésiennes et la construction d'un filet de sécurité sociale. La politique nationale actuelle repose sur l'entente de libre-échange Canada-États-Unis, des politiques axées sur le marché et une diminution des contraintes fiscales. Toutefois, le libéralisme de marché est une stratégie qui manque de cohérence et de vision et qui devrait être reformulée en une quatrième politique nationale que nous appelons: *l'intégration stratégique*. Les trois composantes de cette quatrième politique nationale sont le libre-échange, autant à l'extérieur qu'à l'intérieur de l'union économique canadienne; la mise en place d'une infrastructure nationale de télécommunication basée sur le développement et la diffusion des technologies de l'information; et le développement du capital humain au moyen de l'éducation nationale, du recyclage et des politiques d'ajustement.

As Canadians conclude the 125th year of nationhood, an examination of the evolution of past Canadian *national* policies is appropriate. The term national policy is here defined as the conscious, nation-building policies of successive federal governments. This paper argues that there have been three national policies in Canada: *defensive expansionism* from 1867–1940, *compensatory liberalism* 1941–1981, and *market liberalism* starting in 1982. The defensive expansion phase relied on the Canadian tariff, railway construction and land settlement to build the country. The Second National Policy combined a commitment to the GATT postwar liberal trading order, Keynesian macroeconomic policies, and the construction of a domestic social welfare net. Our current national policy relies on Canada-US free trade (and now North American free trade), market based policies and fiscal restraint. We argue, however, that market liberalism is a strategy which lacks coherence and vision, and should be reformulated into a Fourth National Policy which we call *strategic integration*. The three components of this fourth national policy would be free trade, both external and internal through a Canadian economic union; the building of a national telecommunications infrastructure based on the development and diffusion of information technologies; and human capital development through national education, retraining and adjustment assistance policies.

Introduction

As Canadians conclude their 125th year of nationhood and search for new directions for the 21st century, it is useful to examine the formation and evolution of past Canadian national policies. The term *national policy* is used here to refer to the conscious, nation-building policies of successive federal governments. The purpose of this paper is twofold: first to propose that, in effect, there have been three national policies in Canada since 1867: *defensive expansionism* from 1867 to 1940, *compensatory liberalism* from 1941 to 1981, and *market liberalism* starting in 1982; and second, to argue that the current national policy, which lacks coherence and vision, should be reformulated into a new national policy which we designate as *strategic integration*.

Each of these national policies has within it a conception of the state's relation to the market, the instruments available to the state, and the political and economic constraints on state action. Each was designed to 'nation build,' i.e. to foster a sense of collective identity north of the 49th parallel (Leslie, 1988:23). Moreover, each has the same three nation-building components which we identify as *industry*, *infrastructure* and *society building*. These components parallel, and are more comprehensive than, the three prongs of the First National Policy. The components have subdivided and become more complicated as the federal government assumed new responsibilities after 1945. Canada's current national policy is now narrowing in focus as the government retrenches and adopts a more market-oriented approach.

The First National Policy (NPI), well-known to students of Canadian history as that of Macdonald and Laurier, was based on the tariff, railway construction and immigration. Characterized by Hugh Aitken (1967) as defensive expansionism, this First National Policy was a deliberate effort at constructing a national entity from the disparate and distant British colonies. Anticipating postwar reconstruction, in the 1940s the Mackenzie King government formulated what Donald Smiley (1974) has called the Second National Policy (NPII), which was designed to smooth the transition to a peacetime economy and facilitate postwar reconstruction and economic growth. This national policy was predicated on the continuing primacy of the federal government which emerged from World War II with a large bureaucracy and a strong sense of national purpose. NPII addressed a broader range of issues than its predecessor, including macroeconomic management and national leadership in the development and implementation of a welfare state. Given the combined thrusts of Keynesianism and social welfare policies we identify the Second National Policy as one of compensatory liberalism.

This paper contends that there is now a Third National Policy (NPIII), market liberalism, which began about 1982 with some rethinking of Canadian foreign investment and trade policies by the Trudeau government. The election of the Mulroney government cemented the transition to market liberalism by introducing more market-oriented policies similar to those already in place in Britain and the US. Like the Thatcher and Reagan administrations, the Mulroney Conservatives articulated an economic strategy based on liberalization, privatization and deregulation. The attention to economic efficiency which typifies the new orthodoxy may have come, however, at the cost of reduced commitment to equity issues. Another reason for the reduced commitment is the succession of large budget deficits which have constrained federal expenditures through the 1980s to the present. Among the ingredients of this Third National Policy have been the Canada-US Free Trade Agreement (FTA) and the North American Free Trade Agreement (NAFTA), redefinition of the role of the Canadian Broadcasting Corporation (CBC), privatization of state enterprises such as Air Canada and Petro-Canada, and deregulation of financial and

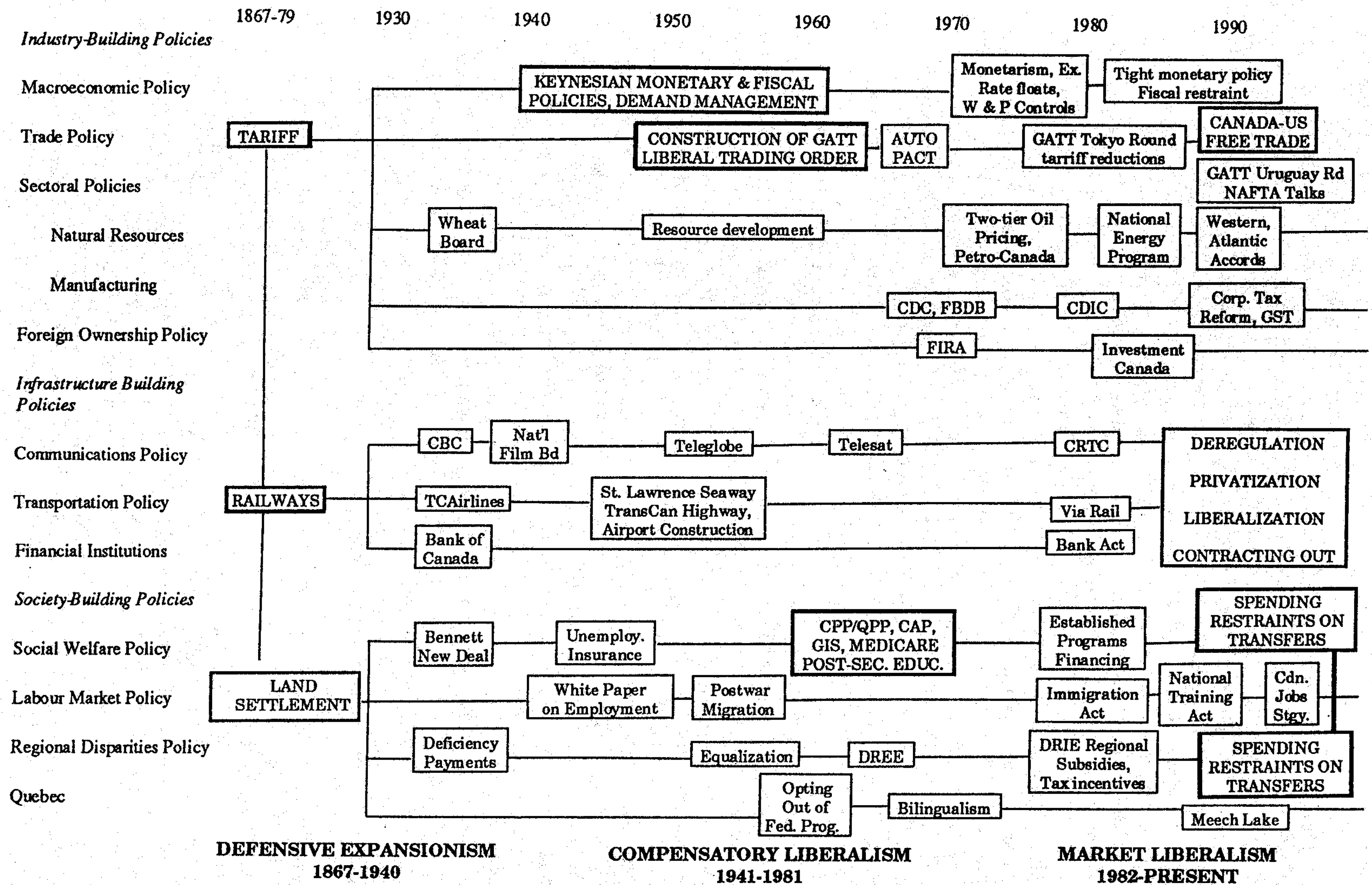

Figure 1 Canada's National Policies – 1867 to the present

transportation markets.

Market liberalism fails, however, to equip Canada to face the challenges of the next century. The globalization of production, together with the reduction of Canadian tariffs under the Tokyo Round of the General Agreement on Tariffs and Trade (GATT), the FTA and the NAFTA, have increased foreign competition, forcing plant rationalizations and disruption to manufacturing employment. Long a problem in Canadian federalism, interprovincial barriers to trade which generate market fragmentation are an additional impediment to competitiveness. Superimposed on these efficiency issues have been increased regional tensions manifest in the continuing debates over constitutional reforms, the October 1992 referendum on the Charlottetown Accord, the rise of new federal parties and the threat of Quebec separation. As a result, we argue a Fourth National Policy (NPIV) that emphasizes: 1/ free trade, both external and internal through a Canadian economic union; 2/ the building of a national telecommunications infrastructure based on the development and more rapid diffusion of information technologies; and 3/ human capital development through national education, retraining and adjustment assistance policies is needed to prepare Canada for the 21st century.

The First National Policy: Defensive Expansionism 1867–1940

The First National Policy took shape as Confederation was being planned, with the acquisition of the western frontier region and a commitment to construct a transcontinental railway. The third component of NPI followed when, in 1878, the Conservative party under Sir John A. Macdonald was returned to power on a platform of nation building by raising tariffs as a means of protecting nascent Canadian manufacturing. In this regard, like other industrializing countries in the late 1800s, Canada pursued a policy of import substitution industrialization. The intent was to generate east-west trade, exchanging central manufactured goods for western staples. The tariff was also expected to generate government revenues to finance the building of a cross country railroad which would carry immigrants to the western frontier.[1] Throughout the 1875–1914 period, half of Canada's exports, most of them agricultural commodities, went to Great Britain (Williams, 1983:30).

The three-pronged First National Policy is illustrated in Figure 1.[2] This NPI, aimed at extensive growth and economic diversification, was a defensive reaction to the threat of US expansionism balanced by the desire to emulate US industrialization and westward expansion. *Defensive expansionism* was continued by successive federal governments, each of which faced the east-west versus north-south tensions and responded by continued high Canadian tariffs, additional infrastructure construction, and increased immigration.[3] Responding to the new infrastructure needs of the 1920s and 1930s, the federal government created the CBC, Trans Canada Airlines and the Bank of Canada. The Bennett New Deal introduced social welfare policies designed to address the social distress occasioned by the depression. However, the bulk of this legislation, for example, unemployment and social insurance, minimum wage laws and efforts to stabilize farm income, were deemed by the Judicial Committee of the Privy Council to be outside the jurisdiction of the federal government.

Table 1 shows the breakdown of federal expenditures in 1933, near the end of NPI. Forty-four per cent of total spending was on debt charges with another 22 per cent on social services – not surprising in the middle of the Great Depression. Federal spending was only 12 per cent of Gross National Product (GNP).

The Second National Policy: Compensatory Liberalism 1941–1981

The Second National Policy had its roots in

Table 1
The distribution of federal expenditures in Canada, 1933–86

As % of total expenditures	1933	1950	1960	1970	1980	1984	1986
1. Protection of persons and property	5.8	25.2	27.4	12.9	9.4	9.5	10.2
2. Health	0.2	1.3	4.5	8.3	6.5	6.0	6.1
3. Social Services	22.4	27.1	27.7	28.6	31.7	31.8	33.6
4. Education	0.5	0.5	1.1	5.5	3.7	3.3	3.4
5. Transportation and communications	6.5	4.5	6.4	6.6	6.3	3.2	3.0
6. Natural resources and industrial development	4.0	4.7	6.2	6.9	10.7	9.3	6.9
7. General development services	7.2	7.9	4.5	6.3	5.1	4.3	4.8
8. Debt charges	44.0	14.9	11.1	7.8	10.8	17.5	17.0
9. International co-operation and assistance	–	0.7	1.4	1.8	1.6	1.7	1.8
10. Other expenditures	9.4	13.2	9.7	15.3	14.2	13.4	13.2
Total expenditures	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Exp. as % of GNP	12.7	14.2	16.6	22.0	20.5	27.2	23.8

Notes: 'Natural resources and industrial development' includes expenditures on the environment for 1933–60. 'Other' includes expenditures on recreation and culture, housing, labour employment and immigration, regional development and environment for 1970–90.
SOURCES: For 1933–60, from Series H161-175 (Leacy, 1983). For 1970–86, Statistics Canada (various years).

the lessons of the depression and in federal efforts to prepare for postwar reconstruction. Determined to prevent a repetition of the unemployment and economic unrest that followed World War I, the federal government began planning for the postwar era long before there were any signs that the hostilities were coming to an end. By the end of the war, three new federal departments had been created (Reconstruction, National Health and Welfare, and Veterans' Affairs) and Unemployment Insurance and Family Allowances introduced (Smiley, 1974:553).

There is no single statement of the Second National Policy; however, Smiley argues that it can be inferred from the combination of Ottawa's White Paper on Employment and Income issued in April 1945, a series of proposals presented to the Dominion-Provincial Conference on Reconstruction[4] held in August 1945, the previously introduced social policies, as well as federal initiatives with respect to housing and vocational training and economic development (Smiley, 1974:553). In effect there were three components to this NPII: macroeconomic management, the creation and maintenance of a welfare state, and Canadian participation in the construction of a liberal postwar international economic order.

These postwar policies were consonant with those being developed in the United States which John Ruggie, writing from the perspective of international relations theory, has termed the compromise of embedded liberalism (Ruggie, 1983). This compromise was predicated on a pair of policies: a commitment internationally to the development of a liberal trading system and domestically to Keynesian macroeconomic management.[5] In Canada more attention was paid to social welfare and distributional issues than in the US. Drawing on Ruggie's conception as well as the particular nature of the Canadian focus, we therefore describe NPII as one of *compensatory liberalism* rather than embedded liberalism.

The Second National Policy can be understood using the same three-pronged framework as NPI: infrastructure, industry- and society-building goals. However, the importance of these goals has varied over time; infrastructure building which was so crucial to NPI is, for example, less central to NPII. Moreover, the range of policies adopted in pursuit of these NPII goals was more extensive than those introduced under its predecessor. NPII implementation was facilitated by history's largest sustained global economic expansion (1950–74). The key to prosperity for a small open economy like Canada – rising export markets – was easily attained in a world economy led by US growth and European recovery.

In terms of the prongs of NPII, we argue that the industry-building goal was addressed through a combination of macroeconomic, trade, sectoral and foreign ownership policies. The infrastructure-building goal was handled through new policies on transportation, communication and financial institutions. Finally, the general policies directed towards the society-building goal can be grouped as social welfare, labour market, regional development and Quebec issues policies. The NPII prongs are depicted in Figure 1, and discussed individually below.

Industry Building

At the end of World War II the federal government made stable and high levels of employment and income a national priority. To accomplish this the King Liberals adopted new Keynesian techniques of demand management (Perry, 1982: chap.1).[6] As part of its adherence to tenets of compensatory liberalism, the federal government played an active role in the postwar reconstruction of the trading system; however, Canadian policy remained mercantilist,[7] aimed at protecting the domestic manufacturing sector. The high tariff policy encouraged foreign investment inflows through the establishment of US branch plants, notably in Ontario and Quebec.

Perhaps the most important industry-building policy of the late 1940s and 1950s was the encouragement of natural resource extraction and exports through foreign investment and generous tax incentives (Royal Commission, 1985:2:465–503; Wolfe, 1984:48). American investment in Canadian resource industries, spurred by US concerns about its depleting resource assets, continued Canada's staples-oriented export trade and helped tie the Canadian economy more closely to that of the US (Aitken, 1961). Although investment in resource extraction was a priority, there were also many federal subsidies to manufacturing and processing (Perry, 1982:23–24).[8] Nevertheless, Canadian exports, in contrast to those of other industrialized countries, continued to be primarily unprocessed or semi-processed resources rather than manufactures.

In the 1960s these general policies continued, with some major exceptions. The Auto Pact, implemented in 1966, had clear industry-building purposes but also served to link Canada more tightly to the US. The commitment to the development of Canada's natural resources was evident in subsidies to Alberta oil production in the 1960s.

The 1970s were a more troubled economic decade: a period of stagflation, labour unrest, high unit labour costs, oil price shocks, continuing concerns about high levels of foreign ownership, and excess capacity in manufacturing and resource production. The decade began with changes in Canada's relationships with its two largest export markets: Britain joined the European Community in 1971; in the same year Canada was unable to secure an exemption from the US balance of payments measures. The Trudeau Liberals responded to these economic challenges by adopting a floating exchange rate in 1970 and wage and price controls in 1975.

On the international side, the combination of growing concern about Canadian trade dependence on the United States and a recognition of increasing US domestic self-preoccupation led the Liberal government to a reconsideration of its trading relationships. This review produced the unsuccessful 'Third Option' which discussed possible promotion of Canadian trade with the European Community and the Asia Pacific. The 1970s also witnessed the continuation of the long debate among Canadian academics and policy-makers about the need for a national industrial strategy; for example, the Economic Council of Canada (1975) argued for free trade while the Science Council of Canada (Britton and Gilmour, 1978) made the case for technological sovereignty.[9]

Continuing high levels of foreign investment generated concerns about US control of the Canadian economy and resulted in a number of reports on foreign investment.[10] These led the Trudeau government to adopt a more nationalistic, inward-looking stance in the 1970s (Clarkson, 1991:107). The Foreign Investment Review Agency, designed to regulate inflows of foreign investment, was created in 1974. While not frontally addressing the industrial policy debate, the federal government nonetheless became more directly involved in sectoral industry building, starting with the formation of the Canadian Development Corporation in 1971, followed by the Federal Business Development Bank in 1974 and the purchase of two failing aircraft manufacturers.[11] The 1973 oil price shock led to the adoption of a two-tier pricing strategy for oil and the establishment of Petro-Canada in 1975.

After a short stay in opposition the Liberals again formed the government in February 1980. Determined to reassert the authority of the federal state, the Trudeau Liberals introduced a series of nationalist policies designed to complement those begun in the previous decade. At the centre was a resource-based industrial policy predicated on energy mega-projects to foster regional development (Doern, 1982). Among the most controversial of these policies was the 1981 National Energy Program (NEP), designed to increase Canadian ownership of what was defined as a key sector of the Canadian economy, to encourage development of frontier oil deposits, and to shift resource rents from oil rich provinces to the federal government.

Infrastructure Building

By the early 1940s the major infrastructural projects needed at the time to link the country together had been completed. Nonetheless, under NPII the Canadian state embarked on new infrastructural undertakings such as the St.Lawrence Seaway, the Trans Canada highway system, and the construction of airports. Continuing deficits of the two national railways forced Ottawa to separate passenger from freight services and to inaugurate Via Rail in 1978. Concern about Canadian control over what had become an important infrastructure linkage prompted the federal government to establish Teleglobe Canada in 1949 and Telesat Canada in 1969 and to augment regulatory authority over broadcasting and telecommunications through the Canadian Radio-Television and Telecommunications Commission (CRTC) set up in 1976. Determination to ensure secure supplies of Alberta natural gas to industrial consumers in central Canada, in the hope of encouraging manufacturing industry, resulted in federal insistence on the construction of a gas pipeline entirely through Canadian territory (Aitken, 1967:219–20).

Society Building

The third prong of the Second National Policy was society building, which we have subdivided into social welfare, labour market, regional disparities and Quebec policy issues. It is in the society-building component of the Second National Policy that we see most clearly the policies which characterize compensatory liberalism. Immigration is a shared federal and provincial responsibility under the *British North America Act*; education, health and social welfare are provincial responsibilities. The federal government was able to circumvent these constitutional strictures through the vehicle of shared cost programs with the provinces.

In terms of employment, the federal government's commitment to full employment was first expressed in the 1945 White Paper on Employment and Income. The link between the goals of full employment and equity is found in the 'social welfare net' legislation developed throughout the 1940s and 1950s.[12] In the 1960s several major social welfare programs were launched; among them were the Canada and Quebec Pension Plans (1965), the Canada Assistance Plan and Guaranteed Income Supplement (1966). In terms of health care, hospital insurance and the *Medical Care Act* rapidly became the most costly component of the social welfare net. Federal grants to fund postsecondary education began in 1952 and were institutionalized as part of federal-provincial financial arrangements in 1967.

Recognition of regional disparities and federal efforts to ameliorate them have been part of the Canadian experience since Confederation. Their institutional expression on equity grounds, however, perhaps first occurred with the introduction of federal-provincial equalization payments in 1957. The federal goal of promoting industry in disadvantaged regions found expression in the 1969 establishment of the Department of Regional Economic Expansion, which was responsible for co-ordinating federal regional economic development programs. An important component of regionalism was the growing attention paid to the assertiveness of Quebec that began with the Ottawa-Quebec dispute over funding to education in the 1950s and the Quiet Revolution of the 1960s. Ottawa and Quebec negotiated a variety of special fiscal arrangements, among them the right of Quebec to opt out of federal programs. To handle pressures on language rights the federal government appointed the Royal Commission on Bilingualism and Biculturalism, and in 1969 official bilingualism became a federal policy.

The instabilities of the 1970s created

more unemployment, exacerbated regional disparities and put increasing stress on the federal government's ability to finance the existing shared cost programs. Federal deficits climbed from $1.4 billion in 1974 to $10 billion in 1978 to $16 billion in 1979 (Canadian Tax Foundation, 1991). Ottawa thus sought to put caps on open-ended commitments to fund medicare, the Canada Assistance Plan and postsecondary education (Smiley, 1976:137–8). In 1977 these programs were brought together under the Established Programs Financing legislation which provided equal per capita grants to all provinces through a combination of cash and tax transfers (Canadian Tax Foundation, 1991). The oil crisis also precipitated changes in equalization designed to lessen the importance of energy revenues in the formula and cut the overall federal commitment to equalization.

The changes in the size and distribution of federal spending over the life of the Second National Policy are illustrated in Figure 1 and Table 1. Figure 1 demonstrates that the components of NPII are much more varied and numerous than in NPI. Federal spending as a per cent of GNP grows from 14.2 to 20.5 per cent from 1950 to 1980 as shown in Table 1. Spending on defence falls from 25.2 to 9.4 per cent, while health, education and social services rises from 28.9 to 41.9 per cent. Spending on natural resources and industry development more than doubles from 4.7 to 10.7 per cent, while transport and communications hovered in the 6 per cent range. Thus NPII clearly emphasizes the philosophy of compensatory liberalism.

From Compensatory Liberalism to Market Liberalism

The Second National Policy began with a strong central government at the end of the Second World War. Over the life of NPII (1941–1981), the provinces challenged federal authority in a number of areas critical to nation building and these provincial challenges contributed to the disintegration of NPII. Also significant in the undoing of NPII were changes in the global economy which weakened international economic institutions and prompted states to engage in more mercantilist policies.

The liberal international economic order created at the end of World War II was unequipped to deal with the growing economic interdependence among developed market economies and the stresses that this gradually generated. Falling tariffs and transport costs created world markets in goods and services so that international trade grew much faster than world output; international financial flows increased even more rapidly. Multinational corporations became the primary agents of trade, investment and technology transfer, with US-owned firms dominating foreign investment flows. Globalization of markets and firms proceeded rapidly (Eden, 1991).

The instabilities of the 1970s, as witnessed by the end of the Bretton Woods agreement, the oil price shocks, stagflation in the OECD countries, and low productivity growth, created a less hospitable international environment for Canada. The global economic crisis of the 1970s demonstrated that the separation of domestic and international policies, the basis of embedded liberalism, was no longer tenable in an increasingly interdependent world (Eden, 1989:88–90; Gilpin, 1987:354–60; Laux, 1990). The decline of US hegemony, symbolized by Nixon's 1971 currency changes, required that Canada reevaluate its so-called special relationship with the United States. Even more than was the case in the United States, a small open economy like Canada, attempting to implement compensatory liberal policies, found it ever more difficult to insulate itself from the vagaries of international markets. While large countries could and did adopt neo-protectionist policies designed to protect their domestic living standards by exporting unemployment, for small open economies there were no buffers – or only very expensive ones – against global shocks. Compensatory liberalism became increasingly difficult for the Canadian government to sustain. The nationalistic, inward looking policies of the 1974–82 period were even less appropriate for Canada as globalization increased.

Although the problems of the global economy in the late 1970s were severe, they were not well understood in Canada. As NPII was coming to an end the Trudeau government attempted to reassert federal primacy through a series of policies that included the National Energy Program (NEP), repatriation of the constitution and entrenchment of the Charter of Rights and Freedoms, a resource driven industrial strategy and the Western Development Fund.[13] A combination of international and domestic forces derailed this strategy. Its economic components collapsed with the decline in world oil prices, rising interest rates and the serious recession of the early 1980s. Domestically, disagreements within the government over the appropriate level of state intervention in the economy, provincial disquiet over federal policy initiatives (most notably in Alberta over the NEP), and the crisis of manufacturing exacerbated by the 1981–82 recession combined to unravel what Trudeau had attempted following the 1980 election.

The Third National Policy: Market Liberalism 1982 – Present

In our view there is now a Third National Policy, one which we identify as *market liberalism* (see Figure 1). In contrast to its more interventionist predecessors, this national policy adopts a market-oriented perspective on nation building. The basic thrusts of NPIII are a reduction in state intervention in the economy and a reliance on market forces to stimulate economic competitiveness. Driven by budget deficits its operative policies are deregulation, privatization, liberalization, and cuts in government expenditure.

In effect, NPIII began during the latter years of the last Trudeau government. Although the Trudeau Liberals had pledged to expand the powers of the Foreign Investment Review Agency, a combination of US pressure and declining investment levels aborted that initiative. Suggestions that the government would mount an industrial strategy were replaced by a strategy of economic development that was market driven (Clarkson, 1985; 1991; Leslie, 1988).

Though clearly not speaking for the government, in 1982 the Standing Senate Committee on Foreign Affairs, which had held a long series of hearings on Canada-US relations, recommended that Canada seek a free trade agreement with the United States. By the end of its final term the Trudeau administration had embraced sectoral free trade with the United States, capped federal transfers to the provinces and begun to liberalize financial markets. Uncertainties about Canada's economic future in the wake of the severe 1981–82 recession led the Liberals to establish the Macdonald Commission whose purpose was to suggest 'appropriate national goals and policies for economic development' (Royal Commission, 1985:1:xvii). The 1985 report rejected economic nationalism and endorsed bilateral free trade.

The Conservatives campaigned in 1984 on the theme of economic recovery. Convinced that Canada required new directions, the Tories introduced policies designed to rationalize and reduce the role of the government in the economy, balance the budget and promote global competitiveness (Department of Finance, 1984). Domestically the Mulroney government was attentive to the arguments of the business lobby (in particular the Business Council on National Issues) which pressed for a less interventionist state and secure access to the US market (Clarkson, 1991: 114). It was also influenced also by the neoconservative policies of Margaret Thatcher and Ronald Reagan. This market liberalism has an overall thrust which has more than three distinct components – the thrust being to liberalize, privatize, deregulate and downsize.

Mulroney came to power in 1984 determined to improve relations both with the

United States and the provinces. To remove irritants in the bilateral relationship, the Tories terminated the NEP, replaced the Foreign Investment Review Agency with Investment Canada, and substantially watered down compulsory licensing of pharmaceuticals. The government reformed corporate income taxes, removed the manufacturers' sales tax and replaced it with the goods and services tax. On the provincial front, the federal government and the western provinces replaced the National Energy Program with the Western Accord (1985) which eliminated several federal taxes and deregulated crude oil prices, in the wake of falling world oil prices. Ottawa also signed agreements with Newfoundland in 1985 and Nova Scotia in 1986 on managing offshore oil and gas development. These policies, while designed to improve Canada's competitiveness, also implicitly acknowledged the inherent inconsistencies of compensatory liberalism for a small open economy in the 1980s.

Industry Building

Throughout the 1980s the federal government continued to run budgetary deficits which rose from 2.8 per cent of GNP in 1980 to peak at 7 per cent of GNP in 1985; by 1989 the percentage had fallen to 4.7. Prime interest rates, which reached a high of 18.3 per cent in 1981, fell slowly through the decade to a level of 10 per cent by 1990. Concern over inflationary pressures led the Bank of Canada to keep interest rates high over the decade. The Canadian dollar rose from 73 cents in 1985 to 86 cents by the end of 1990 (Eden, 1989:91; Bank of Montreal, 1991:2; Canadian Tax Foundation, 1991: 6:4). The overall goals of macroeconomic policy were clearly to bring the deficit under control and to dampen inflationary expectations; these were strengthened when Canada agreed to begin economic coordination with the other G-7 members after the 1985 Louvre Accord.

In terms of other multilateral activities, Canada participated in the Uruguay Round of the GATT talks which began in 1986 and was also active in the Cairns Group of agricultural exporters. Though long a supporter of the multilateral route to expanded international trade, under the Tories Canada shifted to a focus on bilateralism. The Conservatives came to office opposed to free trade with the United States; however, by 1985 their perspective had changed.[14] Concerned about secure and enhanced access to Canada's most important market, the Conservative decision to opt for bilateral free trade put to rest a long-standing debate in Canada over the structure of Canada-US relations (Granatstein, 1985). This policy shift was influenced by the change in attitude of the Canadian manufacturing sector towards free trade and the strong support of the Alberta and Quebec governments (Doern and Tomlin, 1991).

Negotiated between May 1986 and October 1987, the FTA came into effect on January 1, 1989. Although there was continuing concern about international competitiveness of Canadian manufacturing and obvious losses of manufacturing employment as a result of corporate restructuring the Tories did not develop a comprehensive industrial policy; for the Conservatives free trade was the de facto surrogate – a new continental economic constitution.[15]

Although free trade was the government's de facto industrial policy the Tories bought into the continuing arguments about Canadian competitiveness. This growing concern with Canadian competitiveness is a function of the very real loss of manufacturing jobs over the 1980s, which intensified with the recession of 1990–92, and Canada's deteriorating performance based on international competitiveness measures.[16]

Trade Minister Michael Wilson was appointed to head the Prosperity Secretariat which has issued draft proposals on Canadian competitiveness (Canada, 1991b). The paper, *Canada's Prosperity: Challenges and Prospects*, is based upon five building blocs – learning, science and technology, financial investment, competitive markets, and trade – and among other policies recommends increases in R&D spending, a national education policy and reduced interprovincial barriers to trade. The Secretariat collected hundreds of submissions and reports on competitiveness and globalization. Its final report was issued in late 1992.

Infrastructure Building
Determined to reduce the role of government in the economy, the Tories made the privatization of state-owned enterprises one of their policy priorities. In privatizing corporations such as Air Canada, the Northern Transportation Company and Teleglobe, the federal government was reversing the historic Canadian policy of state development of infrastructure for purposes of nation building. The Tories also sold entirely or in part a variety of resource and manufacturing enterprises, among them Polysar, deHavilland, Canadair, Petro-Canada and Eldorado Nuclear (Molot, 1990; Laux, 1991). Moreover, the government deregulated the trucking and airline industries, cut Via Rail financing, and liberalized regulation of financial institutions. Bell Canada's monopoly over long distance telephone lines was also eliminated in a summer 1992 ruling of the CRTC. These deregulations are part of the trend to market liberalism, designed to reduce the direct role of the state in the economy (Laux, 1990).

Society Building
In terms of society 'building' policies, the Mulroney government's initiatives were driven by spending constraints. The government reshuffled responsibilities for labour market policies, but the introduction in 1985 of the Canadian Job Strategy Program did not increase total spending. Expenditures on Established Programs Financing were further capped in 1987. Programs such as a national daycare strategy have been put on hold. Spending on regional development was decentralized to the Atlantic and western regions, shifting decisions on projects to regional agencies. The share of federal spending on education and health has fallen from 13.8 per cent in 1970 to 9.3 per cent in 1984; while that on social welfare has risen from 28.6 to 31.8 per cent of total spending (see Table 1).

The trends in federal expenditures in NPIII can be seen in Table 1 where federal spending fluctuates between 20.5 and 27 per cent of GNP. If debt charges were to be removed, the drop in federal expenditures would be even more marked. In terms of the distribution of spending, there are no marked changes, with the exception of the fall in resource and industrial development over the 1980–86 period.

The other driving force behind the Tories' society-building goals was the attempt to include Quebec as a signatory to the 1982 *Constitution Act*. The first effort, that of the Meech Lake Accord, failed because Ottawa was unable to secure the necessary unanimous approval of all provinces by the June 1990 deadline. In light of the failed Accord, Quebec proceeded to examine its relationship to the rest of Canada through a series of hearings and established a fall 1992 deadline for a referendum on separation from Canada.

The second federal response to the national unity issue began with the appointment of Joe Clark as the responsible minister. On September 24, 1991, the federal government tabled its proposals for constitutional reform, summarized in *Shaping Canada's Future Together: Proposals* (Canada, 1991a). The list of 28 proposals included several with economic aspects, including enhancement of the economic union, monetary and fiscal policy co-ordination and changes to the division of powers. Following a series of five constitutional conferences in January and February 1992 at which concerned Canadians met to discuss these proposals and to offer their own input to the constitutional debate, another round of federal-provincial negotiations produced the Charlottetown Accord in August 1992. With a referendum on this constitutional initiative then scheduled for October 26, 1992 Canadians began an intensive and emotional debate on the contents of the Accord, among them, a triple-E Senate; a distinct society clause; aboriginal self-government; and the shifting of manpower retraining to the provinces. The Charlottetown Accord did not contain proposals on either the economic union or monetary and fiscal policy co-ordination.

Evaluating Market Liberalism

NPIII represents a narrowing in policy focus compared to earlier national policies as the federal government retrenches and reduces its role in the economy (see Figure 1). There are at least two serious weaknesses with this national policy of market liberalism which derive from (a) the policy contradictions that emanate from the Conservative government's priorities of constitutional accommodation and Canadian competitiveness and (b) a somewhat simplistic appreciation of the full implications of what market liberalism means.

Had the Charlottetown Accord been approved, a number of economic functions would have been decentralized and the provinces would have been permitted to opt out of new federal programs with compensation. Without a strong economic union clause this decentralization of policy-making authority would have reinforced what is already happening in the Canadian economy as a result of the FTA, namely the strengthening of long-standing north-south economic links. The Competitiveness Secretariat put forward proposals with the opposite thrust, that of centralization. In other words, to enhance Canadian competitiveness it will be necessary to adopt policies that are national in character and that, among other things, provide for the kind of human resources development appropriate to the needs of a globalized economy. Thus one cabinet-based unit advocated decentralization on political grounds while another proposed centralization on economic grounds.[17]

Second, market liberalism is based on a faith in markets to efficiently allocate existing resources based on national comparative advantage. However, market outcomes which are efficient in the static sense of maximizing current economic welfare from existing resources are not unique, they are path dependent (Dosi, Zysman and Tyson, 1990; Lipsey, 1991). History and current measures of social profitability affect national outcomes in the presence of imperfect competition, increasing returns to scale and externalities. For example, first moves may be able to reap economies of scale and learning that inhibit latecomers from ever catching up. Oligopolistic firms competing over global market shares may shift rents from country to country for reasons that have little to do with comparative advantage.

Under these circumstances, strategic trade and industrial policies can be used to engineer comparative advantage and thus increase a country's share of world production, investment and income (Harris, 1985; 1991). As the knowledge intensity of production increases the role of strategic factors becomes more important, first because knowledge activities tend to generate externalities and second because knowledge-intensive industries are usually imperfectly competitive. Core technologies such as information technologies and biotechnology offer, even more importantly, the opportunity to change national trajectories of economic growth and thus significantly affect the Schumpeterian, or long-run, efficiency of the economy.

Whereas static efficiency maximizes the output from a given stock of resources, dynamic efficiency is concerned with the growth of key resources as well as their short run use. Market liberalism focuses too narrowly on static efficiency gains and therefore undervalues technology as a key influence on the growth trajectories of countries. Simply withdrawing from intervention in the economy and allowing the market to dictate the allocation of resources puts too much reliance on static

Table 2
The components of Canada's National Policies

Components of the National Policies	First National Policy: *Defensive Expansionism* 1879–1940	Second National Policy: *Compensatory Liberalism* 1941–1981	Third National Policy: *Market Liberalism* 1982–Present	New National Policy: *Strategic Integration* Proposed
Industry-building component	Tariff	GATT liberal trading order Keynesian Macro Policies	Canada-US Free Trade	Free Trade External and Internal
Infrastructure-building component	Railways		Free Market Policies (Liberalize, Privatize, Deregulate)	Telecommunications and Info Technologies
Society-building component	Immigration	Social Welfare Net	Fiscal Restraint	Human Capital Development (Education Training, Labour Adjustment)

efficiency considerations and too little on developing directions for long-run economic growth. If current market prices do not signal the dynamic externalities involved in particular industries then static efficiency will come at the expense of long-run efficiency. Nation building requires attention to the development of infrastructure and human capital resources, along with a commitment to liberalized internal markets. Even small open economies with high degrees of foreign ownership have some room to manoeuvre (Lipsey, 1991).

Building a Fourth National Policy: Strategic Integration

As a result of the 1989 FTA and the signing of NAFTA in December 1992, north-south economic linkages are creating a continental market. The country is fragmenting along regional lines in economic space with trade and investment flows increasingly north-south. This same problem challenged the Fathers of Confederation and was handled by Macdonald through the First National Policy. Strong national symbols such as the CBC and the railways also linked the country. With the Canadian tariff no longer available as a policy tool and the weakening of these integrative institutions what policy substitutes are available to bind the country together?

Canada needs to develop a coherent set of policies that better positions the country relative to its major trading and investment partners. Such a strategy we identify as *strategic integration* because it would be designed to strategically integrate Canada into the global economy by engineering our long-run competitiveness. The three prongs of such a national policy would be: international and interprovincial free trade as the industry-building prong; a national telecommunications network based on development and diffusion of information technology as the infrastructure-building component; and human capital development as the society-building tenet. The prongs of this proposed Fourth National Policy (NPIV) are coherent, consistent and mutually reinforcing. Their purpose is to shift the focus of nation building from the static efficiency considerations of NPIII to a focus on dynamic efficiency. We outline the components of NPIV and then address the difficulties of implementing this strategy.

Table 2 shows the transition from NPI to NPIII, including our proposed NPIV in terms of their nation-building components. The thrust of NPIV would be centralist, relying on a strong federal presence to facilitate our adjustment to global changes, promote knowledge-intensive industries and create a sense of renewed national purpose. Individual provinces (for example, Quebec) would be allowed to opt out of these national programs, but every attempt would be made to ensure effective policy thrusts on a national basis. This would mean a stronger federal presence at the expense of the provinces. A proactive approach to competitiveness at the international level requires consistent, directed policies which a decentralized, fragmented federation cannot achieve.

The first prong of NPIV, international and interprovincial free trade, builds on the FTA and NAFTA and extends it. Internationally this means a commitment to the completion of the Uruguay Round of GATT talks and the potential extension of NAFTA to other Latin American countries. At the interprovincial level this means free mobility of goods, services and labour.[18] Creating a Canadian economic union would improve our competitiveness and strengthen the role of the federal government relative to the provinces. While for the Mulroney government free trade is a surrogate for an industrial strategy, free markets alone do not guarantee Canada's long-run share of world markets. Strategic trade and industrial policies are tools available even to small open economies (Harris, 1985); thus the free trade prong needs to be accompanied by a commitment to engineering Canada's competitive advantages through our proposed second and third prongs.

Our suggested second prong, a national telecommunications and information technology strategy, is based on its new importance as the key infrastructure linking markets in the 1990s. Just as the railway revolutionized goods transportation in the late 1800s, the computer has revolutionized the movement of goods and services in the 1980s. Methods of carriage have changed from freight cars to telephone lines and cables, while the content carried is now less bulk freight goods than voice, data and video services. Business services such as telecommunications and financial services, which rely heavily on information technology, are the key infrastructural industries for the maintenance of a healthy manufacturing sector in the 21st century (Rugman and D'Cruz, 1991).

A focus on information technology would therefore both better link the country east to west and facilitate Canada's integration into the global economy. Given that industries in the 21st century will rely most heavily on knowledge-intensive production, with resources and low-skilled labour representing a decreasing proportion of production costs, policies to encourage the adoption and faster diffusion of information technologies will enhance the competitiveness of existing industries, facilitating their movement up the value chain into high value-added activities. Canada has been called a 'fast follower' in terms of technology development (Eden, 1991). To continue as a fast follower in the 1990s we need a coherent national strategy for technology diffusion.

In conjunction with the first two components of NPIV, a focus on labour market policies, in particular a commitment to the development of human capital, is essential to Canada's competitiveness. Canada needs a national education policy at all levels to raise the proportion of high school graduates[19] and the numbers enrolled in university science and engineering degrees. Canada also would benefit from a national retraining strategy to assist workers in industries facing industrial adjustment or technological change and promote their movement into knowledge-intensive industries. Again this requires leadership at the federal level to overcome the myriad of provincial regulations and educational differences. Such adjustment policies are necessary, first, to enable workers to cope with the dislocations that would follow from a more integrative strategy consistent with our free trade prong and, second, to provide the trained labour for the expanded telecommunications and information technology sectors of our second prong.

Implementing the Fourth National Policy

We are sensitive to the difficulties of implementing this national policy of strategic integration. First, the proposed components of our Fourth National Policy do not imply a lessened concern for the ever-expanding federal debt burden. Clearly Ottawa must reduce the federal debt, particularly the reliance on external borrowing. However, fiscal restraint does not have to imply withdrawal from the responsibility to develop a coherent national policy.

Second, there would be winners and losers from such a policy. Large multinationals would be the primary beneficiaries from reduced interprovincial and crossborder trade barriers, yielding benefits to Canada only if high value-added jobs and technological spillovers are generated. Immobile and inefficient producers and factors would suffer and adjustment costs could be high as production is rationalized.

Third, and perhaps most important, NPIV runs counter to the current political thrust towards decentralization as captured in recent constitutional debates. For core-periphery tensions to be reduced and Quebec to be satisfied within confederation, decentralization is apparently essential. Politics demands a weaker federal government role in the economy and a stronger provincial presence. This, however, opens the way to increased fragmentation of government services, competition among governments for capital and double taxation – all problems identified by the Carter Commission (Royal Commission, 1966).

The problem is that Canada faces an historical, but now more pressing, dilemma: for competitiveness we need dynamic efficiency and that implies a strong federal government; for constitutional reasons we need a weaker one (Harris and Purvis, 1991). As external barriers to north-south trade have fallen with the Tokyo Round, the FTA and the NAFTA, the imperative of a Canadian economic union to enhance east-west mobility becomes even stronger. Adaption to a changing global economy will, however, be hindered if a number of provinces introduce individual, and thus possibly conflicting, policies. This implies the need for consistent, proactive, nationwide policy choices; the luxury of a decentralized, non-harmonized federal state – the direction in which Canada has been moving – is no longer appropriate as we move into the 21st century.

Conclusions

The purposes of this paper were two-fold: first, to document the changing direction and components of Canada's national policies over the past 125 years, and second, to argue that a Fourth National Policy based on strategic integration is necessary for the 21st century. The paper has demonstrated that all national policies have industry-building, infrastructure-building and society-building components, even though the policy tools used by the federal government became more sophisticated and varied over the period. Since the early 1980s, however, the state has been withdrawing from its nation-building mandate, which has been a mistake in terms of ensuring the long-run dynamic efficiency of the

Canadian economy.

Canada needs to be attentive to factors that will be key for the 21st century in terms of increasing its share of world markets. Engineering competitive advantage demands a strong federal government. A national policy based on free trade, information technology and human capital development would best equip Canadians to deal with the opportunities and pitfalls of the changing global economy.

Notes

* Eden, The Norman Paterson School of International Affairs; Molot, The Norman Paterson School of International Affairs and Department of Political Science. We would like to thank the editors, Richard Bird, Jeanne Laux, Richard Lipsey, Christopher Maule, Robin Neill, Tony Porter, Alan Rugman, and anonymous referees for helpful comments on earlier drafts of this paper; however, we take full responsibility for the views expressed and for any remaining errors or omissions. Research assistance was provided by David Hood. While we are sympathetic to the comments of McFetridge and Tupper (see this volume), in a paper of this length it was impossible to go into the kind of detail they, and we, feel the subject deserves.

1 This section is deliberately brief because the three prongs of the first National Policy – the tariff, the railway and immigration – are so well-known. For further details see Mackintosh (1964), Dales (1966), Smiley (1974; 1975), Craven and Traves (1979), Marr and Paterson (1980:chap.12), Pomfret (1981:chap.5) and Williams (1986).

2 This figure is designed to portray the development of Canada's national policies since 1867. While we are cognizant that the choice (which to include versus exclude) and placement (which policy category) of certain policies is subject to debate, we feel that for heuristic purposes our choices are defensible since the chart is intended to convey the broad sweep of nation-building policies. Secondly, note that for ease of identification the main prongs of each national policy are highlighted in bold and capitalized.

3 Vernon Fowke (1967) makes the argument that NPI ended in 1930 with the transfer of natural resources to the Prairie provinces; it was succeeded by a new national policy that attempted to deal with the depression. This view has been critiqued by Smiley (1974) who argues that NPII did not appear until the early 1940s. We support the latter view.

4 The full titles of these statements are *Employment and Income with Special Reference to the Initial Period of Reconstruction* (Canada, 1945) and *Dominion-Provincial Conference* (1945), and *Dominion and Provincial Submissions and Plenary Conference Sessions* (1946).

5 The metaphor cited by Gilpin to describe embedded liberalism was 'Keynes at home and Smith abroad' (Gilpin, 1987:355).

6 According to J.K. Galbraith, 'Canada was perhaps the first country to commit itself unequivocally to a Keynesian economic policy' (quoted in Smiley, 1975:48).

7 One exception was a brief flirtation with Canada-US free trade in 1948. For a discussion of those free trade talks see Cuff and Granatstein (1978).

8 Ironically, the one exception to subsidies was the service sector, which somewhat paradoxically grew the most rapidly in the postwar period in terms of employment.

9 See Blais (1986) for a review of this debate.

10 See the Wahn Report (1970), the Watkins Report (1968) and the Gray Report (1972). The percent of foreign control of manufacturing rose from 35% in 1946 to 60% in 1963; the increase in the resource sector was higher (Brodie and Jenson, 1988:220).

11 Both companies, deHavilland purchased in 1974 and Canadair taken over in 1976, were bought to prevent their closure. For details see Laux and Molot (1988).

12 Among the relevant policies are: Unemployment Insurance (1941), Family Allowances (1944), Old Age Security (1951), and a number of conditional grant programs related to social assistance (Royal Commission, 1985:2:547).

13 Smiley (1987:178–84) identifies these as a 'Third National Policy'. Although the NEP remained in force for some years, the constitution repatriated and the Charter passed, these Liberal policies had neither the coherence nor political clout to constitute a 'national policy'.

14 In 1983 Mulroney said: 'Free trade with the United States is like sleeping with an elephant. It's terrific until the elephant twitches, and if the elephant rolls over you are a dead man ... That's why free trade was decided on in an election in 1911. It affects Canadian sovereignty and we will have none of it, not during leadership campaigns, or at any other time' (cited in Clarkson, 1991:123, fn 5). For more on the Canada-US FTA see Doern and Tomlin (1991) and Young (1987).

15 While still adjusting to the introduction of bilateral free trade, the government was forced in 1990 to consider enlarging the agreement to include Mexico (Eden and Molot, 1991; 1992).

16 In the *1990 World Competitiveness Report* Canada dropped from fourth to fifth place and scored particularly poorly on 'international orientation,' 'future orientation' and 'industrial efficiency' measures (Rugman and D'Cruz, 1991:chap.1). In

the 1992 Report Canada dropped even further, to 11th place. See also the Premier's Council (1988).

17 This tension is also evident in an address by Thomas Courchene to the Canadian Economics Association (1992). He sees Canada's dilemma as being that 'economic Canada' has gone continental as economic space has no borders due to globalized firms; 'political Canada' is fragmenting into regions as provincial demands for autonomy escalate; thus leaving the funding of 'social Canada' (traditionally done through east-west transfers) in doubt. His solution opts for decentralization in the belief that political realities dominate. We argue that Courchene's solution of concurrency with provincial paramountcy will lead to fragmentation and jurisdictional competition among governments for scarce capital, a situation that does not make for dynamic efficiency.

18 Estimates suggest that there are more than 500 interprovincial barriers to trade, costing Canadians $6.5 billion yearly (*Globe and Mail*, 1991).

19 In Ontario, for example, over 30% of young people do not finish high school; in Quebec the male high school dropout rate now stands at 42% (*Financial Times*, 1991).

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