

AUTO PACT: Creating a Borderless North American Auto Industry 1960–1971

by Dimitry Anastakis. Toronto: University of Toronto Press, 2005.

This is an important book about a watershed agreement that transformed an industry, changed the direction of Canadian trade policy, and altered the face of the Canadian economy. The 1965 Canada-US Automotive Products Trade Agreement, or Auto Pact as it became known, transformed the Canadian auto industry from a branch plant economy focused on the small domestic market into part of an integrated North American industry. The impact on Canadian industry and trade was profound and catapulted autos to a leading sector in the Canadian economy. Forty years later, the auto sector remains Canada's second largest export and import category of trade between Canada and the United States.¹ Moreover, the overwhelming success of the agreement was a lightning rod spurring deeper North American economic integration across the board through CUSFTA and NAFTA. The Auto Pact was a stark shift from past Canadian industrial policy based on protectionism, and was also contrary to the import substitution policies adopted toward autos in other countries such as Brazil, Mexico, and Australia. The Auto Pact is fascinating from the perspective of the political economy of policy because it became the darling of both protectionists and free traders. Protectionists praise the agreement as an example of the success of managed trade and government intervention. Free traders praise it as the success of trade liberalization. The agreement removed tariffs in the sector with a number of contingencies that protected the North American auto sector from foreign competition and, in particular, auto sector production and employment in Canada. The Auto Pact is viewed as a precursor to the free trade agreement between Canada and the United States, and yet it was later struck down as protectionist by the WTO.

Despite the significance of the Auto Pact for Canada, until now little has been known about the details of this important episode in Canadian eco-

nomie history. Dimitry Anastakis provides a thorough analysis of the making of this agreement and along the way provides an analysis of the evolution of the auto sector up to the 1960s agreement and the impact of the agreement on the sector. Anastakis presents two interesting and compelling theses. First, the author points out that the agreement was a break with the past and was a unique policy approach in the auto industry characterized by import substitution and nationalist policies. Anastakis argues that a confluence of factors combined to lead to this watershed agreement. A key to understanding the agreement is that there were strong protectionist forces in Canada led by the protectionist/nationalist anti-American arm of the Pearson Liberals who wanted to nationalize the auto industry. There was also a free trade arm gaining steam, and the Auto Pact solution was a compromise—managed trade. Second, Anastakis argues that the Auto Pact was a unique event and the conditions that resulted in the Auto Pact could not be duplicated in any other sector of the economy or between any other two countries in the world.

The basic story of the Auto Pact is that something drastic needed to be done to fix the auto industry in Canada. The auto industry was considered crucial to any industrial economy. In the early post-War years this holy grail of industrial policy was a mess in Canada. The high tariffs and dominance of the US auto producers in the Canadian automobile sector created the classic branch-plant economy familiar to Canadians at that time. The market for Canadian automakers was domestic and firms produced small numbers of a variety of different car models, which meant that production runs were short in an industry with considerable scale economies. In the United States, the auto industry catered to the much larger American market, which allowed it to economically offer a wide range of product varieties. Classic symptoms of this economy included high prices for consumers and relatively few varieties of final products relative to the American market. Moreover, there was little or no research and development carried out in the American branch

plants in Canada, hence automobile producers in Canada were unable to keep up with the tremendous technological changes that were occurring in the United States and elsewhere. Overall, it was estimated that the Canadian automobile producers were only two-thirds as productive as their US parent producers. Moreover, the Canadian auto industry relied extensively on imported parts, and Canada had an enormous trade deficit with the United States approaching half a billion dollars by 1963. In 1963 trade with the US, Canada exported \$36 million and imported \$555 million in auto parts for a trade deficit of \$564 million.

It was widely believed that drastic measures were required to fix the auto industry in Canada. In 1960, Diefenbaker appointed an economist, Vincent Bladen, as a “one man Royal Commission” to investigate and propose solutions to fix the ailing auto sector. Bladen recommended unilateral action on behalf of Canada to liberalize trade in autos with a content requirement where companies would be allowed to import cars and parts duty-free as long as a stated percentage of Canadian content was achieved. For a variety of reasons the government dithered on the auto file but, as the auto crisis continued, a new minority government in 1962 eventually appointed Simon Reisman as the chair of an interdepartmental committee to study the Bladen Plan. The minority Diefenbaker government followed the committee’s recommendation and adopted a scaled-down version of the Bladen Plan. The key feature was as an export incentive plan allowing the duty-free import of automatic transmissions and engines contingent on having earned a credit equal to the value of goods it exported to that country. In 1961 duty-free imports of automatic transmissions reached \$32 million (representing about 10 percent of Canada’s trade deficit in auto parts with the United States). The committee estimated that exports would increase by \$20 million per year. The policies had an immediate impact as production increased dramatically in 1962. Reisman and his new Industry Committee recommended expanding the export incentive program to other sectors, but the

Diefenbaker government fell to Pearson’s Liberals in February 1963.

The story gets interesting as the minority Liberal government came with two different and extreme views on economic relations with the United States. The economic nationalists and their anti-American view was led by Walter Gordon and was counter to the traditional Liberal view of free trade and close economic ties with the United States. Meanwhile, Canada’s large trade deficit continued to be a major policy concern. The Liberal Party could have taken Canada down two different paths at this stage. If anything it seemed that the nationalists may have held the upper hand with Walter Gordon well placed to push his view. Moreover, other countries such as Brazil, Mexico, and Australia went the protectionist route: infant industry/import substitution, local content, and nationalization. However, the Liberal government adopted a continental approach to the auto sector that was much more aggressive than the Diefenbaker government had pursued. The Liberal government planned to lower the automotive trade deficit by \$200 million by the next model year.

Anastakis identifies four important factors explaining the continental path that was taken: (i) the interaction of the protectionists/nationalists and the liberal/free traders; (ii) the practical motivation that something drastic needed to be done; (iii) the nature of the industry—a few large players; and (iv) the indifference of the United States towards Canada. The stars aligned. The main beneficiaries lobbying for the agreement were the Canadian automakers and their union representatives. Canadian consumers stood to gain but did not have a voice. The American parent companies were concerned about the alternative nationalist route that seemed to be a credible threat. Lyndon Johnson was preoccupied with Vietnam and was indifferent about relations with Canada.

This leads us to the thesis that this was a unique agreement specific to the time and the industry. This view ignores the evolution of Canadian trade policy

to CUSFTA/NAFTA that extended the Auto Pact across the board. Anastakis recognizes that the Auto Pact provided an important step towards the creation of a continental economy and that the agreement was the antecedent of CUSFTA. He appeals to the people involved, like Simon Reisman and Brian Mulroney. However, he sells short the contribution that the success of the Auto Pact had had on the economic case for a free trade agreement with the United States. The research on the Auto Pact by Ronald Wonnacott and Paul Wonnacott provided evidence that the economic benefits from the scale economies and efficiencies gained from the liberalizing aspects of the Auto Pact were large. The path-breaking work by Canadian economists such as Rick Harris and Jim Brander introduced models with scale economies into general equilibrium frameworks. Harris and co-authors applied these models to the broader Canadian economy and showed that the kinds of economic gains experienced in autos could be substantial when tariff reductions were applied across sectors in a general equilibrium model. This work became the intellectual foundation for widespread support among economists for free trade with the United States. It also became an important part of the Macdonald Commission and a central theme of the report which was adopted by the Mulroney government.

In any case, this is an important and timely book. It sheds valuable light on the agreement that transformed the Canadian auto industry and led to an

integrated North American auto industry, which became one of the most important sectors in the Canadian economy. The Auto Pact protected the North American auto industry from foreign competition, but that protection is now gone and the sector is facing tremendous challenges in the form of competition from abroad. Finally, the great success of the Canadian government in deal-making seems completely alien today when the Canadian government is unable to negotiate sound agreements with the United States and other countries. Even with success in the courts, Canada was unable to procure a good deal on softwood lumber. Moreover, in an era of rapidly expanding regional trade agreements around the world, industrial interests have prevented the Canadian government from forging trade and investment agreements with other countries. The art of deal-making that led to the Auto Pact seems to be an anachronism.

NOTE

¹See Office of the Chief Economist of Foreign Affairs and International Trade Canada, *Seventh Annual Report on Canada's State of Trade: Trade Update June 2006* (Minister of Public Works and Government Services, Canada, 2006): 23-4. <http://www.international.gc.ca/eet/pdf/SOT-2006-en.pdf>

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Partisanship, Globalization, and Canadian Labour Market Policy: Four Provinces in Comparative Perspective

by Rodney Haddow and Thomas Klassen. Toronto: University of Toronto Press, 2006.

In Canada, the constitutional division of labour that apportions responsibilities over social programs and labour market policy is a rich and informative area of research that has generally been overlooked. Comparative studies of this type are usually international in character and, in the case of Canada and other federalist polities, tend to gloss over the significant power that smaller jurisdictions, in this case the provinces, continue to have. This book fills this gap and serves as an important reminder that politics at the sub-national level still matter, even in an age of globalization.

Political scientists Haddow and Klassen make their case by providing a detailed examination of labour market policies from 1990 to 2003 in four provinces: Ontario, Quebec, British Columbia, and Alberta. The authors rely on the international literature on welfare state and production regimes to explain variation in social policy among countries. Canada generally exhibits characteristics that are associated with Anglo-Saxon countries and both its welfare state and production regime tend toward the liberal side. However, the strand of liberalism practised in Canada is not as pronounced as it is in other Anglo-Saxon countries, as for example south of the border. These classifications are then applied to the four provinces in question to highlight their differences. Quebec tends more toward the social democratic model, while Alberta has a long history of favouring market liberalism. Ontario and British Columbia politics are generally more polarized, and were particularly so throughout the past decade and a half, the period of this study. Chapters are devoted to each of the provinces with emphasis on six labour market policies that fall under provincial jurisdiction: workers' compensation, occupational health and safety, employment standards (including pay and employment equity), labour relations, ac-

tive labour market policies (training and education), and social assistance. The authors find that even during the tumultuous reign of the Progressive Conservatives in Ontario and the Liberals in British Columbia, there have been few major policy changes. In Alberta, where the business friendly Conservatives have ruled for decades, the status quo has generally remained intact even throughout the controversial Klein reign. Business has shown to be truly conservative in that it has preferred little or no change over the potential disarray that would inevitably be part of a major revamping of labour market policies. This observation is consistent with the overall conclusion of the book that changes in labour market policies in the provinces studied have been modest.

A separate chapter is devoted to a detailed examination of social assistance. This chapter brings together an analysis of welfare expenditures and the incidence of poverty, as well as measures of inequality for Canada and the four provinces featured in this study. The data show that inequality has been relatively stable since 1980. This is despite concerted efforts of right wing governments to cut back these programs and the putative emergence of globalization. Canada's case is somewhat unusual for Anglo-Saxon countries, as the United States and Great Britain have experienced a marked widening of inequality throughout the same time period. But the authors make no assurances that the relative persistence of equality experienced in Canada over the past 25 years will remain so in the future. Another chapter, written by Steffen Schneider, focuses on how German labour market policies have played out in three Länder (equivalent to Canadian provinces). In contrast to Canada, German policy changes have been more "decisive," although not "transformative."

The evidence brought together by the authors illustrates that politics matter. Whether a centre-left or centre-right government is in office has considerable impact on labour market policies as well as social assistance. However, the room for manoeuvring is not unconstrained as business cycles and the general health of the economy, particularly the level

of unemployment, provide an important context for how much change is possible. But even then partisanship matters, and whether the party in power is sympathetic to labour or capital remains key.

The theme of globalization is less developed. The authors talk little about if and how global markets have affected the economies of the various provinces; for example, the forest industry in British Columbia or the auto industry in southern Ontario. Without such detail it is difficult to tell whether a change in labour market policy is the result of free market ideology or the globalization of production.

If a provincial government introduces market friendly policies, how does one assess whether this is due to the imperatives of the global economy, the domestic economy, or the ideological preferences of the party in power? But this is a small quibble, and this book provides extensive evidence that politics, even at the sub-national level, continue to play a crucial role in an era when it has become fashionable to think otherwise.

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Racing to the Bottom? Provincial Interdependence in the Canadian Federation

edited by Kathryn Harrison. Vancouver: UBC Press, 2006.

FEDERALISM AND ITS DISCONTENTS

It is conventional wisdom within certain Canadian policy-maker circles that competition among Canadian provincial governments is somewhat distasteful, almost un-Canadian. This sentiment may be attributable in part to our founding compact whereby we agreed to redistribute tax revenues from the “have” provinces (currently Alberta and Ontario) to the “have not” provinces (everyone else) through constitutionally-mandated equalization payments. Moreover, there is a lengthy Canadian tradition in pushing federal monies towards various regional economic improvement programs instead of letting certain provinces fight it out to attract investments. By and large, it is thought, we Canucks benefit from these efforts as they lead to a strengthened union and bring economic and social benefits to provincial residents. But do they?

This is the question that a series of researchers strive to answer in *Racing to the Bottom? Provincial Interdependence in the Canadian Federation*. The book has two main strengths. First, it is an interdisciplinary effort by political scientists along with the usual suspects, economists. As such, the book brings to bear a broader range of perspectives on the question in comparison to other efforts in this area. Second, the author of each chapter emphasizes the need to empirically test existing theoretical perspectives on whether competition among provincial governments helps or harms residents within these provinces. In particular, the Canadian empirical literature on the topic appears relatively impoverished at least when compared with efforts over the past several decades by US researchers. The book’s emphasis on empirically testing government competition is thus a welcome contribution that serves to promote a deeper understanding of the competitive processes at play.

The phrase “race to the bottom” generally refers to adverse economic or social outcomes associated with competition among governments. Early work in the field is often traced back to Charles Tiebout’s groundbreaking article in 1956 on “A Pure Theory of Local Expenditure” that theorized competition among US municipal governments for workers would tend to promote beneficent outcomes, namely an optimal level and mix of taxes and spending as workers “voted with their feet” by moving to the city that best reflected their tax preferences. One of the first shots fired hence supported the view that government competition would lead to a “race to the top.” Later tax theorists such as Wallace Oates deflated the earlier and more optimistic view by asserting that government competition for mobile factors such as capital might in fact lead to a “race to the bottom” as each government responded by lowering its taxes to such a point that they would be unable to fund needed government services. As University of Calgary economist Kenneth McKenzie points out in chapter 2, “A Race to the Bottom in Provincial Business Taxation in Canada?,” since that time the theoretical literature on tax competition has matured and deepened so that, depending on the assumptions made and the methodologies employed, theoretical perspectives now seem to support both the “race to the top” and the “race to the bottom” scenarios.

Back to the question then: does competition among provincial governments help or hinder residents of these provinces? Alas, the chapter authors do not provide easy answers upon which to base policy prescriptions. Indeed, the works give a sense of the complexities associated with analyzing interprovincial competition. As indicated by the book’s editor, Kathryn Harrison, a political science professor at the University of British Columbia,

A closer look at the chapters in this volume also suggests a need for a more nuanced understanding of the interprovincial dynamics. Not only does the distinctive character of each province still matter, but also the race to the bottom is not the only game in town (p. 263).

Each chapter author brings his or her unique perspective to different types of tax and regulatory competition, and analysis of these views is beyond the scope of this review. A brief mention of the gist of each chapter will have to suffice. Harrison begins the book with a chapter on “Provincial Interdependence: Concepts and Theories” where she offers a helpful recitation of the different theories that try to assess possible outcomes associated with competition among governments. This is followed by McKenzie’s previously mentioned chapter on provincial business tax competition where he concludes that the empirical evidence is insufficient to suggest that a race to the bottom is taking place; in fact, he notes that provincial taxes on businesses have increased over time.

In chapter 3, “Still in the Game: Efforts to Govern Economic Development Competition in Canada,” Douglas Brown, a political science professor at St. Francis Xavier University, analyzes the state of industrial policy whereby provincial governments try to attract businesses through approaches such as tax relief, subsidized loan guarantees, assistance for training, and so on. In his view, provincial governments have learned over time to tamp down their more destructive “beggar-thy-neighbour” approaches in favour of experimentation to see what sorts of policies might stimulate and sustain local development, as well as follow-the-leader approaches where provincial governments emulate industrial policies deployed elsewhere that seem to have met with some success. Harrison returns with chapter 4, “Follow the Leader and Dominoes: Games that Provinces Play in Tobacco Taxation,” where she discusses how, during the 1980s and 1990s, certain Canadian provincial governments felt it was necessary to initiate tobacco tax cuts to inhibit smuggling from other jurisdictions. She notes that five provinces did not “give in” to tax cuts and queries whether those that did unwisely capitulated to illegal behaviour, undermined provincial sovereignty, and promoted costs to the public health system—without first exploring successful alternatives to tax cutting deployed elsewhere.

In chapter 5 on “Environmental Policy in Canada: Harmonized at the Bottom?,” Nancy Olewiler, an economics professor at Simon Fraser University, scrutinizes interprovincial competition involving environmental policies and concludes that there is little evidence of sustained competition in this area. Instead, each province seems to pursue its own particular environmental policy and tends to be content to remain at this status quo with occasional flirtations with new policies in response to changes in public demand. In chapter 6, “Slouching toward the Bottom? Provincial Social Assistance Provision in Canada, 1980–2000,” Gerard W. Boychuk, a political scientist at the University of Waterloo, reviews whether provinces compete with respect to their social assistance programs to ensure they do not encourage inward migration of social assistance recipients (along with corresponding increases in costs for these programs). In his view, the evidence suggests that during the 1990s there was a slight reduction in the provision of these programs throughout much of Canada although he queries whether this trend resulted from factors apart from provincial competition.

Chapter 7, “Races to the Bottom versus Races to the Middle: Minimum Wage Setting in Canada,” co-authored by Harrison and David A. Green, a professor of economics at the University of British Columbia, describes how provinces benchmark each others’ minimum wage standards, but do not do so out of fear of losing workers—after all, minimum wage workers tend not to be the most mobile of factors of production. Rather, the provincial politicians may simply want to ensure that their minimum wage standards compare favourably to their peer provinces to convince voters that they care for the common folk. Chapter 8, “Policy Races in American States,” provides the concluding study by Mark Carl Rom, a political science professor at Georgetown University. Rom finds “strong evidence” that competition among American states has led to less generous welfare policies, although the evidence is more mixed with respect to competition over public education. Of interest, he notes that studying US state

competition may be easier than studying its Canadian counterpart as a result of a number of factors, including the fact that the states have greater variation in terms of political, economic, and demographic indicators making it simpler to identify and distinguish statistical relationships.

One last shot at the central question under investigation. While cautioning against uncorking the champagne bottle just yet, Harrison concludes the book by indicating,

Contrary to the popular notion that Canada is in a race to the bottom, Canadian provinces have continued to increase their taxes on capital, have restrained their reliance on subsidies to attract investment, and have successfully increased welfare benefits and excise taxes in at least some periods though not others (p. 269).

Perhaps a little healthy competition among friends is not such a bad thing after all.

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Canada's Regional Innovation Systems: The Science-Based Industries

by Jorge Niosi. Kingston and Montreal: McGill-Queen's University Press, 2005.

This book is custom-tailored to support and influence public policy on innovations and research and development (R&D). It aims to explore Canada's regional agglomeration of systems of innovation, innovative firms, and other R&D institutions in a small number of metropolitan areas. The author was prompted to write this work after his previous book about Canada's national system of innovation showed that there are marked regional and industry-specific trends within the system.

In an increasing globally competitive economy, technology and innovation provide an edge to competing firms which public policy endeavours to foster. This book examines the evolution of the current regional innovation system and the roles of the private sector, academic institutions, and the federal and provincial governments. The analysis, observations, and recommendations may play a role in the formulation of federal and provincial policies relating to innovation and R&D.

Existing theories are not generally useful in understanding the development of regional systems of innovation (RSIs). An evolutionary approach is employed by the author, which covers the initial conditions and industrial structure, change factors, economic and policy environments, cumulative patterns, and multi-stability. This approach offers insights as to the attractors and incubators in the five science-based industries that represent important activities in Canada's industrial R&D: aerospace, biopharmaceuticals, telecommunication equipment, semiconductors, and software. Canada's corporations in these industries have a technological edge on their overseas competitors. The author's discussion of each one of these industries is insightful, but the analysis could be enhanced with some of the tools available in Industrial Organization and Regional Economics.

All major Canadian RSIs, or at least their essential components, are located in Toronto, Montreal, Vancouver, and Ottawa. It could be that Canada's RSIs are not large enough to spill over into several metropolitan areas as with the M-4 Corridor in Britain and the Silicon Valley in the United States. In several decades, this could happen in the Montreal-Ottawa-Toronto area. Diversified, not specialized, large metropolitan areas are on the rise. In each case, private firms are the major players. Anchor firms and universities create the labour pool that attracts new firms and incubates new firms. Incubation seems to be the major process in the creation and growth of clusters and RSIs. Venture capital is more important in some industries (e.g., biotechnology) than in others, and government financial support is the main ingredient of agglomeration and growth in aerospace.

Canadian regional policies have not contributed much to RSIs or innovation, possibly indicating that RSIs and innovation agglomerations have not received as much attention in terms of public policy as they require. This policy includes funding university research, negotiating greenfield investment of anchor firms, and attracting skilled labour. In benchmarking, the government should also include measures of flows and networks.

The author seems to downplay government efforts and the work of government laboratories, and to emphasize achievements of academic institutions without analysis of priorities, objectives, expenditures, and results.

The observations and recommendations emanating from this book are important for public policy. The marked regional differences and industry-specific characteristics make it imperative that governments take them into account in developing their R&D and innovation policies. In a mixed economy, such as in Canada, it should not be surprising that private sector decisions take a predominant role in the evolution of RSIs, while governments assist them by creating a favourable environment. Governments deal with many priorities, but it may be more effi-

cient and effective to focus policies on the specific requirements of intended targets, particularly those aimed at enhancing innovation and RSIs. Finally, the evolutionary path, agglomeration trends, networks, flows and other dynamics can be useful both in developing benchmarks and in formulating policies.

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