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## Canada's Resource Curse: Too Much of a Good Thing

DANIEL DRACHE\*

### ABSTRACT

Canada has been both blessed and cursed by its vast resource wealth. Immense resource riches send the wrong message to the political class that thinking and planning for tomorrow is unnecessary when record high global prices drive economic development at a frenetic pace. Short-termism, the loss of manufacturing competitiveness ('the Dutch disease') and long term rent-seeking behavior from the corporate sector become, by default, the low policy standard. This article contends that Canada is not a simple offshoot of Anglo-American, hyper-commercial capitalism, but is subject to the recurring dynamics of social Canada and for this reason the Northern market model of capitalism needs its own theoretical articulation. Its distinguishing characteristic is that there is a large and growing role for mixed goods and non-negotiable goods in comparison to the United States even when the proactive role of the Canadian state had its wings clipped to a degree that stunned many observers. The article also examines the uncoupling of the Canadian and U.S. economies driven in part by the global resource boom. The downside of the new staples export strategy is that hundreds of thousands of jobs have disappeared from Ontario and Quebec. Ontario, once the rich "have" province of the Confederation, is now a poor cousin eligible for equalization payments. Unlike earlier waves of deindustrialization, there is little prospect for recovering many of these better paying positions. Without a focused government strategy, the future for Canada's factory economy is grim. The final section addresses the dynamics of growing income polarization and its lessons for the future. With a global slowdown or worse on the horizon, Canada's unique combination of mixed goods and orthodox market-based policies is likely to be unsustainable in its current form. For countries with a similar endowment, the Northern model is unexportable.

**Key words:** Canada's resources, capitalism, Canadian economy, mixed goods, market policies, Canadian model

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## INSTITUTIONAL DIVERGENCE IN NORTH AMERICA<sup>1</sup>

Mainstream economists have long assumed that Canada and the United States operate from a shared rulebook because they are highly interdependent, liberal market economies. Yet studies by John McCallum (1995), John Helliwell (2002), Andrew Jackson (2002), Keith Banting and Richard Simeon (1997), and Daniel Drache (2004) have documented the sharp increase in divergent market patterns and practices in North America. The most stunning difference is the wealth effect of the resource boom that accounted for 65 percent of all Canada's goods exports, a figure up from 45 percent in 2002. In the same period manufactured exports fell 17 percent, most notably for automotive products. By 2008, natural resources, the powerhouse of the economy, were responsible for almost all the growth in Canada's export earnings. Metal mining, energy, forestry, and agriculture are the cornerstone of the spectacular diversity of Canada's resource abundance. If Canada is not a simple offshoot of Anglo-American hyper-commercial capitalism organized around high-tech industries and finance, the Northern model needs its own theoretical articulation.

The idea that Canada has been experimenting with a different form of capitalism is unimaginable to many Canadians and heretical to the economic elites; but that should not prevent us from considering that in the Northern model, there is a large and growing role for mixed goods and non-negotiable goods in comparison to the United States. Mixed goods are really neither fish nor fowl in the classical neo-liberal paradigm. Pure private goods are those for which there is no collective dimension and are consumed by the individual through a market transaction. Pure public goods are available to all and are not exclusive. Mixed goods are partly negotiable on the open market, partly reliant on public regulation, and critically delivered by the state through its vast array of social and transfer programs to businesses and millions of Canadian families with their indirect and shared benefits.<sup>2</sup>

Few Canadian experts have focused their attention on the social market for mixed goods and its consequences for Canada's economic culture. Goods move along a continuum from private to public, and mixed goods require multiple actors and authorities. For example, investment in knowledge has vital social value and provides many direct benefits for society to respond to global change. The payback

<sup>1</sup> The manuscript for this article was submitted in December 2008 and the text has been updated where possible. Clearly, it is beyond the reach of the paper to address the collapse of the global financial markets and the resulting economic turmoil.

<sup>2</sup> A distinction must be made between public services (often mixed goods) and the cost of the infrastructure required to deliver those services. The proper business of government is much larger and more complex than mixed goods provision. Services, transfer payments, infrastructure and social goals like home ownership, environmental protection, and social equity fall into the mixed goods category.

from non-market activities is very important, and the need to manage the tension between public need and private interest requires authority to promote the highest social return rather than allow private actors the maximum opportunity for rent extraction. It is estimated that the provision for goods in this category is well in excess of Can\$200 billion annually. This is not a precise figure, but it includes universal health care, social programs, education, monies spent on innovation, employment insurance (EI), and equalization and other transfers. Health care expenditures by all levels of government alone totaled Can\$160 billion in 2007 (Canadian Institute for Health Information, 2008). The billions of dollars of mixed goods are a proxy for the distinctive features of Canada's Northern model, an immense expenditure that waxes and wanes according to the business and electoral cycles (Government of Canada, Department of Finance, 2008).

#### AN OVERVIEW OF THE ARTICLE

This article will make three arguments. In part one, I contend that what is unique about the Northern model is the institutional demand and provision of mixed goods, their important redistributive effects for working families and individuals, and the general expectation from the public that the government, using this potent lever, will play a large and significant role in the economy. Governments that ignore this basic expectation do so at their peril. Canadian public policy is, in the vivid conceptual language of Hall and Soskice, a textbook example of a coordinated market economy not a Hayekian liberal variant. The critical difference is the large regulatory role of the state in the economy that is increasingly dominated by natural resources (Hall and Soskice, eds., 2001: 8). Canada's unique blend of skilled human resources, a high-wage manufacturing sector, the dynamism of its powerful resource-based export sector, a modern public infrastructure, a robust financial sector, combined with macro-economic stability, low inflation, and a union-dominant workplace are a number of the critical elements that have produced a successful export-oriented growth strategy and some of the best Canadian public policy practices.

Part two demonstrates the way neoliberal cutbacks and the shrinking of redistributive policies and programs favored private wealth creation to an unprecedented degree throughout the 1990s. The Canadian state's proactive role had its wings clipped to a degree that stunned many observers. Dani Rodrik contends that during periods of sharp global competition states are pushed either to cut taxes, implement new labor market reforms and reduce government spending, or sharpen economic and policy divergence through innovative institutional measures and new spending

initiatives that create new policy spaces (Rodrik, 2007). Institutions and economic culture are always the independent variables that matter most, and this is certainly true in the Canadian case.

Part three examines the way that the uncoupling of the Canadian and U.S. economies has created new policy spaces, in which national governments have tried unsuccessfully to restore the balance between market and social Canada. Paradoxically, the rebalancing has been helped –and hindered– by the global boom in commodity prices for Canada’s energy, mineral, forestry, and agricultural exports (Cross, 2008). With exports of natural resources jumping from 45 percent of all exports in 2002 to nearly 65 percent in 2008, resources are without question king (Cross, 2008). The downside of the new staples export strategy is that by 2008, with the Canadian dollar appreciating by more than 40 percent against the U.S. greenback before the resource boom collapsed in the autumn, hundreds of thousands of jobs had disappeared from Ontario and Quebec’s manufacturing industries. Unlike earlier waves of deindustrialization, with U.S. industry in turmoil, there is little prospect for recovering many of these better paying positions. The future for Canada’s factory economy is grim in the absence of a focused industrial and innovation strategy. Ontario has been downgraded from a “have” to a “have-not” province eligible for the first time ever for federal equalization payments.

The final section addresses an important issue of the complex dynamics of the Northern model and growing income polarization and lessons for the future. The strategic advantage of using a sovereign fund to protect core industries, mastering the knowledge economy and implementing tax reform all depend on increasing the flow of mixed and public goods. The curse of Canada’s resource model is short-termism, not having to think and plan for the future very much. The rents from resource industries are so large that they support a deep culture of complacency about the environment and give the advantage to short-term profit-taking strategies. While experience teaches that economic models are not for export, Canada’s example needs to be put under the microscope for both its best and worst practices. It is not sustainable over the long term.

## THE ECONOMIC CULTURE OF THE NORTHERN MODEL

In his pioneering study *Capitalism vs. Capitalism*, Michel Albert developed the highly intriguing thesis that there are two generalized models of the modern market economy that many experts accept as a given in the global economy. The first is the Anglo-American liberal model with its highly competitive labor markets, low taxes,

declining real wage rates for the industrial non-unionized blue collar and contingent work force, a declining middle class, and a low level of government transfers. The second is the German social democratic model, characterized by high taxes, a high-skill labor market, high wages, and a world powerhouse of global exports. In the global North, capitalism has at least two well documented distinct faces with very different personalities. The American model, based on individual entrepreneurship and corporate success, is always driven by short-term financial gain. By contrast, the German model, with its bent for regulation and the power of its institutions, stresses collective success, the need for consensus, and the importance of maintaining long-term strategies (1993).

In the gilded age of financial excess, countries around the world have learned overtime to navigate around the battle between neo-American capitalism and the German high-tax, high-skill model. They have been apt in defending their own economic cultures while defending their institutions. In a way no one exactly predicted, divergence has become the global trend-line where many countries have followed markedly different trajectories. The British pattern has moved closer to the U.S. model than the German as British jobs and industries have gone off shore and wage rates in blue collar jobs have tumbled. Germany, with its high wage industrial sector and strongly regulated economy, is a world leader in industrial exports. The Scandinavians remain big spenders with very strong redistributive labor market practices focusing on retraining with generous replacement income. Even small Denmark has developed a distinct consensus model of decision-making. It emphasizes cooperation and compromise among the social partners and has worked to society's and its corporate champions' advantage to increase competitiveness and social cohesion. The French and Spanish have developed a hybrid model of protectionism, state interventionism, with strategic privatization of many state enterprises, and selective tax cutting (Crouch, 2005). In 2007, France created more jobs than the United States and unemployment was at a 30-year low. German unemployment tumbled from double digits to just over 7 percent in 2007 before European Union (EU) growth slowed dramatically in late 2008.

### **CANADA: HOW DIFFERENT IS ITS ECONOMIC CULTURE?**

Canada's economic culture and its importance to strong economic performance require a fuller explanation. In a recent paper, the distinguished economist Edmund Phelps has provocatively explored why a country would choose to stick with inefficient institutions from a purely market perspective while not optimally harmo-

nizing its policies with its largest trading partner (2006). Neo-classical economists have been quick to criticize the so-called inhibiting values and attitudes embedded in collective bargaining, social policy, and other institutional guarantees. These “protectionist” kinds of regulations could be thought to deter or hamper good economic performance. Phelps argues that the values and attitudes often entrenched in the economic system are as much a part of it as the laws of supply and demand.

Traditionally, neo-classical economics had no place for cultural elements other than private ownership as part of its theoretical model. Phelps contends that countries have differing institutions because “they have different economic cultures causing them to prefer different systems of institutions” (2006: 3). He underscores the importance of regarding a country’s economic institutions as proxies for the prevailing culture. These institutions will have a mixed character composed of market and social institutions. Economic culture is critical to the way particular capitalist economies are organized because not all goods and services can be bought and sold in a capitalist society.

Divergence in varieties of capitalism can be explained by examining the ratio of the availability of non-negotiable goods to negotiable goods and the preponderance of mixed goods available. Mixed goods like access to information and a clean environment are a benefit to society and the individual and are dependent on public sector activity. The puzzle for the theorist is that a mixed good is a blend of use value for society and exchange value for market transactions. It also is a bridge between the state and the market on the one hand and the individual and collectivity on the other. So, an ample supply of non-market goods is a net benefit for society for reasons elaborated in Lefebvre’s theoretical writing, which argues that they always help organize public life in all of its complexity (Lefebvre, 1996)

In many countries, particularly in urban settings, inequalities in access to good education and affordable healthcare are now immense. By providing equality of opportunity through education and health care, public authorities are able to level inequalities. Access to education and acquiring social capital through skill training are two of the most important factors in reducing the gap between the rich and the poor. Only a properly functioning state has the responsibility to equalize the life chances of all regardless of income, gender, and status (Crouch, 2005).

The Keynesian welfare state’s contribution to providing education and health care to all its citizens is well known (Esping-Andersen, 1990). Mixed goods such as public services and transfer payments are a wedge issue that hand governments a powerful redistributive lever with which to develop best practices like social equity, innovation, and reducing the income gap.<sup>3</sup>

<sup>3</sup> Under the Lisbon Treaty the EU intends to harmonize tax policy and further reduce the orbit of national sovereignty. But the decisive Irish vote against ratification threw a spanner into the carefully orchestrated

## CANADA'S EXPERIENCE WITH A MIXED GOODS REGIME

Canada is a case book study of both these imperatives in the lives of Canadians. The building blocks of Canada's market for mixed goods began to appear in the 1940s with far-reaching entitlements including unemployment insurance (1940), farm allowances (1944), and in 1957, hospitalization and old age insurance. These transfer programs were followed in 1965 by the upgrading of Old Age Security and the expansion of the Canada Pension Plan; in 1966 the much needed Canada Assistance Plan provided crucial federal grant funding for provincial expenditures and the Guaranteed Income Supplement to Old Age Security was introduced. A revised and more generous Unemployment Insurance Act was passed in 1971, followed by a new Family Allowance Act (1973), and the Child Tax Credit (1978) to reduce child poverty in low-income families. The 1982 Charter of Rights and Freedoms provided Canadians with a complex set of legal and social protection for linguistic minorities, First Nations and individuals, which went significantly beyond the provisions of the Canadian welfare state of the time. The ratio of new and old mixed goods to negotiable goods has been large and significant for the last five decades in many key sectors even with substantial declines due to privatization and spending cuts:

Compared to the U.S. type of market exchange, in many areas of public life Canada has an "un-American transactional mode of distribution." Canadians look to the state to lower transaction costs, while U.S. voters have not abandoned their preference for the market and the free enterprise system for setting things right (Hardin, 1974). Americans spend 7.1 percent of GDP on income security measures compared to 11 percent for Canada, a massive difference of 3.9 percent (see table Breakdown of Canada-U.S. Program Spending by Function, 2001). This category is comprised of all social assistance, including employment insurance (EI), elderly benefits, refundable tax credits such as the general sales tax (GST) credit and the Canada Child Tax Benefit, and outlays relating to Canadian public pensions/Quebec public pensions (CPP/QPP), workers compensation benefits, veterans benefits, and motor vehicle accident compensation (Kennedy and Gonzalez, 2005). Programs like these do the most to reduce the harm that derives from income inequality. More than a quarter of Canada's GDP is spent directly or indirectly on redistribution and protecting the social bond.

For a very long period, Canada has relied heavily both on income taxes and income transfers to contain and reduce inequality. These instruments have made an

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plan to deepen the EU. The "no camp" convinced a majority that the Lisbon Treaty failed to protect Irish concerns about abortion, taxation, and neutrality, all of which can be considered public goods connected to Irish identity and its public policy culture. The "dissent Irish" has forced Europeans to think long and hard about the need to defend diversity in their ranks at the highest levels of EU decision-making.



important difference regionally and for low-income families. The poorest 25 percent of Canadians are better off than their U.S. counterparts, and when Canada's system of transfers is added to market income, the regional impact is often huge. When market income plus transfers are counted together, "one quarter of Canadian families are better off than their U.S. counterparts in terms of purchasing power" (Wolfson and Murray, 2000: 3).

| Breakdown of Canada-U.S. Program Spending by Function (2001)<br>(% of GDP)  |      |      |             |
|---|------|------|-------------|
| Function U.S. Canada Gap  |      |      |             |
| Income security   | 7.1  | 11.0 | <b>3.9</b>  |
| Housing and community services  | 0.5  | 1.4  | 0.9         |
| Economic affairs  | 3.2  | 3.5  | 0.3         |
| Recreation and culture  | 0.3  | 1.0  | 0.7         |
| Education   | 6.2  | 5.9  | <b>-0.3</b> |
| Health  | 6.7  | 7.0  | <b>0.4</b>  |
| General public service  | 1.9  | 1.9  | 0.0         |
| Public order and safety   | 2.2  | 1.9  | -0.2        |
| National defense  | 4.0  | 1.2  | -2.8        |
| Total program spending*   | 31.9 | 34.8 | 2.9         |
| Non-defense program spending*   | 27.9 | 33.6 | 5.7         |
| Total program spending in U.S. and Canada   | 27.8 | 31.4 | <b>3.6</b>  |
| * Several adjustments must be made to these figures to reach the national accounts measure of total program spending.<br><b>Source:</b> Kennedy and Gonzalez, 2005. |      |      |             |

## BIG DIFFERENCES THAT MATTER IN PUBLIC SPENDING

Particularly since 2000, public spending on equalization transfers and transfers to individuals and families have continued to have significant redistributive effects (Caledon Institute for Social Policy, 2006). Poverty rates in Canada are about one half

those in the United States, and the contribution of social market in Canada explains much of the difference. Canada's political institutions such as federalism, the four-party political system, and the executive role of government have had continuing relevance in reducing many of the negative externalities of the North American Free Trade Agreement (NAFTA) (Drache, 2008). Even with the hard political right turn with the election of Stephen Harper in February 2006, the Canadian taxpayer has supported a larger state with marginally higher taxes, and bigger social programs and transfers than U.S. citizens (see table below).

Arguably, the Canadian public has rediscovered the importance of the economic role social Canada plays in Canadian politics and the fabric of the country. The high ratio of mixed to market goods is much in evidence in key areas of public life. Health, education, housing, mass media, workplace representation, and urban transportation are not purchased like any other commodity. Rather they are part of a social contract between government and citizenry. For this reason Canada has done much better in learning to reconcile the efficiency of markets with the values of social community.

### Home Ownership

Canadians are very attached to the notion of home ownership, and strictly speaking ownership is a market, not a mixed good. The innovative 10- and later 25-year mortgage at affordable rates for working families introduced by the Canadian Mortgage and Housing Corporation (CMHC) after the war –and quickly adopted by Canada's private banks– put home ownership within reach of the majority of immigrants as well as the native-born. Later CMHC insured mortgages for high-risk individuals with low down payments against default. The number of Canadians owning their own homes remains significant in all major urban centers, and different levels of governments have a direct say in the regulation of the housing market.

By 2006, home ownership was at its highest level in a generation. Sixty-eight percent owned their own homes, up from 65 percent three years earlier, in part made possible by the introduction of 30-year mortgages with relatively low monthly payments. Rents are regulated to varying degrees by local and provincial authorities that protect existing tenants against unregulated rent hikes. The Canadian housing market has held together quite well, and Canada's sub-prime mortgage market is tiny compared to the United States. Only 4 percent of mortgages are sub-prime compared to an astonishing 40 percent in the U.S. Certainly Canada's mortgage market is less competitive than the United States, and only a handful of large Canadian

banks dominate. Government regulations limit foreign competition in this sector and risky mortgages in Canada are hard to negotiate and come by. This is not the case in the United States as the sub-prime crisis has revealed to the chagrin and shock of the U.S. public.

As many as 12 million Americans are “underwater” meaning that their mortgages are worth more than their homes. Moody’s, the financial ratings company estimates that more than 8.5 million Americans will default on their mortgages between 2008 and 2010. They warn that 5.2 million of them will lose their homes (Globe and Mail Nov 12 08). Canada’s distressed home owners are not in this league. Other differences are significant. Condominiums in Canada have to be pre-sold before financing is available; in the U.S., thousands of homes and condos are built on spec and, with the collapse of the housing market, developers have had to dump their product, driving down house prices even further.

### Urban Transport

Urban transportation is another area subject to extensive public regulation and where mixed goods provisions are highly visible and also in decline. In the 1980s, mixed goods plummeted in this key sector when Canada’s national airline was privatized along with much of the publicly-owned rail system. Significant parts of the national rail grid were dismantled. You can no longer take a train from Newfoundland to Vancouver Island. Large parts of rural Canada are without any plane or rail service. Intercity buses have taken up the slack, but even this level of service is inadequate to provide highly efficient service linking communities and businesses within the country’s metropolitan regions. Spending on public transportation is at historic lows. In Montreal and Toronto, with mass transit systems, the consumer is shouldering an increasingly large share of the costs.

It is paradoxical that Toronto spends less public funds per rider than New York and Chicago. Toronto’s subway system has stagnated and not dramatically expanded to serve the Northwest corridor where millions in the greater Toronto area live but do not work. In the principal Canadian cities, transportation is a public utility paid for by public funds, taxes, and passenger fares. However under-funding by public authorities and the lack of long-term commitment to upgrade and improve public transportation systems have pushed urban Canada toward a U.S.-style system of public transportation over the last four decades.

## Mass Media

In the areas of electronic and print media, the market plays a very prominent role, and the Northern model converges with many practices in the U.S. variant. Budget cuts by preceding Liberal governments have marginalized the capacity of the Canadian Broadcasting Company (CBC) to produce prime-time Canadian programming in line with its non-commercial mandate to produce programs in both official languages to strengthen the national identity. Instead the network has relied on prime-time U.S. imports of sitcoms, films, and global sporting events such as the Olympics to make up for the lost revenue. Canada's private TV networks broadcast largely films and U.S. programs and sports. They enjoy large audiences and are profit centers. By comparison to the CBC, they are a major conduit for the importation of U.S. mass culture and television programs into Canadian homes.

Still, sustaining the Canadian identity remains a major responsibility of Canada's public broadcaster. CBC radio remains popular and listened to by millions of Canadians. Its national news broadcast is seen as authoritative and with its foreign correspondents reporting around the world, Canadians expect a "Canadian view." One of the more innovative decisions was to create CBC Newsworld, a 24-hour news channel offering Canadians an alternative to CNN and BBC World. Despite the national broadcaster's importance, Canadians are major consumers of U.S. films, music, sitcoms, and news services for much of the news and entertainment coming into their homes.

## Universal Health Care

In the spheres of education and health care, brand capitalism Canada is somewhere between the social democratic European model and brand U.S.A. with the privatization by stealth of services and under-the-radar-screen expansion of quasi-private hospitals provincially over the last 15 years. The anchor point is the universal health care system that experts reckon has the single largest impact on reducing health inequality. By contrast, the U.S. health care system is famously inefficient ranked thirty-seventh by the World Health Organization (WHO). Its idea of health care efficiency is largely a fantasy.

U.S. health status with respect to infant mortality, preventive care, and access to doctors falls below the standard in many industrialized countries in the global North such as France and Germany. Most revealing is the fact that as many as 60 million Americans who are either uninsured or underinsured. Private insurers exercise more invasive control over doctor selection, treatment and eligibility than any-

thing comparable in Canada. Health Maintenance Organizations (HMOs), private care-for-profit, the type of management care in the U.S., impose limitations on individual treatments that they deem “unnecessary” and disqualify individuals on the grounds of a “pre-existing condition.” For-profit care in the U.S. model has become a nightmare for families and individuals with chronic and difficult diseases. With individuals facing gigantic bills for health care, personal bankruptcy is not uncommon. Canada’s national health system enjoys an iconic status which no government has been prepared to challenge head on in the name of privatization.

Compared to the much more costly U.S. model, Canada’s health care is both efficient and universal and costs Canadians just under 10 percent of GDP annually. Health care privately purchased but paid for out of public revenues is guaranteed as a right and is the most important example of a public good for all Canadians. Landed immigrants, political refugees, and the homeless are all covered by the Canadian Health Act. The general populace reveres it as Canada’s most popular government program.

### Public Education

Private schools are at the margins of Canada’s provincially publicly run education system but have grown in recent times as Canada’s wealthy families have opted out of the public system. Still, education is a public good without equal. About 10 percent of school-age children are enrolled in the private education sector. Sectarian religious schools are for the most part privately financed and not subsidized by taxes with the exception of those in Alberta and Ontario’s Catholic public school system. The latter was a result of a political compromise in the early twentieth century and topped up with more funding by the Ontario provincial Liberals.

In the October 2007 provincial election, the McGinty Liberals trounced the provincial Conservatives who campaigned for state support for private parochial schools. Voters massively rejected it. The victory marks the first time in 70 years that Ontario’s Liberals have managed to win a back-to-back majority. In Ontario, the heartland of Canada’s multicultural society, the election outcome confirmed that immigrants expect to be educated in the public system, are critical of giving public funds to support private religious and secular private schools, and are strongly supportive of broad access to health care as a right.<sup>4</sup>

<sup>4</sup> In 2007 the miserable showing of Ontario Conservatives’ in the provincial election was blamed on its leader’s decision to make public support of private schools a major campaign plank. The Conservatives were soundly defeated by the Liberals who won almost 65 percent of the seats and 42 percent of the votes.

### Work Place Representation

In the areas of labor market practice and workplace representation, the Northern model diverges significantly from the United States. Democracy is one of the most important public goods and industrial democracy in the workplace is one of its modern success stories. Collective bargaining provides an upward pressure on wages through regularized collective bargaining that gives families over time an increased standard of living. Equally, it constrains the power of the employer to hire and fire at will. When institutionalized in the late 1940s in Canada, collective bargaining was a revolutionary idea because modern management had to give "cause" when discharging an employee. An aggrieved employee has the right to challenge the dismissal and a labor court can order reinstatement (Drache and Glasbeek, 1985).

In the United States, these entitlements and practices of industrial democracy have largely disappeared with the union-free workplace. Less than 10 percent of private sector workers are unionized, and the number in key sectors like auto and steel is expected to decline further. Job security is not part of the new U.S. flexible labor market model premised on unchallengeable management rights to dismiss and contract out work. By contrast, the Canadian labor market is regulated through workplace bargaining and provincially-based labor codes. With 80 percent of the public sector unionized and about 15 percent of the private sector unionized, the number of workers covered by collective bargaining in Canada is very large compared to U.S. jurisdictions. In the recent period, wage militancy has declined, but trade unions are a major force, particularly in the Ontario, Quebec, and British Columbia economies. With explosive growth in the part-time, casual labor force, Canada has imported some of the most controversial U.S. anti-union labor practices. But booming resource economies and squeaky, tight urban labor markets in Calgary, Vancouver, and Regina have maintained an upward pressure on wages and working conditions across provincial boundaries.

### THINGS PUBLIC AND WHAT CANADIANS BELIEVE

Compared to the U.S., there is a lot of public authority in Canada, and Canadians have come to expect it. In an era when markets predominate public thinking, governments have been forced to pay more attention to the continuity in values documented by Michael Adams (2003), Frank Graves (2001), and others that show that Canadians are not viscerally anti-state and anti-tax. According to Frank Graves of EKOS, who does polling in both countries, Canadians are much less ideological than Americans. His

studies reveal that U.S. voters are more conservative, more ideological, and more religious. He says that Canadians have become “non-ideological and non-partisan. [Canadians] have the weakest political party affinity in the Western world” (quoted in Valpy, 2008).

Like many other respondents in the Michigan World Values Survey, unsurprisingly, Canadians distrust their politicians but are supportive of a strong role for government and its programs. For instance, asked to rate the top ten most important issues in January 2008 in a *Globe and Mail/ Strategic Counsel* poll, Canadians placed taxes close to the bottom of their priorities along with terrorism. The level of taxation is not one of their major complaints. The most popular program is hardly a surprise; the top rated is Canada’s public health care system, and for a majority of Canadians protection of the environment and action on global warming is their number one priority. If polling data is an accurate predictor of Canada’s political culture, Canadians are not ready to abandon the advantages of the Northern model as they know it for a hard-right political public agenda with fewer mixed goods and dramatically fewer public goods.<sup>5</sup>

As the table below confirms, government in Canada is bigger, more redistributive, and more activist in the social market than its U.S. counterpart. The puzzle is that these differences have persisted despite two decades of privatization, government cutbacks to many programs, and significant cuts to corporate taxes. Canada’s social market economy is smaller and less redistributive than its counterpart in Northern and Western Europe. But the Canadian equivalent is still significant and comes with a history of many ups and downs. It is instructive to look at it briefly.

<sup>5</sup> Attitude toward strong positive government intervention is reflected in changing Canadian voting patterns. The Liberal brand is strongest in Ontario and the Maritimes but the Liberals have lost their grip on Québec since the early 1980s to the separatist Bloc. It has been a quarter century since their huge majority there gave them the seats to be the natural governing party. In the West the Liberals are a fringe party with declining support able to elect only a handful of MPs. By contrast Harper and the Tories own the West electorally with the NDP having pockets of support in British Columbia (BC). Alberta, with its wealth and political culture, is the closest to the Bush’s social conservatism and religious right. With a fractured political system the regional dimension of Canadian politics is very strong. Voters in Québec and Ontario as well as urban BC are distrustful of the corporate Hayekian agenda of the Harper government. Harper has not won any seats in Canada’s largest urban centers where over 60 percent of Canadians live. One consequence is that Canada has been pushed into minority-government mode following the revelations of the Gomery Commission into the Sponsorship scandal. Until 2008, the Harper government remained stuck in the mid-30s in approval ratings in public opinion polls tied with the Liberals led by Stéphane Dion who is perceived to be a lackluster leader. A snap election was called in September 2008 and the strong performance of the Bloc and the NDP denied Harper his majority.

## MOVING THE CENTER TO THE RIGHT

In the 1990s, Canada's political landscape veered to the center right. Canadian voters seemed to have opted for the Anglo-American prototype of markets first, people second. Market Canada's tough deficit-cutting policies first emerged with the Brian Mulroney Conservatives and were adopted with even greater vigor by the Jean Chrétien Liberals in the landmark 1994 federal budget when Paul Martin was the Minister of Finance. Government program spending was cut as much as 40 percent over three years in a frenzy of deficit reduction. These policies systematically and successfully reduced the scope and ambit of the redistributive framework of Canada's complex, multi-tiered system of transfer payments to individuals, families, and governments.

| Comparing Canada and the United States - Public Finance Snapshot, 2006 |  |  |   |                                 |  |   |
|--|--|--|---|---------------------------------|--|---|
|  | Total general<br>government<br>revenue | Total general<br>government<br>expenditure | General<br>government<br>final consumption<br>expenditure | Social<br>security<br>transfers | Net saving<br>of general<br>government | Net lending<br>of general<br>government |
|  | % of GDP                               | % of GDP                                   | % of GDP  | % of GDP                        | % of GDP                               | % of GDP                                |
| Canada   | 40.7                                   | 39.3                                       | 19.3  | 16.8                            | 2.2                                    | 1.4                                     |
| United States  | 33.1                                   | 36.6                                       | 16.0  | 12.0                            | - 2.5                                  | - 3.5                                   |
| <b>Source:</b> OECD, 2007<br>* Consolidated government expenditure     |  |  |   |                                 |  |   |

Ferris and Winer (2007) demonstrate that the size of government, one of the differences between Canada and the United States, has radically closed since 1995. They estimate that the neoliberal discipline on government spending in Canada has transformed the face of the Canadian government. Government spending in Canada shrunk closer to U.S. levels. They do admit, however, that Canadian social transfers as a percentage of the GDP are consistently greater than those in the United States. For the entire post-World War II period, Canada's expenditures have been roughly 25 percent greater than the United States (Ferris and Winer, 2007).



## REINING IN PUBLIC SPENDING

Nonetheless, the Northern model was downsized and put on a strict regime of deficit and program cutting. It is estimated that as much as US\$50 billion dollars in health and social spending were eliminated after the Liberals took office in the early 1990s. Ottawa became focused on competitiveness, market openness, and private wealth creation, adopting much of the inner logic of the neo-American model. The pendulum in public spending that has always vacillated in different periods between social and market Canada moved sharply toward the market end of the spectrum and appeared to be permanently anchored there.

Researchers discovered that when successive federal governments adopted stringent cutbacks and reduced Canada's social security net, Canadians did not wantonly abandon their ideas of equity and fairness in the name of global competitiveness. National differences between Canada and the United States remained rooted in the formative historical events that shaped their values to the present day. In his magisterial study *Continental Divide* (1990), Seymour Lipset referred to Americans as being "anti-statist, individualist and populist" while Canadians were presented as being "deferential to authority, collectively oriented and statist" (quoted in Boucher, 2005). Why has this fault line remained such a definitive statement of Canada-U.S. differences in many respects when the Canadian and U.S. economies were experiencing unprecedented pressure for integration?

According to the research of White and Nevitte the proportion of Canadians who identified with "Canada as a whole" rose from 30 to 40 percent between 1981 and 1990 and remained just below 40 percent in 2000 (White and Nevitte, 2008, 400). Americans and Canadians became more nationalist and attached to their nation-state, not less.<sup>6</sup> In the Pew Survey, Canadian values again sharply departed from the U.S. in terms of moral permissiveness with respect to gay rights, interracial marriage, abortion, immigration, and the role of the state in the economy.

Adams reported that in his study of Canadian values in 2005, 41 percent of Americans replied that father was the master of the house, up from 31 percent in 1995. The contrast with Canada was stark, with only 17 percent agreeing that father was the undisputed master of the family in 2005, a precipitous drop from 33 percent a decade earlier. (Adams, 2006) In fact, in a way that astonished many Canadians, who saw themselves as deferential and very cautious compared to their U.S. cousins, something unique had transpired: Canada had exchanged roles with the U.S. as the North

<sup>6</sup> Mexicans also became noticeably more nationalistic during the golden years of NAFTA. See White and Nevitte, 2008.

American center of small 'I' liberalism with its values of redistribution, solidarity with the most vulnerable, and a strong belief in community. White and Nevitte explain this value shift first and foremost by the continuities in Canada's "resilient domestic economic structures" and political culture.

With the arrival of the Bush revolution in foreign and domestic policies, Canadians have continued to support a strong social democratic set of values of inclusivity, diversity, and solidarity. They do not have a visceral, anti-state attitude like their U.S. neighbors. The driving idea in the Canadian Constitution of "peace, order and good government" effectively translates into a strong attachment for taxpayers' dollars to be spent liberally on public goods as the previous tables demonstrate. What is impressive to these students of Canadian public opinion is that "NAFTA has not resulted in a movement towards more neoliberal values" (White and Nevitte, 404). Canadians embraced deficit cutting, but they were equally committed to more program spending. Is this not the strongest evidence of the way domestic structures are powerful predictors of both social values and voting practices?<sup>7</sup>

#### THE NORTHERN MODEL: A WILDERNESS OF SINGLE INSTANCES?

In other areas of public life, the Northern model has proved unusually vulnerable to the intense pressures from globalization and neoliberal policies. Deep integration through NAFTA as championed in the many studies of Michael Hart and others promised an economic revolution for hard-pressed Canadian businesses (Hart, 1995). The trade agreement challenged the regulatory role of the Canadian state as exclusive manager of the national economy. Canada's business culture has in turn been transformed by the cross-border movement in goods and services. Their research led them to predict that access to the U.S. market would build a group of world-class Canadian corporations and that competitive pressures would eliminate the Canada-U.S. productivity gap of more than 10 percent. Neither happened. In fact, the gap tripled, rising from Can\$3000 to Can\$48 800 on a GDP-per-capita basis.

On the ground, Canada's entrepreneurial culture seemed to have been often fatally weakened by the new competitive conditions. Since 2000, a total of 12 percent of the market value of Canada's core companies has been sold to foreigners. The

<sup>7</sup> It is intriguing to speculate on why Canadians have become less conservative in their social values but also more skeptical about fixed political loyalties. University of Toronto polling expert Larry LeDuc has found in a recent study that four in ten Canadians identify with the political center, another third with the Liberal party, and a significant minority with the social democratic NDP (Valpy, 2008). As the left-right binary has become less pronounced Canadians vote for issues as much as for a leader, which creates much volatility and uncertainty at election time.

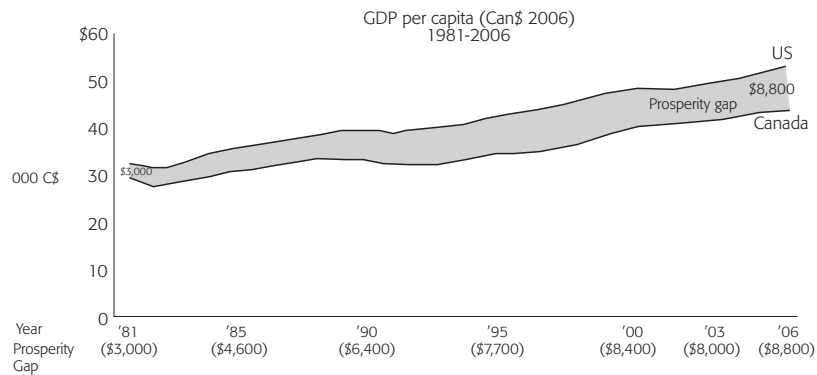
blistering pace of takeovers accelerated after 2003 with the sale of some of Canada's largest and oldest corporations to foreigners including INCO, STELCO, Falconbridge, Bell Enterprises, the Bay, and DOFASCO (Stanford, 2008). Instead of an industrial competitiveness revolution, powerful market forces transformed Canada's comparative advantage in an unprecedented direction. Canada became, once again, one of the world's leading producers of rocks, logs, agriculture, and energy.

The fundamentals of market Canada have also changed dramatically post-NAFTA. Ontario's world-class U.S. and Japanese auto makers now assemble more cars than Michigan. Ontario has the densest concentration of car production probably in the world, and automobiles, the economy's second export-driver, represents 16 percent of Canada's merchandise exports. Domestically, auto production stands for between 3 and 5 percent of the economy. In the past, with an aggressive 63-cent Canadian dollar, Canadian exporters were able to ring up huge profits with the currency advantage, low health care costs, and competitively marketed goods. This strategy's success helped pay down the debt and allowed governments to cut corporate taxes. In late 2007, when the Canadian dollar reached par with the U.S. currency, Canadian business lost its biggest safety net.

In the last three years, over 250 000 jobs have disappeared from Canada's manufacturing industries in Ontario and Québec auto parts and small manufacturing firms (Lin, 2008). Job losses and the number of plant closures are unprecedented. Border towns like Windsor, once the hub of Canada's auto industry, and smaller centers outside of Montreal, are experiencing double-digit unemployment (TD Economics, 2008). With Chinese auto producers planning to enter the North American car market in the next five years, it is projected that Ontario's share of North American auto production and auto parts industries are likely to shrink even further.

In his major study of Canada's productivity crisis, free market advocate Roger Martin contends that the productivity gap grew larger, not smaller, as the theory of free trade warranted (see table Canada's Growing Prosperity Gap). Comparing Canada to the U.S., Ontario, Canada's industrial heartland, ranks 16 out of 18 on his competitiveness ranking index, just ahead of Michigan. Ontario has been slipping badly as one of North America's industrial hot spots. From the right side of the spectrum, nonetheless, he advocates more cuts to corporate and business taxes to tilt Canada's taxation system to a value-added tax basis. The idea is to create what he calls an "entrepreneurial advantage" (Institute for Competitiveness & Prosperity, 2008). The proposed framework is very far removed from any kind of a state-centered industrial strategy.

**Graph 1**  
CANADA'S GROWING PROSPERITY GAP



**Source:** Institute for Competitiveness & Prosperity analysis based on data from Statistics Canada; U.S. Department of Commerce - Bureau of Economic Analysis; and OECD. Available on line at [www.competeprosper.ca](http://www.competeprosper.ca).

**Note:** Currency converted at PPP.

### CANADA'S UNCOORDINATED LIBERAL ECONOMY: A DECADE OF RETRENCHMENT

The distributional consequences of the state's smaller role in the economy and Ottawa's retrenchment as a provider of mixed and public goods has been much analyzed. The Center for the Study of Living Standards reported that the growth in median before-tax income stagnated between 1980 and 2005. The earnings of Canadians, like Americans, stopped increasing in pace with the overall economy (CSLS, 2007). The figures for the two countries are relatively comparable. Between 1975 and 2005, the U.S. economy grew by almost 86 percent, but family income increased only 29 percent and most of it between 1993 and 2000. The big change for Canadians came after 2000 when family income in Vancouver, Calgary, Montreal, and much of the Maritimes grew anywhere from just over 3 percent in parts of the Maritimes to almost 9 percent in Alberta. In Toronto, the picture was bleak with an increase of only 0.7 percent for families recorded.

The crucial point is that Canadian family income has stood still or gone backwards for those in the middle of the income pyramid, and the income for those at the bottom has actually shrunk as mixed and public goods have been in short sup-

ply with far fewer benefits for families and individuals. For working Canadians, the 1990s was a decade of despair and income retrenchment. The most worrying fact is that despite persistent change in taxes and benefits to low-income Canadians, marginal tax rates for low-income Canadians have returned to 1992 levels (Poschmann, 2008: 4). The Keynesian, post-war unemployment insurance program was renamed Employment Insurance in 1996 by the Liberal government of the day. The new name reflected the neoliberal focus on workers as clients and customers not the connection to a full employment obligation on the part of government. Canadians eligible for benefits shrunk from a pre-NAFTA high of over 70 percent to just under 40 percent. Benefits were reduced and qualifying times were increased. In this area more than any other, Canadian policy converged with the much lower U.S. levels.

The mix of government revenues also changed beyond recognition in this period of retrenchment. Ottawa's single largest source of revenue to pay for the business of government and social programs comes from the Goods and Services Tax introduced by the Mulroney government. As many experts acknowledge, corporate income tax as a share of government revenue has shrunk from a post-war high of 30 percent to around 10 percent (Brooks and Hwong, 2006). Of equal significance, the gap between the rich and poor grew disproportionately even though Canada's economy performed better in 2000 than in the previous decade. More Canadians are working longer hours, but unlike the golden decades of Keynesianism, the bottom half have been shut out of the economic gains from North American integration. Armine Yalnizyan has looked in detail at the gap between the rich and poor. In terms of after-tax earnings, between 1976 and 1979, the bottom half of Canadian families accounted for 27 percent of total earnings. By the end of 2004, their share of total earnings had dropped to 20.5 percent (2007).

There is yet more to this story. In this depressing picture of Canada's new competitive condition, the poorest 20 percent of Canadian families have suffered a sharp drop in the earnings pie, from 4.5 percent in the late 1970s to 2.6 percent at the beginning of the new century. New data from latest census reveals just how meager the increase in national median earnings measured in constant dollars has in fact been. Between 1980 and 2005, earnings grew only 0.1 percent. Canadian multiculturalism has not escaped the arc of growing income inequality. Recent immigrants are more disadvantaged and face more labor market barriers than at any time in the last quarter century.

New Canadian census data reveals that in 2005 Canadian-born males with a university degree earned Can\$62,556 compared with Can\$30,332 for a recent immigrant earner in constant 2005 dollars. Canadian-born women with a university degree earned Can\$44,545 and immigrant women with a university degree Can\$18,969.

Michael Valpy, reporting on the spiraling "income gap" found that university-educated, immigrant men and women earned 50 percent less than their Canadian counterparts (Valpy, 2008). The only silver lining in this otherwise grim account of inequality growth is the degree of social protection embedded in Canada's tax system for the most vulnerable. Yalnizyan concludes emphatically that almost two million families would have been worse off than their counterparts in the late 1970s without government intervention and the protection of social Canada (2007).

### **CANADA'S COUNTER-CYCLICAL SOCIAL MARKET: THE SOCIAL STILL MATTERS**

Recent attempts to measure the historical size of Canada's social market have produced some remarkable findings on this critical issue. In their detailed quantitative study, Ferris and Winer found that Canada's transfers to individuals have always been larger than those in the United States: "from 1960 to 2004 the U.S. measure rose from 28 percent to roughly 38 percent of GDP, whereas Canada's government size grew to over 38 percent" (2007: 179). What is also significant is that the growth of government expenditures on persons and businesses is largely driven by the business cycle; so, just as the theory envisages, growth in social market transfers followed the oil shocks of 1973 and 1979 and the recessions of the early 1980s and 1990s.

One need not look for simplistic explanations, but there is a strong correlation between downswings in the business cycle and the growth of Canada's social market, at least until 1994. To extrapolate further, at the present time of deep integration, government spending on public and mixed goods is likely to increase gradually to address structural adjustments for industries and workers arising from competitive labor markets and fallout from global competitive pressures. Ottawa speaks approvingly of investing in skills and job training though the amount of money dedicated to this end remains inadequate by OECD standards: out of 30 or so countries Canada rates in the bottom tier. With huge annual fiscal surpluses in recent times, in theory Ottawa should be entering a new spending cycle.

While government spending on social programs is a key indicator of quality of life, it is not the only one. The size of government in the economy is important because it indicates the resources and priorities that government spending measures reflect. A country with a large social market does better at poverty reduction and providing protection for its most vulnerable. The evidence supports the idea that the Northern model has enjoyed some success in this critical area but only to a limited extent.

The National Council of Welfare in Canada has tracked and documented poverty reduction extensively. Between 1980 and 2005, poverty rates for seniors fell from 34 percent to 14.5 percent. It is quite remarkable to note that poverty rates for the working poor remained largely stable during that period rising from 13.3 percent of the population to 15 percent despite the fact that working incomes are lower today than they were in 1986, once adjusted for inflation. Child poverty rates, for those 18 years and younger, have declined slightly from 16.2 percent to 15 percent, largely as a result of the Child Tax Benefit. Many social advocates are worried, and rightly so, that the after-tax income gap remains a real concern for low-income families. For Yalnizyan and other social policy experts, Canada's tax and transfer system makes the critical difference: "Canada's tax and transfer system stopped the free fall of incomes for almost half the population raising children" (Yalnizyan, 2007: 4).

Leading Canadian scholars have analyzed the market dynamics of the U.S. model demonstrating just how different the two societies have become. The top one million U.S. households received 18 percent of the total income of all Americans, a figure up almost four percent in 2003: their income share was roughly equal to that of the bottom 166 million Americans all together. Analysis of the report showed that, like in Canada, middle- and low-income families are seeing that their slice of the pie is not growing and is even visibly shrinking. A more fulsome explanation is that almost half of the income going to the top one percent of American families comes from tax cuts on long-term capital gain and dividend payouts. In a way that does not surprise Canadian and European researchers, much of the increase in wealth for the super-rich came from tax cuts rather than market gains, although it is difficult to separate the two (Krugman, 2007).

#### THE STRANGE CASE OF MACRO-ECONOMIC UNCOUPLING IN A HIGHLY INTEGRATED MARKET SETTING

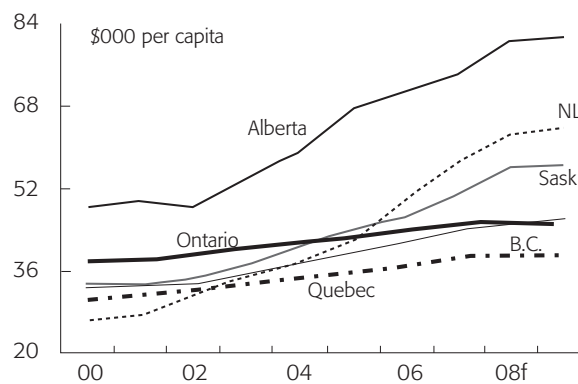
Since 1990, market Canada has witnessed a number of dramatic changes to its economic performance and to the structural dynamics between the Canadian and U.S. economies. The two economies, which were supposed to move in regular and predictable lockstep, are increasingly out of sync with respect to a range of leading macro indicators. Here, also, the ratio of mixed to private goods is significant. Many of these macro trends have caught the attention of Canada's policy community. It is this evidence that has led some business economists to argue that the Canadian and U.S. economies have at least partially decoupled, with different structural dynamics present in each. The line in the sand between the two economies is surely that of the

pivotal role of natural resources in terms of wealth creation, exports and wages and profits. In the words of Stat Can's chief economist Philip Cross, profits have doubled in the export sector since 2002 and since 2004 "natural resources have accounted for all of the growth in Canada's export earnings." (2008) The decoupling hypothesis is important because it speaks to the ability of the Canadian economy to remain resilient in the face of U.S. weakness and find its own path. It highlights growing regulatory divergence like in the sub-prime mortgage market, but in many other areas as well.

For example, Canada is more of a goods-oriented country than the United States. Almost 25 percent of Canadian workers are in the goods production sectors; while the figure is just 16 percent south of the border. Canada continues to be more oriented toward manufacturing than the United States with a 12 percent employment share compared to 10 percent. The most important difference is that national resources and mining are just 0.5 percent in the United States; the Canadian share of employment in forestry, fishing, mining, oil and gas is almost four times the U.S. size. As an investment magnet for foreign direct investment, this pivotal sector is in a league of its own.

According to Stats Canada, business investment in it has increased faster than the rest of the economy since 2002. Investment has jumped from 36 percent to nearly 44 percent in 2008. In terms of job growth, resource-rich Saskatchewan, Alberta, BC and Newfoundland and Labrador have outperformed Ontario and Quebec, once the locomotive of the Canadian economy. The resource sector has become a virtual

**Graph 2**  
PROVINCIAL NOMINAL GDP GROWTH



Source for Historical Data: Statistics Canada.

Forecast: Scotia Economics. Mary Webb, November 4, 2008.



job machine for all parts of Canada outside the central region (Lascelles, 2007). Just how dramatic the provincial differences have become can be seen in the table on nominal GDP provincial growth rates. Canada's resource curse has become a blessing for the once have-not provinces of the Confederation. In a recent note, Mary Webb writes that "for eight out of the ten provinces for the year ending March 2008, they had a combined provincial surplus topping \$11 billion" (2008).

All of the above structural differences translate into some significant policy divides. Canadians remain temperamentally more cautious than their American counterparts. The capacity for debt and risk is much higher in the United States than in Canada. Consumption in the United States represented a remarkable 71 percent of the GDP in 2000. By contrast, Canadian consumption represents just 60 percent of GDP, and debt levels are much lower.

Only a handful of countries along with Canada have enjoyed this kind of fiscal surpluses as the result of very different kinds of dynamics. In 2007, Germany and France joined this select club.<sup>8</sup> Canada has been a member for a decade running huge surpluses after cutting programs in the early 1990s. Canada's resource "curse" has also supported a resource boom and generated significant tax royalties both for Ottawa and the resource-rich regional economies.

### HIGH TAX RATES FOR THE MOST VULNERABLE AND A NEW CENTER OF GRAVITY

Certainly Ottawa is spending more on a regime of mixed goods, but Canadians are being more heavily taxed for these entitlements, new money for the Child Tax Benefit, a partial restoration of cuts to universal health care and new funding for education.<sup>9</sup> In a recent report, the C.D. Howe Institute found that, adjusted for population growth and inflation, federal taxes "have never been as heavy as they are now on individuals and families." Marginal tax rates on low income Canadians remain high and have actually increased due to clawbacks and benefit reductions for those receiving welfare (Poschman, 2008). The Harper government continues to cut business tax rates and the GST, evidence for the cynical observer that at heart Canadians are in

<sup>8</sup> Australia under John Howard and now Kevin Rudd has amassed huge surpluses. Despite the strong neoliberal turn and a frontal attack on collective bargaining rights, Australia has the highest minimum wage of OECD countries.

<sup>9</sup> If public opinion polls are to be believed, Canadians regard the tax burden to be part of their identity along with multiculturalism and diversity. In the *Globe and Mail*/Ipsos poll of February 2008 as well as an earlier *Globe and Mail*/Strategic Council poll, January 2008, when asked what they considered the most important issues, only 3 percent of respondents said that taxes were too burdensome.

many ways similar to their U.S. counterparts, partial to being tax-lite and resource-dependent.

The Northern model's economic center of gravity is now anchored by the global resource boom for Canada's resource and energy products. Canada has benefited massively from it. Net profits in oil and gas have grown by almost Can\$30 billion since 1999. Minerals and base metals have generated vast profits for Canada's resource giants, but the largest are now foreign-owned. Resource super-profits have fuelled the Alberta, Saskatchewan, Newfoundland and British Columbia economies. Canada's booming western provinces have reached full employment status with only 3 percent of the work force jobless. Only Newfoundland is at double digit unemployment, but this may also change with the development of the vastly rich Hibernia oil field off the coast of the belle isle. The gravity-based rig sits on the ocean floor, 111 meters high, and is designed for year-round production capable of withstanding the impact of sea ice and icebergs. Despite its resource wealth and innovative success in providing social Canada with the means to pay for a mixed goods economy, Canadian public opinion is divided about the future of Canada's natural bounty: public curse or lucky country?

The current decade has marked an important turning point in Canada's economic development. In the words of Jim Stanford, "Decades of promoting a more diversified and less resource dependent economy have been reversed" (Canadian Auto Workers, 2008). Canada's economy has once again become dependent on natural resources as the motor of growth, export revenues, corporate profits, and new investments. Right up until the late 1990s, Canada's economy had acquired a greater diversity in production and exports, and its manufacturing sector had developed a capacity to produce more complicated goods and services.

By 2007, the proportion of Canada's resources consisting of unprocessed or minimally processed staple products expanded to nearly 60 percent (Cross 2008). Not surprisingly, Canada's exports to China followed the identical mix of specializing in raw material exports; rising sales of metals, fertilizers, iron ore, nickel, wood pulp, wheat, and coal – a veritable shopping list of Canada's natural bounty. In a study done for Statistics Canada, the most important finding was that Chinese imports of Canadian crude materials have more than tripled since 1998, accounting for nearly one-third of total growth in Canadian exports to China.

The energy sector by itself is massive and diverse, comprised of six sub-industries: oil and gas, coal mining, electric power generation, transmission and distribution, petroleum and coal by-products, and pipeline construction and transportation. Metal mining, forestry, and agriculture round out the spectacular diversity of Canada's resource abundance. Some experts call the mega role of resources a "curse" because

of its distorting effects on income and productivity growth. If natural resources were once evidence of a dependent economy, it is questionable whether the classic “staples trap” as developed by Harold Innis, Canada’s pioneering political economist, is relevant as the appropriate critical lens to grasp fully the dynamics of the Northern model (Innis, 1995; Watkins, 2006).

But it would appear that the Canadian economy has returned to its historical trajectory as an exporter of primary goods with a declining role as an industrial power. In contrast to the classical model of staple production where a single global commodity, such as wheat, square timber, or cod in the earlier times, predominated, Canada is in a privileged position because with record high prices for a range of energy and mineral products, resource exports command top dollar almost from coast to coast.

In a recent paper, Stanford notes that the job boom in resources including minerals and agricultural exports offset less than one-fifth of the jobs lost in Canadian manufacturing facilities (Canadian Auto Workers, 2008). The big winners in terms of job growth are private services and government. The private sector accounts for almost two-thirds of all Canadian jobs while government at all levels accounts for another one-third. Indeed job growth has been so strong that Canadian unemployment had fallen to the lowest level in 35 years until the collapse of financial markets in 2008. Many in these privileged sectors have seen significant per capita income gains. Certainly there are many part-time and contingent jobs in food and tourism, but the jobs and income growth in government, resources, and high-skilled work has been impressive, at least in the short term. Relatively high-wage jobs in public-sector, resources and the information economy co-exist with de-skilling and increases in lower-paid employment in manufacturing and services. By 2010 for the first time ever, Ontario will become a recipient of equalization payments from Ottawa, public funds that go to “have-not” provinces. A record number of job losses combined with the toxic effects of de-industrialization have meant a historic downgrading of its status inside the federation.

In a way that no one could have predicted, the incredible growth in services challenges one of the standard assumptions of globalization: that Canada is becoming more integrated into the global economy. Most service production is consumed domestically and virtually all public services are not traded. It is remarkable to note that only higher-end health and education services, call centers, and banking services are not consumed where they are produced. Stanford makes the compelling case that the most remarkable structural change in the Canadian economy is that Canada was less integrated in world markets at the end of 2006 than it was a decade earlier measured by intense export openness. He documents that Canadian exports reached their peak at over 45 percent of the share of Canada’s total GDP in 2000; by

2007, this had declined by 10 points to 35 percent. What needs to be analyzed in greater detail is the consequences of this double movement, de-globalization in the service and information economy with intense globalization in resources and manufacturing exports (Canadian Auto Workers, 2008).

### **CANADA'S RESOURCE CURSE AND THE APPRECIATION OF THE REAL EXCHANGE RATE**

Economists note that Canada's energy boom is mainly a price effect. Andrew Jackson draws attention to the fact that real output in Canada's energy sector lagged behind the rest of the economy between 2003 and 2007, and that productivity in this key sector has yet to generate significant increases in output. In a recent article, "The Role of Natural Resources in Canada's Economy," Cross underlines that resource industries have not been an important source of productivity or job growth. They are a magnet for foreign investment, but output growth in mining, forestry primary metals has actually fallen since 2002 (2008). Energy-related construction growth is one of the big winners from record high growth rates as thousands have moved to Alberta and bought homes.

But Alberta has done little to mitigate the boom-bust cycle and attract long term industry to the province. Norway has used its US\$375-billion sovereign fund to implement social and political policy at the corporate level. Thirty years ago, in a major study commissioned by the Manitoba government, Eric Kierans urged provincial governments to capture the rents from mining and other resource activities that leased public lands for resource extraction. No Canadian jurisdiction adopted his primary recommendation for public stewardship. Presently, Alberta has rejected the notion that it needs to capture resource rents like Norway and spread the windfall returns over a long time period. Alberta's take from a \$60 barrel of bitumen from the oil sands is one of the lowest royalty regimes in the world at 30 cents a barrel and it permits corporations to deduct royalties for federal corporate income tax purposes (Jackson, 2008).

The immanent danger that Canada faces as a nation from a laissez-faire mega resource boom is that appreciation of the real exchange rate can damage a country's exports and harm its long-term growth prospects. Economists Max Corden and Peter Neary termed this danger "the Dutch disease" after the discovery of North Sea gas in Holland in the 1960s (1982). It explains the loss of competitiveness when its manufacturing industries were sideswiped by an unfavorable rising exchange rate as the price of oil spiked. It led to a large inflow of foreign investment and a surge in resource

exports. Imports rose and de-industrialization was seen to be a direct consequence as a nation's goods industries decline from the mounting resource boom.

Many economists have argued that the shift away from manufacturing is detrimental to the economy as a whole. Once the resource boom runs out of steam, competitive industries are slow to return, and there are far fewer benefits from technological growth in the non-booming sectors. There are only two alternatives. One is to slow the appreciation of the real rate of exchange, and the other is to boost the manufacturing sector's competitiveness by a mix of specially designed measures.

### **THE BRAZIL STRATEGIC MODEL OF RENT APPROPRIATION: WHERE IS CANADA ON THIS STRATEGIC QUESTION?**

The third option is to increase mixed goods and use the vast revenues from oil and gas wealth for broad-based public ends. Norway's government fund sold its close to US\$1 billion stake in Rio Tinto's Grasburg mine in West Papua when it discovered that the Grasberg mine would cause "severe long-term environmental damage in West Papua." Countries such as Mexico, Brazil, and Chile have spent boom revenues for poverty alleviation and broader macro-economic goals. In 2007, Mexico spent US\$19 billion in fuel subsidies. Mexico's huge oil reserves, owned by the nation, supply the government with more than 40 percent of its revenues for public programs. The effects of public ownership of this strategic sector are felt throughout society. The price of a liter of gas at the pump is at least 30 percent cheaper than in the U.S. due to the complex formula the government uses to set domestic prices (Thomson, 2008). As part of the Mexican model of mixed goods and services, the government also relies on subsidies to corn producers to stabilize prices and give families some protection against soaring food prices. Calderón has recently suspended import tariffs on rice, wheat, and corn to lower the potential for social unrest where 40 percent of the 100-million-plus population live in poverty. Its strategic control of this key sector stands in sharp contrast with its inefficient tax system: its gross take from taxes is one of the lowest in Latin America.

By contrast, the Brazilian government is planning in 2008 to use its revenues from recently discovered oil fields to create a sovereign wealth fund to help stabilize its currency. The model is one of shared production where reserves would remain the property of the government and the oil companies would be allotted concessions on what is known as a risk basis and, critically, pay royalties on the revenue they earn. The oil companies have been critical of this model because the government would benefit from every increase in the world price for oil and would leave Brazil's reserves

in control of the nation. Lula is determined to change the royalty scheme to one based on the Norway model where the state is the sole owner. It would have partners and have to pay them but it will be the lead investor (Wheatly and Hoyos, 2008).

It is expected to have US\$100-US\$200 billion as a counter-cyclical contingency reserve in the next five years. The aim is to use its financial resources to reduce public debt and the inflationary impact of government spending. Brazil also has a system of fuel subsidies in place to lower consumer energy prices. Chile already has a sovereign fund holding foreign currency to reduce pressure on its currency (Wheatly and Lapper, 2008). Sovereign funds can protect industries from heavy inflows of speculative capital, a rapidly appreciating currency and provide financing to buyers of Brazilian exports as well as funding for overseas investment for its firms. As prices everywhere surge, southern governments cannot abandon households to a muddle-through model. They have to walk a fine line between fiscal stability and over-cooling the economy by moderating prices and salaries without choking off consumption.

## REVERSING DE-INDUSTRIALIZATION AND PLANNING FOR THE FUTURE

A first-world country like Canada that is seriously committed to successfully participating in the global economy requires manufacturing industries with higher productivity and higher rates of productivity growth. It needs to plan for its industrial future. Late in 2008, French President Sarkozy has just created EUR 20 billion fund to protect France's core strategic industries from foreign takeover and the toxic effects of the credit crunch. The state-backed fund would be among the 20 largest long-term investment funds in the world, and its purpose is to help companies that cannot find financing for their operations in the market because banks are too "timid" and the state must act in France's strategic interest. Certainly, his words could not have been clearer and worth quoting. "The day that we stop building trains, aircraft, cars and ships, what is left of the economy? Memories. I will not turn France into a reserve for tourists" (Hall, 2008).

No Canadian prime minister or ranking bureaucrat has even come close to echoing France's commitment to protecting and developing its core industries. The strategic importance of a sovereign wealth fund is not on the agenda of Canada's Department of Finance.<sup>10</sup> Canada has not found any way to combat the negative costs of a rising dollar and the threat from commodity-driven inflation. Alberta and Ottawa

<sup>10</sup> Alberta has a heritage fund but has none of the policy leverage explicit in the Brazilian and Chilean examples.

have used energy-generated surpluses to lower tax rates rather than take excess revenues from the energy boom to invest outside the country or abroad. Ottawa has dismissed the Norway-style sovereign-fund model on ideological grounds to let continental U.S. interests shape Canada's economic future.

The idea of collecting and saving resource rents to plan for tomorrow up until now is largely foreign to Canada's public-policy culture. For instance, Norway's fund is worth about US\$400 billion and is expected to double in size in the next decade. In a far-reaching detailed 2008 report, the OECD is highly critical of Ottawa and Alberta's wasteful use of unprecedented resource revenues. It recommends that Ottawa use its resource windfall to lower interest rates and stimulate the economy (Scofield, 2008). So far Canada has spurned the idea of a fundamental course correction.

In the last four decades, higher growth in export-led industrial sectors has meant that Canadian employers in core sectors pay on average 25 percent more than the rest of the economy. Manufacturing accounts for over half of private spending in research and development in Canada. But manufacturing employment has precipitously declined from 17 percent of total employment in 2000 to just 10 percent in 2007. Labor's share of national income has fallen from 15 percent in 2000 to under 10 percent in 2007. Corporate profits have never been higher since they bottomed up in the 2001 recession and with the crisis have plummeted in many sectors.

If the present vertically downward trajectory continues, the hollowing out of manufacturing in Ontario and Quebec is a massive price to pay even if resource Canada is booming. Canada's share of technology-intensive industries –auto production, aerospace, advanced economic software and other high value-added industries– is much smaller than a decade ago and this has left its factory economy structurally and competitively weakened. Most of all, the transfer of power to the resource giants and the financial sector is troubling and problematic. Canadians have yet to absorb the fact that Ontario's economic performance and the weakening of its industries have pushed it into the status of a have-not province eligible for equalization payments.

Political economists like Janine Brodie argue that economies are increasingly undergoing rebordering and in the process are denationalized, a conceptual notion to explain the importance of the local and regional in the national economy and the growing role of the citizen in the public sphere (Brodie, 2008). The incipient idea of broadening and deepening North America does not fit easily into this perspective. There is no firm consensus to push North America toward a hyper-model of integration along EU lines. Indeed to the contrary, there is not a lot of evidence that NAFTA has the capacity or coherence to force major changes on the foundational practices of the three NAFTA partners. Most significant is the fact that the House of

Commons Standing Committee on International Affairs and Trade concludes that "the North American project, whatever it turns out to be, is still to be defined" (Brodie, 2008: 450).

The tense balance between social and market Canada is always on the razor's edge of Canadian politics and values and will remain so. Rodrik and many others have challenged market-led strategies of wealth creation that play such a large role in Canada's Northern model on the grounds that they rely on mechanistic thinking about global competitiveness and on the mistaken belief that the social costs of adjustment can be handled by markets without strong government regulation (Rodrik, 2007). Their core idea is that there is no one-size-fits-all policy template. Canadian policy experts may take comfort in the fact that institutional divergence is the policy phenomenon of our time and has many consequences if used to advantage. What options are there for the taking?

#### THE NORTHERN MODEL'S KEY LESSONS LEARNED

It is remarkable that despite the enviable growth record that Canada has acquired among the G-7 nations, there is little national discussion about the best practices that Canadian industry and labor need to adopt. Nor is there any indication of a new consensus for a systematic institutional reframing of public management policy and regional development in ways that would strengthen Canada's capacity for innovation and tap the organizational creativity of a mixed-goods economy (Marsh, 2008). Canadian public policy has not turned this corner and invested in the very large contribution knowledge regimes contribute to wealth-functioning market economies.

Still, for Canadian families and individuals, brand Canada's system of mixed-goods transfers constitutes a major reality in their lives. The blending of use value with exchange value for goods that are publicly delivered and reliant on public regulation are a defining part of Canada's economic culture. Their strategic importance forces us to rethink the somewhat simplistic idea that public spending is the only litmus test of the public good. In an information age, social networks support new actors capable of initiating systemic change as information is devolved downwards (Drache, 2008). The dynamics of power have made publics both nervy and nervous, capable of putting new issues on the public policy agenda.

For these important reasons, Latin Americans with strong populist and collectivist traditions are not wrong to see similarities between their own resource-dominated economies, global commodities booms, the need for fiscal transparency, and democratic accountability. As globalization intensifies the movement of people, ideas,



and information, the Northern model remains an unfinished social project with its own complex dynamics and shortcomings for income redistribution.

Further, in many countries, experience teaches that powerful export strategies strengthen regional and national identities at the expense of a nationally integrated economy. Hence the symbolic and real role for sovereign wealth funds for a resource-rich Latin America and many other countries struggling to put in place effective royalty regimes. The most difficult issue is to use these new instruments not only for macro-stabilization ends but to eradicate poverty and rebuild two decades of public infrastructure neglect.<sup>11</sup>

The decline in public support for more privatization and unregulated labor markets has done more to shatter the illusion that Canadians and Americans are destined to row together toward a common goal and set of understandings. The rebalancing of deep integration with democratic politics becomes part of the strategy to address the cost and benefits from growing economic integration.

Canadians have become over time skeptical of top-down, universal solutions giving markets a free rein. The economics of reform requires coming to terms with the fact that Canada's energy sector can no longer maintain its frenetic pace indefinitely. Energy spiked at close to US\$150 a barrel in the summer of 2008 and has retreated to the US\$50 range since then. The new price of under US\$50 a barrel may well become the operative benchmark in the aftermath of the crash of global neoliberalism in September 2008 and the US\$2 trillion rescue package assembled by the leading banks of the world. (By July 2009, it is reported that the global fiscal rescue package has soured to US\$70 trillion for the Eurozone, the United States and Japan.) In a globalized world where interdependence has become the gold standard of economic theory, countries in the hemisphere are trying to strengthen their long-term economic performance. They are trying to nail down the elusive balance between trade openness, inflation targeting, exchange rate volatility, and the need for effective institutional reform. Smart public policy advocacy suggests that after a long and intense period of globalization with the dislocating effects of intense supply-chain management, countries are forced to find ways to strengthen domestic institutions and enhance democratic participation.

Indeed, the primary lesson that our story underlines is that brand Canada is a highly unstable variety of capitalism. Canada, with 33 million inhabitants, belongs

<sup>11</sup> The bitter legacy of neoliberalism particularly for Mexico, Brazil, Argentina, is that the state's capacity to be an effective actor has been weakened further. To make a dent in a culture of indifference, government needs to reform its tax capacity so that jurisdictions can equalize opportunity for the bottom millions and pursue strongly focused developmental strategies. Governments starved for revenue have only the minimum to spend on reinforcing social cohesion.

to an elite group of nations with large surpluses, record levels of job creation in the energy and information economy, an expanding public sector with significant job hires, record low inflation and a tax system that anti-poverty activists concede prevents two million low income families from falling into poverty. This mix of social values, public goods, and high-value exports has helped maintain the precarious balance between neoliberal market Canada and the redistributive impulse of social Canada. Canadians themselves are not sure of its best practices, and while a coordinated market economy model is preferable to one driven by short-term profits, there is no strategic vision of where the Canadian economy should be a decade from now. Canada with an embarrassment of riches may well become "a reserve for tourism" with only a memory of global industries, to repeat Sarkozy's acerbic words. With the world's financial system in turmoil, the need to become psychologically attuned to thinking in collective terms is ever more pressing, and national economic strategies have acquired newfound credibility and consequence.

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