The Chimera of Industrial Policy: Yesterday, Today and Tomorrow

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Recessions have a habit of heating up the industrial policy debate in the United States and Canada. The misery of unemployment and plant closures, the threats of trade deficits and disappearing industries, and the apparent inability of governments to effect instant cures act like clarion calls to the gurus of government planning. Much of their advice reminds me of a fascinating book about medicine I read recently. It divides the history of medicine into three phases.¹

The first, or primitive phase, lasting well into the nineteenth century and in some societies even into the twentieth century, can be summed up as a direct contradiction of the Hippocratic Oath: doctors did more harm than good. Because there was no scientific basis for understanding the functions of the human body and the causes and course of disease, medicine was a hit and miss proposition. People accepted disease as an ordinary part of life and saw doctors at their peril. With pure luck, however, the prescribed treatment sometimes worked and, as a result, medicine men were not wholly dismissed for the quacks they were.

During the second stage, starting in England in the mid-nineteenth century and gradually spreading from there, medicine was placed on a more scientific basis. With advances in research, doctors began to understand the inner workings of the human body and, as a result, to diagnose and treat disease. In most instances, however, the drugs available to doctors could do little more than help relieve some pain and suffering and could effect a cure in only a very small number of cases. On the other hand, the use of antiseptics made it increasingly possible for patients to survive surgery. These advances added immeasurably to the prestige of the medical profession and elevated the social status of doctors to that of clergymen and lawyers. Doctors were no longer doing harm and sometimes they were doing good.

It is only in the last fifty years that medicine has made such progress that doctors can not only diagnose what ails a patient, but can

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also, in most cases, actually effect a cure. The wonder drugs first introduced during the second world war provided doctors with an arsenal of weapons capable of wiping out some diseases and curing patients suffering from others. Surgery and related techniques became finely tuned instruments to effect miracle cures. As a result, the ratio of harm to good gradually reversed itself. We now appear to be at the threshold of a new stage and we can reasonably expect preventive measures to wipe out even more diseases, enabling people to live longer, more productive lives.

Without belaboring the similarities, I think some interesting parallels can be drawn here between the history of medicine and the state of industrial policy today. To put it bluntly, I think industrial policy has reached the stage that medicine had reached about a hundred and fifty years ago. While it may not be impossible to devise welfare-enhancing, industry-specific policy prescriptions that would nurture the development of particular industries in a country, the majority of practitioners still do more harm than good. Like the doctors of that earlier era, the current gurus of industrial policy are prepared to make extravagant claims about the wonderful nostrums in their bags but wisely clear out before the patient discovers he has been had. Although I have my doubts, I will not dismiss the possibility that perhaps with sufficient research, information and analysis, we can reach the second stage in the foreseeable future and be able to use a few targeted, industry-specific policy measures to add to economic welfare. Any hope of finding precisely targeted policy measures that will work ninety-nine times out of a hundred, however, is still a long way off.

Despite my misgivings about the claims of the industrial policy gurus, I will admit that the ongoing academic debate is exciting and could lead to important new insights. The decade of the 1980s and the opening years of the 1990s have proven remarkably fecund in giving birth to new ideas and theories about economic growth, trade, industrial organization and the role of technology. We are also beginning to see the fruits of multi-disciplinary synthesis of all this work. One of the burdens of academic over-specialization is that one group of experts does not sufficiently appreciate the insights of another. Collaborative efforts are overcoming this problem by, for example, combining the insights of trade and industrial organization specialists. But just as in medicine, there is a long lag between exciting discoveries in the laboratory of models and theories and their application on a day-to-day basis as policy. The insights of strategic trade policy may be critical in providing us with a more satisfactory basis for explaining economic growth.

An excellent introduction to some of the new ideas as well as a good example of the fruits of collaborative effort is the preliminary outline by Richard Lipsey of his ongoing work on economic growth and policy. Richard Lipsey, Economic Growth: Science and Technology and Institutional Change in a Global Economy, CAN. INST. ADVCD. RES. 4 (1991).
and the dynamic effects of trade. Its application to current U.S. or Canadian trade problems, however, still holds more potential for harm than good.

With my bias thus clearly exposed, I welcome this opportunity to discuss the characteristics of industrial policy, its intellectual foundations and its belief system in order to illustrate why the world should be cautious about putting too much faith in its claims. I will suggest that, even with all its flaws, a market-based approach to economic development is less likely to do harm than an industrial policy approach.

**INDUSTRIAL POLICY: WHAT IT IS AND WHAT IT IS NOT**

Industrial policy can be a slippery concept to define. Indeed, a large part of the debate about the desirability of industrial policy is a definitional one. For a start, it is undeniable that the governments of advanced industrial countries have a range of policies and programs in place aimed at promoting the development and maintenance of industry in general, as well as particular industries, within their territories. In Canada, both the federal and provincial governments provide an alphabet soup of such policies and programs. The tariff, for example, has for many years been a favorite instrument of industrial policy and the tariff structure of most countries illustrates which industries were favored at one time or another. Similarly, most governments have learned how to use grants and subsidies, government procurement, discriminatory product standards, limited access to technology and other forms of state intervention to favor various industries. Canada first established a Department of Industry in 1963 and while it has gone through many name and institutional changes over the past thirty years, Ottawa continues to be blessed with a phalanx of programs, boards, agencies and officials dedicated to the promotion of particular industries and economic activities. 4

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3 Strategic trade policy is the work of a group of academic economists exploring the theoretical possibilities of using government policies, such as subsidies, quotas and tariffs, to shift the gains from trade from one nation to another. In effect, it is a leading branch of modern industrial policy analysis. See Strategic Trade Policy and the New International Economics (Paul Krugman ed., MIT Press 1987); Richard G. Lipsey & Wendy Dobson, C.D. Howe Inst., Shaping Comparative Advantage (1987). The arrival in Washington of Laura D’Andrea Tyson as President Clinton’s chief economist has added new impetus to calls for managed trade. As one of the most sophisticated advocates of strategic trade policy, her most recent book, Laura D’Andrea Tyson, Who’s Bashing Whom? Trade Conflict in High-Technology Industries (1992) has become must reading for both proponents and critics of strategic trade policy.

4 The extent of such programs was well illustrated by the mine of information collected in Canada by the Neilsen Task Force in 1984-85. See, e.g., Services and Subsidies to Business: Giving with Both Hands, March 4, 1984; Natural Resources Program: From Crisis to Opportunity, Sept. 1985; and Agriculture, Feb. 1985. Study Team Reports to the Task Force on Program Review (Supply and Services, 1986). On a similar note, Pietro Nivola writes: “The scope of U.S. industrial policy, past and present, is often underestimated. . . . The commitment of
Despite the widespread use and long-standing existence of such programs in Canada, the United States and elsewhere, advocates of industrial policy insist that neither Canada nor the United States has an industrial policy or strategy. In most cases this criticism amounts merely to a complaint that the specific programs the critic favors are lacking or under funded. In other cases, the criticism is leveled that the mere existence of a range of policies and programs does not constitute a strategy. The missing element is an integrative plan that brings the various programs and policies together into a coherent national strategy which allows business, labor and government to work together toward a common purpose. In the United States and Canada, industrial strategy advocates often assert that Japan and Germany have such an integrated, coherent approach.

Putting aside whether Germany and Japan pursue such an approach, I would submit that both the Canadian and U.S. federal governments, as well as the state and provincial governments, do in fact put forth an annual statement of their industrial strategy and have done so for years. It is called the budget. Questions can be raised, of course, about the degree of coherence evident in North American budget statements and about the extent to which such statements represent an integrated view of economic or industrial development or provide a satisfactory basis for a coordinated approach by industry, labor and government. As a matter of record, however, they do represent the considered view of the political authorities of the moment and often reflect significant effort by industry and labor to ensure that their interests are advanced or protected. In effect, the budget, in spelling out in some detail what the government intends — or hopes — to do about raising and spending money, amounts to a veritable blueprint or strategy for the economy.5

Industrial strategy advocates find this characterization of the budget to be annoying. What they have in mind, they insist, is something else. They want an industrial strategy that spells out those industries which the government believes will, or should, prosper and, therefore, will support and those which the government will not support. This criticism, however, is also not well founded. In fact, budgets do spell out exactly what the government intends regarding industrial de-

resources has been large and enduring.” See More Like Them? The Political Feasibility of Strategic Trade Policy, BROOKINGS REVIEW, Spring 1991, at 14-15.

5 In 1981, for example, the Canadian Liberal government’s budget for that year set out in some detail a national industrial strategy based on mega-projects, regional development, and other interventionist schemes. See ECONOMIC DEVELOPMENT FOR CANADA IN THE 1980s (Supply and Services, 1981). Fewer than four years later, the new Conservative government set out its strategy in A New Direction for Canada, an economic statement published in the form of a mini-budget on November 8, 1984. It posited a different, less interventionist national economic strategy, one that the Conservative government stuck to with considerable commitment in the ensuing nine years.

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development. If these intentions are not always coherent and clear, the blame lies in the political need to satisfy many interests rather than in government’s unwillingness to plan with greater precision.

Industrial strategists, of course, contend that a properly constituted plan favors industries with a future and allows industries without them to gradually wither away. Such a plan has a certain surface appeal. But this kind of rational planning inevitably falls victim to the reality of the political process. Every industry claims to be a winner; no one will admit to being a loser. The result is that support often goes to those with the loudest voices and the most insistent political claims rather than to those with the most compelling economic arguments. As Sylvia Ostry has suggested, in a pluralist democratic society it is not impossible for governments to pick winners; it is just more likely that losers will pick the government. To paraphrase Winston Churchill, both democracy and the market present no shortage of problems; combining the two seems at times to accentuate their shortcomings. Their saving grace, however, is that all other forms of political and economic organization offer even greater problems. For my money, the problems of both are more easily ameliorated than the much greater horrors that flow from central planning and authoritarianism. The freedoms guaranteed by the one and the wealth generated by the other provide a setting that promotes the solution of more human problems than any other combination.

The quarrel between those who advocate more industrial policy and those who take a skeptical view, therefore, tends to be more a question of emphasis and degree than of specific programs. Industrial policy advocates believe in a large role for government, i.e., political planning, or what Deepak Lal calls the dirigiste paradigm. Critics of industrial policy assign a larger role to the market and are more comfortable if political direction of the economy is limited to macro programs and policies. They see a role for government but prefer that political decisions be constrained by international and domestic laws of general application. These are more matters of taste, however, spiced by experience, than of dispassionate scientific analysis.

While analysis of this market-planning divide is often couched in terms of capitalism versus socialism, I think it would be more accurate to acknowledge from the start that all governments in industrialized countries engage in a significant amount of economic planning, regulat-

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* Some advocates of industrial policy are prepared to acknowledge this problem. See, for example, Kevin Phillips, *U.S. Industrial Policy: Inevitable and Ineffective*, HARV. BUS. REV., July-Aug. 1992 at 104-112. While Phillips would like to see a more interventionist approach, he recognizes that industrial policies may do more harm than good in the U.S. political setting.


ing and intervening and have done so for most of the twentieth century. The urge to plan is not limited to socialism. It is more widespread. It is heir to the planning ideology ushered in during the first world war and perfected during the second world war. In response to the requirements of war, both government and industry were organized along military lines capable of prosecuting and supplying the war effort. The success of wartime government raised expectations in peace time. Governments — both politicians and officials — were expected to do things to solve problems.⁹

The marriage of this planning ideology to the progressive agenda of the early twentieth century eventually gave rise to a strong bias in North America in favor of activist governments determined to solve the problems that flowed from industrialization, urbanization and mechanization.¹⁰ Large bureaucracies were created to design and deliver an increasing array of social and economic programs and to administer regulations aimed at curbing the excesses of the market and promote a more equitable distribution of its benefits. Each new program, policy, and regulation increased expectations and stakeholders as well as bureaucracies with mandates to control and direct some economic activity. As a result, there is now a widely held view, found not only within bureaucracies and among their political masters but more widely throughout society, that if there is a problem, governments are a necessary part of the solution.¹¹ Even the staunchest capitalist does not hesi-

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⁹ Jan Tumlir, *Evolution of the Concept of International Economic Order 1914-1980*, *Changing Perceptions of Economic Policy* (Frances Cairncross, ed., 1981). This planning ideology became so pervasive in the 1950s and 1960s that it also became the hallmark of big-firm capitalism in the United States. As firms expanded and merged into conglomerates, they did so in part to take advantage of the benefits of planning on a large scale. John Kenneth Galbraith celebrated the triumph of industrial planning in his *The New Industrial State* (1967) and concluded that it would marginalize individual entrepreneurship and the small firm. He argued that the planning required for modern large-scale production could only be accomplished within large firms. Within a generation, however, entrepreneurship and the small firm proved to be the most dynamic element in the North American economy as the deficiencies of the planning ideology became increasingly clear. Conglomerates proved to be the dinosaurs of the late twentieth century. Firms with a future were shedding non-essential divisions, buying from outside suppliers and concentrating on what they knew best. The planning burden proved to be too much; the new value had become flexibility. See John B. Case, *From the Ground Up: The Resurgence of American Entrepreneurship* (1992).

¹⁰ It is often alleged that Canadians are suspicious of the market and look to government for solutions while Americans are suspicious of government and look to the market for solutions. Americans may have a different attitude to the role of government than Canadians, but in both countries governments have become deeply involved in the economy.

¹¹ The extent to which this planning ideology has become deeply ingrained in our consciousness is well captured by Robert Samuelson: "The modern welfare state ... touches all of us, providing us with benefits of various types and claiming a huge part of our incomes. It creates a vast web of dependency on government that is the ultimate source of huge budget deficits ... Paradoxically, government's very generosity helps make it unpopular. Government does so much for so many that anyone can find something that seems wrong or unneeded. ... The irony is that
tate to visit Ottawa or Washington, Toronto or Sacramento, to seek help or relief if his firm is experiencing some problem such as too much foreign competition.

The impulse for governments to manage and fine-tune economic development is also grounded in the positivism of the social sciences. The urge of U.S. academics over the past hundred years to give scientific, mechanistic explanations for the functioning of national economies has led naturally to governments looking for the appropriate buttons to push to influence the direction and detail of economic development. Encouraged by journalistic probing, public expectations and academic conceit, governments now routinely claim that they are in fact managing the economy. The issue thus is not whether governments should be involved in determining appropriate economic conduct or in allocating scarce resources; that bridge was crossed many decades ago. The issues are how, to what extent and to what purpose.

**FINDING AN ANALYTICAL TAXONOMY**

Against this background, it is easy to appreciate why it is important that before discussion continues, we agree on an analytical taxonomy. I would suggest that we do so by dividing what governments do to influence the economy into three groups of policies: macro-economic policies; structural or framework economic policies; and sectoral or micro-economic policies.

First, macro-economic policy. No one today would deny that governments have an important and legitimate role to play in determining macro-economic policies. We rely on governments to print money; we expect them to tax us; and we know that they will spend money on a wide array of programs. From an industrial policy perspective, the aim of macro-economic policy is to provide a stable and reliable supply of money and to keep inflation and interest rates low. Given the increasing importance of international transactions in today’s economy, we not only expect money to retain its value at home in terms of relative price stability, but we also want our currency to retain its value abroad. There are a variety of techniques governments can use to achieve these objectives which need not detain us in this discussion. While there may

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be debate about relative priorities, there are few who would suggest that modern governments get out of this business and let the market be the sole determinant of macro-economic targets.\textsuperscript{14}

Second, governments maintain a range of framework policies that affect the basic structure and functioning of the economy. In market-based economies, many of these structural policies are aimed at providing a framework within which the market will operate, and the extent to which we rely on these policies suggests how silly it is to insist that any economy today operates on a pure market basis. Such policies address, for example, the maintenance of competition, corporate behavior, investment flows, consumer protection and the operation of labor markets.\textsuperscript{15} Again, the industrial policy debate may involve differing views about the design of such policies and the priority to be assigned to their enforcement, but not about whether governments should properly pursue such policies.

Third, we come to the broad range of micro or sector-specific policies that governments have introduced over the years, ranging from product-specific tariffs and quotas to a wide array of investment incentives and other inducements to private firms and individuals to pursue particular economic activities as well as direct involvement by governments in the production and distribution of specific goods and services. What distinguishes these programs is the high degree of product and industry-specific targeting involved and the amount of discretion that can be exercised by the political authorities.

Generally, such sectoral policies assume that there is intrinsic merit in ensuring that certain kinds of economic activity take place within national frontiers. Arguments along these lines have been advanced for more than two centuries in various guises. In the United States, Alexander Hamilton is generally considered to be the father of these views. He maintained that it was “in the interest of a community to encourage the growth of manufactures.” Government activism favoring producers — read tariffs and subsidies — would strengthen the country by making it more self-reliant and “by creating a higher

\textsuperscript{14} Dian Cohen and Guy Stanley, however, make the interesting suggestion that in today’s interdependent global economy, there is less that governments can usefully do about interest and exchange rates and more that they can harmfully do. They believe we could get rid of the annual pretense of Ministers of Finance trying to set fiscal and monetary targets. See DIAN COHEN & GUY STANLEY, NO SMALL CHANGE: SUCCESS IN CANADA’S NEW ECONOMY 152-153 (1993).

\textsuperscript{15} Competition or antitrust policy, for example, has long been an important tool used by governments to promote industrial structure, with the specific goals shifting in the light of changing fashions and circumstances. In Canada, for example, the traditional more relaxed approach to competition policy reflected the assessment that international competition encouraged by lowering trade barriers in many ways achieved the same objectives. More robust antitrust laws and their more vigorous enforcement in the United States from the 1890s through the 1970s reflected the fact of a large, relatively closed, continental economy.
probability of a favorable balance of trade.”

It is currently fashionable to insist on the merits of “high-tech” or “strategic” rather than “infant” industries and to find much to worry about in trade statistics that show a deficit in such sectors. From an industrial policy perspective, such activities must be promoted and protected by the political authorities because without political intervention, these activities might disappear or fail to materialize, victims of international trade and competition. Without these activities, national economies will not develop the strengths and advantages needed to survive in the tough world of international competition. From this perspective, comparative advantage, the theoretical basis for international trade, is regarded with some suspicion, either on the grounds of old-fashioned mercantilism or more sophisticated arguments based on new theories of international trade.

In addition to these three groups of policies, the industrial policy debate involves a fourth dimension. To achieve the objective of strong, nationally based strategic industries, labor and industry must cooperate with government in a national effort. Only on the basis of a coordinated, coherent plan actively pursued by all three groups can the economy produce national champions capable of besting the national champions of other nations. Only by besting the national champions of other countries, will a country be able to extract the rents from international trade that will pay for social and other programs and that will underwrite future prosperity.

The industrial policy debate thus involves four elements: what is an appropriate macro-economic stance for governments; how actively and to what purpose should governments deploy their structural policies; to what extent should governments pursue sectoral policies and to what extent can government, business and labor be made to work together to achieve an agreed set of goals. While a complete industrial strategy would require an integrated and highly structured approach to all three elements, industrial strategy advocates are content in most instances with boosting the weight given to the third and fourth elements, with more limited attention paid to ensuring that the first and second elements are supportive of the goals being pursued by means of industry-specific measures. Additionally, industrial strategy advocates tend

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17 The industry- or sector-specific dimension of industrial policy indicates the extent to which it has a strong elitist, anti-consumer and pro-producer bias. The pro-consumer dimension of antitrust enforcement, for example, rarely figures prominently in the policy mix promoted by industrial policy advocates. They are not content to let the purchasing decisions of consumers dictate which industries will succeed or fail; rather, such decisions are best left to more informed planners who will determine which products have the intrinsic merit that warrants government support. The record, even in Japan, with its fabled success in industrial planning, gives little comfort to this
to place the greatest weight on the need to promote manufacturing, particularly the manufacturing of technology-intensive products. In effect, they would like industrial policy to do for the manufacturing sector what agricultural policy has done for the agricultural sector. It would tie government support to the production of particular products by particular firms. It would pursue trade and industry-specific policies aimed more at achieving specific, numeric results than at promoting broader, less specific opportunities.\footnote{The contrast between these two approaches is well set out in \textit{Gary Clyde Hufbauer, The Free Trade Debate: Reports of the Twentieth Century Task Force on the Future of American Trade Policy} (1989). Clyde V. Prestowitz, Jr. et al., \textit{The Last Gasp of GATTism}, \textit{Harv. Bus. Rev.}, March-April 1991, at 130-138, provides a provocative view of how industrial policy advocates would approach trade policy.}


Fascination with industrial policy in the 1990s flows not only from age-old mercantilism or new forms of protectionism, but also from fear of the unknown. Industrial policy advocates prefer the warm shelter of managed trade to the cold wind of open trade, equality of result to equality of opportunity. Fear of the unknown is particularly strong today because of the tremendous changes flowing from the transformation of interdependent national industrial economies into a much more integrated global knowledge economy.

Developments in information processing, communications technology and transportation facilities have erased borders and shrunk distances leading to fundamental changes in business organization and techniques. The term globalization has been used to capture the international dimensions of this transformation. It involves the rapid and pervasive diffusion around the globe of production, consumption and investment of goods, services and capital. Concurrently, we are seeing the development of what has been called a new economy, based on revolutionary changes in the technology and organization of production and leading to the virtual disappearance of some industries, the rise of approach. Neither Sony nor Toyota, arguably among the most successful firms in the world today, pouring out products with some of the highest levels of consumer satisfaction, was favored by the planners at the Ministry of International Trade and Industry. See, e.g., \textit{Akio Morita, Made in Japan: Akio Morita and Sony} (1986).}
brand new ones and radical changes in employment patterns.\textsuperscript{20}

The changing nature of international commerce and the international trade regime illustrates the extent of the changes taking place and the adjustment pressures these changes are generating. Forty-five years ago, when the basic framework of international trade and economic rules was negotiated, trade in goods was the main vehicle of economic integration. In 1950, for example, the total volume of world trade represented about ten percent of world production. The bulk of this trade consisted of raw materials; most of the rest was made up of finished products; very little trade involved parts and components. Most trade involved transactions between unrelated private parties organized as nationally identifiable companies. The main barriers to trade were government measures imposed at the border (tariffs and quotas) or differential treatment in taxation and regulatory requirements (e.g., commodity taxes and mixing requirements). Relatively high tariffs helped to maintain nationally segmented markets for manufactured products. Exchange rates were fixed, and maintaining a positive current account position was an important goal of government policy.

In the 1950s, most international economic activity was undertaken by large, nationally organized firms. Companies designed, engineered, manufactured, marketed and serviced a range of related products largely within the confines of the firm. Individual firms were hierarchically organized and many employees stayed with a firm for their full working lives. Employees felt themselves to be part of their company and companies felt themselves to be part of a national economy. Most firms — and their products — had a clearly identifiable national origin and foreign investment which generally involved the establishment of miniature replicas of such firms. Foreign direct investment, however, represented only a small proportion of global economic activity.

Government policy — domestic and international — reflected these facts of economic life. The GATT, for example, negotiated in 1947-48, assumes trade among national economies pursued by private entrepreneurs working largely within the confines of national borders. The GATT regards conflicts that may arise between firms in one country and firms in another as involving national interests that can be resolved through intergovernmental consultation. As negotiated in 1947,
it conceded the regulation of domestic economic life — competition policy, for example, or farm income stability — to be largely within the purview of national governments as long as such regulation did not involve overt discrimination between domestic and foreign products except as provided by the GATT-sanctioned border regime.

Business and government attitudes to international trade also reflected the prevailing economic theory that international trade flowed from comparative advantage, a relatively static condition based on national endowments of the principal factors of production: resources, capital, and labor. The trade regime, for example, was based on the concept that government policies that distorted the most efficient allocation of these factors of production were likely to lower national and global welfare while the removal of such barriers was likely to raise them. Similarly, trade and investment were considered to be alternative ways of pursuing comparative advantage; the establishment of a foreign branch-plant was thought to replace production in the home country that would otherwise have been exported to the foreign market.21

Few of these policy-defining assumptions and characteristics are valid today. The liberalization of trade, for example, did not lead to greater inter-sectoral specialization at the national level; rather, we have seen tremendous growth in intra-sectoral trade as countries have exchanged cars for cars and steel for steel leading to much higher levels of international competition in domestic markets than anyone would have anticipated in the 1940s and 1950s. Trade in goods, while it has grown twice as fast as production and now constitutes about twenty percent of world production, is now less important than international investment and capital flows and exchanges of knowledge and technology as instruments of international economic integration. The value of world trade in goods — in real terms about five times larger than its value in 1950 — is now but a fraction of the annual value of capital movements. Fully a fifth of the value of world trade now consists of services, and a further proportion involves services imbedded in goods.

Billions of dollars of capital now flow around the world at the touch of a button. Most major currencies float freely and their values are adjusted constantly and instantaneously. Capital markets operate

21 While the GATT regime may have reflected these concepts, it was not built on them. Paul Krugman in *Does the New Trade Theory Require a New Trade Policy?*, 15-4 THE WORLD ECONOMY, 423-441 July, 1992, convincingly demonstrates that the GATT system is based on an enlightened mercantilism that posits that countries have an individual incentive to be protectionist but can collectively benefit from rule-based free trade. "GATT-think," while popular with officials and politicians, makes little economic sense. Perversely, however, it can lead to economically sensible policy. GATT negotiations have successfully harnessed the producer biases of most national trade policies into a set of rules that lead generally to freer trade. The process of getting there has been described by Martin Wolf as mercantilist bargaining. See Martin Wolf, *A European Perspective, in Brookings Inst. Perspectives on a U.S.-Canadian Free Trade Agreement* (Robert M. Stern et al. eds., 1987).
twenty-four hours a day. Currency markets track minute changes in relative values looking for quick profits. The cost of debt capital is now relatively uniform around the globe, taking into account inflation and exchange rates. The necessary institutions and skills organized to make this fluid, global capital market work are hastening the further globalization of the economy.  

The last decade has seen the devastation or reorganization of traditional industries such as steel, automotive and shipbuilding and the rise of new industries such as micro-electronics, computer software and biotechnology. Global corporations and networks involving local and regional firms now rely on a much more fragmented and decentralized approach to design, engineering, production, marketing and service. They are organized much more horizontally than their counterparts from an earlier era and they make much greater use of expertise and resources outside the firm. They use strategic alliances such as joint production, R&D and other ventures, licensing arrangements, contracting out and brokering among global corporations and networks as basic techniques in organizing their activities. As a result, there has been a tremendous growth in intra-corporate and intra-sectoral trade and in parts and components as well as an increasing reliance on activities taking place far from corporate headquarters or ultimate markets.

New forms of specialization have resulted in the development of strategic links between global corporations and local suppliers and distributors on a global basis. The stability in corporate organizations and relationships that was an integral part of economic life in the 1950s and 1960s has been replaced by a new premium on fluidity and flexibility. Employees no longer experience the same symbiotic relationship with the firm, and firms no longer feel any special attachment to political entities. With the reduction and even elimination of traditional border-based barriers to trade, political frontiers now bear little relationship to economic frontiers.

Prevailing theories about economic growth and international exchange have also become much more sophisticated and varied and have robbed governments of the moral and intellectual certitude that characterized the trade regime of the 1950s and 1960s. New ideas about dynamic comparative advantage, the international division of labor, the complementarity of international trade and investment, the role of technology, the importance of trade in services, the management and organization of production, as well as the role of government policies have challenged the conventional theoretical foundations of trade policy and made governments less certain about the direction of future domes-

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tic and international policies and arrangements. 23

THE LATEST FASHIONS: DECLINISM AND ECONOMIC NATIONALISM

Fear of the unknown and frustration with the growing impotence of national governments to address national problems in this new global economy have given the industrial policy debate a new urgency as well as an ardent nationalist and xenophobic flavor. In Canada industrial policy is the brew of choice for those strongly committed to increasing Canadian economic independence. In the United States, it has strong roots among declinists worried about the United States losing its pre-eminence as the world's leading political and economic power.

The association between industrial policy and economic nationalism has a long track record in Canada. As early as the mid-1950s, Canadian economic nationalists worried about the excessive influence of the United States on the Canadian economy. They advocated the more rigorous pursuit of made-in-Canada policies aimed at differentiating the Canadian economy from that of its neighbor, boosting Canadian ownership of industry and promoting invented-in-Canada technologies. In response, Canadian governments, federal and provincial, have traditionally been prepared to adopt a range of interventionist policies to meet this objective. Regional development, investment, transportation, industrial development and other economic policies have all sought to knit the country together along east-west lines and create a bulwark against the natural north-south pull of geography. The fact that such policies have done little to arrest either the process of globalization and modernization or the continentalization of the economy has only added fuel to nationalist frustration and to the assertion that Canadian governments have not been sufficiently bold and aggressive in their pursuit of a distinctive and independent Canadian economic identity. 24

With the rapid globalization of the economy over the past two decades, U.S. economic nationalists now appear to have been bitten by the same bug. Like their Canadian counterparts, they rue the loss of economic independence, the increasing influence of foreign investors and the growth in imports at the expense of domestic products. 25 Simi-

23 For a discussion of changing theories to explain international trade and their application to trade policy, see Krugman, supra note 21. Also helpful are many of the chapters in TECHNOLOGY AND NATIONAL COMPETITIVENESS: OLIGOPOLY, TECHNOLOGICAL INNOVATION AND INTERNATIONAL COMPETITION (Jorge Niosi, ed., 1991).


larly, their prescriptions are rooted in a pessimistic assessment of the ability of the U.S. private sector to compete in the tough new global economy. Convinced that other governments play a much more active role in shaping economic destiny, they insist that the United States must adopt similar policies. As in Canada, however, U.S. economic nationalists are seeking to address phenomena that suggest less a matter of economic decline and more a matter of rapid economic and social change flowing from globalization and transformation in the technology and organization of production. It is not the lack of certain policies that is drawing the globe together economically, but the inexorable pull of geography and technology.

As numerous studies have shown, the 1980s marked less an absolute decline in the U.S. economy than a decline in its relative position as other OECD economies closed the gap between them and the United States. The huge disparities created by the devastation of the second world war created an unnatural illusion in the United States that it would be possible to maintain such a lead for ever, despite the fact that U.S. trade and foreign policy consciously sought to close this rift as part of its approach to the challenge of the cold war. The narrowing of the gap has meant two things: U.S.-based firms are running into much tougher competition in foreign markets and foreign-based firms are making inroads into the U.S. market. In short, the current U.S. trade position does not accord with U.S. psychological expectations. Those expectations, however, are not based on reality.

It is little appreciated that until the late 1970s, i.e., during the heyday of U.S. global economic leadership, trade played a minuscule role in the U.S. economy. For most of that period, exports constituted less than five percent of U.S. GDP and imports less than five percent of domestic consumption. Inward foreign direct investment ("FDI") was even less significant, not approaching two percent until the early 1980s and only passing four percent at the end of the decade, after a period of unprecedented growth. Most Americans, therefore, grew up at a time when the U.S. economy was relatively self-contained and little touched by foreign competition. Trade policy was more a matter of geo-politics than of domestic politics.


26 See GLICKMAN & WOODWARD, supra note 25.
When foreign goods did begin to make inroads, the response was defensive and protectionist. In the 1950s and 1960s, complaints from import-competing sectors like textiles and clothing were rewarded with various kinds of special protection. In the 1970s and 1980s, as the number of import-competing sectors proliferated, the trade remedy system was strengthened and enlarged to counter what was perceived as the "unfair" advantages enjoyed by foreigners. Aggressive unilateralism — section 301 — sought to address "unfair" barriers to foreign markets. The inability of these measures to stem the flood of imports, reduce the chronic trade deficit and check the rising tide of FDI sucked in by rising demand and burgeoning budget deficits thus gave rise to worries about the "decline" of the U.S. economy. For many Americans, the effect of globalization has been nothing less than the rape of U.S. economic leadership by unfair and unscrupulous foreigners.

The validity of U.S. declinism thus depends to a large extent on Japan and Europe bashing. For some, there is an a priori suspicion that Japanese and European technological and manufacturing prowess could not have been achieved on the merits; for others, no matter how it was done, it denotes something seriously wrong in the United States. For some, not being number one — by a wide margin no less — means accepting that doing things differently in other countries is neither cause for concern nor for penalties. It suggests that there may be some validity to the claims of foreigners that different circumstances give rise to different policies, priorities and values. For others, not being number one can only be explained by the perfidy of others and must be addressed by stern measures. Still others assume that only by adopt-


28 In the United States, Japan bashing has become a major and much admired blood sport. CLYDE PRESTOWITZ, TRADING PLACES: HOW WE ARE GIVING OUR FUTURE TO JAPAN AND HOW TO RECLAIM IT (1989) provides a typical example. In Canada, there tend to be more Japan emulators than bashers because Canadian economic nationalists would like to replicate Japanese policy in Canada and believe that the economic dominance of the United States and slavish attachment to U.S.-inspired policy and regimes block Canada's ability to adopt a made-in-Canada — but designed in Japan — industrial policy. The Canadian equivalent of Japan-bashers are U.S.-bashers, the latest example of which can be found in MEL HURTIG, THE BETRAYAL OF CANADA (1991).

29 There are differences between societies, and different social values do have an impact on economic performance. The U.S. penchant for litigation provides a case in point. The combined effect of product liability, health care and other forms of litigation presents a huge drag on the U.S. economy and on its competitiveness, but there is little chance that Congress will legislate limits to the right to litigate or the size of awards. The media have a wonderful time showing various victims as shining white knights taking on the rapacious, irresponsible corporation. But
ing the same policies as Japan and Germany can the United States hope to catch up. For Lester Thurow, for example, competition between nations is a zero-sum game: one nation’s gain is another nation’s loss. The purpose of policy is to ensure that there are more national winners than losers. The object of industrial policy, therefore, is to try to stack the deck in favor of national champions so that they will benefit and the champions of other nations will not. 30

Lost in the rhetoric is the simple fact that Germany and Japan and the other countries of Europe and East Asia have been catching up, benefiting greatly from U.S. trail-blazing and consequently able to avoid some of the mistakes made by the leader. Following a clearly marked path is always easier than blazing a new one. Having caught up, industrialists in all three areas of the global economy are learning to take advantage of the benefits of a more open global economy — in part due to U.S.-sponsored trade liberalization — as well as the technological forces accelerating globalization. As a result, firms in every corner of the globe now find their ability to grab and maintain a lead much more difficult. Rather than the playing field being tilted against the United States, the long-standing tilt in favor of U.S. firms has finally been overcome and U.S. firms must now learn that competition will be tougher in all markets, including their own. 31 The smart ones have learned to hedge their bets by building an ever expanding array of intercorporate alliances that spread the risk of innovation, investment and marketing around the globe among various participants. The result is a much more integrated and, to an increasing extent, denationalized global economy.

Greater competition on a global scale provides a direct challenge to established U.S. institutions and values — firms, governments and education — suggesting that there are perhaps other, even superior ways of doing things than the American way. For a country born out of a sense of mission that its approach is morally superior, this discovery is traumatic and gives declinism an emotional well-spring to tap. 32

30 See THUROW, supra note 20.

31 It might be good therapy for more American industrialists to reread J. J. Servan-Schreiber’s lament of only a generation ago. See J. J. SERVAN-SCHREIBER’S THE AMERICAN CHALLENGE (1968). Servan-Schreiber contended that the tilt was so sharp that it might prove impossible for others ever to catch up.

32 In Canada, U.S. declinism plays to a well developed sense of anxiety about Canadian identity and proximity to the United States and thus strengthens ever-present anti-Americanism as well as giving further impetus to the economic nationalist desire for autarky. The Canadian urge to identify with Europe or Asia, i.e., anything but the United States, is a delusion that tries to defy the facts of geography and history.
the heart of declinism, therefore, can be found U.S. preoccupation with its manifest destiny — a destiny that can only be validated by being number one. These emotional overtones have tended to obscure the weak intellectual and analytical underpinnings for much of the debate on the subject and made much of the literature difficult for non-Americans to appreciate. It has also given the industrial policy debate in the United States a respectability which experience elsewhere would suggest it does not deserve. Finally, it enhances the risk of U.S. policy makers missing the real problems and concentrating on solutions that are unlikely to have much prophylactic effect.

LESSONS FROM THE REAL WORLD: THE CANADIAN EXPERIENCE

There are real problems raised by the globalization of the economy and the increase in global competition. It means, for example, that low-skilled workers in OECD countries will need to compete with low-skilled workers in the third world on the basis of per-unit cost in the manufacture of standard-technology and other foot-loose production; the social implications of this development are profound. Similarly, it means that the rewards of innovation are less sure than in the past while the costs are higher and the consequences of failure more extreme. That uncertainty undermines the stability and predictability on which business thrives. Alliance building is reinforcing oligopolistic practices and undermining the capacity of national competition authorities to protect consumers and a competitive market. Adding industrial policy to this already difficult set of challenges is more likely to aggravate than alleviate problems. Rather than providing new and better economic opportunities, it is likely to increase inter-firm and inter-governmental conflict.

Such drawbacks might be acceptable if the payoff was clear. Unfortunately, that is not the case. Governments do not have a good track record of picking winners and losers, but losers have an excellent record of picking governments. When governments are committed to picking winners, the losers will show up and insist on their share; the real winners are too busy ensuring the success of the product they make or the service they provide. Industrial policy — or strategic trade policy — inevitably deteriorates into a game won by special interests at the expense of wider consumer or broader national interests. Peter Lilley, former UK Secretary of State for Trade and Industry, put it very well a few years ago: "... interventionist policies are based on the assumption that government has superior wisdom to that of managers and in-

vestors. The fact is that when governments have decided to pick winners they have unerringly chosen losers. . . . once governments start channeling funds to industry, little goes towards new industries, products or processes. The bulk inevitably goes into supporting old, dying industries. Not so much lame ducks as dead ducks." 34

Nevertheless, industrial policy gurus in the United States and Canada continue to insist that the examples of Japan, Germany, Sweden and elsewhere demonstrate that a coherent and integrated industrial strategy pays clear dividends. In fact, these appeals are based more on myth, fanciful reading of the facts and faulty reasoning than on hard evidence. For example, it is argued that Japan is a successful economy; Japan pursues industrial policies — embodied in the mystical powers of the Ministry of International Trade and Industry ("MITI"); Japan must be successful because of MITI. Actual case studies of successful Japanese firms and industries tell a different tale. They suggest that there are complex factors at play but that the influence of MITI and various industrial policies was more likely to have been negative than positive. 35

Evidence in Canada, where there have been many experiments in industrial planning and government intervention, tends to bear out the Japanese experience. In Canada, industrial policy has had three abiding goals:

- **regional development** — governments have tried to bring industry to regions where it does not make much economic sense but where there are compelling socio-political reasons to expand economic activity.
- **diversification of the economy** — governments have sought to broaden Canada’s economic base by starting industries where Canada has failed to demonstrate any comparative advantage.
- **research and development** — governments have sought to expand the native technological base in Canada in the belief that more active domestic research and development will help Canadian industry expand value-added activity.

Billions of dollars of provincial and federal tax dollars have been


35 The paper by S.Linn Williams in this volume provides a series of examples of both the myths and the realities of Japanese planning. The MIT study of the world car industry similarly demonstrated that the success of the Japanese firms was anything but the result of MITI or industrial policy. See James P. Womack, et al., The Machine That Changed the World (1990). Max Holland’s study of the machine tool industry, Max Holland, When the Machine Stopped: A Cautionary Tale from Industrial America (1989) provides overwhelming evidence of how U.S. policy and managerial ineptness led to the decline in the U.S. industry, and how private sector drive and initiative, rather than MITI, fueled the rise of the Japanese industry machine-tool industry. Michael Porter’s exhaustive study of national competitiveness, Michael Porter, The Competitive Advantage of Nations (1990), turned up very little evidence of policies that successfully targeted strategic industries, in Japan or anywhere else.
devoted to the pursuit of these goals; the results have been meager. The list of Canadian “winners” picked by federal and provincial governments over the years provides a chilling and depressing testimony to the benefits of industrial policy: While some ventures may have been technological successes and others have met the goal of generating local employment, few have been commercial successes. What is particularly depressing about so many of the Canadian examples is that not only have they not led to commercial successes, but many have not even met long-term employment or technological goals. They have at best met short-term political goals at very large expense to the taxpayer.\textsuperscript{56}

Although there may be some examples of Crown Corporations or other government-sponsored ventures in Canada working for a while, their problem is that when things go wrong, they are not allowed to bite the dust and fail. Rather, they are propped up and allowed to survive despite wretched management, a precipitous fall in demand, new competition, or other compelling reasons to admit defeat. Political judgment is allowed to crowd out board room judgment. Governments cannot accept failure, the way the market can, because there is always a political point to be proven. As a result, industrial policy usually translates into taxpayer-supported boondoggles. Unlike old soldiers, failed industrial policies rarely fade away. Just because past programs, policies, boards, agencies or crown corporations could not get the job done, new governments have not hesitated in insisting that new programs, policies, boards, agencies or crown corporations will do better. Meanwhile, failed programs and policies are not retired.\textsuperscript{57}

In addition to rarely meeting their goals, Canadian industrial and regional development policies have proven a favorite target for U.S. trade remedy actions, particularly countervailing duties. As a result, Canadian industry as a whole has had to learn to live with the uncertainty and expense of fighting an increasing number of such cases or with worrying about when the next case will affect them, their suppliers or their customers. Senior private sector executives and government officials have spent countless days fighting off U.S. trade remedy cases instead of spending their time on marketing or more productive new

\textsuperscript{56} Peter Foster, \textit{The New Meddlers}, CANADIAN BUSINESS, Jan. 1993, describes a long list of ventures supported by federal and provincial governments that have all, over time, become burdens to the tax payer, including:

<table>
<thead>
<tr>
<th>Venture</th>
<th>Name</th>
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<tbody>
<tr>
<td>Asbestos Corporation</td>
<td>Bricklin</td>
</tr>
<tr>
<td>CANDU</td>
<td>Churchill Forest Ind.</td>
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<tr>
<td>Come-by-Chance oil ref.</td>
<td>Consol. Computer</td>
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<tr>
<td>Glace Bay hvy-water plant</td>
<td>Matane Pulp and Paper</td>
</tr>
<tr>
<td>Novatel</td>
<td>Ontario Hydro</td>
</tr>
<tr>
<td>Suncor</td>
<td>Sprung greenhouses</td>
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\textsuperscript{57} The reports of the 1984-85 Neilsen Task Force, \textit{supra} note 4, provide eloquent testimony to the tenacious hold of old policies and programs; many remain on the books today.
Industrial planning in Canada and elsewhere has merely wasted taxpayers’ money and frittered away scarce managerial and other resources. Within a generally well functioning economy, much of this waste could be absorbed. The tragedy of industrial planning in developing countries runs much deeper. Not only have governments wasted scarce resources, but a long history of misguided planning has delayed and derailed economic development for years to come. The result has been untold human misery.

**WARNINGS FROM THE ACADEMY: THE DEBUNKING OF STRATEGIC TRADE POLICY**

Despite the dismal record of practical examples, the industrial policy debate has in recent years been given a shot in the arm from new theoretical insights into the dynamic effects of technology and production, the organization of production, international trade and investment, the role of learning curves, the nature of the firm, the function of industrial innovation and adaptation, the role of competition and government intervention and more. The theoretical work of trade economists, the insights of the business-historical school, the work of historians of science and technology and the contributions of experts in industrial organization have all enriched our understanding of how wealth is created in a market-based economy. Few theories and policies have been untouched by these new insights from the academy.

Among the more arresting results has been the development of theories of international trade which underpin what has become known as “strategic” trade policy. Theoretical work and models demonstrate that in a world of imperfect competition and oligopoly, it is possible to shift the benefits of international trade from one firm to another and from one nation to another by the judicious use of quotas, subsidies or tariffs without reducing overall global welfare. In other words, strategic trade policy provides a much improved theoretical basis for the ancient arguments favoring infant industry protection. By adding the twist of applying these insights to the protection of “strategic” rather than “infant” industries, the academic community has provided those interested in industrial policy with a powerful new rationale.

Based on the new theories, all kinds of sophisticated arguments can be developed to justify strategic policies. Europe’s Airbus presents

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40 For a discussion of some of these new ideas, see Lipsey, supra note 2.
a good case in point.\textsuperscript{41} The subsidies to the Airbus consortium were justified on the grounds that they:

- offset the past effect of U.S. military aid to Boeing and other U.S. aerospace firms.
- offset the prohibitive entry costs which were a barrier to the establishment of an industry with great technology and spin-off potential. It would induce establishment of a thriving aerospace industry as a center of excellence around which clusters of related industries could develop, benefiting from its R&D, its management and organizational learning curves and its supply requirements (products and services).
- offset the higher costs for aerospace customers flowing from Boeing’s near monopoly and the U.S.-based oligopoly of aerospace firms.

In the event, however, the Airbus experience suggested the extent of the flaws inherent in strategic policy. Instead of meeting the desired goals,

- it led to both industries — in Europe and in North America — requiring subsidies to survive. Not only did prime contractors need a constant infusion of government assistance, but so also did suppliers and others who were part of the production chain.
- strategic alliances within the industry diffused the nationally desired subsidy effect. The aerospace industry is increasingly a global industry. As a result, Airbus’ Asian and North American suppliers benefitted from the largesse supplied by European taxpayers while Boeing’s European and Asian suppliers benefitted from U.S. and Canadian taxpayer support — hardly the intended political effect.
- the oligopsonistic practices of aerospace customers offset the oligopolistic practices of the suppliers. Rather than being mutually reinforcing, they proved mutually offsetting.

The Airbus example suggests that important as these new insights were, their practical application left something to be desired. It thus did not take long for other academic commentators to demonstrate both the theoretical and practical limitations of strategic trade policy.\textsuperscript{42} For our purposes, it is the practical limitations that are of greatest interest. At least six such limitations can be identified:

- \textit{The imperfections of the political market} — No matter how well intentioned and planned, strategic policy in North America must inevitably meet the test of democratic politics. Political considerations mean that governments will adopt very broad definitions of what con-


stitutes a strategic sector or technology, including not only considera-
tions relating to the forward and backward linkages flowing from re-
search and development activity, the benefits of reserving access to
new technologies and the benefits of learning curves but also the polit-
ical rewards flowing from job creation and regional development, of
helping supporters and punishing critics. In the United States, for ex-
ample, President Clinton, who appears to be attracted to more strate-
gic planning, is rapidly learning the realities of Congressional log roll-
ing which require him to buy off various special interests in order to
achieve a pale reflection of what he wants. In effect, he is being forced
to abandon the high road of strategy for the low road of pork-barrel
politics.

- **The inadequacy of information** — Picking winners (firms, industries
and technologies) and choosing the right rent-shifting policy require a
vast amount of very up-to-date information. Even with computer re-
porting, few government agencies have the capacity to collect, collate
and analyze the necessary data. Additionally, in a period when tech-
nology is changing rapidly and being diffused at an ever faster pace, it
is hard to conceive of any one technology as being strategic in an
economic sense.

- **The ease of imitation** — Strategic policy measures will in most in-
stances prove largely self-defeating if everyone else adopts similar pol-
icies. Such policies only work if you can be the first and prevent
others from adopting comparable strategies. The world today is too
open and the flow of information too vast to prevent others from
adopting the same strategies. The net effect will be a downward spiral
of competitive tariffs, quotas, subsidies and other interventionist mea-
sures that will reduce the economic welfare of all nations rather than
increase it for one nation.

- **The facility with which governments** in one jurisdiction can impose
measures that will offset the intended effect of another government's
strategic trade or industrial policy measures — Much strategic trade/
industrial policy can be readily offset through dumping and counter-
vailing duty measures. The rapid diffusion of these procedures in the
1980s has made the successful deployment of industrial policy mea-
sures even less likely in the 1990s. As with the previous limitation, the
net effect of strategic trade and industrial policy measures will then
be a downward spiral of offsetting measures that will lead to a net loss
of welfare for all participants.

- **The ease with which private firms can evade or frustrate** the in-
tended political or economic effect of such measures — The growth in
international strategic alliances and networks tends to defeat so-called
nationally based strategic trade/technology/industrial policies be-

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44 See Soete, *supra* note 41, for a discussion of the difficulties inherent in reaching agreement on what constitutes a strategic industry or technology.

46 Id. at 62-64.

40 Id.
cause these networks diffuse the benefits more widely, the opposite of what is intended. Corporations tend to be more flexible than governments. In response, therefore, to nationalist industrial policy urges, global or multi-national firms are re-organizing into what Luc Soete calls multi-domestic firms. Global firms, masquerading as domestic firms, are able to take advantage of various strategic support measures offered by local, regional and national authorities. Indeed, local authorities do so knowingly because they want to benefit from the externalities provided by these firms — management skills, investment and technology. National policies that try to limit the benefits of strategic support to nationally based firms are thus defeated by local authorities as well as by the logic of the global economy.

- The fact that the frontiers of economic and political markets are no longer synonymous — Strategic trade or industrial policy seeks to give producers located within one political jurisdiction advantages over those located in all other jurisdictions. Increasingly, however, the organization of business ignores the inconvenient nature of political frontiers. Nationally based industrial policies try to deny the fact that the economy now operates at three levels: a global level, a regional level and a local level. What is missing is a national level. Policies, therefore, that address issues as if there is a national level are likely to fail and create problems rather than solve them. Ironically, the very development that has given rise to political pressures to practice strategic trade policy — the globalization of production and consumption — has also given rise to business practices that make its application very difficult. Only by tilting against the forces of globalization — and its benefits — would it be possible to return to circumstances that would make strategic trade policy somewhat more practical.

Given these practical limitations, advocates of strategic trade or industrial policies have outlined a series of heroic requirements that will overcome these flaws. The nature of these requirements, when stripped of their jargon and pretense, provides in themselves a chilling indictment of the deficiencies of industrial planning.

- to overcome the imperfections of the political market, it is necessary to introduce a high degree of central planning and government direction. The inevitable result is authoritarianism. Industrial planners like to cite the examples of East Asia as proof that planning works. They pay little attention, however, to the degree of political authoritarianism that accompanied this planning. The political freedoms North Americans take for granted are, to varying degrees, absent in Singapore, Korea, Taiwan and Hong Kong. Experience in these jurisdictions suggests that while it is not impossible for governments to play a constructive role, it is very difficult. Industrial policy, to the extent it has been tried, has a better track record in authoritarian than in democratic societies, in homogeneous or statist societies than in pluralist

47 Id. at 57-62.
societies that value individualism. 48
- to overcome the inadequacy of information, a high degree of regulation needs to be imposed on private firms, compelling them to gather and report high volumes of information, imposing a heavy cost on firms and undermining their competitiveness.
- to overcome the problems that arise from the ease of imitation and offsetting policies and measures, trade needs to be managed, i.e., governments need to enter into agreements about how much firms within their jurisdictions will produce and sell internationally. Given the complexities of the market, these agreements need constant adjustment, reinforcement and expansion to capture products and firms that supply the original targets. Industrial policy thus requires managed trade and rules about results rather than rules about behavior and equality of opportunity. They lead to fixed-outcome rather than fixed-rule regimes. 49
- to overcome the us/them problem, governments need to impose strict controls on trade in strategic products and flows of FDI and the use of strategic alliances and networks. Such policies are, however, ultimately self-defeating. Some of the policies pursued by the United States and the EC over the past decade or so have resulted in increases in oligopolistic rents for Japanese firms and increased MITI involvement in the management of trade and industry in Japan, the very thing U.S. and EC firms complain about.

The combined effect is to require a massive effort at developing national command/control economies linked on the basis of managed trade and investment agreements. The effect of such efforts would in the end prove self-defeating. Rather than promoting innovation and enhancing national wealth and prosperity, it would create a static world incapable of generating new wealth and encouraging innovation. It would not take long for a static economy to degenerate into a stagnant one.

Experience also suggests that strategic trade and industrial policy is a mug's game for big countries. It may be possible to identify short-term benefits that will accrue in a large economy, although these can be easily eroded on the basis of the factors identified above, but such policies are a disaster for smaller economies. If they adopt them, the result will be a less efficient, isolated economy; if others adopt them, it means they will be cut out of the loop. Smaller countries are rule takers, rather than rule makers. Strategic trade and industrial policy is

48 THUROW, supra note 20, for example, has developed an elaborate set of arguments demonstrating that East Asian and European "communitarian" capitalism is superior to Anglo-American "individualist" capitalism and that only by adopting the communitarian model will North Americans be able to compete head to head with Europeans and East Asians.
49 TYSON, supra note 3, sets out a sophisticated rationale for trade management. JAGDISH BHAGWATI, PROTECTIONISM (1990) and THE WORLD TRADING SYSTEM AT RISK (1991) provide a spirited presentation of the problems of managed trade.
thus a profoundly immoral, power-based game. Given the U.S. propensity for arguing at the normative level — viz the preoccupation with “fair” trade — there is nothing more immoral than power-based games that try to deny the benefits of specialization, trade and innovation to others. Ironically, the most ardent champions of industrial and strategic trade policy are often those with a progressive view on social and other distributional issues.

A ROLE FOR GOVERNMENT: THE ELEMENTS OF GOOD PUBLIC POLICY FOR THE ECONOMY

The emphasis in the above analysis may have given the impression that I do not believe there is a useful role for governments in promoting prosperity and competitiveness. Such is not the case. There is a positive and critical role for governments. But if we are to determine an appropriate role for government, we have to start by recognizing that we live in a democratic, pluralist, market-based economy and that industrial policy does not fit well into such a setting. Democracy and pluralism mean that governments must respond to a wide range of often competing requirements. The solutions lie in finding compromises and in letting the market play a determining role. The market is based on two mutually reinforcing factors — private ownership and competition. In a democratic, market-based economy, the role of government thus becomes one of defending private ownership, promoting competition and providing shelter for individuals — not firms — hurt by the competitive process. What can governments do to promote these goals? Four things come immediately to mind:

- First, governments should maintain a hospitable investment climate, an environment that encourages and rewards initiative and risk-taking. The ingredients for such a climate include a stable currency and

60 “The best industrial policy is to keep inflation low, real interest rates gently positive and exchange rates stable. Then people will save and business will be naturally far-sighted — ie, willing to take a chance on investments that might pay for themselves only after many years. . . . After this, the most promising industrial initiative is to invest in human capital: a well-educated labor force, able to acquire new skills and adapt to changing demands, is the most valuable asset an economy can have. And governments need to invest adequately in infrastructure (such as roads) . . . Macroeconomic stability, education and infrastructure are the elements of a boring industrial policy that would work.” Leader, ECONOMIST, June 8, 1991. Michael Porter sets out similar views in Michael Porter, The Competitive Advantage of Nations, HARV. BUS. REV., March-April 1990, at 73-93, which sets out in more succinct terms the themes developed in his book of the same title.

61 “Just as high savings and investment and high R&D are the key to the dynamic evolution of comparative advantage at the macroeconomic level, the key to such an evolution at the microeconomic level is competition among private enterprises to sort out extremely risky undertakings in new technologies.” Masari Yoshitoni, New Trends of Oligopolistic Competition in the Globalization of High-Tech Industries: Interactions among Trade, Investment and Government, in OECD, supra note 19, at 28.
sound monetary policy and a fiscal policy that rewards entrepreneurship and initiative and ensures the availability of financing. In short, governments should provide a stable macro-economic framework. In Canada, that means more common cause between federal and provincial levels of government to attack deficits and eliminate duplication and offsetting policies. In the United States, it means finding a way out of the gridlock of special interest politics. In both countries, we need to intensify fiscal and regulatory reform efforts aimed at making North America a better place in which private firms can invest and do business. Unless governments at all levels, for example, control and reverse the debt and deficit spiral, we will not be able to generate the wealth that will allow us to maintain, let alone improve, the quality of life we have come to expect. Government fiscal requirements are placing an increasingly intolerable burden on Canadian and U.S. taxpayers and driving potentially successful firms to offshore locations while the demands placed on governments to service the national debt are crowding out governments’ capacity to respond to other needs.

- Second, governments need to maintain an enabling rather than crippling regulatory environment. The regulatory requirements imposed on businesses by all levels of governments are consuming an ever larger share of the resources of small, medium and large firms alike. While some of these requirements may once have served important objectives, many have outlived their usefulness while new requirements sometimes serve questionable needs. Governments at all levels must become more vigilant about the burdens they impose on the wealth-creating sectors of the economy and recognize the extent to which such requirements undermine our capacity to compete at home and abroad. At the same time, as became clear in the past decade, simple deregulation did not lead to the best kind of enabling environment. A spate of deregulation, privatization and free trade may have been necessary to undo the excesses of the past, but such a strategy does not provide a sufficient basis for healthy economic development. We have to learn the difference between effective, purposeful regulation and the kind of regulation that flows from political fads and fashions.52

- Third, governments should invest in people — in education, health and training — in order to nurture a population that is healthy, curious and knowledgeable and that has the skills and understanding to adapt to the challenges raised for national economies by globalization.

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52 The communications industry offers many illustrations of misplaced, outdated regulation. Modern technology, for example, makes it possible to combine telephone and video technology and provide a powerful form of interactive, two-way communication of data, voice and image. Current regulatory structures, however, prevent firms from providing such a service. In both Canada and the United States, bureaucratic inertia frustrates realizing the potential of new technologies, complicated in Canada by misplaced concerns about cultural sovereignty and in the United States by equally spurious worrying about national security. SUSAN ROSE-ACKERMAN, RETHINKING THE PROGRESSIVE AGENDA: THE REFORM OF THE AMERICAN REGULATORY STATE (1992) provides a provocative basis for rethinking the approach to regulation in a market-based, pluralist democracy.
This does not mean spending money governments do not have. It does mean more coherent and practical coordination of the variety of education and training programs now being offered. Our education, health care and social programs are consuming an ever larger share of national resources but are not responding sufficiently to national needs. In both Canada and the United States, we need to redirect and reform these programs if they are not to bankrupt us. In some cases, objectives need to be redefined; in others, more efficient and productive operating procedures need to be introduced; in some, resources need to be released for more pressing priorities while in others expectations need to be lowered.

Fourth, governments need to concentrate not only on renewing the infrastructure of the past but also on building the infrastructure of the future. For example, government should be a partner in the development of an electronic super highway that will allow businesses across the country to take advantage of the miracle of instant telecommunications.

The benefits that will flow to Canadians and Americans alike from sustainable levels of taxation and regulation dwarf what can be achieved through the negotiation and implementation of international trade agreements or the pursuit of trade and investment development programs. If we cannot maintain an economy and society that will attract and keep productive entrepreneurs, all the rest will have little impact.

Within these parameters, there is little room for the kinds of activities traditionally considered as industrial policy. Instead, there is room for an activist trade policy that recognizes that in the more integrated global economy of tomorrow, the scope for inter-firm and inter-state conflict is much greater than in the past. Such conflict will seriously undermine the capacity of governments to govern and industries to generate wealth. In response, we will need to negotiate a new generation of international economic agreements that build on the trade agreements of the past but address issues that go far beyond them. We will need to develop inter-governmental rules dealing with such issues as trade and the environment, social policy, competition policy, investment, innovation and more. We will need more robust institutional and dispute settlement provisions to reduce the inevitable conflict arising from the much deeper integration of globalization. In the words of Sony chairman Akio Morita, we need “to begin creating the nucleus of a new world economic order that would include a harmonized world business system with agreed rules and procedures that transcend national boundaries.”

In effect, a sane industrial policy would start with a set of global rules that would prevent governments from doing the many things they know are dumb but which make so much short-term politi-

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63 Toward a New World Economic Order, THE ATLANTIC MONTHLY, June, 1993, at 88-98.
cal sense. It would welcome, rather than reject, a more thorough version of the GATT. It would point governments toward policies and activities that clearly cannot be done by the private sector and let private capital do what it does best: innovate and take risks.

**CONCLUSIONS**

We are going through a period of rapid and fundamental change requiring adjustments in domestic economies and in international regimes and practices. The stresses and strains already being experienced by existing policies, institutions and procedures suggest that these adjustments need to take place sooner rather than later. International business policy can no longer be divorced from domestic policies and vice-versa. The linkages are significant, particularly with respect to investment, innovation, competition policies, labor markets and intellectual property protection. Appropriate bridges need to be designed and built. Public interest in linking trade policy with traditional non-trade issues such as the environment and social programs is also leading to demands for and concerns about greater international policy convergence and coherence.

Within this complex and difficult setting, we do not need experiments aimed at tinkering with the ability of the economy to generate wealth; rather, we need to let the economy generate the wealth needed to address these issues and respond with appropriate social and other distributive policies. If the accent of trade and economic policy shifts from wealth-generating to wealth-distributing issues, the result is more likely to be perverse: the more equal distribution of misery rather than prosperity. Similarly, if governments get bogged down in planning which economic activities society should promote and which it should let go, we are more likely to get a stagnant rather than a dynamic economy.

What to produce, how to produce it and where to produce it are fundamentally private sector activities. Government policies and programs may prove critical to the success of such activities, but they are not substitutes for a productive, innovative and efficient firm employing dedicated and motivated people with a competitive and attractive product or service to sell. Government policies that are *most* likely to help such firms are those that proceed from a coherent view of the role and limits of government policy. Government policies that are *least* likely to help such firms are those that try to second guess what private firms are doing in response to market signals. As noted by one expert on Japan: “The central lesson of the Japanese industrial policy experience is not, as some Americans argue, that government ‘guidance’ of industry works better than traditional market economies. Unfettered supply and demand determine the direction of growth in Japan at least as much as they do in the United States. The lesson of Japan is that a
government can truly aid private industry if and only if it coherently plans its ordinary activities on the basis of a vision of the economy's future."54