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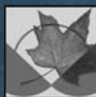

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Backsliding

Manufacturing decline and resource dependency under Harper

Jim Stanford

THE STEPHEN HARPER government has presided over a dramatic restructuring of the sectoral make-up of Canada's economy. The national economy is becoming more dependent on the production and export of natural resources, especially petroleum. Meanwhile, the manufacturing sector — the industry which transforms natural resources into more useful, valuable products — has been in recession almost since the day Harper took office. Several dramatic changes related to this sectoral restructuring include a record-breaking inflow of foreign direct investment, mostly aimed at takeovers of Canadian-owned resource companies, the flight of the Canadian dollar to parity with the U.S. dollar, and the shift of all net new job-creation to service industries, mostly in the private sector.

This restructuring has both its "positive" sides and its "negative" sides. Some sectors of the economy, led by resources, are vibrant and expanding. Others are contracting and retrenching. The whole restructuring process is driven — unsurprisingly, since Canada's is a profit-driven, capitalist system — by the quest for maximum profits by private businesses and investors. In particular, absolutely phenomenal profit rates in resource industries (again, especially petroleum), the result of sky-high global commodity prices, are the driving force behind all the sea changes noted above.

Overall GDP growth and job-creation numbers seemed relatively positive at first, but have more recently turned negative: indeed, Canada's real GDP, adjusted for inflation, began to decline in the beginning of 2008, possibly heralding the arrival of recession.[1] And, apart from the near-term damage resulting from the loss of hundreds of thousands of manufacturing jobs and the potential for a broader recession, this powerful resource-led restructuring should spark intense concern among Canadians regarding our long-run economic stability and prosperity, our role in the world, including our geopolitical security as an energy exporter, our environment, and our federation.

This historic structural change in Canada's economic make-up was not directly "caused" by the Harper government. It reflects the impact of global changes in commodity prices, in energy markets, and in manufacturing trade on a national economy which has been organized, long before Harper came to office, around the operating principle that most major economic decisions will be made on the basis of maximizing corporate profits. But the Harper government's general ideological and policy orientation has clearly ratified this general worrisome direction in our national economic evolution.

The Harper team fully accepts an economic regime in which "free" business decisions, motivated by the hunt for more profit, shape what we produce, where we sell it, and what we buy. Free trade, corporate tax cuts, and a strictly limited role, both regulatory and fiscal, for government are the main pillars of the Harper economic vision. From this perspective, the main fault of the Harper government has been to do nothing to arrest or actively manage this sea-change in Canada's economic trajectory. Their main error has been to sit on their hands.

But there have been sins of commission, as well, not only sins of omission. A number of important actions of the Harper government, from its gigantic corporate tax cuts, which significantly reinforce the dominance of corporate profit over economic decision-making, to its rubber-stamping of foreign takeovers of Canadian resource companies, to its stated explicit preference for a very high dollar, have all clearly made things worse. Despite being constrained — nominally, at any rate — by its minority status, the Harper government's discretionary economic policy actions have all strongly reinforced the dominance of

resource exports, with all its associated side-effects: skyrocketing currency, surging foreign takeovers, shrinking non-resource exports. Worse yet, the government has mapped out a vision for its future direction should it be re-elected (most frighteningly with majority status) that would undoubtedly cement Canada's emerging role as a highly profitable but structurally underdeveloped energy warehouse for other countries.

Manufacturing meltdown

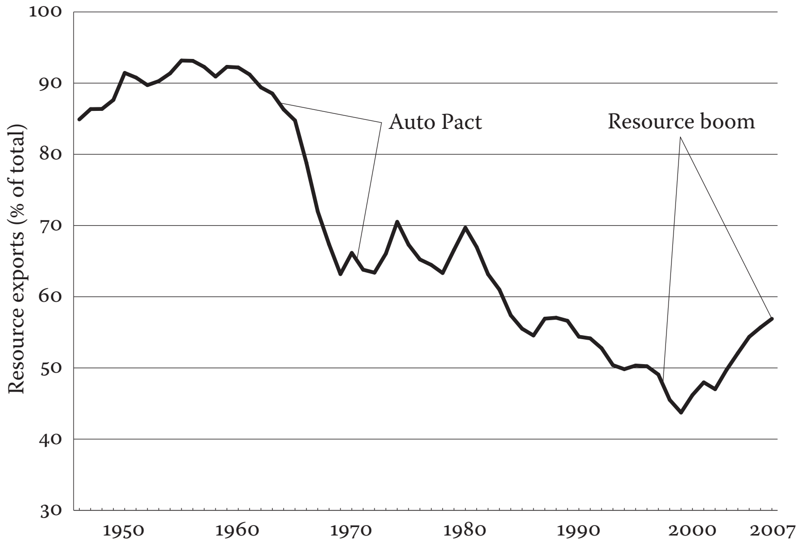
Not surprisingly in light of our geography, our population, and our colonial heritage, Canada has always been uniquely dependent on natural resource industries. Indeed, Canadian political-economy traditionally emphasized the role of successive waves of resource-led development, or "staples," according to the economic historian Harold Innis, to our economic development, our global relationships, and our internal politics. However, even before Confederation, Canadian policy-makers recognized the inherent limits of dependence on unprocessed resources, and worked pro-actively in various ways to stimulate a more diversified, "value-added" economy.

Many different tools were used over the decades to foster other export industries, especially value-added manufacturing sectors, including high tariffs to stimulate domestic industry, targeted public procurement policies to capture industrial spin-offs from our own purchases, strategic trade policies (the Canada-U.S. Auto Pact was especially important), technology and investment supports, and others.

This pro-active approach bore fruit. By the mid-1990s, following decades of gradual progress, Canada had become a global manufacturing powerhouse. For the first time in our history, we had become, in aggregate, self-sufficient in the production of manufactured products. In other words, we exported as much as we imported, and then some. For a country which traditionally relied on the export of natural resources to pay for imports of value-added merchandise, this was a tremendous achievement.

One summary indicator conveniently describes this structural progress. Chart 1 indicates the proportion of Canadian exports — the

CHART 1 *Canada's growing resource reliance: Unprocessed or barely-processed resources as share total merchandise exports*

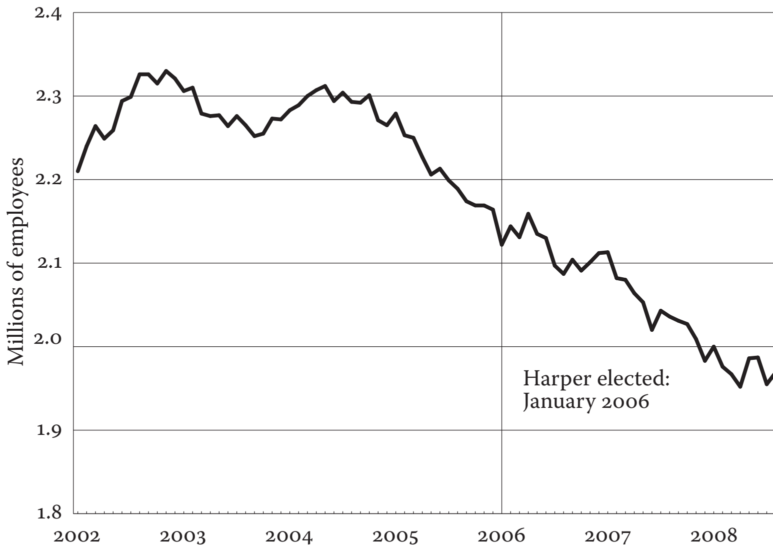


SOURCE CAW Research from Statistics Canada, *Canadian Economic Observer* and *Historical Statistics of Canada*.

things we sell to the world in order to "pay our way" in world trade and finance needed imports — that consist of unprocessed or barely-processed resource-based products, including agricultural goods, forestry products, minerals, and energy. At the end of World War II, Canada was still very much a "hewer of wood and drawer of water." But our reliance on raw resource exports steadily declined over the post-war era. By the early 1990s, Canada reached a turning point. For the first time in our history, a majority of our exports consisted of value-added, higher-technology products, including machinery, automotive products, and higher-value consumer goods.

Sadly, however, this achievement would not last. The importance of value-added exports peaked in 1999. Since then, the importance of resource exports, especially petroleum, has rebounded, and this trend has accelerated markedly since 2002, when global commodity prices began to rise dramatically. In 1999, resources accounted for just over

CHART 2 *Total employment in Canadian manufacturing*

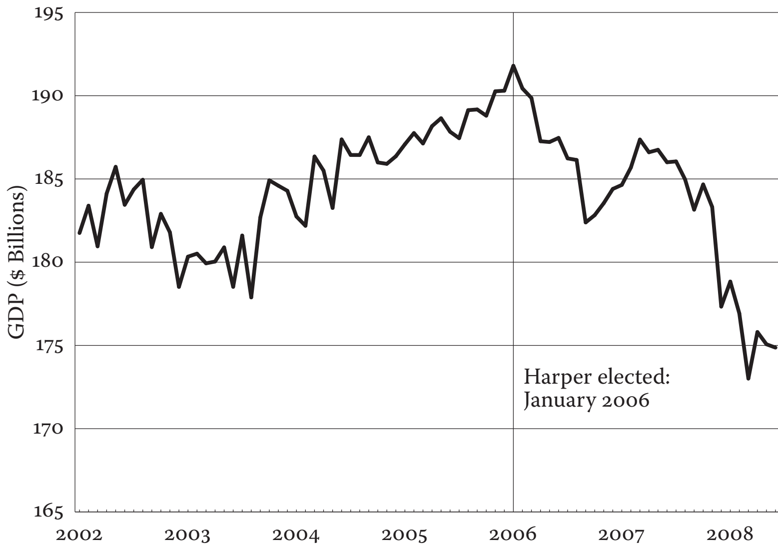


SOURCE CAW Research from Statistics Canada CANSIM Table 282-0094, seasonally adjusted labour force data.

40% of our exports. That has increased by almost half in just eight years: by 2007, resources accounted for almost 60% of our exports. In other words, fully one-third of the post-war progress attained by Canada in diversifying its role in the world economy has been undone in a few short years by the resource boom.

The most visible and painful symptom of this restructuring has been the unprecedented and continuing crisis in Canadian manufacturing. Canada's manufacturing sector has lost almost 400,000 jobs since employment in the sector peaked in 2002 (illustrated in Chart 2). That's a decline of over 15%, and the job loss has accelerated in 2008. Over half of the lost jobs have disappeared since the Harper government came to office in January 2006. Since they took power, Canada's manufacturing sector has lost an average of about 200 jobs a day — the equivalent of closing a medium-sized manufacturing plant each day.

CHART 3 *The manufacturing recession*

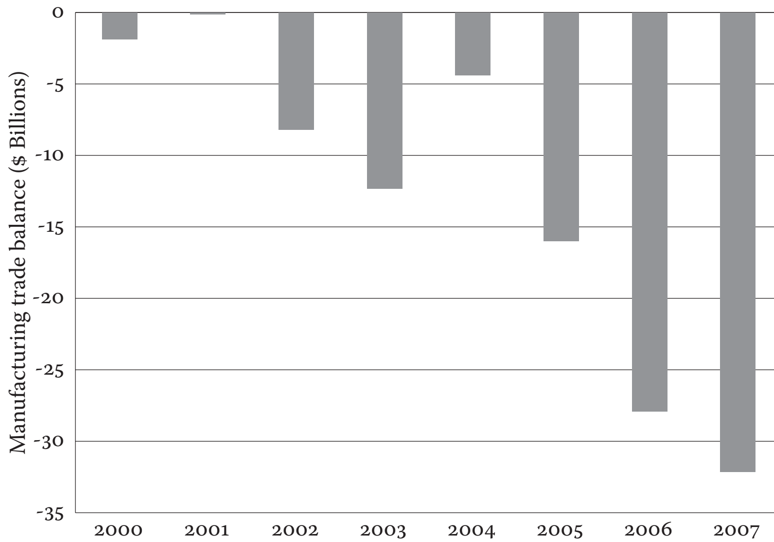


SOURCE CAW Research from Statistics Canada CANSIM Table 379-0027, at factor prices, $2002 constant.

In relative terms, measured as a share of total employment, the decline in manufacturing jobs began earlier: back in 1999, about the same time as Canada's export profile began to change so radically. The share of manufacturing in total employment has fallen by 4 percentage points, or over one-quarter, since 1999, to 11.5% by 2008, by far the lowest in our post-war history. Canada's manufacturing employment has fallen well behind those of several other developed economies, including Germany and Japan, although it is still proportionately larger than in the U.S., which has suffered an even worse and longer-lasting decline in manufacturing.

Initially, the job losses in manufacturing were associated with continuing growth in actual manufacturing output. Real GDP in Canadian manufacturing continued to grow, albeit slowly, through the first few years of the employment downturn; a situation of rising output with falling employment implies especially rapid productivity growth. But, beginning in early 2006, ironically just as the Harper government came

CHART 4 *Manufacturing trade collapse*



SOURCE CAW research from Industry Canada Strategis database, NAICS codes 31-33.

to power, the crisis in manufacturing intensified, and real output began to shrink (see Chart 3). By early 2008, real GDP in manufacturing was down 8% from the same period of 2006.

Manufacturing has thus been in more-or-less non-stop recession, with shrinking output, except for a temporary rebound in early 2007, since the Harper government came to power. And, by early 2008, a sharper decline in manufacturing output, focused on the crisis in Canadian automotive production, pulled Canada's total real GDP into negative territory. It is now clear that Ottawa can no longer simply ignore the painful shake-out occurring in Canadian manufacturing. The shake-out in manufacturing is on the verge of causing a nation-wide recession.

Another glaring perspective on the manufacturing crisis is obtained from international trade data. At the turn of the century, Canada was broadly self-sufficient in manufactured goods for the first time in its history, an important achievement given our resource-dependent past.

TABLE 1 *Hard-hit manufacturing sectors: Job losses since August 2002*

Sector	Job losses to November 2007
Textiles and clothing	70,000
Automotive	30,000
Food and beverage	28,000
Metal and steel	22,000
Paper	21,000
Wood products	16,000
Furniture	16,000
Electronics and appliances	12,500
Plastics and rubber	12,000

SOURCE CAW Research from Statistics Canada data, Table 282-0007.

That achievement has been wasted, however, by the resource boom and the associated squeezing-out of manufacturing exports by oil shipments and the soaring dollar. From a balanced position as recently as 2001, Canada's manufacturing trade has sunk deeply into deficit, which reached over $32 billion by 2007 (Chart 4). Over half of that turnaround represents the shocking deterioration of Canada's trade performance in automotive products. Manufactured imports are pouring into the country, while manufactured exports are shrinking due to an overvalued currency and global competition from new manufacturing leaders, especially China.

Particular sectors of manufacturing industry have experienced especially severe job losses, although the decline in manufacturing has been experienced very broadly, in almost every sector and in every region of Canada. Table 1 summarizes the job losses, to late 2007, in some of the hardest-hit sectors. The Canadian textile and clothing industry has been driven to near-extinction by import competition and the soaring loonie, losing over 70,000 jobs. The broad auto sector, considering both assembly and parts, has lost close to 30,000 positions. The paper and wood products industries have been hammered, in part by the dollar, and in part by the decline in sales to the U.S., including the crisis in the

TABLE 2 *Employment restructuring in Canada: Since August 2002 (Manufacturing employment peaked at 2.4 million jobs in August 2002)*

Sector	**Change employment August 2002–June 2008**
Manufacturing	-367,000
Construction	+329,000
Mining/oil and gas	+81,000
Sub-total: Goods producing	*+43,000*
Public services (incl. education, health)	+722,000
Retail/wholesale trade	+266,000
Finance, insurance, real estate	+161,000
Transportation	+103,000
Hospitality (food, hotels)	+71,000
Other services	+379,000
Sub-total: Services producing	*+1,702,000*
Total economy	**+1,745,000**

SOURCE CAW Research from Statistics Canada data, Table 282-0007.

American housing industry. The food and beverage, metal, electronics, and plastics industries have also lost thousands of positions.

The loss of manufacturing jobs far outstrips the new positions that have opened up in other sectors of Canada's economy. It is not remotely true that displaced manufacturing workers could easily find new work in the Alberta tar sands — as some commentators have crassly suggested. There has only been one new job created in the broader mining and energy sector for every 4.5 jobs lost in manufacturing since 2002 (see Table 2). Job growth in construction has been fairly strong, thanks mostly to the housing boom, although how long that persists through the U.S. mortgage crisis and broader economic weakness is anyone's guess. New jobs in construction and resources roughly offset the jobs lost in manufacturing, and so the overall goods-producing sector has seen no net job creation at all in the last half-decade.

All net new jobs, therefore, have been created in the services sector. That's not all bad news. For example, an impressive 40% of those new service jobs have been in public services, reflecting growing budgets for

health care and education in most Canadian jurisdictions. But the bulk of new service positions are in private services, most of which constitute lower-income, lower-productivity jobs, in sectors such as retail trade, hospitality services, and general personal and business services.

The auto industry

Canada's post-war success in building a more diversified, productive, value-added industrial base reflected incremental progress across a range of different high-value industries, including aerospace, specialty vehicles, telecommunications equipment, and certain types of machinery. But no single sector was more important to our post-war industrial development than the automotive industry, which remains, despite recent tribulations, the most critical pillar in our industrial economy.

When Canada's automotive industry peaked in 1999, we ranked as the fourth largest assembler of motor vehicles in the world, an astonishing achievement for a country of our size. On a per capita basis, we were the largest automotive producer in the world. And we enjoyed a $15 billion trade surplus in automotive products. Canadian facilities benefited from strong investment throughout the 1990s, attracted by highly cost-competitive conditions, including a then undervalued currency, cost-efficient public health care which saved automakers as much as $10 per hour worked in total labour costs, and superior productivity performance. New investment in capital equipment enhanced productivity growth; Canada's auto industry became one of the rare manufacturing industries in which labour productivity is higher in Canada than in the U.S.

Since 1999, however, this key industrial success story has been abandoned by changing economic realities and inaction by policy-makers. By 2006, the large automotive trade surplus of 1999 had melted away into Canada's first automotive trade deficit in a generation; that deficit has ballooned and will exceed $10 billion in 2008. This large automotive trade deficit results from the fact that Canada's automotive trade surplus with our major customer, the U.S., no longer offsets our large and growing trade deficit with other producers. This non-U.S. auto trade deficit reached nearly $18 billion last year. The imbalance is particularly

acute with Japan, from whom Canada imports 120 times as much automotive products as we export there, and Korea, from whom we import 185 times as much automotive products as we export.

The auto trade debacle has been even further worsened by the U.S. economic downturn (the U.S. being the market where over 85% of Canadian-made vehicles are sold), and by record fuel prices which have shifted consumer demand further toward the smaller vehicle segments which are especially dominated by imports.

The shocking decline of Canada's once vaunted automotive sector has been a major source of the decline in our overall value added industrial capacities during this decade. By the same token, arresting and reversing the auto crisis will need to be a central component of a broader strategy to nurture Canadian manufacturing. By all means, a successful auto strategy for Canada must involve measures aimed at improving the fuel efficiency and environmental performance of vehicles. But it must also involve measures to require automakers to maintain Canadian production content, in both assembly and auto parts, broadly proportionate to their sales in Canada. That sensible principle, as enshrined in the Canada-U.S. Auto Pact — which was unfortunately overturned by the World Trade Organization in 2001, just as Canada's manufacturing industry went into decline — will be required to preserve Canada's past automotive success in light of the challenges posed by globalization, energy prices, and environmental concerns.

Why manufacturing matters

The argument is often made that manufacturing must inevitably decline as a result of the transformation toward a "service economy," and that the loss of manufacturing jobs is being experienced broadly across all developed economies. Governments shouldn't attempt to interfere with this historical trend, but rather should embrace the creation of new jobs in whatever sectors are favoured by free-market business decisions.

It is certainly true that services are becoming more important as a share of total employment and GDP, although addressing the fundamental weakness in quality and productivity of many service jobs should also be a central focus of government economic policy. But it would

be very wrong to write off the whole manufacturing sector as "yesterday's" industry. Since the turn of this century, Canadian manufacturing has declined far more rapidly as a share of total employment, by over a quarter, than in comparable OECD economies. By the late 1990s, Canada was a relatively successful manufacturing jurisdiction; but today we are an underperformer. We produce less manufacturing value-added than we consume.

And within the context of the broad structural evolution of our economy, policy-makers should make strong efforts to preserve as much manufacturing activity as possible. For several important reasons, manufacturing makes a disproportionate contribution to our overall productivity and well-being.

- Manufactured goods are essential to successful participation in global trade. Manufactured products account for 75 % of total merchandise trade. A country must be able to participate successfully and competitively in global markets for manufactured goods, to support overall engagement with the global economy and avoid chronic balance of payments difficulties.

- Manufacturing industries demonstrate both higher productivity levels and higher rates of productivity growth. On one hand, this implies ongoing negative pressure on manufacturing employment, unless demand for manufactured output is growing fast enough to absorb higher-productivity labour without job losses, which does not consistently occur. On the other hand, it implies that manufacturing is especially important to national productivity performance. Economists have recognized for decades that a smaller manufacturing sector implies both lower average productivity and lower productivity growth in the broader economy. The sharp decline in Canadian manufacturing is a crucial factor behind Canada's poor productivity performance this decade.

- Higher productivity allows manufacturing employers to pay incomes that are, on average, some 25% higher than in the rest of the economy. Manufacturing jobs are a crucial source of decently-

paid, higher-quality work for working-class Canadians. They are important to maintaining decent income and employment opportunities in key communities, including among newcomer Canadians.

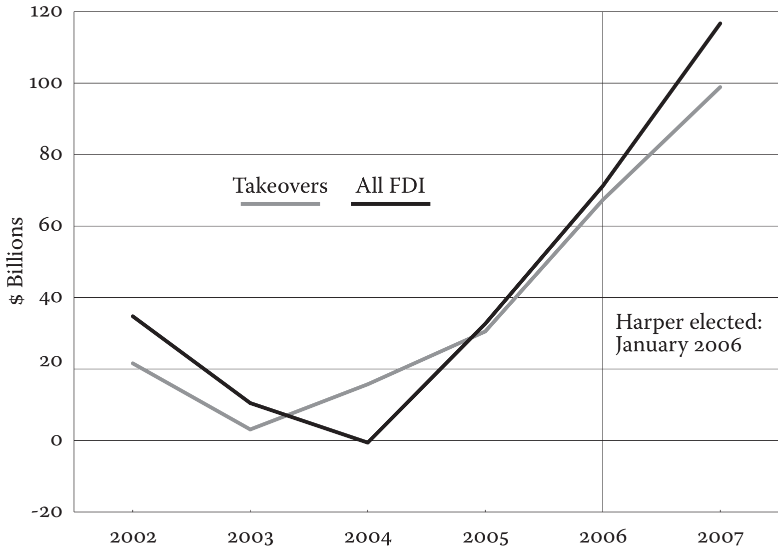
- Manufacturing firms demonstrate much higher levels of commitment to R&D and other forms of innovation. Manufacturing accounts for well over half of all private-sector R&D spending in Canada, paid from a much smaller share, just 15%, of national GDP. Hence manufacturers devote a much higher share of GDP to R&D than resource or service producers. Again, the decline of Canadian manufacturing during this decade is a key factor behind the continuing poor R&D performance of the overall Canadian business community. The rapid decline of Canadian manufacturing implies that Canada's record in this regard will get worse, not better, in the years to come. Minerals and energy firms enjoyed rapid growth in revenues and profits in this decade, yet re-invest very little back into innovation.

In short, there are unique, strategic reasons why a country should work deliberately to retain a viable, competitive manufacturing sector, with special emphasis on high-productivity, technology-intensive sectors, such as automotive products, aerospace, advanced electronics, life science products, and other high-value industries. The broader spin-off benefits of industrial success in those key sectors on national trade performance, productivity growth, and incomes justify the special policy attention that should be paid to manufacturing.

Putting the pieces together

The boom in exports of non-renewable resources, especially petroleum, and the corresponding decline of Canadian manufacturing, are two sides of the same coin. Understanding the links between these trends requires an analysis of the broader economic and financial trajectory of the national economy. Here, in summary, is how the rapid, unsustainable expansion of resource exports, focused mostly in Western Canada, has sparked the broader sectoral adjustments that pose such signifi-

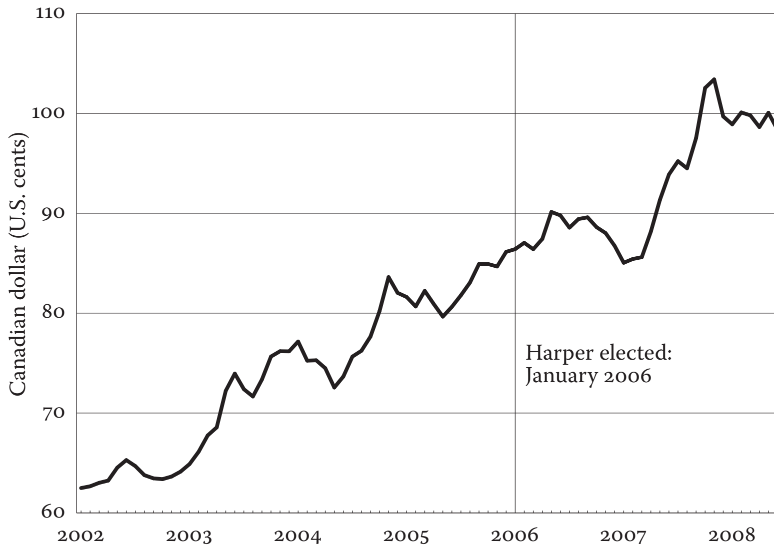
CHART 5 *Foreign direct investment coming into Canada: Total FDI, and takeovers of Canadian companies*



cant risks, both today in the form of 400,000 lost manufacturing jobs, and long into the future, to the rest of the national economy. Moreover, understanding those links will help to inform policy responses aimed at slowing and managing this restructuring process.

- *Super-high resource prices lead to super-high resource profits.* Canadian resource producers, again, especially in the oil and gas business, have enjoyed spectacular profits in recent years, thanks to record global prices for oil and other resource commodities.
- *Record profits have made Canadian companies very valuable.* Canada's economy is now more profitable, measured by corporate profits as a share of GDP, than the supposedly more business-friendly U.S. Canada's stock market has continued rising despite the current economic downturn, mostly because resource profits are so high. Indeed, resource companies alone account for half the market value of the Canadian stock market — and Canada's

CHART 6 *The skyrocketing loonie*



SOURCE CAW Research from Bank of Canada data.

perpetually-profitable financial industry accounts for another quarter.

- *Foreign investors want Canadian companies.* Foreign purchases of Canadian equities have contributed to the record highs reached by Canadian stock markets, even as Canada's economic and trade performance has been crumbling. More dramatically, many Canadian companies, especially in the resource sector, have been snapped up entirely by foreign investors. Canada attracted over $200 billion worth of incoming foreign investment in 2006 and 2007, by far the largest surge of foreign investment in our national history (see Chart 5). This inflow was not aimed at building new facilities and creating new jobs; it was aimed overwhelmingly at taking over existing super-profitable Canadian companies. Indeed, 94% of all incoming foreign investment in the last five years consisted of takeovers of existing firms.

- *Financial inflows drive up the Canadian dollar*. Both types of financial inflow — to purchase shares in Canadian companies or to buy out Canadian companies entirely — drive up the value of the Canadian dollar. The dollar's value is determined on financial markets by the inflows and outflows of financial capital. It does not directly depend on trade performance, productivity, or other "real" economic factors, all of which, perversely, have deteriorated in recent years. The Canadian dollar has been rising against its U.S. counterpart since late 2002, when world commodity prices first started to rise. But the dollar's rise got completely out of control with the wave of foreign takeovers in 2006 and 2007 (see Chart 6). It appreciated by 20% in 2007 alone, reaching and then exceeding par with the U.S. dollar. The dollar has soared by over 60% since 2002 — meaning that Canadian-made products are now 60% more expensive than they were six years ago. International economists, such as those with the Organization for Economic Cooperation and Development (OECD), estimate that a "fair" value for the Canadian dollar, reflecting relative prices for consumer goods and other products, is about 80–82 cents U.S. Thus, with the Canadian dollar at par, the currency is overvalued by as much as 25%.

- *Non-resource exports are squeezed out*. The dollar's rise reflects the powerful impact of resource prices and resource profits on Canadian corporate valuations, and hence on financial flows. It reflects intense international demand for Canadian *companies*, not international demand for Canadian *products*. But many other Canadian industries also aim to sell their products to international markets, especially manufacturing, but also tourism, which has suffered even worse business and employment changes than manufacturing, and other tradeable services, like finance, transportation, consulting, etc. International sales of those products have fallen because the dollar has made them 60% more expensive, too.[2] Record energy and resource prices are in effect "subsidizing" Canada's international trade balance despite the loss of non-resource exports, although not completely: the overall

national balance of payments has deteriorated rapidly during the resource boom. How long this "subsidy" can continue, and what Canada will be left with once the bubble inevitably bursts, is very much in question.

- *Employment and production is shifting to non-tradeables.* This is perhaps the least understood, but most damaging, consequence of the resource boom. The overvalued currency makes it very difficult for Canadians to sell anything other than resources into international markets. But resource industries don't create nearly enough new jobs to absorb the loss of employment in manufacturing, tourism, and other export-oriented, tradeable industries. As a result, most new work and most new production occurs in non-tradeable sectors of the economy: that is, in sectors which produce and sell their output to nearby Canadians, rather than into larger regional and international markets. It seems bizarre in this era of omnipresent globalization, but the proportion of Canada's GDP which is exported has plunged dramatically during the resource boom — from a historical record of 45% of GDP in 1999 to less than 35% today. Non-tradeable sectors include construction, public services, and most private services. In particular, our growing reliance on low-wage, low-productivity private service industries, which is an indirect but clear consequence of the resource boom, may be the most damaging long-run side-effect of the current trajectory.

The overall picture that we paint, therefore, is much more complicated than suggesting that Canada's economic centre of gravity is shifting from manufacturing to resources. That is partly true. But the real growth in resource production, employment and exports is far from adequate to offset the erosion of manufacturing. The whole restructuring process has been intermediated by financial flows, in particular the intense interest of foreign investors in capturing a piece of Canada's uniquely lucrative resource industry. The most important real economic shift that we observe is not from manufacturing to resources; rather, the largest shift is occurring from all non-resource export industries — manufactur-

ing most importantly among them — into non-tradeable services, most of which demonstrate low productivity and low incomes.

Harper's attack on manufacturing

As discussed above, the forces ultimately causing this broad restructuring of the Canadian economy are largely global in nature, and were exerting their influence well before the Harper government's ascension to power. The Harper government's general endorsement of free trade, deregulation, and business-led economic development has clearly reinforced the growing resource dependence and corresponding deindustrialization, which have become so evident during his tenure. The government's failure to respond to the new and worrisome economic challenges resulting from sky-high global commodity prices, a soaring currency, and the other side-effects of the resource boom, gives plenty of reason to strongly reject the far-fetched claim that Conservatives are the best economic "managers."

But more than this, there are several key ways in which the pro-active policy direction of the Harper regime has incrementally contributed to the resource-led restructuring of our economy. Some of the specific ways in which the Harper government has aided and abetted Canada's resource-led deindustrialization include:

- *Massive corporate tax cuts.* Finance Minister Jim Flaherty promised in his 2007 fiscal update to enact a historic schedule of corporate tax reductions, taking the general federal corporate tax rate down to 15% by 2012, from just over 22% when his government came to office. This one-third reduction in corporate taxes, far outstripping the smaller reductions Flaherty also engineered in personal income and sales taxes, will cut federal revenues by 6%, a very substantial reduction in the national government's total revenue base. Flaherty justified this expensive move, in part, by saying that Canadian businesses, including manufacturers, needed help to adjust to the challenges posed by the high dollar and other economic changes. For manufacturers, whose taxable profits currently range from small to non-existent,

a corporate tax rate reduction offers little if any benefit.[3] More importantly, considering the broader economic and financial linkages mapped out above, these tax cuts will make matters *worse* for Canadian non-resource exporters. It is their already-superior profitability performance, centred in resources, that explains both the surge in foreign purchases of Canadian firms and the resulting take-off of the Canadian currency. Tax reductions to make these companies even more profitable and appealing will only accelerate foreign takeovers and further boost the Canadian dollar. Notably, Flaherty's tax reductions overwhelm the very limited increase in provincial royalty rates which the Alberta government recently imposed on super-profitable petroleum companies, as a half-hearted attempt to capture a slightly larger share of petroleum super-profits for Albertans. Thus, perversely, new investments in Alberta's already overheated tar sands sector appear more profitable today than they did before the Alberta royalty changes.

- *Explicitly endorsing an overvalued currency*. Unfortunately, the Bank of Canada has officially ratified the appreciation of Canada's currency as a welcome sign of "adjustment to change." Unlike other countries, most of which have attempted to contain the economic damage caused by rapid, undue currency fluctuations,[4] Canadian authorities have steered clear of attempting to slow down the loonie's flight. Quite the contrary, Canadian officials have actually and explicitly *endorsed* that rise. In unusual testimony to the Senate in December 2007, former Bank of Canada Governor David Dodge seemed to endorse a Canadian dollar at near-par with its U.S. counterpart. Then, early in 2008, Finance Minister Jim Flaherty seconded that opinion, indicating that he explicitly favoured a trading range for the Canadian dollar of 95–98 cents U.S. It may be coincidence that this is in fact where the Canadian dollar has mostly hovered since that time; it wouldn't be unusual for currency traders, in the absence of overarching pressures to the contrary, to use remarks like Flaherty's as broad "guideposts" for their own trading activity and expectation. At any rate, for Flaherty to wade so forcefully

and explicitly into the fray of currency markets, contrary to his official view that the exchange rate should be determined by "market forces," let alone to endorse an exchange rate that is so clearly destructive to the clear majority of Canadian industries, surely damages his already crumbling reputation as a rational and effective economic steward.[5]

- *Rubber-stamping foreign takeovers.* Not surprisingly, the Harper government has continued the recent federal tradition of rubber-stamping foreign takeovers of Canadian firms. After all, it was the previous Conservative government, headed by Brian Mulroney, that dismantled restrictions on foreign takeovers as one of its first acts in 1984. Since then, the largely toothless Investment Canada process has approved over 1,600 takeovers and rejected only one: the proposed takeover of Canadian space company MD&A, which was turned down by Industry Minister Jim Prentice in 2008, thanks solely to a firestorm of political pressure. Worse yet, in July 2008, the Harper-appointed "Competition Policy Review Panel," headed by business magnate Red Wilson, issued a shockingly pro-business manifesto, proposing the elimination of whatever remaining control the federal government holds over foreign investment.[6] Signals from the Harper government indicate its full agreement with the direction proposed by Wilson. Like corporate tax cuts, making it still easier for foreign investors to buy out Canadian resource companies will exacerbate the chain of economic linkages, resource profits, foreign takeovers, rising currency, and declining non-resource industries, which has already critically damaged our manufacturing sector.
- *Derailing an auto strategy.* The decline of Canada's once outstanding auto industry was well in motion before Harper's election, the result of globalization, the World Trade Organization, and the competitive failures of the U.S.-based auto-makers. But cautious, uneven steps were being taken to address the problem. In particular, the previous minority Liberal government had established a new multi-stakeholder body the Canadian Automotive Partnership Council (CAPC), to address the

industry's problems and make policy recommendations, and the federal government had invested in several initiatives, including participation in several key auto restructuring investments and support for new infrastructure and training initiatives, which were helpful to the industry's attempts to re-invent itself. These initiatives were completely at odds, however, with the Harper government's *laissez faire* ideology, and this hesitant progress toward an industrial strategy for Canada's most important value-added export industry has ground to a dead halt since his election. CAPC has hardly met since Harper's election; there seems little point, given the deafening indifference emanating from Ottawa. And Ottawa has indicated its opposition to playing a hands-on role in the industry — for example, rejecting appeals to participate in potential new "green" power-train investments in Windsor and St. Catharines, or to support threatened assembly plants in Oshawa, St. Thomas, and elsewhere. Finance Minister Jim Flaherty, who hails from Whitby, an auto riding, can barely contain his disdain for the industry that employs so many of his constituents, telling laid-off auto-workers in Oshawa to get new jobs in the financial industry, and trying fruitlessly to pin all the blame for the auto industry's tribulations on the Ontario provincial government's refusal to copy his own counterproductive corporate tax cuts. If the Harper government cannot be pushed into action on the auto industry, given its immense economic and political importance in vote-rich Ontario, then there seems little hope of expecting any reversal of its hands-off approach to the overall manufacturing meltdown.

- *More free trade.* The Harper government has enthusiastically endorsed the general free trade orientation of Canada's economy, and worked actively to strengthen and deepen the free-trade relationships that have been a key factor behind Canada's emergence as North America's energy warehouse. Harper has given full support to the Security and Prosperity Partnership, which is exposed and critiqued elsewhere in this volume, and his government has pushed aggressively to negotiate new bilateral

free trade agreements, under the leadership of the turncoat Trade Minister David Emerson. The government's first priority in this regard was a bilateral deal with South Korea, a successful manufacturing powerhouse. Canada's bilateral trade with Korea already perfectly indicates the dangers of our emerging resource pigeon-hole: most of our exports to Korea are resources, most of our imports are high-value technology-intensive manufactured goods, led by $2 billion worth of automotive imports. And the "balance" of these two flows (surprise, surprise) is a large and growing trade deficit.[7] The push to sign an FTA with Korea was derailed by strong political opposition, led by the CAW, but the government is nevertheless committed to proceeding whenever political conditions allow. And the Harper government has forged ahead with other deals, most notoriously including the agreement with Colombia, signed in spite of horrendous human and labour rights violations in that country. If Harper is re-elected, expect an all-out push to implement free trade deals with Korea, followed by Japan and China, that would devastate what's left of Canadian manufacturing.

For all these reasons and more, a re-elected Harper government will only reinforce the dramatic decline in Canadian manufacturing. Supported so powerfully by Western resource élites, who have reaped unimaginable profits from the oil boom, the Harper regime actively celebrates Canada's regression into an energy-producing superpower.

Nothing is inevitable

Supporters of the *laissez-faire* approach of the Harper government claim that it's impossible to do anything about these broad, globally-motivated shifts in Canada's economic make-up. This isn't remotely believable. There are several links in the causal story outlined above, where a determined and pro-active government could successfully engineer a role for Canada in the world economy that reaches beyond simply extracting and exporting natural resources. Instead, we could aim to maximize the spin-offs from those resources, by maximizing the employment

and technology benefits resulting from resource development, stimulate desirable non-resource industries, and regulate and improve the quality of work in non-tradeable industries, like private services.

The notion that Canada's resource dependence is an inevitable result of global market forces is mere camouflage for the underlying issue that really explains why our economy is evolving in that direction. Powerful vested interests, led by the Western petroleum industry, prefer that course of development, because of the immense profits generated by the resource bandwagon. Government policies aimed at enhancing the broader interests of Canadians and building a more diversified, stable, and sustainable economy, in both the economic and the environmental senses of that word, could interfere with the resource boom at several different points:

- *Capture resource profits.* The one-time profits resulting from the extraction of non-renewable resources, especially petroleum, in conditions of record global prices, have flowed mostly to private companies rather than to the people of Canada who, nominally, own those resources. By increasing royalties at the provincial level and corporate taxes at both the provincial and federal levels, governments could capture a fairer share of those resource profits — money which could then be used to support a range of public priorities, including support for industrial strategies in other sectors of the economy.[8] More importantly for the present discussion, higher taxes on resource profits would reduce the appeal of Canadian resource companies in the eyes of foreign purchasers.
- *Slow down new resource developments.* The uncontrolled pace of resource development, especially in Alberta's tar sands, has created numerous negative side-effects for Canada's economy and environment, including regionally concentrated inflation, escalating greenhouse gas emissions, and dramatic shifts in fiscal federalism, since only the three oil-producing provinces now qualify as "have" provinces for purposes of federal equalization transfers. The pace of new tar sands and other

mining developments should be deliberately restricted through development and environmental planning measures.

- *Restrict foreign takeovers*. Foreign investment aimed at genuinely enhancing Canada's economic capabilities, with new investment, technology, and jobs, should be welcomed. But straight-out foreign takeovers of existing Canadian firms serve no positive economic purpose and should be prohibited or restricted under a much more forceful foreign investment review process. This is especially true in the resource sector. Canada is the only major oil-exporting country in the world which imposes no domestic ownership restrictions on this vital industry. The uniquely deregulated status of Canada's oil wealth is a major factor behind the intense global interest in purchasing Canadian resource companies and hence behind the run-up of our currency.

- *Reorient Canadian monetary policy*. The resource boom is the major structural force behind Canada's soaring currency, and the preceding recommended measures — to limit the super-profits of the resource sector and control foreign takeovers of Canadian firms — would automatically release much of the steam from the Canadian dollar. Nevertheless, the hands-off policy of the Bank of Canada has played an important role, too, in the dollar's unsustainable flight and the resulting manufacturing crisis. The Bank can and should be instructed to explicitly take account of the exchange rate and the broader competitiveness and stability of the Canadian economy in its interest rate and other policy interventions, rather than focusing solely on its inflation targets, as is its current policy. These instructions are fully compatible with the language of the existing *Bank of Canada Act*, which instructs the Bank to regulate the overall stability and well-being of the Canadian economy, not just inflation.

- *Actively support non-resource export industries*. Canada's past manufacturing success stories had nothing to do with "comparative advantage," free trade, or the natural workings of markets. They had everything to do with pro-active, effective

> industrial strategy. Our successes in automotive products, aerospace, telecommunications equipment, transit equipment, and a few other high-value sectors were the result of flexible, pragmatic efforts to nurture high-value sectors and diversify and enhance Canada's role in global markets. Unfortunately, that activist tradition was largely abandoned in the 1980s, as free trade became, by default, the only "industrial policy" market-oriented governments were willing to consider. Other countries, however, have continued to utilize and refine techniques of active industrial strategizing, using a range of tools — capital market tools, exchange rate policies, technology transfer, active trade promotion, and more — to foster the domestic presence of desired high-value industries. Unless and until Canada learns from those lessons, and begins to actively target and support high-value industries, including tourism and higher-value service sectors, not just manufacturing, our structural degeneration will surely continue.

These policies are all there for the using. Other countries, including most of our trading partners, rely on them every day. Canada's federal government has chosen to remain passive in the face of a historic restructuring that will limit our national economic prospects for generations to come, even if it generates quick bucks for a concentrated group of resource interests today. This passivity reflects its deliberate and biased *choice* — not any inevitable economic reality. It's a choice that Canadians, especially those whose prosperity is not tied solely to resource extraction and export, should remember well.