

Internationalization and variable confluence in state-assisted economic sectors: Lessons from Canada's experience under free trade

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In light of discordance over the impact of globalization and internationalization on patterns of domestic policymaking, this paper explores alternative explanations for tendencies toward policy convergence and divergence. In examining the disjointed patterns of government retrenchment in state-assisted economic sectors in Canada, the concept of variable confluence is developed to explain the uneven impact of international free-trade agreements on affected subsystems. At the heart of variable confluence is the notion that causation is not static but is rather sensitive to matters of timing and sequence. In the case examined, these dynamics suggest that exogenously imposed rules may be strategically navigated as domestic actors' interpretations and understandings of rules—namely their reach, comprehensiveness, their benefits and the extent to which they are binding—change over time. Employing mixed methods, the analysis demonstrates that Canadian governments abandoned many of the principles and practices of industrial policy following the implementation of free trade agreements, but gradually came to re-engage interventionist practices by both strategically navigating international treaties and by challenging them directly. Findings relevant to contemporary understandings of exogenous influence, policy feedback and critical junctures receive emphasis.

Key words: Internationalization; policy divergence; policy learning; critical junctures; free trade; industrial policy.

Introduction

As comparative case analysis has become the dominant methodology in most social sciences, an absence of empirical affirmation has caused conventional theories of policy convergence and globalization to come under scrutiny (Hale & Gattinger 2010). These confounding findings have been taken seriously by numerous scholars, giving rise to a burgeoning literature on policy divergence (Andrews & Martin 2010; Berger & Dore 1996; Galiani et al 2014). The polarizing themes that characterize these literatures hinge primarily on the relative emphasis of structure and agency in explanatory frameworks, with very few of them taking into account the confluence of variables endemic to many micro-level theories of the policy process (Cohen et al 1972; Kingdon 1984; Ostrom 2011; Sabatier 1988). Taking seriously what Hall (1997) defined as the ‘three Is’ of neo-institutional analysis – ideas, interests, and institutions — I investigate the extent to which Canadian economic policies have converged on principles of economic liberalization. Viewing policy development from a longitudinal perspective, I find strong evidence of policy divergence along two institutional axes. On a normative axis, insofar as the elimination of non-tariff barriers (NTB) constitutes a maxim of free-trade liberalization, Canadian governments have consistently shirked living up to the spirit of international trade agreements. On a regulatory axis, Canadian governments have increasingly come to challenge legal interpretations of what constitutes national-treatment and most-favoured nation (MFN) status under international law.

Testing hypotheses related to both “strong” and “weak” theories of globalization (Hay 2005), this paper uncovers several surprising findings pertinent to theories of policy convergence and divergence. Concluding that there is “no smoking gun” to explain the disjointed pattern of state involvement in the economy — to borrow a recent analogy from Banting and Myles (2013) — I argue that both structural and agent-centred explanations have merit but often fail to fully explain the

confluence of factors influencing policy decisions. In order to bridge these approaches, I develop a framework that is sensitive to variation in the processes in which structure and environment, in addition to interest-based and institutional factors, are mediated by ideas prevalent in policy discourses. These ideas and discourses are theorized to positively condition policy actors to adhere to institutional norms, societal pressure and self-interest in some cases, but condition them to act in defiance of them in others. Rather than viewing ideas simply as a vector for the expression of interests or as something unproblematically conditioned by historically-determined institutional trajectories (Patashnik 2003; Rodrik 2014), I maintain that ideas are rather critical intervening factors that determine how preferences are structured and how institutions are interpreted and otherwise navigated by policy actors (Blyth 2003).

Employing a mixed quantitative-qualitative methodology, I test the relative influence of institutional, structural, and political factors against a model designed to predict imitation and mimicry. Consonant with the “no smoking gun” hypothesis, I find that most conventional predictors of policy outcomes — namely structure, institutions and partisanship — poorly explain political behaviour. In light of these findings, I suggest that expectations and “anomalies” play a considerable role in determining whether institutional rules will invite adherence or defection, with consequences for the degree and type of convergence witnessed in a given policy area.

Understanding divergence as a problem of diffusion and transfer

Stone (2004) differentiates between diffusion and transfer according to the prevalence of structural determinism in the case of the former and human agency in the latter. In as much as convergence is a consequence of path-dependent processes of institutional reproduction (Mahoney 2000), understanding the degree and type of institutionalization is critical to understanding whether patterns of transfer and uptake will exhibit characteristics of rule adherence, norm-adherence, or both.

For this, it is useful to draw upon Keohane's (1989) three-part framework for understanding institutionalization, whereby one dimension relates to "commonality", or the extent to which actors' understandings are shared; another to "specificity", or whether expectations are specified in the rules, and a third to "autonomy", which relates to the ability of an institutions to alter its rules endogenously. Within this framework, separate notions that liberal economic policies have been propelled by "paradigmatic" ideas, on the one hand, and institutions of globalization, such as the IMF, World Bank and WTO, on the other, may be conjoined in that shared normative understandings assuage or complement the more coercive impact that international institutions have on policy behaviour. This speaks to a recurring theme in the literature on both convergence and institutionalization regarding "goodness of domestic fit" and, conversely, instances of "faux paradigm change" and "oscillating equilibrium" in cases where domestic structures and cultural contexts are incompatible or otherwise not permissive to policy transfer and uptake (Cashore & Howlett 2007; Cortell & Davis 1996).

There are thus two general perspectives on diffusion and compliance in the convergence/divergence literature. The first has its origins in international relations theory and explains compliance or defection in terms of enforceability; the second stems from comparative politics and has been predominantly used to explain patterns of convergence and divergence in "soft sectors" (Mattli & Buthe 2003). Despite the fact that the lines between hard and soft theories of convergence and divergence have become blurred as transnational norms have become increasingly institutionalized (Kollman 2007; Ruggie 2004), it is nevertheless useful to analytically differentiate between rule-adherence as it relates to coercion (or the threat thereof) and norm-adherence as it relates to emulation. In addition to this, it is important to take care in defining the type of convergence expected to follow from each of these processes (Bennett 1991; Knill 2005). For this, I borrow the four-fold typology

developed by Heichel et al (2005), but rely primarily on their distinction between convergence on an ideal type — what they call δ -convergence — and convergence as a product of harmonization — β -convergence. It is, however, important to additionally specify conditions in which policies are harmonized via processes of negotiation and those in which β -convergence occurs organically. To avoid confusion with the way in which harmonization is treated in the literature, I refer to the latter process as “levelling”. As will become imminently clear, in the area of trade liberalization, it is crucial to distinguish between δ -convergence as it relates to the pursuit of openness and β -convergence as it relates to the harmonization or levelling of trade policy, since the latter may have little resemblance to former.

The conventional wisdom: Continental free trade and policy convergence.

The two prongs of convergence just discussed receive ample attention in the literature on economic globalization and the state. Speaking to this duality, Stone (2004) argues that convergence is facilitated by three primary sets of economic incentives: 1) the rewards and punishments derivative of being a party to international treaties, 2) “status incentives” derived from belonging to “clubs” like the EU and WTO, and 3) sanctions and other forms of conditionality endemic to international finance. Stone however qualifies the extent to which these measures will be effective, arguing that “[w]ithout a ‘cosmological heritage’ or ‘shared norms’ that shape collective behaviour, compulsion is often necessary to ensure compliance and convergence” (Stone 2004: 554). In this respect, globalization triumphs precisely because hard power is at the ready to influence policy behaviour in the instances in which soft power has fallen short.

This image of “globalization triumphant”, as espoused by analysts like Kenichi Ohmae (1994) and Susan Strange (1996), while well-pronounced in the critical scholarship on Canadian political economy, has been criticized for failing to appreciate the autonomy retained by states (Banting et al 1997; Haddow 2004; Hay 2005). Although such critiques have been illuminating, they have tended to

focus on primarily on empirical questions and matters and methodology, and much less so on theory (Skogstad 2000).

On the subject of hard law, Stephen McBride's concept of “quiet constitutionalism” is probably the most well-known articulation of the impact of international agreements on domestic sovereignty. According to McBride (2003), international agreements constitute a “de facto rewriting of national constitutions” in that they bind successive governments to comply with international laws, thereby locking-in a trajectory of one-way neo-liberal reform. In similar fashion, Stephen Clarkson (2002) has been an outspoken critic of international agreements and their ability to bind not only successive governments at the federal level, but also provincial governments who had little if any input into the terms under which trade agreements would be implemented.

While the hundreds of exemptions contained within international agreements have inspired skepticism of the “hard globalization thesis”, the notion of “neo-liberalism as a conditioning framework”, originally articulated by Grinspun and Kreklewich (1994), has been foundational to the scholarship on “soft power” as it relates to critical theory. Drawing many parallels with Gramsci’s ideas regarding hegemonic worldviews, the conditioning hypothesis relies heavily upon actor perceptions that there are few if any viable alternatives aside from those dictated by hegemonic policy discourses, on one hand, and preference ordering predicated on false consciousness, on the other (cf. McBride 2005: Ch. 7). The conditioning hypothesis closely approximates what Potoski and Prakash (2004) refer to as “sociological globalization” or the diffusion of common norms. Regulation, according to Potoski and Prakash depends upon states’ willingness to adhere to norms in the absence of formal rules. Similarly, Bernstein and Cashore (2007) emphasize processes of “socially embedding market norms” in instances of effective cross-national regulation.

Social embeddedness relates closely to rounds of re-negotiation and re-evaluation implicit in the concept of “membership” as defined by Holzinger, Knill and Sommerer (2008). According to Holzinger and colleagues, institutionalization as a function of membership differs fundamentally from institutionalization as a consequence of “accession” in that, in the case of the former, the legitimacy of institutions must be renewed on an on-going basis, depending critically on whether they are perceived to be effective in solving the problems they are intended to address. In contrast, accession is confined to a discrete moment in time and therefore depends upon either of three characteristics to be effective: 1) that the rules are flexible enough to allow for interests to shift within the institutional framework, 2) that policy preferences remain stable enough to guarantee compliance absent mechanisms of enforcement, and 3) that, absent stable preferences, the institutions possess effective means of forcing compliance with institutional rules through the issuance of sanctions and via other mechanisms of coercion and enticement.

While arguments combining hard and soft perspectives on institutional compliance are reasonably resilient to critique, the hegemony of neo-liberal ideas is a dictum that warrants some interrogation. Jessop (1997), for example, argued that by the mid 1990s capitalism no longer possessed a “final telos.” Instead, according to Jessop, the political economy was rather in the process of being restructured by the “hollow state” according to “uncelebrated” principles of “Schumpeterian workfare.” At minimum, the suggestion to be gleaned here is that Schumpeterian ideas about supply-side stimulus, a strategy formerly championed by Canadian economic nationalists like Mel Watkins (1963) and Kari Levitt (1970), had been successful in making inroads into the political discourse. Howse and Chandler (1997) went further to hypothesize that this logic was more likely to prevail at the provincial level in Canada, owing to provincial jurisdiction over many of the policy areas germane to industrial policy. Courchene (1995) similarly provided an institutional explanation for why this may be the case, given the

gradual transition from conditional federal cash transfers to block transfers. This is not to say that ideas have not mattered; on the contrary, “open federalism” as an attitude about the role of the federal government in facilitating decentralization and devolution has gone hand-in-hand with institutional developments to this effect (Harmes 2007).

Given the apparent influence of Schumpeterian economic theory on Canadian governments (Porter 1991), it is paradoxical that globalization theorists would focus so whole-heartedly on the hegemony of *laissez-faire* ideas. Ironically, proponents of the hard globalization thesis argued precisely that convergence would produce considerable anomalies with respect to the innovativeness of the Canadian economy (Strange 1996). That this has not happened may hinge upon the fact that liberalization has been less than complete (Brownsey & Howlett 2007), yet explanations for why this has not occurred focus primarily on the role of the market and seldom on the role of the state. When the state is considered, it tends to be at the federal level, which may miss important aspects of industrial organization and assistance whose ultimate locus of decision-making is the provincial executive (Conteh 2013; Clarkson 2002: Ch. 14).

The following section outlines a conceptual framework for understanding such disjointed episodes of policy transfer and uptake that is sensitive to matters of jurisdiction — both in terms of geography and with respect to the place of actors in multi-level settings — as well as matters of timing and sequence.

A confluence model of decision-making

While methodologically quite sophisticated, models of policy convergence have been criticized for neglecting to develop conceptual frameworks that consider a broad range of possible influences (Dobbin et al 2007). Instead, highly complex quantitative modelling is typically employed without much regard for the quality of the theory that underlies it, resulting in situations in which one or two (usually

structural) variables are claimed to be deterministic. Also problematic is a tendency to inadequately or imprecisely define what is meant by convergence, conflating similarities in policy outcomes with policy goals and specific instrument mixes (Weyland 2005).

Similar to other areas of the policy sciences, iterative conceptual frameworks have gained currency in the convergence literature as a means of resolving this shortcoming. Central to these frameworks is the notion that institutions become strengthened and transformed over the course of “discursive iterations” (Dodge 2009; Risse & Sikkink 1999) that often precede and accompany policy iterations (Hay 2001). Along these lines, in examining the internal processes of policy emulation, Lee and Strang (2006), for example, explored the ways in which structural and institutional characteristics of policy subsystems both influenced and were influenced by dominant policy discourses. In an important step, Howlett, McConnell and Perl (2013) developed a model for understanding the differential interaction of variables at “confluence points” in the policymaking process. Although theirs is a meso-level processual theory of variable confluence that depends critically upon dominant policymaking contexts (or “streams”), Howlett and colleagues’ approach is informative for theory-building at the macro-level as well. Figure 1 lays out the logic of a confluence model of decision making whereby outcomes vary according to seven factors.

Figure 1: A Variable Confluence Model of Policy Change at Three Decision Points

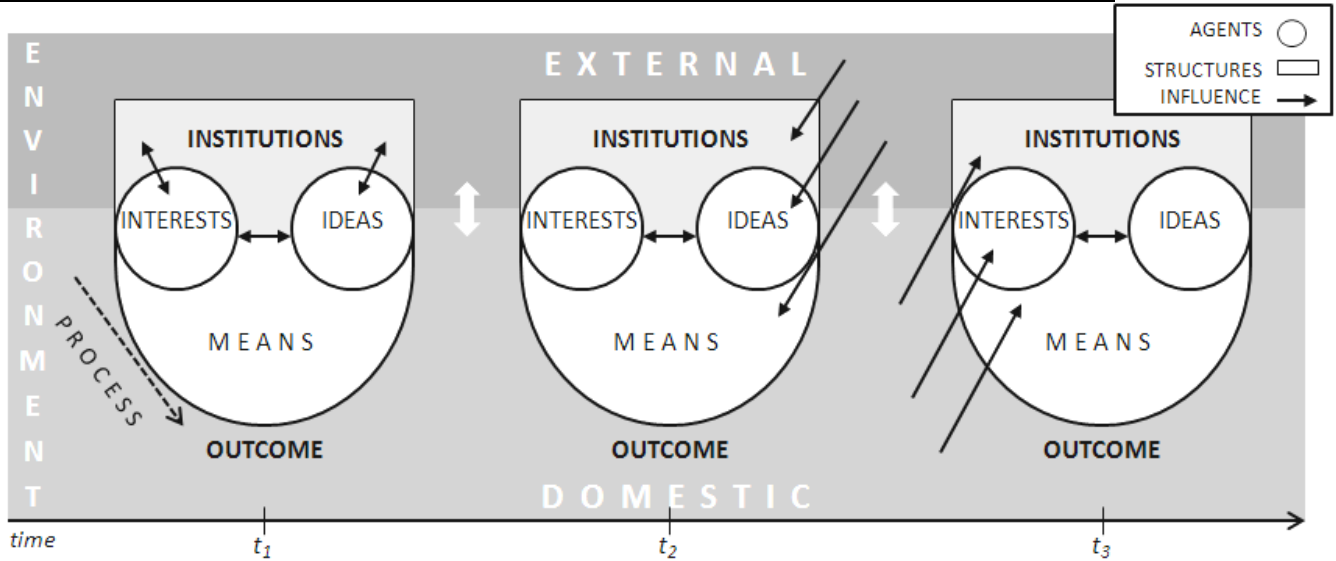


Figure 1 illustrates the interplay of seven factors in the policy process: external environment, domestic environment, institutions, interests, ideas, policy means, and time. The central idea behind variable confluence is that, in scenarios in which variables interact in complex ways, the process of causation will likely vary across time and space, with certain variables aligning at certain points, but diverging at others. To be sure, there will be a complex confluence of all of these factors in every policymaking setting, but the relative influence of structures and agents, as well as the influence of the exogenous and domestic environment, will be variable. For instance, the example at *time₁* in Figure 1 is representative of the standard image of insular policymaking, where interests and ideas interact with institutions and are synthesized throughout the process of policy formulation (Simeon 1976). The example at *time₂* is representative of a situation in which the external environment has a disproportionately strong influence, not only on institutions, but also on ideas and means.¹ Conversely, the example at *time₃* is representative of domestic pressure.²

The case study will demonstrate that each of the latter two examples is pertinent to the story of industrial subsidies in Canada. Critically, variable confluence promotes the understanding that the

external environment may impact the domestic process in contradictory ways, bringing the importance of ideas and their role in determining interests to the fore (Hansen & King 2001; Jacobs 2009).³ Two crucial caveats are, however, in order. Concerning ideas, the framework aims to explore the conditions under which policy ideas, which may be resilient due to prior beliefs and ideological determinism, become malleable (Gilardi 2010; Volden et al 2008). Conversely, concerning issues of timing and sequence and their impact on policy learning, the framework aims to explore the temporal dynamics of institutional change as a product of preference re-ordering (Bennett 1991).

A central argument that I aim to make in this paper is that institutions appear to be very good at organizing, harmonizing and otherwise levelling policy preferences, but they leave much to be desired in terms of determining or institutionalizing those preferences. The case study demonstrates that even hard rules can and will be broken if state preferences diverge from the norms and principles embodied in international institutions. The lessons to be learned here are many. With respect to theory, agents and in particular their interpretations of policy problems and appropriate solutions, matter tremendously. With respect to the effectiveness of institutions, accession has proven only so effective in encouraging certain behaviours, which suggests that, if the programme of liberalization is to go forward, further work is required to align what have become increasingly divergent interests. Given the policy anomalies associated with liberalization, it is however doubtful that free trade norms will be the ends around which the negotiation of future agreements can or should be based. In this respect, it may by this point be that no such common ends exist, in which case policy drift will increasingly become a feature of North American economic policy. However, as the case demonstrates, it is important to be mindful of differences between perceptions of policy failure as a consequence of bad policy, and policy failure derivative of fact that other actors are not behaving according to the rules. From both an empirical and theoretical standpoint, it is worth repeating that the “true” cause of policy anomalies is for the most part

irrelevant, since evaluative criteria are almost invariably politicized during the process of policy formulation (Sabatier 1988).

To this effect, the following section finds that lock-in on policy trajectories converging on neo-liberal policies — in this case, neo-liberal trade norms — has not always been sustained. Several possible explanations are available for making sense of such developments. The most intuitive and empirically verifiable is that the pertinent institutions (i.e., trade agreements) are not as binding, either in legal or practical terms, as earlier commentators believed them to be. In this sense, the strong globalization thesis is falsified in that its necessary conditions have not been met: the institutions purported to constrain governments simply do not exist as such. However, as discussed in the previous section, the soft globalization thesis purports that institutional changes reinforce or complement the ideological positions of policy-makers at the time of an agreement's inception. This exercise in self-binding is momentous, so the argument goes, owing to the forces of ideational and institutional path dependency (Jones & Baumgartner 2005). In a federation like Canada, the ability of decision-makers to determine the policy course of future governments, even in instances in which governments so much as informally adopt packages of mutually reinforcing norms (Helmke & Levitsky 2004), is hypothesized to be significant, first insofar as the central government's international obligations are considered to be binding on its constituent units and, second, insofar as transfer, emulation and policy spill-over is pervasive across provincial borders (Atkinson et al 2013; Harrison 2006). This is essentially the basis of the conditioning hypothesis discussed earlier, which, unlike the hard globalization thesis, rests on a theory of sufficient conditions.

Similar to the soft globalization hypothesis, I explain the confluence of determining factors to be contingent on a process of conditioning, but one that is ideational, as opposed to ideological. The process of arriving at policy outcomes is confluent in the sense that policy actors must undergo two

types of conditioning when faced with institutional barriers to policy entrepreneurialism. First, they must understand institutional barriers in a certain light so as to either (a) determine their policy programmes to be consistent with their treaty obligations, or (b) perceive themselves capable of violating prior agreements, either in spirit or according to the letter, with a degree of impunity such that the benefits outweigh the consequences. Second, they must perceive losses under the existing policy framework to be sufficient to warrant divergence from institutionalized norms. In policy networks and subsystems in which adherence to existing norms is high, divergence will be unlikely in the absence of sustained anomalies or the provocative reframing of policy problems (Baumgartner & Jones 1993; Hall 1993).⁴ The centrality of perception in successive episodes of policy-making is returned to in the discussion of the findings.

The puzzle: The persistence of industrial policy in Canada

Given the previous discussion on “hard” and “soft” theories of economic liberalization in the critical literature (McBride 2005; Clarkson 2002), the persistence of direct intervention in the Canadian economy should be perplexing to most. Even those skeptical of the extent to which the Canadian state has experienced retrenchment in the free-trade era tend to agree that Canadian governments are considerably constrained by the plethora of international agreements. Cameron and Gross-Stein (2000), for example, developed a functionalist typology for understanding state behaviour whereby the state may actively facilitate the ends of neo-liberal globalization by acting as a “handmaiden” or, conversely, act in moderate defiance of international pressures by fostering a “social investment paradigm” that is in some ways antithetical to the globalization project. Nevertheless, the consensus has been that continental integration has been deep, with many arguing that spatially-clustered liberalization has derived at least in part from processes of “channelled learning” with respect to the benefits of economic liberalization (Simmons & Elkins 2004).

Wallner (2008) points out, however, that the idiosyncrasies of Canadian federalism render attempts to affirm the convergence hypothesis problematic. Along these lines, Clarkson and Lewis (1999) have argued that patterns of retrenchment among the provinces have been slower and otherwise qualitatively different than retrenchment witnessed at the federal level in Canada. This may be due in part to ambiguity over the extent to which provinces are bound by international agreements negotiated by the federal government when areas of exclusive provincial jurisdiction are concerned (Herman 2010; Skogstad 2012). As will be shown, the twenty-first century has seen an impressive resurgence of industrial policy activity at the provincial level that flies in the face of both hard and soft explanations for convergence upon liberal trade norms.

Industrial policy, free trade rules and liberal norms

The legacy of industrial policy in Canada is characterized by the prevalence of three ideas regarding market failure. The first has to do with creating employment opportunities when the market is deemed insufficient at doing so. The second has to do with building up protection against market volatility by diversifying industries. The third has to do with attaining an early-mover position in emergent technologies by branching into high value-added niches. Industrial policy in Canada has, however, historically not been concerned with fostering domestic champions but rather selectively enticing international investment according to a “forced growth” logic of “creating” comparative advantage (Mathias 1971; Tupper 1982). This strategy was expressly forbidden in the Agreement on Internal Trade (AIT) as it related to enticing firms to relocate from other provinces, but has been selective enough to prompt trade disputes. For example, the industrial policy surrounding Ontario’s 2011 Green Energy Act involved awarding contracts to the Korean hardware manufacturer Samsung to the exclusion of other transnational firms, precipitating two separate complaints to the WTO, one complaint under the AIT, and two NAFTA complaints by private firms. While industrial policy is

preoccupied with sectoral targeting, direct subsidies are but one instrument available to governments, but are of special interest to this analysis given that they are discouraged by international institutions where they are not forbidden outright (Doern & Tomlin 1996).

Although the 1989 Canada-US Free Trade Agreement (CUFTA) sought primarily to phase out non-tariff barriers (NTB) — the majority of which fall within areas of provincial jurisdiction (Maxwell & Pestieau 1980) — concern quickly arose surrounding the ability of the CUFTA agreement to hold the provinces accountable (Skogstad 2000). Thus, although competitive behaviour on the part of the provinces had by the early 1980s been sporadically identified by both academics and politicians as “self-defeating”, institutionalization at the domestic level of specific means to avoid fragmentation of the Canadian common market and the “balkanization” of Canadian industry did not materialize until the negotiation of the AIT in 1994 (Tupper 1982; Courchene 1995). Thus, while international and intrastate trade agreements were aimed primarily at eliminating NTBs — namely subsidies, preferential treatment and local content requirements — these agreements were only partially successful in breaking down these barriers.

It is therefore important and useful to speak of trade liberalization in terms of both norms and rules. Norm-adherence in this respect relates compliance despite opportunities to circumvent the rules, while rule-adherence has to do with compliance resulting from domestic actors’ interpretation of the rules as binding. Jeffrey Ayres and Laura Macdonald have suggested that North American integration has depended primarily on soft rules and norm-adherence: “In the case of North America, it is commonly recognised that the neo-liberal leanings of the founders of NAFTA led them to consciously minimise the construction of formal political institutions to govern the new region” (Ayres & Macdonald 2006: 28). According to this view, the architects of continental integration did not think the construction of more binding institutions was necessary, the likes of which would more closely

approximate what Holzinger et al (2008) have termed “membership”, given the negotiators’ alleged faith in the mutual benefits of free trade (Pastor 2001). Instead, frameworks of “shallow governance”, institutionalized at discrete points of accession, have facilitated the maintenance of domestic policy regimes despite pressure for continental policy harmonization (Anand 2010; Courchene 1995). Accordingly, Howse and Chandler (1997) observed that sub-national governments in both Canada and United states have made extensive use of loans and loan guarantees in spite of the fact that these often constitute countervailable subsidies.

The perceived strength of the trade agreements as legal institutions has nevertheless been such that Stephen Clarkson went so far as to argue that

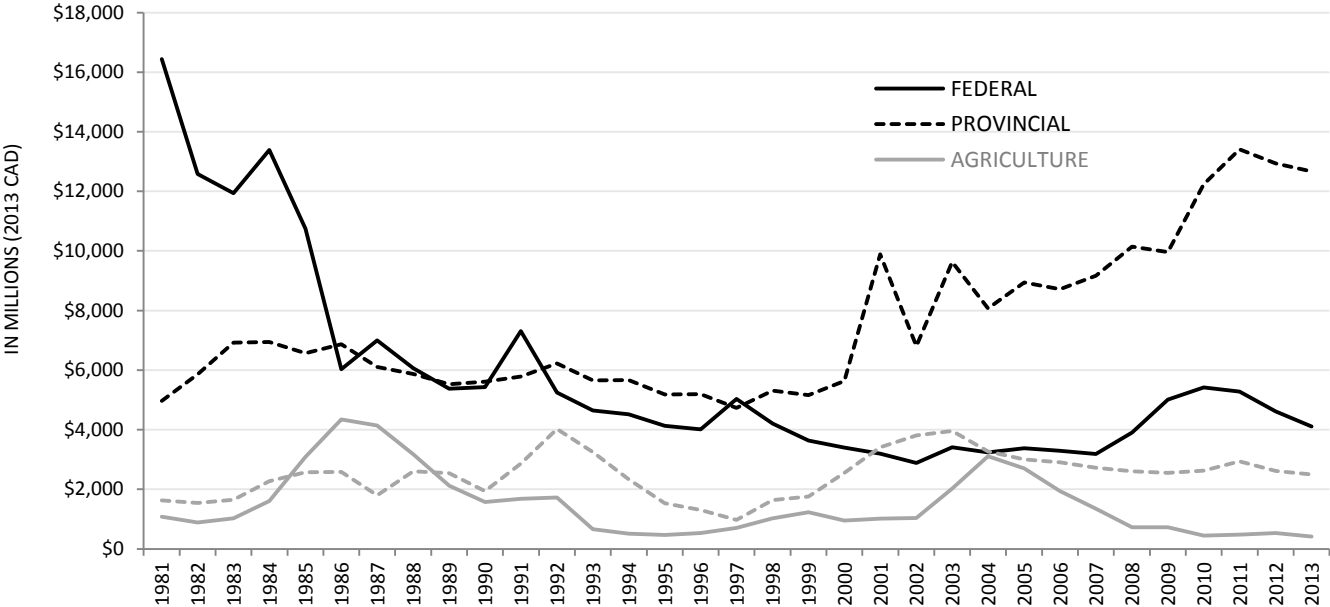
Canada is so directly affected by the US international agenda, whether through the continental or the multilateral agreements that Washington has promoted, that trade policy has become the master disciplinarian of Canadian government. Extensive economic treaties signed in the last two decades contain not just hundreds but thousands of pages of rules which have major implications for Canada's constitutional, statutory, judicial, administrative and even coercive orders (Clarkson 2001: 505-506).

To be sure, the early evidence suggested that the Canadian state had indeed been disciplined by international agreements, whether we think of such discipline primarily in terms of coercion as per Clarkson’s argument or in terms of ideational/ideological conditioning (Grinspun & Kreklewich 1994). Direct industrial subsidies as a tool of industrial policy had, after all, come under scrutiny at the federal level in the Mulroney government’s first budget in 1985.⁵ An analysis of provincial budget addresses reveals a more nuanced picture, in that there was a clear penchant for advertising generous subsidies for struggling and emerging sectors in the 1970s and 1980s, while by the early 1990s, the official attitude toward subsidies in British Columbia and Alberta had shifted in a decisively negative direction. While Manitoba and, to a lesser extent, Saskatchewan continued to promote diversification schemes in official reports until the mid-1990s, by the late 1990s most provinces came to publically disparage industrial

subsidies, frequently citing trade laws prohibiting their use. The prevalent attitudes among officials have thus evolved from being positively-oriented toward subsidies during the GATT years to being negatively disposed to subsidies for reasons related to policy failure during the 1990s. Early on in the new millennium, official attitudes shifted once again to remain negatively disposed to subsidies but for reasons related to defection on the part of other governments, not for reasons of policy failure.⁶

From a longitudinal perspective, these sentiments have however seemingly done little to discourage provincial governments from using subsidies to promote domestic industry. As indicated by Figure 2, the point at which the pattern with respect to federal subsidies departs with the story at the provincial level revolves around the 1995 federal budget, which devoted considerable attention to the issue of phasing out subsidies across all sectors, including those protected by exceptions in the trade agreements.⁷ Even so, federal transfers to business have averaged \$4.9 billion per year since 1995.

Figure 2: Industrial Subsidies—Excluding Agriculture, 1981-2013



Calculated based on Statistics Canada CANSIM table 380-0080: Revenue, expenditure and budgetary balance — General governments, quarterly (dollars), and table 380-0081 Revenue, expenditure and budgetary balance — Provincial administration, education and health, quarterly (dollars).

That said, it is not simply the case that expectations have gone unfulfilled only insofar as the practices of Canada's trade partners are concerned. The rationale for free trade as envisioned by the 1985 Royal Commission on the Economic Union and Development Prospects for Canada was that bilateral free-trade would, above all else, "rationalize" and strengthen Canadian manufacturing. Yet manufacturing has been by far the poorest performing sector of the Canadian economy (Trefler 2005), which may explain why Canadian governments have attempted to find ways to claw back some of the NTBs relinquished during the CUFTA negotiations in 1988. This is a possible and even likely scenario given that, following the salience of international "subsidy wars" in the 1980s, the discourse shifted in the early 1990s toward the elimination of domestic subsidies according to what was for the most part a competitive rationale. As previously mentioned, the new millennium witnessed the discussion of subsidies shift yet again toward the persistence of illegal subsidies internationally. Thus, while the connotation among policy-makers remained negative, the notion that subsidies do not promote growth — and may in fact hinder it — was by and large confined to the 1990s.⁸ It is also worth pointing out that, by the mid-1990s, it was bad publicity for any government to denounce free trade in favour of protectionism.

Figure 2 is therefore illustrative of the disconnect between what can be gleaned from the analysis of public statements and the spending patterns revealed in public accounts. Despite altruistic language on the part of policymakers, Canadian governments appeared just as willing to erect new NTBs by the late 1990s as their competitors. On this note, given that there are and have been many changing exceptions regarding agricultural subsidies, steps have been taken to omit agricultural subsidies from the discussion here to help parse out rule defection from rule navigation; however, in the following quantitative analysis, data limitations forbid this distinction.

The Impact of Internationalization on Industrial Policy Formulation

Many institutional measures have been taken to reduce the both the incentives and the ability of states to pursue industrial policy (Hall 2003). Although GATT has been in place since 1947, the free-trade era in Canada is typically considered to have begun with the negotiation of the Canada-US Free Trade Agreement (CUFTA) in 1989. This trajectory was only further bolstered by the 1994 accession of the World Trade Organization (WTO), the Agreement on Internal Trade (AIT) and the North American Free Trade Agreement (NAFTA). Thus, according to most globalization and internationalization theorists, there is a strong institutional argument to be made for the systematic diffusion of free-market principles (McBride 2003; Simmons & Elkins 2004).

Others argue, however, that Canadian governments have for the most part always appreciated Canada's place in the global economy as a country whose survival has depended on unrestricted trade with key partners (Hart 2002). According to these theorists, it is not so much the institutionalization of hard rules, but rather common sense that prompts Canadian policymakers to adopt a free-trade stance. From this perspective, compliance on the part of policymakers is assumed to derive from the observable structure of the economy, not from the rules themselves. Put differently, Canada pursues free trade because its economy is structured such that trade dependence and sensitivity are salient.

Contrary to the null hypothesis that internationalization will produce no variation in the distribution of industrial subsidies, the thesis that internationalization matters has five dimensions.

The institutional hypothesis. There will be a decline in the use of industrial policy instruments as rules become institutionalized. (This is the standard view in the literature on globalization and internationalization.)

The structural hypothesis. The pattern will vary according to trade-sensitivity across time and geography, with trade-dependent jurisdictions being quicker to eliminate barriers than those with more insular economies.

The political hypothesis. Variance will depend on the party in power, assuming that governments seek to fulfill the policy preferences of their supporters.

The interest-based hypothesis. Cooperation and defection will be is contingent on whether or not specific societal interests are served by adhering to international agreements.

The ideational hypothesis. Rule adherence will be forthcoming only as long as expectations are satisfied.⁹

As discussed previously, δ -convergence predicts convergence on an ideal type. In this case, we can assume that convergence on principles of non-intervention would yield the complete abolition of subsidies. This has clearly not occurred. More complicated is harmonization and levelling between units, or β -convergence. Analyzing the data by province proves to be of little assistance in this respect, as the trend has varied across provinces and over time, producing a 923% difference between the most and least subsidizing provinces at the point of greatest convergence in 1997. Similarly, the addition of federal and state-level data from the United States does little to produce a clear pattern of convergence across the two countries since state subsidies are much more modest than those distributed by the Canadian provinces, while federal subsidies in the United States dwarf total Canadian subsidies by a factor of fifteen.¹⁰ Regression analysis should provide some insight into the pattern and determinants of beta convergence, if any exists.

Methods

As indicated by the previous discussion, the variables under consideration fall into five categories: institutional, structural, political, interest-based and ideational. Given the overlap between interest-based, political, and ideational determinants, means for accounting for interests have been subsumed under the rubric of both politics and ideas. The variables included in the analysis are operationalized as follows.

Institutionalization is intended to account for the effect of trade agreements, both at critical junctures and thereafter. Means for accounting for the impact of accession as well as an approximation for what Holzinger et al (2008) call “membership” is built into the model in a series of dummy variables operationalized according to the frequency, venue and target of trade disputes. Structural variables relate to the size of government deficits, debt per GDP, level of incoming investment (per GDP), the unemployment rate, and trade intensity (measured as exports over GDP). A nominal variable is included for province to control for the structural effect of geography and political culture, but is omitted from the results below because of its impact on the efficiency of the regression. Instead, separate results are reported per province in Table 2. Political variables are organized according to the party in power, whether it is a government’s first term, and whether or not the governing party holds a majority. Partisan variables are, however, also omitted from the reported findings for efficiency reasons, but receive attention in the following discussion.

After conducting an analysis according to these dimensions, variables for predicting imitation and mimicry are included by shifting back by one year input variables measuring increases to the level of subsidies employed by federal, US, and neighbouring provincial governments, as well as variables accounting for trade disputes in various forums. This model seeks to explore the “follow the leader syndrome” that Tupper (1982) argued characterized provincial industrial policy in the previous era. The intention here is to definitively isolate patterns of β -convergence from patterns of δ -convergence.

The dependent variable for all regressions is the level of annual subsidies for a given jurisdiction. It is operationalized as subsidies divided by GDP.

The continuous variable data for the analysis was collected from the Statistics Canada CANSIM database, while many of the categorical and binary variables, such as *neighbour IP announcement*, have been derived from query-based analysis of throne speeches and budget addresses, many of which are

available through the *poltext.org* project. This type of data, often referred to as time-series cross-sectional (TSCS) data, violates assumptions standard to ordinary least squares (OLS) regression regarding the independence of errors. While roughly the same protocols apply to both OLS and time series analyses for avoiding type I error as a consequence heteroscedacity, the standard method for dealing with serially correlated errors — a problem unique in this context to time-series data — is to use the generalized least squares (GLS) method.¹¹

The dependent variable, *subsidies/GDP*, is skewed to the right (toward zero) and thus warrants transformation. Having a positive value and the upper and lower bounds of a proportion, the arcsine square root is an appropriate and common transformation. Elsewhere, it is similarly necessary to transform continuous independent variables according to the same logic; such as *investment/GDP* and *GDP per capita* to their logs.

Tables 1 and 2 report the results of the GLS analysis

Table 1: Combined Results of Generalized Least Squares (fit by Maximum Likelihood)

Independent Variables	Standard Error	Coefficient
<i>Institutional Context</i>		
Accession year	(.007)	0.0070718
FTA	(.011)	-0.0184567
WTO/NAFTA/AIT	(.010)	-0.0481903***
<i>Political Context</i>		
First term	(.005)	-.005
Majority	(.011)	-.007
Party		<i>See below</i>
<i>Structural/Environmental Context</i>		
Deficit	(.000)	-0.0000004
Debt/GDP	(.001)	-0.005598
Export/GDP	(.022)	-0.0401529**
Investment/GDP	(.016)	0.0033525
Unemployment	(.187)	-0.2175823
<i>Imitation/Mimicry</i>		
Neighbour IP up	(.001)	-0.0002951
Federal IP up	(.004)	-0.0034537
Win next election	(.006)	-0.0065592
Disputes		
—Direct dispute	(.013)	-0.0019082
—Any dispute	(.004)	-0.0050782
<i>Controls</i>		
GDP per capita	(.020)	-0.0862878***
Growth per capita	(.000)	-0.0000006

*** $p < .001$ ** $p < .05$

Table 2: Results of GLS Analysis by Province

	FED	AB	BC	MN	NB	NFL	NS	ON	PEI	QC	SK
<i>Institutional Context</i>											
Accession	-.020**	-.002	-.014**	-0.025**	.047	-.020**	.432	-.005	-.006	-.015	-.014
FTA WTO/ NAFTA/AIT	-.045***	.0124	.009	.016	-.080	-.045***	.047	.005	.002	.063**	.084
	-.053***	-.090***	-.004	-.075***	-.035	-.052***	-.080	.007	-.105***	-.021	-.079
<i>Structural/Environmental Context</i>											
Deficit	1.E-07	-9.E-07	2.E-06**	1.E-06	4.E-05	1.E-07	-.035	1.E-07	-93.E-06	4.E-6	1.E-05
Export/GDP	-.052**	.109	-.037	-.149***	0.129	-.053***	49.E-06	-.090**	.065	-.033	.017
Debt/GDP	.022	-.237***	.033	.016	-.552	.022	.129***	-.037	.069**	-.070	-.085
Investment /GDP	.111**	-.108	.032	-.002	.029	.111**	-.553	.006	.097**	.226	-.181
Unemployment Rate	.002	-.619	.104	.638	-.003	.548	.029	.099	-.135**	-.119	-.373
<i>Imitation/Mimicry</i>											
Neighbour IP up		-.06***	-.007	-.039	.002	-.001	.002	-.018**	-.022	-.015	-.021
Win next election		.034	.008	.002	.009	-.002	.009	.021	.021	-.019	-.026
Trade dispute		.023***	.007	.024	-.012	.006	-.012	-.001	.017	.005	.012
Neighbour IP dispute		-.030**	.001	.013	.005	.005	.005	-.002	-.007	.001	.0124
<i>Controls</i>											
GDP per capita	.068	-.219***	.001	-.084	-.518	.068	-.003**	-.0412	.021	.090	-.321
Growth per capita	2.E-07	1.E-07	-1.E-06	-0.025	.000	2.E-07	-.518	1.E-07	1.E-06	1.E-60	-6.E-07

*** $p < .001$ ** $p < .05$

Consonant with Banting and Myles' (2013) "no smoking gun" hypothesis, the results of the holistic model in Table 1 indicate that the combination of NAFTA, the WTO and the AIT have had a statistically significant but weak negative effect on governments' willingness to subsidize industry. Theoretically, this finding complements the other significant (and negative) correlation between level of subsidization and the trade openness variable *exports/GDP*. Attention to the findings per province reported in Table 2, however, suggests that institutions and structure affect the behaviour of different

Canadian governments in different ways. Unlike the holistic model, the per-province analysis suggests that some provinces may learn differently than others.

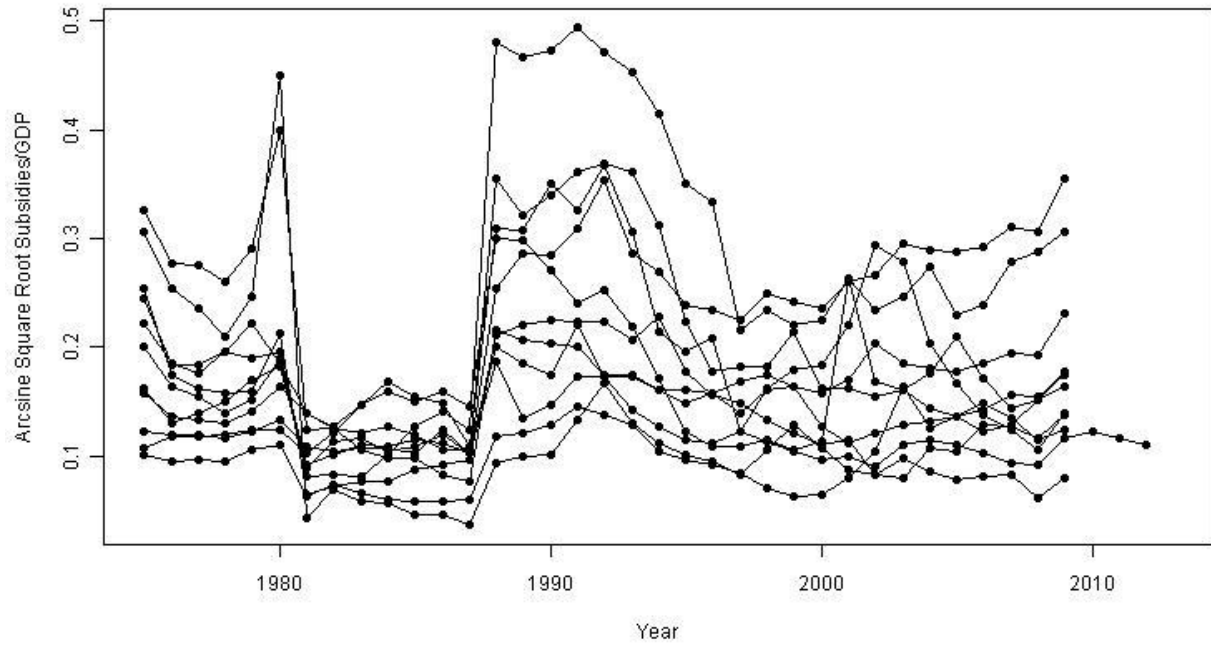
As is the case with the holistic model, institutions appear to also matter in the disaggregated model summarized in Table 2. The story by jurisdiction, however, highlights several nuances, given that accession produced significant and negative correlations in four of the eleven cases. The FTA alone similarly produced two significant negative correlations and one positive, while the combination of the WTO, NAFTA and AIT agreements have had a negative effect across all cases, five of them being statistically significant.

Also similar to the holistic model, the per-province GLS finds that trade sensitivity exists in a significant and negative relationship with level of subsidies in four of the eleven cases. Unlike the holistic model, the per-province GLS reports statistically significant and positive relationships between investment and subsidies in three of the eleven cases. Unlike the findings for the imitation/mimicry variables (and one significant finding for unemployment), the positive findings for investment are supportive of a theory that can explain the manifestly weak correlations across the board, if the two structural characteristics, investment and export intensity, exist in mutual tension with one another.

The three panels in Figure 3 are demonstrative of the underlying pattern introduced earlier in Figure 1 and illuminate the tension between trade sensitivity and investment as it has characterized three free-trade eras: the GATT era (1947-1989), the FTA era (1989-1994), and the multilateral era (1995-present).

Figure 3: Dynamics of Subsidy Elimination and Maintenance

A. Distribution of the Dependent Variable over Time



B. Trade Openness & State Retrenchment: 3 Periods



C. Investment and Program Maintenance: 3 Periods



The distribution of the dependent variable in Panel A reveals that there was greater convergence — both δ -convergence and β -convergence — in the 1980s than there was in the free-trade era. Panel B is demonstrative a negative relationship between trade sensitivity and rates of subsidization but reveals that there is substantial variation across both geography and time with a tendency toward β -convergence around a moderate level of subsidization, particularly during the multilateral era (e.g., the clustering of the blue and red observations in the centre of Panel B). Panel C indicates an opposing tendency regarding investment intensity, with a strong association to time and, consequently, level of institutionalization. While the introduction of institutions designed to liberalize trade and increase investment appear to have been successful in terms of the former, contrary to expectations, investment has gone hand-in-hand with increased rates of subsidization. Similar to the pattern in Panel B, the

investment in the multilateral era has encouraged β -convergence around a moderate level of subsidization.

Finally, it is important to point out that it is not simply the case that the observed clustering is reflective of geographic or partisan tendencies. On the contrary, mean scores for party and province do not reveal startling differences, with the means for Quebec and Prince Edward Island, and, relatedly, those for the Parti Québécois, being slightly but insignificantly higher than those for other provinces and parties. Variation over time is similarly reflective of the lack of a clear pattern in this respect, with outlying observations by province and by party spanning the entire temporal range.¹²

Variable confluence in state-assisted economic sectors

Seeking to explain the incidence of β -convergence instead of δ -convergence on a policy of zero subsidies, Howse and Chandler argued in the mid-1990s that the sustenance of industrial subsidies, at what turned out to be the point of greatest convergence both internationally and intra-nationally, was due to shifting ideas among officials regarding how to attain greater competitiveness.

In general, industrial policy in the two countries [Canada and the United States] appears more alike than it was at the beginning of our period: Canadians are less enthusiastic; Americans a bit more so. Once again, our explanatory task is to understand both the growing similarity in the industrial policies of the two countries and the lingering differences in approach. To begin with convergence, the most crucial explanation must lie in global economic factors. What generated the increased attention to industrial policy in U.S. policy debates was the dawning realization of its vulnerability to international economic forces, such as the competition from Japan and from low-wage newly industrializing countries (Howse & Chandler 1997: 263).

The critical point to be made here is that, according to Howse and Chandler, structural and environmental factors were not causally-relevant in and of themselves, but became influential only as they were synthesized via ideational processes, thereby reorienting the policy preferences of decision-makers toward, not away from, industrial policy. However, contrary to both structuralist explanations

and theories of mimicry and imitation, policy learning, the likes of which often results in emulation, is a longer term and much more interpretive process that can not be predicted using the type of model employed in the preceding analysis. This may explain why both the structural/environmental predictors and the mimicry predictors provided little insight into the behaviour of states.

This analysis reveals the importance of two dimensions that receive insufficient treatment in the convergence literature: time and positive feedback (Bennett 1991; Pierson 1993). Given that North American governance has for the most part taken only the form of “accession”, it has been criticized for possessing only mechanisms for “shallow governance” (Holzinger et al 2008; Ayres & Macdonald 2006). Thus, while periods of institutionalization have constituted critical junctures, they have yielded little in the way of the positive feedback required to sustain, much less reinforce, adherence to either the principles of liberalization or the hard rules contained within the trade agreements. The result, as indicated by the resurgence and acceleration of industrial policy activity in Canada, has been substantial policy drift (Hacker 2005).

Conclusion

While complex and long term phenomena are often the consequence of a battery of causal variables, we are not helpless to understand these intricacies. By the same token, this paper has aimed to resist neat explanations for policy outcomes that rely too heavily on assumptions regarding the logic of state behaviour as determined by clear policy preferences disciplined by institutional rules. The central lesson to be learned in this respect is that institutions of global and continental integration have been less successful in producing convergence on the principles of economic liberalism than is often assumed. Here it has been essential to differentiate between convergence on ideal types and convergence upon an equilibrium arrived at either through conscious negotiation or “organic” levelling.

With respect to the latter, this analysis has demonstrated that two structural factors may contribute to this equilibrium — trade sensitivity and investment intensity — but that they influence policy preferences in opposing ways. While we may assume that states with a lot to lose would avoid antagonizing their trade partners by engaging in defection, the logic of attracting and maintaining investment by subsidizing incoming and extant firms renders the preferences of policymakers ambiguous. Institutions of international economic governance were introduced precisely to order these preferences, in large part by expressly forbidding the latter option. However, over time Canadian governments, particularly those at the sub-state level, have acquired an aptitude for both strategically navigating these rules and challenging them outright.

I have argued that this ability has hinged crucially on the absence of positive feedback characteristic of “shallow governance” arrangements (Ayres & Macdonald 2006). The implication is that, in the face of the incomplete institutionalization of free trade norms, old ideas and the policy preferences that accompany them have gradually come back into currency. Put differently, the desire to attract and maintain investment — the ideational crux of industrial policy — has begun to outweigh the perceived benefits of complying with trade laws, which have themselves proven unable to constrain states from subsidizing industry.

Exploring the impetus for this shift in attitude has been an objective of this analysis, which has revealed that attitudes and ideas about both the political economy and the international trade regime have factored significantly in the discourse on industrial policy in Canada. Crucially, the resurgence of industrial policy has not been found to be characteristic of imitation and mimicry but instead appears to revolve around actors’ perceptions of the behaviour of other jurisdictions. What is less clear, given that a dominant attitude in the mid-1990s was that industrial subsidies were costly and ineffective in achieving policy goals, is whether or not ideas to this effect have decisively changed in the contemporary period.

In this respect, proponents of trade liberalization and the power of international institutions should not despair, as it is likely that a commitment to free trade has persisted in the minds of policymakers, even if the appreciation of international institutions as being effective has not.

¹ In the case of industrial subsidies in the free-trade era, decisions from international bond rating agencies, for example, impacted the domestic political environment, but also the institutions of Canadian fiscal policy in addition to the ideas of policymakers regarding what was considered to be sound fiscal policy as well as the means by which fiscal policy could be pursued.

² This type of influence usually takes the form of associationalism or clientelism (Doern & Tomlin 1996); for example, support among Canadian industry associations in the mid 1990s for a more activist state dedicated to network coordination, the result of which was a shift of state interests, institutions and, consequently, policy means (Roy 1995).

³ On this point, Haas (1992: 1-2) observed: “At its core, the study of policy coordination among states involves arguments about determinism versus free will and about the ways in which the international system is maintained and transformed. Among the overlapping topics of debate are whether national behavior is determined or broadly conditioned by system-level factors, unit-level factors, or some complex interplay between the two; whether state policymakers can identify national interests and behave independently of pressures from the social groups they nominally represent; and whether states respond consistently to opportunities to create, defend, or expand their own wealth and power, to enhance collective material benefits, or to promote nonmaterial values... In focusing on the structure of international or domestic power in their explanations of policy coordination, many authors ignore the possibility that actors can learn new patterns of reasoning and may consequently begin to pursue new state interests. While others mention this possibility, few investigate the conditions that foster a change in state interests and the mechanisms through which the new interests can be realized.”

⁴ Keck and Sikkink (1998: 19), for example, argue that “An effective frame must show that a given state of affairs is neither natural nor accidental, identify the responsible party or parties, and propose credible solutions. These aims require clear, powerful messages that appeal to shared principles, which often have more impact on state policy than advice of technical experts. An important part of the political struggle over information is precisely whether an issue is defined primarily as technical—and thus subject to consideration by ‘qualified’ experts—or as something that concerns a broader global constituency.”

⁵ The philosophical sentiment of the Mulroney Progressive Conservatives was succinctly captured in the 1985 budget address: “The study team examining services and subsidies to business pointed out that undue stacking of benefits can result when investments receive both tax incentives and government grants. I am proposing measures to reduce the undesirable effects of this giving with both hands.... In keeping with the philosophy of greater reliance on market incentives, the government is moving to reduce the use of grants and other subsidies. Industrial subsidies will be reduced by \$100 million this year and \$150 million next year. Agricultural expenditures will be lowered by \$50 million a year.”

⁶ For example, the Ontario Liberal government under Dalton McGuinty announced in 2008 that “Ontario will continue to champion international trade that is open and fair. Unfortunately, our competitors do not always play by the rules. Massive agricultural subsidies in Europe and the US are hurting our farmers and making it difficult for them to compete. Our competitors are ignoring trade rulings on softwood lumber and slapping tariffs on our products. And our auto sector is hampered by trade policies that make it difficult for Ontario-made cars to be sold in markets overseas, even though automakers in those markets have broad access to Ontario's market. We know our people and products can compete with the world and win -- as long as the playing field is level and the same rules apply to everyone. Your government strongly urges the federal government to take action to ensure fairness and to heed today's lessons when negotiating tomorrow's trade agreements.”

⁷ Again citing a reorientation of governing philosophy, the 1995 budget held the following: “The measures in this budget share a common foundation and philosophy. For example, across government, we are taking major action in this budget to substantially reduce subsidies to business. These subsidies do not create long-lasting jobs. Nobody has made that case more strongly than business itself. In this budget, total spending on business subsidies will decline from \$3.8 billion in this fiscal year to \$1.5 billion by 1997-98. That is a reduction of 60 per cent in three years. Remaining industrial assistance will be

targeted on the key engines of economic growth—trade development, science and technology and small and medium size business.”

⁸ The 1996 Ontario budget speech of the Harris Progressive Conservative government is emblematic of this view: “We have put an end to more than thirty direct business subsidy programs. In my opinion, most business subsidies don't create lasting jobs. Too often, the job ends as soon as the government grant ends. Cutting these programs will save taxpayers \$230 million in grants and loans in 1996-97. Our Government is taking a different approach. We are breaking down the barriers to job creation. We are cutting payroll taxes that kill jobs. We are changing the rules so that banks and private investment funds will invest more money in new and growing businesses that create jobs. And we are changing taxes that have blocked the growth of important sectors of our economy.”

⁹ The literature on ideas suggests that expectations can be violated in any number of ways, though the most common to the convergence/divergence debate surround the goodness of fit between international and domestic norms (Kollman 2007). That said, Peter Hall (1993) reminds us that policy that proves counterproductive to the fulfilment of state goals will eventually yield wholesale abandonment of a given policy paradigm.

¹⁰ In some respects, increases and decreases to provincial subsidies have paralleled increases and decreases to federal levels in the United States, but not in any statistically significant sense.

¹¹ Following Fox (2008), preliminary analysis of residual autocorrelations within a simple OLS model (as per a calculation of the Durbin-Watson statistics) confirmed that an OLS model does not appropriately fit the data. A likelihood-ratio test of the parameters of a GLS autoregressive model confirmed that a second-order autoregressive model (AR2) is instead the most appropriate insofar as GLS modelling is concerned.

¹² For example, the federal government, PEI, Manitoba and Saskatchewan had their highest rates of subsidization in 1991 and 1992, while BC, Ontario and Quebec subsidized most heavily in 2009. New Brunswick and Nova Scotia subsidized most heavily in 1980, while Alberta did so in 1988 and Newfoundland in 1975. The years of least subsidization across these jurisdictions is similarly varied. As for variation by party, the mean scores are, ranking from lowest to highest, 0.11 for the federal Conservatives, 0.12 for the Saskatchewan Party, 0.16 for Progressive Conservatives, 0.17 for Social Credit, 0.17 for the NDP, 0.19 for Liberals, 0.19 for the PQ.

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