

Canada 2015 : the governance challenge

Gilles Paquet
Centre on Governance
University of Ottawa

Introduction

1. A framework
2. The globalization/regionalization-regime nexus
3. The productivity/government-business-society nexus
4. Distributed governance and mediating structures

Conclusion

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“What economists need most is humility”

Bill Emmott

Introduction

Bradford DeLong (1998) has identified the process of global economic integration and a general productivity slowdown as the two dominant forces shaping the world scene over the 1980-2015 period. He has suggested that these two broad trends have had and will continue to have important impacts on Canada: (1) globalization entails large-scale international capital flows, a crisis of the labour movement as a consequence of labour being the least mobile factor of production, and a decline in Canada’s macro-economic autonomy; (2) the productivity slowdown has already had major consequences: reduction in the rate of growth of real income per capita, the end of the expansion of the welfare system, and a challenge to social democracy. And from his analyses, DeLong has derived some generic scenarios (power shift to East Asia, rising inequality and the end of free trade, increasingly virulent financial crises).

Interesting though these scenarios may be, they are not without reminding one of 16th century maps – elegant but not very helpful to navigation.

The rate of return on the production of speculative forecasts being rather low, what is needed is a modest effort at validating these trends in a rough manner and much effort at developing an effective strategy to deal fruitfully with these forces.

In the first section, I sketch a conceptual framework to guide our analysis. In the following sections, I probe the existing tensions between the two dominant forces and the mediating structures likely to attenuate their impacts on Canada, but also to provide Canada with a greater degree of leverage on the world scene. In the final section, I explain why Canada is still in denial about the potentially deleterious effects of both the globalization and the productivity crises, and consequently does not feel the need for putting in place the distributed governance system and the mediating structures that would appear to be required.

1. A framework

Even in the old world of hierarchical and somewhat partitioned governance, the boundaries economy, polity and society were never well-defined either conceptually or statistically: they did not correspond to a rigid frontier, but rather to a wavering and evolving fracture zone between subsets of organizations and institutions integrated by different mechanisms but co-evolving in some manner. This has become even more true in the new world of horizontal and interactive governance. Any discussion of Canada’s economic challenges for the 21st century is fraught with references to Canada’s “political” economy, and no discussion of the declining standard of living or of the growing polarization of household income distribution can avoid mentioning the transformation of the Canadian family and other social institutions. Any useful framework must therefore deal with the economy, the society, and the polity as an integrated whole.

Kenneth Boulding has proposed a simple conceptual scheme to map out this difficult terrain (Boulding 1970): a triangle containing three generic ensembles of organizations and institutions dominated more or less by different mechanisms of integration: *quid pro quo exchange* in B (market economy), *coercion and redistribution* in C (polity), and *gift or solidarity or reciprocity* in A (community and society). Each of these mechanisms of integration in its purest form is located at one of the apexes; all the inner territory represented organizations and institutions embodying different mixes of these integrative mechanisms. A lightly modified version of this sort of triangle is presented in Figure 1.

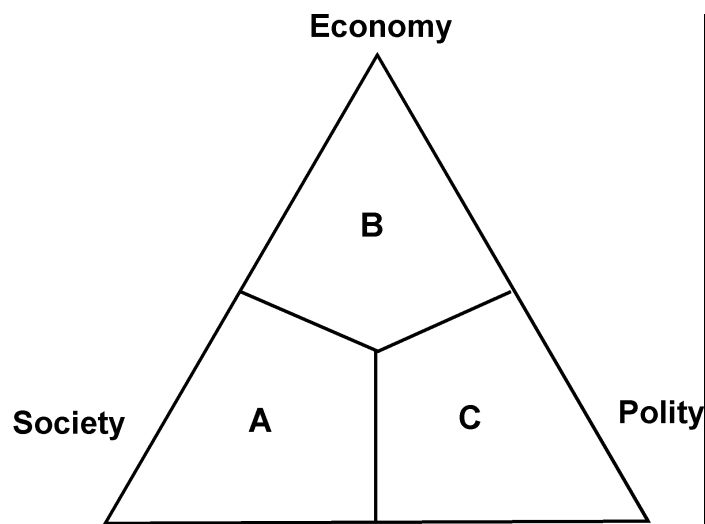


Figure 1

A stylization of the organizational terrain of many modern socio-political economies would reveal that society (A), economy (B), and polity (C) each occupy roughly one third of the terrain, and that the central point is a rough approximation of the center of gravity of the organizational triangle. This does not correspond to the statistical portrait emerging from official agencies, mainly because zone A activities are grossly under-reported: activities in the home, within not-for-profit associations, and in general beyond the market and the state, are poorly recorded and remain largely underground.

These three sectors have not always had equal valence, and need not have a similar weight. A century ago, the C portion was quite limited and the Canadian scene was dominated by the other two sets of organizations. From the late 19th century to the 1970s, government grew in importance to the point where probably half of the *measured* activities fell into the general ambit of state and state-related activities at the end of the period. More recently, there has been a vigorous counter-movement of privatization and deregulation that has caused a reduction of the state sector, and a reverse shift of the boundaries (Paquet 1999a).

There has been, in parallel with these swings (giving more valence to one or another of the family

of integration mechanisms), a tendency for the new socio-economy to trigger the development of an ever larger number of *mixed* institutions, blending these different mechanisms to some extent (market-based public regulation, public-private-social partnering, etc.) in order to provide the necessary signposts and orientation maps in this new confused world. The three sectors have become more and more intermingled. This has translated in the recent past into a much denser filling in of the Boulding triangle with mixed institutions capable of providing the basis for cooperation, harmonization, concertation, and even co-decision involving agents or organizations from the three sectors (Laurent et Paquet 1998). Indeed, the new broad forces in the economic environment have generated pressure to put in place a more *distributed* governance system, a system built on the highest and best use of the mechanisms of the three sectors, and on the broadest possible distribution of power over the range of stakeholders within these sectors.

It is my hypothesis that a more distributed governance system can serve as a very effective mediating structure capable not only of limiting the negative impacts of the forces of globalization and productivity slowdown, but also of enhancing the capacity of the Canadian socio-economy to have more influence and more effectiveness on the world scene.

2. The globalization/regionalization-regime nexus

The global integration movement has been well documented. Between 1987 and 1997, the volume of world trade has nearly doubled, and foreign direct investment has more than doubled between 1990 and 1997. As a result of this more globalized context, there has been an increase in the turbulence of the international world environment and in the fragility and vulnerability of all national socio-economies forced to adjust continually to external shocks in this more highly integrated world economy.

This being said, globalization has neither been as pervasive as is often claimed and nor has it been accepted in the different segments of the world economy as an unmixed blessing, i.e. without some counter-movements. First, the elusive “national character” of production, trade and investment has remained important. This is the Helliwell-McCallum effect showing that the intensity of the intra-national trade flows is dramatically more important than trade flows between regions of different nations given the distance between these sub-national segments and their economic size (Helliwell 1998). There is a similar “home bias” in capital markets that has been very well documented (de la Mothe and Paquet 1998). Secondly, there has been a strong expansion of intra-regional patterns of trade and investment within each region of the Triad. The proliferation of these loosely-coupled regional economic zones and of sectoral regime agreements (which is the sectoral equivalent of regional groupings) have contributed significantly to tempering the impact of the globalizing forces and to insulating groups of countries from the cyclonics emanating from the global system. These patterns of regionalization have not emerged organically. They have been to a great extent orchestrated by transformative states (Weiss 1998). Finally, the North-South chasm is still alive and well, and globalization has not reduced it much.

The most daring of these experiments has been the European regional integration movement. This has been the cumulative effect of all sorts of developments – from the minimalization of obstacles to intra-regional trade, investment, immigration, etc. to the elaboration of particular protocols pertaining to competition policy or sub-national regions powers to enter into agreements with other sub-national units in other countries, to the creation of a single currency and central bank – has brought into existence a distinctive European entity.

The European Union has succeeded in increasing importantly the degree of internalization of trade and investment flows and as a consequence to render the European group of countries less directly vulnerable to crises elsewhere, but it has also freed its own sub-national units and regions from the obligatory constraint of responding to all external challenges in a uniform one-size-fits-all way by allowing these sub-national units to develop agreements and even to sign treaties with other sub-national units of other countries if this provides them with a greater ability to react fruitfully to external shocks.

Many have claimed that such regional/sectoral groupings have resulted in a loss of allocative efficiency as a consequence of the impediments to trade and investment flows that they have erected for countries outside the group. However, there has been a gain in *multistability* of the overall system as a result of the partitioning of the world system in a multiplicity of these semi-disconnected zones.

A mutistable system is one in which a greater ability to adapt is ensured through discontinuities between sub-systems – an adjustment called for by a shift in some essential variables being delegated, so to speak, to a partial system enabling the overall process to adjust to important shocks in the environment in a manner that would have been either impossible or very time-consuming had the overall process been forced to adjust in toto (Ashby 1960; Paquet 1978). This has reduced considerably the probability of the whole system crashing as a result of a systemic crisis spreading to the whole system. A comparison of the impact of the 1930s crash and its propagation throughout the world with the impact of the Japanese crash of the early 1990s shows that the latter was contained much more and was resolved faster (Emmott 1999:17).

The regional zone/regime strategy amounts to a limitation of the dominium of the market place over the world economy through governance mechanisms imposing restraints on flows of commerce and capital across borders into the “regional zone” *and* ensuring some collaborative action on the part of this clutch of countries vis-à-vis the rest of the world.

Canada has joined one such regional grouping in North American over the last decade, and this has generated an increase in the concentration of Canada’s trade with the USA. This increased trade has undoubtedly had a dampening effect on the pains of labour market restructuring that have been triggered by shocks elsewhere in the world system. But it has not increased Canada’s geo-political power over its own future since Canada and Mexico have remained very much “satellite economies” vis-à-vis the United States in a hub-and-spoke type arrangement.

One way for Canada to gain more influence on its own future is to ensure that a broader regional

economic zone containing all of the Americas is constructed. In such a club, Canada might be able to develop alliances with other significant middle-range economies of the Americas to ensure that the “regional zone” does not only serve the interest of the dominant economies (the United States in the North and Brazil in the South), but also those of other significant partners. According to Daudelin and Dosman (1998), this is the only if indirect way in which Canada can increase its geo-political importance on the world scene.

This “hemispheric governance strategy” has been articulated in Canada in 1989. Canada has joined the Organization of American States and has participated in many summits where this strategy has been slowly unfolding. By 2005, it is planned that 34 of the 35 countries of the Americas (Cuba excepted) will become members of a free trade area. However, Canada may not have been promoting this strategy actively enough, and it may not have necessarily done it in the right way.

This is not to deny that there has been action on this front. It has not translated yet into a significant growth of the relative importance of Canada’s trade with Latin America and the Caribbeans (LAC). Over the last decade, Canada’s trade with the LAC has remained a bit under 2% of its total trade. But the stock of Canadian direct investment abroad in thenLAC has doubled over the last decade: from 8.3% in 1989 to 17.2% in 1998. This is a harbinger of foreign trade to come since foreign trade follows foreign investment. But it is important to note that two thirds of this direct investment is in Bermuda and the Caribbeans and that the pace at which Canada would appear to invest in Latin America is relatively slow when compared to what the European strategy.

Moreover, Canada is not taking action domestically to take advantage of its own potentially greater valence in the free trade scheme of the Americas. The Canadian knowledge and competence base about Latin America is limited, and the “winning conditions” for greater penetration of LAC markets have not been analyzed extensively. Indeed, hemispherically distributed governance is neither promoted nor even discussed openly, so Canada is unlikely to be in a position to take full advantage of this new distributed governance scheme when it materializes.

Instead of promoting in a persistent but sensitive way the development of a stronger mediating structure binding the Americas together and the design of a strategy to take advantage of the synergies and opportunities for increased leverage it offers, Canada is currently tempted to scatter its efforts in a diffuse way in all sorts of directions. The unfocused nature of Team Canada’s activities illustrates this sort of scattered approach that may not only disperse ineffectively scarce resources but end up putting Canada in a multiplicity of bilateral dependencies built on dyadic engagements with dominant economies like the USA and Japan. This is unlikely to foster either the development of mediating structures capable of protecting Canada from international cyclones or the development of a stronger geo-political power base for Canada.

A sensitive and effective way to promote hemispheric governance does not simply suggest an extension of the North American free trade agreement to the rest of the Americas. This approach is unlikely to succeed as larger economies in the South, notably Brazil, are unwilling to become a

spoke to the USA's hub. Rather, what is likely to generate a consensus is the proliferation of ad hoc functional arrangements negotiated in a variety of arenas as a "disaggregating response of sovereign states to the complexity of a highly interconnected world" (Falk 1999).

These arrangements entail a devolution and dispersion of authority, and the participation in the rule-making of private, public and civic sector representatives. While it may not square well with the promotion of a single agreement as the United States would like to see the 2005 process evolve, the progress via this piecemeal approach might serve as a reasonable way to test whether middle-power countries like Canada (in alliance with other middle-power countries) may be able to gain an influence within the Americas. Influencing the process itself would be a meaningful test case.

3. The productivity/government-business-society nexus

The worldwide productivity slowdown is also well documented. In the case of Canada, average productivity growth was over 2% in the 1960s while in the period from 1979 to 1997, the average rate of growth of productivity was 0.3%. This has been rather important since these numbers would indicate that Canadians could double their standard of living every 35 years at the former rate, while at the more recent rate, it would take 230 years.

The roots of this productivity slowdown have been sought in a variety of economic sources like the increase in oil prices or changes in the capital/output ratio. This has led many observers to argue that there is nothing to this slowdown that could not be cured by freer trade and *extensive growth* efforts through more human and physical capital. But this is too reductionist a perspective.

In a knowledge-based economy, additional human and physical capital does not suffice. Much depends on the development of forms of organization designed for effective learning. The lack of *intensive growth* (based on a capacity for continuous innovation and on the requisite development of organizational capital) is at the source of the productivity slowdown. In this new world, the conflictive activities of government, business and society are dysfunctional: new collaborative ways in which the sectors cooperate and co-evolve are at the core of an effective learning economy (Paquet 1998).

This latter message flows from studies like the one produced by the Public Policy Forum (1993) that emphasized the lack of good government-business relations as a major source of the productivity slack, or from the work that has more recently pointed to the decline in social capital as a probable cause of productivity slowdown (Paquet and Roy 1998). These studies have drawn attention to the fact that the source of our lack of productivity growth might be ascribable to the lack of smooth interaction and co-evolution among the three sectors of the Boulding triangle.

For these observers, the root cause of the productivity slowdown has much more to do with the inadequacy of what Alfred Marshall called "organizational capital". As he put it "capital consists in a great part of knowledge and organization; and of this some part is private property and other part is not" (Marshall 1920: 138). Brian Loasby has shown that for Marshall organizational capital

referred both to the internal organization of the units and to the network of relationships (region, district, etc.) within which it is embedded , and the set of capabilities they embody (Loasby 1991).

Coherence and innovation demand forms of organization that are capable of some co-ordination of economic activities but not too much, so that some discretion is left for discovery and learning. A lack of productivity is evidence that the organizational capital is not capable of generating both the requisite coherence and the right unbalance that triggers innovation. Nothing less than a massive investment in re-organization and new organizational capital can solve the problem (Granovetter 1973; de la Mothe and Paquet 1999).

Triangle-wide governance would appear to hold the key to a useful response to the productivity slowdown. It provides a recipe for making the highest and best use of the different integration mechanisms by intermingling these private, public and civic sector principles into both domestic and transnational organizations and institutions capable of generating the requisite coordination and gumption in the socio-economy.

This may take many forms, but all of them point to a network society in which the different partners find ways to coordinate better their activities. This may require the intervention of the catalytic state, since the organizational capital may not emerge organically and require modifications in the legal structures (de la Mothe and Paquet 1997). For example, a shift from shareholder capitalism to stakeholder capitalism might transform the socio-economic performance by shifting from an exclusive emphasis on the well-being of a limited number of actors toward a system that attempts to take into account the well-being of all of them. The productivity record of Canada would in all likelihood be dramatically affected by such a massive organizational transformation. But such a transformation would require some overhauling of both corporate law (to avoid corporate boards being accused of diverting corporate profits from what might be regarded in the present context as their rightful owners – the shareholders) and in the very notion of property rights in good currency.

In the same way that the economic cyclonics generated by the world economy, as trade and investment flows increased, have had to be tamed by distributed governance – groups of regionally-joined or regime-joined governments imposing some light constraints on an ever greater share of world trade and investment – it can be said that distributed governance through a variety of moral contracts binding the stakeholders is needed to constrain the operations of the national economies if they are to be productive (Pratt 1997). The central problem has to do with the way in which this can be accomplished. It is our view that what is required is a transformation of the governance structures to ensure that a more decentralized, more participative, less technocratic system is put in place that draws on the most effective mix of the private, public and civic sectors (Hock 1995; Paquet and Roy 1998).

4. Distributed governance and mediating structures

The Canadian socio-economy has much resilience. It has already reacted to both the increasing globalization and the productivity slowdown even though one may have reservations about the depth

of the adjustment of its governance system, and the extent to which it has fallen short of what was and is needed. Suffice it to say that Canada has gone beyond the sheer fatalistic speculations about the world trends and its relative inability to do anything more than simply cope.

As explained in the last sections, counter-strategies to both these world trends have entailed the construction of mediating structures embodying some form of distributed governance or triangle-wide governance (i.e. some arrangements capable of generating, through cooperation among the private, public and civic sectors, some attenuation of the negative impacts of the broad forces at work on the world scene).

(1) the hemispheric strategy

It is more than a decade since Joe Clark announced Canada's Latin American Strategy and there has been a strategy update in 1996 (DFAIT 1996). If one were to judge Canada's policy by this latter public statement, one would feel very encouraged by the enthusiasm it displays. But reality is less glorious.

Canada has become ever more integrated into a strictly North American production structure over the last decade. Canadian trade and investment in the rest of the Americas has grown relatively slowly. Despite trade missions to the south of the hemisphere in 1995 and 1998, the commercial basis for Canada's integration into the whole hemisphere has been shrinking. As Daudelin and Dosman (1998) suggest, there is no functional necessity to Canada's option for the Americas. Only a robust policy initiative would appear to be able to generate some effort in this direction. But this policy initiative has to be more sophisticated than the simple suggestion of quick trade liberalization and elimination of capital controls and the negotiation of a single agreement for all countries where the USA would be eminently first among equals. Latin American countries are more concerned about the United States unilateralism than Canada. Therefore a soft and slow regime-type approach might be called for.

This strategy goes of necessity through the Organization of the American States (OAS) which could be a deliberative forum through which governments, business communities and civil societies might be able to shape a regional consensus. Such a consensus is unlikely to be constructed except on a piecemeal basis through some regime-building in different areas until the time is ripe for more universal rules. But this will require a creative leadership on the part of the Canadian government to ensure that both the Canadian business and NGOs communities are mobilized, and the requisite resources for capacity-building in Canada are found. For the degree of ignorance in Canada about Latin America is immense. By the way, it is not much better in the United States.

It is only if and when there is the requisite mobilization and capacity building that one can expect the Canadian government to be able to take the leadership in the development of an organized system of cooperation with Brazil, Argentina, Venezuela, Peru, Chile, etc. Such cooperation will require much imagination especially when it involves countries like Brazil and Argentina that might be seen as competing with Canada in a number of key areas. But this also provides opportunities for joint

strategies.

The integration of the Americas *par morceau* (around Brazil in Latin America as it has proceeded around the USA in North America) is promising in the long run. As the United States' valence in the world economy diminishes with the strengthening of regional groupings such as the European Union, and Latin American countries become much more sizable economic powers than Canada in the next decades, Brazil, Argentina and other LAC countries are likely to remain throughout this slow process of integration the natural allies of Canada against the forces of the United States which tend to foster protectionism and unilateralism (Lipsey and Meller 1997).

These alliances would work in a variety of ways: through some constraints on the flows of commerce and investment to insulate somewhat a region or a group from catastrophes elsewhere, through the development of zone or regime institutions to facilitate the adjustment of the group to external shocks, through policy coordination enabling the group to define more effective ways either to prevent the shock hitting the group or at least to attenuate the impact, through compensatory mechanisms put in place to ensure that those most seriously hit by these shocks are somewhat compensated through some sort of redistribution scheme, and through collaborative mechanisms capable of providing adequate forums for consultation and co-decision.

(2) the network strategy

If the external organizational capital on which Canada might build is a loose and progressive integration with the rest of the Americas through regime-building, involving the private, public and social sectors, the corresponding internal organizational capital has to be constructed on a much closer collaboration among government, business and civil society.

The required speed, flexibility and innovative adaptation necessary in the new globalized socio-economy can only be generated by non-centralization. Hierarchical structures have proved inadequate. What is required as a result of this "dispersive revolution" is a more distributed governance (de la Mothe and Paquet 1994). Another reason for this development has been the process of democratization that has multiplied the number of players involved in the process of governance. These two features have generated the need for cooperative arrangements among the public, private and civic sectors.

The reason why the guidance system has to be decentralized, collaborative and adaptive is that this sort of arrangement is best if one needs to continually adjust to new circumstances in order to generate knowledge value-addition. This is also the recipe for productivity gains in a world of alliances and partnerships across borders, and among different layers of networks.

Hierarchies have limited learning abilities, and markets have limited capacities to process information effectively. Network alliances are a way to counter these failures: they reduce uncertainty and adaptation costs arising from the complexity of the environment through an increase of the collective organizational capabilities of the partners (Paquet 1999a). These collaborative

arrangements through networks foster faster and more effective learning, but the development of such arrangements call on the state to recognize that it cannot achieve its goals by simply relying on its resources. The state must assume a dominant role in coalition-building both internationally and domestically. This is what Michael Lind (1992) has called “the catalytic state”.

The proliferation of regional/regime agreements and the evolving character of close government-business-society relations in Japan, Germany, etc. are manifestations of the new importance of the catalytic state (Weiss 1998 :210). But not all states have the same catalytic capabilities. Some like the US have the clout necessary to exploit international leverages; others like Germany and Japan have both domestic and international clout in coalition building; still others like Canada would appear to lack both capacities.

Indeed, it may well be that the sort of consensus required among private, public and civic partners is not possible for large fractured countries like Canada; that the only way to generate catalytic action is at the level of region-states, through the empowerment of sub-national powers (Courchene 1999). This is a pattern that has developed in the European Union where sub-national segments of a country A may enter into agreements or treaties with sub-national segments of country B without asking any permission from higher order governments. Maybe in Canada such decentralization is the only way to ensure that the socio-economy *in toto* can evolve faster toward a less ineffective governance *par morceau*. This would appear to be a model worth examining in Canada for the design of learning organizations well adapted to different cultures is not simple. Sparsely connected networks are stagnant, and overly connected networks are frozen; maximal nimbleness would appear to be achieved at low connectivity especially diagonal interdependence across boundaries for they are more likely to stimulate innovation.

(3) cognitive dissonance

It may be difficult to understand why those strategies are not naturally evolving very rapidly in the face of globalization and slower productivity increase. Yet, they are not.

On the international scene, Canada would appear to be betting on a blind search for liberalization in all directions as if this were a panacea. Moreover, our foreign commercial policy would appear to neglect the possibilities of hemispheric governance both because of our culture of dependency vis-à-vis the United States, and because of the cultural barriers that would appear to stand in the way.

Moreover, when alternative strategies are proposed, they would all appear to be short-run driven (simply because the market shares are there -- i.e. Japan) without much serious geo-political reflection.

On the national scene, our collective action is based on a culture of contentment. Even though the productivity slowdown has hit Canada more than any other member of the G-7, we are still in a state of denial about the need to do something about productivity. For our political leaders, it has been easy to deny the reality of the productivity gap vis-à-vis our trade partners, the erosion of social

capital in Canada, and the difficulty in generating the requisite amount of collaboration among government, business and groups in civil society by pointing to the United Nations's rating of Canada's quality of life. Since, according to opinion-molders, there would appear to be no problem with our present performance, there is no need felt for any overhaul of our governance system.

Moreover, whenever Canadian political leaders have been mugged by reality, as in the critical period of the late 1980s and early 1990s, there would appear to have been a disconnect between the mood of the country and the mood of the political class when occasions were provided (through votes on the Meech or the Charlottetown accords) for decisions about proceeding with decentralization of the Canadian governance process in an orderly way.

Despite the fact that an extensive literature has shown that, both internationally and nationally, the new distributed governance system has proved most effective in coping with globalization and productivity slowdown (Naisbitt 1994; v.N Whitman 1999; Leadbeater 1999), the degree of cognitive dissonance remains high in Canada. The cumulative effect of a certain degree of glibness, much blindness, an immensity of denial, and a pervasive centralized mindset that prevents the engineering of the requisite degree of decentralization (Paquet 1999b) has amounted to accepting many broad world trends somewhat fatalistically, and to suggesting that we need not worry about the needed governance overhaul for Canada is obviously capable of surfing on these trends successfully.

Conclusion

The root causes of our predicament when one examines the challenges facing Canada in the next 6000 days are a multitude of factors amounting to a crisis of leadership. These are seriatim – the lack of clear foreign policy, the denial syndrome of Ottawa vis-à-vis the external threats Canada is facing, the crippling effect of political correctness on national debates in a Canadian forum where dissent amounts to treason, the lack of a meaningful role of the media in the process of social learning, the rational apathy of the citizens without the help of a meaningful opposition in the House of Commons to guide them, etc.

None of these factors in isolation really amounts to an explanation of Canadian lethargy. But all of them together have created a bizarre situation in which complacency, denial, etc. entail that Canada is not developing a meaningful strategy to overhaul its governance in order to face more effectively the challenges brought forth by globalization and productivity decline.

This fatalistic and myopic attitude does not necessarily mean disaster in the short-run. However in the long haul, it can only mean disaster.

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