1974

Industrial Strategy: A Canadian Substitute for Trade Liberalization?

Ronald J. Wonnacott

Follow this and additional works at: http://ir.lib.uwo.ca/economicsresrpt

Part of the Economics Commons

Citation of this paper:
Research Report No. 7409

INDUSTRIAL STRATEGY: A CANADIAN SUBSTITUTE
FOR TRADE LIBERALIZATION?

R. J. Wonnacott

September 1, 1974
INDUSTRIAL STRATEGY: A CANADIAN SUBSTITUTE

FOR TRADE LIBERALIZATION? ¹

In the present world in which access to a large market is judged an
important key to industrial efficiency, every other industrialized Western
country has either inherited such a large market (like the U.S.) or has
recently entered one via trade liberalization (like the Europeans). But an
alternative is now being suggested for Canada: the pursuit of an industrial
strategy—or to be more specific, a "go-it-alone" policy aimed at increasing
the efficiency of Canadian industry by the application of Canadian policies
only; (these may include unilateral changes in our own tariff, but no form
of reciprocity since this would have to be negotiated). For purposes of
comparison, we shall distinguish between two go-it-alone proposals and one
which is not:

(1) Go-it alone proper (GIAP), i.e., select a few of the most
promising industries and encourage, induce or force the
merger or cartelization of the large number of existing
firms in the presently fragmented Canadian market, with
the objective being to produce fewer items at greater vol-
ume and lower cost; this may or may not include changes
in the Canadian tariff in those selected industries.

(2) Unilateral free trade (UFT), i.e., the elimination of Canadian

¹The author is particularly indebted to Paul Wonnacott, since some of
the ideas in section 2 had their origins in earlier joint research [15]. I
should also like to thank, without implication, André Raynauld, Peter Cornell
and John Downs. Some of the material in this paper was developed in the
course of writing a research report [16] for the Economic Council of Canada.
tariffs across-the-board.

(3) Reciprocal free trade with all other countries, or any subgroup including the U.S. (RFT).

Note that special domestic policies (such as government encouraged mergers) which are so explicitly a part of option (1), are also compatible with options (2) and (3); accordingly, it is assumed that, if deemed desirable, they may be introduced in these cases as well.

The conclusions can be easily summarized: there is a whole set of GIAP proposals, each defined by a different set of specific provisions. Some of these would be counterproductive (lowering Canadian efficiency and income rather than raising it). But if we restrict ourselves to that subgroup that would increase Canadian efficiency, each proposal must (like UFT or RFT) involve an increase in our exports, imports and international interdependence—thus disappointing the expectations of many of its proponents. In other words, the argument that efficiency can be increased within the confines of the Canadian market without increasing exports will be shown to involve a clear logical contradiction.

The final conclusion is that UFT would be economically the most beneficial go-it-along policy; but RFT would be more beneficial yet again.

The need for an Initiative

In its initial stage, the argument for all three policies is identical, being based on the existence of unexploited economies of scale in the small Canadian market.¹ But it is essential to consider how serious this problem

¹This is no longer an issue of substantial debate in Canada, being accepted by proponents of all three options. The research studies that have
is, since it has important policy implications. In particular, it is important to ask: "How rapidly would Canadian costs fall with increased volume?" It has been estimated that free access to the U.S. market would allow a reduction in Canadian costs of about 15%, on average;\(^1\) this suggests that Canadian cost curves may fall very rapidly. But this conclusion just does not follow, since servicing the U.S. market may imply an increase in volume of product or process by several hundred percent—or perhaps even up to 1,000% or more. At the margin, Canadian costs may in fact drift down at a very slow rate, with the cost reductions feasible from a modest increase established and in some cases empirically measured economies of scale include [1], [3], [4], [6], [7], [9], [11], [12], and [15]. Additional indirect confirmation is also provided by the evidence in [3] and [15] of a higher capital/output ratio in Canada than in the U.S. (despite higher Canadian interest rates); this illustrates how overhead capital costs are allocated over a smaller volume of output in Canada, thus raising unit costs.

Daly et al. [3] also found that although there may be some unexploited economies of scale to Canada at the firm or plant level, more are found at the process level. In other words, the problem is not so much that Canadian firms or plants are too small, but that production runs are too fragmented. This conclusion receives indirect support from F. M. Scherer ([14], Tables 2 and 3) who found evidence of only modest diseconomies of scale at the plant level in Canada (in his sample of 12 industries, there were several in which smaller plant size could explain higher costs in Canada than the U.S., and several in which it could not). On average over his sample, Canadian plant size was about half that of the U.S.—but more important, it was about 3/4 of minimum optimal scale. For further confirmation see, for example, [13], p. 61: "In this (auto tire) industry, the ratio of market size to the smallest efficient size of plant was 7 in 1960, the actual number of plants was 9 and some plants were up to or exceeded the smallest efficient size. And yet only a very small portion of the industry's output was judged to be made at minimum costs, because of the large number of lines of tires made in each plant."

---

\(^{1}\)This is a very rough approximation; over a sample of 13 industries, costs in Canada were estimated in Ch. 14 of [15] to be anywhere from 3% to 23% higher (mean = 15%, median = 16 1/2%) because of smaller market size. This difference is to be attributed not only to economies of scale proper, but also to other inefficiencies of a small market (such as the smaller degree of discipline it may provide over oligopoly excesses).
in volume of, say, 10% being almost imperceptible; empirical evidence of this is given in [17]. This is an important point because any GIAP policy that involves only changes at the margin is unlikely to provide significant benefits; to be effective, it must (like UFT or RFT) allow for massive rationalization where required. Note that this conclusion is very imprecise, and necessarily so: without knowing more about how costs do fall in specific products, it is obviously not clear whether 1/2 the items now produced in a specific industry should be dropped, or 3/4, or what. In the case of trade liberalization this decision is taken by the firms concerned; but in the case of GIAP this is one of several perplexing problems the government would have to address in deciding how far its policies would have to be pursued.

Suffice it to conclude that, to the degree that political opposition in Canada to trade liberalization is based on a natural resistance to change (and in particular the reallocation of labour), GIAP would provide no simple escape.

It is in the second stage of the argument—in which a specific set of policies is proposed for achieving the desired rationalization—that advocates of GIAP and trade liberalization part company. A major problem immediately encountered in any analytical comparison of these options is that there is not yet any clear agreement on what GIAP would specifically involve.¹ Whereas the central question is: "Can Canadian industry be rationalized by the application of Canadian policies alone?" most GIAP proposals also include

¹Compare, for example, the articles by Solandt, Studnicki-Grizbert, Mintzberg, Gordon, Kierans, and Saltzman in [2]. This suggests that "to have an industrial strategy" is an amorphous phrase which has not yet settled on any single, concrete meaning; rather it is an invocation to accept the set of policies the particular spokesman recommends.
other policy recommendations not directly relevant (e.g., Canadian ownership should be increased, or our industry should be nationalized, or even that Canada should consider joining OPEC). This provides each such policy package with its automatic support and opposition, and a guarantee that the discussion will run so far afield that the central issue is unlikely to be even addressed. In order to limit this paper to this central question only, we have restricted ourselves to the simplest possible "consensus" definition of GIAP as given in (1) above.

To illustrate, consider how GIAP might have been applied to the auto industry, as an alternative to the trade liberalization that has already taken place under the Auto Pact.\(^1\) The rationalization of this industry as a result of reciprocal tariff elimination in 1965 has involved cost reductions\(^2\) as producers (e.g., Ford) have concentrated on higher volume output of fewer models (Maverick and Pinto); surplus production of these selected models is now exported to the U.S., and models dropped from Canadian production are imported. The GIAP alternative would be to induce or force the auto industry to cartelize its Canadian market, and thus similarly specialize its production; to keep the illustration simple, suppose the auto companies were to be instructed by the government to get together and agree on which will produce

\(^1\)This industry is chosen as an example, not only because its products are familiar, but also because the question of whether it needs to be (or should be) rationalized is no longer a sensitive one.

\(^2\)In large part passed on to factors of production. This distribution of gains has been possible because of the protection built into the agreement (in fact, it is a unique mixture of free trade and protection, with its free trade elements providing the gains from increased efficiency, and its provisions protecting employment in Canada allowing a very special and controversial distribution of these gains--both between various groups within Canada, and between Canada and the U.S.).
only a small car (say, Ford, the Pinto), which a medium-sized car (Chrysler, the Valiant), and which a large car (G.M., the full-sized Chevrolet).\(^1\)

Canadian small car production would no longer be fragmented into Pinto, Vega, etc., but would instead be concentrated exclusively on Pinto; as a consequence production volume of Pinto would be increased, and costs reduced. Similarly, G.M. and Chrysler, by concentrating production on one model each, would also achieve economies of scale. This would allow a reduction in the price of these selected models to the Canadian consumer; but the same variety would still be offered, since the discontinued lines of Canadian production could still be imported.

It will now be shown that such a GIAP policy of simply redividing the Canadian market to achieve greater efficiency via increased scale cannot succeed. To argue that it could involves implicitly accepting three propositions: each of these taken alone is implausible enough, but taken together they involve a logical contradiction. Specifically, the following three questions would all have to be answered in the affirmative:

1. **Would GIAP be Institutionally Feasible?**

   While forced merger or cartelization cannot necessarily be rejected out of hand in an industry characterized by a high degree of Canadian ownership (like furniture), it would raise major problems in industries characterized by substantial U.S. ownership, since any participation by U.S.

\(^1\)More extreme GIAP variants have also been suggested—for example, forcing all three companies into the production of one car "the beaver" (especially designed for Canadian conditions—although precisely how this would be defined has never been made clear). By and large, it may be confirmed that this solution would involve the same problems— but to an even greater degree— than the more moderate form of GIAP outlined above.
subsidiaries would be viewed by the U.S. courts as a restraint of trade violating existing U.S. antitrust statutes.¹

A second major problem is this: under trade liberalization, market forces would decide which plants would be closed down in the process of rationalization, with the government standing by to provide various forms of assistance. But under GIAP the government would take an active role in promoting or forcing rationalization; accordingly, it would become involved in decisions that may require closing some plants. This is an extraordinarily difficult task: no matter how compelling the case for reorganizing an industry, it is difficult to see how a Canadian government could be party to a decision to close down a plant in, say, Nova Scotia in order to expand and rationalize facilities in, say, Ontario. Once decisions on the how and where of rationalization slide into the political arena—-as they must if the government is forcing mergers—-they will be influenced by non-economic considerations; and the risk is that inefficiencies overcome by rationalization will be replaced by inefficiencies of a different sort.

2. Will the Larger Sales Volume in Canada Materialize?

To use autos again as the example, the question is: could Canadians be induced to concentrate their purchases on those specific items chosen for production specialization in Canada (i.e., the Pinto, Valiant and Chevrolelet)? To answer this question, we make the most favourable possible assumption (and one that must be questioned later)—namely, that the price

¹A massive effort to negotiate with the U.S. to have its law changed could hardly be justified (even if there were some chance of success); there are too many crucial issues to be negotiated, without expending our bargaining cards in pursuit of an objective which is not feasible in any case, for reasons cited below.
of these items is somehow lowered as economies of scale are realized, but the price of competing imported items (Vegas, etc.) does not fall.

Many Canadians who previously purchased a Vega may be expected to switch to Pinto,¹ attracted by its lower price. The problem is that, in a world of highly differentiated products, there may be a substantial number of consumers who are attached to specific products (not in the selected range), or who just like variety for its own sake, who consequently would not switch. When they buy imports (e.g., Vegas, etc.), the volume increase necessary to lower Pinto production cost may not materialize.

A key issue here is the consumer trade-off between variety and price, i.e., how readily can the consumer be attracted away from his present purchases by price reductions on items of Canadian specialization; or, to put the issue the other way around, how strongly is he attached to his present purchase by non-price considerations? This is an empirical question, on which insufficient evidence now exists. But suffice it to note that the success of GIAP requires that price be important relative to non-price considerations; and if this is the case, then why has not at least one Canadian producer already seized the profit opportunities this implies, by specializing his Canadian production, and using lowered cost and price to capture a large and profitable share of the Canadian market?²

¹Or one of the other products of Canadian specialization—i.e., the Valiant or Chevrolet.

²The standard reply in an oligopoly situation where firms do not cut their price is that if one did, it would set off a price war damaging them all (mutual dependence recognized). But it is not at all clear that this answer is applicable in this case, since consumer sensitivity to price (and insensitivity to other influences) implies that all firms may be able to increase profit by specializing and reducing price. In other words, the price competition that would be ruinous if non-price considerations dominated, need not be if price considerations are relatively important.
suggests that non-price considerations may be important; and if so, GIAP will involve the problem of large increases in imports coming in to "fill the gaps" as Canadian-produced lines are dropped, with this eroding the volume base necessary in Canada to keep costs down. This in turn may make it impossible to maintain price at the originally projected low level. As a consequence, an additional group of (marginal) consumers is likely to be attracted to imports; and so on.

In such a vicious circle, pressure will be brought on the government to raise tariffs in order to "maintain the domestic base necessary for a fully efficient industry"—i.e., in order, by a more prohibitive pricing of imports, to more effectively corner the Canadian consumer against his wishes into the domestically-produced segment of the market. If this route of higher protection is followed then GIAP would very quickly become a damaging policy—for three reasons: (1) it would lead Canada away from the GATT world in which tariffs are being reduced; (2) consumer satisfaction would be reduced; and (3) greater protection could act as a cover for even greater levels of domestic production inefficiency. In other words, the effect would not be the desired improvement in Canadian production efficiency, but quite the opposite. The conclusion so far is that it seems unlikely that Canadian consumption can be sufficiently redirected to make GIAP viable. Thus, the answer to this question (like the one that preceded it) seems to be in the negative; yet neither need be belaboured,

---

1But perhaps not quite certain, since enough is not yet known about precisely how fast Canadian cost curves fall; (this in turn may be important in determining how much erosion of domestic base would be consistent with minimum costs).
since even if they could be answered in the affirmative, a contradiction will
be encountered when we examine the third question, namely:

3. Will Cost Reductions Result in Price Reductions?

For any GIAP policy to succeed in increasing Canadian efficiency and
income, the answer to this question must also be in the affirmative because
price reductions are required to induce the necessary redirection of
consumption.¹,² (Another non-essential, but still very important issue is
the distribution question of whether the Canadian consumer or producer should
receive the windfall gains from GIAP rationalization; for obvious reasons
this may become a critical economic—and political—issue in industries with
substantial foreign ownership.)

But how can there be any assurance that prices will fall with costs,
especially in view of the fact that these selected industries would be
increasingly monopolized as a result of merger or cartelization? There are
two ways: (1) force prices down by a unilateral reduction or elimination
of the Canadian tariff; or (2) have some government agency explicitly
monitor price reductions.

Of the two, only (1) provides a credible guarantee: (2) may be judged
not feasible. Consider, for example, the recent inability of the Canadian

¹Consumption is used here as a generic term to include the purchase of
a good by consumers proper, or by other producers using it as an input.
Thus this condition may be viewed as the standard requirement for increasing
efficiency: namely, that a product with declining relative cost be used more
heavily throughout the economy—and this requires that its relative price falls.

²Note that we restrict ourselves to that subset of GIAP policies that
increase efficiency, hence we do not consider the possibility of redirecting
Canadian consumption by raising tariffs—a policy which would be unlikely to
succeed in any case.
government to influence auto prices via moral suasion. Moreover, this has been in circumstances particularly conducive to success: the auto industry has for several years already been rationalized, and in addition has benefited from removal of the U.S. tariff. Neither of these favourable conditions would apply under GIAP.

But if a government is unable to persuade, can it not force price reductions? No matter how this might be set up institutionally, it would reduce to the same thing: operating Canadian production under price regulations similar to those imposed on public utilities. In these circumstances there is a substantial risk that the cost reductions achieved from production rationalization would be at least partially dissipated in other forms of inefficiency which often appear when an industry has to justify itself to a government agency rather than a competitive market. But even more important: monitoring prices can become a bureaucratic nightmare. It is almost impossible just to keep prices from rising during a freeze. But GIAP involves a much greater problem: administering price reductions—which, worse yet, would depend on efficiency gains from rationalization, hence vary between industries. Thus for each selected industry, such gains would have to be assessed—an impossible task, since it is only the industries themselves, rather than the government, that can know even roughly what these gains may have been, or when they were realized. This is but one reason why any tough negotiation of a price reduction between a treasurer of a multinational corporation and a government official would represent a mismatch.

1The Canadian factory price (before federal sales tax) was 10% above the comparable U.S. price in 1965 immediately following the signing of the Auto Pact. This difference was reduced to 6% in 1969, but rose to 12% in 1972. See [5].
This leaves Canadian tariff reductions in the industries selected for rationalization as the only feasible method of enforcing the required price reductions (and the more responsible proponents of GIAP do recommend such supportive tariff reductions). This seems to lead to the conclusion that the GIAP problem of translating cost cuts into price reductions could be solved by Canadian tariff elimination in the selected Canadian industries. But it is not that simple; since it is applied only to one—or a few—industries, it would leave those industries facing negative effective protection,\(^1\) hence seriously—if not irreparably—damage our industries specifically selected because of their promising prospects.\(^2\)

But there is an even worse problem: elimination of the Canadian tariff in an industry selected for GIAP specialization will eliminate the price advantage of domestic products over imports; then how is the redirection of consumption to take place? Accordingly the basic contradiction in any GIAP policy is seen to be this: it requires both price reductions in selected products and a redirection of consumption towards those same

\(^{1}\)I.e., their output price would be lowered to the world price level, but their costs would remain inflated because of the continued protection on their inputs.

\(^{2}\)On the other hand, if their tariff is only reduced rather than eliminated, then the question becomes "By how much?" which brings us back to the impossible task of assessing what the productivity gains of these industries would support (plus another major difficulty discussed in the next section).
products. But the only way of achieving the first objective (price reductions) is by cutting the corresponding Canadian tariff; yet it is precisely this policy that guarantees that the second objective (redirected consumption) will not be achieved. The contradictory implications of GIAP may be seen from another point of view by considering how the government would be torn in two directions: (1) the only way to ensure lower price and increased efficiency is to lower the Canadian tariff; but (2) it may face a clamour from business to raise the tariff for a reason that may seem highly justified to both politicians and the public—namely, to prevent imports from filling some of the discontinued gaps in Canadian production, and thus eroding the domestic base necessary to achieve economies of scale.

So far we have assumed that any GIAP policy is limited to the confines of the Canadian market, and it is precisely that limitation that has forced these contradictions. If efficiency in production cannot be achieved by inducing the Canadian consumer to specialize, then it can only be achieved by increasing exports.

**The Key Role of Exports**

It has, of course, always been recognized that the rationalization of industry under trade liberalization implies increased exports (and imports);\(^1\) but it has not been commonly recognized that the same is true for any GIAP policy that succeeds in increasing efficiency.\(^2\) Some GIAP proponents have

---

\(^1\)Thus, for example, UFT implies no attempt to induce Canadian consumers to specialize. Instead imports would be allowed free entry, with consumers provided substantial benefits as a consequence. This increase in imports would be moderated by a Canadian dollar floating down, in the process inducing an increase in exports; it is this increase in exports—rather than a redirection of Canadian consumption—that would provide the volume necessary to support lower cost specialized Canadian production.

\(^2\)I.e., precluding an increase in Canadian protection.
conceded that increased exports would be desirable;¹ but few have recognized that they would be necessary—perhaps because increased trade implies increased international integration, and hence may violate what is often regarded as the whole purpose of the exercise. Moreover, any substantial increase in exports may raise a serious problem for GIAP: unless the Canadian price is completely reduced to the world level (by a complete elimination of the Canadian tariff on items of specialization), increased Canadian exports will be vulnerable to foreign anti-dumping restrictions; and the greater our success in increasing exports, the greater our vulnerability. But on the other hand, if price is reduced (by tariff elimination) to the world level, then the Canadian producer will face negative effective protection. In either case, how can he be counted on for the increase in exports that GIAP requires?

This suggests that once the necessity of tariff reductions in selected industries is conceded, the logic leads almost inexorably to across-the-board UFT: it guarantees Canadian invulnerability to foreign anti-dumping charges, and ensures that promising industries will not be damaged by a negative effective rate of protection;² the protection required to maintain Canadian industrial employment³ would come from exchange depreciation—a relief that would not occur to any substantial degree if tariff elimination is limited as under GIAP to one (or a few) industries. Thus it is concluded that, of all go-it-alone

---

¹ See, for example, [12].
² Since nominal and effective rates would be zero for all industries.
³ In fact industrial employment would shrink somewhat, with some Canadian resources shifted into resource activities. This effect however is unlikely to be substantial; for more detail, see [10].
policies, UFT is the best. (Note however that such a policy would have to be introduced in an appropriate way, with tariff reductions phased in over time, along with short-term subsidies\(^1\) deemed appropriate to cover major turn-around costs).

**The Income Distribution Implications**

This important issue is one that any GIAP advocate must address. To illustrate, consider a specific policy recently advocated, which may carry some prima facie appeal: in say, ten carefully selected industries, the Canadian government should require the merger of existing firms. It should provide "tariff, purchasing and other government policies designed to protect the new corporation during the decade or so it might require to achieve a commanding position in the industry."\(^2\) How might such a policy redistribute Canadian income?

It has already been pointed out that by increasing protection such a policy may reduce efficiency and total income and thus be counterproductive. But even if it were to meet its objective of raising efficiency and total income, it is important to note that producers would be the beneficiaries of any such windfall gains—since they would come in the form of lower costs, and no provision is made for lowering the tariff to ensure benefits to consumers. Instead, the tariff would be increased,

\(^1\) Short-term subsidies to producers to ease rationalization would not come at the consumer/taxpayer's expense provided these subsidies remain less than the price reductions forced by tariff elimination (as would be the case, for example, if these subsidies were to be fully financed by a sales tax in each product equal to some proportion of its tariff cut). In this case the consumer/taxpayer would only be deferring benefits.

\(^2\) [8], p. 11.
raising the possibility that producers might raise price, and thus receive an additional benefit in the form of a transfer from consumers. (Such a price increase seems a good bet in view both of the monopolization of the industry, and its increased protection; how the consumer might defend himself is left unexplained.) Finally, producers might receive a further transfer, this time from Canadian taxpayers in the form of some sort of direct or indirect subsidy.\(^1\)

Such a set of transfers may be attractive for producers, but it is hard to justify for the nation as a whole—especially in view of the possibility that total income might in the process be decreased rather than increased.

**Conclusions**

Any GIAP policy aimed at increasing Canadian scale and efficiency can be shown to involve a contradiction—unless it results in increased exports (and, of course, imports). But once this is conceded, then such a policy tends to lose its political advantage over trade liberalization. And on economic grounds, trade liberalization would be more beneficial. Specifically, it has been shown that UFT is superior to any GIAP proposal—in other words, the best go-it-alone policy is UFT.

But in turn RFT would be superior to UFT, for reasons detailed elsewhere,\(^2\) but easily summarized: RFT provides most of the advantages of

---

\(^1\)Saltzman ([12], p. 105) has suggested inducing rationalization by reducing taxes on production designated for Canadian specialization. While this would have the advantage of being a completely voluntary incentive (and hence provide a better pattern of rationalization than one forced by a government agency), it raises the same questions of how new income will be distributed, and existing income redistributed.

\(^2\)See [16], ch. 5. This also provides an explanation of why RFT must include the U.S.—otherwise its superiority over UFT is not guaranteed.
UFT, without involving the same degree of short-run dislocation;\(^1\) nor would it necessarily involve the (limited) long-run shift of Canadian activity from manufacturing to resources that is to be expected under UFT. In addition RFT would provide an important advantage that neither UFT nor any GIAP policy would offer: elimination of partners' tariffs, which act as a tax on Canadian exports\(^2\)—a tax that will become even more onerous as Canadian exports increase with the rationalization of Canadian industry. In short, there is no set of domestic policies that can substitute for recapturing an international transfer of income (i.e., the duty we have historically paid to the U.S. treasury). There is another very unfavourable effect of the U.S. tariff: like any other tariff, it is erratic, with high rates in some industries, low rates in others. Hence it heavily influences the structure of Canadian industry, and in particular the decision on what Canadians will or will not produce; (in an industry with substantial economies of scale, a high U.S. tariff typically acts as an important deterrent to Canadian production).\(^3\) This influence of the U.S. over Canadian economic activity would be removed by RFT, but not by GIAP or UFT.\(^4\)

---

\(^1\)Under either UFT or RFT, Canadian industries would lose protection in our own market; but under RFT they would at the same time gain preferential access (i.e., a special kind of protection) in partners' markets. Nonetheless, RFT, like UFT, would require that tariff reduction be phased in over time, and that short term turn-around subsidies be provided.

\(^2\)For more detail on this point, see [16], chapter 3E.

\(^3\)This also indicates an important problem that would be encountered in any GIAP selection of promising Canadian industries. Our most promising industries at present (in the face of Canadian and U.S. tariffs) may not be our most promising industries in the future (when and if these tariffs are lowered or eliminated).

\(^4\)For an example of a GIAP proposal that (correctly) recommends supportive Canadian tariff reductions, but does not recognize the obvious further advantages of removing foreign tariffs, see [12]. Also note that Moore's selection of the furniture industry seriously biases his implicit comparison (pp.84-89) of GIAP with RFT: on the one hand, fewer GIAP problems would be encountered in this industry than most others, since it has less U.S. ownership, hence
Even though it may be concluded that GIAP advocates have not found a substitute for trade liberalization, they do have one clear and useful message: the importance of encouraging mergers as Canadian trade is liberalized—provided such liberalization cuts deeply enough to guarantee that prices will fall with costs, hence ensure that efficiency gains will be realized and the excesses of increased monopolization will be avoided. But if trade is not being adequately liberalized, there is a substantial risk that any GIAP merger scheme may do more harm than good. Its internal contradictions may lead us in precisely the opposite direction to the one intended, by setting up a situation in which a government under pressure may increase Canadian tariffs; this in turn would (1) set the stage for a possible further irrationalization of Canadian industry and a consequent reduction of total income; and (2) redistribute income from consumers to producers in Canada, a redistribution which (by virtue of the fact that many producers in Canada are not Canadian) may lead to a further reduction in total Canadian income.

It seems unlikely that Canadian producers who have historically benefitted from the Canadian tariff at the expense of consumers would prefer such a further redistribution in their favour to an equal opportunity to compete in the international marketplace; but this opportunity can be provided only his merger recommendations would run into less problems with U.S. laws; on the other hand, this is one of the Canadian industries with least favourable RFT prospects, often being cited as an industry that would face the toughest problems in meeting international competition. In any case, the implication from his discussion of this one industry (that his GIAP policy would be econom-ically superior to RFT) is later abandoned as a general proposition (p. 129) where he concedes that free trade would provide more efficiency gains than GIAP; thus his objections to RFT reduce to assertions about social, political and ownership implications. (For a discussion of the political and ownership issues, see Chapter 8 in [16].
by negotiating down foreign tariffs--those barriers to trade that not only act as a tax on our income, but also heavily influence what we do and do not produce, and how efficiently we produce it. Thus the final conclusion is a simple one: if the problem is inefficiency because our industry is operating in a relatively small market, there is no substitute for getting into a large one.
References


