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COMMENT, Professor King: You have given us a very stimulating talk and, if anything, you have been very thought provoking. I wanted to throw the session open to questions. Yes, sir, Joel Davidow.

QUESTION, Mr. Davidow: It is helpful to try to focus all of this in one's mind to tie these sectors to the question of which sectors still have high tariffs, if one assumes that 70% of all trade is already at either no or low tariffs. Those sectors that will change are those where the tariff is high enough that it matters. Can you tie your analysis in to where the high tariffs currently exist?

ANSWER, Mr. Beigie: I don't necessarily agree with that. You are precisely right about the fact that a large percentage of the trade that actually takes place is without tariffs. That's true, but it strikes me that many of the industries, particularly from a Canadian perspective, but I think this is also true in the United States perspective, are affected by apprehended tariff barriers and nontariff barriers.

In terms of corporate decision-making, there is a fear of the NTB imposition and that has had a very dramatic effect in recent years on the behavior of corporate decision-making in Canada. We must also consider the nature of the competitive process that takes place within the country and between firms who are domiciled in one county and have subsidiaries in the other country.

QUESTION, Mr. Erdilek: I totally agree with your conclusions with regard the potential impact of a freer trade agreement on the activities of U.S. subsidiaries in Canada, and on Canadian manufacturing. I reached those similar conclusions on the basis of looking at the literature on both sides of the border, and I also talked to about thirty U.S. multinationals.

I have a question about the exchange rate. What are the pros and cons of a flexible exchange rate regime as we have it now, versus a fixed one from the Canadian viewpoint?

ANSWER, Mr. Beigie: First, at the end of a transition period, I want a freely fluctuating exchange rate. If you are going to have the same currency, which is what a fixed exchange rate is going to give you, then you are not going to have the degree of economic policy independence that I think Canada, as a sovereign nation, should insist on.

I don't like the EMS in Europe. It is too rigid and you throw away the baby for the bath water. The issue is what do you do in the transition period? We will take a number, say, ten years. I would say, pick five years and keep the currency within a certain range. It is now at 76.50, [US = CN$] but I still like the idea of 70 to 75 as the band. If actual value were to go up to 75, Canada would be allowed, as part of the agreement, to lower the interest rate spread between Canadian and U.S. securities, T bills, and bonds. Canada would be allowed during this transition period, if necessary, to have a negative interest rate spread, regardless of what was going on in the inflation rate during that transition period.

If it went toward 70, then Canada would have to raise the interest rate spread to keep it above that. At the end of five years, depending on where it went within that, I would raise it a penny a year or lower it a penny a year; between the first year of the agreement and the tenth year of the agreement, you would have a total possible move from 65 to 80.

It could be anywhere within that range, but it would be bound by a 5% band during the transition, because you need to have, in my judgment, some security to carry out the kinds of things that the Canadian business community would have to do. After that, let it go. Don't interfere with it after that.

QUESTION, Mr. Miller: In order for Canada to take advantage of some of the dynamic efficiency gains that you were talking about, you were saying that Canada had to get in at a much earlier stage in terms of a product life cycle. That implies that somehow innovativeness and entrepreneurship in Canada are going to be important. My question is, what is your view on the effect of Canadian foreign investment policy, and perhaps the level of foreign ownership in Canada, on Canadian entrepreneurship and Canada's innovative ability?

ANSWER, Mr. Beigie: That's a very difficult question to answer briefly, as I'm sure you are aware. I have been on record as saying that I didn't object to the national policy of 1973. I objected to the fact that we didn't have furor right there at the starting point; because what you do when you put in an infinite industry argument, and then you let everybody in that wants in, you create an excessive diversification of your production and you do not give advantage to the innovative types.

Instead you are scrambling around trying to figure out how you are going to engage effectively in nonprice competition with your other competitors who are equally inefficient because they are too small. Now, I don't make my business friends very happy when I say what I have just said, but I believe in it.

I think if you are going to put in something like the national policy, you have to have a complete policy. You can't just throw in tariffs and say, well, then go do your thing, because there are incentives that are created by government intervention and the result is that you have another form of intervention. Well, the fact in that one is that we didn't have a countervailing intervention in the early transition period, so that's where I think the vast majority of the MRS's (Miniature Replica Subsidiaries) came into play.

I have focused on what I think is dominant. Having said that, there are a number of companies where the traditional MRS systems were not all that apparent and the companies still did relatively well. For example, in the mining industries, we are really first rate in terms of world leadership on a number of technological developments, so I don't want to paint too broad a picture and say everybody is terrible.

In that area of manufacturing where there have been relatively meaningful economies of scale and specialization, we did not get the correct kind of policies to take advantage of that. I like this product life cycle notion. We are relatively comfortable at a high income stage in the life cycle; most countries in similar stages are much poorer than we are now.

Now, with the resource abundance falling down in terms of its bailout for the Canadian economy, as the Macdonald Commission has pointed out, I think we have trouble. We have got to find some way to break into that process.

QUESTION, Mr. Miller: Investment policy; how do you think it should go now that we are totally eliminating our national policy? It may have been good in 1973, but what should we do with it now?

ANSWER, Mr. Beigie: I want to see what the negotiation results are. The negotiation results will really determine what we can do on that.

QUESTION, Mr. Miller: You see it as a strategy?

ANSWER, Mr. Beigie: If the Americans were to say, do whatever you want, I would be extremely surprised. Behind the scenes there is a fair amount of discussion on the appropriate approach to investment policy between the two countries, because one of the big payoffs for the United States is to have a prototype to present to the rest of the world.

QUESTION, Mr. O'Grady: You seem to be saying that in the future it is going to be relatively more important to make the newer products before somebody else makes them. It's not going to be so important to make the old products as well. You seem to think that would argue in favor of the Americans staying out of the free trade area, but I couldn't put that together with the point in the middle of your speech where you said the free-trade agreements would lead to better and more rational product specialization. If you got that specialization, why wouldn't you get the innovation in the Canadian plants and in the products in which they were specializing?

ANSWER, Mr. Beigie: I am a little ambiguous in my own head about what drives the U.S. negotiators on this. I'm not saying it shouldn't. I'm delighted that they are interested. I'm delighted that the President of the United States has expressed his interest in negotiating what I have throughout my career in Canada thought we had to get on with. It is just one of those things, a block for Canada. We have to get a modern trade policy.

I ask myself what is really in it for the United States? Maybe they are just being nice to us. The point that you raise is an interesting one. My argument would be, if I were now speaking on behalf of the United States that we could achieve whatever product specialization we want to within the United States market. It is big enough. What does one-tenth of the size mean? If I were advising a head office of a multinational, I would single out the global tariffs. I would single out exchange rate volatility and what it is doing. Then I would go back and re-evaluate the original go, no-go decision under which most of these Canadian subsidiaries were formed.

COMMENT, Mr. Beigie: That was a clearly stated phrase. You had a go decision 50, 100 years ago. That decision with whether to export from the United States or to produce in Canada given the tariffs at the level they were under the national plan originally, resulted in going with a subsidiary in Canada, rather than exporting from the United States.

Today, under the same exact no-go-type of decision, the vast majority would say, if we had to do it over again, we would export. That was the term. I don't feel in any way that Canada loses by having the dynamic boost to its productivity effort on the product life cycle. I'm just not sure what the United States gains if that is the principal objective that we are trying to achieve. I'm not saying stay away from the United States. I'm not Mel Hurtig.

QUESTION, Mr. Marshall: You identified one of the main challenges to the negotiators as being management of the transition in order to permit the net losers to make the adjustment. Beyond the exchange rate scenario that you raised, notwithstanding the current volatility, would you offer them any other suggestions as to what they might be doing and how they ought to be approaching that?

ANSWER, Mr. Beigie: The budget deficit must be lowered. How does that relate to it? I'm concerned that there is going to be a call for assistance by government to the transition process. The pure theorists would say that if the private market is so smart, why doesn't it see what will happen and, therefore, take the rational expectations-type of approach to things.

The problem is that I think there will be an expectation within the regions of Canada for some assistance to them as they make the transitional adjustments; and that's going to be one of the issues that has to be negotiated with the United States. What can the government do in terms of assistance? The problem is that, as I see the political situation arising out of the budget deficit of Canada at this time, there's not going to be a lot of flexibility.

If I told you what I really believed, what I would say is that you are going to have to say an awful lot. That's one of the most effective forms of adjustment.

COMMENT, Mr. White: Going back to an earlier comment you had made about the presence of the U.S. firms and the go, no-go decision; once those firms have made the decision to go, which is an historicial event now, they are captive of their investment. Once the investment is in place, it achieves a life of its own and you are very reluctant to recede from that investment. The people associated with that investment have an ongoing interest. That investment derives its own life and you don't back away from that investment.

COMMENT, Mr. Beigie: I understand that very much. Having said that, I think you would agree that there are conditions under which you have to make a decision.

QUESTION, Mr. White: Where does the next plant go?

ANSWER, Mr. Beigie: That's right. Economists play at the margin all of the time; and whether it is come or go, it is all marginal.

QUESTION, Mr. Aretz: There's a lot of talk about the transition period. What will happen economically during the transition period? What will happen to the structure of Canadian manufacturing?

ANSWER, Mr. Beigie: Take the Autopact. The Autopact was not a serious problem because it was a closely-knit industry on both sides of the border. Something that people haven't realized is that it was a very good growth period and it was forcast to be a good growth period by the negotiators at the time. Even though there was a very substantial shifting of incremental investment, of trade, of export flows, and all of this, the disruption of employment on either side of the border was minimized by the fact that it was a very strong, growing environment.

If you were Mr. Reisman or Mr. Mulroney, having the ink dry on the signature, you are praying that before it goes into effect the world economy goes into a very buoyant growth period so you can minimize those massive disruptions. Unfortunately that's not going to happen. 1988 will be a fairly good year, but there are a lot of reasons to suggest that things are building to a rather difficult time as we enter the 1990s. That's going to make the transition kind of harder than what it was during the days of the Autopact.

QUESTION, Mr. Knopf: I don't understand your theory of why the branch plants here would end up benefiting by specialization agreements, if all tariff and nontariff barriers were removed.

What is the incentive for specialization agreements in a real free-trade situation, especially if at the same time we move, as you suggest, to an earlier stage on the product life cycle and presumably in the high-tech area, which is probably the direction that we ought to be going in—or that a lot of people want us to go in.

ANSWER, Mr. Beigie: I'm sorry, I want to make sure that I understood the question. Are you essentially saying, what is in it if we stay up in Canada?

COMMENT, Mr. Knopf: Yes. If you go back to the go, no go decision, if we are talking about electronic products or whatever—

ANSWER, Mr. Beigie: In Canada, the auto companies are greatly exceeding the safeguard levels of production under the Autopact. This is due to the existing wage level, adjusted for the exchange rate. Making automobiles in Canada is very attractive to these companies.

I see no reason why that is confined to the auto agreement. One of the problems that people continue to have is failing to understand how we could be doing well in something that we manufacture. The fact is that we are efficient. Given equal opportunity our workers are quite good, and if all industries were like the auto industry, the Canadian dollar would be at or near par.

The key to an economist is having to raise the fuel cost of heating our plants because it is so cold during the winter. Then you will have an appropriate exchange rate lowering, or a wage rate lowering, relative to the superior location, the United States, to handle that problem.

Exchange rate flexibility, or price flexibility, will solve anything if you give it time. That is why ultimately economics is not the dismal science. From a micro standpoint, economists are extremely positive if you have flexible prices. It is when you don't let the price system work that you get pessimistic.

COMMENT, Professor King: That was just great and we thank you, Carl.