

## B. Evaluation of Assumptions

While emphasizing the importance of the qualitative agreement reached by the studies on the consumer benefits of free trade, Hazledine raises the following problems with regard to the effects of the assumptions made in the various studies on the accuracy of their results:

In relation to pricing, all the models used assume that Canada is a price taker for its imports (i.e. that Canada pays United States or world prices) and thus that Canadians bear the full cost of our own tariff. However, the empirical evidence to support this assumption is limited. Moreover, it seems plausible, in a world in which countries frequently complain about each other dumping imports at below domestic costs, that firms exporting to Canada absorb at least some of our tariff. This point is important since in most of the models, the size of the fall in import prices determines the size of the fall in domestic prices induced by free trade.

Evidence supporting the argument that free trade will force Canadian producers into rationalizing to achieve greater productivity, is conflicting. The Canada/United States auto pact, for example, resulted in product specific economies of scope -- savings that result from specialization on fewer products coupled with longer production runs. This process caused productivity levels in Canadian auto-plants to rise from 70% to 100% of U.S. levels between 1967 and the mid 70s. On the other hand, the Canadian farm machinery industry, operating under conditions close to free trade for decades, has not closed the gap on its United States counterpart. Moreover, while tariffs fell several percentage points as a result of the Kennedy Round, the gap between Canadian and United States labour productivity appears not to have narrowed in the corresponding period.

It has been estimated that, on average, about two thirds on average of foreign tariff costs are absorbed by Canadian exporters. In the event of such tariffs being eliminated, exporters will thus be better off but may not increase their sales or benefit from the economies of scale expected in some of the studies.

The studies appear to have taken little account of the possibility, under bilateral free trade, that the higher price of imports from the rest of the world still subject to tariff, may dilute the incentive for importers of United States goods to pass on the full bilateral tariff cuts.