Canada lets relatively inefficient, but highly subsidized foreign grain producers take over world markets, efficient Canadian industries will be wiped out. The non-cooperative outcome in this case will push Canada to come up with a subsidy to the threatened industry and perhaps some retaliatory measure against the foreign country. The danger, of course, is that interest groups in each country will move in and entrench what was supposed to be a short term defensive measure. This situation may continue over a protracted period, with taxpayers in both countries saddled with maintaining the subsidies. The current problems in the agriculture sector in industrialized countries are, grosso modo, evidence of this phenomenon. Industrial policy has resulted in distortions in all countries and made most of them worse off. Yet to abandon a competitive industry facing unfair competition is also unpalatable.

The practical application of strategic and industrial policy is beset with difficulties, whether the intention is to shift profits to oneself or to retaliate against rivals who are allegedly doing so. That government should aggressively pick and choose among industrial sectors is more an invitation for vested interest groups to capture trade policy with the politics of protection than a mechanism for promoting market champions. The first best solution requires that the institutions governing trade policy be based on multilateral negotiations and effective market-based rules. This is often a painstaking, incremental process—but it is critical to finding long term, economically efficient solutions.

3. THE EXPERIENCE OF STRATEGIC TRADE POLICY

> "When they [*mercantalists*] say country, read aristocracy, and you will never be far from the truth."
>
> John Stuart Mill
> (Italics added)

3.1 Empirical Evidence on Strategic Trade Policy

Empirical work in this area is still in its infancy, although a number of industries have been examined in order to see what types of outcomes may be possible. The predominant method that has been used in these studies has been that of a "calibrated equilibrium".[22]

[22] This procedure calls for the investigator to posit a particular model of an industry by specifying the mode of conduct, the extent of market integration, the possibilities for entry or exit, and so on. The investigator then inserts what data and parameters are readily available into the model. Finally, unavailable data and parameters are generated by the investigator so that the equilibrium solution of the model matches the observed outcome for some base year.