board. The exchange rate would adjust so that the pattern of trade was unaffected. But relative Canadian living standards would be reduced, thus creating incentives for labor migration. The only way to remove these incentives through policy would be to attack the cause of low Canadian productivity. A generally available 10 percent subsidy to business costs, for example, would not do the trick. Real standards of living depend on real output, which, in turn, depends on real productivity. A subsidy that lowers the money costs of production for business must be financed by tax revenues that take the equivalent purchasing power from taxpayers, so that the net tax-subsidy effect on living standards is zero.[6]

As this example shows, a generally available advantage stemming from differences in economic performance may set up migration pressures because of resulting differences in living standards. But a generally available advantage that is set up by a policy measure will be cancelled out by the exchange rate, leaving only second-order effects on migration incentives. For example, a Canadian tax subsidy policy that lowered Canadian money costs across the board by 10 percent would be offset by a change in the exchange rate. The only economic pressures set up by such a policy stem from any deadweight losses of tax collection that lower overall living standards, and any redistributive effects that lower some people's incomes and raise others. In both cases, migration pressures are put on those who lose by the policy, but in such across-the-board policies these pressures are probably negligible.

The Effect of a Free Trade Area

We now come to the key issue: the effect of a free trade area on pressures for policy harmonization between the two countries. As we have already pointed out, a crucial issue for Canada in developing its negotiating