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POST US ELECTION PROSPECTS FOR ALBERTA, CANADA AND THE US IN A GLOBAL ECONOMY

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BY GRANT ALDONAS

Center for Strategic and International Studies

*Western Centre for Economic Research,
School of Business, University of Alberta
Edmonton, Canada T6G 2R6
www.business.ualberta.ca/wcer*



Western Centre for
Economic Research

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Grant Aldonas

Grant Aldonas is founder and principal managing director of Split Rock International, a political, economic and business consultancy. Split Rock offers strategic advice to corporations, governments and international institutions on political and economic developments shaping global markets.

Mr. Aldonas also serves as an adjunct professor of law, senior fellow and member, Board of Directors, at Georgetown University Law Center's Institute for International Economic Law, as a senior advisor on international economic matters to the Center for Strategic and International Studies in Washington, and as a member of the board of directors of the Information Technology and Innovation Foundation.

From 2001-2005, Mr. Aldonas served as the U. S. Under Secretary of Commerce for International Trade. In that capacity, he was responsible for the United States' trade promotion efforts, managing a federal agency with an annual budget of \$350 million and offices in over 80 countries around the world. He also served as a leading adviser to the President on international economic matters and negotiated on behalf of the United States on a broad range of trade and investment issues, including the free trade agreement between the United States, Central America and the Dominican Republic.

Mr. Aldonas served simultaneously as the Executive Secretary of the President's Export Council, Executive Director of the Trade Promotion Coordinating Committee, which was responsible for coordinating the export promotion efforts of 22 federal agencies, and as a member of the board of directors of the U. S. Overseas Private Investment Corporation.

Prior to joining the Bush Administration, Mr. Aldonas served as Chief International Trade Counsel to the Senate Finance Committee from 1997 to 2001. During his tenure with the Committee, Congress passed the landmark Trade and Development Act of 2000, which included a significant expansion of trade preferences to Central America and the Caribbean.

Before joining the Finance Committee, Mr. Aldonas was a partner with the Washington, D.C. law firm of Miller & Chevalier, where his practice focused on international trade, tax and investment law and government procurement from 1986-1997. Prior to entering private practice, Mr. Aldonas served as a trade negotiator in the Office of the United States Trade Representative, where he was responsible for implementing the original Caribbean Basin Initiative, and as a Foreign Service Officer in the U. S. Department of State.

Mr. Aldonas graduated from the University of Minnesota with a B. A. in International Relations in 1975 and earned his J. D. from the University of Minnesota Law School in 1979. He is the author of *Globalization and the American Worker: Negotiating a New Social Contract* (2009) and *Rethinking the Global Trading System – The Next Frontier* (2009).

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Post US Election Prospects for Alberta, Canada and the US in a Global Economy
by Grant Aldonas, November 8, 2012

I want to talk about the implications for Alberta and Canada of the outcome of the United States elections, but I want to start in the reverse order. I want to begin by providing some economic context which, unfortunately, is going to be somewhat pessimistic.

For that reason, I would welcome any challenge you raise to what I have to say during the conversation because I would like to leave happier than I came. I am going to try and lay out what I think are some of the challenges that we are confronting.

Then, I will talk about the politics. I am happy to discuss as much 'inside baseball' as you want about American politics and the outcome at all levels, not only the presidential outcome, but also Congress, governors, and state legislators all the way down to the municipal level because these make a difference because of our fiscal situation.

Finally, I will come back to the implications of a status quo election for our relationship with Canada and particularly a resource based economy in Alberta.

First, the trends. We have a very unhealthy U.S. economy—very slow growth, under 2%. The net effect is that we have defied all predictions of Keynesian economists in terms of stimulus. We have not recovered nor seen the accelerator effect that President Obama's economic adviser, Larry Summers, said we would see.

We continue to pluck along at a rate of economic growth that does not allow us to put a dent in unemployment. Employment has grown during the 'recovery.' But that is largely due to workers exiting the labour market.

Unemployment currently runs between 8 or 9%, far higher if you take into account the workers who have dropped out of the work force or those who are underemployed. Unfortunately, for a whole generation of young Americans, the prospect that they will be employed, that they will find that which gives them an identity and a purchase in the future economy, and a sense that the investment they made in their human capital is worthwhile, doesn't look like it is coming on the horizon, particularly if we continue to see where we are going in terms of our financial situation.

We have also seen the steady erosion of middle class income. Now, this has been going on for a period of 20 to 30 years but one of the very interesting statistics that I want you to focus on is that we are not talking the low end in America. It is the middle class and the college educated in the most recent years that have seen the downward pressure on their real incomes. Some of that has to do with both higher costs for

education and health care, but a lot of it has to do with just slow growth and the inability to find another job or have the opportunity to say, "I am going elsewhere if I don't get the wage I want."

We are in the midst of a period of stagnation. I made a bet with myself when the financial crisis hit. In my early years in the 1980s, I was in the State Department doing Latin American debt negotiations. You saw the consequences there of the financial and fiscal situation that the United States is in now. What that implied was 10 to 20 years of very slow growth coming out of that kind of financial crisis. So the bet I made was that it would take a decade to climb out of this, almost regardless of what we do. That has largely been borne out in terms of both growth and unemployment, unfortunately, despite Ben Bernanke's easing of monetary policy or the President's enormous fiscal stimulus. We are still just perking along; we never did see the significant uptick some people, like Larry Summers, predicted.

At the same time, due to our approach to fiscal policy, our finances are a shambles. At \$16.4 trillion, our current debt to GDP ratio is close to or exceeds 100% of GDP and there is no end in sight. Each of the last 4 years, President Obama has proposed a budget in deficit by anywhere from \$1.2 trillion to \$1.7 trillion. His next budget would add another \$1.2 trillion to our deficit. In other words, we are adding a trillion dollars or more to the deficit on an annual basis.

That is without taking into account the fiscal cliff we face at the end of this year which could see taxes rise significantly on both personal income and on corporate income, as well as stiff spending cuts. On one hand, all things being equal, one might say that this will help us with our fiscal situation. On the other hand, however, there is little doubt that going over the cliff would lead to slower growth. What slower growth means in this context is lower incomes, lower revenues because of the decline in tax collections, and still higher deficits.

Now, what is interesting about those figures I just quoted is that they represent only the federal government's debt. They do not reflect the debt at the state level or municipal level. For those of you following California's politics, you know there was an effort to raise taxes for the first time in a very long time to grapple with their deficit. Those taxes will help fund some educational programs, which I think would be very helpful in California. But the tax increase does not do much to grapple with California's mounting fiscal deficit.

We also have, in the private sector, enormous unfunded pension liabilities – in other words, a very substantial private sector debt. If you add to that our current account, which is a debt we owe to other countries, we have a financial dilemma that you can only cope with by structural changes.

Question: Personal Debt

Answer: You would be surprised how much deleveraging has been going on since the financial crisis. For those of us who are sceptical of Keynesian economics, the running joke is that Keynesians believe that the American public is too stupid to stay in debt, so the government will have to go broke for them. The reason for the joke is that we have seen in individual households a very disciplined effort to deleverage, while the government is bleeding red ink. But there are real economic consequences to deleveraging among households. It translates into lower consumer demand and slower economic growth.

Nonetheless, the deleveraging is healthy. Before, we were always betting that our income would rise faster than the debt we had collected. That is why you go for the 30-year mortgage, a way, essentially, of borrowing from your future income stream. Households have largely stopped doing that; so many households are in a better financial situation.

But the companies in the private sector, particularly those companies who have had union contracts for a long time, face enormous debt at this point that cannot possibly be covered by any earning scenario. There has been far less adjustment there.

You can see the implications for the fiscal situation. While households have been very disciplined to get out from underneath debt – and, as difficult as lots of foreclosures are, they also wipe the slate clean – we have not seen the same level of adjustment in either the corporate sector or in government.

In the meantime, we are essentially on fiscal autopilot. What comes at the end of the year [if we go over the fiscal cliff] is a rapid, sharp increase in taxes and ‘sequestration,’ which means we will be cutting roughly \$600 billion out of the federal budget. Those cuts will come out of the budget that funds the day-to-day operations of the federal government. The problem is that cutting the ‘discretionary’ side of our spending does nothing to restrain the growth entitlements, which is what is really driving our debts.

We are doing nothing about the accumulating debts from social security, Medicare, or Obamacare. The spending cuts – those \$600 billion – [will be] out of roads, schools, federal emergency management, and the defense department. I am one of those right of centre guys who nonetheless loves the bumper sticker that says “I will be happy when the Education Department has a trillion dollars and the Defence Department has to have a bake sale.” But I do not think it is shrewd to put them on a ‘bake sale’ budget overnight, which is the way we are headed at the end of the year with sequestration on the budget.

Unfortunately, progress will [be slow unless there are] negotiations between two political parties that were just involved in a very antagonistic election in order to come together and find a solution.

There are other longer terms trends in the global economy that are not helpful. First, our population is aging along with a lot of other populations among the OECD countries, even with immigration. Second, the nature of our immigration trends becomes important in a period of dramatic economic change.

As we age, we are eroding our capital stock. People are retiring and starting to convert assets into current consumption, taking away from what would otherwise be building up the U.S. capital stock. That forces us to think about how we raise our productivity in an era of lower capital investment. The reason is that, with more retirees per worker, we must raise productivity dramatically in the rest of the work force simply to keep our GDP at the same level.

The point is that some of what we are seeing in terms of slow growth isn't just the consequences of the financial crisis or failed macroeconomic policies. It also reflects the demographic challenge we are facing.

Now, when these trends are discussed, the discussion generally finds hope in immigration. Why? Immigration offers a way of adding lots of young, productive people in their peak earning years to the country.

I'm less optimistic. The problem is that, in our economy, the technological revolution has accelerated the race between education and technology. In the future, if your job can be reduced to an algorithm a computer will do it. What that means is that holding a good job in the future will mean finding work that cannot be reduced to an algorithm. Better still if that job involves writing the algorithms.

You can see the burden that puts on the educating our populace – the need for both a very solid basic level of education from kindergarten through grade 12 and a means of expanding access to post-secondary education. At a lower level, teachers' unions have blocked changes that would improve kindergarten through grade 12 education.

This is one area where I personally give President Obama a lot of credit because he has taken on a constituency of his own. He has said we have to do something differently. We are not educating people at a level that would even qualify them for that higher education we know they are going to need if our economy is going to make progress.

That challenge is amplified by the rising cost of higher education, which is skyrocketing. We are not doing much to ameliorate the effect of that on our middle class, even though the cost of higher education is rising faster than the cost of health care.

So given all that, why do I say immigration is a problem? The reason is that most of the immigration we see, because of our immigration laws and because of illegal immigration, is unskilled. While many of those immigrants are young and could be enormously productive over their lifetimes, they are also poorly educated by American standards. Many recent immigrants are coming with less than a kindergarten through grade 6 education. But they are entering a job market where the jobs are moving in the direction of technical skills and education beyond the high school level. Immigration of that sort will not raise our productivity, even though it is changing the age dynamics that we see in our society, unless we make a considerable effort in remediating those educational gaps.

Now, you have to ask yourself, what is the appropriate suite of policies that would go along with trying to convert that immigration in a more powerful force yielding higher productivity, higher growth, and a higher standard of living? You would say we need things that encourage retraining on the job, things that pull people up. Many companies have been forced to do this because there is no public policy in support of it.

A good example would be Caterpillar, which has essentially taken East St. Louis, a very poor area of Illinois, and pulled people into Caterpillar by giving them a new high school education and then providing for the ability to get educated above and stay on the job in Peoria, Illinois. Why? Because there are no public policies that would encourage this, that convert that immigration stream into something that would be raising productivity rather than something inhibiting productivity.

Question: Please comment on the cost of higher education.

Answer: Let us take the issue of high cost education one step further. Think about a health care system that limits the return that someone made on his or her investment in human capital and you will see that the situation is worse than you think. You take a student in medical school and put them \$250,000 in debt just to be able to perform a function that society definitely needs. Then, you create a health care system that limits the return on that \$250,000 investment and makes it increasingly difficult to pay it off.

What does that imply as an incentive for people to go into higher education? It implies a very low return and ultimately fewer people going to medical school and, in the end, higher health care costs.

When you think this through, you realize that our problems stem not just from the individual ill-conceived policies, but from the incentive structure they create, which works against solving the economic challenges we confront, particularly in an era of globalization.

Globalization has fundamentally altered the way we compete and reshaped the pattern of industrial organization. It has softened the boundaries of firms by decreasing the incentive for vertical integration and led to the rise of global supply chains.

All of this flows from the dramatic effect globalization has had on transaction costs. As Nobel Prize Winner Ronald Coase taught us, the reason we organize business activity within firms is that it reduces the cost of various business functions relative to acquiring those same services through transactions in the market.

One practical example involves loading docks and shipping departments. It makes sense to have my own loading dock and shipping department only to the extent that it saves me money relative to buying the logistical services on the open market. Today, we live in a world in which UPS and Fed Ex can provide those same logistical services more efficiently at a lower cost than the loading dock and shipping departments in most vertically integrated corporations.

So what does that do? It decreases the need for vertical integration by increasing a firm's ability to raise its productivity and profitability through acquiring those services from other firms in the global economy. That, in turn, requires the company to manage a global supply chain. This requires a great deal more communication with outside suppliers than was previously the case. Suddenly, the boundary of the firm starts to soften. You can no longer think of it as a vertically integrated enterprise engaged in a series of arm's length transactions. Rather, it is now operating a global supply chain in which its input suppliers have, in one sense, become a part of the enterprise.

Apple provides a good case in point. A couple of guys at Harvard Business School challenged the assumption that America is any good at manufacturing anymore. They took a look at Apple and said that this is a disaster for America because Apple has everything manufactured in China.

What they ignored, however, is the fact that Apple dictates everything that goes on the shop floor by Foxconn in China: the machine tools employed, the quality of the glass used, the chemistry behind it -- all of that is driven by decisions in Apple. In other words, Apple is not just involved in design, research and development, setting product and quality standards, and engaging in branding and marketing. It is still actively engaged in manufacturing through its suppliers, like Foxconn.

The better way to think about Apple and the example it represents is to think about the softening of the boundary of the firm to encompass Apple's suppliers and to think of this as an innovation ecosystem, rather than saying it is individual enterprises simply engaged in arm's length transactions. No surprise then that the level of information flow among

those enterprises in the ecosystem is both quantitatively and qualitatively different.

The reason for the excursion into transaction cost economics is what it implies for U.S. economic policy. Given the reality of the global economy, you have to ask what are you doing to make your economy competitive in that environment? What are you doing to lower the cost of doing business and make your country an attractive place to investment?

Tax policy is one big element of that equation. By this, I mean by tax structure, not just rates. The United States has the highest corporate tax rate among OECD countries. If you want America to be an attractive place to invest, you would need to get the rate down.

You would need to get it down at least to the OECD average in order to be competitive. But you would also have to radically rework the structure of the current U.S. tax code, which is absurd, if you were going to stay in the game because the structure imposes costs on doing business beyond that tax rate.

What do I mean by that? It helps to think in terms of a practical example. As I said, we now live in a world where there are fewer and fewer arm's length transactions. But the U.S. tax system is predicated on the assumption of vertical integration and the existence of an arm's length price. The dissonance between how businesses must organize themselves to compete globally and that manner in which we tax them creates an enormous friction that results in higher costs and a much less favourable business environment.

It is also lousy from the point of view of fiscal policy and tax collection. We live in a tax system that ignores economic reality and tries to identify income within the integrated corporation by developing a hypothetical arm's length price, rather than starting from the assumption that we need to define where value is created, look at what returns flow to that value, then tax that accordingly.

The logic extends well beyond tax policy. We should also want to make our economy attractive to the things that are most important in a globalized economy and these are capital, talent and ideas. That means, in practical terms that, in addition to thinking about corporate tax policy, I also need to be thinking about my income tax policy, my immigration policy, my education policy. Why? Because I have to attract executive talent to the United States. That means I need to think about how I tax that executive's income, how I facilitate his or her entry into the United States, and how I educate his or her children because the executive wants to work where his children will get a good education.

You can see where I am going. There is a suite of policies that have to be there to tackle these challenges. When we talk just about the individual items, we are not actually taking into account the entire challenges we are facing economically.

The one bright spot in the United States is energy. The United States is once again the largest energy producer in the world. The unfortunate thing is that we also have an administration that has largely resisted the implementation of the technologies that would allow us to accomplish more in terms of energy development and have inhibited our abilities to sit down with our partners in Canada and Mexico to develop a North American energy strategy.

This is an ironic situation. We had such a sustained high price for energy that it encouraged innovation, and the innovation is now bleeding through the entire energy sector. The fracking technology not only works on the gas, but when you take it down to the Permian basin, all those wells we thought were depleted in Texas are productive again.

We have a real change here but then you make policy choices, whether it is in terms of environmental policy or land policy in the Interior Department, which inhibit your ability to surf that technology wave to collaborate with your friends and neighbours on how we would achieve scale and drop the cost of energy. You have a policy that acts as a brake on the one area that could really offset and help us in terms of productivity, lowering costs and encouraging a better economic picture.

That was the economic context going into the election.

Here is the political context. We are a deeply divided nation. It is divided along geographic lines, economic lines, social lines and cultural lines.

Geographically, the nation is divided. Have many of you been to New York lately? There was once a middle class in Manhattan. Now, below 30th Street to the Financial District and around New York University, the 'brown stones', where middle class families lived, are all gone. What are left in New York are either very well-to-do elites or very poor people. That is the evolving picture of much of urban America.

When you look at the electoral map, which you may have seen on election night, you saw the classic division people make, which I don't like but it is useful for illustrative purpose, on red and blue places on the map. In the Electoral College, you saw states go either blue or red depending on the outcome of the election.

But if you looked on the state precinct level, you would see these little islands of blue, highly populated areas in a sea of red. What that reflected was the division geographically between the urban poor and urban elites, on the one hand, and suburban and rural America (i.e., the middle class), on the other. The sharp geographic divide we are looking at is not north-south, east-west, or east and west coasts versus the mid-west and western states. Rather, the divide is between groups that are urban who vote Democratic, and groups that are suburban and rural who vote Republican.

We also have greater income inequality, which could lead to great political polarization. There is a level at which you worry about the Gini Coefficient, which measures income inequality and has been rising over time. That's a concern. But I worry less about the Gini Coefficient¹ and the disparity between the high to low than I do about the diminishing prospect of rising from low to high over a lifetime.

In one sense, we can afford to be less concerned about the growth in the gap if incomes and standards of living are rising at all levels. The same holds true if we see that people are not spending much time at the poverty level but, over time and over their career, they succeed in rising into the middle class. Unfortunately, the pace and opportunity to make that transition appears to be slowing down, even while the Gini Coefficient is rising.

Reversing that trend will require a number of significant shifts in economic policy in Washington and in the various states. But above all, it reflects a need to restore private sector-led economic growth and renewed job creation.

The best indication of whether our current economic policies serve that end may not be adequately measured by the conventions of national income accounts. A more reliable measure of the problems and challenges we face may lie in simply following the money.

As it turns out, the worst disparity in income in the United States lies between Washington, D.C. and the rest of the country. The five richest counties in the United States lie in a ring around the nation's capital. They are not around Silicon Valley. They are not around Austin, Texas. They are not around the booming hubs of the energy sector in Houston, Dallas, or Denver. They are not around Minneapolis with grain and processing. They are not around New York with finance and culture. They are around Washington, DC.

What that gross disparity in income should tell you is that we are witnessing the return of a 'rent seeking society' – one which rewards those who are most adept at achieving their economic goals through the political process, rather than obliging them to compete for capital and consumers in the marketplace.

No one should be surprised by that development. Since President Obama's election in 2009, we have seen dramatic growth in government spending. That alone encourages rent seeking because, as anyone who has worked on a farm can tell you, when the slop is in the trough, the hogs come to feed.

¹ The Gini coefficient measures the inequality among values of a *frequency distribution* (for example levels of income). A Gini coefficient of zero expresses perfect equality where all values are the same (for example, where everyone has an exactly equal income). A Gini coefficient of one (100 on the percentile scale) expresses maximal inequality among values (for example where only one person has all the income).

The shift toward avowedly redistributionist economic policies reinforces the incentive for rent seeking behaviour. Once you recognize that the income you or your enterprise earns is likely to be defined by legislation or regulation, rather than competition in the marketplace, you invest a great deal more in trying to influence the process of dividing up the pie in Washington, rather than focusing your time and energy on research and development, innovation, marketing or lowering your costs and passing the savings on to consumers, which is what market competition ensures. Even if that is not your first instinct as a chief executive officer, the incentive for rent seeking in our current economic policies encourage you to invest heavily in shaping the legislative, regulatory and spending agenda in Washington, simply to avoid being put at a competitive disadvantage by the others engaged in the political game.

As the Under Secretary of Commerce, I was happy to promote the export of General Electric products wherever I went in the world. Given the company's long history of innovation, GE products represent a powerful example of what is best about America and its economy. At the same time, however, it is also true that General Electric has been the best rent seeking American business since the days of Thomas Edison.

So now as a private citizen, despite my respect for General Electric, whenever I see Jeff Immelt, the chairman of the board and chief executive officer of General Electric standing next to President Obama talking about the need to promote 'green energy,' what do you think I do? My reflective action is to cover my wallet with my hand, because I know that the effort to promote green energy implies higher taxes and the benefit will flow to GE and its shareholders, rather than U.S. consumers and taxpayers. That is where we are headed.

This is not an indictment of President Obama or Democrats alone. We have been headed in this direction for some time – at least since 9/11 when the Republican Party started to expand government with the Orwellian named "Department of Homeland Security Department." The expansion of government certainly has shifted under President Obama and a Democratically-controlled Congress during President Obama's first two years in office. But the shift back toward higher government spending and the incentive that creates toward rent seeking behaviour began long before President Obama and the Democrats gained control of the executive and legislative branches.

Now why do I think this is important? First, the incentive to rent seeking diverts talent, time and capital from productive entrepreneurial behaviour to unproductive entrepreneurial behaviour. That works powerfully against the effort to restore economic growth because rent seeking behaviour focuses solely on dividing up the pie, rather than expanding it.

Second, rising incomes in the political class in Washington insulates those making decisions that affect the economic prospects of Americans beyond the 'Beltway' that rings Washington from the economic effects of those decisions. If, for example, you are sitting at the Environmental Protection Agency and someone says you have to write regulations under the Clean Air Act that help diminish climate change, you may well ignore the impact your decision has on the livelihoods of people in places like West Virginia if you are insulated from the economic impact of your choice.

That, of course, is not hypothetical. Under EPA's Administrator, Lisa Jackson, the agency published new rules regarding emissions by coal-fired power plants that ensure the decommissioning of all current coal-fired plants and ensure that it will be too costly to build a new coal-fired plant in the future. The economic impact on the EPA bureaucrats issuing the regulations was negligible. But the economic adjustment the new rules imposed overnight on families and communities in West Virginia that depend on mining coal was stark.

You wouldn't find disagreement from me about the need to shift toward cleaner energy for a host of reasons. I am also sceptical of the idea of 'clean coal', which we have pursued at great expense to U.S. taxpayers without anything to show for it. That said, I also recognize that it is entirely unfair to impose the burden of economic adjustment on families and communities in West Virginia when the problem we are trying to solve is a societal one (i.e., the failure of both producers and consumers to pay the full environmental cost of their economic choices).

How, then, you might ask, does the United States, find its way onto a path that is sustainable both economically and environmentally? The right approach to the problem is one that creates a broader disincentive to the use of dirtier forms of energy and ensures that the burden of adjustment is levied as broadly and evenly as possible.

Ironically, the EPA's choice does the opposite. It puts [us] on a path that is neither environmentally or economically sustainable. The EPA opted for regulations which immediately devalued existing private investments in coal and eliminated the prospect of future investment. That lower price coal will find a market – but it is likely to be a market in China or India and, in the meantime, the return to workers and communities in coal country will diminish sharply. You can see why parts of Ohio and West Virginia voted for Governor Romney rather than President Obama.

My point is that incentives for rent seeking behaviour do not flow simply from excessive government spending. They also flow from processes that put economic choices in the hands of bureaucrats in Washington. Ceding more influence to government decision only yields more lobbying. It encourages not just the expansion government at the

expense of private sector-led investment and growth, but an entire industry – I call it the ‘rent seeking services industry’ – that provides access to government decision-makers for those who can afford it.

The entire ‘rent seeking services industry’ represents negative entrepreneurial activity and further skews government in favour of those constituencies that are best at manipulating it. What that means, ironically, is that the redistributionist policies that President Obama and his supporters in Congress have put in place in the name of great equality tend to redound to the benefit of the politically sophisticated who have both the means and money to influence government decision-making. Those people, unfortunately, are not the poor and the economically and politically disenfranchised in our country, even though the rent seeking interests will try to tip the moral balance in their favour by suggesting that their goals coincide with those of the poor.

We are, of course, divided as a country by more than income inequality or economic opportunity. We are also sharply divided on cultural issues, particularly abortion and gay marriage. The art of President Obama’s re-election campaign lay in the President’s ability to use fear about abortion, contraception, the treatment of gays, and illegal immigration as a way of bringing out the vote in 2012.

The tactics are not unique to President Obama or the Democratic Party. Karl Rove and other Republican strategists, for example, certainly used fear of terrorism as a way to drive the vote in 2004. But regardless of which candidate or party employs the tactic, a very smart thing to do in terms of political strategy (i.e., appealing to the divisions in society to drive turnout in elections) can nonetheless be a very damaging thing to do in terms of the country.

The tactics reinforce, rather than heal, those divisions. That hampers our ability to come together and solve the problems we confront as a society. The tactics reinforce our identification with particular groups within society, rather than with the society as a whole. All of which makes it more difficult to define who we are as a society and what unifies us.

In the contest of 2012, the path was open for Governor Romney to take the opposite tack. He had the opportunity to cast the President’s tactics in the negative light they deserved by offering a positive narrative of our national purpose and demonstrating a willingness to confront the real issues we face as a country. Most Americans realize that we face a complex set of issues and choices, both at home and abroad. In my view, the electorate was open to a serious discussion of hard issues because most Americans recognize that those issues demand a response.

To put that in context, it helps to think in terms of whom Governor Romney had to persuade in order to win the election. In 2008, many Americans voted in favour of history. Given the troubled history of

our country on issues of race, President Obama's election in 2008 was historic. It measured the distance we have come as a society in the span of one lifetime. President Obama took office just 45 years after the civil rights marches led by Dr. Martin Luther King, Jr. in Selma, Alabama, in 1963.

In 2012, President Obama relied heavily on the residual goodwill that many Americans hold toward the first African-American president in our nation's history. To win, Governor Romney was going to have to persuade any number of Americans of goodwill that they could walk away from their previous vote in favour of President Obama. But to do that, Governor Romney had to offer more than a critique of the President's manifest failures in terms of economic policy, precisely because many of those Americans who voted for President Obama were not motivated by their own economic interest.

In my view, that defined the arc of the election. Governor Romney proved unable to shift from the critique of the President to articulate a positive vision of how we might confront the issues we face as a nation, rather than as a collection of voting blocs. With the exception of the first presidential debate in Denver, Governor Romney proved unable to outline substantive solutions that would contrast with the lack of substance being put forward by the Democratic side.

Ironically, because of his previous experience in both business and government, Governor Romney was far better qualified to be president, given the challenges we face. He was uniquely placed to understand the challenges of the global economy in a way the President seems unable to grasp. But you have to demonstrate that fact. To me, that could have been done most effectively by engaging the President and the American people in a serious conversation about the challenges we face.

It is true that you need an educated population to be effective citizens. It may well be that the American public was not sufficiently economically literate about the economic issues to be able to have that conversation. What that says to me, however, is that both candidates and both parties failed to use the election as a teachable moment. In the event, Governor Romney had more to gain from turning the election into a teachable moment, precisely because of the bright light it would have shone on the lack of substance in President Obama's campaign. But the Romney campaign ultimately failed to seize that opportunity.

The net result was a win for the status quo. The President survived and won another four years. But at the same time, the American voter strengthened Republican control of the House of Representatives, which is the body in our political structure that is closest to the people. On the Senate side, the Democrats picked up seats, but the newly elected senators are likely to create greater division within the Democratic caucus. In terms of the fiscal and economic challenges we face, the politics

looks much like it did for the past two years following the President and his party's loss of control of the House in 2010.

There are number of other factors which will tend to reinforce the status quo and the entrenched positions of both parties and which will diminish the likelihood of real progress in addressing the challenges we confront. For starters, President Obama will have to confront the fact that the day after his re-election, he became a lame duck.

In the end, that may prove more disabling to his ability to accomplish his second terms agenda, whatever that is, than his Republican opposition. As it turned out, the President ran an enormously effective tactical campaign that assured his re-election. What he did not do, as most presidents have done in winning re-election, was ensure that his party remained beholden to him. He did not do the normal things a politician does in our elections to help people down the ticket. Over the course of the fall campaign, he reportedly made only one phone call on behalf of a Democratic congressional candidate.

He is now a lame duck. He is not running again and he confronts a more fractious Democratic caucus that owes him nothing in terms of their political futures. The tactics of the campaign also ensure that he will face a hardened opposition from Republicans as well. In that sense, the election may have done more than simply reinforce the status quo. It may have made the political situation considerably worse, at least in terms of the country's willingness and ability to confront the economic challenges we face.

The only question is whether our fiscal and financial situation finally becomes so serious that we are actually forced by the fiscal cliff or financial markets to confront our challenges and pull together as a country to solve them. I am betting, unfortunately, that is not the case.

If you think of the outcome of the election, there is no reason for either side to compromise. The President won re-election and will feel emboldened by his victory. The Democrats saw gains in the Senate. On the other hand, as I noted, in the body in our government closest to the people, the House of Representatives, Republicans prevailed. Interestingly, we saw the same result at the state and local level, where the races for governors, state legislatures and mayors largely went Republican as well. In other words, at that level, the President and his politics of division did not persuade voters to elect candidates that shared the President's instinct for division.

There is not much incentive on either side of the divide to compromise. Presidential ads went after certain narrow American constituencies to drive the turnout. They will now feel the President owes them and that their issues should come first on his second term agenda. All of which works against the prospect of doing something serious about our economic challenges. Regardless of the relative merits of tackling the

politically difficult and morally charged issues of gay marriage and abortion, the pressure to take on those issues diminishes the President's ability to take on serious economic reform, even if he were inclined to do so, which does not seem to be the case.

The same conclusion (i.e., preservation of the political status quo and stalemate) holds true on the Republican side, although for different reasons. Take the traditional Republican opposition to raising taxes and support for cutting spending. Those are instincts I share because I think both will promote growth, but opposition to raising taxes and support for cutting spending are simply not sufficient as answers to the manifold problems we face.

Reducing your policies and politics to those two stances largely ignores the powerful role government has to play as a part of a functioning economy. It ignores the seemingly obvious point that the income tax rate is not the only policy instrument the government exercises. Indeed, obsessing about tax rates even ignores the fact that the structure of our tax code has at least as detrimental an effect on entrepreneurial investment, innovation, productivity gains, and economic growth as does an increase in rates alone.

When I look at the outcome of the election from that angle, you can see why I am getting depressed. I hope I am depressing you too because I don't want to be alone.

We are in a situation where I don't even see the reason for compromise unless we create one. Our news media, which has become the abattoir of American culture and a conduit for the unrepressed id of commentators, who make up for their lack of credibility with attitude, is fundamentally incapable of encouraging anything other than deeper division. The American electorate will not get another chance for at least another year when the off elections come in a number of states like Virginia, where they always have the election in an odd year. But it will not come at a national level until you get to the next Congressional election two years down the road.

It is becoming increasingly difficult to kick the can down the road, particularly if you have to kick it down the road over and over again for a minimum of two more years. At some point, the financial markets do balk and when they get to that point, the unwinding of our debts will take place in the worst of economic and political environments.

What does that imply in terms of energy policy, for Canada and particularly for Alberta? On energy policy, you can see this leaves us in a position where technological change will continue. It will continue to alter the landscape in terms of our energy production, despite the implications of a government that is indifferent at best, and hostile at worst, to these new technologies coming on stream, because it is too powerful and already too deeply entrenched in our energy future.

In trying to regulate innovation in energy as a means of discouraging the use of fossil fuels and a means of encouraging the development of alternatives, you would face legal, legislative, and, above all, economic challenges. What that means is that the technological revolution that is remaking North America's energy outlook will continue apace and continue to shape the energy sector outlook in the United States and Canada, particularly in Alberta.

One important factor is that the technological revolution mostly affects the production of natural gas in the United States. I did say it is affecting oil production in Texas and the Permian Basin, but the far greater and more immediate impact is on natural gas. That means that the U.S. will be able to supply its own needs and more in natural gas, which will become the predominant fuel used to generate base loads in terms of electricity production. The natural gas revolution will not, however, have as profound an effect on the oil and gasoline we use for transportation in the U.S. market.

There is still a considerable gap between U.S. supply and demand that will be most securely filled by Canadian oil. The real question is whether or not we will allow that to happen on terms that make it cost effective to develop Canada's and Alberta's resources and export them to the United States. President Obama's decision on the Keystone pipeline project raises a serious question whether his administration will allow progress on that front.

Under those circumstances, do I think there is an advantage for Canada's Prime Minister and provincial officials in thinking about an alternative of going to Asia? From Alberta's perspective, of course I do. Anytime you can bring more buyers to the table to bargain for what you have, the higher price you will likely be able to demand for what you have to sell.

At the same time, I think it would be far wiser if, on the American side, we encouraged the conversation about developing our North American resources on the most efficient basis so we could drive growth and innovation in both manufacturing and services across North America – in the United States, Canada and Mexico. That would be the ideal situation, given the need we have to foster economic growth and expand employment. Unfortunately, given President Obama's opposition to date, I don't see it happening.

In that sense, the energy sector is a microcosm of the broader circumstance in which we find ourselves. Thus, for example, I see Canada far outpacing the United States on trade and engagement in the global economy. To be blunt, President Obama has no trade policy. The opposition from labour towards trade liberalization in any form has inhibited the President from moving on trade even if he were so inclined, which he does not seem to be.

The best evidence of that is the President's delay in implementing three free trade agreements signed by President Bush before he left office in 2008. Elsewhere on the trade front, the only negotiations in which the United States is currently engaged involve the Trans Pacific Partnership which was launched at the tail end of the Bush administration. President Obama has failed to launch any new initiative aimed at liberalizing trade and investment in four years in office. In historical terms, you would have to look back as far as Herbert Hoover to find an American president and an administration that has done less on trade.

The President's antipathy toward trade as a means of solving the economic challenges we face is evident in more practical ways as well. When I think of the friction we still have over practical issues like the Ambassador Bridge, I see a President and an administration that is focused inward on the United States, even though engaging more effectively in the global economy is one of the surest and most cost effective way of meeting the economic challenges we face.

That inward focus affects all of our trade relationships. I like to say to my Canadian friends, if you are feeling a cold shoulder, you are not alone. All the rest of our trading partners are feeling that too. Given what I said earlier, you can understand why we are focused on our own problems. But you should also be able to see that what that implies is the continuing friction that we always generate in Canada-U.S. relations largely by our indifference. Rather than indifference, the right approach is to build on the strength of our relationships and think strategically about the cooperation we could encourage and, therefore, end up with both of us better off.

While I think that is the obvious thing to do, I must admit that I don't expect that much will change. I feel issues like the discussion on Keystone will continue to build up and create conflicts for us. I wish we would emulate what Prime Minister Harper was doing in India when he said to his Indian counterparts

'that Canadians need to be engaged in a free trade relationship with India and to be building toward something that said (particularly to our friends in China) that we will put maximum pressure on you to apply rules as they are, but be sure you know, the invitation is open to have a much more mature, balanced and much more powerful collaboration on economic issues with us.'

I would argue that what Prime Minister Harper said about India applies with even greater force to the United States and Canada. Unfortunately, I don't see that happening with President Obama, even after his re-election.

Now, it is possible that things might have been worse on trade in some respects, although not with Canada, had Governor Romney been elected. Our trade relations would definitely have been more fractious

with China. It would have been much more confrontational, which would have made it hard to extend a hand of invitation in these times of change in Chinese politics. This is another area in which I wish the United States emulated Canada.

Lastly, to Alberta. The status quo is a problem, if only because it could make everybody in Alberta even more cynical about the relationship on energy and other economic issues with the United States. While we actually need the collaboration more profoundly than we ever did, if we want to continue to live in societies that provide many of the social benefits and social programmes we have, I don't see that emerging as the guiding principle of U.S.-Canadian relations in a second Obama term.

Just to put that in its appropriate context, to solve the underlying economic challenges we face in the United States, we must raise our productivity. The energy question is absolutely central to our ability to do that. A sharp reduction in energy prices would offset many of the other structural costs our system imposes on businesses operating in the United States. In other words, reducing energy costs is a way of offsetting those structural costs and ensuring that the United States continues to be an attractive place to invest.

In addressing the energy question, it goes without saying that we would be better off if the United States and Canada, particularly Alberta, looked at this together. Because of the deep linkages between the U.S. and Canadian economies, it would be far better if we thought about how to solve our challenges and how we both continue to attract capital, talent and ideas to the energy sector and other industries on both sides of the border. People in Alberta and the United States have a stake in the same positive outcome.

Unfortunately, the way I see the politics stacking up, we seem to be moving in the opposite direction.

This is where I will stop. I would like someone with lower blood pressure than mine to tell me I am wrong.

Questions were not audible on the recording of the forum; however, answers by Mr. Aldonas suggest the tenor of the questions.

Question: The question took issue with Mr. Aldonas' tone of American expectations and exceptionalism.

Answer: Let me start with the question about American expectations and American exceptionalism. We are an exceptional country. There is a reason for what we are and who we are. Walking away from that would be unwise, in my view.

What does that mean? Does that mean you think you can dictate to other people what the terms should be? That is not what I think is the value of American exceptionalism.

America represents an experiment in building a society around two values – one is individual liberty; the other is equality of opportunity. It is an imperfect experiment, with race being the predominant blight in our history of building a society that truly vindicated those values.

But if you ask me, as someone who spends most of their time involved in the economic challenges facing developing countries, what those countries most need, I would answer as follows. They need the institutions that you and I enjoy, including most importantly the institutions that guarantee individual freedom and equality of opportunity. Without wanting to sound too chauvinistic, I do think that the institutions in the United States and Canada that offer freedom, equality of opportunity, and a commitment to expand the capacity of our citizens to exercise their freedom to build their own futures, is the foundation of both economic development and a good society.

Now, much of what I think of when I think of our institutions is both our constitutions and our legal systems, but also a suite of mostly government policies. The government has to provide these public goods precisely because no individual or firm is going to pay for them. By this I mean a sound public education system and things like that which offer a practical way to fulfill the promise of the equality of opportunity our laws guarantee.

That is what I think of as American exceptionalism. Do I think of it as if the United States was a sheriff striding around the world with six-guns to dictate terms? That is a kind of an illusion. Our ability, much less the obligation, that some in the United States felt to do that was an illusion even in the aftermath World War II when America was unchallenged in terms of both economic and political power. As you recall, that didn't last. It gave way to the Cold War a few short years later.

But I am old enough to have seen cycles like this before, where people say that the United States and what we represent is in decline. That certainly was prevalent after the end of the war in Vietnam in 1975, during the trade wars with Japan in the 1980s, and now with the rise of China. To hear our media tell it, everyone in Washington, but particularly in Congress, is afraid of what China represents as a competitor.

I completely disagree. I do not worry about them as a competitor; I worry about them falling apart. When I think of the economic and social challenges that China faces, I think they would be far better off with the institutions that both Canadians and Americans enjoy as citizens of 'exceptional' countries because of the experiment we have had with democracy and free markets, both economically and politically. I think China's future will be far brighter if they find a way to guarantee the core

values that animate both the American and Canadian experiment – human freedom and equality of opportunity.

Do I think, then, that the United States should walk away from the effort to validate those ideas, both in how we continue to build our society at home and in the shape of our foreign relations? Do I think that we should trim our sails and cease to be advocates for those values?

No. To the contrary, I think that would be wrong because in the absence of our efforts to vindicate the values that we, the United States and Canada share, we will ultimately lose sight of those values ourselves. In the absence of U.S. and Canadian leadership – together with that of any number of other countries that share our perspective, we would see the steady erosion of the political and economic model that our experiments represent.

Now if you believe that is the case, as I do, you better ensure that there is a moral solvency to your view of your own exceptionalism and that there is a financial solvency behind it as well. I worry about both sides of that equation in an American context – whether we continue to have both the moral and financial solvency to vindicate our values in an emerging global society.

But if I turn your question around and ask whether, as an American, I could justify the exceptionalism right now, given the lack of moral and financial solvency that lies behind it? I would say no for many of the reasons I have already discussed. The challenge is to encourage a thoughtful discussion on how best to restore that solvency and then to proceed to act with the intent to do just that. If we truly believe in the values of freedom and equality, we would be foolish not to try that.

Question: Are you giving me a typical American view?

Answer: How many Americans actually talk about the underlying values in our society? How many people like to talk about how individual liberty and equality and opportunity have to be maintained in balance and the problem of our politics where one of our parties likes individual liberty and one party likes equality of outcome? How many American actually talk about that? I dare say you have probably never heard an American say that before. So no, I do not think that I am giving you the typical American view. But that does not diminish what I see is the truth in the proposition.

Question: Americans have an insular, lack of a worldview.

Answer: Let's turn it around and I will make it personal. I am a son of a Lithuanian who was a refugee after World War II and a mother whose parents had emigrated from Sweden in the early 20th century. I am the fortunate son of their choice and the choice of my country's willingness to

accept them. I have benefited from a public education at all levels, up to and including my undergraduate and legal education at the University of Minnesota.

I have worked in the private sector and benefited directly from an economy organized around markets, individual freedom, and entrepreneurial opportunity. I have worked in the institutions of government that support that free market system as well as the society that functions according to the values that I discussed previously.

I have been fortunate enough in my professional life, both in and out of government, to have spent most of it in the international arena seeing how the world works. In the process, I have gotten a pretty good glimpse of what the world looks like. Through those experiences, I have seen places that are well governed as well as places that are burdened by the worst forms of government imaginable.

Given those experiences, you might disagree with my view that we should remain committed to the ideals that represent the core of our society, but it would be hard to argue that the perspective is unworldly or uninformed. It is idealistic. But I think a certain degree of idealism is necessary to accomplish anything worthwhile in a Westphalian system of nation states in which power shapes international relations.

Now, if what you are concerned about is pure American chauvinism, of course, I agree with you. The idea of Uncle Sam walking around the world acting like Clint Eastwood's character in *Dirty Harry*, as much as I like Clint Eastwood in that role, is just foolish. But that's not what I'm suggesting.

Nor am I suggesting that we as Americans have nothing to learn from other countries. There are important things you can learn from the French, for example. The whole idea of 'earning the right to throw a tantrum' was one of my first lessons as a young diplomat, taught to me by a wonderful Frenchman. But in adopting that lesson, I thought I should put it to use as an advocate for the values that my country represents, rather than thinking that they were somehow passé or no longer valid.

I mean it when I say we have a lot to learn from others. We do need a very different perception among American politicians and in the American public – about the global economy, our role in it, who are our friends, and why they are our friends based on the values we share. It would help to lose the illusion that we either could or should dictate to other countries, particularly in the face of the changes we see in the world.

But at the same time, recognizing that does not imply a need to walk away from the idea that I know there are good, valuable things about the United States and Canada, both at a personal level and professional level, that I would like to see vindicated around the world.

Just to illustrate what I mean, let me put this in a different context. My first tour of duty as a diplomat in the U.S. Foreign Service was in Mexico. Jose Lopez Portillo was President of Mexico at the time. The Mexican economy was sclerotic and Portillo's party, the Partido Revolucionario Institucional or PRI, had been in power for over 70 years. It had become a political brokering system rife with corruption. It was not all that hard to see what both economic and political liberalization would mean for the people at the bottom of the pyramid in Mexico. Many of them were passing through the Consulate every day trying to do just that by emigrating to the United States.

But then, in the 1990s, under Presidents Salinas and Zedillo, over the opposition of many in their own party (still the PRI), Mexico began to embrace both economic and political reform.

The United States and Canada helped in that process by joining Mexico in the North American Free Trade Agreement, which offered Salinas and Zedillo something more than just expanded economic opportunity by opening our markets. It was also a way of institutionalizing many of the rules that encouraged broader economic and political reform.

What both the United States and Canada did in that instance was manifestly in our own economic interest, but it was also profoundly useful in propagating the values that we share and that we know work for those at the bottom of the pyramid, who lack the means to engage in the political brokering or rent seeking that prevailed in Mexico when I was first there.

Now, it is worth adding that we entered into that agreement at a time when we had the moral and the financial solvency to do it. I think that is the most serious question America faces today – the solvency of our approach.

If, for example, we can't resolve the divisions of race and culture in our own society, there will be very little moral solvency to our advocacy on behalf of the values of freedom and equality of opportunity that we purport to represent. We will have business trying to tell other people what they should do. If, on the other hand, we are actively trying to create a society that does vindicate those values, our efforts and our example will reinforce the appeal of those values.

Now, let me bring this back to the most recent election. Which way are we headed in terms of rebuilding the moral and financial solvency of our model? I've already described our fiscal and financial situation, which is not hopeful. On the moral front, what we witnessed in the recent campaign on the question of race was divisive, rather than unifying. The President, and Vice President Biden, in particular, made a very blunt appeal to race as a way of turning out the vote on election day.

In the process, the President and the Vice President reinforced the divisions in our society, rather than looking for ways to overcome them.

At a minimum, I would say that those actions did not add to the moral solvency of the model we purport to represent as a country. I would submit that we add to the moral solvency of our model when we commit ourselves to creating a better future for every American and, frankly, a better future for the world around us. We diminish the moral solvency of our model and devalue the currency of our ideals when, instead, we practice the politics of division and reward this group or that based on how much they paid for access to the Democratic or Republican Party or how many votes they can deliver on election day.

Question: How much power does the US President have? To what extent is the American public either afraid of change given the awareness these problems, or is it true that they don't want to know about it so they are burying their heads in the sand?

Answer: I think you are right on both counts. What do you do when someone jumps from behind the door and scares you? Everybody says it is flight or fight. In reality, you go into a defensive crouch.

There is a lot of that going on in American life, including in politics and corporate boardrooms. The uncertainty and the risk they see is inhibiting their willingness to look clearly at where we are headed and start to steer us onto a better course.

In situations like that, there is the tendency to blame the other person. Everyone is pointing the finger at someone else when we should be pointing the finger at ourselves. It is like the old Pogo cartoon in which Pogo says, "We have met the enemy and he is us!"

To put that more concretely, let me use the mortgage interest deduction in our tax code as an example. It was introduced as housing policy to encourage home ownership by lowering its cost by making the interest you pay on your mortgage deductible against your income taxes. Today, it helps finance huge, beautiful 'McMansions' in the outer suburbs of Washington, D.C. for individuals with high incomes who derive their livelihood either directly from their employment in a government program or in a business they created to serve a government programme.

In the meantime, the deduction does nothing to put a roof over a poor person's head. Since a poor person pays no income taxes, the mortgage interest deduction has no value to them. As a housing policy it is not just inept, it's counterproductive. But it is now so broadly available; no politician dares to touch it. In short, "We have met the enemy and he is us."

There are a lot of people who think our economic challenges will somehow be solved without confronting situations like that. And this

comes back to your question. We have lived so well so long that it is hard to believe that some other positive thing won't save us – a new Silicon Valley or a new energy revolution. Something has always happened to put us back on the right track economically.

But that concedes too much to chance. The reality is that there is a reason why that 'something' happens. It happens because we have an institutional structure and an incentive structure underpinning our economy and our society that encourages it.

The question now is whether the economic policies we have adopted are eroding that incentive structure. I think they are, which is why I worry about the instinct to fear change, to bury our heads in the sand, or to adopt a defensive crouch. That cripples us from confronting the problems we face, finding solutions, and restoring that moral and financial solvency of the model the American experiment represents.

Question: How do you envision an achievement of economic and environmental sustainability when we are at the point where the world's ecological footprint is beyond sustainability? We know the availability of resources will not be there in the future if we continue on the way we are now. We need heavy-duty thinking and a readjustment and change in our lifestyle. This does not seem to be a problem of which Americans are sufficiently aware. Are Americans living in some kind unreality?

Answer: Let me take issue with the underlying premise that for some reason America's footprint is growing larger and we are past the point of sustainability. It turns out that, by virtue of higher prices, we find ourselves in the midst of an energy revolution. Because of that energy revolution, our carbon footprint has actually diminished significantly. It has resulted in a shift from coal to natural gas as the base load of our electricity supply.

The point being is that market forces (i.e., higher prices) drove innovations that have improved the sustainability of the U.S. economy, far more than any intervention by the government has to date. Our goal should be to ensure that both producers and consumers absorb the full environmental cost of their economic choices. The most efficient means to achieve that result is to ensure the ability of the market to yield that result, rather than distorting the market through regulation or subsidies that are ultimately designed to favour one industry or one enterprise over another.

What the recent revolution in energy underscores is that the market is going to be far better in terms of driving the innovation we need than investments in questionable firms like solar panel manufacturer Solyndra or lithium ion battery maker A123, both of which went bankrupt and cost U.S. taxpayers roughly \$1 billion. Those specific

examples help illustrate why the amount we spend on subsidies to alternative energy exceed even the broadest claim of subsidy to fossil fuels by roughly 9 to 1 and the alternatives remain completely uncompetitive and commercially unviable.

When you look at the multiple failures in our government's efforts to subsidize or create a market for alternative fuels, you understand why I would prefer to let the market decide what works. But that comes with the proviso that your economic policies are lined up to ensure that environmental costs fully are captured by the price that a consumer pays when he or she goes to the gas pump.

I think that is where the United States has fallen short. Let me pose this question. What is the best approach to getting the incentive right? I recall that when President Clinton proposed a carbon tax, Republicans roundly criticized him. But consider what Clinton's tax would be relative to our current approach. By introducing the tax at the level of energy consumption, it would have forced producers and consumers throughout the entire value chain to pick up the cost of the environmental externalities and I would feel a lot better about where we are going with our environmental footprint.

By way of contrast, under our current approach, the government applies either the salve of a subsidy, or substitutes its choice for that of the market in terms of investment in any particular technology. If you asked yourself which was the more efficient result in terms of shaping producer and consumer behaviour, there is a strong argument for the carbon tax rather than assuming that bureaucrats at the Energy Department will choose the right investments to bend the curve in terms of energy consumption.

Now, let's take that one step further and think about the political economy of a government investment in a particular firm or product. The United States heavily subsidizes solar panel producers. So too, does China. Neither the U.S. nor Chinese subsidies make solar energy cost competitive under current market conditions and, all things being equal, those investments in solar are going to look even less attractive the deeper the current energy revolution takes hold.

So what does that leave the United States and China to do with their subsidies to solar energy? We start a trade war over subsidies to solar devices. This, of course, drives up the cost of the solar devices in the U.S. market still further, making them even less competitive relative to fossil fuels. That leads the Obama administration to propose additional subsidies to solar in its more recent budget. It is just foolishness upon foolishness.

We are doing this in lieu of making sure that the environmental externalities are part of the price that consumers and producers pay. When you see what market prices have already done to foster an energy

revolution that has led to a sharp reduction the United States' carbon footprint simply by taking advantage of the instinct of both producers and consumers to save a dollar, it is doubly ironic that the price mechanism has worked despite our best efforts from preventing it from doing so.

What I personally like about a carbon tax relative to other forms of government intervention, if I was forced to make that choice, is that it reduces rather than encourages rent seeking and it has the subsidiary benefit of helping us solve our fiscal and financial situation. If you talk to Americans who want a free ride, well guess what? You don't have to add much in a way of energy tax to generate a lot of income. It is a way that doesn't distort the investment decisions if you are integrating the tax at the level of BTUs. It is hard to imagine any politician supporting that approach in the United States because of our politics, but that simply underscores that our politics are not about reality.

Question: Comment on Obamacare.

Answer: This is like the U.S. and Canadian lumber agreement. Whenever you have both industries saying the agreement is a good deal, it is likely that consumers on both sides of the border are being screwed. I know enough about health care, having being involved with these industries before, that when you reach a bargain with the insurance companies that requires an individual mandate, what you are doing is shifting the burden and cost of adjustment toward consumers and discouraging competition. I cannot envision a circumstance in which you get lower consumer costs when you lower competition. Insurance companies are very inefficient to begin with, which suggests there was not enough competition in the health insurance market even before we got into this unholy alliance between the American federal government and health insurance companies.

Now, what makes this really interesting is that, in our government, we have a model that works. It is the federal employee health care system. You would be amazed. Roughly every quarter, you get this package in the mail when you are in the government and it has scads of insurance companies bidding on your business. What does that mean? Does it mean a government takeover? No, it is the government structuring a market in a way that generated a lot of consumer choice and as a consequence creates a good deal for people who happen to be federal government employees.

The irony that I see in healthcare is that the President couldn't take that model and say, I am for the market. In terms of our health care industry and pharmaceutical industry, and you know this in Canada, both have gone to great pains to restrain trade and limit international

competition in both insurance and in provision of health care. That is one of the reasons we are stuck where we are. You can find surgery all over the world that is very high quality. Trying to get that to qualify for a health insurance payment in the United States is very hard. There is a variety of things that the industries have done, wholly apart from Obamacare, to try to limit competition.

It is one of the difficult things we all face in business or in government. I have never met a business that wasn't looking for a niche where it didn't have to compete and where it could earn higher profits. It's not a moral judgment. It's just a fact of life in the challenging world of business.

But what do I want if I am in government acting on behalf of the American or Canadian consumer? I want to encourage competition. So in government, the question is always, "How do I distinguish between what businesses want, and legitimately need, in terms of economic policy to be competitive and encourage a healthy economic environment in which they can prosper, by meeting consumer needs, relative to those economic policy choices that rent seeking interests want simply to create a niche in which they don't have to compete?" Unfortunately in health care, President Obama opted for the latter, not the former.

Question: The Keystone Pipeline

Answer: It gets done. But it gets done very slowly. The pressure will build over time. Right out of the blocks, what the President has said about climate change policy does not lean in the direction of his environmental supporters, one of his core constituencies. He has to confront the fact that he already made a choice in their favour. He also very much needed them to win re-election. It didn't mobilize votes in a lot of places. As a consequence, how he tries to step back from that, and tomorrow says we are going ahead with Keystone will be a difficult political challenge even for someone who is unburdened by the need to get re-elected again.

I don't want to lose sight of the fact that in our system, it doesn't mean that Congress would necessarily make that happen. There are a lot of tools that a Democratic Senate, where the Chairman of the Environment Barbara Boxer from California, could use to try to a crimp in any plan that the President would try to move ahead on this quickly. We are in a slow thing where we allow the political pressure to build by unions who want to see the work – you see it as an employment issue more than an energy security issues – and eventually it gets done.

At the same time I have to say – this is one of my heuristic biases – that Canada is a better friend to the U.S. at times when it articulates a very independent course of action. When it is simply following the U.S. lead, as Prime Minister Harper said he would on climate change, Canada

is less useful as a friend to us. The irony is that while we had difficulties with Pierre Trudeau, it may have been a time when Canada was a very good friend in the positive sense of the word because it was capable of having conversations with people around the world that we could not have. It was capable of offering policy choices that could not be produced in our political system but that we could see across the border.

The mind set in Alberta and in Ottawa is that you very much need to engage in the partnership and strategic dialogue with the United States if it is available. But failing that, the United States is not your only customer. The fact that you open a dialog about exporting energy to Asia actually helps our side. It focuses our attention.

It is like one of those funny things in trade negotiations. For example, the New Zealand Ambassador comes and says, "We are a small country where dairy is what we are about." That is part of the story. New Zealand actually has the most productive dairy industry in the world. "But," he says to me, "Dairy should be an easy issue for the United States because it is such a small part of our economy." My response was, "I hate to say this but you are not big enough to ask us for that." The difference is Canada is more than big enough on energy under most circumstances to ask. That's one of the reasons I think the pipeline will be eventually approved and gets built.

Now, that doesn't excuse everyone from making a better effort. The folks at TransCanada must work on the issue at the state level, the same way they win the provinces. If they want to build the pipeline out to the coast, they are going to have to go to the First Nations in British Columbia and negotiate piecemeal to get something built. Sounds crazy but they will do it. Well guess what? That is what you do with the legislature in Nebraska. You treat them as another nation. You have that conversation because we really are just trying to find a way to solve each of the individual problems so the whole goes forward.

It all has to start with the backdrop of policy makers that are willing to take a very independent course. They say we can find other options. So you need the backdrop of going to the people who will back the private sector and say, look we can't do it here, we have to find another option.

One thing I didn't touch on, if you look at the broader trends globally in terms of demographics, urbanization and rising incomes, energy becomes far more important in terms of transportation and infrastructure. That is oil, not natural gas. We have an infrastructure and it is a global market for oil in a way you do not have for natural gas. The revolution going on energy-wise is about electrical power in the United States, much more than what is going on globally. As a consequence you start to say, if I am sitting in Alberta and I want some positive news, the

trends globally over the long term are favourable for the resource-based economy that Alberta is.

Now would I suggest that Alberta stay there and feel comfortable about its future? Absolutely not. The larger lesson still comes down to attracting capital, talent and ideas. For my money, you take what you have in the way of revenues from that resource knowing where that broader trend is going. You invest them as heavily as you can so that Alberta becomes a place that is generating the next innovation, the next energy revolution. It is creating the engineers that become part of every energy enterprise around the world. It becomes a place where the constant of cross filtering innovation becomes the classic hub in what we think of as economic geography.

So that is the kind of investments to make from the income the province can generate from what you see as the longer term, very positive future in terms of the resource and its availability and its use.

Question: In this era of the changing form of the firm, who are the leading thinkers?

Answer: It is fascinating the number of people who are working on those issues. It is a lot of good people recognizing what is going on, recognizing the economic dynamic, reasoning as to where we are in terms of what a firm looks like, what the role of an enterprise is. They are not policy makers. One of my stock lines about the United States is, when I go up to Capitol Hill, which I don't do much anymore, but when I testify in front of the Joint Economic Committee on Ways and Means for Finance, I realize they have a vision of the global economy, the United States economy, that is 40 years out of date. I talked to them about value chains and what they imply. I talked about what the global economy means in terms of what we have to do to make our economy attractive to capital, talent and ideas. It does not register.

In terms of developing those choices, there is very small group. There are some real leaders at the World Bank, at the American Development Bank and a group that is affiliated with the World Trade Organization. We are holding two conferences, one in Washington, one in Geneva that are going to look at this issue, both at what individual countries need to do and what you want to do in the terms of the incentives based on the global trading system.

How would you rewrite the rules in a way that would acknowledge the reality of lower transaction costs? In terms of conventional trade policy: tariffs are very low, actually as a transaction cost, far lower than information barriers. So when we think about trade policy now, we need to think about reducing those transaction costs that inhibit buyer and seller, as opposed to the conventional things like tariffs

and subsidies that have always been the heart and soul of the GATT and the WTO.

So the revolution that is coming is which country grasps more quickly that it has to organize its own trade policy structure in a way that is deeply consistent with the way the economy is already operating. That is the way the thinking is going, but it is done by a real limited group and it certainly is not the US Congress, unfortunately.

Question: What do you think is likely to develop in the Trans Pacific Partnership in this term, and with trade promotion and negotiating with China and Japan?

Answer: From Obama, nothing. From the Congress, something quite different. In contrast to everything I've said, it's clear that the Chairman of the Finance Committee Max Baucus is intent upon moving regardless of what the President was willing to do. Chairman Baucus recognizes that we need to move on both personal income tax reform and corporate income tax reform. The structure of the system was really working against us. Apart from the question of rates and where they should be and the progressivity of an income tax, the organization of the system is a powerful detractor for investment.

Similarly, the Chairman recognizes the need for a set of counterpart reforms that make an effort in terms of our global economic engagement. That could be thought of narrowly as just trade policy and trade negotiation authority or, more broadly, the need to create a legislative initiative designed to improve our global competitiveness, of which a trade negotiating authority would be a part, but only a part. The overall bill would represent a counterpart to tax reform. These two things have to work side by side.

Our current situation reminds me of the Clinton years. Because of impeachment, Clinton couldn't ask for a trade negotiating authority because it would offend the labour constituency that had supported him in his effort to remain in office. That led to an effort on Capitol Hill by congressional leaders in both parties to see if we could give it to him whether he asked for it or not.

Now, as was true then, I see enough of a consensus on the Ways and Means Committee and Senate Finance Committee among both senior Democrats and Republicans to move something on trade as well, regardless of whether the President wants it or not. The overall sentiment is that, wherever we are going, we cannot stay where we are now on trade. It will certainly take time, not unlike the Keystone pipeline, but I think you will get movement. The timing will be driven by what else is going on in Congress.

When I go back to Washington, I will once again be 'partisan' in politics because, in our system, it is the only way you can drive ideas into the public space. But everything I do on trade will be trying to create the political space for that sort of movement. I know I can't move the Administration. Politically, they are stuck in a rut due to their constituency. So they won't be able to move anytime soon on the issue. But Congress can move, and with leadership there, I expect it will.