

Toward Monetary Union

Recent year-to-year fluctuations in bilateral agricultural trade can be attributed in part to changes in the value of the Canadian dollar relative to the U.S. dollar. High trade barriers--especially nontariff barriers--buffer the agricultural sectors on both sides of the border from exchange rate shocks. Now that the barriers are reduced, there is less protection from exchange rate risk. For example, a 25 percent decline in the real value of the Canadian dollar, as occurred between 1991 and 1995, would roughly translate into a 25 percent drop in the price of Canadian goods exported to the U.S. market--a major improvement in their competitiveness. On the other hand, U.S. goods exported to Canada could cost 25 percent more in Canada.

The exchange rate could emerge as an especially troublesome risk factor with the decline of other trade barriers. With an unpredictable shift in the exchange rate, enterprises with a comparative advantage and making a profit on exports unexpectedly could find themselves taking losses on exports even though technology, factor endowments, and management remain unchanged. This type of instability adds economic trauma and reduces the benefits to both countries from freer trade. Eliminating exchange rate risk deserves high priority in Canadian-United States trade relations.

Similar pressures have pushed the European Union toward monetary union. Because of greater similarities in cultural and other characteristics between the U.S. and Canada than between many countries of Western Europe, a Canadian-U.S. monetary union would seem to be as feasible economically as an EU monetary union.

References

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