

they regarded as national interests by raising barriers against foreign goods, services and ideas. National governments were at times forced by political pressure to yield to protectionists, often against their better judgment. There remains a real danger that if recession and unemployment persist, the international order struggling to be born will be aborted by an old-fashioned trade war.

### **Painful adjustment**

Nowhere have the pressures toward interdependence and integration on one hand and the backlash against them on the other been more apparent than in the Canada-US relationship. As there have been no substantial barriers to the flow across the border of capital, ideas and entertainment, the technologies of high speed travel and instant communications have had free rein. The two countries have been drawn into an ever closer and more complex relationship, and at the same time have been trying to adjust to structural changes in their economies as they move into a post-industrial era — that is to say, as they move from the production of industrial goods to the production of knowledge and services. In response, nationalist and protectionist pressures have appeared in both countries to resist integration itself, or at least the terms of the deal. But the process of integration has continued, in defiance of the Third Option and of US threats of reprisal against Third Option policies.

Trade between the two countries has continued to grow so that Canada has not been able to reduce its dependence on the US market. And while the flow of capital into Canada for direct investment declined, the flow of Canadian capital into the US for business investment accelerated, for three main reasons.

First, Canadian corporations growing to maturity in their own small national market look for new opportunities and find them in the United States. To cite one highly visible example, real estate companies, having developed city centres, suburbs and shopping plazas in every major city in Canada, have turned for new business to the great cities and the fast-growing sunbelt region of the United States. Second, manufacturing companies recognize that they need markets larger than those in Canada if they are to become big enough to compete with foreign countries. For example, Northern Telecom realized that it could not generate in the Canadian market enough revenues to support the research and development programs it would need to remain competitive with foreign companies. The best way to grow for many Canadian corporations is to create a subsidiary in the United States. Third, intervention in the economy by federal and provincial governments has persuaded some Canadian entrepreneurs that the climate for business and the rate of return on investment is better in the United States.

The significance of this interest in the US market is that Canadian corporations have been becoming continental, or even international, in their outlook. Canadian entrepreneurs view the United States not as a remote and difficult environment, but as a market only an hour or so away by jet in which they can do business as easily as at home, or even more easily. If taxes become too high in Canada, or regulations too oppressive, they turn their energies to the United States where the business culture

and for the most part, the language, is almost identical with their own.

While private capital for business investment was flowing from Canada to the United States, Canadian governments and other public authorities were borrowing heavily in the United States to finance new developments and growing debts. And so, during the decade, the total of private and public capital investment across the border rose substantially and created new economic links. This meant that with the change in the international monetary system and the rapid fluctuation in the value of currencies, the value of the Canadian dollar was fixed even more obviously than in earlier times by markets in New York. To maintain the value of the dollar, or to manage the movement of the value up or down as markets dictated, the Canadian government has little option but to keep interest rates in Canada roughly in step with those abroad.

### **The agony of interdependence**

The growing realization in all the democracies that their economies were interdependent has brought about a change in the nature of relations between countries. As the 1981 report of a colloquium organized by the Royal Commission on Conditions of Foreign Service<sup>2</sup> put it:

Two closely related developments in the scope and content of international relations are the growing importance of the economic component of relations between nations and the increasing interdependence of national economies. Economic interdependence means that traditional adversary-style relationships are no longer tenable. The contagious nature of economic diseases is perhaps one of the most significant postwar developments in terms of its effects on relations between nations.

In other words, national governments have come to understand that they cannot export their economic problems. In the long term, one country cannot continue to be prosperous if its trading partners are suffering hard times. Inflation spreads rapidly from one country to another. Capital flows to the country where the rate of interest or the prospect of profit is highest. To solve their problems, countries have to coordinate their national policies, and that limits freedom of action.

The Royal Commission report noted also that "an increasing proportion of Canada's international relations is conducted by the business community." This is particularly true in relation to the United States where most of Canada's foreign business is done. Somewhat the same point was made in an article discussing Canada's relationship with the United States by Allan Gotlieb, then Under-Secretary of State for External Affairs, and Jeremy Kinsman, then Chairman of the Policy Planning Secretariat at the External Affairs department, published in 1981: "The economic dynamics are those of the private sector and they are the bases of the relationship. Much of the substance of economic cooperation and interchange between private sectors takes place on its own terms."<sup>3</sup> But as we have seen, the Canadian private sector has become increasingly continental in outlook, in contradiction of the Third Option strategy.