export- and import-competing industries. A Canadian current account surplus then would appear as the inevitable counterpart of the capital outflow from Canada. Under such circumstances, the sentiment for trade restrictions might grow in the United States -- just as it has in the current situation of an overvalued U.S. dollar -- only this time it would be directed solely at Canada rather than at the whole world. Since an FTA would rule out tariffs and quotas, the United States might place pressure on Canada to try to hold up the external value of the Canadian dollar. Assuming the Canadian government could not regulate the capital flight that would result, pegging the Canadian dollar would set up severe recessionary forces in Canada. (To support the dollar, the Bank of Canada would have to buy Canadian dollars, thus contracting the Canadian money supply.) The current account surplus needed to finance the capital flight would then be effected by the fall in Canadian imports that would result from a fall in income and employment in Canada -- rather than by a rise in Canadian exports due to a fall in the value of the Canadian dollar, as in the case of a free exchange rate. This is a serious scenario for Canada. The normal corrective to capital flight -- a falling Canadian dollar and an expanding export industry -- would be frustrated by the fixed exchange rate, and the capital flight likely would be combined with a serious Canadian recession.

Opposite forces would be set up if the initial capital flow went the other way. If the FTA caused a boom in the Canadian economy sufficient to attract a major capital inflow, the value of the Canadian dollar would be driven upwards. This would put Canadian export- and import-competing industries under pressure and would open up a current account deficit. Canada might then pressure the United States to stop its currency from depreciating vis-à-vis the Canadian dollar.