Trade hysteresis became a topic of discussion following the rise and decline of the U.S. dollar against the Japanese yen in the 1980s and the response of the U.S. trade deficit.[27] From 1980 to 1985, the dollar rose from 200 Yen to 250 Yen, and there was some concern that the overvalued dollar had led to a deindustrialization of the United States. The dollar depreciated during and after 1985, but U.S. exports were slow to recover. It was thought that the temporary rise in the value of the U.S. dollar had led to a permanent shift in the U.S. trade balance.

The trade hysteresis theory has also been applied to Canada.[28] The Canadian dollar rose 22% against the U.S. dollar from February 1985 to the end of 1991, and was generally regarded as overvalued between 1989 and 1991 when it traded in the US$.84 to US$.89 range. It was argued in the press that our overvalued currency led to a permanent decline in the Canadian manufacturing sector by reducing exports and raising imports. Employment in the manufacturing sector fell each year between 1989 and 1992 and real manufacturing output was stagnant at best.

The Bank of Canada and Richard Harris have done extensive research on trade hysteresis and the Canadian experience, focusing on the 1989-91 period.[29] They reached two important conclusions:

- It is very difficult to differentiate between long lags and permanent shifts in the response of trade to exchange rate movements.
- An insufficient period of time has passed to determine whether the overvalued dollar has permanently effected Canadian trade.

The existence of sunk costs, or an investment of resources required to enter and/or exit international markets, helps explain why trade flows do not appear to respond immediately to currency movements and why more time may be required to determine the ultimate effects. If, in order to enter a foreign market, a firm must undertake certain expenditures on plant expansion, setting up a local distribution

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27 See R.G. Harris, *op. cit.*, p. 37, and R.G. Harris, "Exchange Rates and Hysteresis in Trade." In *The Exchange Rate and the Economy*. Ottawa: Bank of Canada, 1993, p. 362.

28 See R. Amano, E. Beaulieu and L. Schembri, "Trade Hysteresis: Theory and Evidence for Canada." In *The Exchange Rate and the Economy*. Ottawa: Bank of Canada, 1993, p. 403.

29 See R. Amano, E. Beaulieu and L. Schembri, *op. cit.*, and R.G. Harris, *op. cit.*