powerful because they remove most harmonization pressures stemming from the mobility of goods.

The mobility of traded services also exerts powerful pressure for policy harmonization. For example, deregulation of the airline and telephone industries in the United States has encouraged Canadian firms to engage in "border skipping" — routing via Buffalo-Seattle instead of Toronto-Vancouver direct. Changes in U.S. regulatory practices thus put economic pressure on Canada to emulate such changes or lose business to U.S. companies.

Capital Mobility

Highly integrated capital markets exert policy harmonization pressures on monetary and tax subsidy policies.

The pressure on monetary policy that follows from capital mobility is that the price of capital — the interest rate — will tend to be the same everywhere and, thus, a small country's ability to have an independent monetary policy is limited. In spite of some assertions to the contrary, both economic theory and a volume of experience from around the world show that a small country such as Canada has only a limited ability to make its interest rates deviate from world rates. Where almost complete policy independence does exist is on the inflation rate. Attempts to set up interest-rate and/or exchange-rate divergences from their free-market values affect the rate of monetary expansion and, hence, the rate of inflation. Evidence from around the world shows all too clearly that small countries have major policy independence with respect to their inflation rates and only minor, and short-term, policy independence with respect to both their interest rates and their exchange rates.