Since the pass-through of a currency appreciation is generally somewhere between these two extremes, the profit of exporters will usually fall for two reasons. The volume of exports declines due to their price increase in the foreign market, and the new exchange rate reduces the domestic-currency value of foreign currency profits.

When an exporting firm chooses to maintain market share by absorbing exchange rate movements rather than altering its market price, it is said to be engaging in a "pricing-to-market" strategy. Japanese and German firms did this in the mid to late 1980s in the U.S. market. This resulted in the persistent U.S. trade deficit despite a declining dollar.[23] Schembri notes that there is sufficient evidence -- both theoretical and empirical -- to suggest that pricing-to-market behaviour is widespread among exporting firms across many countries.[24] Export prices are slow to respond to price changes brought about by movements in exchange rates.

One implication of the pricing-to-market approach is that firms pursuing a perfectly rational pricing strategy, without engaging in predatory pricing, can be exposed to anti-dumping action in export markets. By absorbing an appreciation of the domestic currency instead of passing the effects on to foreign consumers, exporters have, in essence, lowered their export price relative to their domestic price (and costs). When such a gap exists, exporters can be accused of dumping.

The Canadian Experience

The Canadian evidence on the pass-through of exchange rate changes shows import prices reflecting exchange rate movements quite closely.[25] The prices of Canadian imports are set in U.S. dollars and variations in the exchange rate are passed through to Canadian consumers. If the Canadian dollar declines against the U.S.

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[23] It is important to recognize that the U.S. trade deficit represented a fundamental imbalance between savings and investment. With low domestic savings, caused in part by the large federal government deficit, imports were drawn into the U.S. to satisfy domestic demand.

[24] See L. Schembri, *Export Prices and Exchange Rates: An Overview.* Presented at the Global Disequilibrium Conference, Montreal, June 1989, p. 17.

[25] See R.G. Harris, *Exchange Rates and International Competitiveness of the Canadian Economy.* Ottawa: Economic Council of Canada, 1992, p. 34.