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than 80% of exports went to the US. It is clear that north-south economic integration has increasingly dominated east-west integration, and this led to questions about the real costs and inefficiencies to trade that arise fr

Under the current system, the exchange rate has floated since the early 1970's and since the early 1990's monetary policy has been focused solely on attaining a target rate of domestic price inflation, leaving the level of the exchange rate to be determined by the market. Only when it appears that short-term volatility in exchange markets is based upon speculative forces and risks creating dynamic instability will authorities intervene, and then with a view to stabilizing the market rather than achieving any particular level of exchange rate.

A flexible exchange rate provides an important buffer against external economic shocks. A deterioration in Canada's terms of trade, for example through a decline in commodity prices, will reduce Canadians' purchasing power. To the extent that consequent exchange rate depreciation allows for some of the required adjustment to occur through trade, domestic output and employment are buffered from the full effects of the shock.

Two desirable conditions for defining an optimal common currency area are that the structure of the economies in the area be similar and that there be full mobility of the factors of production among the various regions. The first condition suggests that external shocks will have much the same effect on the various regions sharing a common currency. The second condition provides for easier and more rapid adjustment where the first condition does not hold. The Canadian and US economies, though becoming more integrated, are still distinct with respect to the relative importance of commodity production and export. For example, a fall in commodity prices will reduce Canada's terms of trade while increasing US terms of trade.[2] Similarly, although trade is much more liberalized and capital flows are unimpeded, the mobility of labour between the two countries is far from free and restricted labour mobility would complicate adjustment within a common currency area.

Against this background, there are two main arguments that are advanced for fixing the Canadian dollar to the US dollar.

The first is that the flexible exchange rate regime has contributed to lower rates of productivity increase than would have occurred in Canada had our dollar been effectively pegged to the US dollar. Proponents of this argument sometimes allege that there is a "lazy dollar" or a "lazy manufacturer" phenomenon at work. That is, Canadian manufacturers of traded goods have not faced the competitive pressure to modernize their operations and increase productivity because the declining dollar has 'bailed them out' in international markets. As a result, Canadian productivity has lagged US productivity and our relative standard of living has declined.

The problem with this argument is that there is very little evidence to support it.[3] And there are two empirical observations that strongly suggest it is not the case. The first is

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[2] As a share of GDP, the production of commodities is roughly three times higher in Canada than in the US and while Canada is a substantial net exporter of commodities, the US is a net importer. (Robson and Laidler).

[3] Courchene (2001) cites some earlier empirical work by McCallum that found a lagged relationship between exchange rate depreciation and relative productivity deterioration in manufacturing.

In principle, alternative regimes range from simply fixing the dollar (and using monetary has served us well. To give it up one would have to have confidence that the US economy would be well managed.

Third, the Canadian government now earns ‘seignorage revenue’ from the issue of currency that is estimated to amount to almost $2.5 billion per year.[10] It might be possible to have the US allocate a ‘seignorage amount’ based upon Canadian use of US-denominated notes and coins but this would require negotiation.

Finally, the Bank of Canada now plays an important role as a ‘lender of la economic adjustment over the medium term and it may not be appropriate to peg our currency to theirs since our fiscal and trade fundamentals are much healthier.

- The political impetus behind the Euro is totally absent in North America and, indeed, monetary union with Canada or Mexico is simply not on the US political agenda.
- As noted above, the Canadian dollar has appreciated substantially since late 2002 and, somewhat surprisingly, exporters have apparently been able to adjust to the higher level of the dollar more quickly than had been anticipated.

While it appears that monetary union may be one of those issues whose "future is all behind it", the debate has helped to illuminate the issues that would have to be addressed if future conditions made it appear more appropriate than it does today. For those who believe that further economic integration with the US is desirable, a more appropriate route to pursue would be to push for the removal of restrictions on labour mobility. This would not only enhance the gains from trade but assist in creating conditions whe.8.Gu 454.su43.yiraᏦ.Ac5n