

either of the two large countries or automatic changes in the terms of trade in response to differential price movements inevitably affect Canada far more than they affect the United Kingdom or the United States. Because of the greater vulnerability and lack of diversification, Canada's bargaining position is, on occasion, weakened and Canada is at a disadvantage in opposing unfavourable policies or in negotiating for more favourable policies.

Quite apart from the danger of directly unfavourable policies, which may be due to factors entirely unrelated to Canada but which may incidentally deal shattering blows to Canadian trade, is the inevitable swing in the terms of trade. Canadian trade with the United Kingdom and the United States is of a complementary nature and is a classic example of the working of a basically sound international division of labour. While Canadian cereals feed Britain, British textiles clothe Canadians; while Canadian products of forest and mine, processed by hydro-electric power, feed the industries of the United States, the coal and iron products of the United States equip Canadian factories. But in any exchange of this nature there may be, and are likely to be, wide variations in the price trends of the various classes of products. Thus, Canada may, at any time, find the prices of most of her exports declining more rapidly, or rising more slowly, than the prices of what she buys, or the reverse situation may result. In times of depression Canada finds the impact of the depression intensified by the fall in the real purchasing power of the bulk of her commodities (in the past decade, gold has been an important exception) while the United Kingdom and the United States can look forward to some important increases in the real value of their exports.

In all other external transactions, Canada is also vitally affected by the policy of the United Kingdom and, even more, by that of the United States. United Kingdom and United States investments in Canada; Canadian investments in the United Kingdom and the United States; the integration of a large portion of Canadian industries with those of the United States; the huge seasonal tourist exchange, periodic migrations of labour and the continuous exchange of individuals; and the existence of international labour, business, and professional organizations, all give rise to a continual ebb and flow of funds on a very large scale and a continual process of adjustment of prices, costs and profits. The total of these 'invisible' items in the balance of payments with the United States are far larger than the total transactions on merchandise account and, in some ways, may have an even more direct effect on comparative price levels and thus eventually on purchasing power parities. Canada, in the past, has followed virtually the full swing of violent fluctuations in the United States, modified only slightly by the greater stability of the United Kingdom. A vital difference in the effect of the notoriously abrupt and extremely fluctuating North American business cycle on Canada and on the United States is the substantially higher net income of the latter. Thus, Canada is compelled to accept the full measure of fluctuation that accompanies the highest standard of living in the world—without as high a standard of living to absorb it.

Besides tending to transmit to Canada the full extent of economic fluctuations in the United States, the invisible items of foreign trade give rise to some special features that intensify the pressure on the economy in times of depression. The most important item on the income side of the balance of payments transactions,