# Canadian mouse should get ready to roar

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Pierre Trudeau famously compared Canada beside the United States to a mouse in bed with an elephant, affected by every twitch and grunt.

For many Canadians, seeing the rogue beast of the Bush administration replaced by Barack Obama - a benign image more like Dr. Seuss's Horton - made the northern side of that bed a happier place.

Yet the Obama administration and a Democratic Congress will challenge their smaller northern neighbour with twitches, grunts and worse. On economic matters, a populist U.S. elephant, intoxicated by distress and self-righteousness, is charging shortsightedly about. The Canadian mouse needs to watch out - and seize the opportunities the U.S. economic rampage will present.

Take the financial morass first. Washington's unsure handling of over-leveraged households and banks is troubling on many levels. The key elements of a "good-bank/bad-bank" resolution are no mystery. But noxious politics - unhealthy intimacy between policy-makers and financial executives, allergy to recognizing losses, populist pandering - are preventing it.

In the near term, this wobbliness threatens more financial upheaval - unhelpful to a Canadian recovery. In the longer term, sick banks may further transform the U.S. Federal Reserve from a traditional central bank to a direct lender throughout the economy. Since the fall, the Fed has lent colossal amounts to new borrowers on unprecedented terms. If political pressure keeps the printing press running even as the U.S. economy recovers and inflation starts rising, Canada will be particularly exposed to currency and interest-rate stresses.

The U.S. rampage is even worse on the fiscal front. Mr. Obama's budget proposes to borrow an eye-popping 40 cents of every dollar spent on programs this year and next. The latest numbers are uglier yet, with Washington tracking a deficit for the 2009 fiscal year of more than $1.8-trillion. Unlike in Canada, U.S. federal employee pensions and Social Security programs hold no real assets, and are headed for demographic disaster.

Speculation that the United States will lose its AAA credit rating rattled markets last week. The coming U.S. fiscal squeeze will depress growth - glum news for the mouse that depends on it for about three-quarters of its trade.

Which brings us to a third direction the U.S. elephant is running amok: protectionism. January's "Buy American" twitches from Congress and grunts about the porous northern border from Homeland Security Secretary Janet Napolitano have been followed by worse. From banks to car makers, U.S. bailouts privilege domestic investment and jobs.

By violating its obligations under the North American free-trade agreement to let Mexican trucks operate in the United States, Congress and Mr. Obama showed that union pressure trumps international agreements and good relations with a key - and troubled - neighbour.

Mr. Obama's recent proposals for heavier taxation of foreign investment, heavily flavoured with populist rhetoric, also showed short-term politics overriding long-term economics - in yet another area where Canada, with its extensive cross-border investment links, is especially vulnerable.

Many Canadians are star-struck by the new President. Others doubt that we can tame our huge neighbour. Tempting, then, to ignore the ominous rumblings south of the border - but that would be a mistake. We may be smaller, but we are not powerless. More positively, U.S. mistakes offer a chance to get a leg up on the behemoth.

Take the credit market snarl and the risk of inflation. Canada has healthier financial institutions - and their mammoth U.S. counterparts' collapse has made Canadians much less mouse-like by comparison. Canada has stronger, less politically compromised regulation. And Canada backs its currency with a promise to hold inflation to 2 per cent - a promise honoured with remarkable success since 1995.

Our fiscal advantages are no less stark. While the latest deficit numbers in Canada are disconcerting, our shortfalls are a fraction of theirs and - if we can resist the urge to imitate their spending orgy - will be shorter lived. We face no drastic cuts in public services. A decade from now, Canada should have a decisive edge in business taxation, and more individuals - at all income levels - will prefer the fiscal package this side of the border. We used to fear a southbound drain of brains and capital. In the future, the flows should be northbound.

Even the thickening of the U.S. border offers opportunities for Canada. Falling barriers to trade and investment in the past revealed that liberalization benefits not only consumers but also producers, whose competitiveness improves with access to better and less costly inputs. Welcoming immigrants brings new ideas and energy from abroad - another magnet to capital and entrepreneurship. Even if the United States closes, Canada can open, becoming - in appearance and in fact - the better place to be.

The Canadian mouse cannot and should not ignore the economic twitches and grunts south of the border. Cuddlier image or not, the U.S. elephant is headed for trouble. Canada must defend its interests - and seize every chance to make itself the premier place to live, work and invest in North America.