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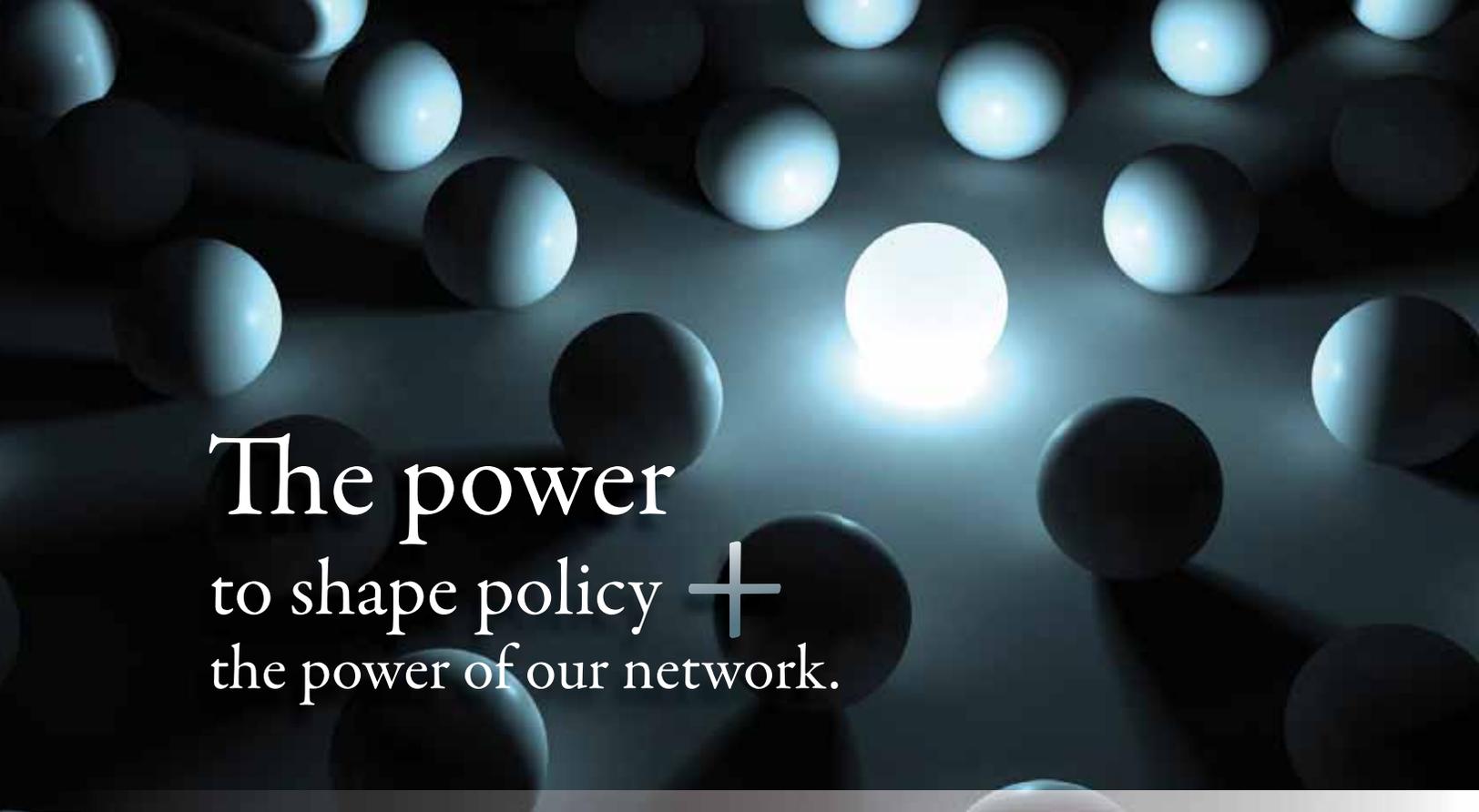


# STRENGTHENING OUR TIES: Four Steps Toward a More Successful Canada-U.S. Partnership

*December 2010*

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## Overview of Canada-U.S. Relations

Twenty-two years ago, Canada and the United States (U.S.) entered into a free trade agreement that set a new standard for trade liberalization between industrialized nations. The product of extensive negotiations involving every level of government, the Canada-U.S. Free Trade Agreement (Canada-U.S. FTA) produced economic efficiencies and increased growth in both Canada and the U.S. Since signing the FTA, and later the North American Free Trade Agreement (NAFTA), Canada's trade with the U.S. has increased by over 80 per cent. The U.S. has also benefited from these agreements. In the decade after NAFTA was signed, U.S. employment increased by 20 per cent while Canada and Mexico remain the largest export market for American goods and services.<sup>1</sup>

Over two decades later, the extraordinary benefits secured by the Canada-U.S. FTA and NAFTA are imperilled by changing economic and political trends. In 2008, in reaction to the financial crisis, the U.S. adopted protectionist policies that not only ignored the integrated nature of North American supply chains but also harmed businesses on both sides of the border. While the *Buy American* requirement was dramatic, it is only one symptom of the slow erosion that must be reversed.

Canada and the U.S. have long enjoyed one of the world's most prosperous trading relationships, with millions of jobs depending upon hundreds of billions of dollars in bilateral trade. But the relationship goes beyond economic integration to include family ties, language, shared values, a singular environment and common interests abroad. These two North American neighbours have typically cooperated on everything

from foreign policy to security issues, with few areas of major contention. Each year there are over 200 million individual border crossings between the two countries. There is no doubt that Canada and the U.S. are close friends and excellent allies. Canadians benefit from this relationship, with half of our wealth being derived from our trade and investment with the U.S.<sup>2</sup>

Unfortunately, relations between Canada and the U.S. have been under pressure in recent years. Heightened security has destroyed the "undefended border." Trade disputes in a variety of sectors including agriculture, natural resources and intellectual property have caused increasing friction.<sup>3</sup> To make matters worse, the *Buy American* policy called into question the market access on which investments have been confidently made for over 20 years. According to Alexander Moens, senior fellow at the Fraser Institute, Canadians "...are hurting from a thousand cuts as Canadian-American relations are caught in the strong currents of American security and economic nationalism."<sup>4</sup>

The world is a different place for the U.S. Not only is it struggling to emerge from the worst recession in recent memory but unemployment levels continue to be a concern, as do high levels of public and private debt. In June 2010, the U.S. trade deficit widened to \$49.9 billion—the largest gap since October 2008—while economic growth is expected to proceed at a slower pace than initially expected throughout 2010.<sup>5</sup> In addition to the domestic pressures, all of North America is facing increasing competition from Asia. The growing influence of China and India, particularly as a magnet for industrial production, will continue to affect the dynamics of North American trade and investment flows.

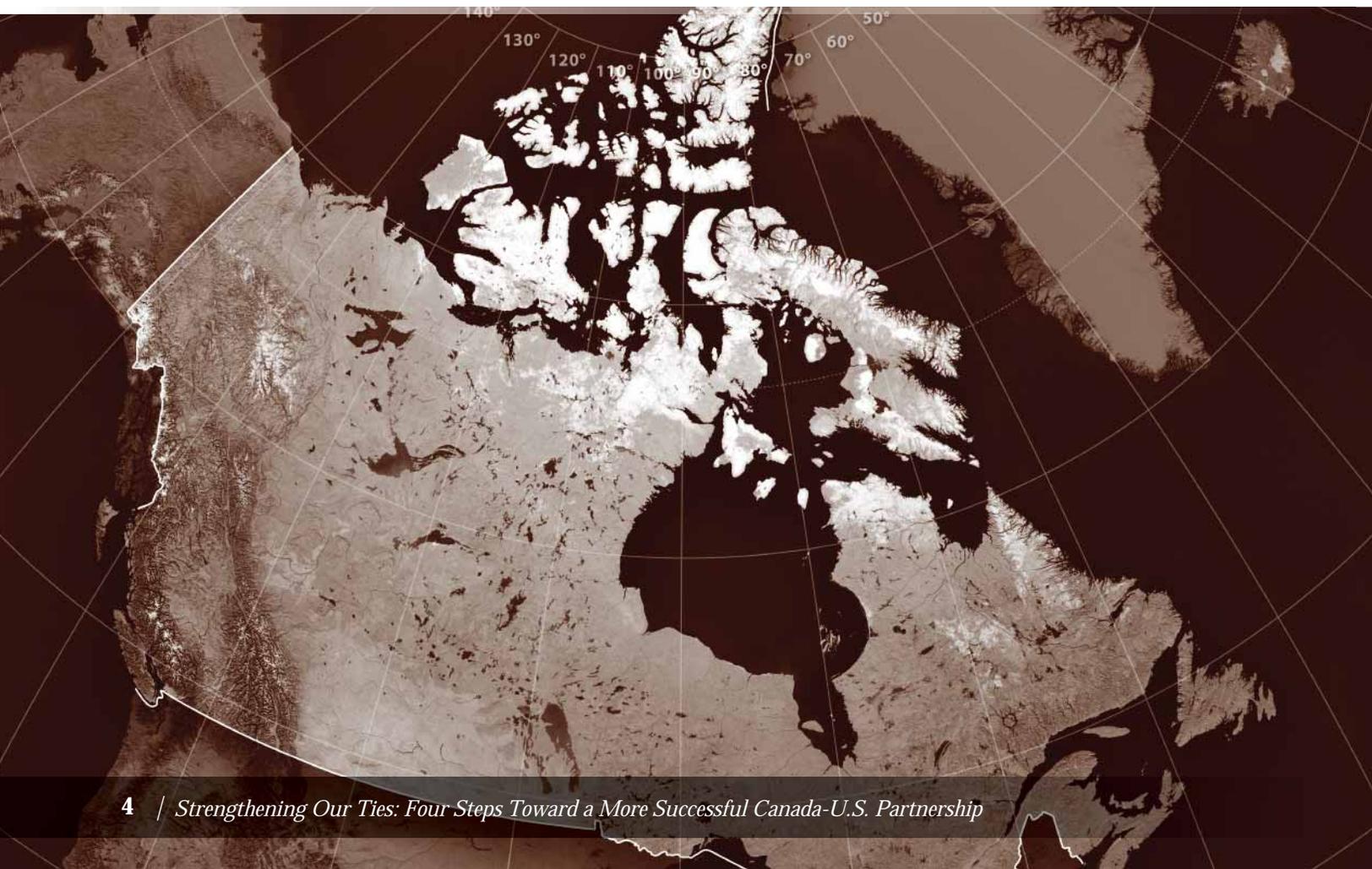
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- 1 The United States Department of Commerce. "Report to the President on the National Export Initiative: The Export Promotion Cabinet's Plan for Doubling U.S. Exports in Five Years." September 2010.
  - 2 Moens, Alexander. "U.S. Trade is Canada's No. 1 Concern." *Telegraph Journal*. January 2, 2010. <http://telegraphjournal.canadaeast.com/opinion/article/907186>.
  - 3 Ek, Carl. "Canada-U.S. Relations." Congressional Research Service. May 12, 2009.
  - 4 *Supra note 2*.
  - 5 Willis, Bob. "U.S. Trade Deficit Unexpectedly Widens by \$49.9 Billion in June." *Bloomberg*. August 11, 2010. <http://www.bloomberg.com/news/2010-08-11/u-s-trade-deficit-unexpectedly-widens-to-49-9-billion-as-exports-decline.html>.

Reacting to these threats, the U.S. will naturally undertake to protect its own interests. A good example of how this has been achieved is through the erection of barriers to foreign industry. The *Buy American* provisions in the *American Recovery and Reinvestment Act (ARRA)* were used to bar foreign firms—including Canadian entities—from participating in projects where they had traditionally enjoyed access. Months of intense discussion—a major diplomatic effort—were required to merely restore much of the market access which had traditionally existed.

Given the deeply-linked nature of North American supply chains and the extent of our economic partnership, the U.S. must remain at the forefront of the Canadian foreign policy agenda. Strengthening the economic and security relationship will make both countries more efficient and able to compete. For Canada, an effort to renew our ties with our neighbour has become urgent given our economic reliance on our relationship with the U.S. The U.S. also stands to benefit from stronger ties with Canada. Canada is a close ally and major source of secure, reliable energy. Canada is also a major

destination for U.S. exports and a key element in North American production networks. As was the case with the FTA, Canada must once again provide leadership. It must convey that policies that hinder the free flow of legitimate goods and services across the border not only reduce North American competitiveness but also weaken the foundations underpinning the Canada-U.S. FTA and NAFTA. Many of the benefits that came from eliminating tariff barriers between our two countries have now been lost to regulatory differences, delays and compliance costs along our border. To avoid further erosion, Canada needs to approach the U.S. with a list of priorities for greater engagement and stress the mutual benefits to be gained from improved cooperation in these areas.

This paper argues that Canada should focus on four core issues: trade, regulatory cooperation, energy security and the environment, and border efficiency. Notable progress in these areas has the potential to usher in the next generation of economic growth and prosperity between these two allies.



# CHAPTER ONE: THE IMPORTANCE OF A CANADA-U.S. TRADE RELATIONSHIP

Canada and the U.S. enjoy one of the most prosperous relationships in the world. Our nations share a history of cooperation and friendship. The strength of this relationship is reflected in the staggering volume of bilateral trade which totalled approximately \$593 billion in 2009.<sup>6</sup> This equates to over \$1.6 billion in two-way trade and over 300,000 travellers crossing the border each day. Since NAFTA entered into force in 1994, the total bilateral merchandise trade has grown by more than 120 per cent.<sup>7</sup>

Thanks in part to the integrated nature of our supply chains, Canada is the largest export market for 35 out of the 50 U.S. states.<sup>8</sup> Yet the true importance of the Canadian market to the U.S. is often underestimated. Canada buys more from the U.S. than Germany, Japan, China and the United Kingdom—combined.<sup>9</sup> In fact, the Canadian market for U.S. products is larger than that of the entire European Union (EU), the population of which is more than 15 times that of Canada. Furthermore, Canadians import 90 cents worth of American goods for every dollar of Canadian exports to the U.S.<sup>10</sup> With such high levels of return, it is not surprising that eight million jobs in the U.S. and three million in Canada depend on continued bilateral trade.<sup>11</sup>

While both Canada and the U.S. have long benefited from this relationship, recent years have witnessed a decline in trade. During the 1990s, Canada experienced a strong period of growth in merchandise trade with the U.S., yet this growth has not been sustained over the past 10 years.<sup>12</sup> Recent Statistics Canada data shows that Canada's trade with the U.S. has been dwindling,

particularly for manufactured goods. Statistics Canada's annual review of merchandise trade confirmed that Canadian exports to the U.S. dropped by almost 25 per cent in 2009.<sup>13</sup> For the first time, countries other than the U.S. accounted for more than a quarter of Canadian exports. American exports to Canada also declined during this period, having decreased by 21.6 per cent from 2008. While this decline can partially be attributed to the effects of the economic recession, the shift in trade patterns is still startling and is cause for concern. Many Canadian businesses expect that economic recovery in the U.S. will be coupled with increased export earnings, yet this is not necessarily the case. First, because of the increasing demand for two of Canada's largest exports—energy and commodities—and exploding U.S. debt, the Canadian dollar is likely to remain strong in relation to the greenback. Furthermore, the high levels of unemployment in the U.S. are expected to continue into 2011, reducing demand for Canadian exports. When coupled with the lower levels of Canadian productivity and growing competition for production from low-cost regions like China and Mexico, Canadian exports to the U.S. will continue to suffer downward pressure.<sup>14</sup>

To avoid further erosion of the competitive advantage granted by the integrated North American market, Canada must work with the U.S. to eliminate unnecessary barriers to trade and investment. Neither Canada nor the U.S. can afford to allow minor irritants to disrupt overall economic and trade relations. We need to resolve both U.S. protectionist impulses and the costs associated with an inefficient border.

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- 6 The Government of Canada. "Trade and Investment: The Canada-U.S. Trade and Investment Partnership." May 2009. [http://www.canadainternational.gc.ca/washington/commerce\\_can/index.aspx?lang=eng&menu\\_id=45&menu=L](http://www.canadainternational.gc.ca/washington/commerce_can/index.aspx?lang=eng&menu_id=45&menu=L).
- 7 The Embassy of the United States in Canada. "Did you know—Why Canada is Important to the U.S." [http://ottawa.usembassy.gov/content/can\\_usa/pdfs/didyouknow.pdf](http://ottawa.usembassy.gov/content/can_usa/pdfs/didyouknow.pdf).
- 8 The Government of Canada. "State Trade Fact Sheets 2009." June 2010. [http://www.canadainternational.gc.ca/can-am/commerce\\_can/2009/index.aspx?lang=eng&menu\\_id=199&menu=L](http://www.canadainternational.gc.ca/can-am/commerce_can/2009/index.aspx?lang=eng&menu_id=199&menu=L).
- 9 The Government of Canada. "Canada and the United States: No Two Nations Closer." 2009. <http://www.canadainternational.gc.ca/can-am/Closer-etroites.aspx>.
- 10 Sands, Chris. "Many Happy Birthdays Canada." *Macdonald Laurier Institute Blog*. September 29, 2010.
- 11 Baughman, Laura; Francois, Joseph. "U.S.-Canada Trade and U.S. State-Level Production and Employment: 2008." 2010.
- 12 *Supra note 2*.
- 13 Statistics Canada. "Canadian Merchandise Trade." February 2010.
- 14 *Supra note 2*.

# Learning the Hard Way

## Buy American

*“You should take no comfort from the hole in my end of the boat.”*

-United States Trade Representative Ron Kirk.<sup>15</sup>

*Buy American* policies remain one of the most significant developments in Canada-U.S. relations in the past several decades. In 2009, the U.S. passed a \$787 billion stimulus package in response to the global financial crisis. The *American Recovery and Reinvestment Act of 2009 (ARRA)* was intended to encourage spending in the American market and to help offset job losses. While this initiative was designed to inject funds into the American economy, it was laced with clauses requiring the U.S. government to give preferential treatment to U.S.-made goods. As a result, Canadian iron, steel and manufactured goods were excluded from hundreds of billions of dollars of state and local projects. This exclusion demonstrated that the U.S. would not hesitate to block market access to Canadians in an economic downturn, despite the fact that many North American firms depend upon the free movement of goods and services across the border. These protectionist policies run counter to the spirit of NAFTA and place the security of Canada-U.S. trade relations in jeopardy.

Protectionism is not a new idea, particularly in the U.S. Similar provisions have been embedded in certain U.S. federal legislation since the 1930s. The original *Buy American Act of 1933* is a prime example of how protectionism can lead to tit-for-tat trade wars. Fortunately the *Buy American* clauses in the ARRA did not lead to a domino effect which would have crippled the global economy. This is not to say that *Buy American* has not had serious impacts for many businesses on both sides of the border or that we can turn a blind eye to future protectionist measures.

The Canadian and American supply chain is far too interconnected not to be weakened by policies that restrict the free flow of goods across the border. The high degree of North American economic integration means that any escalation of trade barriers could have serious, long-term consequences for businesses that conduct cross-border trade. The *Buy American* provisions in the ARRA alone are known to have caused severe delays in project delivery and have stunted job growth. Coupled with the worst recession in a generation, these restrictions are prohibiting some U.S. firms from bidding on projects. The hardship is even worse for small- and medium-sized enterprises that have difficulty navigating the technical aspects of the legislation and with filing the necessary paperwork.<sup>16</sup>

A recent study undertaken by the U.S. Government Accountability Office found that the *Buy American* requirements in the ARRA negatively affected the ability of five federal agencies—the Department of Homeland Security, The Department of Commerce, The Department of Education, the Environmental Protection Agency and the Department of Housing and Urban Development—to select or start certain projects funded by the ARRA.<sup>17</sup> Among the examples cited in the report is an Electronic Baggage Screening Program, funded by the ARRA, which was delayed pending a waiver for the *Buy American* provisions. It was determined that restricting all parts to U.S.-manufactured goods would have negatively affected the integration of an airport’s security systems.<sup>18</sup>

In October of 2009, the Canadian and American governments began negotiations on a deal to exempt Canadian firms from the *Buy American* provisions in the ARRA. After months of negotiations, the agreement entered into force on February 12, 2010. *The Agreement between the Government of Canada and the Government of the United States of America on Government Procurement (Canada-U.S. AGP)* exempts Canadian firms from the majority of the *Buy American* exclusions at the state and local level. Canadian provinces have also, for the first

15 Kirk, Ron. Remarks by United States Trade Representative Ron Kirk Speaking at the Global Services Summit. Washington, D.C. September 28, 2010.

16 The United States Chamber of Commerce. “The Cost of Buy American Mandates on American Jobs: Reviewing the “Buy American” Requirement on the Recovery Act’s Anniversary.” February 17, 2010.

17 The United States Government Accountability Office. “Recovery Act: Project Selection and Starts Are Influenced by Certain Federal Requirements and Other Factors.” February 2010.

18 *Ibid.*

time, agreed to sign onto the World Trade Organization's Agreement on Government Procurement (GPA). This means that Canada has broken new ground by partially opening sub-federal markets to U.S. companies for the first time in an international treaty.<sup>19</sup>

Under the GPA, Canadian businesses will now have access to procurement opportunities in the 37 U.S. states covered by the agreement. In return, Canada agreed to provide temporary access to certain provincial and territorial construction projects not covered in the GPA until September 30, 2011. The agreement also included a commitment to short-track consultations if new legislation with *Buy American* restrictions appears. One of the primary criticisms of the agreement is that the permanent market access commitments agreed to by the U.S. excluded some key state-level departments and agencies and that Canadian companies experienced problems accessing the American market due to the exceptions included in the agreement.<sup>20</sup>

While the Canada-U.S. AGP is far from perfect, it does place Canada in a better position than before the deal was reached. First, the agreement is an important first step in terms of engagement with the U.S. following the economic crisis. Second, it lays an important foundation for the argument that Canada should be excluded from future *Buy American* provisions. Third, the deal included a commitment from both governments to sit down within 12 months to discuss a permanent procurement agreement that would go beyond both NAFTA and the GPA. Finally, the rapid pace of the negotiations—similar talks have typically required more than a few months—suggests that both governments recognized that many industries in both Canada and the U.S. rely upon a single supply chain.

The hard work by various levels of government in both countries consumed time and human resources that could have been used elsewhere, such as the negotiation of other FTAs that could have spurred job growth and injected badly needed funds into the economy. Instead, negotiators were diverted to an agreement that should never have been necessary and served primarily to undo some of the damage that had been done by pointless

and counterproductive protectionism. Canada must work to counter future protectionist endeavours before they are put in place and continue to actively promote and protect free trade. The Canadian government must stress that policies designed to protect jobs at the cost of trade will only end up having the opposite effect. The success of the Canada-U.S. AGP is a step forward, but Canada's interests continue to be threatened in a variety of areas.

## Country-of-Origin Labelling

*Buy American* may be the most infamous form of growing U.S. protectionism, but it has not occurred in isolation. Another serious irritant for Canadian businesses stems from the 2002 *Farm Security and Rural Investment Act*—also known as the 2002 *Farm Bill*—and the *Food Conservation and Energy Act (2008)*. These bills require country-of-origin labelling (COOL) at levels of production and sale for agricultural commodities including pork, fish, chicken and beef. Some helpful exemptions exist for processed foods and products sold by small businesses, yet both bills have negatively affected cross-border business.

Each year, Canada exports billions of dollars' worth of livestock to the U.S. Difficulties arise out of COOL because of the tightly integrated nature of the North American supply chains. Under the COOL regulations, an animal must be born, raised and slaughtered in the U.S. to be labelled a product of America. However, 50 per cent of the livestock sold in American markets will spend time outside the U.S. during the various stages of production. For example, a pig might be born in Canada but raised, slaughtered and sold in the U.S. The meat from this pig would have to be identified, under COOL requirements, by mixed labelling as "Canada-U.S." In recent years, Canadian pork exports have accounted for approximately seven per cent of the American market and were valued at \$482 million in 2008.<sup>21</sup> In 2009, the rising value of the Canadian dollar and the labelling rules caused a 33 per cent decrease in American demand for Canadian pork. Beef exports have also suffered but to a lesser degree.

19 Report of the Canadian House of Commons Standing Committee on International Trade. "Canada-United States Agreement on Government Procurement." May 2010.

20 *Ibid.*

21 Krauss, Clifford. "Canada Seeks Redress on Food Labelling Law." *The New York Times*. Oct 12, 2009.

COOL's adoption has depressed demand for Canadian cattle and hogs. In 2009, U.S. Agriculture Secretary Tom Vilsack introduced more stringent guidelines that further decreased Canadian beef prices and Canadian pork exports. The labelling requirements not only allow consumers to "Buy American" products and discriminate against mixed labels but have also introduced a significant paperwork burden. Due to the additional requirements, many American companies avoid Canadian meat products altogether. Former Canadian International Trade Minister Stockwell Day characterized the rules as "so onerous that they affect the ability of our cattle and hog producers to compete fairly in the United States."<sup>22</sup>

Recognizing the U.S. reliance on Canada for a portion of the production cycle, the Obama administration loosened the regulations to allow animals originating in Canada and slaughtered immediately in the U.S. to be processed with animals born, raised and slaughtered there. In these cases, the products may be labelled "Product of Canada and the United States."

Country of Origin labelling requirements are beginning to spread to other industries. In early 2010, a bill was tabled in the U.S. House of Representatives that would extend COOL to motor vehicle fuel. The purpose of the legislation is to allow American consumers the choice of purchasing fuel based on the country of origin. This is yet another form of protectionism that will directly affect Canada as the largest supplier of fuel to the U.S.<sup>23</sup>

## A Growing Problem

The increasing inclusion of protectionist language in U.S. legislation poses a significant problem for Canada. The continued high unemployment levels in the U.S. and the voter unrest demonstrated in the congressional elections mean that policies aimed at securing American jobs, regardless of the cost to international trade, will be viewed as good politics. With each piece of protectionist regulation adopted in the U.S., the risk of retaliatory actions within Canada grows. Provincial and territorial governments must be steadfast in advocating open markets and avoiding retaliatory "Buy Canadian" policies.

If Canada does not become more assertive in building domestic support in the U.S., it will quickly be overshadowed by competition from other countries that are prepared to press their cases more aggressively. To be successful, Canadian marketing in the U.S. must mobilize domestic political constituencies. Such an exercise will be neither cheap nor easy. Overcoming protectionism and capitalizing on the North American advantage of closely integrated markets requires a comprehensive strategy of engagement. The U.S. is the most competitive political and media market in the world. The excellent work done by Canada's diplomatic representatives in the United States needs to be supplemented by a sustained, well-funded and carefully organized private sector effort. Canada has a significant range of players that can be enlisted to advocate our country's case, including federal and sub-national governments as well as non-governmental organizations and the business community.

## RECOMMENDATIONS

That the Canadian government:

1. Put in place a mechanism above and beyond the fast track consultation mechanism in the Canada-U.S. AGP to ensure that Canadian businesses have access to procurement projects in the U.S.
2. Move rapidly on the commitment to negotiate a permanent procurement agreement.
3. Continue to seek exemptions from *Buy American* provisions in highly integrated sectors where Canadian businesses have historically been able to compete.
4. Encourage and help resource a well-funded, sustained, private sector-led initiative to promote Canada's interests within the United States.

<sup>22</sup> The Department of Foreign Affairs and International Trade Canada. "Canada Requests WTO Panel on U.S. Mandatory Country-of-Origin Labelling." The Government of Canada. October 2009.

<sup>23</sup> Todgham Cherniak, Cyndee. "United States Moving Towards Country of Origin Labelling on Fuel." *Trade Lawyers Blog*. February 2010.

# CHAPTER TWO: REGULATORY COOPERATION

## Introduction

Opposing regulatory systems can become a major hindrance to cross-border business and can stifle economic recovery. Non-tariff barriers resulting from minor differences in product labelling, health and safety, food safety standards, emission controls and other areas must be addressed. This can be accomplished through mutual recognition, the adoption of common standards or, in some areas, through regulatory alignment.

Recognizing the need for greater collaboration on regulatory policies, North American governments have undertaken several helpful initiatives in recent years. For instance, improved regulatory cooperation was embedded within the 2005 Security and Prosperity Partnership (SPP) process that brought together the leaders of Canada, the U.S. and Mexico. This process was designed to improve North American security while facilitating the free flow of legitimate goods and people across borders. In 2007, the leaders of Canada, the U.S. and Mexico released a list of priorities for the SPP that included developing a regulatory cooperation framework.

The 2007 leaders' statement recognized the need to streamline regulatory processes, encourage compatibility and eliminate redundant certification requirements.<sup>24</sup> While the series of trilateral negotiations is now defunct, the important dialogue on regulatory coordination continues. More recently, in March of 2010, the Department of Foreign Affairs and International Trade called for input on future areas for North American regulatory cooperation as a continuation of the process started by the SPP.

While such signs of progress are welcome, the regulatory regimes in North America are constantly evolving and continual monitoring is needed to reduce unnecessary regulatory barriers. For example, despite being regulated under NAFTA, the temporary entry of professionals continues to present problems. There

are four criteria for temporary entry permits under NAFTA: traders or investors, professionals, intra-company transferees and business visitors. While rules are in place governing entry requirements, the growing red tape associated with temporary entry permits is a serious non-tariff barrier and an ongoing concern to businesses operating on both sides of the border.

A patchwork series of fixes will not ensure the competitiveness of our economies. Contrary to the belief held by opponents of alignment, compatible regulatory policies do not require adopting a lowest common denominator approach to standardization. Both countries have an interest in maintaining high standards of consumer protection, environmental stewardship and business ethics. In areas where legitimate differences exist, variations in regulatory structures can be justified. However, more often than not, the need for commonality is clear. Greater alignment of our regulatory regimes, when designed in a strategic manner, will enhance the ability of North American businesses to compete and grow.

As the smaller economy, Canada needs to have a clear sense of what it wants and should lead in defining the agenda. Canadian regulators must identify the key areas where strategic alignment will benefit both countries and enhance economic competitiveness. Once these areas have been identified, the benefits of alignment must be presented to counterparts in the U.S. with a set timeframe and clear goals. Policymakers must also understand that regulations do not operate in a vacuum and that the implications from a singular restriction can ripple across many sectors. Regulatory alignment can best be achieved through an updated, institutionalized process similar to the structure embedded in the SPP. To be successful, regulators on both sides of the border must actively collaborate to identify and work on areas where regulatory reform would be mutually beneficial. While there are many sectors where regulatory alignment is badly needed, the following section highlights a few of these areas.

<sup>24</sup> North American Leaders' Summit. "Leaders Statement." Montebello. 2007.

## Sectors in Need of Attention

### Transportation

Given its vital role as an economic enabler, the transportation sector needs careful, bilateral consideration of regulatory policy. The interwoven nature of the Canadian and American economies means that North American transportation should be viewed as a single, multimodal network. A cooperative framework for transportation, particularly regarding infrastructure investment and regulatory policies, would greatly enhance North American competitiveness and reduce inefficiencies.

For instance, the regulatory framework for marine transportation urgently requires improvement. The basis for this cooperation was laid out in the 1909 Boundary Waters Treaty and the 1978 Greater Lakes Water Quality Agreement. Embedded within both of these agreements is the requirement that both Canada and the U.S. weigh the potential impacts of their regulatory decisions on the other party. While these agreements are important examples of successful cooperation, both governments need to collaborate on joint regulatory development and on enforcement. For example, vessel operators on the Great Lakes St. Lawrence Seaway (GLSLS) are currently under the authority of 12 different jurisdictions, including 10 provincial and state level bodies, as well as the federal authority of both the U.S. and Canadian governments. The wide variety of regulations in this region imposes a serious burden on operators and adds unnecessary inefficiencies for the North American transportation system. For instance, the recent adoption of the U.S. Environmental Protection Agency Vessel General Permit (VGP), forces operators on the GLSLS to comply with eight different requirements for ballast water control, in addition to the existing Canadian requirements. Furthermore, under the VGP, New York State has implemented ballast water management requirements that are not feasible with current technology. Left unamended, these requirements will disrupt not only international trade, but also Canadian interprovincial and U.S. interstate movement of goods.

The marine mode is not the only transportation sector crying out for greater regulatory alignment. Canada-U.S. trade and travel is predominantly achieved through land and air modes, which are equally challenged by regulatory inefficiencies. For example, there are 64



jurisdictions in North America responsible for regulating the trucking sector alone. Even the importation of empty shipping containers differs between Canada and the U.S.

The effective management of the North American transportation network requires a coordinated approach to policy and regulatory formation. Such coordination would not only limit unnecessary layering of regulations but would also go a long way toward ensuring that regulations adopted by either country consider the possible economic, environmental and health impacts on both sides of the border.

## Aerospace and Defence

The aerospace and defence sector represents another area where regulatory policy reform is needed. Canada is a world-class aerospace leader, following closely behind the U.S. and Europe. Aerospace and defence is also an important contributor to the Canadian economy, with total sales in excess of \$23 billion in 2008.<sup>25</sup> Several Canadian firms have captured up to 80 per cent of the global market share in their class while certain Canadian manufacturing hubs are among the few places in the world where an entire aircraft can be assembled by firms located in less than a 50-km radius.

Canada and the U.S. share one of the most extensive and mutually beneficial defence arrangements in the world. Because of shared defence interests, Canada and the U.S. also enjoy a deeply integrated defence industry. Canada is the fifth largest importer of aircraft and aircraft parts, with two-thirds of these imports originating in the U.S.<sup>26</sup> American suppliers of aerospace inputs are a significant contributor to Canadian manufacturing in general, accounting for 50 per cent of total inputs.<sup>27</sup> In turn, many of Canada's defence-related firms are subsidiaries of U.S. prime contractors with specialization in products destined for future integration into U.S. systems.

Unfortunately, the efficiency of this integration is being challenged by outdated and overly burdensome export control regulations in the U.S. The International Traffic in Arms Regulations (ITAR) is the set of U.S. export and import controls that regulate the defence industry. Under ITAR, access to U.S. defence services, defence articles and technical data is limited to individuals and end-users registered and licensed by the U.S. Department of State. The restrictive nature of ITAR has often functioned as a significant barrier to trade.

Canada is the only country in the world that has an exemption written into the ITAR. This is likely due to the defence relationship between Canada and the U.S. and the fact that North American defence industries are closely integrated. More specifically, the Canadian ITAR exemption is mainly for low-risk goods whereby certain U.S. defence articles and services

could be exported to Canadian federal and provincial governmental authorities and to "Canadian registered persons." Canadians born outside of Canada or those with dual or multiple citizenships (i.e. dual nationals) are generally eligible to receive access to defence articles and services under the Canadian exemption. Under export licensing agreements outside of the use of the Canadian exemption however, dual nationals and third country nationals must undergo a lengthy and often unpredictable application process. Additionally, dual nationals with citizenship from a country proscribed or embargoed by the ITAR are ineligible for the exemption or authorization under an export licensing agreement. Not only has this significantly limited the size of the workforce able to work on ITAR-related projects in Canada, but it has also been a source of contention between the U.S. and allies like Canada concerning human rights issues.

Even with the Canadian exemption, Canadian firms continue to be subjected to onerous licensing requirements and uncertain processing and approval times. The costs and delays resulting from the ITAR have a direct, negative impact on Canadian firms sourcing or competing for the supply of ITAR-controlled components to the U.S. and cooperative ventures between Canadian government agencies and their U.S. counterparts requiring access to defence articles and services. For example, under the current system, it can be difficult to export even low-technology goods that are commonly available—like certain nuts and bolts—if they have military origins.<sup>28</sup> Given that both Canada and the U.S. share defence concerns and the significant aerospace trade between the two countries, regulatory issues such as the ITAR must be managed in a coordinated manner as quickly and as effectively as possible.

The Obama administration has signalled its willingness to remove some of the more harmful export control policies regulated by ITAR. The announced reforms include updating policies and definitions that were adopted more than 20 years ago as well as improvements to the approval process for exported materials like low-risk technology or parts.

<sup>25</sup> Aerospace Industries Association of Canada. "Industry Statistics." June 2009. <http://www.aiac.ca/canadas-aerospace-industry/industry-statistics/>.

<sup>26</sup> The United States Commercial Service. "Canada: U.S. Companies Capture Large Share of Canada's Aerospace Market." United States Department of Commerce. July 2009.

<sup>27</sup> *Ibid.*

<sup>28</sup> Graham, Ian. "Official Explains Need for Export Control Reform." *American Forces Press Service*. April 21, 2010.

The U.S. Department of State has issued a proposed amendment to the ITAR concerning dual nationals and third country nationals employed by foreign end-users. The proposed amendments are widely viewed as a laudable effort to address human rights issues related to the treatment of dual and third country national employees of foreign end-users, while achieving a commensurate gain in the national security of the U.S. and Canada. These announcements are positive signs of progress for Canadian and U.S. businesses with extensive cross-border operations that have been hindered by the lack of clear definitions and jurisdictional authority. Canada must press the American government to keep its commitments to export control reform.

The American announcements present an opportunity for Canada to identify specific areas of concern not only within the U.S. system but also domestically. There are remaining issues that must be addressed locally to avoid diluting the benefits for Canadian industry.

The full resolution of human rights and other concerns requires the Canadian government to do its part in amending its own regulations, policies and programs to assure its industry's protection against future, related problems. Creating a stable and certain regulatory framework for Canada's domestic aerospace and defence industry will create benefits that outweigh the investments required and that will strengthen investment in the Canadian aerospace and defence sector to the benefit of both countries' industrial and national security interests.

Specifically, and in the spirit of continuous improvement to meet changing policy and security requirements, Canada must continuously review, examine and enhance its own policies and programs related to industrial security and controlled goods and appropriately amend statutes or regulations, like the Canadian Controlled Goods Regulations, to formally reflect and align ITAR compliance in Canada. Likewise, Canada must also work to alleviate U.S. fears of lax Canadian security, particularly in areas such as enforcement and accountability of its own export and domestic controls regime. This would include increasing the ability of Canada's industrial security program to process higher

volumes of industrial security clearances and other administrative requirements in support of a domestic control program that is aligned to function in tandem with the ITAR.

## Agri-Food

The Canadian agri-food industry is the second largest manufacturing industry in Canada, employing 291,000 Canadians.<sup>29</sup> It provides a significant proportion of Canadian exports—69 per cent of these exports flow into the U.S., with a value of \$31 billion annually<sup>30</sup>—and accounts for 14 per cent of all Canadian manufacturing shipments.<sup>31</sup> Today, food processing is the largest employer in the manufacturing sector, yet it remains one of the most heavily regulated industries in North America. In Canada, it is subjected to the jurisdictional authority of three levels of government and dozens of federal departments and agencies. The situation is similar in the U.S., with multiple federal, state and municipal regulatory authorities.

Given the regulatory differences across jurisdictions, it is not surprising that significant barriers have long existed throughout the North American supply chain. While NAFTA removed some of these barriers, the industry continues to suffer from government interventions and limitations on market access. For example, since the 2008 Listeriosis crisis in Canada, Canada and the U.S. have been diverging on certain aspects of animal health, food safety and nutritional standards. These differences are compounded by the addition of new bio-security measures, country-of-origin labelling and crop and bio-energy subsidies. Canada and the U.S. also currently use different standards for meat cut nomenclature that have no effect on the quality of the product or additional benefits to consumer health and safety.

The perishable nature of these goods means that increased delays and inspections at the border impose significant costs on industry. Furthermore, deliveries are often modified to accommodate last-minute requests, making compliance with new regulations involving advance notice a logistical nightmare. Canada and the U.S. need a strategy for greater alignment of food

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<sup>29</sup> Invest in Canada. "Canada's Agri-food Advantages." The Government of Canada. August 2010.

<sup>30</sup> *Ibid.*

<sup>31</sup> *Ibid.*

safety and security regulations based on an intelligent approach to supply chain management. Doing so will limit unnecessary delays at the border without risking consumer health and safety.

Canadian firms attempting to penetrate the U.S. market face additional challenges because of the scale of U.S. manufacturing operations, subsidies and legislation, like the recently proposed amendments to the U.S. *Food, Drug and Cosmetics Act*, which compromise bilateral trade in agri-food products without having clear public or animal health benefits. Within Canada, the *Food and Consumer Product Safety Action Plan* is expected to lead to amendments to the Canadian *Food and Drugs Act* that would add new import licensing, prior-notification and inspection requirements that could further complicate Canadian agri-food imports from the U.S. The Canadian Food Inspection Agency has also recently announced a new import licensing regime that could further complicate trade. These policies and proposed regulations place Canadian firms at a significant disadvantage relative to their U.S. counterparts at a time when American agri-food exports to Canada have been increasing.

The success of bilateral regulatory cooperation requires dialogue that takes into account the extensive support within the U.S. for American firms while avoiding reciprocal trade wars. For instance, Canadian meat exports to the U.S. are being subjected to increased testing, plant audits, inspection presence requirements and changes to importation notices. In turn, access to the Canadian market has been complicated by certain regulations on labelling, grade and container size.

Canada needs to work with the U.S. to identify areas where greater cooperation would be mutually beneficial. At the same time that work is being done to identify these areas, Canada must review its own regulations and enforcement to increase consumer confidence in Canadian products.

## The Financial Sector

Canadian firms offering and requiring financial services in the U.S. face numerous hurdles because of the differences in Canadian and American regulatory systems. For example, Canadian companies must provide detailed information about business practices and are required to obtain a U.S. tax ID for online

banking. Small differences, like the time required to process cheques and the shorter window for reporting unauthorized withdrawals—only two days—can burden businesses that are entering the U.S. market for the first time. Canadian retail businesses offering online merchant services also experience challenges as they must accept credit card payments without applying a foreign exchange to consumer purchases.

Various agreements have been reached to minimize barriers in the financial sector. *The Convention Between the United States of America and Canada* (Canada-U.S. Tax Treaty), was adopted in September 1980. This treaty was negotiated in order to resolve some of the problems associated with the free flow of services and people across the border, in particular to avoid the double taxation on income which might otherwise affect businesses operating in both countries.

Since the Canada-U.S. Tax Treaty, several additional protocols have been negotiated. The most recent of these additional protocols makes several modifications, like the elimination of withholding taxes on cross-border interest payments, that will make doing business across the border easier. Before the new protocol, interest payments were charged a withholding tax of 10 per cent. Under the new amendments, withholding tax on payments between unrelated parties is being eliminated, giving businesses more flexibility when working with bankers. Attempts to centralize operations would have caused financial institutions working with the business to request reimbursement for withholding tax on any outstanding investments due.



Thanks to the recent changes, Canadian companies with American subsidiaries will no longer shoulder the administrative and legal burden associated with differences in banking practices across state jurisdictions. This is positive news for businesses conducting cross-border transactions, as the new provisions will increase cross-border investment and reduce borrowing costs.

While portions of these recent changes will facilitate cross-border transactions, some sections may hinder industry. Canadian businesses entering the U.S. for the first time may find these new regulations overly burdensome. For example, the new protocol has added a “hybrid entities” clause. Under tax law, hybrids are considered to be any entity that is defined differently by Canadian and American legal systems. Under the requirements imposed by the new protocol, hybrid entities, which are increasingly common, might be subjected to increased tax withholding rates. The new restrictions have the potential to decrease the effectiveness of certain business practices, including the use of hybrid entities.

Also of concern is the expanded definition of “permanent establishment” to include the provision of services. Prior to January 1, 2010, the taxability status of Canadian businesses operating in the U.S. was based upon a physical presence, be it an office or permanent staff. The adoption of the additional protocol changed this practice by expanding the definition to include the provision of services to U.S. customers. A particular problem is the inclusion of any Canadian firm that sends employees to the U.S. for a total of 183 days in any 12-month period. This means that companies must now closely monitor cross-border travel to ensure that they comply with the new requirements.

As the U.S. undertakes reforms to its financial sector, Canada must resist the creation of an overly burdensome and complex regulatory system that will negatively affect Canadian firms. This is as true within North America as it is globally. Canadian financial regulation has been identified as one of the most effective systems in the world. By 2012, Canada will have the lowest statutory corporate income tax rate in the G7. The success of the Canadian financial regulatory system

has placed the country in better standing than its main competitors. The Canadian government must continue to push back against policies that will only hamper Canadian competitiveness and hinder global economic recovery.

## Domestic Regulatory Barriers

It would make little sense for Canada to initiate a process of bilateral regulatory reform without addressing its outdated domestic system. The patchwork system of regulations that partitions Canada’s already small domestic market enshrines inefficiency and curtails our ability to compete. The Canadian government must significantly accelerate its work with the provinces and territories to remove the remaining internal barriers to trade, investment and labour mobility. Other federations, including the U.S., have already removed many of the barriers to labour mobility and trade. The continued existence of these barriers in Canada has virtually set the country apart from its peers and continues to hinder the ability of the provinces and territories to capitalize on the innovativeness that arises from the free flow of products and skills across jurisdictions.

Canada’s continued inability to dismantle internal barriers to trade is not only counterproductive, but flies in the face of the free trade agreements that are being negotiated with other jurisdictions. According to Robert Knox, a principal with R.H. Knox & Associates and a CD Howe researcher, “...Unless Canada ensures that its professionals and skilled workers can work anywhere in the country, it could limit our ability to attract the people our economy needs.”<sup>32</sup>

The news to date is not unremittingly bad. Since the Agreement on Internal Trade (AIT) came into effect in 1995, the provinces and territories have been working to eliminate domestic barriers to trade and mobility, albeit at a pace that remains much too slow. The AIT offers concrete benefits for Canadians in all parts of the country. For example, the 2009 revisions to the labour mobility provisions of the AIT were meant to ensure that any individual certified in a profession in one province or territory is recognized as qualified in all other provinces and territories. The 2009 revisions

32 Knox, Robert. “Who Can Work Where: Reducing Barriers to Labour Mobility in Canada.” C.D Howe Institute. June 2010.

33 Industry Canada. “The Agreement on Internal Trade (Consolidated Version)”. 2009.

also introduced a government-to-government dispute resolution mechanism which strengthens the enforcement mechanism of the agreement through the introduction of monetary penalties of up to \$5 million for continued non-compliance.<sup>33</sup>

The recent progress with the AIT is a welcome step in the right direction. However, provincial and territorial governments must do much more to remove the remaining interprovincial barriers to trade and mobility. The New West Partnership Trade Agreement (NWPTA) between Saskatchewan, Alberta and British Columbia is an encouraging initiative to facilitate the free movement of goods, services, capital and people across provincial lines. Elements of the NWPTA can be adapted for use in a broader, pan-Canadian agreement.

## Protecting Canada's Intellectual Property

Another area of domestic regulatory policy in need of immediate attention is the insufficient protection of intellectual property rights (IPR) in Canada. The debate over Canadian IPR continues to heat up, particularly in relation to the different standards of enforcement between Canada and the United States. Canada has yet to fully ratify the 1996 World Intellectual Property Organization (WIPO) Treaties. It has not improved its patent regime in any meaningful way and has yet to successfully update its copyright legislation, despite recognizing the need to do so. Canada's weak protection of IPR in all of these areas undermines its international reputation, discourages investment in the knowledge economy and remains a major irritant to the U.S. Improving Canada's IPR regime will have positive effects on Canada's relationship with all of its trading partners and will benefit the thousands of Canadian businesses that continue to suffer disproportionately from outdated laws as well as the millions of Canadian consumers who demand and deserve top-quality innovative products.

Intellectual Property is the "ultimate asset" of the future.<sup>34</sup> Thousands of Canadian businesses of all sizes depend on the protection of their IPR for their success. For instance, in the Kitchener-Waterloo region alone,

there are more than 400 high-tech firms that depend upon the commercialization of their IP. Research-based biopharmaceutical and pharmaceutical companies are responsible for generating 60,000 jobs and fund 27 per cent of all health science research and development in Canada. Unfortunately, patent protection can easily be invalidated, posing a challenge to fair return on investment into research and development (R&D).

In addition, Canada's entertainment industry is growing rapidly. Creative industries alone represent seven per cent of Canadian GDP and employ more than 1 million people.<sup>35</sup> Yet products of the creative industry can be easily copied in the digital era making them extremely vulnerable to theft.

For these businesses to compete and grow, and to increase Canada's presence in global value chains, a stable and predictable IPR system with clearly-defined rules is needed. A competitive IPR system is a vital component of any internationally competitive knowledge-based economy. Without clear and effective rules governing IPR protection, knowledge-based industries are at a disadvantage because of the difficulty in attracting the venture capital needed to commercialize innovations, the unfair competition from free riders that do not have the burden of the costs of research, development and licensing, and the challenge of attracting foreign investment without assurance that investments will be protected under the law.

For years, softwood lumber topped the list of trade irritants between Canada and the U.S. This has recently been displaced by Canada's ongoing poor protection of IPR. Canada is a well-known haven for sites promoting peer-to-peer file sharing and the Business Software Alliance estimates that Canada's software piracy rate is nine per cent higher than in the U.S.<sup>36</sup> Some of the most popular, illegitimate online file-sharing sites in the world are now based in Canada, and many sites or information sources claim that moving to Canada allows them to more easily and legally conduct business.<sup>37</sup>

Washington has been aware of the problem since the mid-1990s when Canada was first added to the "Watch List" in the United States Trade Representative's (USTR'S) annual Special 301 Report. For the past two

34 Kamil Idris. "Intellectual Property: A Tool for Economic Growth." World Intellectual Property Organization. 2005.

35 Conference Board of Canada. "Valuing Culture: Measuring and Understanding Canada's Creative Economy." 2008.

years, Canada has been elevated to the “Priority Watch List,” a position that it shares with Russia, China, Pakistan, Venezuela and others. This elevation is a clear sign of the growing discontent in the U.S. regarding the lack of action in Canada.

While progress has been slow, the Canadian government is aware that it needs to update its IPR system, not simply to remove an irritant in our relationships with the U.S. and other countries with more advanced intellectual property regimes, but because doing so will encourage innovation in Canada and provide a level playing field for creators. Not only have various government departments recommended updates to Canadian copyright law, but a commitment to do so was included in two consecutive speeches from the throne.

In June 2010, the Canadian government introduced a bill to update the *Copyright Act* for the first time in a decade. Bill C-32 is designed to finally bring Canada in line with other industrialized countries by ratifying the

WIPO Internet treaties and strengthening IPR protection in Canada. The Canadian Chamber of Commerce applauds the introduction of Bill C-32 and calls on the government to follow through on its commitment and update the *Copyright Act*.

There are other areas where Canada continues to lag. In addition to copyright protection, counterfeiting remains a tenacious problem in Canada. The Canadian government must strengthen the ability of border officials to seize and destroy counterfeit goods at the border and must increase the penalties for the counterfeiting and piracy of physical goods.

In addition, while the Canadian Chamber of Commerce applauds the Canadian government for its most recent improvements to IPR for biopharmaceutical products in 2006, clearly more needs to be done to strengthen Canadian IPR to place Canada back at the forefront of investment in research and development in life sciences, information technology and other sectors.



36 Business Software Alliance. “Global Piracy Report”. 2009.

37 Sookman, Barry; Schwartz, Eric. “Copyright Law in Canada and the United States: The Digital Challenge.” Canada Institute. September 2009.

## RECOMMENDATIONS

1. The Canadian and U.S. governments, in partnership with industry must increase their efforts to identify areas where regulatory cooperation would be mutually beneficial. Both governments must focus on the removal of inefficiencies and redundancies as well as the elimination of unnecessary regulatory barriers in key sectors.
2. The Canadian government must ensure that regulatory cooperation be one of the core policies for Canada's engagement with the U.S.
3. The Canadian and U.S. governments should examine the feasibility of creating a more permanent and integrated regulatory review process. There is a clear need to update current governance mechanisms and institutions through which North American regulatory policies are adopted.
4. The Canadian government should work with industry on the enhancement, amendment and enforcement of current aerospace and defence regulations, policies and programs in Canada.
5. The Canadian government should continue to press the U.S. to follow through with its commitment to bring the necessary reforms to its export and import control regimes.
6. The Canadian government should avoid the adoption of an overly burdensome and complex financial regulatory system that will negatively affect Canadian firms.
7. The Canadian government should work with the provinces and territories to eliminate the remaining barriers to labour mobility across Canada and continue to strengthen the AIT.
8. The Canadian government must work with industry to identify areas where greater domestic regulatory cooperation is needed.
9. The Canadian government must immediately update Canadian copyright law to reflect the modern digital age. It is important that updates to Canadian copyright laws provide clear, predictable and fair guidelines in accordance with the stated objectives of the legislation.
10. The Canadian government should grant the necessary legislative authority and allocate sufficient resources so border officials can more effectively search and detain suspected shipments of counterfeit goods at the border on an ex-officio basis (i.e. without a formal complaint being laid).

# CHAPTER THREE: ENERGY SECURITY AND THE ENVIRONMENT

## Introduction

Canada and the U.S. enjoy a long history of cooperation in resource development and trade. For years, the two countries have successfully co-managed trans-border environmental issues like water quality and air pollution. The primary manifestation of this arrangement is the International Joint Commission (IJC), which was created as a dispute resolution mechanism and a forum for increased collaboration. Other agreements include the Great Lakes Water Quality Agreement (1978), the Great Lakes Binational Toxics Strategy (1997) and the Air Quality Agreement (1991). However, the strength of this partnership will be tested as energy security and environmental policy rapidly evolve into the most critical policy areas facing the bilateral relationship in the long term.

## Environmental Policy

Although Canada must develop its own environmental policies that are in the best interests of Canadians, these policies must be as compatible with the U.S. system as possible. Canada and the U.S. share our continent's air, land and water. Because of the trans-border nature of many environmental concerns, the development of environmental policies in North America has always required coordination to be effective. This is a well-

known fact in Canada, with almost 94 per cent of Canadians supporting bilateral collaboration with the U.S. on environmental policies.<sup>38</sup> The Canadian and American governments also seem to understand and have been collaborating in this area. In 2009, President Obama and Prime Minister Harper recognized the need to foster the existing partnership when they launched the Clean Energy Dialogue. This vision for a low-carbon energy economy is focused on encouraging the development and use of green technology while improving the efficiency of the energy grid.

The Obama administration signalled that climate change is a high international priority and has committed to the development of green technology as a means to reduce American reliance on fossil fuels and as a sustained source of job creation. The Canadian government should view this focus as an opportunity to work together on innovative projects and to attract greater international investment in our own green economy.

In April 2010, the Declaration of Intent (DOI) for Cooperation in Energy Science and Technology was signed by representatives from both countries. The DOI provides the framework for future joint initiatives like carbon capture and storage and the development of bioenergy. This partnership will see greater cooperation in developing alternate energy sources and green technology. Among the many projects that will benefit



38 Cowen, James. "Threat to U.S. a Threat to Us, Canadians Say in Survey." *The Montreal Gazette*. April 2009.

from the agreement is the North American Carbon Atlas Project, which focuses on mapping geographical areas in North America where carbon capture and storage might be possible. Many innovative programs rely upon such close bilateral cooperation. For example, the Weyburn CO<sub>2</sub> Monitoring Project can help drive innovation and cooperation in the development of green technologies. The Weyburn field, located near the border with North Dakota in southern Saskatchewan, is an international research program examining the economic viability of capturing CO<sub>2</sub> and storing it in subterranean reservoirs.

Both governments are also working together on limiting the production of greenhouse gases (GHGs). GHGs are a by-product of the combustion of fossil fuels, and their emissions have increased significantly over the past century. North American partners share a singular environment; therefore, GHG reduction targets must align to be effective. Canada has taken a positive step in the right direction by pledging to match the U.S. commitment to reduce GHG emissions by 17 per cent from 2005 levels by 2020. One of the primary contributors to GHG emissions is the transportation sector. In 2008, this sector accounted for 27 per cent of the 734 megatonnes of GHG emissions produced within Canada.<sup>39</sup> Recognizing the integration of North American transportation networks, both governments have been collaborating on the adoption of new regulations. For example, the Canadian government has announced that it will harmonize regulations targeting GHG emissions from new vehicles with the U.S. beginning in 2011.<sup>40</sup> As a result of these proposed regulations, it is projected that the average GHG emission performance of new vehicles in the 2016 model year will be about 25 per cent lower than those sold in Canada in 2008. The adoption of consistent, compatible standards that will not disadvantage manufacturers on either side of the border is a welcome initiative.

The Canadian Chamber of Commerce welcomes these efforts and urges the Canadian government to work with the U.S. to ensure that all efforts to combat climate change are based upon science and are economically viable. As both countries adopt environmental policies and regulations, it is critical that they take into account the integrated nature of the North American economy.

Any unilateral action runs the risk of causing serious economic damage. For instance, if Canada were to set a price on carbon which is out of synch with U.S. levels, Canadian businesses would be at serious disadvantage vis-à-vis their American counterparts. The effects of such misalignment would ripple throughout the supply chain and hinder Canada's ability to compete.

While collaborating with the U.S. is important, Canada must be wary of waiting to take action. Working with the U.S. on the development of environmental policy does not mean that Canada has to necessarily follow its lead. Instead, Canada can ensure that policies and regulations are adopted in a way that is the most beneficial for Canadian citizens and Canadian businesses.

## RECOMMENDATIONS

That the Canadian government:

1. Continue to work with the U.S. through the Clean Energy Dialogue in developing compatible regulatory and business frameworks and in promoting science and technology to combat climate change and reduce GHG emissions.
2. Ensure, where possible, that new environmental regulations and emission pricing systems are compatible with U.S. standards and international norms.
3. Work with the U.S. to ensure that any border adjustment tax is WTO compatible, predictable and minimizes the administrative burden on Canadian businesses.
4. Promote bilateral pilot programs that can drive innovation and the development of green technologies including information sharing and the identification of best practices.
5. Promote joint clean energy research as a means of mitigating the negative effects of climate change and encouraging investment in our own green economy.

<sup>39</sup> Environment Canada. "Sectoral Greenhouse Gas Emission Summary." Last Updated April 30, 2010.

<sup>40</sup> Chase, Steven; Kennan, Greg; Vanderklippe, Nathan. "Canada, U.S. Team Up To Restrict Auto Emissions." *The Globe and Mail*. April 15, 2010.

## Energy Security

The International Energy Agency (IEA) predicts that global consumption of energy will have increased by 45 per cent by 2030 and that North America will consume 20 to 25 per cent more energy than it does today.<sup>41</sup> Because of the growing consumption rates, energy security is quickly becoming a major objective for many of the world's leading powers, and the U.S. is no exception.

Economic growth is dependent upon stable sources of energy. Unfortunately two primary sources of energy are tied to major security concerns. First, many oil-producing countries are in geopolitically unstable regions, meaning that production is vulnerable to disruption. Second, the growing international focus on nuclear energy means that there is an urgent need to minimize the proliferation risk posed by dual-use technology. It is not surprising that securing the American energy supply has literally become a matter of national security.

As a vibrant source of stable, secure and reliable energy, it is critical that Canada capitalize on the attention the U.S. is placing on energy security. It must also recognize that in the eyes of the U.S., energy security and climate change are two sides of the same coin.<sup>42</sup> Canada has been blessed with ample energy resources and is in a very strong position to meet growing international demand. Canada is a major producer of energy, and the energy sector accounts for \$70 billion worth of Canadian GDP. According to the IEA, Canada is the fifth largest producer of energy in the world.<sup>43</sup> Every year the energy sector is responsible for 35 per cent of total private sector investment and employs more than 372,000 people. Since 1980, Canada's production of energy has almost doubled, and it now exports more than half of the energy it produces.

In 2009, Canada was the largest producer of uranium fuel for use in nuclear energy production, the third largest producer of natural gas and hydroelectricity, the seventh largest producer of crude oil and nuclear energy,

and the eighth largest producer of petroleum products.<sup>44</sup> In terms of Canada's relationship with the United States, Canada remains the single largest supplier of energy to the Americans and the single largest consumer of U.S. energy exports. In other words, Canada is the key to America's energy security.

However, rising consumer demand for energy efficiency and growing concerns about climate change mean that the Canadian energy sector must conform to the best possible environmental standards. Canada must position itself as a reliable source of secure and responsible energy.

There are several ways to accomplish this goal.

First, Canada must invest in the development of green technologies and alternative energy sources. Not only will such responsible stewardship mitigate negative impacts on the environment but it will also help secure a Canadian presence in the U.S. market. Without investment into clean technologies, Canada runs the risk of losing out to competitors—like China—that have not only made substantial investments into their energy sector but also have access to an abundance of low-cost labour.

Second, Canada must do a better job of overcoming the negative rhetoric surrounding “dirty Canadian energy.” The environmental lobby in the U.S. has effectively mobilized a campaign against the importation of Canadian oil sands products, and there is a risk of new trade barriers targeting Canadian oil. Canada needs to remake its image by being frank about the existing challenges and by highlighting the efforts that are being made. There has been significant progress in minimizing the environmental footprint of the oil sands, and this sector is quickly becoming a centre for innovation in green technology. For instance, Alberta was the first North American jurisdiction to regulate GHG reductions for industrial facilities emitting more than 100,000 tonnes of carbon dioxide equivalent per year.<sup>45</sup> In the three years since the regulations were adopted, companies in all sectors have been able to

41 International Energy Agency. “World Energy Outlook 2008.” November 12, 2008.

42 Burney, Derek. “Canada-U.S. Relations at 150.” Remarks made at the Canada at 150: Rising to the Challenge Conference. Hyatt Regency Hotel, Montreal. March 28, 2010.

43 International Energy Agency. Key World Energy Statistics. 2008.

44 International Energy Agency. Key World Energy Statistics. 2009.

reduce their emissions by more than 17 million tonnes.<sup>45</sup> Not all sources of American oil imports have the ability to tell similar stories.

Canada is also a vibrant source of both conventional and non-conventional energy. For example, there is significant potential in Canada to increase the amount of hydroelectricity being exported to the U.S. Hydroelectricity is a clean, reliable and renewable energy source. Many states in the U.S. have adopted Renewal Portfolio Standard (RPS) programs that have acknowledged hydroelectricity as a renewable energy source. However, recognition of such by U.S. Congress and American state legislators would be an important step towards increasing Canadian electricity exports to the U.S. While a lot of good work is being done in Washington, there is a need to further develop relationships with U.S. legislators and policymakers at the state and local level to fully highlight the benefits of the Canadian energy supply.

It is clear that with the increasing importance of energy security that Canada needs a Canadian sustainable energy strategy. Last year, after extensive consultations with members from across the country, the Canadian Chamber of Commerce released a report entitled, *Powering Up Canadian Prosperity*. This report calls upon all levels of the Canadian government to come together with industry stakeholders to develop a Canadian sustainable energy strategy which would support economic growth and the responsible development of the Canadian energy sector.

This strategy must be based on the principle that the development of Canadian energy will benefit the entirety of the country and North America. The potential loss because of inaction is high—loss in terms of

employment, opportunities and prosperity. Developing such a strategy would not only strengthen investor confidence in our energy production but would also help our businesses compete in international markets. Properly designed, this energy strategy would increase Canada's capacity to export various sources of energy thereby providing North America with a stable, secure and affordable energy supply. Beyond the creation of a national energy strategy, Canada must work with the U.S. to jointly develop a continental approach to energy and environmental policies to ensure that Canadian interests are protected. Bilateral regulatory consistency will allow open trade in energy, create clear signals for industry and attract energy sector investment throughout North America. The gains for both nations from such cooperation are clear.

Finally, no discussion of energy security is complete without addressing the need for greater investments in North American energy infrastructure. Such investment should focus on the electricity grid, oil and natural gas pipelines and the shared transportation network. Much of North American energy production relies heavily on outdated infrastructure that can no longer keep pace with demand. For example, Canada and the U.S. each rely on a decades-old electricity grid that simply does not have the capacity to deal with 21<sup>st</sup> century energy demands. The development of smart grid technology, better management of the grid and the digitization of the distribution system can help make energy delivery more reliable. The U.S. has already invested heavily in the development of "smart grid" technology that will improve the efficiency of the entire energy supply chain. Given the significant bilateral trade in energy, the Canadian system must be compatible and reliable part of our two countries' distribution systems.

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<sup>45</sup> Government of Alberta. "Alberta in the World." 2010.

<sup>46</sup> Government of Alberta. "Alberta's Clean Energy Story." 2010.

## RECOMMENDATIONS

1. That the federal and provincial governments work with the Canadian energy sector to promote Canada as a source of safe, responsible and secure energy, particularly with U.S. state and local level policymakers and legislators.
2. That the Canadian government develop a national energy strategy that provides a predictable regulatory framework and encourages private sector investment in the energy sector.
3. That the Canadian and U.S. governments collaborate on the development of a continental energy strategy that addresses the need for joint infrastructure investments and regulatory consistency and addresses mutual environmental concerns.
4. That the Canadian federal, provincial and territorial governments, along with Canadian industry, increase efforts to have all sources of renewable energy, including hydroelectricity, recognized as a renewable energy source by U.S. Congress and American legislators.
5. That the Canadian government work with the U.S. to ensure continental energy security by investing in the development of smart grid technology and energy infrastructure. In particular, there is a need to strengthen and expand North American electricity connections by facilitating the permitting and construction of new energy infrastructure.

## Introduction

The continued success of the Canada-U.S. economic partnership depends on having a border that works. Over \$1.6 billion worth of trade and 300,000 people cross the border each day.<sup>47</sup> Eleven million jobs—eight million in the U.S. and three million in Canada—depend upon the bilateral trading relationship. One-third of this bilateral trade is the intra-company delivery of input goods. Successful management of the border not only has the ability to put North American economies back on track but is critical for the health of North American supply chains.

Since 2001, the number of fees and inspections has grown dramatically. This has been coupled with additional penalties for minor infringements, the layering of regulations, increased regulatory complexity, uncertain wait times and infrastructure constraints. When added together, all of these factors drain businesses' bottom lines and pose a serious and unnecessary hindrance to the free flow of legitimate trade and travel. For example, between 2007 and 2009, almost \$30 million in fines were levied against industry under the Canadian Administrative Monetary Penalty System.<sup>48</sup> The growing inefficiency of the Canada-U.S. border coincides with the removal of such barriers by North America's main competitors. The EU has removed many of the internal non-tariff barriers to trade and is well on the way toward an integrated border environment. The competitive advantages of the Canada-U.S. FTA and NAFTA are being eaten up by compliance costs, fees and delays that inflict greater damage on the North American industrial base than even our foreign competitors could have reasonably hoped for.

The citizens of our two countries know that the current system of border management needs to be revamped. A 2009 Nanos poll indicated that 85.7 per cent of Canadians

believed that the flow of goods and people across the border has to be enhanced.<sup>49</sup> A similar poll indicated that approximately 71 per cent of Canadians and 75 per cent of Americans believed greater cooperation is needed in terms of border security.<sup>50</sup> Small businesses have also identified non-tariff barriers as a primary obstacle to trade with the U.S.<sup>51</sup>

Despite the widespread recognition that border operations must be improved, progress has been far too slow. For example, both the 2001 Smart Border Agreement and the 2005 Security and Prosperity Partnership have done little to reduce the red tape experienced by businesses. Frustration in both Canada and the U.S. is growing as many of the practical steps that could alleviate the problems have yet to be taken.

A dramatic reform of border policy is needed. Instead of serving as a wall between countries, the border must be reconceptualized as another piece of the supply chain. This goal can be achieved without compromising the physical security of our two countries. For too long, politicians have avoided the promotion of a perimeter approach to security. This approach would focus on ensuring that we know what cargo and travellers are coming to our continent long before they ever reach our shores, while ensuring that the internal border becomes more transparent to legitimate crossings. Given the shifting global economic climate and increasing competition from emerging markets, this redefinition, which will reduce the damage to our integrated industrial base, is essential.

Work to reduce the border quagmire must have three political outcomes. First, it has to make North American citizens more secure by increasing participation in trusted traveller and trusted trader programs. Doing so will allow border agencies to focus their limited resources on areas where they are needed most. Second, it has to improve the predictability of the border in

<sup>47</sup> The United States Department of State. "Background Note: Canada." 2008.

<sup>48</sup> Tower, Courtney. "Oh My, How They Do Add Up The AMPS Fines Laid Bare." *Bar Code Border*. June 2010.

<sup>49</sup> *Supra note 38*.

<sup>50</sup> Eagles, Munroe; Nikita, Nanos; Kolundzic, Daniel. "The Public Opinion Environment for Canada-American Relations: 2005-2009." 2009.

<sup>51</sup> Canadian Federation of Independent Business. "Report on Trade." October 2004.

terms of wait times, inspections and fees, accompanied by service commitments and standards. The long-term economic health of both countries requires streamlining supply chains and facilitating border access. Third, better management of the border would strengthen economic growth by facilitating the movement of legitimate people and goods.

## Finding the Balance

In 2008 and in 2009 the Canadian Chamber of Commerce and the U.S. Chamber of Commerce partnered with more than 40 business associations on both sides of the border to recommend actions that would reduce border costs while strengthening security. The recommendations put forth in the 2009 report, *Finding the Balance: Shared Border of the Future*, embrace the post-9/11 security environment and were designed to build upon the recommendations in the 2008 report. A summary of the report's main findings is included below.

### The High Cost of Being a Trusted Shipper

The governments of Canada and the U.S. understand the need to focus the limited resources of border officers where they are most needed—on unknown cargo and travellers. Over the past number of years, there has been progress in improving trusted shipper and trusted traveller programs. Programs like Free and Secure Trade (FAST), NEXUS, Customs Self-Assessment (CSA), Customs-Trade Partnership against Terrorism (C-TPAT) and Partners in Protection (PIP) are all excellent ways to reduce border congestion by allowing customs officials to focus where they are most needed.

The Canadian Chamber of Commerce is a strong advocate for such voluntary programs. However, the costs to become a trusted trader or traveller are often high and, thus far, the benefits are limited. For instance, certification in trusted shipper programs can take years and can cost more than \$100,000.<sup>52</sup> While large firms may not find this fee overly burdensome, small- and medium- sized enterprises have a hard time justifying these costs. Additionally, many firms have indicated

that ensuring compliance requires dedicated, full-time staff. Overlap among these programs in areas like risk assessment, program conditions and client interaction causes additional complications for participants. There is a need to reduce redundancies by integrating trusted trader programs and for better alignment between Canadian and U.S. programs.

Those who depend most heavily upon the border have expressed concerns that both governments are relying upon user fees to cover the costs of the increasingly unwieldy border. For example, the U.S. Animal and Plant Health Inspection Service (APHIS) fee is applied to vehicles and travellers crossing the border into the U.S. The proceeds collected from the fee are then diverted to cover the costs associated with inspections of certain imported agricultural products into the U.S. It is estimated that the total cost of the APHIS fee to cross-border businesses is \$78 million per year.<sup>53</sup> The imposition of user fees is an unnecessary disincentive for border use. For those who rely most on the border, like participants in trusted trader programs, these fees are in addition to the costs associated with participation in voluntary programs.

The security benefits of focusing on unknown trade and travel are clear. Unfortunately, businesses have yet to witness sufficient gains from participation in these programs. Wait times continue to be an issue as border line-ups often extend beyond the entrances to dedicated FAST and NEXUS lanes, forcing participants in these programs to wait despite having paid for expedited access. Additional fees, high penalties for violations and subsection to secondary inspections are all problems that have been noted by participants in these programs.

Expanding trusted shipper programs to other government departments with mandates in border services would have a positive effect on industry participation. Currently these programs are administered by the Canadian Border Services Agency (CBSA) and the U.S. Customs and Border Protection (CBP), but the inclusion of other agencies like the Canadian Food Inspection Agency or the U.S. Food and Drug Administration would appeal to a larger number of industries that are subjected to additional screening by these other government departments.

<sup>52</sup> The Canadian Chamber of Commerce; the United States Chamber of Commerce. "Finding the Balance: Shared Border of the Future." 2009.

<sup>53</sup> *Ibid.*

## RECOMMENDATIONS

1. That the Canadian and American governments set up a pilot trusted shipper program for companies that are regulated by government agencies other than the CBSA and CBP, like low-risk food importers from Canada and the United States. More companies would then be able to join trusted shipper programs, which would secure a greater portion of the supply chain and make border crossings more predictable for businesses.
2. That the Canadian government work to reduce redundancies, minimize costs and maximize benefits of trusted trader programs by aligning existing programs both domestically and with the U.S.

### **Achieve a Critical Mass of Cross-Border Travel Documentation**

There has been significant good work done on communicating the new requirements under the Western Hemisphere Travel Initiative (WHTI) that came into force on June 1, 2009. The Canadian Chamber of Commerce is pleased by the acceptance of various WHTI-compliant travel documents like enhanced drivers licences (EDLs) as well as NEXUS, FAST and Pass Cards. The successful communication of the new requirements to the general public resulted in a relatively easy transition. However, both the Canadian and American governments must do more to promote and expand the benefits of participation in these programs and to encourage wider participation. For example, the government of Canada has recently launched a pilot program in a limited number of airports where NEXUS cards can be used to fast-track domestic security. The Canadian Chamber of Commerce welcomes this initiative and encourages the government to consider expanding the project to other ports of entry.

<sup>54</sup> Fuestch, Michele. "Transport Topics." 2009.

<sup>55</sup> Public Border Operators Association.

## RECOMMENDATIONS

That the Canadian government:

1. Expand NEXUS to include a voluntary option to handle multiple entries for business travellers who need NAFTA visa approval to enter either country. Storing visa information on NEXUS cards would allow border officials to be better prepared to make entry decisions.
2. Examine the feasibility of expanding the NEXUS program for domestic use to fast-track domestic security lines.

### **Border Wait Times**

Reduced trade between Canada and the U.S. caused by the economic crisis had a direct impact on the amount of traffic crossing the border. In 2009, exports from Canada to the U.S. by truck were down 31 per cent, while exports from the U.S. to Canada by the same mode were down by 27 per cent.<sup>54</sup> Fortunately, there are signs of recovery. In the first quarter of 2010, the volume of trucks crossing the Ambassador Bridge between Detroit and Windsor increased by 22 per cent. While the traffic volumes have yet to recover fully, the increase is cause for optimism for the return of pre-crisis volumes.

As trade volumes increase, the structural problems at the border, which have yet to be addressed, will once again result in delays. These delays will slow the speed of economic recovery by limiting supply chain efficiency. It is important to remember that the delays of 2007—which caused backups so severe that the Ontario Ministry of Transportation was forced to install portable toilets for travellers trapped along Highway 402—happened at a time when commercial traffic was down by four per cent from the previous year.<sup>55</sup> Without adequate expansion and investment in current border infrastructure, similar delays will undoubtedly reoccur.



Industry stakeholders have identified several factors that contribute to unpredictable border wait and inspection times, including insufficient border infrastructure, poor training of customs officials, inadequate staffing at border crossings, lack of modern technology, inadequate information regarding updates to security and regulatory requirements, and redundant processes and procedures.

One area that has repeatedly been identified by businesses as a source of delays at the border is confusion over admissibility requirements. Each year, new regulations and requirements are imposed upon firms conducting cross-border business. Businesses must be kept abreast of changes in reporting requirements to avoid delays caused by unintentional non-compliance and unnecessary inspections. For example, both Canada and the U.S. are moving towards collecting import and export data electronically. While this venture is welcome, there are several issues that are of concern to businesses. First, this information is only being collected electronically by customs agencies, meaning that businesses must duplicate reporting to other government departments. Additionally, there are significant concerns that new requirements ignore the reality of the supply chain by requiring information that is difficult, costly or in some cases impossible to collect. Both governments must ensure that policy or regulatory

changes affecting the border are communicated effectively to the business community and that they consult with industry to ensure that these changes are designed to minimize red tape.

Another area needing greater attention is joint investment in border infrastructure to ensure that border crossings are capable of handling future demand. For example, the Ambassador Bridge in Detroit handles \$130 billion worth of trade per year, with more than 68,000 individual travellers and 8,000 trucks crossing each day.<sup>56</sup> Given that in the next 30 years these numbers are expected to more than double, it is imperative that border infrastructure can handle the increasing demand.<sup>57</sup> In April 2009, the Canadian government offered \$550 million to the government of Michigan to help cover the American portion of costs for the Detroit River International Crossing (DRIC), which would add an additional, publicly-owned crossing. As the Canadian and American governments move forward with investments in border infrastructure, they must make sure that these investments are designed to address security concerns and future demand.

While critical to border functionality, investments in border infrastructure must be coupled with increased staffing, training and hours of service at major ports of entry. Although the border is a critical component of North American supply chains, not all border booths are operating at full capacity during peak commercial hours. Because traffic patterns are largely predictable, hours of service and staffing models should be based upon expected volume, instead of time of day. Basing staffing requirements on known arrival times would allow shipments to pass through the border more quickly while removing some of the congestion during peak leisure travel hours. Many businesses have noted that their goods are being held at the border while awaiting inspections by other government departments. The prearranged availability of staff from other government departments, like inspectors from the Canadian Food Inspection Agency, would also alleviate delays to commercial traffic.

Finally, there is a need for a single, accurate method of collecting border wait time information. Various government departments on both sides of the border

<sup>56</sup> Transport Canada. "Canada announces Another Step to Fast-Track the New Windsor-Detroit Border Crossing." April, 2010.

<sup>57</sup> *Ibid.*

have started collaboration on the rollout of automated measurement and dissemination of wait time data. This is a welcome initiative, but to be effective it must be coupled with the completion of the Bi-National Border Wait Time Study Project, which is being undertaken by the U.S. Department of Transportation, the U.S. Customs and Border Protection Agency and the Canadian Border Services Agency. Once completed, the data collected from the study must be used to develop accurate staffing models and in the deployment of necessary technology like the use of Radio Frequency Identification (RFID) readers at all border crossings.

## RECOMMENDATIONS

1. The Canadian and U.S. governments should collaborate to develop accurate staffing models for border services that reflect and respond to demand, including those of other government departments with border mandates to do inspections and offer support services 24/7 at major border crossings.
2. The U.S. Department of Transportation, the Canadian Border Services Agency and the U.S. Customs and Border Protection should complete the Bi-National Border Wait Time Study Project.

## A Border Contingency Plan

There are several factors that could lead to a closure of the border, including the outbreak of a pandemic, a terrorist attack or a natural disaster. Such a closure would have a major effect on North American supply chains and on economic stability.

Both the American and Canadian governments have recognized the critical importance of keeping the border functional and the need to ensure that high-priority people and goods can cross the border during an emergency. In 2009, the CBSA released its *Plan for the Movement of People and Goods During and Following*

*an Emergency*. While the development of this plan is a welcome initiative, the CBSA must continue to work with the CBP to develop a joint contingency plan. This plan should build on the joint 2009 framework for the movement of goods and people across the border during and following an emergency.

## RECOMMENDATION

That the Canadian and U.S. governments work together with their regional agencies and with the business community on both sides of the border to immediately put in place an effective border contingency action plan to manage the movement of goods and people during and following a full or partial closure of the border.

## A Hole in the Border

While the governments of Canada and the U.S. must collaborate to facilitate legitimate trade and travel, they must also coordinate efforts to secure the border. One area for immediate attention by both governments should be illicit trade. While the countries have made good progress in increasing security at recognized border crossings, the illicit trafficking of weapons, people, drugs and tobacco remains a major issue along parts of the border. For instance, the Cornwall region has become a hub for arms, tobacco, narcotics and human trafficking. Many security experts in Canada have long identified the known smuggling route as a potential entry point for more serious threats like terrorism.<sup>58</sup>

Tobacco products, alone, have become a major source of income for criminal organizations, and, in recent years, the production and trade in contraband tobacco products has attracted over 175 known criminal or terrorist organizations, including the Hells Angels and Hezbollah. According to the RCMP, 75 per cent of the groups involved with the smuggling of tobacco products are also involved in other forms of trafficking.<sup>59</sup>

<sup>58</sup> Blackwell, Tom. "The New Big Tobacco: Contraband Capital." *The National Post*. September 21, 2010.

<sup>59</sup> C/Supt Joe Oliver. Appearance before the Public Safety Committee. April 2010.

The problem has grown to the point where, in 2008, seizures in this region of cartons, resealable bags and fine-cut tobacco represented 38 per cent and 42 per cent of the seizures nationwide.<sup>60</sup> Contraband tobacco seizures in 2008 were at record levels and illicit tobacco purchases represented 32.7 per cent of the Canadian tobacco market, up almost 11 per cent from 2007.<sup>61</sup> The expansion of the contraband market has had a negative impact on federal and provincial tax revenue with estimates placing the losses at over \$1 billion each year.<sup>62</sup> This lost revenue is being shifted into the pockets of criminal organizations. The illegal trade in cigarettes also impacts the health of Canadians. There is no quality control for contraband tobacco products or enforcement of regulations prohibiting their sale to minors. It is important to increase awareness of the dangers and illegal nature of these products, particularly among youth.

The Canadian government has recognized the extent of the problem and the RCMP and the CBSA have undertaken several initiatives to combat contraband in recent years. Since April 2008, 25 criminal organizations involved in illicit tobacco trade have been disrupted with 740 charges being laid under the *Excise Act, 2001*.<sup>63</sup> In 2009, the number of charges laid increased to 770 and in April of 2010, for the first time in Canadian history, an individual charged with gangsterism was sentenced for his involvement with contraband tobacco.<sup>64</sup>

More urgently, the problem needs to be combated at its source. According to Chief Superintendent Joe Oliver (Director General, Border Integrity, Royal Canadian Mounted Police), to be successful, enforcement efforts

must be coupled with “enhanced partnerships and increased coordination, domestically and internationally.”<sup>65</sup> The only way to address such holes in the border is through improved coordination and cooperation between the relevant government agencies in Canada and the U.S., particularly along well known smuggling routes like in the Cornwall region.

## RECOMMENDATIONS

That the Canadian government must:

1. Continue to press the U.S. government to prevent contraband goods from entering Canadian territory.
2. Ensure that Canadian laws relating to the tobacco trade are adequately enforced.
3. Continue to foster collaboration and coordination between relevant agencies and departments on both sides of the border.
4. Improve communications to the general public on the negative consequences and illegal nature of contraband tobacco products.
5. Ensure that cooperation on counter-smuggling operations remain on the agenda at appropriate bilateral meetings and work with the U.S. to address the growing problem.

<sup>60</sup> The Royal Canadian Mounted Police. “Contraband Tobacco Enforcement Strategy: Progress Report 2008-2009.” 2009.

<sup>61</sup> The GfK Group. “Illegal Tobacco Sales: A Crisis for Canadians National Study for the Canadian Tobacco Manufacturers’ Council.” September 2008.

<sup>62</sup> Gabler, Nachum; Katz, Diane. “Contraband Tobacco in Canada Tax Policies and Black Market Incentives.” Frazer Institute. July, 2010.

<sup>63</sup> *Supra note 60.*

<sup>64</sup> *Supra note 59.*

<sup>65</sup> *Ibid.*

# CONCLUSION

When NAFTA entered into force, it was the envy of the world. North American partners enjoyed an ear of unparalleled economic success. In the first 10 years of NAFTA, U.S. employment levels increased by 20 per cent while Canadian exports to the U.S. soared. Since that time, minor irritations have slowly eroded the gains that were made more than 15 years ago. The signs of this erosion were glaringly apparent in America's reaction to the financial crisis. The *Buy American* requirements rattled our confidence in the strength of the Canada-U.S. relationship, and the time and effort required to reach the Canada-U.S. AGP should never have been necessary. While *Buy American* may have been the most dramatic sign of drifting relations, it does not stand in isolation. Canada needs to develop a dedicated strategy for engagement in the U.S. that focuses on highlighting the gains from the bilateral arrangement and promoting free trade.

North American businesses continue to struggle under the weight of increasing regulatory differences. The “tyranny of small differences” between Canada and the U.S. not only increases the costs associated with cross-border business but hinders greater economic integration. There are many areas where greater regulatory cooperation would not only make sense but is badly needed. Unnecessary variations in health and safety standards, emission controls, product labelling and other areas present a valuable opportunity for Canada and the U.S. to work together to strengthen the economic partnership. Left unaddressed, such variances leave North American companies vulnerable to growing international competition.

The border is another area crying out for greater attention. A 21<sup>st</sup> century border cannot be defined as a physical line on a map. Modern security challenges necessitate pushing back the border by identifying threats long before they arrive. Such a perimeter approach to security allows for the identification of threats long before they reach North American shores. Focusing resources where they are most needed—on unknown cargo and travel—would simultaneously facilitate legitimate cross-border traffic. Both Canada and the U.S. must continue to invest in border infrastructure, reduce the red tape burden to businesses, improve the efficiency of trusted trade and traveller programs and eliminate unnecessary fees and regulations.

Trade, regulatory cooperation and the border have long been high on Canada's agenda with the U.S. It is time, however, for Canada to adopt a more forward thinking approach to its engagement with the U.S. Canada must take advantage of this fact by leveraging itself as a safe, reliable and secure source of energy to the U.S. Canada must ensure that all Canadian energy sources are marketed in the U.S. as a solution to American energy security concerns. In Washington, energy security and environmental policy are two sides of the same coin. At the same time, both countries must continue to collaborate through the Clean Energy Dialogue on environmental policies that are economically viable and sustainable.

Canada must do a better job of promoting the natural advantage granted by proximity, language and the integrated Canada-U.S. supply chains. A sustained, well-financed and well-organized advocacy campaign in the U.S. that emphasizes the importance of the Canadian-American relationship and the economic edge granted by the North American market can strengthen the ties between our countries. The onus for such leadership is not on the Canadian government alone. The business community, the academic sector and individual Canadians all have a role to play in mapping out the road to success.

A stronger North American partnership is inevitable. It will come either by default, as the forces of technology, commerce and common security bind Canada and the U.S. more closely together or by design, if politicians, with leadership from the business community, among others, create a compelling vision of a true North American community. It is time for Canada to present the U.S. with new goals, new ideas and new areas for partnership that will not only secure the future of both economies but will launch the relationship in a new, more prosperous direction.

# SUMMARY LIST OF RECOMMENDATIONS

## 1. A Growing Problem

That the Canadian government:

- Put in place a mechanism above and beyond the fast track consultation mechanism in the Canada-U.S. AGP to ensure that Canadian businesses have access to procurement projects in the U.S,
- Move rapidly on the commitment to negotiate a permanent procurement agreement,
- Continue to seek exemptions from Buy American provisions in highly integrated sectors where Canadian businesses have historically been able to compete, and
- Encourage and help resource a well-funded, sustained, private sector-led initiative to promote Canada's interests within the United States.

## 2. Protecting Canada's Intellectual Property

- The Canadian and U.S. governments, in partnership with industry must increase their efforts to identify areas where regulatory cooperation would be mutually beneficial. Both governments must focus on the removal of inefficiencies and redundancies as well as the elimination of unnecessary regulatory barriers in key sectors.
- The Canadian government must ensure that regulatory cooperation be one of the core policies for Canada's engagement with the U.S.
- The Canadian and U.S. governments should examine the feasibility of creating a more permanent and integrated regulatory review process. There is a clear need to update current governance mechanisms and institutions through which North American regulatory policies are adopted.
- The Canadian government should work with industry on the enhancement, amendment and enforcement of current aerospace and defence regulations, policies and programs in Canada.

- The Canadian government should continue to press the U.S. to follow through with its commitment to bring the necessary reforms to its export and import control regimes.
- The Canadian government should avoid the adoption of an overly burdensome and complex financial regulatory system that will negatively affect Canadian firms.
- The Canadian government should work with the provinces and territories to eliminate the remaining barriers to labour mobility across Canada and continue to strengthen the AIT.
- The Canadian government must work with industry to identify areas where greater domestic regulatory cooperation is needed.
- The Canadian government must immediately update Canadian copyright law to reflect the modern digital age. It is important that updates to Canadian copyright laws provide clear, predictable and fair guidelines in accordance with the stated objectives of the legislation.
- The Canadian government should grant the necessary legislative authority and allocate sufficient resources so border officials can more effectively search and detain suspected shipments of counterfeit goods at the border on an ex-officio basis (i.e. without a formal complaint being laid).

## 3. Environmental Policy

That the Canadian government:

- Continue to work with the U.S. through the Clean Energy Dialogue in developing compatible regulatory and business frameworks and in promoting science and technology to combat climate change and reduce GHG emissions,
- Ensure, where possible, that new environmental regulations and emission pricing systems are compatible with U.S. standards and international norms,

# SUMMARY LIST OF RECOMMENDATIONS

- Work with the U.S. to ensure that any border adjustment tax is WTO compatible, predictable and minimizes the administrative burden on Canadian businesses,
- Promote bilateral pilot programs that can drive innovation and the development of green technologies including information sharing and the identification of best practices, and
- Promote joint clean energy research as a means of mitigating the negative effects of climate change and encouraging investment in our own green economy.

## 4. Energy Security

- That the federal and provincial governments work with the Canadian energy sector to promote Canada as a source of safe, responsible and secure energy, particularly with U.S. state and local level policymakers and legislators.
- That the Canadian government develop a national energy strategy that provides a predictable regulatory framework and encourages private sector investment in the energy sector.
- That the Canadian and U.S. governments collaborate on the development of a continental energy strategy that addresses the need for joint infrastructure investments and regulatory consistency and addresses mutual environmental concerns.
- That the Canadian federal, provincial and territorial governments, along with Canadian industry, increase efforts to have all sources of renewable energy, including hydroelectricity, recognized as a renewable energy source by U.S. Congress and American legislators.
- That the Canadian government work with the U.S. to ensure continental energy security by investing in the development of smart grid technology and energy infrastructure. In particular, there is a need to strengthen and expand North American electricity connections by facilitating the permitting and construction of new energy infrastructure.

## 5. The High Cost of Being a Trusted Shipper

- That the Canadian and American governments set up a pilot trusted shipper program for companies that are regulated by government agencies other than the CBSA and CBP, like low-risk food importers from Canada and the United States. More companies would then be able to join trusted shipper programs, which would secure a greater portion of the supply chain and make border crossings more predictable for businesses.
- That the Canadian government work to reduce redundancies, minimize costs and maximize benefits of trusted trader programs by aligning existing programs both domestically and with the U.S.

## 6. Achieve a Critical Mass of Cross-Border Travel Documentation

That the Canadian government:

- Expand NEXUS to include a voluntary option to handle multiple entries for business travellers who need NAFTA visa approval to enter either country. Storing visa information on NEXUS cards would allow border officials to be better prepared to make entry decisions.
- Examine the feasibility of expanding the NEXUS program for domestic use to fast-track domestic security lines.

## 7. Border Wait Times

- The Canadian and U.S. governments should collaborate to develop accurate staffing models for border services that reflect and respond to demand, including those of other government departments with border mandates to do inspections and offer support services 24/7 at major border crossings.
- The U.S. Department of Transportation, the Canadian Border Services Agency and the U.S. Customs and Border Protection should complete the Bi-National Border Wait Time Study Project.



# SUMMARY LIST OF RECOMMENDATIONS

## 8. A Border Contingency Plan

- That the Canadian and U.S. governments work together with their regional agencies and with the business community on both sides of the border to immediately put in place an effective border contingency action plan to manage the movement of goods and people during and following a full or partial closure of the border.

## 9. A Hole in the Border

That the Canadian government must:

- Continue to press the U.S. government to prevent contraband goods from entering Canadian territory,
- Ensure that Canadian laws relating to the tobacco trade are adequately enforced,
- Continue to foster collaboration and coordination between relevant agencies and departments on both sides of the border,
- Improve communications to the general public on the negative consequences and illegal nature of contraband tobacco products, and
- Ensure that cooperation on counter-smuggling operations remain on the agenda at appropriate bilateral meetings and work with the U.S. to address the growing problem.

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