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# Canada and Obama
## Canada's Stake in the 2008 US Election

by Alexander Moens and Derrick Schroeter






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# Contents

# Executive summary

The new US administration under President Barack Obama faces growing long-term government debt as well as looming deficits in America's major social programs. The current financial crisis and economic downturn come at a time when national debt has risen from 36% of GDP in 2000 to 48% of GDP in 2007. In foreign policy, the new president faces a rising threat in a nuclear Iran, the questions of how to consolidate Iraqi stability while drawing down troops, and whether and how to expand the war against radical Islamists from Afghanistan to Pakistan.

As the biggest trading partner and energy supplier to the United States, as well as one of its closest political and military allies, no country is more susceptible to policy changes in the United States than Canada and no country has a higher stake in seeking to influence these choices than Canada.

At the same time, no Canadian government can proceed far in influencing or co-ordinating with the United States on important economic or foreign policies without public understanding of why it is in Canada's national interest.

The aim of this publication is to identify Canadian interests at stake in future American choices and what the main proposals by the new president will mean for Canada. The purpose is to inform the Canadian public about what strategies in dealing with the new administration and Congress will maximize Canadian prosperity and security.

The chief concern for the Canadian economy today is the expected impact of the economic crisis in the United States and worldwide. Despite Canada's weathering the financial storm quite well, our closely integrated economy is likely to decline with the US economy in the next year. Whether president-elect Barack Obama will choose tax and economic policies that will dampen or hasten American economic recovery will directly impact Canadian well-being, as Canada traded 67% of its total trade with the United States in 2007, amounting to 40% of Canadian GDP.

The integrated Canada-US energy market in oil, gas, and electricity is taking a larger share of Canada's exports. Keeping that market regionally integrated is also of top concern to Canadians. Canada-US energy trade would benefit from greater regulatory convergence. Any environmental or carbon measures that would imperil this trade will be very costly to Canada's trade ledger.

Getting the attention of the new US president in early 2009 amidst all the challenges the US faces will be very difficult for any Canadian prime minister. Prime Minister Stephen Harper's constructive and pragmatic co-operation with the United States since 2006 puts him in a good position to engage the new team coming to Washington. Canada should present itself and Canadian proposals as a constructive element of solving America's own problems, including revitalizing North American manufacturing, improving North American energy supplies, and helping to end the insurgency in Afghanistan.

The election campaign revealed major differences between John McCain and Barack Obama on tax policy, economic relief, energy policy, and trade policy. This paper details all these campaign differences and puts them in a comparative perspective.

McCain wanted to add a variety of tax cuts, including on corporate income and capital gains, to stimulate economic activity. Obama, on the other hand, is calling for tax increases on upper income earners, capital gains, and corporations. These tax hikes are accompanied by five new, refundable tax credits aimed at the lowest tax brackets and, in most instances, will actually be payments to people who pay no tax at all.

In recent weeks, both candidates have called for a variety of economic relief plans. When the total of spending increases are added to their existing economic policy plans, the extra annual spending proposed by McCain amounted to US$58 billion, while the number for Obama equals US$117 billion per year. Fiscal discipline will be the cornerstone of a return to long-term economic confidence, but Obama's spending plans thus far are pointing in the opposite direction.

Both McCain and Obama made very costly promises on energy policy, with annual costs to the US economy for a cap-and-trade system of reducing carbon emissions estimated at some $56.5 billion. Obama has made a renewed energy economy his top priority. However, Obama's plan to bring solar and wind up to 10% of total electricity production by 2012 (from the current 1.2%) faces a tremendous challenge.

The NAFTA- and free-trade-friendly approach by McCain would certainly have been a plus for Canadian interests. Obama, on the other hand, faces political pressure from his core base of support, including labor unions and environmental lobbies, to pursue protectionist measures and new regulatory burdens. The implication is that product standards compatibility and regulatory convergence begun in the Security and Prosperity Partnership (SPP) talks will have far less chance of progress under an Obama administration.

Canadians have expressed their preference for Barack Obama as president based on ideological factors. However, they need to realize that on all the key economic and bilateral issues between our countries, including trade, energy, border management, and defense, an Obama administration would not enhance Canada's immediate interests.

There is no indication that Obama would change the American approach to border security or the so-called "thickening" of the US border since he calls for six times as much new border-security funding as McCain. Obama's plans on border security do not augur well for "thinning" the border of complex paperwork and new security measures.

Despite the challenge of getting Canada on the US agenda under Barack Obama and getting Canadian interests acknowledged, Prime Minister Stephen Harper would be well advised to meet early with the new president and put in a maximum effort to build a personal relationship of trust and respect. On the positive side, the Canadian public supports Obama and this will give Harper a window of opportunity to engage the new US administration. This effort should include the following points:

- The Security and Prosperity Partnership (SPP) appears to have run out of steam and, as a result, Harper should take the opportunity to renew efforts to open bilateral discussions on trade and border issues. Canadian steps toward more border staffing and deeper co-operation on homeland security, as well as joint projects on accelerated infrastructure, should be a start.

- The decision to withdraw Canadian Forces from combat operations in Afghanistan in 2011 should be reconsidered by the Canadian Parliament. Canada should signal a strong willingness to find a common strategy with the Obama administration on how to achieve long-term security and stability in that country. Such a strategy should include a combination of military power and diplomacy.

- An agreement to proceed with a common Canadian-American approach to carbon emissions rather than separate policies should be negotiated with special protection for the oil sands industry to give it time to move towards more steam-assisted gravity drainage, the use of nuclear power to generate steam, and carbon sequestering. While a cap-and-trade system to reduce carbon emissions is not good policy for either nation, the worst case scenario would unfold if the United States proceeded with such a system and Canadian energy and manufacturing products would be faced with a tariff or levy, possibly pricing them out of the US market and, at the minimum, reducing Canadian export earnings.

# Introduction

The new administration in the United States faces growing long-term government debt as a result of continual excessive spending. In the near future, Americans also face large unfunded liabilities in major government programs such as Social Security and Medicare/Medicaid. Continuing trade deficits as well as national economic turmoil add to the fiscal concerns. The latter is a result of a combination of factors, including the fallout from the 2008 mortgage leveraging crisis and, until recently, rising energy prices. In foreign policy, the new president faces a rising threat in a nuclear Iran, the questions of how to consolidate Iraqi stability while drawing down troops, and whether and how to expand the war against radical Islamists from Afghanistan to Pakistan.

As the biggest trading partner and energy supplier to the United States, as well as one of its closest fighting allies in Afghanistan, no country is more susceptible to policy changes in America and no country has a higher stake in seeking to influence these choices than Canada. In addition, Canada and the United States are facing unfinished bilateral challenges. These include a more efficient border for trade, combined with a more secure border for the movement of people. Since 2005, both countries, with Mexico included, have been engaged in low-profile negotiations to foster more product standards compatibility and more regulatory convergence to allow greater economies of scale for our manufacturing and transportation sectors and fewer regulatory barriers in energy, agriculture, and the service sector. This process has fallen below turtle speed in the last two years, putting North America's competitiveness at risk in a global trading world.

Because the Canadian and American economies and political systems are far more compatible than their Mexican counterparts, Canada needs to go back to a bilateral process with the United States that has traditionally yielded the highest returns. Such an initiative is arguably Canada's highest priority with a new American administration. This will lead to some hard bargaining and difficult choices. Canadian demands for lower-cost commercial access to the United States are met by American demands for greater security compatibility in how we manage domestic or homeland security issues, including the sensitive subject of immigration and asylum seekers. Given president-elect Barack Obama's expressed hesitation for free trade agreements and his promises to seek more labor and environmental conditions in agreements such as the North American Free Trade Agreement (NAFTA), Canada will likely face more than security demands from the new administration in bilateral negotiations on trade deepening.

The high Canadian dollar in recent years, the growth of Asian imports, the weakening of American consumer demand, and the so-called "thickening" border between Canada and the United States have created a "perfect storm" in the Canadian manufacturing sector. As elements of the American manufacturing base move to the south and away from the border, the export industry in Canada, which has become an integrated and intra-firm process of supply chains, faces a new challenge on how to maintain its comparative advantage. The idea that Canada would simply diversify and sell its exports elsewhere has, in times past, proven more difficult and less advantageous than fine-tuning Canada's relationship with the United States. This fundamental truth still holds today, even with recent Canadian attempts to negotiate a free trade agreement with the European Union.

In addition to unfinished bilateral business, new and large bilateral problems surrounding energy and the environment loom beyond the horizon. Even though it failed this year, the Warner-Lieberman measure in the United States Senate is considered a harbinger as both Barack Obama and Senator John McCain have strongly supported such a plan. The Warner-Lieberman measure proposed a carbon cap-and-trade system in the US economy aimed at reducing emissions of carbon dioxide. Apart from the many problems such a scheme faces in its own right, Canada is particularly sensitive to arbitrary caps on carbon set in Washington which would directly affect Canadian oil and manufacturing exports. Rather than separate systems, Canada will benefit from a single Canadian-American system should the United States decide to go ahead with the carbon cap-and-trade scheme. On the flip side, should a Canadian government implement a Canadian cap-and-trade system or a Canadian carbon tax, Canadian businesses would face higher costs, giving American exporters an unfair advantage. The imposition of import tariffs to offset such an advantage would make a mockery out of the last 40 years of trade liberalization and would give the United States ample ammunition to retaliate. It is in Canada's interest to avoid carbon schemes of any type in energy production or in manufacturing. However, if the new US administration and Congress do, in fact, move toward a cap-and-trade system, American energy producers and manufacturers will no doubt demand import levies or fines on Canadian energy and manufacturing products. Even if the United States and Canada each had their own cap-and-trade system, American lobbies would look for opportunities to exploit small differences and throw up protectionist barriers. Therefore, simply to minimize Canadian losses on this issue, it would be best for Canada to adopt the American cap-and-trade system so no regulatory daylight can be found between the two markets. It is in Canada's interest not to be out of step with American measures, as the harmful trade effects of any of these measures will incur large economic costs.

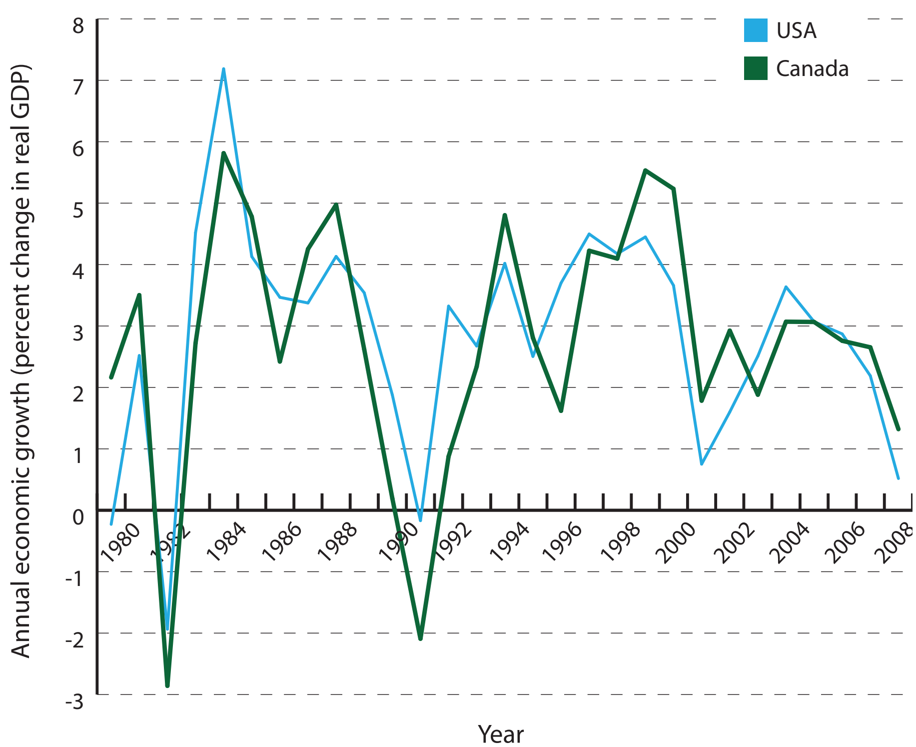
No Canadian government can proceed far in influencing or co-ordinating with the United States on important economic or foreign policies without public understanding of why this is in Canada's national interest. As polls show, most Canadians favored Barack Obama over John McCain by a wide margin. However, it seems Canadians are largely inspired by the general ideological affinity they perceive in Obama and have not well considered Canadian interests at stake. The aim of this publication is to identify Canadian interests at stake in future American policy choices and what the main proposals by the new president will mean for Canada. Finally, this paper aims to inform the Canadian public about what strategies in dealing with the new administration and Congress will maximize Canadian prosperity and security.

The first section of this paper evaluates the economic state of the Canada-US relationship. The next section assesses the political and strategic developments in recent years. The third part describes and evaluates the key policy challenges facing the United States, as highlighted in the 2008, election and the Canadian interests at stake in the policy positions advanced by Obama.

# Part 1: The state of Canadian-American relations in 2008

The high degree of economic interdependence between the American and Canadian economies is often mentioned in passing but becomes quite striking when one compares the two countries' main indicator on economic growth. Long-term trends in Gross Domestic Product (GDP) growth rates reveal very similar directional movements in the United States and Canada over time.

***Figure 1: Long-term trends in Canada-US annual GDP growth rates, 1980–2008***




Source: IMF, 2008

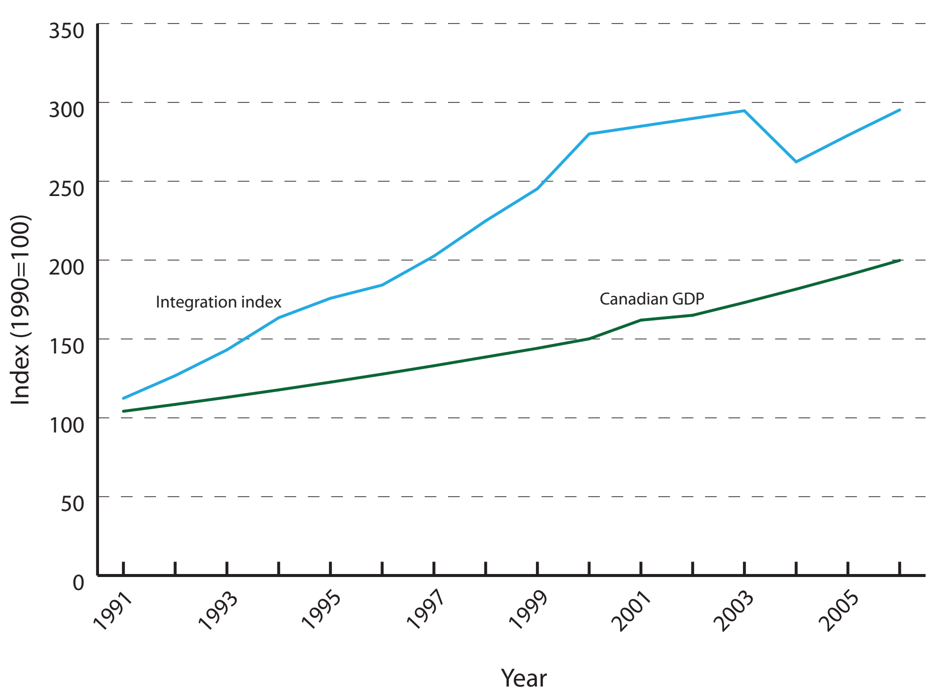
The similarities in these movements indicate that economic outcomes and shocks originating in the United States have a strong tendency to extend beyond its national economy and exact a similar impact on the economic performance of Canada. These economic spillover effects illustrate the considerable degree of market dependence of Canada on the United States.

For example, the September 11, 2001 attacks on the United States caused a large decline in the US stock market and a major disruption of several sectors such as the airlines. American GDP growth fell from 3.66% in 2000 to 0.75% in 2001. In response to the American shocks, cross-border commerce dropped considerably. Canadian GDP growth fell from 5.23% in 2000 to 1.78% in 2001 (IMF, 2008).

The chief concern for the Canadian economy today is the expected economic impact of the sub-prime mortgage crisis in the United States, where forecasted GDP growth for 2008 is being depressed to 0.5%. Depressed US consumer demand for Canadian goods and the tightening of credit in Canada as a result of the US and global reaction to the credit crisis are already pushing Canada's growth rate downward. Canada's GDP growth rate for 2007 was 2.65% and the forecast for 2008 is now just above 1% (IMF, 2008). Given the October shocks to the US economy, GDP declines in both countries may turn out to be bigger yet.

What is less well known to Canadians is that the degree of integration between the Canadian and US markets means that, as the costs of transactions between the Canadian and American economies goes down, Canadian economic growth rises disproportionately. Thus, following the Canada-US Free Trade Agreement of 1988 and subsequently the North American Free Trade

***Figure 2: Trends in Canadian nominal GDP and the integration indices***




Source: Sydor, 2008; calculations by author.

Agreement, as trade barriers fell, Canadian exports rose at a faster pace than American exports. The ability for transactions to occur freely across our border has been the key engine of Canadian growth in the last two decades. In order to show this integration dynamic, Foreign Affairs and International Trade Canada has created an estimated measure of the rate of Canadian-American integration which considers the amount of trade barriers and trade volume, as well as GDP growth and productivity.

The index shows the steep rise in Canadian integration with the US market and parallel GDP growth. For example, Canada's trade with the United States, as a share of Canadian GDP, rose from 35.7% in 1990 to 65.4% in 2000 (Sydor, 2008). The index also reveals smaller trends such as the decline in integration as a result of heightened border measures after 2001 and an initial decline in Canadian GDP growth. After 2004, the Canadian GDP growth rate seems less tied to the United States than before 2000, mainly as a result of the climbing Canadian dollar, softer US demand for Canadian products, and the growing cost of commerce crossing the border in terms of time lost. A 2008 summary of the various costs to border crossing for Canadian and American merchandise moved by truck revealed that the total commercial costs (excluding government security costs for border controls) due to old infrastructure, understaffed border and customs offices, and new security procedures are estimated at between 2% and 3% of overall trade volume, which was $576 billion in 2007 (Cust and Moens, 2008).

## Recent Canada-US trade: Facts and figures

Between 2000 and 2007, Canadian trade with the United States remained the strongest driver of the Canadian economy. Canadian exports to the United States accounted for 79% of all exports in 2007, while Canadian imports from the United States accounted for 54% of all imports. Trade volume with the United States accounted for 67% of Canada's total trade volume in 2007. Canada's trade surplus with the United States in 2007 was $135.4 billion.

***Table 1: Canadian trade balance with the United States, real CA$ (millions)***

| Canada-US trade | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|---|---|
| Exports | 359,289 | 351,751 | 345,366 | 326,700 | 348,144 | 365,803 | 359,254 | 355,951 |
| Imports | 229,660 | 218,290 | 218,497 | 203,822 | 208,987 | 215,196 | 217,642 | 220,479 |
| Balance | 129,629 | 133,461 | 126,869 | 122,878 | 139,157 | 150,607 | 141,611 | 135,473 |

Source: Industry Canada, 2008

*Table 2: Canadian trade with the rest of the world, real CA$ (millions)*

| Canada-world trade | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|---|---|---|---|
| Exports | 53,926 | 52,334 | 51,015 | 54,371 | 64,146 | 70,454 | 81,012 | 94,423 |
| Imports | 127,332 | 124,821 | 130,460 | 132,319 | 146,899 | 165,663 | 179,003 | 186,258 |
| Balance | -73,406 | -72,486 | -79,444 | -77,948 | -82,753 | -95,209 | -97,990 | -91,836 |

Source: Industry Canada, 2008

Excluding trade with the United States, Canada's trade deficit with the rest of the world in 2007 was $91.8 billion (C-DFAIT, 2008).

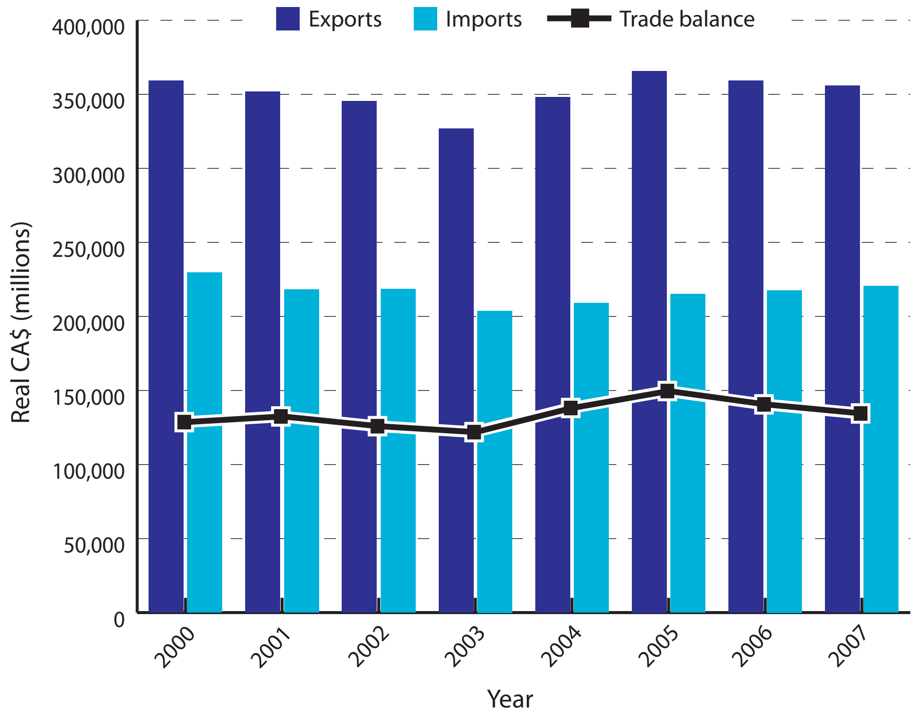
While Canadian imports from the United States also remained the largest, we see a clear trend of Asian imports catching up. Canadian imports from Asia in 2007 constituted 42% of non-US imports. Canada's $91.8 billion trade deficit with the rest of the world is a significant increase from the 2000 number. At the same time, Canada's net trade surplus with the world in 2007 was $43.6 billion, a decrease of 21% from 2005. While Canadian exports to the rest of the world grew strongly, most of this growth was in minerals and resources rather than manufactured products. Canadian exports are not keeping pace with imports, causing a gradual deterioration in the balance of payments. Canada's remaining surplus of some $43 billion is entirely due to our strong US exports (C-DFAIT, 2008).

In 2005, Canada's total trade volume with the United States was equivalent to 51.7% of Canadian GDP, while US trade with Canada equaled only about 4.5% of the US GDP. In 2007, these figures changed to 40.2% and 4.2% respectively. The decline of Canada-US trade as a share of Canadian GDP (from 65% in 2000 to 40% in 2007) should not be read simply as proof of the diversification of the Canadian economy from trade with the United States. The decline in manufacturing exports—first as a result of the rising value of the Canadian dollar and now as a sign of the onset of a US recession—may point to the start of slower GDP growth in Canada (C-DFAIT, 2008).

When broken down by major sector, we see a significant decline in exports of Canadian automotive and forestry products and a flat machinery and equipment sector. Recent high fuel prices and tightening credit have further depressed demand for North American vehicles and pickup trucks. The declining US housing market and continuing export taxes have similarly depressed Canadian softwood lumber sales (C-DFAIT, 2008).

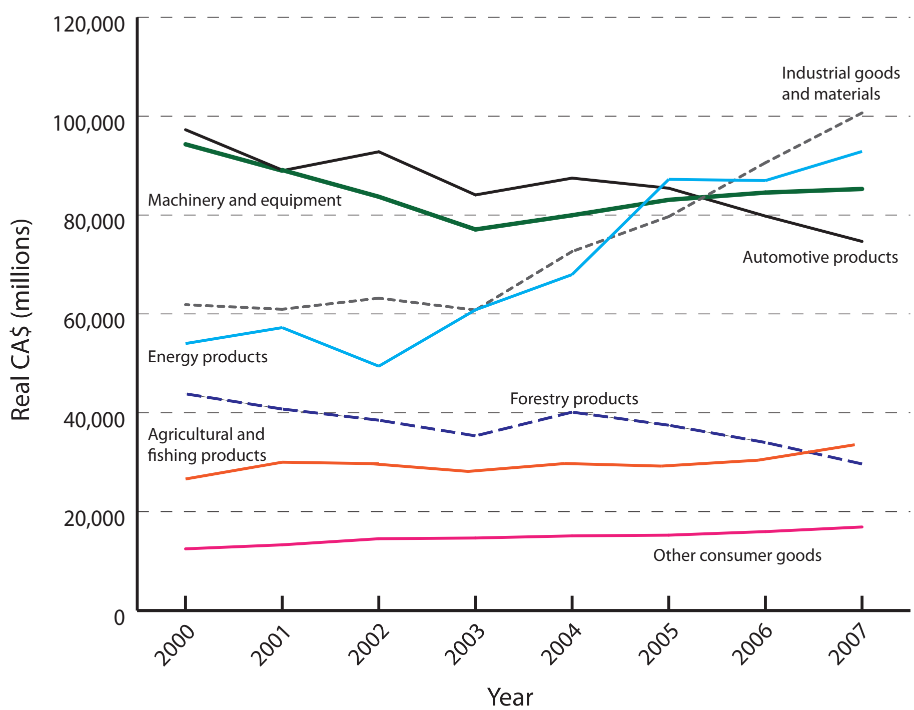
Compensating for most of this decline are Canadian energy exports, which rose from $50 billion in 2002 to over $90 billion in 2007. Canada supplied 16.4% (107.3 billion cubic metres) of total natural gas consumption in

## *Figure 3: Canadian trade balance with the United States, 2000–2007*




Source: IMF, 2008

## *Figure 4: Canadian exports, by industrial grouping, 2000–2007*



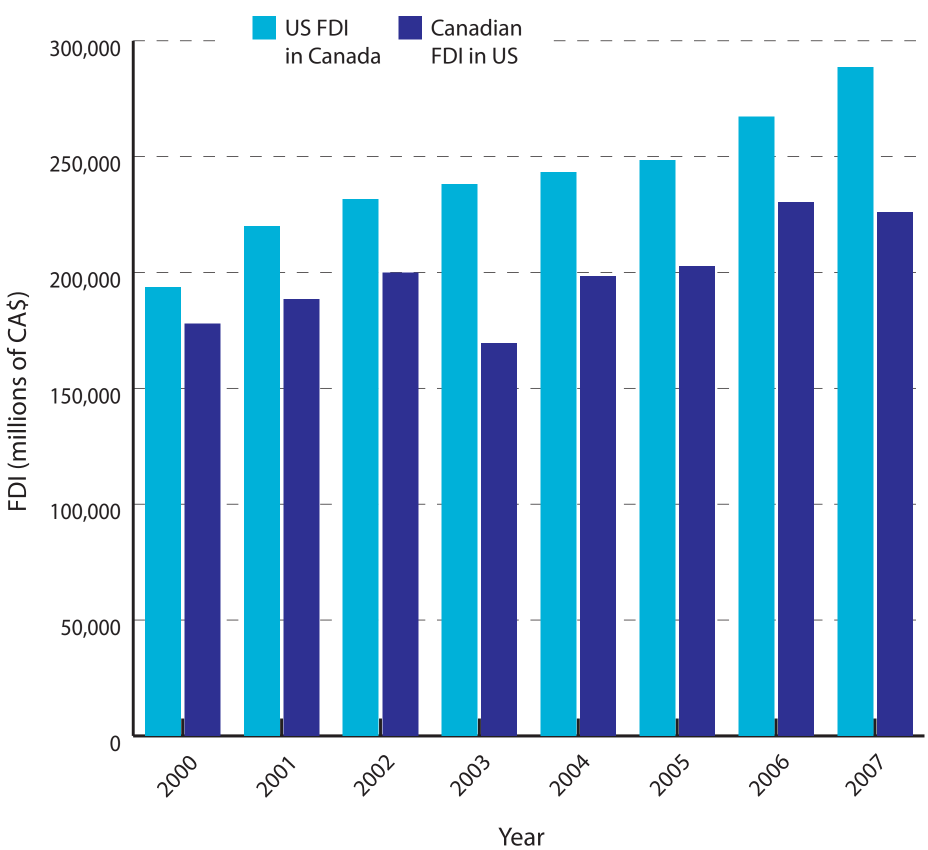

Source: C-DFAIT, 2008

the United States in 2007. Canada also supplied 17.8% of US crude oil product imports, amounting to 2.46 million barrels a day of conventional and bitumen exports out of a total of 13.63 million barrels the US imported per day in 2007. Also sharply up are industrial materials or mineral exports such as nickel, copper, and zinc to the United States and to the emerging markets in Asia (C-DFAIT, 2008).

## Canada-US investment update: Slight diversification in 2007

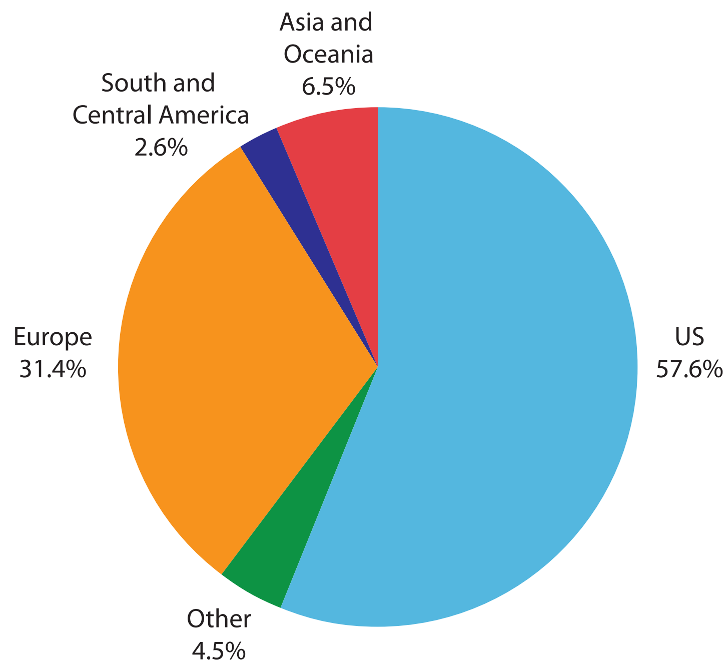
On the investment side of the relationship, we see that from 2005 to 2007 the stock of US Foreign Direct Investment (FDI) in Canada increased by 16%. However, the share of American FDI in Canada fell from over 64% in 2005 to about 58% in 2007 as investment from outside North America outpaced US direct investment. The single largest component of US investment in Canada (24%) went into

***Figure 5: US stocks of foreign direct investment (FDI) in Canada, 2000–2007***



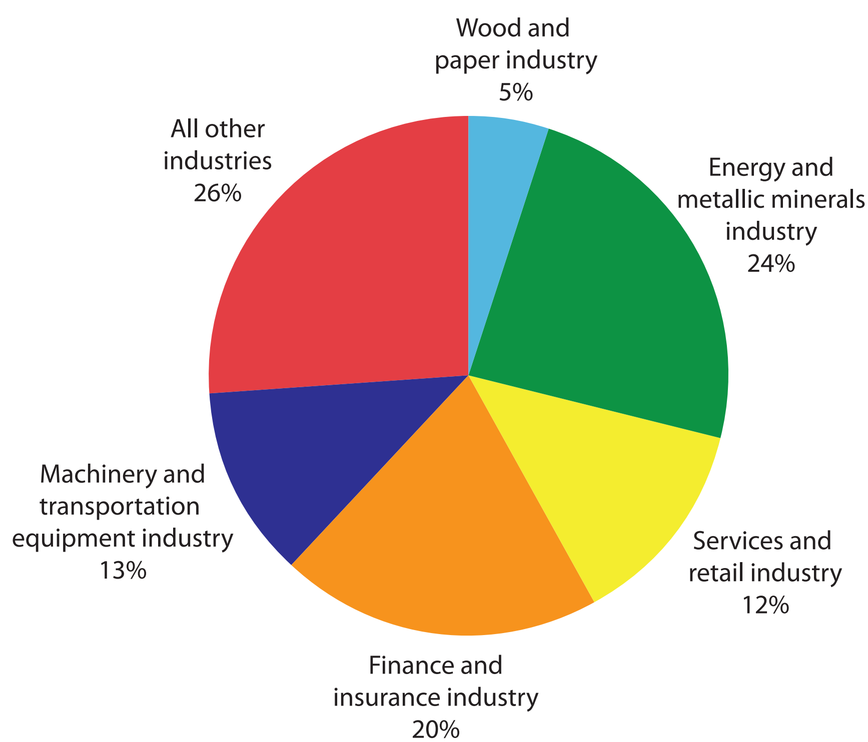

Source: C-DFAIT, 2008

***Figure 6: Stocks of FDI in Canada by country / region, 2007***




Source: C-DFAIT, 2008

***Figure 7: Share of US FDI by industry, 2007***




Source: C-DFAIT, 2008

the production of energy and metallic minerals. This number is up from 17% in 2000. In second place (20%) was investment in finance and insurance industries. On the downside, investment for machinery and equipment went down from 18% in 2000 to 13% in 2007 (C-DFAIT, 2008). Meanwhile, Canadian FDI in the American economy is slightly up from 2005, accounting for 44% of Canada's total foreign investment (C-DFAIT, 2008).

## Conclusion

Seen in a seven-year perspective, Canada's 2007 trade and investment figures with the United States point to several trends. In the first place, the automotive sector has experienced continual decline due to the high Canadian dollar and soft US demand. High commercial border costs due to waiting times and the replacement of just-in-time delivery with building new warehouses on both sides of the border reveal that intra-firm trade in car parts is facing a costly and unnecessary bottleneck. Clearly, Canada needs to work with the United States to make the commercial border much more efficient. Also, as the traditional automotive sector declines, Canada faces a tough question: how to renew its manufacturing base? Modernization or new manufacturing in Canada would benefit from integration with a larger American production process to lower costs across North America and globally. To obtain this advantage, Canada and the United States need not only open borders but also foster much more product standard compatibility and regulatory convergence in order to remove statutory differences that prevent large production runs.

Getting the trading regime right will not absolve the Canadian economy of all challenges or put it automatically into overdrive. Since 1997, the cumulative productivity gains in Korea, China, and India have been 81%, 67%, and 46%, respectively. The American rate is at 17%, while Canada's pace stands at a lowly 11%. Output per hour in the Canadian private sector in 2006 was 21% less than in the United States (Drummond, 2006, Aug. 29).

Second, the integrated Canada-US energy market in oil, gas, and electricity is taking a larger share of Canada's exports. Keeping that market regionally integrated as it grows is important. One of the major bottlenecks in this sector is slow approval processes made even slower by environmental processes that deter new exploration and production. Besides more efficiency and speedy processes on both sides of the border, the Canada-US energy trade would benefit from greater regulatory convergence.

Any environmental or carbon measures that would imperil this trade would be very costly to Canada's trade ledger. Given the very high production costs of bitumen and Alberta's overheated labor market, the needed investment growth in this sector may be more precarious than is generally understood, especially as some new projects are based on a crude oil price of $90 or $100 per barrel, now well above the market price, to turn a profit. The very recent decline in the value of the Canadian dollar somewhat offsets the effect of lower crude oil prices for Canadian producers.

Oil sands production estimates from June 2008 show projections on the low end of 2.8 million barrels per day for 2015, and 3.5 million barrels per day in 2020. On the high end, estimates are 3.1 million barrels a day for 2015, and 4.1 million barrels a day by 2020 (CAPP, 2008). Capital investment spending from 2007 to 2011 is estimated to be about $110 billion (A-DEII, 2007). Also, oil sands capital investment grew 330%—or 41% annually—from $4.2 billion in 2000 to $18.1 billion in 2007, with $20 billion forecast for 2008 (CAPP, 2008).

Third, some degree of diversification from the American economy has taken place in the last seven years, but it is not clear whether it will produce high levels of GDP growth in the long-term such as our market integration with the United States has produced. Trade diversification policies are always tempting to Canadians. The 2008 initiative to negotiate a free trade agreement with the European Union (EU) is the latest manifestation. While any free trade deal is good for the Canadian economy, caution about Canadian expectations is warranted. As a percentage of total trade, Canada's trade with the EU has been fairly moderate, though it has grown most recently, increasing from 7.4% in 1998 to 9.8% in 2007 (C-DFAIT, 2008). The recent growth in exports has been mainly due to higher prices for minerals and resources while Canadian imports from the EU have consistently outpaced our exports. A joint Canada-EU study revealed that expected income gains from a free trade agreement in goods and services between the two would only be 0.77% of GDP for Canada by 2014 (European Commission and Government of Canada, 2008). Being ready and well situated to benefit from a US economic and manufacturing revival, including expanding the intra-firm production process, continues to be most important for Canadian economic growth.

# Part 2: Canada-US strategic-political review

## Recent developments

The election of Stephen Harper as Canada's prime minister in 2006 restored the Canada-US political relationship at the highest level of government. Harper abandoned the attitude of aloofness and public criticisms directed to the United States as used by his two predecessors and adopted an approach of pragmatic co-operation. Harper has avoided spearheading or joining multilateral attempts that endeavor to isolate the United States. Despite attempts by some Canadian politicians to paint Harper as a close ally of President George W. Bush, Harper has essentially kept a good deal of public distance between himself and President Bush. From time to time, the Conservative minority government has stated its disagreements with Washington, such as on Canada's claim to the Northwest Passage. The Conservative minority government also invoked thinly veiled political reasons to block an American firm from purchasing the space technology division of a Canadian company.

One of the most significant areas of co-operation between the two countries has been on NATO operations in Afghanistan, where Canada, with only 2,500 troops, has been fighting the Taliban with one hand in order to do limited reconstruction and development work with the other. The operation, which began in earnest in 2001, has thus far cost nearly 100 Canadian lives and between $5.9 billion and $7.4 billion in military costs above salaries alone (C-OPBO, 2008). In order to better protect Canadian Forces and give them more modern fighting power, the Canadian government has purchased or ordered a large amount of new and used equipment, including three types of airlift, new vehicles, and weaponry. In many of these purchases, the American administration has gone out of its way to give Canada preferred access over other allies or allowed it to jump the production queue.

On the North American front, the United States is very supportive of Harper's "Canada First" strategy to invest in more land, air, and water capability to patrol and control the Arctic. Regarding the question of the Northwest Passage, however, the United States, Russia, and the European Union firmly maintain that it must remain an international strait rather than an inland passage.

The second major issue in bilateral relations emanated from President Bush's call in 2005 to merge several ongoing Canadian and Mexican initiatives with the United States on border security into the Security and Prosperity Partnership (SPP). Some of the trilateral discussion produced tangible results in 2006, such as on reducing the costly administration of rules of origin on products not fully produced inside NAFTA and on emergency plans to deal with epidemic outbreaks. Some of the credit goes to Harper for his 2006 proposal that an advisory panel of business groups from the three countries be set up to help prioritize the agenda for the talks. However, the output of SPP began to shrink in 2007 and virtually dried up by 2008. Problems with the lack of safety standards in several goods imported from China and ongoing unilateral action by the United States on the Canada-US border, including a new agricultural inspection fee and new secure identity standards, troubled the political waters. Given the high cost of the border and the need for more product standards, infrastructure, and transportation compatibility, as mentioned in the previous section, engaging the new US administration on this issue is among the top Canadian policy interests.

Getting the attention of the new American president in early 2009 amidst all the challenges the US faces will be very difficult for any Canadian prime minister. Moreover, Obama depends on the support of labor and environmental lobbies in his party, entities that are most skeptical about free trade talks. At the same time, Democrats in Congress are increasingly blocking votes on free trade accords.

## The challenge of Canadian public opinion

Despite the recent positive trends in Canada-US relations, the Canadian public holds a relatively skeptical view of relations with the United States. Many Canadians view Harper as being too close to US policy demands. About 60% of Canadians believe that the Canadian government gives the United States whatever it wants (Ipsos Reid, 2002). In March 2008, Bob Rae, the Liberal Party's foreign affairs critic and one of the frontrunners for the upcoming leadership convention, referred to Harper's Conservatives as a "Republican farm team in Canada" in an attempt to stoke negative public opinion of Canada-US relations by drawing parallels to an unpopular Republican brand (Delacourt, 2008, March 8).

Reflecting better knowledge of our trade interdependence, opinions in the business world are more positive about the relationship than are those of the general public. In May 2008, a survey in Canada reported that 60% of manufacturing CEOs felt that enhanced relations with the United States would provide better access to the large US market. An additional 26% of individuals surveyed thought that the government should work to improve relations with the Untied States as a key strategy to industry growth (Compas Inc., 2008).

Heading into the 2008 US elections, 47% of Canadians said they would prefer a Democrat as president, while only 12% said they would prefer a Republican. In terms of the candidates themselves, 43% of Canadians preferred Barack Obama as opposed to 12% who favored John McCain (CE Net, 2007, Jan. 11; Angus-Reid Global Monitor, 2008, May 28).

About 60% of Canadian CEOs felt that McCain would be the best choice for security and defense, while they were relatively undecided as to who would be best at furthering bilateral relations (Obama and McCain each received 23% support) (Compas Inc., 2008).

## Conclusion

Canada's stake in the new American administration is very high. The trade and investment ties to the United States remain Canada's economic engine. However, the manufacturing sector is under a great deal of stress and needs an overhaul. To make matters worse, carbon emission reduction measures threaten growth in the oil industry, which is becoming Canada's largest exports earner.

The political relationship between Canada and the United States has been well tended since 2006 and Canada's efforts to stabilize Kandahar Province in Afghanistan have made Canada a crucial member of NATO's International Security Assistance Force (ISAF). This has been well received in Washington by both political parties. Canada's positive standing offers growing goodwill for a bilateral forum on border and trade integration issues. However, Canada is on record to withdraw its troops from combat activity in Afghanistan in 2011. Given that Obama has indicated a strong preference for escalating military activities in Afghanistan and that the United States already has few fighting allies in that area, Canada's plans will certainly raise his attention and lead to counter-pressure.

Meanwhile, the Canadian public remains quite leery of working with the United States and it remains to be seen if it will change its view under an Obama administration. Canadians are almost evenly split on the operations in Afghanistan and showed little support for the Security and Prosperity Partnership initiative to deepen trade relations. Any Canadian government faces a tough political challenge in explaining why it is in Canada's vital national interest to move towards closer trade integration and border efficiency with the United States, as well as to bring the integrated energy markets even closer, even though the economic logic is clear.

We now turn to the issues and prospects in the 2008 American election and how Obama's victory directly impacts on these Canadian interests.

# Part 3: A comparison of the two candidates

## The dynamic of the 2008 election campaign

The Democratic Party's establishment clearly went into the primary campaign with a preferred candidate in the person of Senator Hillary Clinton. After her presumably inevitable nomination, the plan was to divide and conquer the disparate Republican ranks by splitting off enough people unhappy with Bush's fiscal and defense policies, leaving the Grand Old Party (GOP) with its social-conservative core.

Barack Obama's victory in the Democratic primaries complicated the Democratic Party's plan to appeal to disenchanted Republicans, as well as independents, because Obama won on his own charisma and eloquence and because his policies are more traditionally liberal in terms of spending and government program expansion than Hillary Clinton's policies. Neither fiscally conservative Republicans nor Reagan Democrats were impressed with such redistribution policies.

Obama's relatively low polling numbers (mid to high 40% range) until the financial crisis in September and McCain's surprisingly high numbers before the Republican Convention in August (low to mid 40% range) are explained by the fact that many of the fiscal Republicans have not left the GOP ticket. At the same time, some Reagan Democrats and independents swung over to McCain.

Choosing Alaska Governor Sarah Palin as the vice-presidential candidate gave McCain a short-term boost, turning the contest with Obama into a virtual tie in early September.

Using his well-established trademark as a maverick and a non-establishment Republican, McCain offered voters an opportunity to cast a vote against the Bush administration without having to vote Democrat. Voters who clung tenaciously to Hillary Clinton until the convention moved to the McCain side initially.

However, in late September, the race changed dramatically. The credit crisis and the resulting market meltdown, combined with an increasing pace of government buyouts and loan guarantees, shook the American public and eventually most of the world. During the financial crisis and the negotiations on the $700 billion bailout package passed by Congress on October 3, Obama steadily gained support. By mid-October, Obama's gains in the national polls boosted him to 50%. He also developed leads in most of the six key battleground states (Real Clear Politics, 2008).

Counting all national elections since World War II, the chance of either party winning a third victory in a row (as McCain was attempting) is only 20% (Cook, 2008, Sept. 9). Also, McCain's main economic policies, such as lowering corporate taxes and introducing individual health accounts, are essentially market-based solutions which are usually a more difficult sell during elections than the promise of government handouts (Feldstein and Taylor, 2008, Sept. 2).

By mid-October, the election campaign took on a predictable quality: as economic turmoil increased, the voters turned harshly against the incumbent Republicans. Obama had two additional advantages. Most polling was based on voter registration records that did not yet reflect the large number of young voters signed up by his camp. The Obama campaign also had an enormous financial advantage, having amassed nearly triple the $85 million of public financing that McCain received. Obama also had better local, on-the-ground organization to capitalize on higher voter turnout. Finally, Congress appeared set to elect bigger Democratic majorities. A nine-seat win in the Senate would have given Democrats 60 senators and the ability to stop Republican filibusters, thus enhancing the Democratic influence on whatever policies emanate from the next resident of the White House.

## Bush's economic legacy and the current economic climate

The 2008 American election was defined early on by how Republicans, particularly President George W. Bush, have fared in governing the United States during the last eight years. Even though Democrats have controlled Congress in the last two years, Republicans dominated the House of Representatives from 1995 to 2006, held the Senate for all but one year in that period, and occupied the White House for the last two presidential terms.

The two presidential candidates found themselves in one of the most challenging economic environments in recent memory. Real GDP growth was 0.9% in the first quarter of 2008 and 2.8% in the second. It is now predicted to be as low as 0.5% for 2008, which implies negative growth in the last two quarters. Given the financial crisis that burst into the open in September and October, the overall 2008 number is likely to fall even lower. In the last few years, steady declines in the manufacturing sector have resulted in a growing unemployment rate. The nearly doubling of world oil prices from an average of US$64 per barrel of crude in 2007 to US$116 in 2008 (as of September) has added to the inflation rate and dampened consumer demand (EIA, 2008b). By October, the crude oil price fell back to $70.

The current economic crisis is taking place in a setting where the total federal debt is already at very high levels and where unfunded liabilities in the major programs such as Social Security and Medicare/Medicaid point to a huge debt challenge in the future, with Social Security going into deficit as early as 2017 (US-GAO, 2008: 9). By 2030, Medicare, Medicaid, and Social Security spending is set to double to a staggering 15% of GDP (US-GAO, 2008: 23).

Given the 9/11 tragedy and the resultant spending on defense and national security, as well as large amounts of domestic spending, including two richly subsidized farm bills and a new Medicare Part D program for seniors, US government spending has risen by 27.9% on an inflation-adjusted basis during the George W. Bush administration, resulting in large fiscal

***Table 3: Cross-administration economic comparison, 1981–2008***

| Economic indicator | Reagan administration | Clinton administration | Bush administration |
|---|---|---|---|
| Economic growth (total percent change, real GDP) | 31.9% | 33.8% | 17.5% |
| Economic growth (annual percent change, real GDP) | 4.0% | 4.2% | 2.2% |
| Growth in GDP per capita (total percent change) | 22.6% | 21.7% | 9.6% |
| Total disposable income (total percent change) | N/A | 69.88% | 76.64% |
| Average percent increase in health spending | 11.4% | 5.5% | 8.6% |
| Unemployment (percent change) | -31% (7.6% to5.2%) | - 47% (7.4% to3.9%) | +18% (3.9% to 4.6%) |
| Net debt (percent of GDP at end of admin.) | 44.5% | 36.6% | 47.9% |
| Private investment (percent of GDP end of admin.) | 19.5% | 20.7% | 17.3% |
| Human Development Index value (world rank) | N/A | 3rd | 12th |
| Inflation (average annual percent) | 4.67% | 2.64% | 2.73% |
| Average mandated spending (billions of US$) | $381.2 | $804.5 | $1,208.3 |
| Average discretionary spending (billions of US$) | $391.1 | $555.5 | $875.9 |
| Annual average defense spending (billions of US$) | $242.9 | $278.3 | $439.5 |

Sources: US Census Bureau, 2008; IMF, 2008; FFC, 2008; OECD, 2008; UN, 2008a, 2008b.

imbalances and with net government debt growing to an estimated 47.9% of GDP. As table 3 shows, the George W. Bush administration has performed poorly in terms of economic and fiscal indicators as compared to the Clinton and Reagan years.

Excessive spending over the last seven years has put the US government in a much weaker position and is dampening confidence in the American market. The most important issue for the new administration will be how to curb spending.

Both candidates pledged to set up a cap-and-trade system in carbon emissions, with McCain's plans slightly less ambitious than Obama's. The cost of both of these plans is estimated at $56.5 billion per year (NTUF, 2008). While the current economic climate may postpone such carbon schemes, the political momentum for such measures is growing, as witnessed in the Lieberman-Warner Senate resolution that failed in spring 2008. Obama is the most adamant on reducing carbon emissions. One of his aides has even speculated that under an Obama administration, the Environmental Protection Agency may classify carbon as a pollutant, imposing taxes and regulations if Congress does not make progress on setting a cap-and-trade reduction plan in action (*Wall Street Journal*, 2008, Oct. 20).

Tables 4 through 10 provide the main policy contrasts between McCain and Obama and include a specific monetary promise and cost on items where available.

# Candidate comparison on the main issues

## *Table 4: Taxation*

| John McCain | Barack Obama |
|---|---|
| Make permanent the 2001 and 2003 Bush personal income tax cuts expiring in 2010. | Make permanent 2001 and 2003 personal income tax cuts for people making less that $250,000 a year ($200,000 if unmarried). |
| Double the personal exemption for dependents from $3,500 to $7,000. | Increase the top marginal tax rate from 35% to 39.5%. |
| Gradually decrease corporate tax rate from 35% to 25%, reducing the combined marginal corporate tax rate from 49.1% to 39.1%. | Add 12.4% Social Security tax for incomes in excess of $250,000. |
| Cut capital gains taxes in half for two years from 15% to 7.5%. | Eliminate income taxes for seniors making less than $50,000. |
| Eliminate taxes on unemployment benefits for people looking for work with under $100,000 in annual income. | Raise the federal corporate tax rate from 35% to 39.6%. |
| Increase the exemption amount to $5 million on estate taxes and lower the rate to 15%. | Raise capital gains and dividend rates from 15% to 28%, and deduction phase-outs of 1.2%. |
| Reduce the tax rate on IRA and 401(k) withdrawals for seniors, making the first $50,000 taxed at only 10%. | Enact windfall profits tax on oil companies. |
| Repeal the 54-cents-per-gallon tax on imported sugar-based ethanol. | Grant $500 credit for people paying Social Security. |
| Increase depreciation rate and R&D tax credit. | Add Making Work Pay Tax Credit of $500 per worker ($1,000 per couple). |
| | Add American Opportunity Tax Credit of $4,000. |
| | Add Mortgage Interest Tax Credit of 10% of interest paid. |
| | Add Health Care Tax Credits of 50% refund on premiums paid by employers. |
| | *Existing tax credits made refundable:* |
| | • The Savers Credit on 50% of the first $1,000 of savings under $75,000. |
| | • The Child and Dependent Care Tax Credit on 50% of the first $6,000 in child-care expenses. |
| | • Earned Income Tax Credit (already refundable) would be expanded to increase the number of working parents eligible. |

Source: McCain-Palin, 2008; Obama-Biden, 2008

### Table 5: Economic policy

| John McCain | Barack Obama |
|---|---|
| Install PAY-GO system of budgeting by which existing programs must be cut before new spending is approved.<br><br>Create a HOME plan to assist sub-prime and other mortgage borrowers at a cost of $337 million annually.<br><br>Create a mortgage abuse task force at a cost of $2 million annually.<br><br>Create a Katrina recovery infrastructure plan at a cost of $1.6 billion annually.<br><br>Create a national commission on workplace flexibility at a cost of $2 million annually.<br><br>Provide $3.5 billion annually in unemployment compensation for older workers. | Provide $1,000 emergency energy rebate stimulus at an estimated cost of $60–$65 billion.<br><br>Create a $25 billion state industry growth fund and a $25 billion job growth fund.<br><br>Invest $60 billion over 10 years to create a National Infrastructure Reinvestment Bank.<br><br>Create an advanced manufacturing fund with annual cost of $100 million.<br><br>Create a $40 million annual public-private partnership program.<br><br>Add $2 million to commodity futures markets.<br><br>Create a $10 million annual credit card rating system.<br><br>Create a $10 billion foreclosure prevention fund.<br><br>Provide a $6.5 billion annual increase in unemployment benefits. |
| **Total annual spending increase: $5.441 billion** | **Total annual spending increase: $57.275 billion** |

Source: NTUF, 2008

### Table 6: Economic relief plan as of October 22, 2008

| John McCain | Barack Obama |
|---|---|
| Reduce the tax rate on IRA and 401(k) withdrawals for seniors making the first $50,000 taxed at only 10% (estimated cost = $36 billion).<br><br>Cut capital gains taxes in half for two years from 15% to 7.5% (estimated cost = $10 billion).<br><br>Eliminate taxes on unemployment benefits for people looking for work with under $100,000 in income for the year (estimated cost = $6.5 billion).<br><br>Provide $300 billion in homeowners assistance (to be funded out of $700 billion bailout package). | Enact a $60 billion economic rescue plan for the middle class to be divided among the following provisions:<br><br>Offer a $3,000 tax credit to firms for each new full-time job hire.<br><br>Add a 90-day moratorium of housing foreclosures for homeowners making "good faith" efforts to keep up payments.<br><br>Temporarily eliminate taxes on unemployment benefits.<br><br>Create a new body to provide state and city governments with liquidity during credit contraction.<br><br>Create penalty-free withdrawals of up to $10,000 of registered savings plans. |
| **Total annual increase in spending: $52.5 billion** | **Total annual increase in spending: $60 billion** |

Source: Shear, 2008, Oct. 14; BBC News, 2008

### Table 7: Trade policy stance

| John McCain | Barack Obama |
|---|---|
| Plans to honor all existing trade agreements and complete new bilateral agreements with Columbia and South Korea.<br><br>Believes the US should engage in multilateral, regional, and bilateral efforts to reduce barriers to trade, level the global playing field, and build effective enforcement of global trading rules.<br><br>Plans to decrease farm subsides by $169 million annually. | Vows to renegotiate and amend NAFTA to the advantage of the United States.<br><br>Resistant to engage in trade negotiations unless a set of labor and environmental criteria is satisfied.<br><br>Provides a tax credit to companies that maintain or increase the number of full-time workers in the US.<br><br>Removes tax incentives for companies whose ventures provide work abroad. |

Source: McCain-Palin, 2008; Obama-Biden, 2008

### Table 8: Energy and environment

| John McCain | Barack Obama |
|---|---|
| Construct 45 new nuclear power plants by 2030 (unknown subsidy or incentive costs).<br><br>Create a $56.5 billion (annual cost) cap-and-trade system to reduce emissions by 66% by 2050.<br><br>Commit $2 billion annually to advancing clean coal.<br><br>Allow lower emissions car purchases to qualify for tax credits of unspecified amounts.<br><br>Gain access to the estimated 18 billion barrels of crude oil and 77 trillion cubic feet of natural gas in the Outer Continental Shelf (OCS). | Invest $150 billion over 10 years into future clean energy programs, which includes putting one million plug-in hybrid cars on the road by 2015 and a $7,000 tax credit for purchasing advanced vehicles.<br><br>Create a $56.5 billion (annual cost) cap-and-trade system to reduce emissions by 80% by 2050.<br><br>Ensure 10% of electricity comes from renewable sources by 2012, and 25% by 2025. |

Source: McCain-Palin, 2008; Obama-Biden, 2008; NTUF, 2008

There was a significant difference between the two candidates on tax policy. McCain proposed adding a variety of tax cuts, including cuts on corporate income and capital gains, as well as several targeted tax breaks to stimulate economic activity. Obama, on the other hand, is calling for tax increases on upper income earners, capital gains, and corporations. These tax hikes are accompanied by five new, refundable tax credits aimed at the lowest tax brackets and, in many instances, will actually be payments to people who pay no tax at all. In essence, Obama's policy, as promised in the campaign, amounts to an assertive redistribution of income.

Estimating the revenue impact of tax cuts is complicated since tax cuts do not necessarily lead to losses in revenue. For example, capital gains revenues more than doubled after the 2003 cuts, going from $50 billion in 2003 to $103

### *Table 9: Homeland and border security and law enforcement*

| John McCain | Barack Obama |
| --- | --- |
| Invest $1.5 billion in border security.<br><br>Invest $2 million in the Interagency Task Force on Human Trafficking. | Invest $9.8 billion in border security and immigration reform.<br><br>Invest $12 million in catastrophic emergency management.<br><br>Invest $176 million in child support payments enforcement.<br><br>Invest $330 million in community policing services.<br><br>Invest $30 million in cyber crime prevention.<br><br>Invest $120 million in disaster planning.<br><br>Invest $77 million in re-entry and prison-to-work programs. |
| **Total annual increase in spending: $1.5 billion** | **Total annual increase in spending: $9.8 billion** |

Source: NTUF, 2008

### *Table 10: National defense and foreign aid*

| John McCain | Barack Obama |
| --- | --- |
| Commit $3.6 billion to US brigades in Afghanistan.<br><br>Put $15 billion into the Armed Forces.<br><br>Put $45 million into multinational nuclear enrichment centers.<br><br>Put $1.9 billion into theater and national missile defense systems. | Provide $2.8 billion in non-military aid to Afghanistan and Iraq.<br><br>Put $6.6 billion annually into Armed Forces.<br><br>Invest $1 billion annually in international nuclear security.<br><br>Issue $5 billion annually in foreign aid.<br><br>Begin reducing troop numbers in Iraq and Afghanistan, reducing costs by $91 billion annually.<br><br>Put $1.67 billion into improving co-operation between US and foreign intelligence and law enforcement agencies. |
| **Total annual increase in spending: $22.5 billion** | **Total annual increase in spending before troop withdrawal from Iraq: $17 billion.**<br><br>**Decrease in annual spending after troop withdrawal from Iraq: $73 billion.** |

Source: NTUF, 2008

billion in 2007 after rates were cut from 20% and 10% to 15% and 5%, depending on income (CBO, 2008). Thus, Obama's plan to raise such taxes from their current level will have a negative impact on the federal budget. Also, the 2003 corporate tax cuts were followed by a 180% increase in corporate tax revenue from 2003 to 2007 (CBO, 2008).

Obama's plan to increase the top-marginal federal personal income tax rate from 35% to 39.5% will have a large impact. Currently, the top 1% of income earners pays nearly 37% of federal income tax, while the lowest 20% of income earners pays less than 1% of all federal income taxes (Biggs and Smetters, 2008, Oct. 7). Because Obama's new tax credits are refundable, many people who do not pay taxes at all will still receive government payouts.

While Obama's income tax plans are set to raise more government revenue, the total cost estimate for all his tax credits is $80 billion annually (Williams and Gleckman, 2008). At the same time, annual spending for Obama's economic policy plan is estimated at $57.3 billion—far larger than McCain's $5.4 billion in new annual spending. Also, Obama's most recent economic relief plans costing $60 billion per year are slightly more expensive than McCain's would hav been. Surprisingly to Canadians, Obama also plans to spend more on homeland security—and nearly six times more on border security—than McCain. Obama's defense spending plans, at $17 billion, are slightly below McCain's would have been, at $23 billion; however, Obama promises annual decreases in defense spending of $73 billion as troops return from Iraq.

Obama's promise to raise US corporate tax rates, which are already among the highest in the Organisation for Economic Co-operation and Development (OECD), does not bode well for long-term investment. He has added several tax breaks for companies keeping businesses in the United States and reducing emissions to offset this tax (Obama-Biden, 2008). Obama's windfall tax on oil companies is devoid of any economic logic. For example, when looking at Exxon Mobil Corporation—the biggest oil company in the United States and the world—its net income as a share of total revenue has remained fairly constant at about 10% since 2003, which is close to the average for the industry and well below many other sectors, such as computers (14%) and electronics and appliances (14.5%) (*Wall Street Journal*, 2008, Aug. 4). Moreover, taxing "windfall" profits risks investment in new oil exploration (Exxon Mobile, 2008).

Both McCain and Obama agreed on one element of energy policy: the cap-and-trade system of reducing carbon emissions estimated to cost some $56.5 billion. Obama's renewable energy plans of bringing solar and wind up to 10% of total electricity production by 2012 face a tremendous challenge. As a share of total energy generation, solar and wind energy accounted for only 1.5% in 2007, up from 1.2% in 2006 despite a 30% increase in global investment to US$71 billion (BP, 2008).

Entitlement reforms are necessary as Social Security, Medicaid, and Medicare spending is set to rise from about 8% of GDP in 2007 to 20% of GDP by 2050 (US-GAO, 2008: 23). McCain proposed to tackle this important problem by redirecting employer-paid taxable benefits to individual tax credits. Such individual health accounts would increase competition and lower the cost of health care. Obama proposes to increase the tax ceiling on Social Security which, combined with his personal income tax increases, would put the marginal tax rate over 50% for higher income earners. On health care, Obama's plans would increase the federal share of spending as he offers a federal subsidy to provide insurance to the currently uninsured.

# Part 4: Canada and Obama— Conclusions on Canadian-American relations impact

Given America's triple deficits (government budget, trade, and entitlement programs), the incoming Obama administration cannot spend the United States out of its current economic turmoil without seriously impacting global investment and consumer confidence in the long-term economic outlook of the United States.

Fiscal discipline will be the cornerstone of a return to economic confidence, but Obama's spending plans are pointing in the opposite direction. To the extent that the American economy continues to decline, demand for Canadian products will fall, and that economic weakening will constitute the biggest impact on Canadian-American relations.

Canadian crude oil exports, which are largely bitumen and upgraded synthetic crude valued at $41 billion in 2007, are not easily diverted to other markets, even with high oil prices. Therefore, any US measure to impose a carbon cap-and-trade system will result in a direct loss in Canadian export earnings as US industry will demand protectionist measures. The cap-and-trade scheme proposed by Obama would require Canadian participation not because it is good public policy but simply to minimize the costs Canadian producers and exporters would incur. If the Obama administration and Congress were to introduce a carbon cap-and-trade scheme, American energy producers as well as manufacturers would most likely press for import levies or other protectionist measures *vis à vis* Canadian imports. Thus the Canadian economy would suffer directly from American carbon measures. Even if the Canadian federal government or provincial governments were to introduce carbon emission reductions, Canada would still risk American countermeasures. Only if the American system was adopted in Canada, leaving no regulatory differences between the two markets at all, would protectionist voices in the United States lose the opportunity to penalize Canadian imports. It is only for this reason that Canada should join an American cap-and-trade system, namely to minimize its losses. Obama has been most outspoken on the issue of so-called "dirty oil," which is a highly debatable term when compared to oil exploration in other areas of the world or when accounting for the growing and cleaner method of oil sands exploration known as "steam-assisted gravity drainage."

If and when the American and Canadian manufacturing sectors rebound, Canadian industry would again benefit from a closely integrated supply chain and production process in order to reach the economies of scale to be competitive in a global market. The North American Free Trade Agreement (NAFTA) and the free-trade-friendly approach by McCain would certainly have been a plus for Canadian interests. Obama, on the other hand, faces political pressure from his core base, including labor unions and environmental activists, to pursue protectionist measures. The implication is that product standards compatibility and regulatory convergence begun in the Security and Prosperity Partnership (SPP) talks will have far less chance of progress under an Obama administration.

There is no indication that Obama will change the American approach to border security or the so-called "thickening" of the US border. Indeed, Obama's more ambitious spending plans for border security do not augur well for "thinning" the border of complex paperwork, congestion, and new security measures. A more efficient border-crossing system will require more Canadian security measures on the flow of people coming into Canada as Democrats are no less concerned about this perceived threat than Republicans. Thus, Canada faces difficult trade-offs and very tough negotiations to speed up border flows.

On defense and energy policy, Obama exhibits less awareness and a smaller stock of goodwill on Canada's important role in Afghanistan and on Canada's energy role in North America. Unlike McCain and Palin, who both made good relations with Canada a stated part of their platform, Canada has not featured in the Obama campaign except in the flap over a Canadian memo leaked to the press in which an aide to Obama indicated that Obama was less critical of NAFTA than his campaign rhetoric would suggest.

Canadians have expressed their preference for Barack Obama as president based on ideological factors. However, they need to realize that, on all the key economic and bilateral issues between our countries, including trade, energy, border management, and defense, an Obama administration would not enhance Canada's immediate interests. President Obama will be in a difficult political position to negotiate deepening trade relations such as product standard compatibility and regulatory convergence given the positions of labor and environmental lobbies. He does not appear open to lessening border restrictions and has been most critical of Canadian bitumen production. To the extent that Obama would deal with the current economic crisis by adding even more to US government debt, the outlook for long-term economic growth and stability will be weakened, directly affecting the future of Canadian exports.

Despite the challenge of getting Canada on the US agenda under Barack Obama and getting Canadian interests acknowledged, Prime Minister Stephen Harper would be well advised to meet early with the new president and put in maximum effort to build a personal relationship of trust and respect. This effort should include the following points:

- The Security and Prosperity Partnership (SPP) appears to have run out of steam and, as a result, Harper should take the opportunity to renew efforts to open bilateral discussions on trade and border issues. Canadian steps toward more border staffing and deeper co-operation on homeland security, as well as joint projects on accelerated infrastructure (bridges and roads), should be a start.
- The decision to withdraw Canadian Forces from combat operations in Afghanistan in 2011 should be reconsidered by the Canadian Parliament. Canada should signal a strong willingness to find a common strategy with the Obama administration on how to achieve long-term security and stability in that country using both military power and diplomacy.
- An agreement to proceed with a common Canadian-American approach to carbon emissions rather than separate policies should be negotiated before the Obama administration and Congress agree on any such measure. While a cap-and-trade system to reduce carbon emissions is not good policy for either nation, the worst case scenario would unfold if the United States proceeded with such a system and Canadian energy and manufacturing products would be faced with a levy or tariff, possibly pricing them out of the US market and, at the minimum, reducing Canadian export earnings. Such an accord must give special protection to the oil sands industry to give it time to adopt more steam-assisted gravity drainage, the use of nuclear power to generate steam, and carbon sequestering.

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