



# Canadian-American Relations in 2007

## Recent Trouble, Current Hope, and Future Work

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## Executive summary

The state of the relationship between Canada and the United States in 2007 is in transition. A recent period of chilled political relations, highly publicized trade disputes, and lack of substantial progress in defence relations is coming to an end. Political changes in 2006 in both Canada and the United States have created conditions for more cooperation in trade, security and defence policies.

Rather than continuing to negotiate on a piecemeal basis, this report recommends that the government of Canada pursue two comprehensive agreements with the United States, one on security measures and the management of the shared border, and another on creating integrated defence structures in land, sea, and missile defence, modeled on the existing arrangement in air defence.

Divergence in security and defence policies between Canada and the United States began in the late 1990s. It was complicated by aloofness and non-cooperation at the highest political levels from 2001 onward. As a result

- ⌘ trade and regulatory disputes such as those about softwood lumber and BSE became political “footballs,” eroding Canadian attitudes towards the United States
- ⌘ timely and optimal solutions for reforming the security and defence structures after the attacks of September 11, 2001 were stalled
- ⌘ the US Congress took action on border and security measures without significant Canadian influence (via a close presidential relationship).

Meanwhile, Canadian prosperity remained highly dependent on bilateral trade, which showed a rebound in 2004 and 2005 after a few years of decline. At the same time, the United States added security measures to existing border controls, raising the cost of cross-border trade.

### ***Recent changes in domestic and bilateral dynamics***

The following political changes in Canada and the United States in 2006 have created conditions for reviving the bilateral relationship.

- ⌘ The newly elected Canadian government under Stephen Harper replaced the acrimonious tone with constructive engagement. Harper completed a deal about softwood lumber, raised defence spending, and committed Canadian Forces till 2009 in the fight against insurgents in Afghanistan.

- ⌘ The newly elected Democratic majority in Congress ended President Bush's domestic agenda and, in conjunction with the 2008 race for the White House, put the withdrawal of American troops from Iraq as its priority.
- ⌘ A solid majority of Americans converged against Bush's Iraq policy, further eroding Bush's political capital.

Given the goodwill in Ottawa and the need for the Bush administration to score success in a foreign arena outside of Iraq, a window of opportunity has opened for a new deal with Canada.

***Recommendations for reviving the relationship***

First, Canada should continue to seek more harmonization in policy areas such as in energy where a high-degree of market integration exists. Second, Canada should remove the root causes of long-standing disputes like those about softwood lumber and BSE by moving towards more private tenure and private ownership in forest lands and a single regulatory area for specialized markets such as cattle and beef. Finally, Canada should try to move away from ad-hoc and piecemeal measures in border security and defence and engage the Bush administration on two new treaties:

- ⌘ a secure border treaty, including a customs union, a comprehensive border management strategy with maximum binational features, common security criteria for the flow of people in and out of North America, and enhanced labour mobility;
- ⌘ a binational defence treaty that builds upon the NORAD model, including space, land, and maritime structures.

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## The Problem

Canada and the United States have been “ambivalent allies” for most of their shared history [Thompson and Randall, 2002]. Typically, there have been periods of close and constructive cooperation such as those under Louis St. Laurent and Dwight Eisenhower or Brian Mulroney and Ronald Reagan and George H.W. Bush amidst longer periods of drifting apart like those while John Diefenbaker and Pierre Trudeau were in power. The growing distance between Canadian and American defence, security, and foreign policy in *recent* years began in the mid-1990s when Canada aligned its international objectives with soft, Western European, security goals and disconnected them from American diplomatic and security interests. The benign neglect given to Canadian foreign policy by the Clinton Administration kept the tension from spilling into the open. During the period from 2001 to 2005, however, while Canada was under the stewardship of Jean Chrétien and Paul Martin, the lingering discord came into plain view and there was new friction at many levels: divergence on security and defence policies, several highly publicized trade disputes, and political aloofness at the highest level.

### Divergence in defence policy

Canada missed an opportunity shortly after 9/11 to expand the existing North American Aerospace Defence Agreement (NORAD) to include maritime and land defence when the US was forming Northern Command [Stancati, 2006]. Canada worsened the situation by delaying its decision and eventually refusing to take any responsibility for cost-free participation in ballistic missile defence. A lack of Canadian defence investment and an unwillingness to commit to a reformed defence regime after 9/11 caused the United States to act more on its own than it might otherwise have done in reorganizing its North American defence structures.

It appears that negotiations for enhanced military cooperation in the so-called binational planning group, which began its work in 2003, did not have enough political support on either side of the border. By this time, the reorganization in the United States was well underway. Moreover, Canada’s negative decision on ballistic missile defence diminished the importance of NORAD to the United States [Jockel and Sokolsky, 2006]. The newly elected government of Stephen Harper was only able to add a modest maritime function before the NORAD renewal deadline in early 2006. In sum, Canada and the United States today have less effective binational cooperation for the new security threats facing North America.

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## Trade disputes: BSE and softwood lumber

Two disputes turned into prolonged bilateral irritants with a high public profile in Canada: trade in cattle and beef, and softwood lumber. The border closure as a result of Bovine Spongiform Encephalopathy (BSE) in 2003 dealt a severe blow to Canada's cattle and beef industry. The loss in exports is estimated at nearly \$6 billion for the period from 2003 to 2005 [Moens, 2006: 43]. The US Department of Agriculture (USDA) actually tried to resolve this interruption in trade expeditiously. It restored trade in most beef products within months. Using internationally agreed-upon procedures, it designated Canada a "minimal risk region" and planned to open the border to trade in live cattle under the age of 30 months by January 2004. However, spurred by a case of BSE found in an American cow that had been imported from Canada and the subsequent collapse of beef exports from the United States, a US lobby called R-CALF successfully challenged the US government in court to halt implementation of the minimal-risk-region status until the summer of 2005. The very public criticism by various Canadian officials that the American government did not proceed quickly enough worsened political relations, as the US government could not simply bypass a court order.

Canada and the United States failed to renew the 1996 Softwood Lumber Accord in 2001 or to negotiate a new, managed-trade deal. There was an expectation on the Canadian side that the NAFTA/WTO framework would now be robust enough to deal with US trade action in lumber. Unlike the BSE dispute, where the US administration was restrained by a court order, protectionist forces within the US system seemed to have a free hand in challenging every NAFTA ruling from 2001 onward. This dispute was very costly to both Canadian producers and American consumers. Total levies paid to the US government with interest amounted to \$5.3 billion. The US National Association of Home Builders estimated in 2002 that the cost of the US tariffs on Canadian lumber added \$1000 to every new home built [Heavens, 2002].

## Political aloofness

Hovering over the disagreements in defence and trade was a cool and distant political atmosphere at the top. Most damaging of all was the public dispute between Canada and the United States over Iraq. Canada missed an opportunity to decline participation in the war—as several allies did—*without* registering vocal international opposition to an act that the United States considered to be part of its vital national security. What ensued was a climate of mutual suspicion and limited cooperation.

In dealing with both the terrorist threat and the flow of illegal migration from Mexico, the Republican-controlled Congress focused on border security with

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insufficient regard for efficient trade flows between Canada and the United States. The White House did little to counter Congressional measures that had a negative impact on Canadian interests in border issues or in bilateral disputes such as softwood lumber, in part because there was no political capital invested by Canada in a close relationship. The Canadian side forgot the lesson learned in the 1980s: as then-Ambassador Allan Gotlieb put it, “[o]nly the White House has any clout in Congress, and this is why we have to keep on good terms with the presidency” [Gotlieb, 2006: 75]. Only when the president’s success is closely linked to working with Canada on issues of importance to him can a Canadian government expect some presidential effort in building coalitions in Congress on issues that affect Canada. For example, Lester Pearson’s pro-active role “in putting together a United Nations peacekeeping force for Cyprus, thus preventing a war between Greece and Turkey,” caused Lyndon Johnson to expedite the 1964 Auto Pact by using his considerable influence in Congress [Granatstein and Hillmer, 224–26].

## Political change in 2006

### Canada

The Canadian government under Stephen Harper that was elected in early 2006 has worked on three areas to improve political relations and remove the relative lack of substantial cooperation between Canada and the United States.

#### ***Restoring political relations at the highest level***

The new leadership in Ottawa understood and applied what former Ambassador Derek Burney described as follows: “When leaders get along well with one another, as Mulroney did with Reagan and Bush, they converse frankly and frequently. Their priorities become priorities for others. Their officials, to a great degree, take their cue from this rapport and act accordingly” [Burney, 2005: 187]. The top-level governmental relationship, including at the ministerial and ambassadorial level, improved markedly. As US Ambassador David Wilkins put it: “There’s now a feeling of shared responsibility as we tackle problems and more of a, ‘let’s fix the problem’ rather than trying to fix the blame. And that’s positive for both of us” [O’Neil, 2006].

#### ***Removing the softwood lumber dispute***

Even before he became Prime Minister, Harper sent signals that he would seek an immediate negotiated end to the softwood lumber dispute. Trade Minister David Emerson was recruited from the opposition bench to finalize this deal. The 2006 softwood-lumber agreement erased numerous WTO and NAFTA disputes and rebated 80% of the some \$5 billion in levies that Canada had paid since 2002. The deal again creates a temporary, *managed* trade relationship rather than *free* trade—as had all the softwood lumber agreements before it, including the option of a quota of maximum 34% share of the US market with a sliding scale of export tax, or a range of US market prices for lumber with a sliding scale of export tax. The agreement was by no means received warmly by the Canadian industry. Some felt that pursuing litigation in American courts would eventually lead to a Canadian victory. On the other hand, there were rumblings in Washington that such legal victories might unleash a movement in Congress to revisit NAFTA in its entirety. On the positive side, the agreement removes a highly polarized and public dispute between Canada and the United States and keeps export levies in the Canadian government’s coffers.

#### ***Investing in defence***

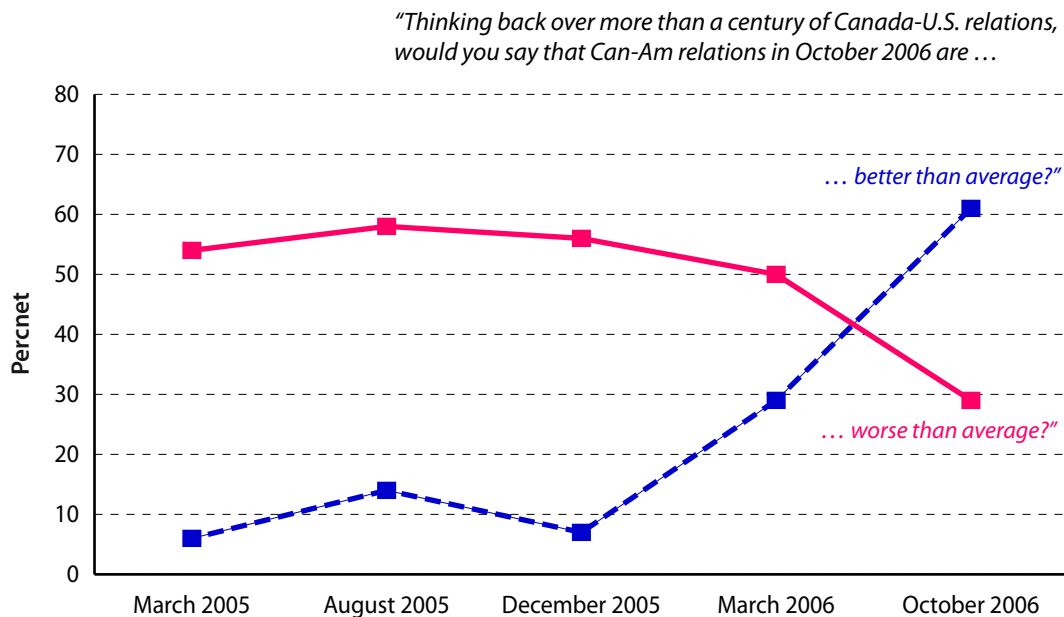
Stephen Harper’s government also took action in the area of defence. It added another \$5 billion to the already-scheduled increase in spending on defence, for a total of \$17.6 billion over five years, though most of this outlay is marked for the 2010/11 [MacDonald, 2006].

Secondly, it committed Canada to a leading role, including combat operations alongside American and NATO forces in the south of Afghanistan at least until 2009. Third, it began to order new equipment—some of it off the shelf to speed up delivery times—including C-17 strategic heavy-lift aircraft, Hercules tactical transport planes, Chinook helicopters, and logistics trucks [Stewart, 2007]. Finally, maritime warning (but not surveillance, control, or operations) were added to NORAD’s mandate in the NORAD renewal agreement of May 2006.

**A new climate**

The new tone in political relations, the quick resolution of the softwood dispute, and Canada’s substantial commitment to defence spending and the fight in Afghanistan registered in Washington as a new beginning in bilateral cooperation [Alberts, 2006]. The better political climate influenced the outlook of Canadian business people quickly. Five polls conducted by COMPAS Inc. since March of 2005 show that business leaders believed the relationship between Canada and the United States was improving dramatically as of early 2006. When asked to think back over more than a century of relations, only 7% of CEOs thought the relationship was better than average in March of 2005. However, by October 2006, 61% believed so [Compas Inc., 2005–2006] [figure 1].

**Figure 1: Survey of CEOs about the relationship between Canada and the United States**



Source: COMPAS Inc., 20045–2006.



The attitude of the Canadian public towards the United States has become increasingly negative since the late 1990s. The Pew Global Attitudes Project found that the number of Canadians expressing a favourable attitude towards the United States declined from 71% in 1999 to 63% in 2002 and 59% in 2005 [Pew Research Centre, 2005]. Several polls by Ipsos Reid showed that, while in 2002 60% of Canadians named the United States “Canada’s closest friend,” the number dropped to 53% in 2005. However, a modest recovery was found in 2006 with 58% of Canadians naming the United States as closest friend. Perhaps more indicative of the recovering trend is the finding that, in 2006, 65% of Canadians thought the relationship was “improving” or “staying the same” [Ipsos Reid, 2006].

## United States

### *The 110<sup>th</sup> Congress*

The first major change occurred in the mid-term elections in November 2006 when the Democratic Party gained control of both houses of Congress. Beating Republicans by 13% in the national popular vote, Democrats gained a 31-seat majority in the House of Representatives and a narrow (51-49) lead in the Senate.

### *New leadership and a new agenda*

The new Democratic leadership’s so-called “Six for ’06” legislative agenda for its first 100 hours included implementing more recommendations first raised in the “9/11 Commission Report” of 2004 [National Commission on Terrorist Acts upon the United States, 2004], raising the minimum wage, reducing the interest rate on some college loans, rolling back oil subsidies in order to boost alternative energy, broadening federal support for stem-cell research, and mandating the government to negotiate lower prices for pharmaceutical products in Medicare’s prescription drug program. The House passed these proposals in January 2007. They are modest in scope and tailored to scoring public-relations points and most will either be amended or voted down in the Senate and some are under threat of veto from the White House. Still, the new Democratic leadership proved two things. First, that it has the discipline and coherence to get things done and, second, that Republican solidarity is weak as scores of Republicans voted with the Democrats on most issues. The average number of Republicans voting with the Democratic majority on these six items was 62 [Bowman et al., 2007].

The substantive legislative agenda in the next two years will be dominated by four big issues, even though passing a final bill on any of these appears unlikely. The four issues are reform of Social Security, health care (including expanded health-care

coverage), a new immigration bill, and fiscal discipline that may include bringing back “pay-as-you-go” legislation that mandates spending cuts or tax increases before new bills can be approved.

#### *President Bush and the 110<sup>th</sup> Congress*

President Bush invested tremendous political capital to add private accounts to Social Security in 2005, traveling for months from one town hall meeting to the next. Yet, his domestic priority did not make it into legislation. Republicans were worried about the additional debt the government planned to incur in the process, especially in the wake of the costly prescription-drug benefit for seniors that Bush had persuaded Congress to pass in early 2003. At the same time, Democrats were adamantly opposed to any privatization [Moens, 2005]. In 2007, most Democrats and some Republicans want to address the future shortfall in Social-Security funds by raising the current ceiling on payroll taxes.

On health care, the Democrats and the White House are also far apart. Bush’s approach is to expand individuals’ health-savings accounts. Started in 2003, these accounts allow individual Americans to make tax-free savings for health-care needs provided they choose low-cost, high-deductible, coverage [MacKinnon and Solomon, 2007]. The White House agrees that taxing the hitherto tax-exempt employer-provided health-insurance benefits at the higher end could help offset tax credits for individual health-savings accounts. In effect, Bush’s proposal to cap employer-deductible health benefits is the first tax increase proposed during his administration.

While the White House sees eye to eye with many Democrats on declaring an amnesty for illegal aliens, a large bloc of Republican representatives in the House adamantly opposes the measure. Passing legislation on any of these key issues will be difficult given the evenly divided 110<sup>th</sup> Congress and the opposition between the new, centre-left, Democratic leadership on the Hill and a Republican president.

## **Iraq**

### ***The loss of public and political support***

Beginning in the summer of 2006, a solid trend emerged in which nearly two thirds of Americans are convinced that the war in Iraq is a lost cause. Bush’s approval rating is firmly tied to the American public’s disapproval of his handling of the war. And, the reaction to the change of strategy in Iraq (the so-called surge option) announced on January 10, 2007, as measured by a national poll that ABC conducted after the address, confirmed that the two thirds of Americans disapproving of the President’s handling of Iraq are not to be persuaded otherwise [ABC News, 2007]. Also, for the first time a majority of Americans (52% in mid-January) believe the United States should withdraw from Iraq [Langer, 2007].

### ***The threat of a fraying US-Shiite coalition***

What made the political efforts of the United States in Iraq possible in the first place after the 2003 removal of Saddam Hussein was the fact that the United States was on the side of the Shiite majority. Increasingly, Prime Minister Nouri al-Maliki appears to rely also on key Shiite militias. As the Iraqi government anticipates the withdrawal of American troops, it can be expected to depend even more on these forces for its survival. Bush's strategy of more boots on the ground and more embedded trainers will need to bring about a major reduction in violence in Baghdad by summer 2007 if it is to be considered successful.

### ***The waning power of the president***

But, this narrow definition of success has slipped out of Bush's reach even if the final outcome of the war in Iraq is still unknown. As long as daily mayhem dominates the news from Baghdad, American public opinion is not likely to shift. Jimmy Carter's presidential fortunes from 1979 onward were in the hands of the Iranian hostage takers in Tehran. Likewise, Bush's political capital is now at the mercy of the perpetrators of violence in Baghdad. Given the political trap Bush faces, we can expect increasing numbers of Republicans in both the House and Senate to vote with the Democratic Party to start cutting off funding or putting restrictive conditions on military operations and troop numbers. In mid-February, 17 Republican House Representatives voted in favour of the Democratic non-binding resolution disapproving of Bush's surge strategy in Iraq. At least 7 Republican senators were also ready to break away from the party line [Rogers, 2007]. In early March, the first binding resolution (*US Troop Readiness, Veteran's Health and Iraq Accountability Act*) to begin the withdrawal of American troops was introduced in the House as was a similar bill in the Senate [Tapper, 2007].

The final version of the \$124.2 billion spending bill passed the House by the narrowest margin possible: 218 to 208. While just two Republicans voted with the Democrats, the strength of the House leadership showed as only 13 of the 40-odd member "Out-of-Iraq Caucus" (who demand immediate withdrawal of US troops) voted against this compromise measure. At the core of the bill are benchmarks for the Iraqi government to reduce sectarian violence. If these are not met by July 1, US troop withdrawals will begin and wrap up by the end of 2007. Even if these benchmarks are met, the bill states that US troop withdrawals would commence in October and be completed by March 2008 [Weisman and Williamson, 2007].

Bush made good on his word that he would veto any bill that stipulated a schedule for troop withdrawal. Thus, negotiations started again in this prolonged game of chicken between the Congress and the White House, which may well drag out until the 2008 presidential elections. Though the president holds the power of override-proof vetoes for now, Congress ultimately holds the power of the purse. Democrats cannot afford to undermine the troops and are thus moving slowly towards a gradual squeeze

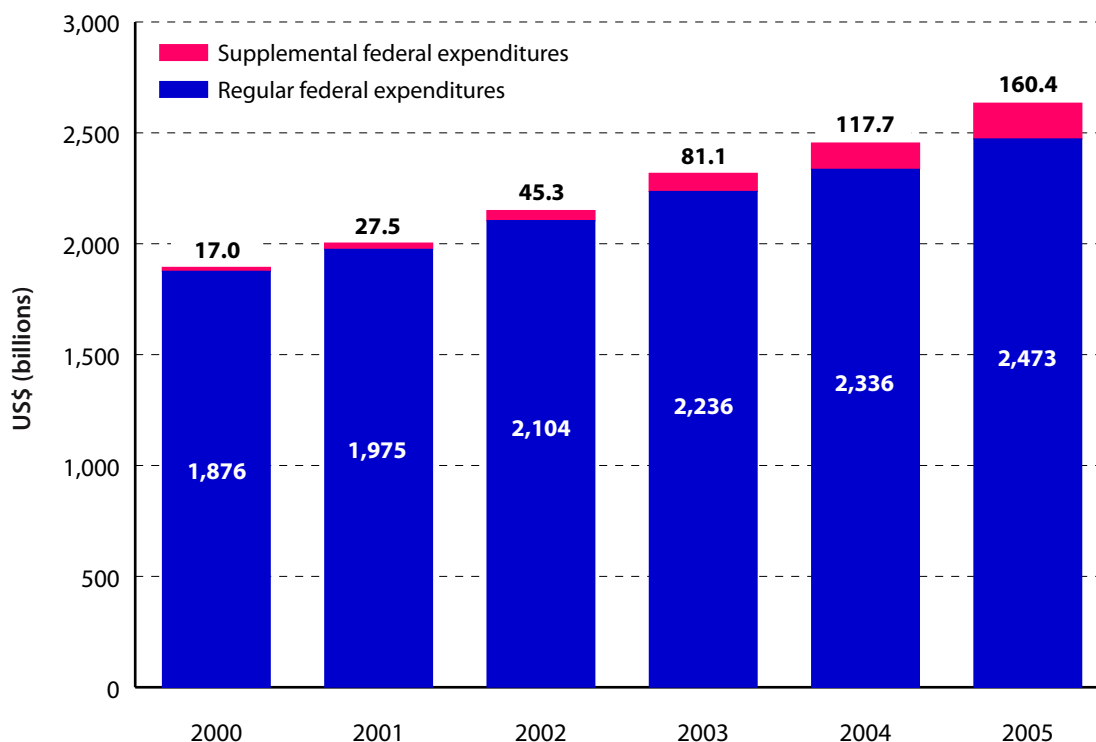
on Bush's policies in Iraq. As deadly bombings in Iraq continue, public opinion will likely become increasingly supportive of the Democrats' position. The latest bill passed the Senate with a small margin of 51 to 46 as two Republican senators voted with the Democrats and two abstained. However, many more feel the pressure as in 2008, 21 of the 35 Senators up for election are Republican incumbents. There is one caveat in this forecast of Bush's lost political capital: a major terrorist strike on the United States or a military conflict with Iran could cause a sudden rally behind the president.

## Implications for cooperation between Canada and the United States

### US economy

Federal expenditures in the United States, including supplementary spending in defence [figure 2] have grown significantly in the last five years under Republican majorities in both Houses. This development concerns Canada to the extent that a growing federal debt coupled with long-term concern about unfunded liabilities in Social Security, Medicare, and Medicaid would, in the words of Federal Reserve Chairman, Ben Bernanke, “have an effect on the vibrancy, efficiency, and growth rate of our economy” [Ip, 2007: 2]. Thus, if Democrats can achieve more fiscal discipline, including re-instating “pay-as-you-go” measures, this would have a positive impact on American economic growth and directly benefit trade between Canada and the United States.

Figure 2: Total federal expenditures (including supplementary expenditures), United States (2000–2005)



Note: Supplemental federal expenditures require that supplemental budget authority be enacted.

Source: Bureau of Economic Analysis, 2007; Congressional Budget Office, 2006.

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## Free trade

The trend inside the Democratic Party is away from free trade. While over 100 Democrats voted to ratify NAFTA in 1994, only 15 voted to confirm the US-Central America Free Trade Agreement (CAFTA) in 2005. The 2006 Congressional elections augmented the ranks of free-trade opponents in the Democratic Party. Sixteen of the newly elected Democrats in the House in 2006 and five of the new senators are known as “trade skeptics.” While most of this protest is a reaction to out-sourcing and primarily aimed at Asian and Latin American countries, Canada will find less support for free-trade solutions in the current Congress. If, for example, Canada should seek to add a customs union to the existing NAFTA treaty, it would find few allies in Congress and would need a lot of support from the White House to persuade Congress.

## Afghanistan

Withdrawals of US troops from Iraq, perhaps beginning in late 2007 or early 2008, will likely be seen as an insurgent victory. Taliban and Al Qaeda forces in Afghanistan will be emboldened by the defeat of American efforts in Iraq. As a result, their activities could intensify and cause “blowback” to Canadian (NATO) operations in Afghanistan. Given the Canadian government’s very public commitment to the security and reconstruction of Afghanistan, a stronger insurgency there would likely extend Canada’s commitment in troops and funds for many years.

## Canadian voice

The 110<sup>th</sup> Congress has twice as many committee chairs from states near the Canada-US border as its predecessor. Whether this will lead to more favourable consideration of Canadian trade, travel, and tourism interests is an open question. One Democratic proposal arising from the promise to enact more provisions from the report of the 9/11 Commission would stipulate mandatory screening of all shipping containers entering American ports as well as cargo on airplanes. This blanket, rather than targeted, measure is not an improvement over Republican handling of the border and risks slowing down traffic at commercial border crossings.

It would be beneficial for Canadian interests if the US Administration and the new Congress were to pass a new immigration bill that includes not only a legal process for dealing with temporary migrant workers but also security provisions for the US-Mexico border. Such a new measure would take Congress’s focus off the *southern* border and create an opportunity for Canada to engage the Administration and Congress on new ways to streamline the movement of trade and people across the *northern* border.

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## The context for Canadian trade and investment

### The risk of insecurity

The expression “security trumps trade,” which has been used in recent years in Washington, should alert Canadians to what is at stake should another terrorist attack take place. While trade is the single largest Canadian interest in its relationship with the United States, the events since September 11, 2001 have shown that America considers a stable security relationship of greater importance. When the United States perceives that its security interests are not met *and* that its political ties at the highest level are distant, the free flow of trade between these two countries may be endangered. While American security concerns centre on continental defence, domestic terrorist threats, and the secure flow of people across the border, American actions in response have an impact upon border management and trade.

### The importance of trade and investment to the Canadian economy

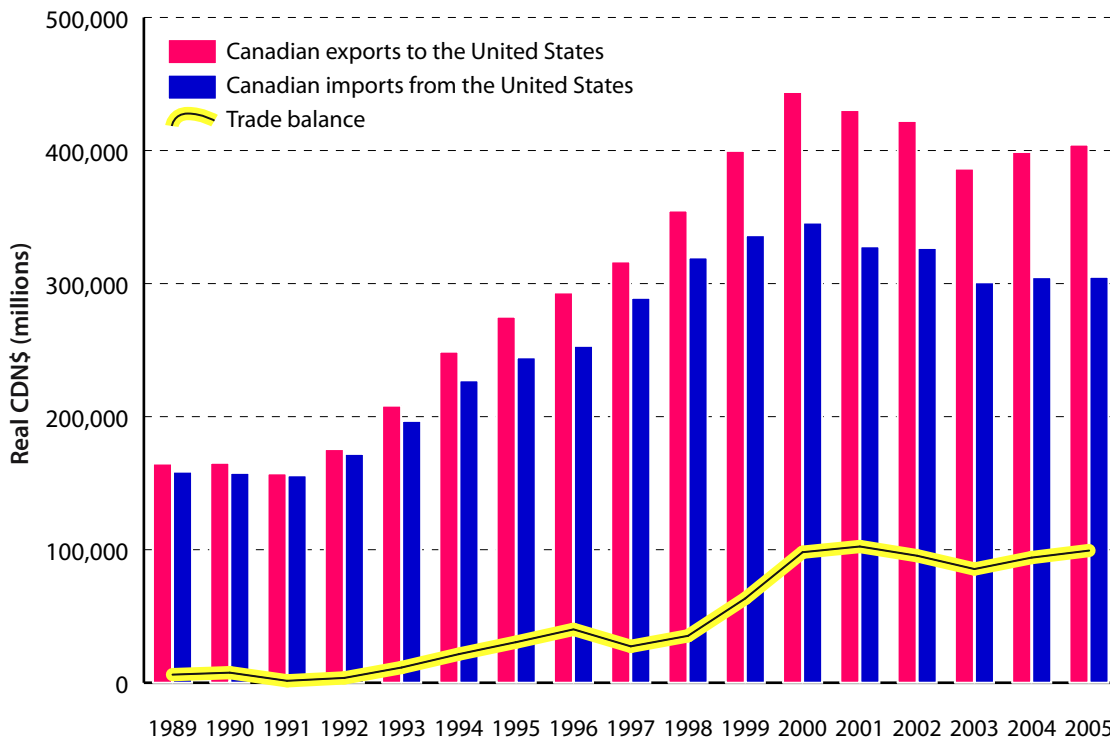
Canada has an enormous stake in the free flow of trade and investment to and from the United States. In 2005, 78% of Canadian exports went to the United States and 65% of imports came from the United States. The value of total trade with the United States (\$709 billion) amounted to 51.8% of the total value of Canada’s GDP in 2005 [Foreign Affairs and International Trade Canada, 2006]. Since the implementation of the Canada-US Free Trade Agreement, Canadian trade with the United States has grown 120% in real terms, with exports outpacing imports. [1]

Canada was the beneficiary of a large trade surplus—almost \$100 billion—with the United States in 2005 [figure 3]. In the same year, Canada had a \$50-billion trade deficit with the rest of the world—\$22 billion alone with China, leaving Canada with a \$50 billion net trade surplus in 2005. Clearly, Canada’s current account surplus is a direct result of its strong trading relationship with the United States.

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[1] Figures have been adjusted for inflation using Canadian or American GDP deflators. The results are displayed as real 2005 dollars. Most figures are also converted to Canadian dollars using purchasing-power-parity exchange rates.

Figure 3: Canadian trade balance with the United States (1989–2005)



Source: Statistics Canada, 2006b.

**Recent trends**

Many factors affect the trade flows between the two economies, including exchange rates. While recently exports in automotive products, machinery, and equipment have declined, largely due to the considerable strengthening of the Canadian dollar from 2002 onward, [2] exports in energy products have risen sharply, offsetting these losses [figure 4]. As a large part of trade in manufacturing products (especially in the automotive sector) is intrafirm trade, imports have fallen parallel with exports. Canadian merchandise exports rebounded in the third quarter of 2006, posting an annualized growth of 5% [Conference Board of Canada, 2007].

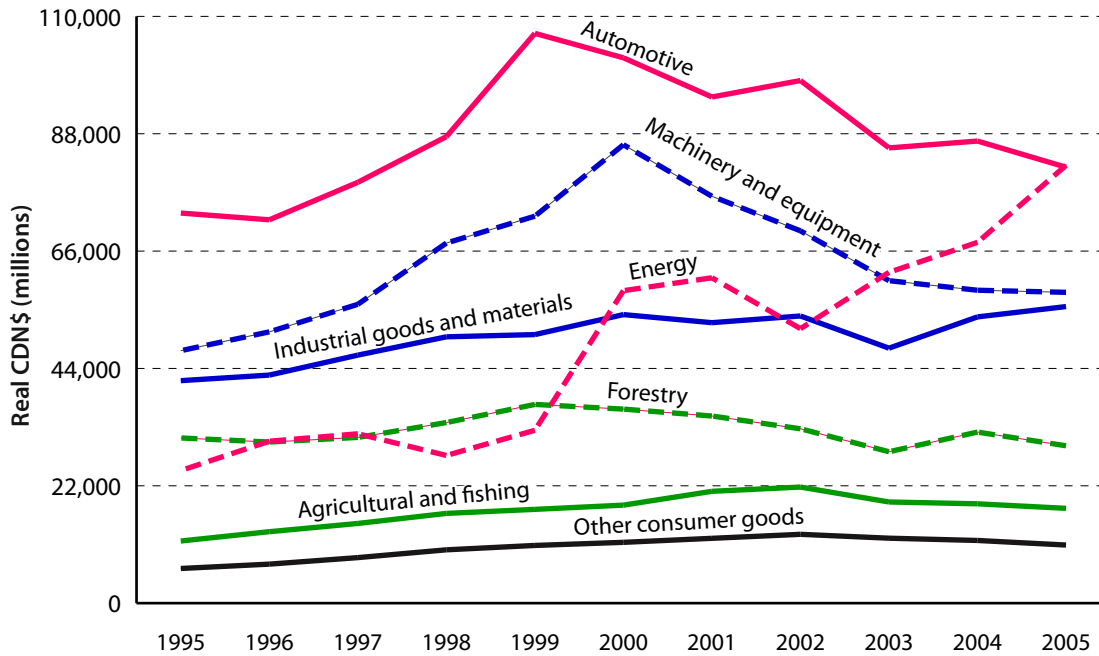
**Investment**

Canada’s economic stake in the relationship with the United States extends beyond trade to investment. The United States has been, and continues to be, the dominant source of foreign direct investment (FDI) in Canada [figure 5], representing 64% of all foreign direct investment in Canada in 2005 [Statistics Canada, 2006a].

[2] The Canadian dollar hit a low of US63¢ in 2002 and rose to 87¢ in 2005 [Bank of Canada, 2006].

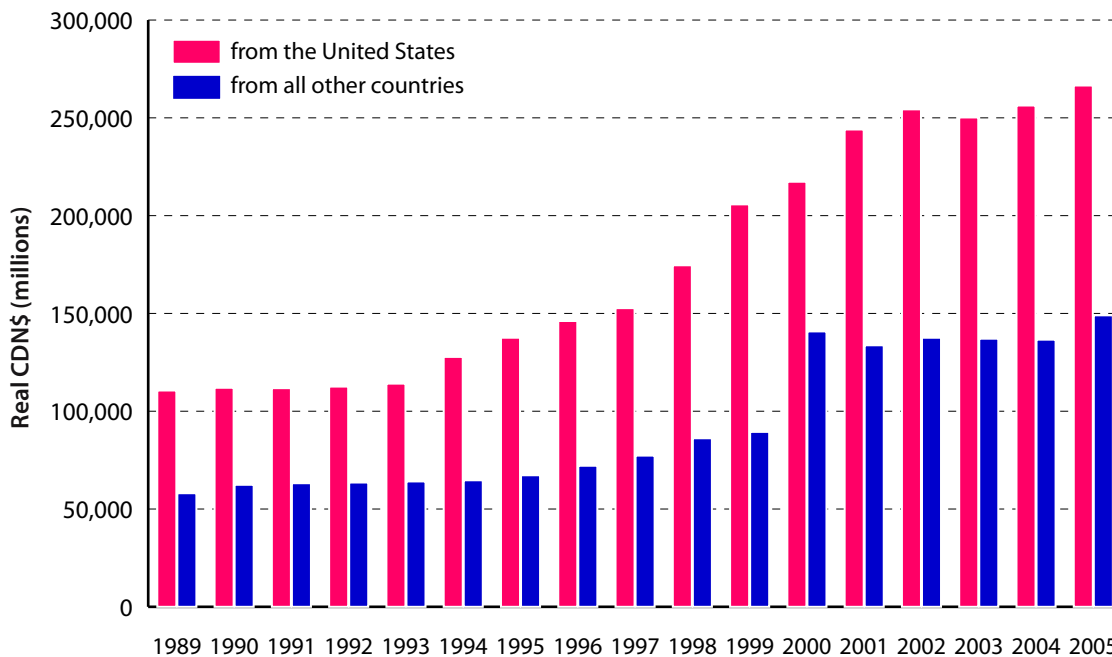


Figure 4: Canadian exports to the United States, by industrial grouping (1995–2005)



Source: Statistics Canada, 2006b.

Figure 5: Stocks of foreign direct investment in Canada (1989–2005)



Source: Statistics Canada, 2006a.

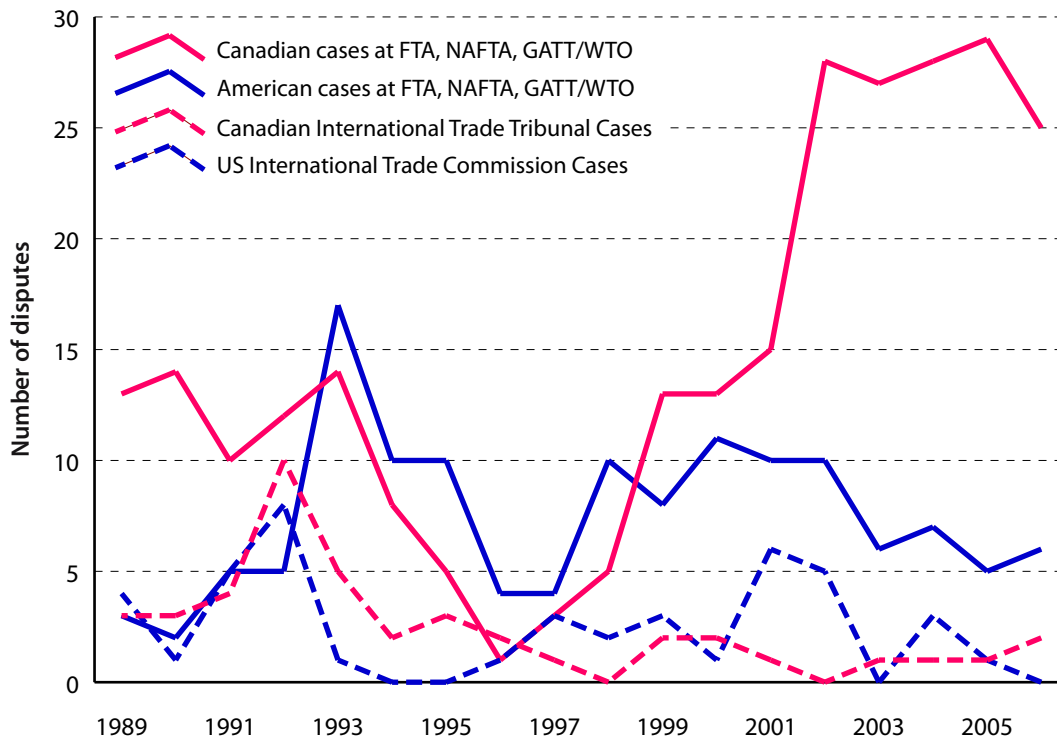
## The threat of trade disputes

Because such a large part of Canadian economic well-being depends on its trade and investment relationship with the United States, avoiding trade disputes and achieving more free trade in areas where trade is now restricted should remain a priority for Canadian policy makers. As figure 6 shows, not all disputes have been resolved. The downward trend in Canadian cases in 2006 resulted from the softwood lumber deal, which erased numerous WTO and NAFTA disputes. One new case arose in early 2007 when Canada requested a WTO consultation regarding American subsidies for corn and other agricultural products.

## Other barriers to trade

The Canada-United States Free Trade Agreement (FTA) of 1989 and the North American Free Trade Agreement (NAFTA) of 1994 did not remove all non-tariff barriers to trade. Regulatory differences, procurement policies, domestic ownership requirements

Figure 6: Domestic and international trade disputes, Canada and the United States (1989–2006)



Sources: NAFTA Secretariat, 2006; World Trade Organization, 2006; Canada Border Services Agency, 2006b; US International Trade Commission, 2006.

in certain industries such as air transport, telecommunications, and broadcasting as well as various subsidies amount to actual or potential barriers to trade. Most recently, security concerns have added to the cost of border crossings, causing Canadian concern that a new, de-facto, barrier is on the horizon.

Since the terrorist attacks of September 11, 2001, additional security measures at the Canada-US border have raised the waiting times and cost of cross-border shipments. Despite several attempts to streamline border traffic, there is a growing concern and partial evidence that border costs are too high and that the border in effect is turning into a growing barrier to trade.

### ***The SMART Border plan and the Western Hemisphere Travel Initiative***

The Canadian government took the initiative after the 9/11 attacks to engage the American government on expediting border crossings. The results were mixed. While the SMART Border action plan of 2001 led to important innovations such as the NEXUS and FAST (Free and Secure Trade) voluntary pre-clearance programs [Foreign Affairs and International Trade Canada, 2001], they did not satisfy Congressional security concerns.

Congress passed the Intelligence Reform and Terrorism Prevention Act in 2004. It introduced the Western Hemisphere Travel Initiative (WHTI) [US Department of State, 2007]. It stipulated that American citizens and foreign nationals alike require passports in order to gain admission to the United States. Full implementation is expected by June 2009. There are concerns on both sides of the border that this new requirement will cause a decline in two-way travel and in tourism, in particular.

Still, Canada and the United States have been adding on a piece-meal basis provisions to avert border blockages [Coalition for Secure and Trade-Efficient Borders, 2005]. For example, there is the Container Security Initiative, under which officials work in each other's major ports to facilitate pre-clearing of shipping containers. Also closer cooperation between border and security agencies as well as the use of biometrics are assisting both governments in border management.

### ***The Security and Prosperity Partnership (SPP)***

In March of 2005, Canada, the United States, and Mexico announced the creation of the Security and Prosperity Partnership (SPP) [Security and Prosperity Partnership, 2007]. The prosperity stream of the SPP is organized into 10 working groups that address specific issues such as manufactured goods, financial services, energy, and so on. The security stream deals with continent-wide security standards and streamlined, risk-based, border processes.

The results of SPP consultations are not binding and the entire project resembles a slightly formalized form of trilateral ad hoc-ism. This attempt to bundle the security and economic issues among all three nations, as opposed to assessing them in separate bilateral agreements, ignores some of the fundamental differences between Canada's

relationship with the United States, on the one hand, and the relationship between Mexico and the United States, on the other. In contrast to the northern border, the overwhelming problem on the US-Mexico border is illegal migration. Therefore, dealing with security and trade between Canada and the United States in tandem with the US-Mexico agenda is unlikely to meet Canada's short-term, bilateral, security and trade interests.

## The cost of the border

While there is as yet no comprehensive study of the cost of the border over a long period of time, several snapshots suggest that the border produces major costs to trade. Border costs in 2004 were estimated at 2.3% of cross-border trade [Hart and Dymond, 2006: 66]. Another study estimated the total costs of brokerage, duties, customs administration, and waiting times for shipments across the border for companies in 2001 to be between US\$7.52 and \$13.2 billion, with a midrange estimate of \$10.3 billion [Taylor and Robideaux, 2003].

Such costs threaten to undo the gains achieved by highly integrated production processes and make North American producers less competitive in comparison to off-shore production. For example, because of the integration of the automotive industry, each vehicle produced in Canada or the United States requires seven trips across the border, bringing the compliance and delay costs to approximately \$800 per vehicle [Coalition for Secure and Trade-Efficient Borders, 2005]. The rising cost of the border may also lead to foreign direct investment moving out of Canada into the United States. Michael Hart and Bill Dymond correctly call the border "dysfunctional to the deeply integrated bilateral trade and investment relationship" [2006: 66].

## Conclusion

Contrasting relations between Canada and the United States during the period from 2001 to 2005 and during 2006 leads to three conclusions.

- ⌘ ad-hoc and piecemeal measures in defence and security are not the most effective in fostering Canadian-American relations
- ⌘ American security concerns and bilateral political aloofness and divergence delay the resolution of bilateral issues
- ⌘ a lack of common security policy has a negative impact on trade and the flow of people.

Political change in both Canada and the United States in 2006 has created an opportunity for more cooperation between Canada and the United States in 2007 and beyond. Should a new government be elected in Canada in 2007, it would be well advised to use the new momentum to push for comprehensive bilateral agreements in security and defence.

***Achieving comprehensive agreements  
in border security and defence***

During the 1980s, Canadian officials faced a difficult and prolonged struggle in convincing the Canadian public and American legislators to start the comprehensive trade talks in 1985 and 1986 that led to FTA and NAFTA [Burney, 2005: 108–09]. Likewise, today Canadians must be informed about the vital need for new comprehensive measures on border control, security, and defence. Even a Canadian government with a strong mandate will have to make considerable effort to articulate the need for closer security and defence ties to maintain our efficient trading and travel status with the United States.

It will also require enormous diplomatic effort to generate the political momentum in the United States to negotiate a new paradigm for the border in which common security and trade policies and a continental perimeter gradually replace most of the physical barrier as we know it today. The US domestic agenda is quite filled and the 2008 race for the White House is in full swing. At the same time, the foreign agenda is dominated by the war in Iraq. Still, such preoccupation does not historically mean that the Executive Branch cannot be engaged on bilateral issues. Often presidents in their waning years reach out to foreign partners to accomplish things. The Canadian government should begin now to prepare the ground for big changes that may be consummated from 2009 onward.

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## Recommendations

The Canadian government should continue to work with the United States [3] on long-term market-based harmonization in areas such as energy where there already exists considerable compatibility. Next, it should remove the root causes of long-standing trade disputes such as those about softwood lumber and BSE (the list could be expanded to many other sectors). Free-trade agreements cannot overcome economic disputes caused by fundamental market distortions. Even sophisticated trade-dispute mechanisms such as are found in NAFTA cannot permanently resolve trade disputes arising from such distortions.

### Removing root causes of disputes

#### *Softwood lumber*

The managed-trade deal on softwood lumber reached in 2006 does not remove the root cause—stumpage fees in Alberta and British Columbia—of this dispute that goes back more than 20 years. In western Europe, in the United States, and in eastern Canada, most forested land is privately owned. In British Columbia and Alberta, only 3% to 4% of the forested land is privately owned [Natural Resources Canada, 2006]. Public ownership of the resource has inherent operating inefficiencies and in the long term has added risk for private investors. Private ownership, combined with clear government regulations on environmental management and reforestation, will attract more investment and make this sector more competitive in the long run. This is even more important now that old growth forests are no longer available in abundance. The federal and provincial governments in Canada must begin to move towards private tenure and privately owned forest land and move away from stumpage fees. At the same time, given the ramifications of constitutionally protected land claims by Natives, privatization of forest land will involve a drawn-out and complex legal process in western Canada. Such a move should coincide with an American commitment to move away from quotas and trade action in lumber and the elimination of export taxes levied on the industry.

#### *Bovine spongiform encephalopathy (BSE)*

The United States Department of Agriculture (USDA) has now put its Minimal Risk Rule No. 2 up for public comment (closed on March 12, 2007). The rule proposes to open the border to live cattle and breeding cattle over 30 months (but not over 104 months) as well as to beef products of any age. As in the past, Canada should expect

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[3] And, through the Security and Prosperity Partnership (SPP), with Mexico.

challenges by lobby groups such as R-CALF to slow down the process. Another risk for Canada is the 60-day period given to Congress to disallow USDA's new rule to re-open full trade [Canadian Cattlemen's Association, 2007]. While President Bush has indicated he would veto such a Congressional resolution, it is of the utmost importance that the Canadian government at the highest levels lobby both the Executive and Congressional branches vigorously to expedite this process.

Both the Canadian incidence rate of BSE and the legal ruling of the Ninth Appeal Court in 2005 should give USDA confidence to close the comment period quickly. Based on international rules, the USDA defined Canada as a "minimal risk region" in 2004 as long as it had no more than two cases of BSE per million cattle (in the over 24-months age bracket) for four consecutive years [USDA, 2005]. Canada's herd size for animals over 24 months was approximately 5.5 million in 2003 and rose to 7 million in 2006. In other words, Canada could have had 10 cases per year in 2003 and 13 in 2006 and still be under the limit. In reality, Canada has had a total of 8 cases in these four years and two cases so far in 2007. Thus, the Canadian incidence rate over four years has been less than 20% of the US ceiling. In the same time frame, the United States diagnosed three BSE cases. In July of 2006, USDA switched from "enhanced BSE surveillance" to "ongoing BSE surveillance." Testing was drastically scaled down from 400,000 animals in 2005 to 40,000 in 2006, indicating that the USDA estimates the risk as very low. At the same time, the Ninth Court of Appeal ruled in 2005 that USDA had full legal mandate to set the scientifically based risk margins and to determine border measures on this basis.

The long-term solution to the dispute over BSE is the recognition that trade in cattle and beef between Canada and the United States is really a single market based on a deeply integrated herd. Therefore, Canada's position that the standards of regulation should be harmonized is a good start, especially as the Canadian level of regulations such as in animal identification and the removal of most risky tissues used in animal feed already exceed US regulations. As of March 2005, the United States, Canada, and Mexico have begun to explore harmonization of North American standards for trade in beef and cattle [Becker, 2005]. To reduce the risk of border blockages even more, Canada should explore moving from harmonized standards of regulation to harmonized regulations and joint inspections, and eventually to a fully integrated single market in cattle and beef.

## **Treaty to ensure a secure border and the free flow of trade and people**

Canada should initiate negotiations for a comprehensive new treaty to create a secure border that permits the free flow of trade and people. The treaty should include the following measures:

- ⌘ a customs union to remove differential external tariffs and the cost associated with determining certificates of origin and whether products qualify for tariff-free shipment
- ⌘ a security-perimeter and border-management strategy that would include pre-clearing of all commercial crossings, joint border management and infrastructure, and harmonized biometric checks on people
- ⌘ common security criteria and harmonized processing systems for visas, refugees, and immigration
- ⌘ a binational border command to deal with crime, smuggling, and terrorist threats
- ⌘ steps to enhance labour mobility across the border.

### **Binational cooperation in continental defence**

Canada should also initiate negotiations for a new binational defence treaty that would include the following components.

**Binational command structure**—a single, North American, binational command structure responsible for defence of air, space, sea, and land reporting directly to US and Canadian decision-makers; and based on building out the NORAD model or, if that structure is now too far behind, by building a new binational command out of US Northern Command and Canada Command;

**Strategic plan**—a strategic plan that makes joint response the norm of dealing with any threat to North America;

**Expanded Canadian defence capacity**—a Canadian commitment to invest in defence capacity in all areas, including Arctic security.



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