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The North American Imperative

*A Public-Good Framework for
Canada-U.S. Economic and
Security Cooperation*

William B.P. Robson

In this issue...

A focus on North American public goods — payoffs from coordinated investments by Canada and the United States that are larger than either partner can achieve on its own — provides a compelling strategic framework for North American economic and security cooperation. While such a strategy requires larger up-front investments of resources and political capital than a piecemeal approach, it promises larger and more durable improvements in North American prosperity and safety.

The Study in Brief

Recent new and intensified challenges to Canada-U.S. economic and security relations have generated many proposals for closer collaboration. While individual ideas, such as more liberal rules of origin and mutual recognition of standards in the economic area, and better border control and defense integration on the security front, have many merits, a piecemeal approach to achieving them may prove inadequate. Adverse developments in both countries indicate that any past special relationship between their leaders has eroded. An event such as a terrorist attack at the border could not just prevent further progress, it could also undermine existing cooperation.

This *Commentary* argues that securing proposed economic and security improvements requires people in both countries — and particularly Canadians, in whose hands any significant initiative currently rests — to think more boldly, and develop a strategic framework that focuses on North American public goods. Public goods, familiar in such domestic activities as anti-fraud laws and inoculations, have international counterparts: areas where coordinated contributions yield payoffs larger than individual countries can realize acting on their own.

The logic of public goods is implicit in many past Canada-U.S. agreements, ranging from the Auto Pact to NORAD. An explicit focus on the benefits from economic and security collaboration can help both countries — whether their other domestic and international policies converge or diverge — to enjoy comparable benefits. A concentration on public goods also helps to define areas where joint action affecting all activities inside the territories of Canada and the United States, and possibly Mexico as well, makes sense, while selecting out those concerns where the appropriate focus is on specific sectors and regions.

Because the promotion of public goods involves coordination to overcome the incentive that each partner alone faces to under-invest in them, they do not occur spontaneously. Enjoying the benefits of North American public goods requires up-front investments of physical resources and political capital. Failure to make such investments will hamper negotiations across the border and domestically, increase the risk of unhelpful reflexive responses to unforeseen events, and rule out many legislative changes that could make improvements permanent.

To advance a North American public-goods agenda, Canada must provide a clear vision of the benefits, a framework that matches specific discussions to the payoffs they aim to achieve, and high-level commitment to succeed.

The Author of This Issue

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Canada's long internal debate about its economic and security links with the United States intensified after the terrorist attacks of September 2001 and the war in Iraq that began in 2003. Inability to decide how intimately to cooperate with the United States has muddled recent Canadian words and actions. On the economic front, federal officials have rejected major changes, such as a customs union, even as they pursued essential elements of those same ideas. On the security front, high-profile criticisms of U.S. foreign and military policy coincided with the deployment of Canadian forces alongside those of the U.S. in Afghanistan.

Seeing the need for a more constructive tone in dealings with Canada's chief trading partner and ally, Ottawa has floated several ideas in the past several months. In a March 2004 speech in Washington, Scott Brison, then parliamentary secretary for Canada-U.S. relations, outlined such projects as mutual-recognition agreements on product standards, revamped rules of origin, common standards for e-commerce, more cooperation on energy and the environment, and freer flows of labour (Brison 2004).

At the level of its individual elements, such a program is unobjectionable. Each of these ideas has attracted something of a consensus among experts seeking more harmonious Canada-U.S. economic and security relations. From a larger perspective, however, an approach focusing exclusively on these and other possible "little deals" looks inadequate. The challenges facing Canada in the early 21st Century are so profound that without a compelling vision of a stronger and more secure North America, a coherent map for getting there, and major investments of resources and political capital, Canada may fail to advance cooperation and past gains may erode.

This paper does not attempt a detailed critique of past proposals, or a comprehensive survey of the many recommendations for strengthening Canada-U.S. relations put forward in the past three years.¹ Rather, it focuses on the strategic approach that holds the best hope of securing such gains.² In this connection, it makes three main recommendations: First, a clear vision of the collective economic and security benefits available from cooperation — a set of North American public goods — should inspire Canada's approach; second, the framework must anticipate the various geographic areas and spheres of activity in which different public goods are available, and, finally, the rich rewards from cooperation require a sizeable up-front investment.

1 Rich sources in this regard are Goldfarb (2003b), Hart (2004), and Schwanen (2004).

2 This paper owes much to discussions with, and reviews by, Alan Alexandroff, Danielle Goldfarb and Jack Mintz. Because their contributions in several areas are clearly visible, I emphasize that they bear no responsibility for any errors, and should not be presumed to endorse my recommendations. I also thank André Belelieu and Christopher Sands, along with Tom Axworthy, James Blanchard, Andrew Coyne, Wendy Dobson, Kevin Doyle, Drew Fagan, Rafael Fernandez de Castro, Gordon Giffin, Allan Gotlieb, David Laidler, Finn Poschmann, and other participants in a May 2004 C.D. Howe Institute seminar on Canada-U.S. relations for comments, and Jan Moffatt and Payam Pakravan for research assistance.

The Public Goods of North American Economic and Security Cooperation

The first recommendation reflects the rewards when the actions of countries, like those of individuals, take the legitimate interests of neighbours and partners into account. The concept of a public good rests on a key insight: When benefits can be enjoyed without payment, and when one person's enjoyment of them does not diminish another's, coordinated investment — by individuals, businesses, or countries — can offset the incentive that each individually would have to underinvest in them.³

The implicit positive-sum logic of coordinated investment in international public goods underlay past Canada-U.S. economic and defense accords, and will be no less important in the future. Like neighbours who improve their living conditions by looking out for each other's interests — even while pursuing distinct goals on either side of the fence that divides their properties — Canada and the United States can bolster their prosperity and security with investments that expand the payoff from beneficial interactions.

The Need for a Framework That Matches Different Public-Good Spaces

The second recommendation responds to the fact that opportunities for coordinated public-good investment differ in scale and scope. Lighthouses, firefighting and vaccinations — familiar examples of activities that provide public goods — yield benefits over different areas. For administrative convenience, different public goods are often organized and delivered within the same space, as when a municipality uses the same boundaries for its fire-fighting and policing services, and when national borders mark the boundaries of legal and monetary systems. Where administrative practice and effective delivery do not coincide, payoffs from coordinated improvements are possible.

North American public goods are benefits available over areas and activities that transcend national borders. While some potentially encompass the entire continent, others do not. As the existence of regionally oriented collaborations of Canadian and U.S. sub-national governments, such as the Pacific Northwest Region and the Conference of New England Governors and Eastern Canadian Premiers⁴ exemplifies, different economic and security payoffs are available in specific sectors and geographic areas. Mexican participation will make sense in

3 Public goods are special because of the difficulty of excluding people who do not pay for them from their enjoyment and because one person's enjoyment of them does not diminish the ability of others to enjoy them. Whether they are financed by public money or produced by public employees is irrelevant.

4 The former, dating from 1991, includes Alberta, British Columbia, Yukon, Alaska, Idaho, Montana, Oregon and Washington. The latter, dating from 1973, includes New Brunswick, Newfoundland and Labrador, Nova Scotia, Prince Edward Island, Quebec, Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island and Vermont. Abgrall (2004) describes these and many more specialized cross-border agencies.

some areas and not others. Sector-specific accords will work for some industries, though not others. Within the overarching public-good benefits from high-level national cooperation, then, a promising negotiating framework must be flexible in dealing with different public-good spaces.

The Desirability of Coordinated, Sizeable Investments in Public Goods

The third recommendation reflects a judgment that a low-key approach is unpromising for exactly the reason that many find it attractive. Public goods do not occur spontaneously. They require coordinated action, and coordinated action requires the kind of commitment that only a high-profile political effort can achieve.

For Canada to avoid proposals that need legislation by Congress, for example, may lead to gains that are only marginal or transitory — what one administration grants, another can as easily take away. On the Canadian side, a low-stakes approach makes quitting when negotiations get tough and domestic opposition runs high too easy. High-profile political commitment is likelier than piecemeal engagement to mobilize the coalitions both sides need to pursue joint goals.

The Rest of the Paper

The following section reviews key challenges, as well as the political circumstances on both sides of the Canada-U.S. border that make them harder to respond to. The next sections survey the main elements in possible approaches to those challenges, highlighting their public-good aspects, the differing scale and scope of potential public-good benefits from case to case, and the investments necessary to achieve them. Explicit attention to the nature of North American public-good benefits, the paper concludes, can help Canada frame an agenda for successful negotiations.

Background and Challenges

The idea of North American public goods is powerful but relatively unfamiliar. An exploration of possible elements in economic and security accords can usefully start, therefore, with a survey of four areas in which Canada and the United States currently enjoy public goods — a rules-based trading system, arrangements governing deeper economic integration, defense cooperation, and domestic security coordination — as well as several challenges to maintaining and strengthening those arrangements.

Traditional Trade Liberalization

The benefits from voluntary exchange are among the best explored topics in economics. Voluntary exchange enables people to focus their efforts where they are most productive, exchanging goods and services with others who excel at something else. A rules-based market divorces exchange from other aspects of

relationships: People can benefit from exchange with partners they may not know and might not like if they did. The result is higher living standards at lower cost in work and resources.

Governments can improve from the results of such exchange. Rules against misrepresenting quality, for example, increase confidence that partners in a transaction will get what they expect — a public good that magnifies positive results. Governments can also make exchange costlier or impossible. Barriers between countries that favour domestic producers, for example, often appear different than they would between neighbours or within a country, but they should not: Either way, protectionism increases the cost of achieving a given level of well-being.

Because protectionist pressure typically involves groups seeking large per-person benefits by imposing costs on the entire population that — while larger in aggregate — are smaller per person hurt, unilateral lowering of trade barriers is rare. One response is agreements creating mutual obligations to avoid protectionism. Rules-based trading systems have a public-good aspect, helping countries achieve together what they cannot manage on their own. Like other public goods, these payoffs require coordination among potential parties to an accord: They occur when governments invest political capital up front.

Payoffs from Rules-Based Trading Systems

Canada has supported liberalized international trade since World War II. Multilateral efforts in the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) reduced the traditional trade barriers of tariffs and quantitative limits, and restrained contingent protection through anti-dump and countervail penalties. The results validated these efforts; countries that lowered barriers raised living standards more effectively than those that did not. A liberal trading order helps smaller countries particularly because extending rules-based trade beyond political borders reduces the cost of political independence.⁵

Canadian experience conforms to the correlation between openness and prosperity. Indeed, the period following the Canada-U.S. Free Trade Agreement (CUFTA) and the North American Free Trade Agreement (NAFTA) provides more specific illustrations of the spur liberalization gives to living standards.⁶ Even leaving aside the gains to consumers and the enhanced competitiveness of Canadian exports in third markets from lower tariffs on imported components, the boost these arrangements gave Canadian prosperity are clear.

5 Both theory and evidence suggest that freer trade makes size less important for growth. See Ades and Glaeser (1999), Alesina, Spolaore and Wacziarg (2000), Alcalá and Ciccone (2003) and Alesina and Ferrara (2003).

6 Although hopes that closer trade ties would narrow Canada's productivity gap with the United States have been frustrated, and the absence of a counter-factual scenario makes conclusions tentative, liberalization does appear to have spurred Canadian productivity. Bilateral trade grew faster in sectors liberalized by the CUFTA (Schwanen 1997), and exporting plants generated almost three quarters of the productivity growth in Canadian manufacturing in the 1990s (Baldwin and Gu 2003), with labour productivity in the sectors affected rising 17 percent over the decade, a huge boost to incomes (Trefler 2001).

The gains from CUFTA were a natural goal for Canada. The United States is a major source (68 percent in 2003) of the imports of goods and services that contribute to Canada's high living standards, a dominant market for Canadian exports of goods and services (80 percent in 2003), and a key focus when thinking about future investment and jobs in Canada. Barriers between Canada and the United States are like a thickening of the Canada-U.S. border, which could lead more producers to locate investments and create jobs on the side of the border where the larger market exists, namely in the United States. Secure access to the U.S. market was one of the main reasons Canada signed the Auto Pact in 1965 and CUFTA in 1988. Securing those gains rather than having them diluted by a separate bilateral U.S.-Mexico FTA — which would have created public-good payoffs for U.S. producers and consumers, but not for Canadians — was a spur to join NAFTA in 1993.

Furthering Traditional Liberalization

The logic and results of past trade liberalization are straightforward. So is the future challenge: maintaining and furthering the public good that rules-based systems provide by containing protectionism at home and abroad — and particularly in the United States.

Progress in multilateral forums has lately become more difficult to achieve. The liberalization of tariffs and quotas, mainly targeted in the past, are less salient now. And as the benefits of a liberal order have induced more countries to join it, the rising number of voices and diversity of interests at the table is making multilateral negotiations unwieldy, and diluting the public-good payoffs for any single member. A good second-best for Canada in this situation is to enhance its position next to the United States by building on CUFTA and NAFTA.

CUFTA and NAFTA eliminated tariffs on most goods crossing international borders in North America. High-profile exceptions remain in such areas as agriculture, however. Even in liberalized areas, further impediments to commerce exist. Free-trade agreements require rules of origin that dictate how much transformation, and how much in-area content, qualify items for duty-free entry — otherwise, importers in a country with higher tariffs will bring goods in through a partner country with lower tariffs. Growing experience with free-trade agreements has shown that rules of origin can be instruments of protectionism (Estevadeordal and Suominen 2004). NAFTA's relatively strict rules limit sourcing options and raise costs, hampering trade and investment.⁷ Other impediments, such as border-clearing procedures and inspections, resemble physical distances in reducing the benefits of exchange,⁸ and are also subject to protectionist manipulation.⁹

7 Their costs have been estimated to be as high as 2 percent-to-3 percent of NAFTA area GDP, with the heavier burdens falling on Canada and Mexico (Appiah 1999).

8 Taylor and Robideaux (2003) estimate the cost of transit, processing delays, and so on at the Canada-U.S. border to industry at about US\$10.3 billion annually.

9 Seventy two percent of respondents to a 2003 survey of Canadian exporters said they faced "unofficial" trade barriers to their exports to the U.S., up from 45 percent in 2002, a change that the majority of respondents attributed in part to a worsening of Canada-U.S. relations over that year (McMahon, Curtis and Adegoke 2003).

CUFTA and NAFTA also failed to do away with protectionism through anti-dumping actions and countervailing duties. Reviews of trade-remedy actions by bi-national panels appear to have curbed their use, and Canada and Mexico suffer less from U.S. actions relative to trade volumes than other countries (Macrory 2002) — likely reflecting the impact of growing cross-border integration, since penalizing imported components raises costs for exporters or affiliates. Repeated U.S. attacks on Canadian softwood lumber show, however, that contingent protection can undermine the benefits of a rules-based system. The threat of such actions can deter a company from competing aggressively in foreign markets, or induce it to locate in the largest market. For all countries — and particularly those wanting to overcome the economic penalty of small political size — bolstering and enhancing rules-based systems is a sound investment.

Globalization and Deeper Economic Integration

Declining transport and communication costs, lower traditional trade barriers, and the growing variety of goods and services that people produce and consume, are increasing the scale and scope of the benefits of exchange in intermediate goods and services, labour, capital and technology. The merits of voluntary exchange and the public-good aspects of rules-based systems governing it also apply to these flows. But the line between interventions to achieve public goods, such as enhanced confidence through laws against fraud, and interventions designed to give favoured producers advantages over competitors is harder to draw in many of these areas — a problem aptly summarized in Ostry's (1993) phrase "system friction".

Flows of Intermediate Goods, Services, Capital and Labour in North America

Canada-U.S. trade in intermediate goods is dominated by related-party transactions. By the end of the 1990s, almost four-fifths of trade in goods was intra-industry, and two-thirds of it was intra-company, with previously imported items making up fully one-third of the value of Canada's exports (Cross 2002). In highly integrated industries such as automobiles, individual components may cross the border many times before the finished car is sold.

More than a fifth of the value of Canada's recorded trade transactions now involve the exchange of services, while activities related to licensing and the informal transfer of knowledge with investments constitute a growing, though largely unmeasured, element in Canada-U.S. commerce (Hart 2003). With as many as 70 million individual border crossings each year, 2.4 billion telephone calls (Blake and Lande 2004), and uncountable interactions on the Internet and proprietary networks, total non-merchandise transactions loom much larger in Canadians' lives than measured exchange would suggest.

Direct investment by residents of Canada and the United States in the other country has grown faster than trade since CUFTA. U.S. investment amounts to about two-thirds of total foreign direct investment in Canada, while Canadian investment in the United States accounts for 8 percent of the U.S. total. Rather than

being a substitute for more extensive trade, investment flows now appear to complement it (OECD 2003, 176-77; Hejazi and Safarian 2002), with the reduction of barriers to investment serving as a natural extension of the trade liberalization that has proved beneficial in the past.

Securing Benefits from Integration in the Face of System Friction

Because system friction afflicts all the world's more developed countries, they have tried to address it in multilateral agreements.¹⁰ Still, disputes on such matters as health and safety certification, environmental policy, competition laws, and investment restrictions often involve policy-makers uninterested in, or hostile to, international liberalization (Hancock and Robson 2003). The diversity and numbers of countries involved, and the worsening balance between the public-good payoffs available to each country and the costs incurred in reaping them, are making progress in wider forums tougher.

Formal barriers to trade in services in North America are less important than barriers to goods. CUFTA and NAFTA largely liberalized trade in financial services and telecommunications. Discussions are underway on professional certification requirements. Limits on services traditionally dominated by state provision, such as health and education, are not a high-profile problem because few providers of such services try to sell across international borders.

Impediments to capital flows are also less important than they were. Canada reformed a restrictive foreign-investment regime in the 1980s, and NAFTA Chapter 11 provided an appeal process for foreign investors treated less favourably than their domestic counterparts.¹¹ Still, North America lags other places — particularly the EU, where integration has fostered the freest regimes in the developed world. OECD measures show Canada as relatively restrictive toward inward direct investment, with widespread screening, and regulations on equity investment, management and operations in financial services, telecommunications and air transport.¹² The United States, in the middle of the OECD ranking, restricts foreign investment in shipping, power, and communications, and has wide discretionary power to screen investments in companies engaged in inter-state commerce or affecting national security. Mexico's prohibition on foreign participation in its energy sector is a highlight of a regime that is highly restrictive by developed-country standards.

Tax policies also fragment North American capital markets. The European Union (EU) has made coordinated investments of political capital to reduce the impact of withholding taxes and discriminatory treatment of interest deductibility on cross-border flows. The resulting benefits — more dynamic financial

10 Efforts include the WTO's General Agreement on Trade in Services, the OECD's Code of Liberalization of Capital Movements, and the OECD's Declaration on International Investment and Multinational Enterprises.

11 Alexandroff, ed. (forthcoming) provides a detailed review of the operations of Chapter 11.

12 Guillemette and Mintz (2004) argue that the OECD rankings (OECD 2003, 169-72) overstate the restrictiveness of Canadian screening.

intermediation, higher returns to savers, and lower costs of capital — are also available in North America.

Defense

The idea of public good in security arrangements is more familiar than in commerce. Positive spillovers from individual investments in policing, for example, feature in textbook discussions of public goods that, without coordination, would be under-supplied. On an international scale, collective contributions to security let countries benefit from their partners' deterrence of potential attackers — a key spur to military alliances. While close cooperation with a neighbour that is both extraordinarily powerful and highly unlikely to attack has given Canada's situation unusual aspects, this logic has guided Canada in the past.

Canada-U.S. Cooperation on Defense

The respective pledges of President Franklin Roosevelt and Prime Minister William Lyon MacKenzie King to protect Canada, and to prevent Canadian territory being a base for an attack on the United States, were landmark expressions of Canada-U.S. mutual security interests in the mid-1930s. The 1940 Permanent Joint Board on Defense and the related 1946 Military Cooperation Committee, whose chairmen report to the top military commanders in the respective countries, institutionalized Canada-U.S. cooperation. After World War II, the North American Aerospace Defence Command (NORAD)¹³ — with a commander in chief appointed by and reporting to the Prime Minister and the President — embodied collaboration in North American defense.

Canadian and U.S. participation in the North Atlantic Treaty Organization (NATO), established in 1949 to protect Western Europe from a potential attack by the Soviet Union, highlights the geographic specificity of this type of public good. NATO and NORAD allowed Canada, like other members, to project force abroad and to defend its own territory more effectively than a solo commitment of the same resources could have done. Though NATO and NORAD were complementary in many ways, each alliance produced joint payoffs for members in the specific areas it covered.

The importance of coordinated investments — both of resources and of political capital — is also obvious in these alliances. Defense cooperation did not preclude Canada-U.S. differences on sensitive issues such as Vietnam and Cuba because both partners were willing to expend political capital in the common purpose. Indeed, the material and political commitment to these alliances helped sustain them when members differed on foreign policy goals, and when anti-Americanism and pressure from advocates of unilateral disarmament might have dissolved less formal arrangements.

¹³ Established in 1958 as the North American Air Command.

Responding to New Military Threats

Two widely noted changes have challenged Canada's traditional military stance. The break-up of the Soviet empire diminished the prospect of a massive conventional attack on Western Europe or a large-scale nuclear attack on North America, while the spread of modern weapons technology raised the prospect of serious injury at the hands of enemies formerly too weak or far away to pose threats. On the military front, the weapons and deployments suitable for a bipolar world make less sense in a world of more diffuse threats. Politically, the western democracies are less cohesive: Without the collective benefit of unity against a single threat, popular resentment of the sole world superpower is feeding on the collisions of national interest that are inevitable among great powers.

A second key change is the decay in Canada's military capacity. The stability of the cold-war era appeared to show that Canada could reap public-good benefits from collective security without making a proportional contribution. Canada became a free-rider, reducing the numbers and material preparedness of its armed forces — a process accelerated by fiscal pressures in the mid-1990s. Canada's difficulty in deploying troops to Afghanistan after the overthrow of the Taliban demonstrated its declining ability to sustain commitments abroad. Commentators such as Ignatieff (2003), Granatstein (2003), and Middlemiss (2003) have pointed out that Canada cannot now independently project force abroad, and has to depend instead on the United States for territorial protection. Simply forestalling further deterioration would require an increase in the defense budget of many additional billions annually (Bland 2003).

The terrorist attacks of 2001 showed the horrific potential of a previously neglected kind of threat, and prompted key reorientations of U.S. military efforts. Among the most notable of those changes for Canada was the U.S. creation of a Northern Command (NORTHCOM), responsible for North American land, sea, and air defense operations, independent of Canada. The public good of cooperation in North American defense is still available, but the investment that magnified the payoff in the past has run down.

Domestic Security

The public-good aspects of cooperation on security are most obvious when partners defend common territory. The image of a chain — only as strong as its weakest link — illustrates the point that cooperative efforts on a secure perimeter amount to more than the sum of individual elements.

North American Security Cooperation

Much of the line dividing Canada and the United States — often characterized as the world's longest undefended border — has in the past been almost completely permeable. Even large-scale movements of goods and people usually received token scrutiny and, in many places, a determined individual or small group can still cross on foot or by boat unobserved.

Since fortifying the border to preclude any crossing anywhere by unwanted individuals and goods would impose huge costs and impediments to ordinary travel and commerce, the two countries have a powerful incentive to cooperate on domestic security. At the same time, administrative economies of scope make the border a convenient line of defense in the face of such threats as disease and unsafe food — a more important consideration in the United States, which has to deal with two borders and neighbours at different stages of development and standard-setting.

Confronting New Domestic Security Concerns

The terrorist attacks of 2001 changed U.S. views of the border with Canada from a minor point of pride to a major focus of anxiety. The combination of all or part of 22 U.S. agencies into a new Department of Homeland Security was largely a retrofit of systems designed to facilitate movement of people and commerce to protect against terrorism. Such programs as the Customs-Trade Partnership against Terrorism (C-TPAT) and the Container Security Initiative are recasting the operations of exporters to the United States. Inspection rates are up and new technology will allow more comprehensive examinations as time goes by.

Implicit recognition of the public-good payoffs from security cooperation and the benefits of high-profile commitment to achieving them produced the Canada-U.S. Smart Border Declaration of December 2001 and the Action Plan that followed it. By the end of 2003, the NEXUS program to expedite crossings by pre-screened, low-risk travelers, and the Free and Secure Trade program, designed to do the same for low-risk commercial shipments, were operating at about a dozen crossings. At the same time, the number of bi-national Integrated Border Enforcement Teams of police, immigration, and customs officials has expanded.

Canada-U.S. cooperation on migration has also improved. The Advance Passenger Information and Passenger Name Records system aimed to automate sharing of immigration and criminal data on passengers into and out of the United States by 2004. Other instances of cooperation are the Statement of Mutual Understanding for information exchange, the Safe Third Country Agreement on refugees, greater harmonization of visa policies (common policies now exist for 144 countries), and exemption for Canadians from biometric tracking under the U.S. Visitor and Immigrant Status Technology program.

As Belelieu (2003) notes, however, the Action Plan's successes obscure a loss of momentum behind the Smart Border process. Not only has much of the low-hanging fruit been harvested, the effort to prevent security concerns from impeding border traffic faces constant headwinds. Not the least of these is the fact that normal growth in the Canadian and U.S. economies and in the trade between them continually presses against the limits of existing road and rail lines — both truck and rail crossings were some 50 percent more numerous in 2002 than in 1994.

Other developments also complicate the effort. Concern over cross-border movements of pharmaceuticals, for example, has grown as shipments of Canadian pharmaceuticals into the U.S. market expand. Tighter enforcement of United States regulations prohibiting non-U.S. drug manufacturers from re-importing U.S.-made

drugs, and closer inspection of shipments to find illegal recreational drugs or deliberate contamination by terrorists, are impeding legitimate trade.

Security concerns have also intensified the frictions over sanitary and phytosanitary standards that are a well known feature of deeper economic integration. The huge disruptions caused by two “mad cows” in 2003 and 2004 demonstrate that — especially when opportunities for protectionism arise — the border is a natural place to mount defenses against unsafe food. Mandatory advance notification of shipments to U.S. Customs and Border Protection and the Food and Drug Administration will disadvantage Canadian food producers relative to their U.S. competitors.

Even shipments of trash — not normally a focus of trade experts¹⁴ — threaten to jam the border. Canadian garbage has been turned back because of medical waste and Michigan, a major destination, is tightening its rules on what it will let in. Garbage has been used as a cover for shipments of illegal drugs and its heterogeneity, multiple sources, and resistance to easy inspection make it a plausible vehicle for a terrorist attack (Robson, W. 2003).

Public-goods aspects of North American security are also evident in a number of areas where the border is not an explicit concern. Controlling and cleaning up pollution of air and boundary waters are familiar examples. Responding to floods, storms, forest fires and other natural disasters that affect both countries is easier when each can draw on the other’s resources. After an ice-storm blacked out eastern Ontario and Quebec in 1998, the U.S. military airlifted Canadian military field kitchens to the affected areas. The Aug. 14, 2003, black-out demonstrated that the increasing integration of the North American electricity grid has extended the distances over which one market participant’s actions can affect others. The convergence of telecommunications and Internet technology is exposing communications networks to disruption from the failure or deliberate sabotage of equipment and software.

U.S. Unilateralism and Economic Nationalism

Many of these challenges reflect, or even exacerbate, a running down of past investments in cooperation. The more profound changes have occurred in the United States, where the trauma of Sept. 11, 2001, accelerated a trend toward more nationalistic economic and security policies.

A More Unilateral and Pre-Emptive Military Stance

The change in U.S. attitudes on security, though often noted, nevertheless merits emphasis because many Canadians underestimate its force. U.S. residents sense that they are now on the front line of the battle against rogue states and terrorists, and bear a disproportionate share of the burden of containing them. That sentiment is especially strong in Washington, where reminders of heightened security are a fact of daily life.

¹⁴ Taking trash is technically a service export by the jurisdiction accepting the shipments.

U.S. failure to obtain widespread international support for action in Iraq has fueled U.S. domestic debate about specific elements in U.S. foreign policy. But such developments as corruption in the UN Oil-for-Food program, attacks on U.S. personnel by peacekeeping nationals of other countries, and the apparent role of the March 2004 terrorist attacks in Spain in swinging an election in favour of an anti-U.S. party will likely increase Washington's willingness to proceed alone when it sees fit. Perhaps most important, the attacks of Sept. 11 made pre-emptive action look more attractive than a combination of defensive measures and deterrence.

The Protectionist and Mercantilist Mantles

Increased U.S. unilateralism in security matters arises, unfortunately, as part of a long-standing turn away from international economic cooperation.

Unlike in Canada, where NAFTA was somewhat of a postscript to the intensely debated CUFTA, the three-country pact occasioned high-level controversy in the United States, and "no more NAFTAs" afterwards became a rallying cry of nationalists and protectionists. This alliance largely paralyzed U.S. trade liberalization efforts during the 1990s, and the Bush Administration only obtained Trade Promotion Authority in 2002 through such protectionist trade-offs as high tariffs on steel imports, expensive new farm subsidies, promises of sectoral exceptions, and labour and environmental provisions in upcoming agreements (Hufbauer and Schott 2003).

The confluence of new competitive pressures from China and India with a period of rapid productivity growth and hence weak net job creation in U.S. manufacturing intensified the country's protectionist sentiment. Some commentators note that U.S. commercial policy now more closely ties trade accords to support by partners for other foreign-policy goals.¹⁵ Perhaps declining support for freer trade in general is focusing U.S. trade negotiations on bilateral arrangements with relatively small partners. In any case, the consciousness of mutual benefits from rules-based exchanges that Canada customarily counted on when dealing with the United States appears to be lower than in the past.

Canadian Ambivalence

Canada, by contrast, seems to have become increasingly unable to choose between two contrasting approaches to foreign policy: an idealistic vein that gives pride of place to noble-sounding motives and downplays practical interventions; and a realistic vein that pursues national interests in a straightforward, results-oriented manner.¹⁶ As Prime Minister Paul Martin's 10-week hesitation before accepting an

15 Although there is no formal U.S. policy that calls for linking trade agreements to other foreign-policy considerations, a May 2003 statement by U.S. Trade Representative Robert Zoellick mentioned general foreign and security policy cooperation among a list of criteria for determining a given country's priority for U.S. trade negotiators (Fergusson and Sek 2004, 2-3).

16 Gotlieb (2004) provides an extended exploration of this ambivalent stance.

invitation for an official visit to Washington in April 2004 symbolized, Canada is in a prolonged national dither.

Soft Internationalism

When it comes to North American defense and security, the problem is not so much Canadians' unwillingness to cooperate as it is their evident unwillingness to invest the necessary resources to make a significant contribution to continental security. A genuine involvement in missile defense, coastal patrols, and better border monitoring would require relatively large increases in federal spending, which several decades of experience suggest Canadians are not willing to support.

On more general foreign policy issues, Canada has reacted to forceful U.S. stances by re-emphasizing softer issues and multilateralism for its own sake.¹⁷ Canada's support for the land mines treaty, the International Criminal Court, and the Kyoto Protocol had little practical effect on the number of landmines deployed in the world, on the likelihood that dictators abusing their citizens will be brought to justice, or on the prospects for the earth's climate. Its opposition to the war in Iraq similarly appears to have had little impact on the actual course of events. In all these instances, the attractive packaging of a stance different from that of the United States arguably mattered more than substance in shaping Canadian policy.

Casual Assessment of Economic Threats

On economic issues, most Canadians also appear to support the principle of closer cooperation (Alexandroff and Guy 2003). But this support is tepid, and Canada-U.S. tensions inspire little sense of urgency.

Many Canadians underestimate how much Washington's fresh focus on security has accelerated the depreciation of political capital invested in the old Canada-U.S. special relationship. Too much focus on personalities and transitory political configurations — particularly a belief that U.S. attitudes and actions will change profoundly when George W. Bush leaves the White House — has obscured for Canadians the extent to which the targeting of the United States for terrorist attacks and its unique ability to confront such challenges as nuclear proliferation has altered the underpinnings of U.S. foreign policy. The timing of this U.S. re-evaluation of the practical value of its alliances is unfortunate for Canada: It comes at a time when Canada's military capacity and world standing are low, reducing U.S. responsiveness to its concerns.¹⁸

Canadians console themselves with the undeniable fact that the U.S. has a vital interest in keeping the border open, without appreciating the asymmetry of vulnerability to a less permeable border. Two-way trade in goods and services

¹⁷ See Dymond and Hart (2002) and Granatstein (2003) for forceful critiques of this tendency.

¹⁸ As Sands (2003) puts it: "Canada ... is viewed today as an ally similar to the Netherlands. That is, wealthy, talented, generally friendly, but a small contributor to the international order which the United States finds itself responsible to maintain ... And because this re-assessment of Canada is not punitive, it is also not likely to change soon."

amounted to 53 percent of Canadian GDP in 2003, while the comparable figure for the United States was only 4 percent of GDP.

A closer look at Canadian exports of goods to the United States amplifies concern about Canadian exposure to border disruptions. Even using relatively high thresholds for judging vulnerability, Goldfarb and Robson (2003) estimate that sectors exposed to security-related border disruptions account for as much as 45 percent of Canadian exports to the United States, exports that support 390,000 jobs and \$3.7 billion of annual investment. Harris (SCFA 2003) estimates that a 10-percent increase in border costs — an increase smaller than actually occurred in the year following Sept. 11, 2001¹⁹ — would cut Canada-U.S. trade volume by some 25 percent over time and lower the net prices received by Canadian exporters by about 10 percent.

Tighter border security measures threaten Canada more than Mexico. Canadian and U.S. products are closer substitutes, and moving production to northern border states from Canada — which those states would welcome — is easier than moving it to southern border states from Mexico.

Canadians are also too relaxed about more nationalistic and aggressively bilateral U.S. trade policy.²⁰ If competitive pressures on U.S. manufacturing, and concerns about outsourcing services, lead to new barriers, or if proliferating bilateral deals leave Canada outside the North-American hub, Canada can only lose. Advocates of diversifying Canadian trade away from the United States give too little weight both to the U.S. market's unique wealth, physical and cultural proximity, and absence of country-specific risk (Hodgson 2003), and to Canada's history of failed diversification attempts.²¹

A final prominent justification for Canadian inaction is the claim that Canada cannot attract sufficient U.S. interest to forge a broad new economic agreement. This argument is psychologically powerful because it appears to take the responsibility for improving Canada-U.S. ties, as well as the power to do so, out of Canadian hands. However, the proposition is insupportable. U.S. concern over its strained global relations alone would create favourable conditions for a Canadian approach. Moreover, as the review of the possible elements in a new Canada-U.S. economic and security arrangement in the next section of this paper illustrates, the logic of creating North American public goods through coordinated action applies

19 Between September 2001 and September 2002, import, transport and insurance costs, expressed as a share of Canadian exports to the U.S., rose by 12.4 percent, after more than five years of declines (NAFTA FTC 2003).

20 As Weintraub (2004) remarked: "The parade of bilateral and plurilateral free trade negotiations seems relentless. The United States has concluded FTAs with Canada and Mexico (in NAFTA), Chile, the five Central American countries (Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua, in CAFTA), and is now negotiating or planning to negotiate with the Dominican Republic, Panama, and most of the Andean ... countries (Colombia, Ecuador, Peru, and potentially Bolivia). The only significant Latin American omissions are the four countries of Mercosur (Argentina, Brazil, Paraguay, and Ecuador), and Venezuela. If Mercosur and the EU conclude FTA negotiations, this would split the hemisphere (at least for a time) into European and U.S. affiliated groups, which is less than ideal from the viewpoint of a unified hemisphere."

21 As Gotlieb (2003) points out, when the "third option" was enunciated by the government of Pierre Trudeau, 65 percent of Canada's exports went to the United States; 11 years later, 80 percent did.

to the United States, as well. The electoral cycle and the ebb and flow of international events will create opportunities to advance a public-good agenda. Canada's challenge is to make that case convincingly, and to be ready to back it up with a coherent negotiating framework and serious political commitment.

Items for a North-American Public-Goods Agenda

The public-good payoffs from economic and security cooperation, the differing geographic and sectoral scope of these payoffs, and the need for investments in coordinated action to obtain them, are clear in many proposals for Canada-U.S. negotiations. The list I present in the next section is not comprehensive, but highlights proposals that have attracted a reasonably strong consensus, and in which the logic of coordinated action is clear.

Finishing the Unfinished Business of Trade Liberalization

The elimination of many traditional trade barriers between Canada and the United States under CUFTA and NAFTA shows the mutual benefits of coordinated curbs on protectionism. Further investments in freer flows of goods across the Canada-U.S. border — and, where Mexico is ready to join, throughout the NAFTA area — can build on these gains.

Reducing Remaining Traditional Barriers

A striking share of remaining traditional trade barriers between Canada and the United States affect agricultural products.²² Headline Canadian complaints concern U.S. trade restrictions on exports of sugar and sugar-containing products, while U.S. complaints target Canadian barriers to the dairy products, eggs and poultry covered by marketing boards, as well as regulatory impediments to shipments of fresh fruit and vegetables and grains.

While the power of agricultural interests to construct barriers to imports is an awkward fact, it is also an oblique indicator of the magnitude of the consumer benefit from reducing those barriers. Canadians old enough to remember how unpalatable typical domestic wines were before the trade liberalization of CUFTA have first-hand experience, not only of the effects of liberalization on prices, but of the boost that competition can give to quality in previously protected sectors.²³ Even a very long-term program to expand amounts of agricultural products admitted at a lower tariff under tariff-rate quota systems — by, say, 3 percent

²² Canadian and U.S. complaints about each other's trade barriers can be found in DFAIT (2004) and USTR (2004).

²³ I thank Michael Hart for bringing my attention to this example, which also illustrates a successful application of transition assistance to a sector newly exposed to competition.

annually — while lowering the applicable tariffs by small degrees each year would promote a rationalized industry, lower food prices, and higher food quality across the continent.

Some commentators argue that bilateral liberalization would deprive Canada and the United States of bargaining chips they could use in the multilateral forum, where hopes for large-scale dismantling of barriers to agricultural trade persist. Current obstructions have not stopped deeper cross-border integration in the food industry, however, making lower barriers as obvious a route to greater competitiveness in North America's agri-food sector as they are in other areas. A protracted liberalization would help contain protectionism in North America, while still giving the two countries — perhaps moving in concert — something to offer at the WTO.

Tariff Harmonization and Simpler Rules of Origin

To reduce the distorting and potentially protectionist effects of rules of origin in the NAFTA area, the three countries should simplify the rules themselves and introduce tariff changes that would make them less salient. One option is to waive rules of origin where the incentive for importers in one country to avoid its tariffs by using another country as a conduit are low — that is, where most-favoured-nation tariffs are zero or tariff rates among the NAFTA countries are close.²⁴ Hufbauer and Schott (2003) recommend that the NAFTA countries waive rules of origin in any category of goods where a specified proportion of tariff rates are within a given threshold amount.²⁵

The benefits from eliminating rules of origin have been estimated as larger than the benefits from moving to common (lower) external tariffs (Kunimoto and Sawchuk 2004), and eliminating rules of origin for a category of goods would likely weaken political support for tariff changes that might prompt their re-establishment. A stronger bulwark against divergent tariff changes that would also cover rules of origin is tariff harmonization. Hart (2004) advocates common tariffs on as many items as possible through a combined process of tariff-rate simplification and harmonization toward the lowest rates among the NAFTA countries. Such changes are easier to contemplate for Canada and the United States alone because, as Goldfarb (2003a) documents, Canadian and U.S. tariffs on imports from outside NAFTA are typically very close. A sector-by-sector approach, though untidy, would allow rapid progress in industries that both countries tend to treat similarly, as is currently the case with computers and parts, and might also enable Mexico to join when it is ready, while not holding the effort up when it is not.

24 Canada's tariff schedule has 6,821 industrial tariff lines; that of the United States, 8,445. Of these, roughly 3,000 describe items on which no duty is charged. For some 40 percent of the remainder, the difference in tariff rates is less than 2 percentage points (CCCE 2004).

25 Specifically, they propose waiving rules of origin when 90 percent of the three members' 8 digit HTS rates in any 2 digit HTS group fall within plus or minus one percentage point of the average for the three.

Sector-Specific Trade-Remedy, Competition-Policy and Subsidy Accords

Attractive complements to moves to harmonize tariffs and do away with rules of origin are sector-specific agreements to limit trade-remedy harassment, reduce tension over subsidies, and address regulatory barriers. The rationalization and growth of the North American vehicle industry following the Auto Pact shows how a sectoral agreement over a well-defined economic area can reap major gains.

Sectoral accords are an attractive route past U.S. resistance to an across-the-board exemption for Canada from trade-remedy laws. Hufbauer and Schott (2003) say that time-limited (say, renewable every five years) sector holidays might be negotiable — an idea all the more attractive because the integration that such holidays would promote would tend to generate support for making them permanent. Hart (2004) proposes the gradual removal of certain sectors from Canadian and U.S. trade-remedy actions directed against each other's imports, and the substitution of joint remedies against third-country imports in those sectors.

A useful complement to such arrangements would be sector-specific agreements to apply common competition policies. Anti-dumping actions brought by producers with market power, or against producers without it, are suspect in principle because fear of predation is the only economically coherent rationale for these penalties. Involving competition authorities — those of the importing country in the former case, and those of the exporting country in the latter — in screening anti-dumping actions would help insulate many sectors from them. A more ambitious approach would follow through on the original commitment by the NAFTA partners to develop common merger policies. As the North American market becomes more integrated, national borders become increasingly less relevant to competition policy concerns.

Canada's reluctance to discuss controls on subsidies in the CUFTA negotiations lengthened the odds against getting exemptions from U.S. countervail laws. Here too, however, sectoral deals offer a possible way out of the current impasse. Negotiations on a green-yellow-red system that draws lines between policies (including subsidies below a certain level) that should be immune from countervail and those that are not could further limit trade-remedy conflicts. Limiting countervailing duties to amounts that would offset the net difference between subsidies available in the exporting country and those available in the importing country, rather than the gross amount of the former, would reduce the size — and therefore the incentive to seek — some countervailing duties.²⁶

U.S. interest in a secure energy supply from Canada offers a useful entry into discussions that could address Canadian concern over other energy-related U.S. subsidies, such as those to pipelines and electricity, as well as commodities where U.S. interests have proved adept at manipulating trade-remedy rules, most notably softwood lumber. Such agreements could also defuse trade disputes over some agricultural products, with grains and oilseeds being a promising area where both sides have concerns about market access and subsidies.

²⁶ Schwanen (2004, 43-44) suggests wording for a treaty article on such matters.

Responding to Deep Integration

Sectoral accords, in which Mexico might or might not take part, can also help ease the frictions of deeper integration. Coordinated action does not, of course, always offer benefits larger than the costs of losing domestic autonomy,²⁷ but there are numerous areas where a high-profile commitment to cooperation could yield important gains.

Harmonization and Mutual Recognition of Standards

The scope for mutual benefit from harmonization and mutual recognition agreements (MRAs) in health, safety and other areas is evident from Canadian and U.S. lists of trade irritants. Canadian complaints highlight barriers such as country-of-origin labeling for beef and other foods, requirements for industrial alcohol testing, and potential barriers, such as certification of forest products. For its part, the United States complains about numerous national and sub-national labeling, testing and certification requirements.

As Hart (2004) and Haynal (2004) emphasize, Canadian and U.S. health and safety standards are fundamentally similar. In most sectors, differences in standards are trivial, and arguably hurt Canada — obstructing exports and, in such areas as pharmaceuticals, where Health Canada approvals are notoriously slower than those of the U.S. Food and Drug Administration, harming consumers. While not without friction, consensual standard-setting already exists in many areas. From a technical standpoint, little prevents sectoral working groups from producing action lists for harmonization and MRAs in these areas, including harmonized approaches to restricted or prohibited goods. The prospect of overarching agreements along the lines of the 1988 Trans Tasman MRA between Australia (and its state and territorial governments) and New Zealand, under which each country legislates the acceptability of goods that could be legally sold in the other, would be a useful spur to work in individual sectors. Sectoral agreements covering goods such as chemicals, pharmaceuticals and agricultural products would also dovetail effectively with new security arrangements.

Similar comments apply to many areas of services. Canadian and U.S. financial services regulation responds to essentially the same imperatives, and national and sub-national agencies from the two countries have promoted common standards and cooperation on enforcement in many forums. Recognition of public-good benefits from cooperation in securities regulation is evident in the Multi-jurisdictional Disclosure System, which streamlines Canadian and U.S. regulation of cross-border issuing, trading, disclosure and filings, and gives Canada a unique position in the U.S. market (Stromberg 2003). Intergovernmental agreement in this area — ideally complemented by further relaxation of restrictions on foreign

²⁷ Some commentators have argued that monetary integration, for example, would remove an impediment to North American commerce. Others, however, maintain that the public-good costs imposed by the necessary changes in central banking and financial regulation would likely exceed the benefits (Robson and Laidler 2002). For that reason, such proposals do not appear in this list.

investment (especially in Canada) and business activities (especially in the United States) — could codify and solidify an already close arrangement.

Another candidate for a sectoral arrangement is telecommunications. Canada's barriers to investment and participation in broadcasting and telecommunications irritate U.S. political and business leaders, while U.S. obstacles to the export of telecommunication services aggravate Canadians. Air transport — where restrictions on investment and services raise prices to consumers and reduce industry competitiveness in both countries — is another. In both cases, restrictions crafted to protect domestic suppliers are increasingly out of place in a more integrated economy, and many objectives — such as Canada's desire to support domestic cultural products — can be addressed in less distorting ways.

The sectoral approach may also help reduce disputes over government procurement practices, a form of protectionism that is hard to control because of the number of levels of government and the variety of agencies through which it operates. Adding open procurement provisions to agreements in such areas as fossil fuels and electricity would make the necessary investment of political capital easier and enhance the benefits of sectoral accords to both sides.

Many product and professional standards are so complicated that no overarching political agreement can realistically anticipate the precise changes that harmonization, either for its own sake or to facilitate mutual recognition, would necessitate. But complexity is no reason to avoid such agreements — indeed, high-level political direction can help negotiators maintain the focus and momentum necessary to reach an accord.²⁸

Pacts on Migration, Social and Environmental Standards, and Taxation

Canada and the United States have a common interest in facilitating the benign movement of people into and within North America. Broadening the categories of workers covered by temporary-entry programs would be straightforward. A more ambitious approach, again borrowing from the Trans Tasman MRA, would be to address, likely sector by sector, each occupation affected by legislative requirements for registration and certification, looking for places where agencies responsible for certification in one jurisdiction could, or would have to, respect decisions of counterparts elsewhere.²⁹

Tax-related distortions of flows of investment and investment income also hold out hope for mutual benefits from reducing them. Cutting or eliminating withholding taxes, and removing discriminatory provisions in Canada's taxation of dividends and both countries' treatment of interest deductibility, would improve resource allocation throughout North America. Existing tax treaties show that the benefits of such cooperation have warranted their political price in the past.

28 On the similarity of U.S. and Canadian regulatory objectives, and the need for political direction as a spur to regulatory cooperation, see Industry Canada (2002).

29 Schwanen (2004) has proposed a model for agreements that would commit sub-national governments to mutual recognition once a critical proportion of them signed on.

In the NAFTA negotiations, Canada resisted provisions that would have permitted penalties related to member countries' social and environmental practices, fearing that these would become protectionist tools. If, as Hufbauer and Schott (2003) maintain, social and environmental cooperation would improve the salability of new arrangements for North American economic integration, Canada must forestall putative public-good arguments that could justify new barriers at the border. Piecemeal Canadian accommodation of U.S. desires on these matters is less desirable than a higher-profile pact that would commit both sides to avoiding protectionism — an accord that would be more challenging to achieve, but arguably more effective, if Mexico were part of it.

Bolstering North American Defense

Canadians require less convincing about U.S. interest in common defense and security arrangements, but their ambivalence warrants a review of the public-good aspects of cooperation in these areas, and the importance of political direction to ensure that the necessary coordination occurs.

Ballistic Missile Defense

Militarily, the most pressing concern is translating Canada's January 2004 decision in principle to participate in missile defense into amendments to NORAD that make Canada a partner in the system's design and construction. As Mason (2003) explains, the United States has framed its current plans without Canadian participation and without specific provisions for protecting Canada. Missile defense will be more effective at less cost if Canada participates, however — and, if successful, will protect Canada's most populated areas.

The Aug. 5, 2004, agreement to attach NORAD's missile warnings to the U.S. missile defense system was a key step. Fully integrating NORAD with the new system would build on a cooperative arrangement in which both countries have high confidence, and preserve Canadian access to U.S. strategic decision-making at the highest level (Robson, J. 2003).

Continental Defense

NORAD, because of the bi-national cooperation it embodies, makes an attractive vehicle for other joint North American defense efforts, particularly since the United States has made its commander of NORAD the commander of NORTHCOM. Putting more land, air and sea forces under NORAD would expand the capabilities of each country's forces in a framework that both sides have found to be an acceptable compromise between integration and preservation of national sovereignty.³⁰

³⁰ Forces are assigned to NORAD for specific purposes, and their command remains with the assigning country.

Equally important is that Canada should improve the numbers and quality of its armed forces to bolster their contribution to North American defense generally, and their ability to operate jointly with U.S. forces in particular. Mason (2004b) outlines possible U.S. priorities in this regard: rebuilding a self-sufficient blue-water fleet; new maritime helicopters; airlift capability; new investments in information technology and command-and-control capability, and more numerous reserves. Expanded joint Canada-U.S. procurement and training would also benefit both countries.

Mexico's profoundly different military and foreign-policy posture makes territory north of the Rio Grande the apt focus of these efforts. A high-profile Canada-U.S. commitment to closer defense cooperation would serve two related goals — help the Canadian government make the needed expenditures, and induce the United States to make Canada a fuller partner in procurement and deployment — expanding the public-good payoff.

Enhancing Domestic Security

Cooperative efforts to protect citizens from bombs, chemical weapons and bio-terrorism are obviously in the interests of Canada and the United States. Existing administrative structures make the border a natural line of defense against them, as well as against such inadvertent threats as disease and unsafe food. So reducing the border's salience requires a conscious effort to redefine the scope of health-and safety-related public goods to encompass both countries' populations.

As Rowswell (2004) points out, the principles underlying the defense agreements of the 1930s and 1940s are identical to those that should inform Canadian and U.S. attitudes to other types of continental security threats. And in this area, too, higher-profile efforts can magnify the benefits from cooperation. Visible up-front investments will assure each country that the other's actions enable the safe redeployment of resources away from a long, hard-to-control border. The result would be better monitoring of a more manageable set of entry points into North America, and more explicit focus on cross-border areas defined by the potential scope of accidents and natural disasters.

Screening Goods and Services

Pushing the screening of dangerous goods out to a North American perimeter could mitigate many current and emerging blockages to cross-border commerce. The stakes for Canada in this area have risen with such developments as the U.S. requirement for 24-hour advance notice of cargo manifest data, for registration of foreign food processing facilities and for pre-notification of the FDA for food shipments, as well as restrictions on Canadian transportation companies handling explosives.³¹

³¹ The presence of these complaints in Canada's list of U.S.-related trade irritants (DFAIT 2004) highlights their compatibility with protectionist motives.

Joint efforts to secure the continent, with a clear commitment behind them, have other positive features, as well. They can add heft to security measures that each government individually has trouble pursuing, such as ridding seaports and airports of organized crime. They can promote inter-operable screening technology, curbing the normal industrial-policy tendency to set standards tilted toward procurement of screening products manufactured (and exported) by favoured suppliers. They confront suppliers, brokers, and governments abroad with uniform requirements for the entire North American market, allowing economies of scale and adding negotiating clout. And they provide a visible commitment by each country to watch out for the other, promoting the mutual confidence needed to realize the public-good benefits of such cooperation.

Screening People

The flip-side of facilitating benign movements of people is curtailing malign movements. Canadian and U.S. authorities already exchange information and cooperate at the working level. However, the U.S. deportation of Maher Arar — a Syrian-born Canadian citizen suspected of links to Islamic extremists — to Syria, where he says he was tortured, highlighted problems when such cooperation does not have high-level commitment and open endorsement. Canada supplied information to the United States that it appears to have been unwilling or unable to act upon itself. The United States did not send Arar back to Canada, where it presumably thought him too likely to disappear or yield no useful information. The aftermath has been rumours and finger-pointing, instead of a joint claim of credit or acknowledgement of error by the two governments.

As with screening goods, common approaches to deterring and detaining unwanted people at entry points into Canada and the United States make more sense than trying to catch them at the Canada-U.S. border or trying to find them after they have disappeared in either country. Simply separating citizens of the two countries (or possibly the NAFTA area) from other migrants would speed processing at airports. More customs pre-clearance at airports and land-crossings, as well, would reduce border congestion.

Uniform documents and identification standards would facilitate the exchange of data that still eludes separate agencies within each country.³² Canadian business leaders have proposed extending the voluntary biometric identification cards used in the NEXUS and Free and Secure Trade programs to a single biometric card both countries would accept (CCCE 2004). Resolving remaining challenges in harmonizing visa-waiver country lists, visa conditions and alerts regarding undesirable people would be easier — and would clear the way to a bi-national entry-exit system to track visa overstays (Rowswell 2004) — if political leaders in

32 OAG (2004) documents gaps and inconsistencies in watch lists to screen visa applicants, refugee claimants, and travelers seeking to enter Canada among the several departments and agencies playing a role, and no oversight of the timeliness and quality of watch-list data. Hufbauer and Schott (2003) discuss the lack of coordination between U.S. immigration, intelligence and policing agencies.

both countries made prominent public declarations of their determination to look after each other's interests.

Disaster Response and Recovery

Many measures to prevent or recover from terrorism resemble or overlap with responses to such dangers as disease, failures of energy and telecommunications infrastructure, and natural disasters that may transcend national borders (Goldfarb 2004). SARS and the August 2003 blackout established new lines of communication among people working on the front lines of health services and electric power industries. Here too, high-level coordination can help overcome domestic resistance and turf-protection, and curb the administrative tendency to use the border as a line of defense.

Important as extensive sub-national cooperation is in making accords on bi-national protections and responses effective, the essential features of such agreements are fairly straightforward. Each country would commit to making its services as available to people on the other side of the border as they are to people on its own territory. And each side would commit to refraining from measures that would disadvantage people on the other side of the border more than its own citizens. A further useful adjunct would be a commitment to source security-related products from the best supplier, regardless of which country that supplier is located in.

For threats from natural disasters or infrastructure failures, the scope of the public-good benefit from these accords is clear. The need for bi- or tri-national collaboration, as the case may be, flows logically. Industry and infrastructure-specific bodies, such as the North American Electric Reliability Council, testify to the existence of these public goods, and have already effectively defined much of the scale and scope over which cooperation would be helpful.³³ Here again, the logic of public good indicates that coordinated investments, in which each side puts more into the common cause than the payoff from unilateral action would have justified, are superior.

A Framework for Negotiations

These are among the approaches that have attracted a good deal of consensus from experts. The public-good benefits they offer, and the technical and political obstacles to reaping those rewards, permit several observations about the most promising strategies for Canada as it approaches the United States — and, in many areas, Mexico.

The Key Focus: North American Public Goods

The concept of North American public goods that require international cooperation should be at the centre of Canada's strategy.

³³ Dukert (2004) notes that giving legal effect to the reliability standards agreed within the North American Electric Reliability Council requires action by Congress — an illustration of the need for coordinated investments of political capital to reap certain public-good rewards.

Canada can, of course, act on its own to improve its economy and its security. It can align its tariffs with those of the United States. It can benefit consumers and enhance its competitiveness by unilaterally liberalizing agricultural and services trade. Less restriction on investment in telecommunications, broadcasting, financial services, and air transport is also an important goal in its own right. Harmonizing to U.S. standards in areas where differences are small would enhance Canadian producers' position in the North American market. Canada can reduce damaging taxes, such as levies on capital and high marginal rates of tax on personal and business income.

Dealing with security, Canada can improve border infrastructure and address the problems recently highlighted by the Auditor General in airports and intelligence coordination (OAG 2004). It can reduce outflows of trash. It can reform its refugee determination process. It can enforce its visa regulations more diligently and replace local staff in sensitive areas in its embassies and consulates with Canadians (Rekai 2002). Strengthening its armed forces is clearly something Canada can do on its own. Indeed, the Prime Minister recently pledged more investment in border security and military equipment, and new refugee systems.

The logic of public goods, however, shows why Canadian unilateralism is less satisfactory in many of these areas than coordination. As Belelieu (2004) points out, recent steps toward a national security policy for Canada need adequate funding and focused follow-through to become a reality. Overcoming obstacles such as domestic protection and anti-Americanism is easier when the additional benefits from joint action in a well-defined area are in prospect. Defense spending has finished well behind even low-priority areas such as Crown corporation spending and business subsidies in recent federal budgets, showing how hard it is for Canada to sustain its military commitments on a piecemeal basis.

The multilateral arena offers benefits larger than those that are available through unilateral action. The WTO may achieve agreement on lower agricultural subsidies and less protectionist food safety standards, and it may also clarify trade-remedy procedures in ways that would lessen the need for NAFTA Chapter 19 reviews. Likewise, such options as the Free Trade Area of the Americas negotiations (FTAA), and transatlantic or other bilateral accords, may bring new approaches to harmonization and MRAs.

Its uncertainties and intrinsic neglect of payoffs specific to North America, however, make the Doha round an unattractive substitute for Canada-U.S. discussions. As well, the FTAA negotiations may come to nothing. While multilateral efforts can complement U.S.-focused work, Canada must not allow multilateral approaches to detract from efforts centred on the United States. Trying to integrate the recently concluded U.S.-Australia free trade agreement with NAFTA, and similar efforts to get inside other bilateral accords between the United States and other partners, is a sensible, though unsatisfying and reactive, tactic. Economic agreements that do not include the United States offer smaller payoffs at best — life in a spoke on a European hub, for example, will be less prosperous than life in a North American hub — and represent suboptimal investments of Canadian leaders' time, attention and political capital.

On military matters in particular, Canada should avoid making multilateralism an end in itself — a badge that sets Canada apart from the United States. Most

countries in the United Nations are not interested in North American public goods and many are downright hostile to them. The creation and expansion of public goods depends on coordinated action by the countries best positioned to enjoy them, and in the defense area, Canada and the United States are in a category of their own.

The Varying Scope of Different Public-Good Payoffs

As well, there are many different public-good benefits on offer in North American economic and security cooperation, and the more closely a negotiating strategy matches different potential accords and institutions to the specific geographic areas or spheres of activity at issue, the likelier it is to succeed.

At the highest level, a simultaneous commitment by leaders on both sides to address each other's principal economic and security concerns offers an overarching bi-national payoff. Especially for Canadians who doubt their ability to capture U.S. attention on economic grounds alone, negotiations on economic and security issues at once have obvious attractions. The erosion of support for trade liberalization in Washington doubtless makes enhanced integration under the security heading more compelling to U.S. leaders (Anderson 2004); Mason (2004c) argues that a "big idea" from Canada, centred on the single North American security space, will find a receptive U.S. audience. As Gotlieb (2003) puts it: "Canada's stance on security and defense issues is treated with intense importance in the White House. It opens doors like no other key." Despite the greater preoccupation of Canadians with the economic realm, and of U.S. leaders with security, the larger benefits to each side from coordination in both — and the inducement to each side to invest more than it otherwise would in both — make a compelling case for an encompassing approach.

At the same time, examination of specific areas of potential closer cooperation reveals that the benefits from various economic and security-oriented measures are not all available in the entire territory bounded by the Canada-U.S. outer perimeter, or for everyone engaged in any activity in the two countries. In some sectors, especially manufacturing, accords on tariffs, MRAs or investment will be relatively easy to achieve; in others, progress will be slower and less comprehensive. A successful framework will need to be robust when, as always happens in negotiations, the number of tables surrounded by experts and interested parties begins to rise.

A related point concerns timing. Some sectoral accords would unite economic and security elements in one package suitable for simultaneous discussion. But accords on various sectors, and different elements in security and military agreements, can proceed faster or slower as needs dictate.³⁴ To pick an extreme example, making progress in agriculture contingent on progress in missile defense would be to offer gratuitous hostages to fortune.

34 Noble (2004) argues, for example, that the March 11, 2004, attacks in Madrid and the presence of numerous terrorists on its own soil make improved domestic security too urgent a priority for Canada to wait for consensus on a program for Canada-U.S. economic cooperation before proceeding.

Mexican participation, or not, in different elements of a North American negotiation offers several examples of different public-good benefits from cooperation in different geographic areas and spheres of activity. North American public goods do not stop at the U.S. southern border, but a Canada-U.S. negotiating agenda will not resemble a Mexico-U.S., or a trilateral, negotiating agenda.

In economic matters, more interests coincide, and many of the opportunities for improvement would involve modifications of NAFTA. Even where Canada and the United States end up moving first, Mexico could accede to the relevant agreements and institutions later. In areas such as mutual recognition of professional credentials, however, Mexican participation would be more difficult. Migration generally is a more contentious topic for Mexico, and that country's involvement in any arrangements that matched adjustment funds with liberalization efforts would inevitably complicate the discussions.

Mexican-U.S. security concerns are very different, and military cooperation is at a far lower level than is the case with the Canada-U.S. relationship, while Mexican participation in NORAD is not relevant to any of the parties — a key difficulty, given the centrality of security and military concerns in the U.S. These complications do not preclude agreement among all three countries on many matters. They do signal that in some respects, however, deeper North American cooperation is going to resemble arrangements in Europe, where numerous individual exceptions mean that the boundaries of the major international economic and security spaces are not identical.³⁵

The overall shape of a negotiation, therefore, has to balance two considerations. On the one hand, Canada requires a broad package to mobilize a winning coalition of interests both in the United States and at home. On the other, several distinct sets of discussions of specific economic sectors, border mechanics, cross-border cooperation in response to emergencies, and military cooperation, have to proceed with a large degree of independence.

Although the idea of two- or three-track negotiations under a broader agreement lacks elegance, it has merit not just because it squares an awkward circle. The payoffs from rules-based systems of exchange, from joint efforts to secure domestic territory, and from cooperation abroad are compelling goals, each in its own right. There is more to deeper and broader collaboration in pursuit of North American public goods than a simple bargain where Canada makes concessions on the security front to obtain U.S. concessions in the economic field. Many U.S. leaders have to be convinced of the merits of economic accords, just as many Canadians need convincing of the merits of security agreements. An overarching determination to pursue both can create a mutual commitment to a larger investment of political capital in persuading each group.

35 As Abgrall (2004, p. 24) notes: "Europe offers an example of such a complex combination of associations among nations. For instance, Norway is a member of the Schengen Agreement, of NATO, but not of the European Union. Austria is a member of the Schengen Agreement, of the European Union and of the Euro zone, but not of NATO. U.K. is a member of the European Union, not of the Euro Zone, not of Schengen, but it is a member of NATO. France, Germany and others are part of all."

Big Payoffs Require Big Investments

Public goods require coordinated action, and coordinated action necessitates commitment. The intuition that substantial returns require substantial investments — which in this case would mean both commitments of tangible resources and investments of political capital — is an important inspiration for phrases such as the “big idea” (Dobson 2002), or a “grand bargain” (Gotlieb 2002), to describe efforts to move Canada-U.S. relations decisively forward. Indeed, maintaining good high-level Canada-U.S. relations is a real public good in its own right, meriting investment of resources beyond those needed to secure the individual benefits at issue.

Many of the measures outlined in Brison’s speech, or otherwise aired in recent Canadian government documents³⁶ — simplifying or eliminating rules of origin, tariff coordination, sectoral trade-remedy and MRAs, broader temporary work travel arrangements, coordinated efforts to combat bio-terrorism, build cross-border infrastructure, and monitor maritime access — are, in principle, achievable through incremental discussions. Incremental management of economic issues has been a constant in Canada-U.S. relations, and was evident in the quick success of many of the Smart Border initiatives.³⁷ Canada-U.S. relations are so broad and deep that departments and agencies in each national capital have links with their counterparts, and many sub-national governments coordinate closely, as well (Sands 2003). For private-sector bodies such as the Canadian Standards Association, engagement with U.S. counterparts is an ongoing task. Day-to-day life is an incremental business, and in areas where both sides agree on solutions, they can proceed without waiting for bigger packages.

Yet while cooperation across a broad range of small issues can mitigate the effects of adverse larger trends, Canada and the United States both need more. Deliberately restricting proposals to those that the executive branch of each government can grant the other aims too low. It takes away the broader vision that can motivate incremental moves that, considered individually, might not seem worthwhile. It deprives timetables and deadlines of significance. It precludes a larger-scale trading off of special interests for the sake of larger mutual gains. It reduces the opportunities for each side to improve on negative perceptions in the other, and increases the risk that new events — and new terrorist attacks in particular — will trigger unhelpful reflexes. And it rules out the legislative changes that would help make improvements permanent.

Incrementalism is not a compelling banner behind which either the Canadian or the U.S. governments can muster troops. On a political level, a big push towards more harmonious economic relations and more cooperation in security and defense

36 See Barry (2003), who cites Graham Fraser, “Plan Would Give U.S. a Say in Our Energy,” *Toronto Star*, January 9, 2003, pp. A1, A17; Drew Fagan, “Is It Time for a Summit?” *Globe and Mail*, January 14, 2003, p. A15; Steven Chase and Greg Keenan, “Canada, U.S. Consider One Steel Market,” *Globe and Mail*, February 1, 2003, p. B2. See also Drew Fagan, “PM looks at tightening Ottawa’s ties with U.S.” February 24, 2004.

37 Belelieu (2003) points out that much of this work had roots earlier in the 1990s: in the 1995 Shared Accord on the Border, which improved customs and immigration procedures; and in the 1997 Border Vision Initiative, which improved information sharing and inter-agency coordination.

gives leaders a key lever over legislators and officials who are prone to protectionism or recriminations and name-calling. The way the 30-odd committees and working groups established under NAFTA have bogged down illustrates the need for high-powered direction of such work.

Exaggerated U.S. claims about Canada's lax attitudes toward security and congeniality toward terrorist groups, like Canadian characterizations of U.S. leaders and citizens as "morons", "bastards" and "idiots", threaten cross-border relations more when leaders feel little need to counter or rein in those who are pointing, or giving, fingers. Business leaders, experts and others on both sides of the border can much more easily support attempts to improve relations when there is a concrete program to provide energy and focus. Canadian prime ministers who commit to a major negotiation will not only find it easier to engage U.S. interest — they will also find it easier to bring their compatriots on side.

Conclusion

The need to improve North American cooperation on economic and security matters has prompted many useful ideas. Yet Canada and the United States face economic and security challenges that are different and in many ways more awkward than those of the past half-century, and adverse political trends in both countries indicate that past political capital invested in the special relationship in North America has largely depreciated. Those circumstances may not only prevent these individual ideas becoming reality, they may even unravel previous cooperative efforts.

Dealing with these challenges requires both countries — but especially Canadians, in whose hands initiatives to move ahead mainly rest — to think more boldly about the benefits from improving commercial opportunities and physical security in North America. Because these payoffs have important public-good elements, Canada and the United States can coordinate to achieve gains bigger than the sum of each country's individual actions. Since different benefits are available over different areas and spheres of activity, a framework that provides the vision of overall cooperation, accepting the need for separate discussions of individual elements, is essential. And because coordination is a response to the incentive to under-invest in public goods that will otherwise affect each potential partner, the negotiations require an investment of political capital at the highest level.

Key elements in a package that would enhance Canadian and U.S. prosperity and security are well known. Piecemeal efforts to advance them leave these objectives exposed to risk from unforeseen events; preparation of a larger package offers the chance to strike when the electoral cycle and outside events create the right opening. To advance a North American public-good agenda, Canada needs a clear vision of the benefits, a framework that matches specific discussions to the payoffs they aim to achieve, and high-level commitment to succeed.

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