



Bilateral Security Relations and Canadian Prosperity Danielle Goldfarb¹, C.D. Howe Institute, September 2004

In the next 10-to-15 years, the odds are that Canadians will experience new terrorist attacks in North America and new border security requirements that affect movements of goods, people and, by extension, services. While some Canadians may be indifferent or even hostile to U.S. policies and politicians, Canada's prosperity will depend in large part on its ability to continue to capitalize on its geographical proximity to the world's economic and military superpower. A major share of the nation's exports, jobs, investment, and the incomes that provide Canadians with high quality social goods will be vulnerable to security-related border disruptions. And Canada will face increased global competition for trade and investment.

Canada's challenge in this context will be to ensure that domestic and regional physical security measures reinforce, rather than jeopardize, its economic security. Maintaining predictable access to the U.S. market, while addressing physical security in the current environment is one thing; however, another attack on the U.S., especially one linked to Canada,² will make this a far more daunting problem. As well, Canada — and its prosperity — could suffer from direct attacks, even if the U.S. is the ultimate target. Al Qaeda can hardly have overlooked the fact that disrupting Canadian critical infrastructure such as energy supplies or transportation networks can cause severe economic damage to the United States.

This paper discusses considerations for Canadian policymakers as the country develops its security relations with the U.S. in the context of a regional economic space.

Background

Canada and the U.S. share the world's largest bilateral trade relationship, with two-way merchandise trade of C\$531 billion in 2003, and as much as 80 percent of Canada's goods and services exports going to the U.S. Despite some concerns over the accuracy of the trade statistics, the two economies are unquestionably highly integrated and, over the next 10-to-15 years, they are likely to remain so and perhaps even become more intensely inter-dependent.

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² U.S. officials have warned that al-Qaeda may be in the final stages of preparing another attack in that country and the FBI says the group may try to move terrorists into the U.S. through Canada to carry out the plot (Stewart Bell. Al-Qaeda may target Michigan, U.S. warns. July 8, 2004. National Post. A4.).

The need for secure access to the U.S. market motivated Canada to pursue a bilateral free trade agreement with the U.S., followed by NAFTA. But the attacks of September 11, 2001, jeopardized the relatively predictable — albeit imperfect — access gained under those agreements. The U.S. effectively embargoed its own economy by virtually shutting down its borders and later adopted a series of new security requirements, many of them at border crossings.

Canadian officials tempered some of the negative economic consequences of the new measures by promoting a risk-based approach to security under the Smart Border Accord. Among other activities, the two countries expanded their joint program for facilitating low-risk travelers and established the joint Free and Secure Trade (FAST) program for fast-tracking cargo. Canada also secured exemptions for its citizens from the U.S. VISIT program, which requires fingerprint scans at United States entry and exit points, and fought to tone down advance notification requirements at the border. Ottawa developed a national security strategy and created a counterpart agency to the U.S. Department of Homeland Security, measures likely to improve trust and make U.S. decision makers more aware of Canadian interests. Despite these efforts, many U.S. decision makers still view the border as a front line of defense, and Canada's economy is still vulnerable to existing and potential security-related border restrictions — and the repercussions of another attack.

Issues

As new threats unfold and Canadians determine how best to approach security as part of a shared regional economic space, they should consider the following:

Canada has a large stake in regional security. Security is not just a domestic issue; security risks in each country directly affect the other. When the two nations act individually, they may not take into account the effect of their actions on the other country, making clear the need for joint action in their mutual interests. From an economic viewpoint, trade and investment thrive in predictable and secure environments. With a relatively small, open economy, regional stability is critical for Canada. And with limited resources to address real security threats, Canada has an abiding interest in building its bilateral security relations.

Border tightening disproportionately affects Canada's economy. There are a number of possible responses to security imperatives, and those that lessen predictability at the border impose large economic costs. Frequent security-related border disruptions³ and onerous border security requirements matter more for Canadian prosperity than for the U.S.⁷ for several reasons.

—Predictable access to the U.S. affords Canada far greater growth prospects than if the country were confined to selling to its relatively small domestic market. In 2003, U.S. goods exports to Canada made up less than 3 percent of United States GDP, while goods exports to the U.S. constituted about 27 percent of Canada's GDP.

³ There are many non-security related reasons for border disruptions, but these are not addressed here.

—Large parts of Canada’s trade depend critically on predictable access to the U.S. economy. Manufacturing industries in Ontario and Quebec primarily use just-in-time (JIT) inventory management, a system in which goods must be delivered within hours of order. Uncertainty forces companies to carry more inventory, nullifying the increased competitiveness that JIT provides. Other Canadian exports, such as fresh seafood from the Maritime provinces, are also time sensitive and highly exposed in the event of border crossing uncertainty. Not only that, a significant proportion of trade takes place in intermediate, rather than final, goods (one-third of Canada’s export value is import content — Cross, 2002), and delaying materials in either direction affects production on both sides. Ontario can only increase its exports of cars if it simultaneously increases its imports of car parts.

—Producers can entirely avoid the border by making their complete product in the U.S. and selling it in that large internal market. If border crossing becomes too onerous or unpredictable, or is even perceived to be so, the advantages of locating production in the relatively smaller market to serve the larger one disappear. Though some exports — natural resources products, for example — can only be produced in Canada, many U.S. manufactured goods can easily substitute for Canadian ones. The auto industry, in particular, faces medium-term threats: As China’s auto sector develops, that country will likely attract investment away from North America.

U.S. perceptions of Canada’s security policies matter for Canada’s prosperity. Congress and the U.S. media regularly voice concern that Canada has lax immigration controls. Accurate or not, the perception that Canada does not share the U.S. view of the threat can translate directly into U.S. policy decisions, such as stricter border controls. As well, a more impenetrable border can lead to investment gains in the U.S., so there is a danger that U.S. defense and protectionist interests may join forces in calling for tighter border controls, particularly during election years. Such calls would be difficult to counteract in the event of a new attack, especially one linked to Canada.

Border requirements may be different in 10-to-15 years. Are truck and trade volumes likely to remain stable or change? As Canada responds to competitive pressures from large developing economies, will trade become more services-oriented? If it does, will that require more two-way people movements — making smooth cross-border people movements critical — or will we depend less on borders by trading services electronically or by phone? Are current infrastructure choices consistent with future border technology? Will Canada and the U.S. harmonize or mutually recognize non-security-related border policies, such as tariffs and regulations, eliminating or moving border administration to the perimeter?

Choices

Over the next decade or so, Canada faces difficult choices as it determines how to strengthen access to the U.S. market and promote regional security, while maintaining control over policies important to meeting other domestic objectives. Canada’s national interest can be defined as protecting its territory, security, unity, independence and prosperity (Granatstein, 2003). When it comes to bilateral security initiatives to meet that

interest, Canadian decision makers start with a number of givens. For example, Canada cannot choose to pursue bilateral initiatives that do not meet U.S. interests. The fact that Canada is highly integrated with the U.S. and with global markets is unlikely to change in the next 10-to-15 years. And there are probably going to be more terrorist attacks in North America. Decision makers' choices must be rooted in these realities.

Canadians must first determine what price they are willing to pay for security. Strengthening security — whether unilaterally or through coordinated action with the U.S. — can have an infinite cost. And other desirables, such as economic prosperity and civil liberties, can be eroded if security is pursued to the limit. Decision makers should also consider who should pay for security enhancement and cooperation — the private sector, governments, or both. And should industries or modes of travel that present relatively greater security risks have to bear greater costs?

Next, Canadians should determine which approach to security relations best meets their national interest. That decision can involve looking at a continuum of choices, ranging from acting unilaterally to maintaining ad hoc bilateral security relations to pursuing a much more integrated approach to security. Ad hoc relations might involve incremental improvements in the status quo that improve security and flows strictly at the border. That approach might require increased spending on staffing, infrastructure, new crossings and tighter border security measures. Or it might lead to increased investor locational incentives to offset border crossing costs.

A more integrated approach might focus on joint inspections at entry into North America, with random and intelligence-based inspections, as well as post-audits, rather than continued routine checks at the internal border. Such a policy could require more harmonization, or mutual recognition of, immigration, agriculture, health and food safety policies (Taylor et al, 2003).⁴ And it would probably also require more spending on internal policing and intelligence. Canada might pursue such an approach as part of a deeper security and economic relationship, or perhaps as part of a much larger package encompassing public health, defense, environment and other issues that may benefit both countries by being addressed regionally.

Potential Flash-Points

The economic aspects of security cooperation may raise points of concern for some observers:

Does deepening the bilateral security relationship imperil Canada's ability to pursue independent foreign and domestic policies?

When considering closer security relations with a superpower neighbour, maintaining control over Canadian policy levers is certainly a legitimate area of concern. But would alternatives better protect Canada's ability to set policies in its own interests? Foregoing

⁴ Taylor et al (2003) estimate that the benefits of this approach would be equivalent to 3 percent of the value of goods traded.

deeper bilateral security relations may actually weaken Canada's ability to maintain its independence. Without a more proactive bilateral approach, Ottawa may have little or no influence over U.S. policies that greatly affect Canadian prosperity, jobs, investment and the incomes from which to finance high quality social goods, such as health care and education. Indeed, greater border uncertainty caused by U.S. security decisions could undercut domestic priorities. Also, a pre-established closer security relationship might enhance Canada's ability to differ on foreign policy without threatening the entire relationship, in the same way that NAFTA — essentially a pre-agreed set of trade rules — helped protect Canada from possible economic backlash after Ottawa decided not to support the U.S.-led invasion of Iraq.

If secure access to the U.S. is difficult to achieve, should Canada diversify its trade, rather than cooperate on security to gain predictable access to the U.S.?

The reality is that Canada's large, politically stable neighbour is already highly diversified by sector and region and will remain the predominant market for Canadian goods and services for the foreseeable future. Maintaining secure access to that market must be Canada's priority. At the same time, Canada must develop a parallel strategy for businesses to capitalize on market opportunities in growing regions such as Asia.

Additional issues to consider are whether Canada should incorporate Mexico into any trade and security initiatives, and whether Canada should adopt U.S. technologies to ensure compatibility, even when this results in inferior security or technology.

Recommendations

Over the next 10-to-15 years, Canadians are likely to face new terrorist attacks in North America, and increased global competition for trade and investment. In the event of an attack with a Canadian connection, the U.S. government would almost certainly tighten border security. Although the border is unlikely to close permanently, crossing it might become so onerous and unpredictable that it would greatly discourage flows of both goods and people. In the medium-term this could have a critical impact on trade in both manufactures and services, though technological advances that allow some commercial services to be handled electronically or by phone might mitigate the severity of the effects on trade in services.

On the continuum of choices that I have outlined, Canadian decision makers would best serve the national interest by extending current security collaboration towards a more integrated relationship where possible and appropriate. Doing nothing fails to stop U.S. policymakers from taking decisions that could damage Canadian interests. Ottawa's current approach to bilateral security relations is largely ad hoc — a key exception being the Smart Border Accord. An ad hoc approach may be insufficient to protect Canadian interests and restore U.S. confidence in the security relationship.

With a more integrated relationship, and a seat at the table, Canada will be better able to boost the degree of trust between the two countries and ensure that U.S. responses

to security imperatives take into account the reality of the interconnected economies. Cooperation also enables greater Canadian influence over U.S. policies — even when views differ. At the same time, Canada should not pursue improved security relations at the expense of all other priorities.

Specifically, the prime minister might consider:

An agreement in advance. Because of the asymmetric relationship between Canada and the U.S., Canada's interests will be better served if the two countries agree on how they will cooperate in advance. Rules-based cooperative agreements on dealing with economic and physical security, rather than power-based, case-by-case decisions, best enable the smaller country to protect its interests in dealing with its superpower neighbour. Also, without high-level political commitment or agreement it is difficult to maintain momentum. Rowswell (2004) says the two countries should make a "joint, solemn and enduring commitment to prevent future terrorist attacks in North America to protect against the threat of a terrorist attack on U.S. soil if delivered through Canadian territory". An agreement might be framed as part of a much larger package of regional initiatives on the economy, public health, the environment and defense.

Perimeter inspections. Given that the two countries essentially form one economic and security space, it is not clear the border is the most efficient or appropriate place to deal with either issue. Responses to security imperatives that increase unpredictability at the border effectively thicken it, diluting the potential gains for Canada from operating in a North American economic area. Consequently, Canada should work toward shifting inspections away from the border itself to places where goods and people first enter North America. This may not be possible or desirable in every area, so the border would remain. The two countries could nevertheless work to alleviate pressure at the border by shifting away from routine inspections to more intelligence-based checks, while harmonizing⁵ or agreeing to recognize each others' policies at the external perimeter. Where it is not possible to change security-related border policies, dealing with customs activities at the perimeter could relieve some of the pressure at the border.

Domestic initiatives. Addressing bilateral security issues will be insufficient to protect Canada's economic security. The country will have to undertake domestic initiatives, as well, to ensure it remains globally competitive.

Conclusion

Canada thrives on cross-border economic and social linkages, which afford residents an enviable quality of life. As security and competitive threats arise over the next 10-to-15 years, Canada's best strategy for protecting its prosperity is to collaborate with the U.S. to address regional security, though not to the exclusion of all other priorities. Ottawa should take the lead in proposing innovative joint security approaches that protect the two countries' common economic and security spaces, press to establish agreements in

⁵ Where Canadian policies differ from U.S. policies but where objectives are the same, the two countries could adopt the same policy without harming Canada's national interests.

advance and move inspections away from the internal border to North American entry points where possible. The U.S. will relentlessly address real and perceived security threats — with or without Canada. Canada's choice is to strengthen its relationship, protect its prosperity and have some influence, or accept a higher degree of risk and allow its national interests, including its prosperity, to erode.

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