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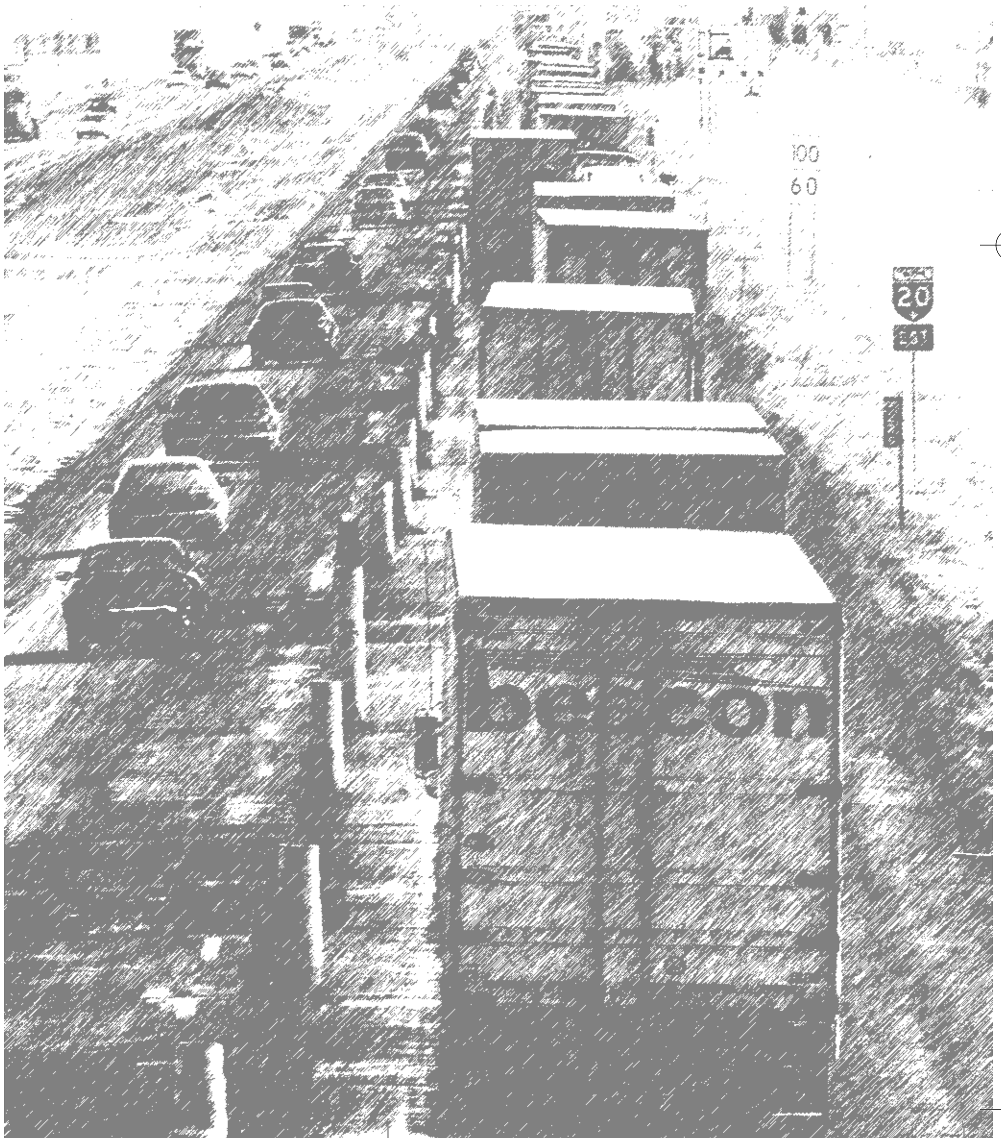
PART I THE POLICY CHALLENGES

TRADE AND GLOBALIZATION



CANADIAN ENGAGEMENT IN THE GLOBAL ECONOMY

Michael Hart

This chapter argues that Canada's principal priorities in getting more out of its international engagement are threefold. The federal government's first priority should be to pursue further domestic economic reforms that will allow market forces — that is, the choices made by Canadians as producers and consumers — to reach their full potential. Twenty years ago, Canadians accepted that they needed to banish the last vestiges of the National Policy. Remnants of the interventionist state, however, continue to limit the capacity of Canadian firms to compete in the global economy. These range from supply-managed agriculture to ownership restrictions in the financial services, telecommunications, transportation and energy sectors. Such policies may serve politically persuasive public policy goals, but they also limit Canadians' capacity to maximize benefits from their global engagement.

As a second priority, the federal government should reduce activities that provide the illusion of engagement but that lead, at best, to marginal results — from the Doha Development Round of World Trade Organization (WTO) negotiations and the pursuit of free trade agreements with minor markets to the promotion of more diversified trade patterns with new, emerging markets such as China and India. A successful Doha Round offers too few benefits to Canadians to be worth the considerable expenditure of political and human capital needed to bring these talks to a successful conclusion. Free trade agreements with minor trading partners such as Costa Rica and the Dominican Republic are marginal in their economic and commercial impact but large in their ability to gobble up political and financial resources. Government-led trade diversification has no basis in the real economy; in any event, governments agreed to eliminate or discipline the requisite instruments in multilateral and other trade negotiations because they accepted that such tools — from tariffs and quotas to subsidies and procurement preferences — were detrimental to global and national economic well-being. Trade missions and similar programs, while popular with ministers, have virtually no enduring impact on trade and investment patterns.

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Finally, the federal government should make it a priority to strengthen the policy framework that governs cross-border trade and investment with the United States in order to enhance North America's — and Canada's — capacity to participate effectively in the global economy. Productive relations with the United States are the indispensable anchor of Canadian security and prosperity, and on both fronts there are important policy issues in which the two governments need to engage. Specifically on the economic front, the two governments must do more to address the dated, dysfunctional and intrusive nature of border administration, the haphazard process leading to deepening regulatory convergence and the frail institutional capacity to govern accelerating integration.

The analysis here proceeds on the assumption that Canadians do many things right as they work to maximize the benefits of engagement in the global economy, and they should continue to do these things — from participating actively in such international organizations as the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) to maintaining a strong domestic macroeconomic environment. The focus of this chapter is on two policy areas where the federal government can do more and one where it should do less; in all three cases, such an adjustment would have a material impact on the extent to which Canadians benefit from global engagement.

GLOBALIZATION, INDUSTRIAL FRAGMENTATION AND CROSS-BORDER INTEGRATION

If we are to maximize the economic benefits of international engagement, we must first recognize the tremendous changes in the global economy that have taken place over the past few decades: the rapid and pervasive diffusion of production, consumption and investment of goods, services, capital and technology. In response to developments in communications technology and transportation facilities, and to the progressive liberalization of global markets, production is steadily being reorganized on a global basis, and the nature of extranational economic transactions reflects this change. The global economy has been transformed into "a highly complex, kaleidoscopic structure involving the *fragmentation* of many production processes, and their *geographical relocation* on a global scale in ways which slice through national boundaries" (Dicken 2003, 9).

The fragmentation of production through a process of outsourcing and subsequent rebundling within large and technologically sophisticated supplier networks

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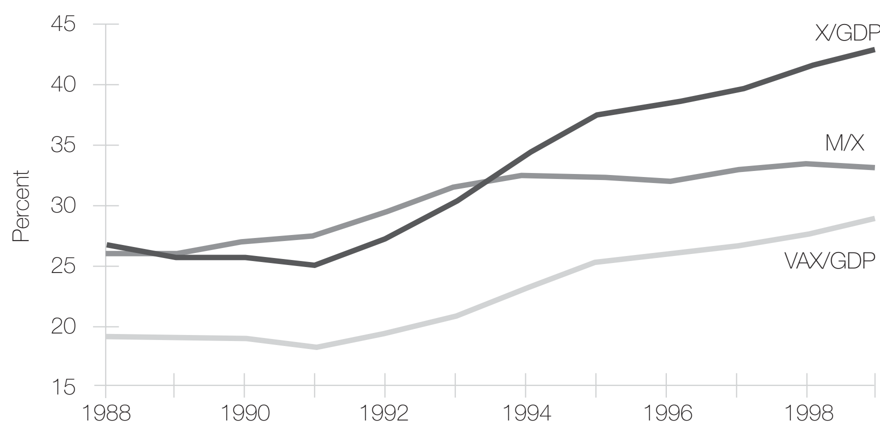
has become increasingly prevalent in, for example, food processing, aircraft and motor vehicle production and the manufacture of apparel, electronics and household products. Value-chain fragmentation and the sophistication of the firms that make up the fragments have made it easier to relocate specific nodes of production and to take advantage of a range of distant factors, from low-cost labour, specialized skills and attractive markets to access to critical inputs and public policy considerations. Fragmentation and integration combine to increase the extent and intensity of international transactions, encouraging the relocation of slices of the production process to the best possible site and allowing firms to specialize to a much greater degree and reap greater advantages from economies of scale and scope (Sturgeon 2006; Gereffi 2005).

Systematic data on the extent of this spatially dispersed integration are difficult to find, in part because conventional statistics fail to capture the full extent of trade in parts and components, the full value of cross-border service links or the input of services provided through proprietary and other networks — for example, design, engineering and marketing, whether done in-house, outsourced locally or outsourced internationally (Ridgeway 2006; Mandel et al. 2006). Statistical agencies cannot quantify the value of the Italian design and the German engineering of a toilet that is ultimately manufactured in Mexico and imported into Canada through a US distribution network. They count the computer on which this chapter is written as a Chinese import rather than the fruit of the design, engineering and marketing expertise at Apple's campus in Cupertino, California. In a world in which tariffs are low or nonexistent, customs officials are less interested in the origin or foreign value added of a particular cross-border transaction than in its final transaction price. The data these officials supply to statistical agencies often severely overstate the value contributed by the designated country of origin and undervalue the diverse inputs of other countries.

From a public policy perspective, governments are particularly interested in the intersection of firm-specific and location-specific value. Firms are now less constrained in their choice of geographic location by technology and policy, and they seek to increase value by dispersing their value-adding activities spatially. Governments, in the interest of attracting value-adding activity to their jurisdictions, now compete in promoting policy settings that are congenial to increasingly mobile slices of production by removing barriers and providing positive incentives. In this quest, they are learning that the trade agreements of the past may have been critical in providing the framework of rules that initially facilitated fragmentation and integration, but they are no longer sufficient to address contemporary policy challenges.

What is happening at the global level has a longer history at the bilateral Canada-US level. Proximity, history, technology, opportunity and policy have combined to create deep and irreversible ties between Canadian and American production and consumption patterns. Starting with US investment in Canadian mining and forestry through the establishment of tariff-jumping, miniature-replica branch plants, Canadian production has long been intimately tied to US production, trade and investment patterns, while Canadian consumers have long expressed a strong preference for American products. The implementation of the Canada-US Autopact (1965), followed by the Canada-US Free Trade Agreement (CUFTA, 1989) and the North American Free Trade Agreement (NAFTA, 1994), deepened the integration of the Canadian and US markets by accelerating the process of cross-border fragmentation and agglomeration. As US business economist Stephen Blank concludes, "Ottawa and Washington talk about the world's largest bilateral trading relationship. But we really don't trade with each other, not in the classic sense of one independent company sending finished goods to another. Instead we make stuff together…[We] share integrated energy markets; dip into the same capital markets; service the same customers with an array of financial services; use the same roads and railroads to transport jointly made products to market; fly on the same integrated airline networks; and increasingly meet the same or similar standards of professional practice" (2005).

FIGURE 1. EXPORTS (X) AND VALUE-ADDED EXPORTS (VAX) AS A PERCENTAGE OF CANADA'S GDP 1988-99



Source: Cross (2002).
Note: M/X is the import content of Canadian exports.

Philip Cross and his colleagues at Statistics Canada have done extensive work in an effort to understand the changing nature of cross-border production, trade and investment patterns. They have calculated that the import content of Canadian exports has risen steadily over the past two decades: it was 25.9 percent in 1988 and peaked at 33.5 percent in 1998 (see figure 1). The rapid rise in trade in the 1990s was in large part the result of rationalization; imported components replaced domestic components and the final product was exported to a broader market base. More significant than the rise in exports as a share of GDP was the rise in value-added exports in GDP — from 19.1 percent in 1988 to 28.8 percent in 1999 (Cross and Cameron 1999; Cross 2002). Economist Glen Hodgson concludes that "trade has evolved beyond the traditional exporting and importing of goods, and has entered the next generation of trade — integrative trade. Integrative trade is driven by foreign investment and places greater weight on elements like the integration of imports into exports, trade in services and sales from foreign affiliates established through foreign investment" (2004). Nowhere has this process of integration been more pronounced than between Canada and the United States.

High levels of both two-way intra-industry trade and foreign direct investment indicate continued cross-border integration and rationalization of production between Canada and the United States, as well as a deepening interdependence between manufacturing and service industries. Integration has allowed Canadian industry to become more specialized and has had a significant impact on the growth of value-added sectors. The changing intensity and composition of bilateral trade have contributed greatly to making Canadians better off both as consumers and as producers. Canadians employed in export-oriented sectors have consistently been better educated and better paid than the national average. As Cross and Cameron point out, "The importance of trade to the economy does not come from an excess of exports over imports: rather, it is from the productivity gains that accrue with increased specialization" (Cross and Cameron 1999, 3.3). Specialization, in turn, increases as markets expand in response to the openness fostered by trade agreements.

DOMESTIC IMPEDIMENTS TO CANADIAN GLOBAL ENGAGEMENT

Progress in reducing conventional barriers to trade and investment flows has now reached the point where, with a few exceptions, the Canadian economy is open to broad international competition and participation, as are most markets of interest to Canadian suppliers and investors. Canadian trade and investment patterns

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TABLE 1. CANADIAN TRADE AND INVESTMENT PATTERNS, 2000-06 (BILLIONS OF CANADIAN DOLLARS)

	2000	2001	2002	2003	2004	2005	2006
Exports of goods and services							
Total[1]	489.1	480.8	477.5	460.1	493.0	518.0	523.7
United States	394.3	387.9	384.4	363.9	386.8	404.4	397.6
European Union[2]	32.4	33.9	33.2	34.4	37.7	40.7	46.0
Japan	14.5	13.3	13.1	11.7	12.9	13.8	13.4
Rest of world	47.9	45.7	46.8	50.1	55.8	59.1	66.7
Imports of goods and services							
Total	427.8	417.9	427.4	415.7	440.2	466.9	486.5
United States	308.6	295.6	297.5	283.4	295.6	305.0	311.3
European Union	43.7	45.8	47.3	46.9	49.1	51.1	55.8
Japan	13.8	12.7	14.7	13.4	12.7	14.6	15.1
Rest of world	63.7	63.8	67.9	72.0	82.8	96.2	104.3
Outward FDI flows							
Total	66.3	55.8	42.0	30.1	56.3	41.3	47.8
United States	38.0	27.8	17.6	5.7	40.1	23.0	22.9
European Union	15.9	7.8	10.9	14.4	3.8	3.3	13.6
Japan	3.7	1.8	1.7	.3	1.3	.6	4.3
Rest of world	8.7	18.4	12.8	9.7	11.1	14.4	7.0
Inward FDI flows							
Total	99.2	42.9	34.8	10.7	2.0	41.0	75.6
United States	16.5	39.2	28.4	5.2	6.7	18.4	21.0
European Union	76.9	1.3	4.4	4.0	-14.3	8.5	29.5
Japan	.2	.2	.8	.5	.6	.7	1.2
Rest of world	5.6	2.2	1.2	1.0	10.0	13.4	23.9
Outward FDI stocks							
Total	356.5	399.3	435.5	411.9	451.4	465.1	n/a
United States	177.9	188.5	200.0	169.9	196.3	213.7	n/a
European Union	75.2	82.5	90.3	102.8	121.2	110.3	n/a
Japan	5.6	7.0	9.7	8.4	8.5	7.4	n/a
Rest of world	97.8	121.3	135.5	130.8	125.4	133.7	n/a
Inward FDI stocks							
Total	319.1	340.4	356.8	364.7	381.0	415.6	n/a
United States	193.7	219.9	231.6	235.6	248.5	266.5	n/a
European Union	96.0	92.1	94.3	97.3	96.6	104.4	n/a
Japan	8.0	7.8	9.3	9.9	10.3	10.8	n/a
Rest of world	21.4	20.6	21.6	21.9	25.6	33.9	n/a

Source: Foreign Affairs and International Trade Canada (n.d.).
FDI = Foreign direct investment
n/a = not available
[1] Totals may not add up due to rounding.
[2] EU-15 for 2000-01; EU-25 for 2002-06.

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(see table 1) thus reflect increasingly the market choices of Canadian consumers, investors and traders and decreasingly the effect of Canadian and foreign government trade and investment policies. Nevertheless, there remain pockets of border protection — for example, for supply-managed dairy and poultry products and for a few consumer products, such as clothing and footwear. Eliminating tariffs in these pockets would reduce existing drags on the economy by allowing markets to determine areas of comparative advantage (see table 2).

Canada also maintains a variety of domestic policies that serve as reminders of an earlier era of regulatory zeal and nationalist foolishness. These include ownership restrictions in the telecommunications, energy and transportation sectors; subsidies to favoured sectors; restrictive banking regulations and tax policies that coddle some economic activities and shackle others; and competition policies that limit mergers and acquisitions and growth. More important, such policies impede Canadian participation in global value chains and North American integration. They belong to an era in which it was assumed that products and firms had clear national identities and benefited from policies that promoted national champions. But if Canadians want to get more out of their engagement in today's world of deep regional integration and complex global value chains, then they will have to be prepared to consign such policies to the dustbin of history.

TABLE 2. SELECTED CANADIAN TARIFF LEVELS, 2006

Product	Rate (percent)	Product	Rate (percent)
Butter	298.5	Ships	25.0
Cream	292.5	Footwear	20.0
Cheese	245.5	Clothing	18.0
Milk	241.0	Cloth	14.0
Chicken	238.0	Knits	14.0
Yogourt	237.5	Carpets	12.5
Eggs	163.5	Leaf springs	8.0
Turkey	154.5	Yarns	8.0
Barley	94.5	Cotter pins	6.5
Wheat, other	76.5	Rivets	6.5
Wheat, durum	49.0	Crushed or ground spices	3.0

Source: Canada Border Services Agency (2006).

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For example, Canada imposes severe restrictions on foreign ownership and control in selected sectors of the economy. There is no apparent reason why the standard rules of investment protection agreements should not be applied to foreign direct investment (FDI) in protected industries. Most FDI today originates with transnational corporations and involves large sums of money; it is often part of a larger regional or global strategy. The widely owned corporation is one of the distinguishing features of modern business, in terms of both its financial arrangements (the sharing of risk among a large number of otherwise unrelated investors) and its institutional arrangements (a hierarchically structured organization aimed at exercising efficient control over a large number of participants in the productive process). A variety of inter- and intracorporate arrangements now allow business to be pursued efficiently and effectively on a global basis, all of them involving some form of FDI.

The presumed benefit of linking ownership to the achievement of a range of regulatory objectives appears to be a holdover from a time when there were many more regulated industries — particularly so-called natural monopolies in, for example, fields related to the telephone, electricity and urban transit — and when there was a prevalent belief that such restrictions were needed to ensure effective public regulation. Over the years, economic theory and practice have demonstrated the benefits of competition, privatization and foreign investment even in these industries, as well as the capacity of governments to regulate in the public interest without regard for foreign or domestic ownership or control (Safarian 1993). Canadians would be better off if these lessons were applied across all sectors of the economy.

Ironically, some Canadians worry that Canada is not getting its fair share of NAFTA inward foreign direct investment. Putting aside the question of whether the idea of "fair share" has any merit, Canada lags in attracting FDI for a very simple reason: Canadians have chosen to hobble the most mobile and internationally active sectors of the global economy by limiting foreign participation in those sectors in Canada. As the annual *World Investment Report* catalogues, a large share of global investment activity involves mergers and acquisitions in the telecommunications, financial services and transportation sectors (United Nations Conference on Trade and Development 2004). Canada limits participation by foreign investors in all three sectors. Simply by changing these rules, Canada could increase the relative share of FDI it attracts and thereby improve the performance of its economy.

Similarly, subsidies help some industries while penalizing others. No matter how welcome any particular government grant or "investment" may be to individual firms, regions or industries, each involves a transfer of resources from one group of taxpayers to

another. Jobs "created" or "saved" by such a program necessitate reduced opportunities for other firms or sectors. Whether a subsidy is delivered through a grant, a tax writeoff, a loan guarantee, a research and development incentive or any other government intervention, the result is the same: the substitution of political for market judgment. It may be theoretically possible for governments to make choices that over time prove wise and beneficial, but experience has not demonstrated the superiority of political over business judgment. The factors that are persuasive to governments are rarely those that are persuasive to private capital. The result is typically a misallocation of scarce resources, missed opportunities and reduced prosperity. In the long run, Canadians will see greater benefits from their engagement in the global economy if there are fewer programs that involve politically motivated investments of public funds in market-based activities.

As discussed in more detail in the chapter prepared for this volume by Andrew Sharpe and the commentaries contributed by Don Drummond and Richard Harris, there are many ways in which Canadian public policy creates a business environment that promotes private investment in productive, efficient and competitive economic activity in Canada. Nevertheless, as they also point out, there remains considerable scope for improvement. Such improvement should be undertaken not only for its own merit but also because it can strengthen Canadian engagement in the global economy and ensure greater benefits from that engagement for individual Canadians.

RETAIL TRADE POLICY AND CANADIAN GLOBAL ENGAGEMENT

Canada's self-image as a trading nation and its record of active and constructive international trade negotiations have created the inertia that is now controlling contemporary trade policy. As becomes evident when one reads the speeches of Trade Minister David Emerson and his immediate predecessors, officials busy themselves with a wide range of initiatives, from trade negotiations to export financing. To be sure, some problems are still amenable to negotiation. World agricultural markets, for example, remain deeply distorted by misguided subsidy, border and other measures; the markets of many developing countries are less open than those of developed countries; and the spread of trade remedy measures to an ever-increasing number of countries is a blight on the international trade regime. These policies may affect the interests of individual Canadian firms, but their impact on the Canadian economy as a whole is now marginal. The pursuit of trade, investment and other international economic arrangements will continue to preoccupy Canadian officials. Much of this

activity, however, now serves what might be characterized as retail trade policy: it responds to the interests and complaints of individual Canadian firms rather than to the broader interests of the Canadian economy.

In the on-again, off-again Doha Round of WTO negotiations, Canada has found itself largely on the sidelines, unable to contribute constructively (Hart and Dymond 2006). In the not-too-distant past, Canada was a player and, together with the United States, the European Union and Japan, essentially determined the agenda and outcome of multilateral trade negotiations; but India, Brazil and Australia have displaced Canada. Convinced of the political weight of Canada's farm lobby, Canadian politicians of all stripes insisted that Canada make every effort to bring down trade barriers and subsidies on Canada's exports, but not at the expense of supply management and the monopoly marketing of wheat and barley. This posture left Canadian negotiators little room to manoeuvre. However, even if Canada had adopted a negotiating position consistent with its interests as a major net agriculture exporter and left the dwindling herd of dairy and chicken farmers to face up to reality, it would have remained a minor player because it now had little to contribute to or gain from multilateral trade negotiations. The simple fact is that Canada's most basic economic interests have become inextricably bound up with those of the United States and can no longer be addressed multilaterally in the WTO.

The fact that the WTO's role as a negotiating forum is diminishing does not mean that Canada should be indifferent to other developments at the WTO. The rules and procedures embedded in the WTO and its constituent agreements provide an essential basis for the conduct of world trade, including cross-border trade with the United States. Eventual success in concluding the Doha Round may be of marginal net benefit to Canada. That success is more important to the prosperity and welfare of developing countries, but as long as most of them persist in thinking that the rules of the game are stacked against them and that they need special treatment in the negotiation and application of the rules, the impact of multilateral negotiations will remain marginal for them as well (Hart and Dymond 2003). Canada is not well placed to effect a more productive approach to a revived Doha Round; as a result, both government and business have correctly concluded that Canada should maintain a relatively low profile in multilateral negotiations while remaining an active player in the day-to-day affairs of the WTO.

As indicated in table 1, Canada's trade beyond the United States is relatively modest and is concentrated in a limited number of markets. Taking into account the supply capabilities of the Canadian economy, the returns on extensive government trade and investment promotion programs beyond North America are likely to be fairly small. Much of this

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activity amounts to the provision of a service to individual firms — a service that makes very little difference to the level of Canadian economic activity or the prosperity of Canadians as a whole. Inertia, however, maintains the extensive array of programs and attitudes developed in an earlier era, and it contributes to the myth that they have an important role to play.

Most modern industries, from the automotive to the electronics and banking industries, have developed sophisticated global and regional supply and distribution networks and would be hard pressed to identify the national origin of their inputs and even of some of their final products. Individual firms are not averse to using Canadian commercial representation at embassies abroad, but few would be prepared to pay for the service, suggesting that its importance has become marginal to their interests. In these circumstances, it may be time for the government to reconsider the benefits Canadians derive from the extensive trade and investment promotion services offered at Canadian missions around the world. Many domestic services to Canadians have been placed on a cost-recovery basis, from access to all but the most basic statistics to passports and the delivery of the mail. Given the cost of maintaining trade promotion services at dozens of posts around the world and the limited number of Canadians who are dependent on such services, Canada could stretch its foreign representation activity by exercising part of it on a cost-recovery basis — as it has already done with certain aspects of Canadian immigration programs — and by reducing or eliminating other parts.

Some Canadians believe that the government must become more actively engaged in diversifying Canadian trading patterns. They are worried that the concentration of Canadian exports to the United States exposes the Canadian economy to serious risk should the US economy falter. This sentiment has a surface appeal, but it does not survive closer scrutiny. Canadian producers have long known that US customers offer the most profitable and constant opportunities. Some of their exports to the United States are incorporated into products that end up in other countries; others come back to Canada to be further processed or consumed by Canadians. In each case, markets determine the best use of scarce resources. In the other direction, US firms supply more than 60 percent of Canadian imports, roughly the norm for the past 150 years. As discussed earlier, modern manufacturing and distribution supply chains make it increasingly difficult for government statisticians to track the origin and destination of products with any precision. Many of these US-origin products may contain substantial foreign content. In the final analysis, however, none of this matters. What does matter is that the Canadian economy is functioning at a high level of productivity and efficiency, underwriting the prosperity and welfare of Canadians.

Who Canadians trade with is also of little import. Nevertheless, given current patterns of production, trade and investment, Canada's proximity to the United States and the extent to which Canadian firms are already part of US-based supply chains, Canadians will benefit the most from efforts to ensure that the Canada-US relationship is as good as it can be. In a world of disaggregated production and open markets, little trade now takes place among unrelated firms exchanging nationally identifiable products. Instead, modern trade involves highly complex exchanges within spatially disaggregated value chains dispersed not only within one national economy but also among many. The growth potential for Canadian firms relies on how well these firms are integrated into US-anchored value chains, rather than on policies based upon the false premises of national markets and products and on the assumption of a wise and all-knowing government.

Proponents of more diversified trading patterns insist that they do not want to reduce trade with the United States. Rather, they want to boost trade with the rest of the world. Again, serious analysis of this proposition suggests that the issue is political rather than economic. With the economy running at or near capacity and enjoying the fruits of a cyclical global resource boom, there is little room to produce more goods for export without setting off inflationary alarm bells at the Bank of Canada. As the Canadian dollar strengthens, particularly against the US dollar — another product of the resource boom — some Canadian manufacturers are having difficulty maintaining their competitive position. At the level of the individual and the firm, the resulting pressure can be very hard to bear. At the level of the economy as a whole, the disappearance of some manufacturing firms releases resources to shift to other areas of comparative advantage — for example, resource exploitation and processing. At some point in the future, the prospects for manufacturing and resource exports may reverse, as they did in the late 1970s and early 1980s. The result then was a change in the composition, direction and terms of Canadian trade, the opposite of what has happened in the last few years. In both instances, fundamental global economic forces fuelled the changes and thus contributed to the strengthening of the economy as a whole, although at the expense of some individuals and firms (Goldfarb 2006). Few if any of these changes in trade and investment patterns can be attributed to the success or failure of trade promotion or other government programs.

For the government to intervene in this process of market-based creative destruction in order to achieve more politically pleasing patterns of Canadian imports, exports and production would be highly detrimental to the long-term prosperity of most Canadians. To forestall such a development, governments, including the Canadian government, have spent the last 70 years devising rules and procedures that reward countries that abandon the instruments of protection and intervention and penalize

those that maintain or reintroduce them. At one level, this is a difficult fact for some well-meaning politicians and lobbyists to accept. At another, most Canadians accept that the international trade regime has underwritten their prosperity and that only short-term gain and long-term pain would flow from undermining its principles. In this light, efforts to diversify Canadian trade patterns may remain an important part of Canadian political discourse, but they are unlikely to lead to any major policy initiatives.

Over the past decade, China has demonstrated that it is finally emerging from its long sleep, India has begun to dismantle the highly protectionist regime that has long shackled its economy, and Brazil has enjoyed sufficient stability in its politics and policies to allow some of its more adventurous entrepreneurs to look beyond its borders. Modernization, urbanization and marketization are now taking place at a dizzying pace in all three economies ("New Titans" 2006). Recent economic growth has averaged nearly 10 percent a year in China and a little less in India and Brazil. China can now be considered the workshop of the world, while India is becoming its call centre.

Some Canadians worry that unless we start trading more with these and other emerging economies, we will miss the boat and others will develop the relationships that will determine future trade and investment patterns. This is a highly overwrought concern. Should current patterns of growth and development in these markets continue, global economic activity will accelerate to an unprecedented degree, creating continuing strong demand for goods and services. Canada will be a major beneficiary of this growth, regardless of whether Canadian exporters are active in these markets or continue to concentrate on those markets with which they are most familiar. For Canadians, the potential for additional exports to emerging markets is modest. The real challenge lies in forging investment arrangements that will harness complementary strengths. Such arrangements will require cooperation between government and private investors that goes well beyond the hoopla of Team Canada missions. The increasingly integrated nature of North American production and investment patterns suggests that Canada must also work with the United States to ensure an enhanced North American platform for trade with emerging markets.

In recent years, the instrument of choice for pursuing trade diversification and strengthening trade and investment with new partners has been the free trade agreement. After the Mulroney government concluded CUFTA and NAFTA, the Chrétien government sought to establish its free trade credentials by concluding FTAs with smaller trading partners. This was an admirable policy impulse, and it signalled the extent to which free trade, rather than protection, had become the default position in Canadian trade policy. Experience has demonstrated, however, that it is difficult to conclude such agreements with minor partners. Negotiations with Chile and Costa Rica concluded

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successfully, but negotiations with the rump of the European Free Trade Association (EFTA) — Norway, Switzerland, Iceland and Liechtenstein — and the Central American four — Guatemala, El Salvador, Nicaragua and Honduras — proved difficult in the face of small pockets of politically significant opposition: shipbuilding in the former case and clothing in the latter. The current bilateral negotiations with South Korea — a market that is at least large enough to warrant some serious attention — similarly faces well-organized opposition from the auto sector and will experience an uphill struggle to conclude. Rumoured negotiations with other minor partners are likely to suffer similar fates. In the absence of strong support from the business community as a whole, such negotiations are easily derailed by entrenched import-competing interests concerned about the loss of a cherished remnant of the interventionist past. Ministers correctly conclude that the amount of political capital needed to reach such agreements is out of all proportion to the economic and commercial benefits. This leads to a willingness to initiate, but not conclude, such negotiations. The resultant misuse of resources signals a lack of seriousness that will not advance long-term Canadian trade and investment interests.

In sum, the best trade and economic policy for Canada in its relations with the rest of the world is one of benign neglect at the macro level and assistance to individual firms as needed. Government officials should be prepared to help individual Canadian firms with specific access or related issues. If a government-induced barrier prevents a Canadian firm from achieving its full potential, then the federal government should make every effort to negotiate its removal. Federal officials should insist that other governments live up to the rules and their commitments. They should use the dispute settlement provisions of international trade agreements to defend the trading rights of Canadians, and they should be equally prepared to live up to Canadian trade and investment obligations. Much of this activity, however, will have at most a marginal impact on the prosperity of Canadians as a whole. Billions of dollars in international transactions now take place daily without government direction or intervention due to the successful implementation of a sophisticated and mature global trade regime. In these circumstances, significant savings can be realized by reducing resources and programs devoted to marginal activities and redeploying them to areas of greater potential.

CANADA AND THE UNITED STATES

The area of greatest potential is the United States. Engagement with our southern neighbour is the indispensable foundation of any Canadian policy to maximize

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benefits from international trade and investment. The key will be to achieve a seamless border embraced within an agreement implementing rules, procedures and institutions consonant with the reality of ever-deepening, mutually beneficial cross-border integration. To get there, Canadians will need to decide whether they want their government to help or hinder cross-border economic integration. While some might express horror at any policy explicitly aimed at facilitating integration, few would support the imposition of barriers to the millions of visits that Canadians make to the United States each year, to the thousands of trucks that cross the border every day, to the billions of cross-border phone calls, to the dozens of US TV channels beamed into Canadian homes, to the millions of US books, movies, CDs and magazines delivered to Canadian homes every year. The default position is integration, and the challenge for governments is to pursue the most effective measures to achieve that end.

The policy attitude of the past decade or more has been that such alterations as may be desirable to facilitate Canada-US trade and investment can be tackled through incremental improvements in discrete policies and programs, many of which can be made by Canada on its own. There are a number of problems with this approach. To begin with, incrementalism is slow and fails to take advantage of the synergies that may arise in dealing with related issues, particularly those that may be of interest to the United States and thus provide scope for trade-offs. Second, if the purpose of many of these programs is to strengthen US confidence in Canada as an economic and security partner, then bilateral engagement is critical. Third, experience tells us that Canadians are reluctant to do what makes sense unilaterally; they need the goad and reward of a trade or similar international agreement. Finally, given the forces of proximity and consumer and producer preferences, deepening integration is inevitable, but without bilateral engagement, it will happen on a basis that favours US default positions rather than jointly agreed-upon programs.

To reap the full benefits of deepening cross-border economic integration, Canada and the United States must engage in three fundamental and interrelated challenges: reducing the impact of the border; accelerating and directing the pace of regulatory convergence; and building the necessary institutional capacity to implement the results of the first two undertakings. Each will prove difficult, and solving the problems associated with either of the first two will prove illusory if we do not also address the others.

Border administration

The first challenge is to rectify the increasingly dysfunctional impact of border administration (Robson and Goldfarb 2005). Even after 15 years of "free" trade,

the Canada-US border still bristles with uniformed and armed officers determined to ensure that commerce and interaction between Canadians and Americans comply with an astonishing array of prohibitions and restrictions. The list of rules and regulations for which the border remains a convenient, and even primary, enforcement vehicle has grown rather than diminished since the implementation of free trade, particularly in response to the new security realities created by 9/11. One study estimated that Canadian border officials are responsible for ensuring compliance with nearly 100 statutory instruments on behalf of several dozen federal departments and agencies; on the US side of the border, officials verify compliance with some 400 statutory instruments (Hart and Noble 2003). This has not created a single, integrated North American market but has instead produced two markets with many cross-border ties that are hostage to the efficiency and reliability of customs clearance, an issue of greater importance to Canadian-based firms than to US-based ones. The logic of the market dictates that new or expanded production facilities locate in the larger market and export to the smaller market. Canadian policy for the past 70 years has been geared toward reducing the impact of this logic. Much progress has been made, but as long as a border separates the two markets, firms that locate in the smaller market will start out with a distinct disadvantage.

Canada and the United States share three goals: a secure border; the rapid movement of legitimate travellers and efficient clearance of freight; and the interdiction of terrorism, illegal drugs, smuggling, illegal migrants, money laundering and other criminal activity. These goals are broadly shared by the two national governments — they differ only on matters of detail and emphasis. The clearance of a shipment of goods through either Canadian or US customs, for example, is contingent upon border officials being satisfied that the goods, the vehicle (truck, train, plane or ship) and the driver or operator are all eligible for entry. Establishing the eligibility of goods may involve, among other things, considerations related to customs (tariffs, rules of origin and similar issues), health, safety, labelling, government procurement, trade remedies, taxes and the environment. The vehicle must be certified to meet safety and similar requirements. The driver or operator must satisfy immigration requirements regarding citizenship, visas, criminal records, professional certification, labour regulations and similar matters. In each case, Canadian and US laws seek to safeguard security, health, safety, employment and other important policy goals.

Infrastructure investment that has failed to keep pace with the near tripling in Canada-US trade volumes since the mid-1980s has put additional pressure on border-crossing operations. In recognition of the extent of their shared objectives — as well

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as in an effort to reduce costs, facilitate legitimate travel and commerce and address pressure on infrastructure — Canadian and US officials over the course of the 1990s initiated a series of programs and dialogues aimed at making the border more open, effective and efficient. Such programs as CANPASS, FAST and INSPASS were designed to ease travel for frequent, low-risk border crossers. Other initiatives — from the Shared Border Accord, announced in 1995, to the Canada-US Partnership Forum, formed in 1999 — tried to make better use of emerging technologies, find ways to streamline the implementation of border policies, share information, coordinate activities and otherwise make existing laws and policies work more effectively.

Since 9/11, the two governments have incorporated these various initiatives into the broader program set out in the 2001 Smart Border Accord and subsequently encompassed in the 2005 Security and Prosperity Partnership. Both initiatives, however, have been limited by the decision to work within the confines of existing legislative mandates and by the lack of an intellectually coherent, strategic framework. Creating such a framework, investing in infrastructure and in technology (both at ports of entry and in the corridors leading to such ports) and targeting resources at preclearance programs for goods, vehicles and people are critical components of any comprehensive effort to improve the management of the border and reduce its commercial impact. Ultimately, the objective should be to create a border that is considerably more open and less bureaucratic within a North America that is more secure.

In considering ways and means to address the increasingly dysfunctional economic impact of border administration and remaining trade barriers, it is useful to distinguish between efforts to ensure compliance with a host of regulatory requirements and efforts to enforce laws and other matters that fall within the ambit of police and security considerations. Most of the requirements administered at the border involve regulatory matters and are secondary to the objective of maintaining a secure border. Therefore, a key aspect of any initiative to ensure the more efficient and effective operation of the border is the identification of those functions within the border clearance process that can be performed away from the border or — as discussed in more detail later — that can be eliminated altogether.

Much of the customs clearance of goods, for example, involves onerous information and reporting requirements — requirements that can be met in a way similar to that in which normal domestic reporting requirements for firms in both economies are met. Most of these reporting requirements operate as though the two economies were not joined by a free trade area. Additionally, most customs requirements — like origin certificates — can easily be streamlined by, for example, harmonizing most-favoured-nation tariff levels. A well-designed initiative to identify those remaining

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aspects of customs administration that can be either eliminated or addressed away from the border would contribute greatly to making the border function more effectively. The $430-million initiative announced by the government in January 2007 to strengthen electronic risk assessment procedures away from the border is a step in the right direction (Canada Border Services Agency 2007).

Similarly, virtually all travel across the border is undertaken by properly documented and eligible individuals in pursuit of legitimate objectives, from business to tourism. Much of the activity of immigration officers, therefore, is routine and makes at most a marginal contribution to safety and security. Attempts to cross the border by those who pose potential threats to either Canadians or Americans are rare and isolated, particularly relative to the huge number of crossings: about 400,000 every day. Every port of entry is, of course, vulnerable to penetration by undesirable elements, but experience indicates that those with serious criminal intent have ample space — and resources — to bypass port of entry controls without much effort. Again, a well-designed initiative to determine how these routine requirements could be eliminated, performed away from the border or satisfied by relying on more modern technologies would pay handsome dividends; it would create a more efficient, effective and secure border and a better-functioning North American economy. The solution to any real threat lies in directing more attention and resources to intelligence gathering, information sharing and entry by individuals and goods from non-North American points of origin, rather than to increasing routine inspections at the Canada-US border.

Some Canadians have expressed alarm at the idea of moving in this direction because they believe it would require the two countries to establish a "common perimeter." It is hard to take this concern seriously; a de facto North American perimeter is a matter of long standing. The decision to maintain a North American security perimeter and pursue a North American economic space was made many years ago and based on agreements ranging from NATO and NORAD to the Autopact and NAFTA. The issue today is how, in the face of heightened security concerns, the two countries can strengthen the perimeter that already exists and address security issues within their common economic and security space.

More resources at the border seem unlikely to achieve greater security, absent extraordinary further investments in human and physical infrastructure. Furthermore, to increase resources to such an extent is to risk causing considerable collateral damage to economic interests; solutions can be found more effectively and efficiently by other means. The two governments need to work with each other at every level, institutionalizing contacts, enhancing cooperation and sharing information on matters small and large. They could make much greater investments in intelligence gathering and gradually focus ever-larger parts of that effort on initial entries to North America. They could also make far larger investments

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in infrastructure and in technology. Both types of investment are critical to any comprehensive attempt to improve the management of the border. Such investments should not proceed on the basis of current inspection methodologies but should rely much more on risk assessments and random inspections. They should also focus more on targeting resources at preclearance programs for goods, vehicles and people. Finally, the two governments need to engage in discussions about increasing the level of convergence in US and Canadian policies governing such matters as cargo and passenger preclearance programs, law enforcement programs of all types, and immigration and refugee determination procedures.

Reducing border administration will have beneficial effects at three levels: it will decrease enforcement and administrative costs for governments and compliance costs for industry, and it will reduce trade and investment disincentives. Various attempts have been made to quantify these benefits. As Pierre Martin concludes, "Although the total costs are difficult to estimate with precision, they are significant and likely to become higher" (2006, 15). Perrin Beatty, then president of Canadian Manufacturers and Exporters, claimed that "border delays alone cost the Canadian and US economies an estimated C$12.5 billion annually. In the automotive industry alone, it is estimated that the additional reporting, compliance and delay costs translate into an estimated $800 Canadian per vehicle" (2005). Canada's former ambassador to the United States, Michael Kergin, has said that nontariff border costs add 5 percent to the invoice costs of most exports, and the figure could be as high as 10 to 13 percent for trade-sensitive products (2002). John Taylor and Douglas Robideaux have made the most detailed study of Canada-US border costs, and they estimate that direct costs — out-of-pocket costs to government and business of administering border requirements — add between US$7.5 and US$13.2 billion annually to cross-border trade, with a midpoint of US$10.3 billion (Taylor and Robideaux 2003). Indirect costs are even more difficult to estimate. Automotive industry analysts estimate, for example, that "a lost hour of assembly output due to a parts shortage costs approximately US$60,000 per hour in lost earnings" (Andrea and Smith 2002, 19). The impact that a more open border would have on either direct or indirect costs is equally difficult to estimate. The European Union experience, however, suggests that the move toward a more open border — the Schengen Agreement — both boosted commerce and reduced direct and indirect costs without any significant negative impact on security and regulatory objectives (Egan 2001; Hart 2004b; Hart 2006).

Regulatory cooperation

A key component of trimming border congestion is meeting the second challenge: reducing the impact of regulatory differences between Canada and the United

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States. As Europeans have learned, regulatory cooperation and the reduction of border formalities are two sides of the same coin. There may be a long tradition of pragmatic, informal problem solving between the regulatory authorities of the two federal governments, as well as among provincial and state governments, but the time has come to ask how much regulatory enforcement needs to be exercised at the border and how much can be exercised behind the border. More fundamentally, as regulatory cooperation and convergence proceed, the two governments need to ask whether they are ready to proceed to a more formal, treaty-based process of regulatory cooperation aimed at eliminating, to the largest extent possible, what can be characterized as the tyranny of small differences. When those differences are eliminated, much of the rationale for border administration disappears.

The extent of regulatory convergence and cooperation today is largely determined by bureaucratic agendas and preferences. The results have been interesting: Canadian jurisdictions align their regulatory goals and objectives with those of their US counterparts, work with US regulators in many areas, but maintain sufficient regulatory autonomy to chart their own path. This has produced two very similar but autonomous regulatory regimes characterized by extensive duplication and redundancy. However, broader goals — from economic development to regulatory efficiency — remain of secondary importance. This default position also avoids confrontation with the two related issues: the border and institutional capacity.

The External Advisory Committee on Smart Regulation (EACSR), appointed by Prime Minister Chrétien, concluded that this model was no longer adequate and recommended that the federal government "work to: achieve compatible standards and regulation in areas that would enhance the efficiency of the Canadian economy and provide high levels of protection for human health and the environment; eliminate small regulatory differences and reduce regulatory impediments to an integrated North American market; move toward single review and approval of products and services for all jurisdictions in North America; and put in place integrated regulatory processes to support key integrated North American industries (e.g. energy, agriculture, food) and provide more effective responses to threats to human and animal health and the environment" (Canada, EACSR 2004, 17, 21).

The government broadly accepted the recommendations of the EACSR, and in the context of the Security and Prosperity Partnership adopted by the Presidents of the United States and Mexico and the Prime Minister of Canada in Waco, Texas, in March 2005 — confirmed by the three leaders a year later — it took important steps to move the agenda along. It appointed a group in the Privy Council Office (PCO) to pursue the

path charted by the EACSR. Additionally, the federal government's Policy Research Initiative was charged with considering ways and means to implement the EACSR recommendations. What has emerged to date is a commitment to what might be characterized as accelerated incrementalism. The result is a higher level of awareness of regulatory developments in the US among Canadian policy-makers, leading to enhanced opportunities to align Canadian regulatory policy with developments in Washington. What is missing is a strong political commitment to regulatory cooperation and a plan to put it into effect. Not surprisingly, the pace in implementing this program has been glacial.

The current Canadian approach also appeals to American regulators, who have to date exhibited little appetite for more. The US decision-making system is extraordinarily resistant to centralized control and thus offers little more than piecemeal, regulator-to-regulator cooperation. The US president, for example, may appoint commissioners to the Securities and Exchange Commission, but once in office, the commissioners act with full independence. Nevertheless, in both Washington and Ottawa, regulatory reform and streamlining has a growing number of supporters. Congress in 1980 established the Office of Information and Regulatory Affairs (OIRA) in the Office of Management and Budget, and successive presidents have, through executive orders, set out the basis for OIRA to provide systematic, centralized review and appraisal of all federal regulations. Much of this initiative has been coordinated with broader international ones, particularly at the OECD. Canadian efforts parallel those of the United States. Since 1978, Canadian federal regulatory activity has been subject to a constant, comprehensive, centralized process of review, housed initially in the Treasury Board, subsequently in the PCO and now in Industry Canada, with a view to eliminating duplication and redundancy and promoting best international practice. The guiding policies developed in both capitals for rule making and review are remarkably similar in tone and intent and reflect the high level of ongoing discussions at the OECD and bilaterally. A sound foundation has, therefore, been created for a more formal program of cross-border regulatory cooperation and even coordination. But to go to the next level, the two governments will need to develop an enforceable agreement and the institutional capacity to make it work.

Initially, the two governments should build confidence and gain experience at the federal level, but given the federal structure of the two countries, the sooner they engage provincial and state regulatory authorities in a similar process of mandatory information exchange and consultations, the sooner they will arrive at a "North American" approach to meeting their regulatory goals and objectives. Because of the large number of jurisdictions involved, this is an area that will require some creative

decision rules as well as institutions to make them work. Fortunately, as at the federal level, extensive regional networks of collaboration already exist between Canadian provincial and US state regulators. Any successful federal strategy on economic integration and regulatory convergence will need to both complement and take advantage of these existing cross-border institutions.

The benefits of further regulatory convergence lie in reducing costs and duplication. Lack of compatibility in various sectors — from transportation and food safety to telecommunications, pharmaceuticals, environmental protection, labour markets and professional services — adds to compliance and enforcement costs for both government and industry, continues to segment the two national markets and necessitates continued border administration. Lessons from Europe and elsewhere suggest significant benefits from cooperation leading to more effective regulation, higher levels of compatibility and reduced border administration (Egan 2001; Bermann, Herdegen, and Lindseth 2000).

As the Canadian beef industry learned in 2003-05, it does not take much to cause chaos: a single incident of BSE (mad cow disease) led to the closure of the border; it was not fully reopened for more than two years. Failure to pursue an integrated regulatory regime consonant with the integrated market proved costly, with estimates ranging from $4 billion and up (Moens 2006; Le Roy and Klein 2005). Other sectors of the economy could face similar problems as regulators on one side of the border or the other address issues without regard for the reality of integration. But, as the beef industry also learned, once the two sets of regulators develop the basis for an integrated approach, problems are quickly resolved. There was one incident of BSE in Canada in 2003, leading to more than two years of trade disruption. There were five cases in 2006, not one of which led to trade action.

For consumers, regulatory divergence is tantamount to a concealed "inefficiency tax" that citizens pay on virtually everything they purchase. This tax is the sum of the costs of duplicate regulations, border administration delays and other regulatory impediments. For businesses, higher costs of compliance hinder international competitiveness and complicate the efficient deployment of scarce resources. For governments, regulatory divergence increases risk, reduces efficiency and leads to less than optimum outcomes in achieving regulatory goals. Polling in both countries has suggested strong public support for regulatory convergence and more cohesive North American policies to improve living standards.

Compliance with different national and subnational rules, together with the redundant testing and certification of products, processes and providers for different markets, raises costs for manufacturers and providers operating in an integrated

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market. Complex and lengthy product- or provider-approval procedures can slow innovation, frustrate new product launches, protect domestic producers from foreign competitors and create a drag on competitiveness, productivity, investment and growth. In its latest survey, the Fraser Institute indicated that between 1975 and 1999, over 117,000 new federal and provincial regulations were enacted — an average of 4,700 a year. It estimated that administrative costs had reached $5.2 billion by 1997-98, compliance costs were $103 billion and "political" costs (regulation-related lobbying) were $10.3 billion, adding up to the equivalent of more than 12 percent of Canadian GDP (Jones and Graf 2001). The Canadian Federation of Independent Business (CFIB) estimates that Canadian business annually spends $33 billion, or 2.6 percent of Canada's GDP, complying with this profusion of regulatory activity (CFIB 2005). Producing such estimates is at best an inexact science, but the figures do provide an indication of orders of magnitude. Canada's Policy Research Initiative is looking at better ways to measure the extent and costs of Canada's regulatory regimes (Ndayisenga and Downs 2005; Ndayisenga and Blair 2006).[1]

While greater cross-border regulatory convergence would not eliminate these costs, it would certainly reduce duplication and overlap, particularly for the Canadian government. Even a 10 percent reduction in duplication would make an important contribution to reducing compliance and administration costs.

Institutional capacity

Progress in addressing the governance of deepening integration depends upon building sufficient institutional capacity and procedural frameworks to reduce conflict and provide a more flexible basis for dynamic rule making and adaptation for the North American market as a whole. It may well be necessary to overcome traditional Canadian and US aversion to bilateral institution building and look creatively to the future. While the European model of a complex supranational infrastructure may not suit North American circumstances, there are lessons Canadians and Americans can learn from the EU experience.

Rather than seeking to create structures where they are not needed, the two governments should focus upon the functions that must be performed for the efficient governance of deepening integration and create new institutions only where current arrangements are unsuitable. To some extent, this could be accomplished by making creative use of existing Canada-US cooperative arrangements, by vesting officials in agencies on both sides of the border with new responsibilities or by building on existing models that have worked well.

The two governments could, for example, stipulate that the Canada Border Services Agency and the US Customs Service coordinate their efforts to ensure efficient administration of third-country imports. Similarly, an appropriate understanding could be reached requiring Transport Canada and the US Department of Transportation to coordinate their efforts to ensure highway safety; for example, before any new rules and regulations were enacted, mandatory coordination efforts could be made to achieve compatible outcomes and recognize each other's approaches to the same problem. A good basis for this kind of cooperation already exists in informal networks among officials and in the relatively minor differences in regulatory approach. What is missing is an agreed-upon mandate to resolve differences and a more formal institutional framework with authority to ensure mutually beneficial outcomes. Establishing a bilateral commission to supervise efforts to establish a more coordinated and convergent set of regulations governing all customs or transportation matters could prove critical to providing the necessary momentum and political will.

In both countries, labour mobility is hampered by provincial and state labour laws and delegated professional accreditation procedures. NAFTA put in place a modest process to permit temporary entry for business and professional visitors and mutual recognition of professional accreditation. The latter has been hampered by the conflict of interest inherent in a system of self-regulation. As the EU learned, a more centralized approach was required to overcome conflicts of interest and bureaucratic inertia. From architects and accountants to doctors and dentists, there remains considerable scope for enhancing mutual recognition arrangements (Hart 2004b). An important step toward breaking the logjam would be to appoint a bilateral task force to develop model mutual recognition arrangements for consideration by state and provincial accreditation bodies.

Much can be achieved on the basis of existing networks of cooperation; specific joint or bilateral commissions can be added where existing networks are inadequate. More will be achieved, however, if the two governments commit to the establishment of a limited number of bilateral institutions with a mandate to provide government with the necessary advice and information to effect a more integrated North American approach to regulation. An independent Canada-US secretariat with a mandate to drive the agenda and report annually to the president and the prime minister on progress could, for example, prove critical to overcoming bureaucratic inertia. Similarly, a joint advisory board for the president and the prime minister could contribute some creative drive to the development of new bilateral initiatives. As numerous studies have demonstrated, regulatory agendas are prone to capture, geared

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to serving the narrow interests of regulator and regulatee. Bilateral initiatives limited to regulatory authorities are unlikely to be immune to this reality. Regular review by an independent advisory board of progress in implementing a bilateral program of guided regulatory convergence could thus prove valuable in the attempt to keep the program focused on broader objectives.

Governments must think carefully about any initiative that could compromise their ability to discharge their responsibility for the security and well-being of their citizens. Canadian experience in negotiating international rules and pursuing regulatory cooperation, both multilaterally and bilaterally, suggests that there is no inherent conflict between these responsibilities and such rule making and cooperation. Nevertheless, vested interests can mount emotional campaigns casting doubt on the idea that regulations made jointly can serve to fulfill Canadian responsibilities. Fortunately, it is not difficult to dispel such doubts. Canadians, for example, routinely travel in the United States, comfortable with the reliability of US safety regulations. They eat and drink as freely in the United States as they do at home, and if they fall sick, they can rely (although at considerable expense) on US medical advice and US-approved drugs. From almost any perspective, Canadians have few if any qualms about the goals and efficacy of US regulations when in the United States. There are few other countries in which Canadians routinely exhibit such confidence. The reason is simple: Canadian and US regulatory regimes are, in almost all respects, closely aligned. The differences are matters of detail that may matter to individual regulators but have little impact on residents of either country.

CONCLUSIONS: COSTS AND BENEFITS

More than ever, the two-way movement of goods and services across the Canada-US border is Canada's economic lifeline. The extent of economic integration or linkage between the two countries has reached the stage where Canada's economic well-being is directly tied to an open and well-functioning bilateral border. Failure to maintain or even enhance an open border will have a corrosive impact on Canada's continued economic prosperity. To that end, the federal government needs to mount a major initiative to conclude a treaty-based arrangement that addresses current impediments to a better-functioning, integrated North American economy (Gotlieb 2003). Fundamental to such a treaty are a better-functioning border, deeper regulatory convergence and enhanced institutional capacity.

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The federal government is currently devoting considerable resources to activities that will have at best a marginal impact on the productivity and well-being of Canadians — from participation in the Doha Round of multilateral trade negotiations, to extensive trade promotion activities in obscure markets around the world, to negotiation of free trade agreements with minor trading partners. Most of these activities respond to the perceived needs of individual constituents, but at a much higher cost than is generally realized. For example, teams of up to 85 individuals representing 20 or more federal agencies routinely travel back and forth between Canada and South Korea in pursuit of a trade agreement that may never see the light of day. Dozens of officials scattered throughout Ottawa continue to participate in various aspects of the Doha Round, with a clear mandate to hold the line on a program — supply management — that costs Canadian consumers billions of dollars annually. Hundreds of trade commissioners deployed to European, African, Latin American and Asian countries dutifully fill in annual forms claiming the amount of business "influenced," even as trade with these places stagnates. Others are engaged in building "gateways" and organizing Team Canada missions that are big on photo ops and press announcements but not so big on measurable increases in trade and investment.

Meanwhile, a growing agenda with the United States languishes on the back burner as politicians and bureaucrats shrink from tackling "controversial" issues. In the absence of sufficient resources and a bureaucratic home with enough clout to move rent-seeking officials to engage the bilateral regulatory agenda, little will be accomplished that goes beyond Ottawa's commitment to incrementalism. Even a stealth agenda requires clear objectives and the resources to pursue them. Instead, the government maintains a trade department led by a senior minister saddled with an increasingly marginal mandate, and it has not been able to figure out how to organize the bureaucracy to prioritize Canada's most important trade and economic partner.

As a matter of priority, therefore, the government should take some of the resources now devoted to marginal trade negotiations and trade promotion activities and redeploy them to the Canada-US agenda. The resources needed to establish a department of North American integration can be found not only in the trade components of the Department of Foreign Affairs and International Trade, but also (and even more so) in the Departments of Finance, Industry, Natural Resources, and Agriculture and Agri-food. Led by a senior minister and an experienced deputy, such a department would have the authority to take on the dozens of small bilateral initiatives scattered throughout the bureaucracy, mould them into a coherent agenda and pursue them strategically and urgently.

As this department's work progressed, it would feed back into the domestic agenda and provide an intellectually and politically persuasive basis for tackling some of the remaining sacred cows of Canada's waning nationalist heritage, from provincial trade barriers to supply management and ownership restrictions. While each of these issues should be tackled on its own merits, experience demonstrates that success is more likely in the context of a broader initiative, in which politically persuasive gains can be used to offset the inevitable wailing from narrow but entrenched interests.

Ironically, building the basis for a deeper and more functional bilateral engagement will allow Canadian firms to strengthen their participation in US-based global value chains and thus increase their profiles in other markets. Modern trade and investment patterns reflect the critical importance to most firms of a strong regional base. For most Canadian firms, that base is North America. For those for whom diversification is the Holy Grail, deeper bilateral integration holds the key.

The benefits to Canadians of such a reordered agenda and redeployment of resources are potentially enormous. A reduction in the direct and indirect costs of administering the border would alone be worth the effort. Reducing overlap and duplication in Canada's increasingly costly regulatory regimes would put even more dollars in the pockets of Canadians and increase their capacity to pay for other priorities, from health care reform to education. The indirect benefits of redirecting private resources to more rewarding activities would be even larger —the Canadian economy would be strengthened, as would the ability of Canadians to focus on other important matters. The only cost that would arise would be political — that is, Canadians' exaggerated preoccupation with ephemeral concepts of sovereignty and nationhood. As the past two decades of experience with bilateral free trade has demonstrated, however, these concerns have no basis in reality. Canada is a stronger country now than it was 20 years ago, not despite but because of bilateral free trade. The time has come to complete the project and reap its full advantages.

Reordering the agenda along these lines inevitably raises serious political concerns, including Canadian sovereignty and engagement with the rest of the world. To each of these concerns, there are serious responses, which need to be discussed frankly and openly. Such concerns have been used instead to shut off debate, resulting in the drift that now characterizes Canada's engagement with the United States and the rest of the world. Canadians deserve more from their analysts and scholars.

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NOTES

1 These costs are consistent with other national estimates. The Adam Smith Institute, for example, reports that British estimates of the costs of compliance with national and EU regulatory requirements annually add up to 10 to 12 percent of GDP (2007). An extensive survey of these costs in the United States has been catalogued by the Cato Institute. In a 2004 report limited to federal regulations, it reported:
- The *Federal Register* contained 71,269 pages in 2003 and a record 75,606 pages in 2002.
- Regulatory agencies issued 4,148 final rules in 2003 and in the Unified Agenda reported on 4,266 regulations that were at various stages of implementation throughout the 50-plus federal departments, agencies and commissions — an increase of 2 percent from the previous year.
- Of the 4,266 regulations in the regulatory pipeline, 127 were "economically significant" rules that would have at least $100 million in economic impact — that is, they would create at least $12.7 billion yearly in future off-budget costs.
- The five most active rule-producing agencies, which accounted for 46 percent of the rules under consideration, were Treasury, Transportation, Homeland Security, Agriculture and Environmental Protection.
- Regulatory costs of $869 billion are equivalent to 7.9 percent of US GDP; these added up to more than twice the $375-billion budget deficit and exceeded all corporate pretax profits, which totalled $665 billion in 2002 (Crews 2004).

Mark Crain calculates that the total cost of the federal regulatory burden had risen to US$1.1 trillion by 2004 (Crain 2005; see also Crain and Hopkins 2001).

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