The Tipping Point: Effects of Post 9/11 Border Security on Canada - United States Economic Competitiveness

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THE TIPPING POINT: EFFECTS OF POST 9/11 BORDER SECURITY ON CANADA-UNITED STATES ECONOMIC COMPETITIVENESS

Session Chair - Margaret Martin
Canadian Speaker - Paul Storer
United States Speaker - Gary Hufbauer

INTRODUCTION

Margaret Martin

MS. MARTIN: Hi. Welcome back to the last session of the day. My name is Margaret Martin, I am an assistant professor at the University of Western Ontario in the Faculty of Law. The topic of this afternoon's session is “The Effects of Post-9/11 Border Security on Canada-U.S. Economic Competitiveness.”

Now, the first question I think we have to ask is whether 9/11 has had a negative impact on trade between our two nations. And as we will see in our first presentation, answering this question is no easy task because there are so many detailed variables that have to be analyzed. And after we understand the past, only then can we begin to make recommendations for the future, and this will be the topic of our second discussion. So at least partly we will deal with the future policy recommendations.

Now, today's talk is particularly pressing because we cannot just sit back and be passive about this issue. If we do not make policy recommendations to our different governments, then we will not have healthy trade relations in the future. So this is why I am thrilled to announce our distinguished speakers, Paul Storer, who is our first speaker, and Gary Hufbauer.

Paul Storer is a professor and chair of the Economics Department of Western Washington University.1 He is a member of the board of directors of the Pacific Northwest Regional Economic Conference.2 And this is his latest

book; I thought I would plug it for him. It is excellent. I read it recently. And it is entitled *The Impact of 9/11 on Canada-U.S. Trade*, and it was co-written by Steven Globerman, and I recommend it.

And then our second speaker is Gary Hufbauer, and he has resumed his position as Reginald Jones Senior Fellow in 1998. Previously he was Marcus Wallenberg Professor of International Financial Diplomacy at Georgetown University, and served in the U.S. Treasury Department from 1974 to 1980. And he was very prolific last year, he had two co-authored books. The first one entitled *Economic Sanctions Reconsidered*, third edition, and the second entitled *U.S. Taxation of Foreign Income*.

So without further ado, Paul Storer.

CANADIAN SPEAKER

*Paul Storer*

MR. STORER: Thanks, Margaret. Thank you to the organizers for inviting me to the conference and for putting the two economists at the end of the day.

Thank you for the plug on the book, too. The book has the same title as my presentation, no coincidence. I felt we maybe should have renamed the book “The Audacity of Despair” due to my despair over what is happening to

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6 Id.

7 Id.

* Paul Storer is Professor and Chair of the Economics Department at Western Washington University. He is a member of the board of directors of the Pacific Northwest Regional Economic Conference (PNREC) and served as editor of the Northwest Journal of Business and Economics from 2001 through 2005. Storer's research focuses on Canada-US business and economic relations and cross-border integration. Among Storer's recent publications (both joint with Steven Globerman) are: "Canada-U.S. Integration Following NAFTA" (in *North American Economic and Financial Integration*, Elsevier, 2004) and *The Impacts of 9/11 on Canada-U.S. Trade* (University of Toronto Press, 2008). He has previously published in such journals as the Canadian Journal of Economics, Canadian Public Policy, the American Review of Canadian Studies, Contemporary Economic Policy, and the Journal of Banking and Finance. Storer is also a coauthor on the 13th edition of the introductory economics textbook by Lipsey, Ragan, and Storer.
the relationship that Canada and the United States have built over time. I am concerned by the extent to which those gains may be getting eroded by a variety of factors, some of which may be around the nexus of security. The impact of these developments on trade and competitiveness are some of the issues I am going to be addressing in this presentation.

The reference to audacity comes in because we needed a dose of audacity back at the time when people in Canada took a leap of faith in negotiating the Free Trade Agreement with the United States, and that kind of audacity of thinking does not seem to be in abundance presently in terms of moving forward. Whether it should or should not be I will leave Gary to talk about, so we will move through this.

Let me just tell you again about the focus of the presentation. I am going to try to talk about not just the evidence that Steve and I have, but other evidence that I will mention about the actual factual quantitative evidence related to how border security problems affected the trade between Canada and the United States since 9/11. Now, if I was not an economist, I would probably just show you this graph and be done and then turn it over to Gary.

Looking at a graph of Canadian exports of goods to the United States from 1996 to 2005, the eyeball is drawn to what looks like a significant decline after 2001. The shaded period shown in the graph on the screen is the post-9/11 period where we see a sharp drop-off in the amount of the Canadian surface export (rail, pipeline, and, predominantly, truck) flows to the United States from Canada. And you can see why it seems like a precipitous drop-off after the second quarter of 2001.

Now you would be tempted of course to just ascribe this decline in exports to security events, but it could be other things are going on. We have the usual suspects, which we will address more carefully later. The list of suspects includes changes in the level of economic activity in that we know there was a slowdown, changes in the exchange rate, or changes in other economic factors such as tariffs on lumber.

Being economists, what Steve and I have done is to rely on a statistical method known as linear regression to tease out the contributions of those other “usual suspects”. Anything that is left over after looking at other things, we ascribe to post-9/11 security effects. So I cannot stop the story with the graph on the screen, I have to show you more analysis. But I was supposed to be multidisciplinary, too, so I will give you a little bit of history in the next slide.

We have already had a reference to the Smoot-Hawley tariff escalation from the time of the Great Depression. We all want to avoid repeating the errors of Smoot-Hawley today. For the Canadians in the audience, we should
also talk about avoiding the errors of the National Policy. The last time that Canada built a policy wall at the border was in the late nineteenth century in response to fears that American manufacturers would take away the prosperity of Canadian manufacturing workers and farmers. On the screen you see an election poster from this period and we see Sir John A. Macdonald benevolently smiling down at his protected charges—the manufacturers and farmers sheltered behind the tariff wall of the National Policy.

This cartoon is reproduced from Michael Hart's excellent book A Trading Nation, a comprehensive history of Canadian trade policy. Michael provides a fascinating description of the state of the Canadian auto industry just before the Canada-U.S. Auto Pact came into effect in the mid 1960s. Michael cites studies from the period which found car prices much higher in Canada than in the United States while at the same time wages in the Canadian auto industry, which was a domestic protected industry, were lower.

So prices were high and wages were low in Canada and to make matters worse the choice of models available in Canada was incredibly limited. What happened after the Auto Pact, which moved Canada and the U.S. into an integrated North American market for the auto industry, is that economies of scale and the ability to specialize were realized through binational production. The automotive sector is the poster child for a binational model of shared production that Stephen Blank describes as "making stuff together." As a result of the Auto Pact, Canada moved to a situation where wages went up, profitability went up, prices of cars went down, and model choice went up. And of course those are also the types of outcomes that we were expecting from NAFTA and Canada-U.S. Free Trade Agreement. These broad agreements were supposed to bring all those benefits realized by the auto industry and extend them to the all sectors of the economy.

One of my particular causes of despair is the fear that those benefits from trade liberalization that should have spread throughout the economy have

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10 See id. at 240-70.
11 See id. at 241 (discussing that “Canadians often paid as much as 50 percent more than Americans did for the same car”).
12 See id. (concluding that “Canadian workers earned about 30 percent less than their US counterparts”).
13 See Hart, supra note 9.
failed to achieve their promise. In particular, smaller businesses are less able to shoulder the costs of dealing with security and those businesses will find it increasingly difficulty to exploit the benefits of NAFTA.\footnote{See Gary Clyde Hufbauer & Jeffery J. Schott, \textit{NAFTA Revisited: Achievements and Challenges}, Institute for International Economics (2005); see also John W. Foster & John Dillon, \textit{NAFTA in Canada: The Era of a Supra-Constitution}, in Hemispheric Social Alliance 59 (2003) (noting the Canadian business concern over U.S. security “preoccupations”).} While the bigger players will have a reasonable chance to foot the bill for increased security, the smaller ones, for whom we were hoping to democratize free trade to a greater extent, may be shut out of trading due to rising security costs.

I would now like to summarize some of the sources of evidence that increased border security has affected Canada-U.S. trade. While I will mainly focus on econometric studies. I will also talk about what is happening to the waiting times, estimates of cost and profitability. I will also discuss findings from surveys done by various authors, and then turn to the econometric studies, both the one that Steve and I did and then one from the Conference Board of Canada by Michael Burt.

The evidence related to border security and waiting times shows up in two effects, both of which can have significant consequences. One effect is an increase in average waiting times as measured by mean or median crossing times. The other effect is an increase in variability of waiting times as measured by standard deviations or variances.

We need to be concerned about the impact of security on both the average length and variability of border delays. If you are waiting for a longer time at the border, you are going to be burning more fuel, you will be later making delivery, and it will cost more money for labor.\footnote{Goldfarb, Danielle, \textit{Reaching a Tipping Point: Effects of Post-9/11 Border Security on Canada’s Trade and Investment}, Conf. Board Can. 16 (2007).} The increase in variability is also an issue because predicable arrival times are needed to get the benefits of “just-in-time” inventory management systems.\footnote{E.g., Goldfarb, Danielle, \textit{Is Just-In-Case Replacing Just-In-Time? How Cross-Border Trading Behaviour Has Changed Since 9/11}, Conf. Board Can. 7 (2007) (discussing how firms are now stockpiling materials instead of just-in-time materials handling).}

A study conducted by Danielle Goldfarb for the Conference Board of Canada has expressed the concern that efficient just-in-time procedures might be replaced by potential wasteful duplication of facilities that are needed as a form of insurance “just-in-case” there is a border disruption.\footnote{See id.} In an earlier session at this conference we heard Garland Chow describe the interesting case of such a “just-in-case” facility in Kent, Washington which may well have been set up in order to have inventories on both sides of the border. You only need the insurance policy created by this redundancy if you
are worried about the possibility of significant variability in waiting times at the border.

One observation I would like to make is that we have a lot of difficulty getting consistent on-time serious data on waiting times.\textsuperscript{19} It would be nice if we had some better data over time on waiting times. What we have now seems to be episodic and more anecdotal than scientific.

Another study that is relevant was conducted by Prem Gandhi of SUNY Plattsburgh and Wayne Glass of Schoolcraft College in Michigan.\textsuperscript{20} Prem and Wayne did some very interesting work in which they took the increased waiting times experienced at the Canada-U.S. border and converted them into an equivalent extra distance.\textsuperscript{21} For example, if you have to wait an extra hour, and you could drive 60 miles an hour, the increased border waiting time effectively "widens" the border by 60 miles.

The next step in the Gandhi-Glass study is quite clever: they fed their calculated increased in distances into gravity-type models (gravity models explain trade between states and provinces).\textsuperscript{22} Gravity models have a long history of being used to explain the volume of trade based on factors such as distance.\textsuperscript{23} The Gandhi and Glass method predicted declines in trade volumes in the range of 12 to 20 percent level.\textsuperscript{24} Interestingly enough, similar magnitudes of drops in Canadian exports were found in the econometric study that Steven Globerman and I conducted, despite the fact that we used a very different methodology.\textsuperscript{25} So we find the work of Gandhi and Glass very interesting.

Some of the existing academic studies of border security effects have attached dollar amounts to increased waiting times. You have already heard discussion at this conference of costs in the millions or billions of dollars. Similar increases in costs have been found for carriers involved in working across the border.

One study by Lee, Martin, Ouellet and Vailancourt at the University of Montreal looked at Quebec's exports to the United States and began by


\textsuperscript{21} See id.

\textsuperscript{22} Id.

\textsuperscript{23} Id.

\textsuperscript{24} Id.

\textsuperscript{25} Id.
obtaining a dollar amount for the increase in transportation costs.\textsuperscript{26} The study then determined how much of these higher shipping costs would be passed onto the final customer. Finally, they determine how much exports would fall due to these price changes.\textsuperscript{27} A key ingredient of this last step is a measure of how much demand falls when prices rise — something economists call the price elasticity of demand. This procedure yields a much smaller decline in exports from Quebec to the United States than was found by Gandhi and Glass.\textsuperscript{28} In fact, the number reported by Lee at al is about one percent.\textsuperscript{29}

Now, someone earlier in this conference said that lawyers will always give you a yes-and-no answer. Well of course economists are just as renowned for having giving answers containing the phrase “on the other hand.” It should be little surprise, then, that here is still some debate among economists regarding the size of these elasticity estimates. The one percent trade reduction found by Lee and her co-authors may be a bit low because they use a fairly low price elasticity of demand number.\textsuperscript{30} Using higher (but still plausible) price elasticities could give a trade effect as high as four or five percent. But this modification still gives a number that is substantially lower than what Gandhi and Glass or my study with Steven gets. So, I feel obligated to provide full disclosure on some of the range of information that is coming out about the effect of border security on trade.

There is an interesting development that has been identified from surveys of Canadian exporters and U.S. importers. Evidence of changing export practices has been reported by John McPherson from Export Development Canada and by Anneliese Vance who recently finished her Ph.D. in Geography at SUNY Buffalo.\textsuperscript{31} One of the trends that shows up in their conversation with businesses is that Canadian firms that used to handle customs and cross-border logistics operations themselves are now hiring experts to do these tasks for them.\textsuperscript{32} For people who either are working in trade law or in logistics, that is good news but it may be bad news for exporters to the extent that it raises the costs of engaging in Canada-U.S. trade.

\begin{thebibliography}{9}
\bibitem{27} Id.
\bibitem{28} See Gandhi, \textit{supra} note 20.
\bibitem{29} See Lee, \textit{supra} note 26.
\bibitem{30} Id.
\bibitem{32} See Anneliese, \textit{supra} note 19.
\end{thebibliography}
Anneliese finds that the businesses that are outsourcing their logistics operations did so for two reasons. First, they believe that logistics firms have the expertise to minimize border delays. A secondary reason is that Canadian exporters felt they would be partly insulated from the consequences of security-related border delays because exporters feel that the logistics firm rather than the exporter will be blamed in the event of a delay at the border. If the use of logistics firms gives "cover" for Canadian exporters, then U.S. firms might choose to keep on buying from Canadian suppliers. On the other hand, if a U.S. firm needs an intermediate input to show up at their factory they might not care whether a delay is the fault of the Canadian manufacturer or the logistics company. If a shipment is late, it is late, regardless of the reason. I know that Annaliese will be doing some more follow-up work on this topic and I look forward to learning the results.

Let me now tell you about the econometric studies that Stephen Globerman and I have done. Of course, economists love to explain their models with equations containing Greek letters and here’s ours:

\[ \ln(\text{Exports}) = \beta_0 + \beta_1 \ln(Y_{t-1}) + \beta_2 PFX_{t-j} + \beta_3 D911 \]

Basically what this equation says is that we explain the natural logarithm of Canadian exports to the United States based on changes in two economic variables with a direct impact on trade: Gross Domestic Product (GDP), abbreviated as Y in this equation, and the Canada-U.S. exchange rate, abbreviated as PFX. The final term in the equation, the \( \beta_3 \) times \( D9/11 \), captures the effect of post-9/11 border security policy. We use a so-called a dummy variable, an on/off binary variable, to capture the effect of changes in trade related to 9/11. So again, we explain the things that we think are the usual suspects such as GDP and the exchange rate. Anything left over we ascribe to the impact of border security.

And what do we find? Well, we find significant impacts. We actually look at separate impacts for the third and fourth quarters of 2001 and then allow the impacts for 2002, 2003, and 2004 to be different by year. Our study ended in the middle of '05 in part because the data that we bought was very expensive, costing thousands of dollars. And I thank the Border Policy Research Institute for providing funding to purchase the data.

Turning to our results, we find exports shortfalls beginning at about five billion dollars per quarter in the third quarter of 2001. This effect rises to a

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33 See id. (stating that hiring third parties the burden of passing though border crossings is now on the third party).
34 See id.
35 See id. (noting that most firms studied indicate an instance that other parties on the supply chain assume responsibility for shipments).
maximum of about 14 billion dollars in the fourth quarter of 2003. These dollar figures reflect declines of roughly 10 to 20 percent of Canadian exports to the United States. Now by the end of our sample period in mid-2005, the effect is starting to become statistically non-significant. The effect of security on trade could be attenuated after 2003 because of all the benefits of programs like FAST, C-TPAT as well as the increase in personnel working at the border. The drop in exports could also be reduced because there is less non-commercial traffic holding up the truck traffic. For whatever reason, by the end of our sample, the effects of security on trade are getting smaller and starting to go away.  

Another interesting result from our research is that we did not find any significant effect for traffic going from the United States to Canada. So most of the security effects on trade seem to be going in one direction, which might not be surprising because we know that the border security was increased more for entry into the United States than for entry into Canada.

On the other hand, our finding of an asymmetric impact of security on trade is puzzling because many items that cross the border (pistons for use in cars, for example) travel across the border many times before they are sold to a consumer in a final product. For products like these, if there is an increased cost of getting into the United States, that is also going to impact trade going to Canada. So the effect of tighter U.S. border security should not be showing up in only one direction unless the big trade impacts we are seeing are for the firms who are the least likely to ship components that cross the border multiple times. Instead, our security-related trade effects could be driven by smaller businesses that are doing more one-way as opposed to two-way trade. So that is a possible interpretation of what we are seeing here.

One piece of evidence that may support this small versus large firm interpretation is that when we do our analysis at the level of individual ports of entry, we see less of a trade effect for ports with a lot of automotive-sector trade such as Detroit, Buffalo or Niagara Falls (although we do see a big effect for Port Huron which we know is auto-related). Detroit and Buffalo-

36 See generally, Anneliese, supra note 19 ("54% of all respondents indicated that in the 2 years since 2004, delays had decreased significantly and border crossings were no longer as difficult or time consuming").
37 See Anneliese, supra note 19.
38 See, e.g., Goldfarb, supra note 15 (indicating that "Goods often cross the border repeatedly as value is added at each production stage. Even small increases in border barriers such as border security costs are magnified as parts cross the border multiple times").
Niagara seem to recover more quickly than some of the other eastern ports (such as Champlain-Rouses Point, Highgate Springs, or Alexandria Bay-Lansdowne) and most of the west coast ports.\footnote{U.S. Department of Transportation, \textit{North American Freight Transportation: U.S. Trade with Canada and Mexico}, Bureau of Transportation Statistics (2006), available at http://www.bts.gov/publications/north_american_freight_transportation/ (discussing the three busiest truck crossings at the U.S.-Canadian Border; Detroit, MI; Port Huron, MI; and Niagara/Buffalo, NY). (last viewed Oct. 10, 2008).}

This is probably a good point to acknowledge that Michael Burt from the Conference Board of Canada uses an approach similar to ours but comes up with estimates that are somewhat smaller.\footnote{Burt, Michael, \textit{Tighter Border Security and Its Effects on Canadian Exports}, The Conference Board of Canada, June 2007, available at http://www.internationaltransportforum.org/2009/pdf/CDN_TighterBorder.pdf} I will not get into details of econometric methodology, but there are some differences in approach that account for these different results. Burt uses a different sample period, for example, but we do not think that is the whole story. We have ongoing discussions about methodology, and of course we believe ours is the correct one. But I will be modest on the fact there is some debate.

To explore the effects of a longer sample period we have extended our sample to include an earlier time period. When we go back and look at the results for a sample starting in 1976, we find evidence that the increased trade prompted by formal Canada-U.S. trade agreements has been eroded. This effect is illustrated by the graph shown on the screen which measures the year on the horizontal axis and the volume of trade on the vertical axis.

Between the beginning of the longer sample period in 1976 and CUSFTA in 1989, we see a steady yearly growth of trade shown by the increasing line. What we think happened in 1989 is that with the beginning of the Canada-U.S. Free Trade Agreement, the line gets steeper as trade grows more quickly over time.\footnote{United States - Canada Free Trade Agreement Implementation Act of 1988, 102 Stat. 1851, U.S.-Can., Oct. 4, 1988.} This faster growth of trade shows the positive impact of signing a Free Trade Agreement between Canada and the United States.

Trade continues to grow at this faster rate until 2001 when border security increases and the line shifts down. The pattern implied by this story is exactly what our statistical results are telling us. We are finding that the initial steepening of the line in 1989 followed by the drop in 2001 have almost brought us back to where we would have been if trade had continued to grow at its pre-1989 rate.

This reversal in our statistical results illustrates the concerns that Danielle Goldfarb mentions in her study. There is a lot of anecdotal evidence that companies are starting to revert to some of their pre-free-trade practices,\footnote{E.g., Goldfarb, \textit{supra} note 16.} so
that some of the adjustments that were made to take advantage of that faster growth are now being undone. So we have a fear that the benefits of trade liberalization are being undone by border security.

Our graph can be used to make the point that if you do not actually take into account the increase in the pace of growth between 1989 and 2001, you miss-measure the size of the trade effect due to border security. The size of the trade effect that Steve and I measure is the difference between the volume of trade after 2001 and where it would have been if it had not shifted down in 2001. If we ignore the fact that NAFTA in 1994 and CUSFTA in 1989 had trade-enhancing benefits, we would have underestimated the growth rate of trade between 1989 and 2001 and our estimate of the impact of security on trade would have been too small.

To sum up, we find statistical evidence that increased security in the post-9/11 period might have undone some of the benefits of NAFTA, at least temporarily. I think that Gary has some ideas of how we can avoid having those security costs and how we can start to take trade forward again.

MS. MARTIN: Thank you very much, Paul. And now I will turn the floor over to Gary.

UNITED STATES SPEAKER

Gary Hufbauer†

DR. HUFBAUER: I really want to endorse Paul’s book. When we wrote NAFTA Revisited, published a couple years ago, we looked for data on the security impact, and there was nothing like what you have here. The numbers are very sharp, $10 billion of Canadian exports lost a quarter, $40 billion lost a year. That is significant. And secondly, there is probably an

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44 See id. (arguing that “these new behaviours [are] reversions back to those that existed before the Canada–U.S. free trade agreement”).

† Gary Clyde Hufbauer resumed his position as Reginald Jones Senior Fellow in 1998. Previously he was the Marcus Wallenberg Professor of International Financial Diplomacy at Georgetown University, and served in the U.S. Treasury Department from 1974 to 1980. Dr. Hufbauer holds an A.B from Harvard College, a Ph.D. in Economics from King College at Cambridge University, and a J.D. from Georgetown University Law Center. His co-authored publications include Economic Sanctions Reconsidered, third edition (2007), US Taxation of Foreign Income (2007), US-China Trade Disputes: Rising Tide, Rising Stakes (2006), and NAFTA Revisited: Achievements and Challenges (2005).

45 See Hufbauer, supra note 14.

adverse differential effect on smaller and medium-sized companies, and I will come back to that in a moment. Paul and Steve Globerman have written a very fine study which I think is a landmark in the field.

While everyone knows that trade and foreign direct investment are growing across North America, the fact of the matter is that trade between the U.S. and Canada and direct investment between the U.S. and Canada are far, far below their potential. Yes, the magnitudes are better than they would have been thanks to the Canada-U.S. Free Trade Agreement and NAFTA, but the magnitudes are well below their potential.

The paper that I am alluding to is one where a colleague of mine and I looked at the big reasons for the shortfall. One obvious suspect is currency fluctuations. It is a Canadian choice to have a Canadian dollar. There are good macroeconomic reasons for that. But different currencies do kill trade and economic integration.

Another reason for the shortfall is the array of regulatory barriers; this is Michael Hart's great specialty. Regulatory barriers are very pernicious in reducing the extent of integration between the U.S. and Canadian markets.

The third reason, and the one I am going to talk about, is the security tax. Everybody knows about the rising security tax. We are paying this rising tax because we want to avert future adverse events. But we also want to think about how we deal with the aftermath of the next terrorist episode.

Like many people in this room, I am persuaded there will be another terrorist event. When it comes is hard to say. But let me focus for a moment on an event that would be quite destructive to economic integration: that would be a suicide vessel hitting an oil tanker on the high seas. Then all ports would be closed, at least all U.S. ports would be closed, and then we would have to deal with the aftermath. Today we are paying security taxes to try to avoid such events, even though one may at some point happen.

Here's the interesting thing about security taxes. When we think about security, broadly, we do not tax participants who are in the theater of battle.

47 See id. at 23.
48 See, Hufbauer, supra note 14.
50 See Hart, supra note 8.
52 See generally, Lisa M. Seghetti, Jennifer E. Lake, and William H. Robinson, Border and Transportation Security: Selected Programs and Policies, Congressional Research Service (March 29, 2005) (describing the current border policy programs in use to attempt to avoid terrorist attacks).
53 See 26 U.S.C. § 112 (2007) (excluding from gross income pay received while serving in a combat zone for the armed forces).
We generally pay for security through taxes, broadly distributed sales taxes, income taxes, whatever.\textsuperscript{54} 

So to be very specific on that point, we have a security problem in the Middle East.\textsuperscript{55} We are fighting a couple of wars there, partly because it is an oil area.\textsuperscript{56} We might not be fighting those wars if the problem were in the Congo even though a lot of people are being killed there.\textsuperscript{57} But do we put a special tax on oil imported from the Middle East? We do not.\textsuperscript{58} We support the military through all our taxes. And most of us are happy to make those tax payments.\textsuperscript{59} 

But when we come to border security, where do we put the taxes? We put the cost on the shippers and the producers.\textsuperscript{60} This way of paying the security tax does fragment markets, and I would suggest that our leaders need to think about that.

I live in Washington and I wanted to get my NEXUS card for trips to Canada. So I went through the website and disclosed my whole history since the second grade, how much I drank, and on and on. I finally get to the page where I schedule an interview. But no interviews are conducted in Washington. Instead, I can go up to Buffalo, which I am sure would be an interesting trip, or I can go to Toronto. While I travel often to Toronto, I do not want to make a special trip for my interview, so I still do not have my NEXUS card.

We talked about the 100 percent cargo scanning requirements under the Container Security Initiative.\textsuperscript{61} That is coming on very soon. This will make life more difficult for a lot of smaller countries.\textsuperscript{62} Exporters based in those

\textsuperscript{54} E.g., J. R. Hicks, U.K. Hicks & L. Rostas, \textit{The Taxation of War Wealth} 29-34 (Oxford University Press 1941).

\textsuperscript{55} See Belasco, Amy, \textit{The Cost of Iraq, Afghanistan, and Other Global War on Terror Operations Since 9/11} at 1, Congressional Research Service, (July 14, 2008).

\textsuperscript{56} E.g., Edward Nell & Willi Semmler, \textit{The Iraq War and the World Oil Economy}, 17 Constellations 557, 569-70 (2007); See also, Greenspan, Alan, \textit{The Age of Turbulence: Adventures in a New World} 463 (Penguin Press 2007) ("I am saddened that it is politically inconvenient to acknowledge what everyone knows: the Iraq war is largely about oil").

\textsuperscript{57} Pierre Englebert & James Ron, \textit{Primary Commodities and War: Congo-Brazzaville's Ambivalent Resource Curse}, 37 Comp. Pol. 61, 61-62 (2004) ("three main militias . . . directly killed at least 12,000 persons . . . [and] displaced 860,000").

\textsuperscript{58} See generally, Singer, S. Fred, \textit{How to Trim Oil Imports, Dampen Price Swings}, 8 J. Pol'y Analysis Mgmt. 116, 117 (1989) (discussing the options for taxing oil imports).

\textsuperscript{59} See Office of Management and Budget, \textit{Analytical Perspectives: Budget of the United Stated Government Fiscal Year 2008} at 339-40 (2007) (totaling the combined spending from the Department of Defense, Homeland Security, and Veterans Affairs Departments at 23% of the total taxable outlays in 2007).

\textsuperscript{60} See Anneliese, \textit{supra} note 19.

\textsuperscript{61} 6 U.S.C. § 982(a) (2007) (listing the SAFE Port Act as requiring one hundred percent screening of cargo containers and high-risk containers).

\textsuperscript{62} See, e.g., Stephen L. Caldwell, Dir., Homeland Security and Justice, \textit{Supply Chain Secu-
countries will first have to ship to one of the larger ports, before shipping to
the United States, and that is not going to promote development.63

Paul talked about how you translate time delays into trade costs. The
interesting thing is that he reported results. I have seen some other gravity
model results dealing with North Africa.64 The finding is that, if you increase
the time of shipments by a couple of days, you cut the trade a lot.65

Within the Container Security Initiative, it should be possible to reach an
agreement that sealed containers arriving in Canadian ports and transported
south, will not be scanned a second time when they enter the United States.66
These containers should all be radio tracked on their journey through Canada
to the U.S. border.

Everything I say here echoes one of the questions at lunch directed to
Ambassador Wilson. We are talking cultural change as a precursor to reform.
Americans need to accept the basic proposition that there is risk everyplace,
there is risk in shipping from Texas to Colorado. You can have terrorists in
Texas.67 They might ship to Colorado to carry out their terrorism.68 But the
risk is not higher on goods coming from Canada to the United States than
from Texas to Colorado.69 That is the basic proposition. Before we can make

rity: Challenges to Scanning 100 Percent of U.S.-Bound Cargo Containers, Testimony Before
the Subcommittee on Surface Transportation and Merchant Marine Infrastructure, Safety, and
Security, Committee on Commerce, Science, and Transportation, U.S. Senate (June 12, 2008),
available at http://www.gao.gov/new.items/d08533t.pdf. (discussing that some countries
consider the one hundred percent scanning requirement an unfair barrier to trade) (last visited

63 Id.
64 See, e.g., Alberto Portugal-Perez & John S. Wilson, Trade Costs in Africa: Barriers and
visited on Oct. 10, 2008).
65 See generally, id. at 2 (discussing the prohibitively high cost of trade due to multiple
factors in Sub-Saharan African countries).
66 See U.S. Customs and Border Protection, Container Security Initiative, available at
2008).
67 E.g., Holy Land Foundation for Relief and Development v. Ashcroft, 333 F.3d 156 (D.C.
Cir. 2003) (upholding that the Texas based Holy Land foundation, was correctly categorized a
68 Cf. Counterterrorism Threat Assessment and Warning Unit, National Security Division,
mestic terrorist plot to attack Fort Hood, Texas and the terrorists planed return to a safe house
located in Colorado); see also Whidden, Michael J., Unequal Justice: Arabs in America and
69 See MacPherson, supra note 31 (“To date, no U.S.-bound commodity shipments from
Canada have been found to contain bombs, bio-chemical weapons, or other illegal sub-
stances”).
changes, somebody at a leadership level has to get this message across. Of course Canadians have to accept the same proposition about U.S. goods.

I will not spend much time on travelers except to say that we come back to a security tax. Somebody showed me a credit card-type of device that has a radio chip, and that is a good improvement for travelers. But these things cost money, and what we are doing is putting that cost on individuals, many of whom do not have a passport or do not have one of these smart driver's licenses. We need to think about subsidizing this cost for the next five years. When we think about what we are paying generally for security, this is a very small amount of money.

Now let us turn to goods. Here I totally endorse this idea where we have certified examinations at the factory in Canada or the United States prior to shipment. And we have joint rules. The merchandise is put in sealed trucks and shipped across the border. The containers are not scanned a second time at the border except for occasional random audits.

But coming back to my first principle, we ought to have the same frequency of random audits on trucks carrying containers between California and Illinois as for trucks carrying containers from Quebec to Michigan. For other regulations and for product taxes, we have already accepted the national treatment principle that we are not going to put a higher burden on shipments between the United States and Canada than we do within our respective countries. We should accept the same principle for shipping goods, and use high-tech equipment to inspect containers in both cases.

Looking forward, we should go in the direction that security checks are generally conducted at the North American perimeter. This is slowly happening, bit by bit, as we have heard today. All I am urging is that we make perimeter inspection an announced goal, and go more rapidly in that direction to reduce congestion at the border.

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72 See U.S. Customs and Border Protection, supra note 66.

73 Id.

74 Id.


76 See U.S. Customs and Border Protection, supra note 66.
And to get here, we need a strong push from the President and the Prime Minister. And this may happen now that NAFTA has been put into play for the next administration in Washington. Prime Minister Harper may very well take up the challenge as well.

Prime Minister Harper, and President Bush should agree to launch a commission which explores what practical steps can be taken to push the security examination back to the perimeter.

I know all these recommendations sound like pie in the sky. But as was mentioned earlier, the United States depends on Canadian energy.\(^\text{77}\) I would say to officials sitting in Ottawa, there is no reason why the energy card should not be played, in some suitable way, to move forward the agenda on security.

Thank you.

MS. MARTIN: Given the fact that Gary has to leave promptly at the end of the session, I will ask that questions be kept terse I guess. But let us begin with opening the floor to questions.

DISCUSSION FOLLOWING THE REMARKS OF PAUL STORER AND GARY HUFBAUER

MS. IRISH: Maureen Irish, University of Windsor. A quick question to Gary concerning the security perimeter. Would this have to be namely for goods? I have been interested in the connection between security for goods and security for persons. As we heard in the last panel, there are lots of differences or significant problems with the safe third country agreement.\(^\text{78}\) But can we in fact separate out security for goods and security for persons?

DR. HUFBAUER: I think security for persons is much harder for privacy reasons which I am sure you know better than I do.\(^\text{79}\) Also, we have different standards for issuing visas. I would like to see progress on persons, but I think we are much closer to getting progress on the goods issue.

MR. CRANE: Thank you. David Crane. Now that Gary's raised the interest in proposition of playing the energy card he says in a suitable way, how would he suggest that be played then?

DR. HUFBAUER: David Crane is a brilliant commentator, so he probably has better and more subtle ideas than I do. It cannot be that Canada would threaten to join OPEC or anything like that. But the U.S. really needs


\(^{79}\) See generally, Seghetti, *supra* note 52 (describing the Computer Aided Passenger Pre-Screening System (CAPPS) which was discontinued due to privacy concerns).
more energy from Canada (which is happening anyway) and Canada probably is chaffing a bit at the provision in NAFTA which essentially says that Canada will not try to create a two-tier energy market—cheaper energy for Canada than shipped to the U.S.—and in an emergency energy will be proportionately allocated.\footnote{See Gordon Laxer & John Dillon, \textit{Over a Barrel: Exiting From NAFTA's Proportionality Clause} (Parkland Institute, 2008).}

So I guess the subtle way would be this. Tell the U.S. leaders that we know you want Canada to continue going forward with the Mackenzie oil sands development in Alberta, and we know you want more hydropower, and so on.

We Canadian leaders will discuss these energy security issues, but Canada also wants a serious reconsideration of how the security partnership is handled because, if Paul Storer is right, this is having a lot of adverse affect. Not on GM probably, not on Ford, but on numerous smaller companies. The security tax is depressing investment in Canada.

So we have to deal with this because you, the U.S. by your policies are basically depriving us of one of our great advantages which is assured proximity to the U.S. market.

MS. PAWLUCH: Quick question on the continental perimeter concept. Can it move forward with Canada and the U.S. to the exclusion of Mexico? And if not, is that not one of the hurdles to moving forward? I see you have identified it as a joint approach. Realistically, can you see it moving forward that way?

DR. HUFBAUER: Whoever asks the next question should toss it to Paul, but I will briefly try to answer this one.

I believe that the U.S. can go forward with Canada first. And if we cannot go forward with Canada on some new concept, who can we deal with? Beyond Canada, there is Mexico, there is Singapore, there is Hong Kong, and others. If we want to create a larger zone of safety than we now have, Canada is obviously the place to start.

And I honestly believe that Mexicans would understand that this issue first has to be addressed on a pilot basis with Canada before a security perimeter can be considered for Mexico. So I do not think Mexico would object if the U.S. and Canada went ahead.\footnote{See Wallace Clement & Leah F. Vosko, \textit{Changing Canada: Political Economy as Transformation} 244 (McGill-Queen's University Press, 2003) (indicating that Mexico's position in the [security perimeter] arrangement is ambiguous).}

MS. FREEDMAN: Hi. Katherine Freedman from the University of Buffalo.

At several points today there have been conversations regarding the security perimeter and reference with respect to renegotiating NAFTA and
rebuilding NAFTA. And I am just curious if either of the panelists have any opinion or ideas with respect to pushing the envelope regarding the establishment of a customs union as well between Canada and the United States?

From my perspective, the security perimeter, it is a different issue from a customs union. And I am just wondering if there are any discussions in that regard, if these two issues should be handled simultaneously, or if we should move forward on one and see what can be accomplished with the other?

MR. STORER: I think that the main reason we will not have a customs union in the short run it is one of those “third-rail” political issues in Canada. I have been told by some industry groups that academic economists should stop using the term "customs union" because we hurt their efforts to broaden and deepen NAFTA. Every time a reference to customs unions gets reported in the news, people view that it is going to be some sort of political union. CBC has been running a miniseries on this lately about the Trojan Horse series. 82

So a full-blown customs union is probably not going to come right out of the sky, but one thing that is interesting, is that there is a mini-customs union right now in the NAFTA. This sectoral customs union has been in place since 1994 for computers and computer parts. It would be very interesting do some follow-up work on how this sectoral customs union has worked out. 83 It does not seem like Canada’s lost its sovereignty, and it has been implemented in the current framework with Cuba still on the bad person list.

So maybe just like the Auto Pact was extended beyond that sector, maybe that mini-customs union in computers and computer parts could be extended into some more sectors that people do not feel are sensitive. And as people realized that the gradual extension of the customs union happened without disaster, maybe that would point the way to move to a full customs union once people realize it is not the threat they think it is.

Oh, can I say something about perimeter security? The work I have seen by the Perimeter Clearance Coalition shows several ways to implement a lot of the benefits of perimeter security. 84 Countries can check people’s

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credentials at the point of entry in North America so that we do not have to double-check them again if the visitors to North America cross the Canada-U.S. border. This perimeter verification can be done without giving up sovereignty. One idea is to have a card with an embedded chip that would let you know what kind of permissions a visitor has to enter the United States or Canada.

So it would not be that you would be just letting people into North America and then just waving the door open, but you would be coding information for both Canada and the United States at the first point of entry. And so then when the person arrived to the Canada-U.S. border, this encoded card would already provide that information. It would just expedite crossing. You might not just walk right through the Canada-U.S. border but you would walk through a lot faster because you would be scrutinizing the person the most intensively when they came from, say, Belgium to Canada or the United States. And I think that method has a lot of the benefits of the perimeter security without having to give up sovereignty.

MS. MARTIN: Any more questions?

MR. CRANE: Can I make another point?

MS. MARTIN: Sure.

MR. CRANE: You touch on something interesting.

These border differences do affect behavior, and Gary mentioned, for example, investment. There is no doubt that while the Ford Motor Company and GM want total ease-of-border access, it may be at the economic development offices of Michigan and Ohio would prefer to see border differences so they can say to Japanese automakers you are better off locating in the U.S.

On the Canadian side it is very interesting because of differences and how we handle immigrants, that Microsoft has now put a big R & D lab in Vancouver because of Microsoft's difficulties getting those same people into the United States. So it also might also be interesting to study how these differences also lead to these kinds of outcomes.

In fact, I was at a conference yesterday where a suggestion that other major cities should try to follow Vancouver's example and get one of things, and I remember after 9/11, Mike Lazaridis who runs Research in Motion suggested that because of difficulties of foreign post-ops getting into the U.S., that our universities who are supported by pretty big government should just sweep up all these people from China and India and the Middle

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East and Russia and elsewhere at the post-op level and bring them into our University and create our next generation of professors.

DR. HUFBAUER: Leaping in with a very brief comment on that. You are right, David. There is a lot of unspoken protectionism going on, and everyone here knows the current mood in the United States which is not in favor of going ahead on the liberalization agenda. It is not necessarily going back quickly, but it is certainly not in favor of going ahead, and certainly there are multiple small differences of all kinds in regulatory barriers. There is always somebody who has a small advantage or even a big advantage in regulatory differences and is going to play it.

For the last couple of decades, national governments have been pushing in the other direction with the assistance of companies who are on the other side of the debate and really want to move forward on liberalization. But right now the liberalization agenda is stalled. I hope it will get going again. But your guess is better than mine.

On the specific aspect of immigration, this is another place where the U.S. is falling behind. My colleague, Jacob Kierkegaard, wrote a paper—which is on our website—on what is happening in terms of the high-skilled fraction of the U.S. population, including skilled immigrants, and what is happening in Canada. The U.S. is distinctly falling behind in terms of skilled immigrants and the general skill level of the population.

MR. HERMAN: Larry Herman from Toronto.

I agree with Gary's comments. I always agree with Gary's comments—he knows that—about the difficulty of moving ahead on the trade liberalization agenda currently in the United States, so that is a reality. It is a political reality. So pushing that button is not going to get very far with the United States.

My view is that the Canadian response particularly in light of what some of the candidates for President have said about the trade liberalization, which is to roll back I think the gains of the NAFTA, I think that Canada should be pursuing another avenue, and I think the security avenue is the right one.

What we have heard today I think is that there are a myriad of arrangements, agreements, or different sorts of programs to try to facilitate


88 See id.
transport of trade, but there has been no big-picture agreement.\textsuperscript{89} I think that is what is needed.

In fact, if you look at the—if you look at the treaties, the government-to-government, federal-government-to-federal-government, state-to-state treaty between Canada and the United States, in this complex world there are very, very few.

What is needed I think is a—and I like your comments on this—is an approach that said okay, let us not deal with a trade liberalization issue. Let us pursue President to Prime Minister, Canada-U.S.—forget Mexico—Canada-U.S., a treaty, a major treaty that deals with the security issue because that I think from what I have heard both of you say would help advance the trades liberalization agenda. It would be called a security agenda, but it would deal away with a lot of the problems at the border.

**DR. HUFBAUER:** I will give a quick comment and then, Paul, you should weigh in on this one.

Yes, I think that is a great idea, and I think there are three big issues that conceivably could be packaged together. Energy I have spoken about, that is a continuing issue. There is hopefully a joint U.S.-Canada approach on cap-and-trade or carbon taxes to address climate change. And then there is security.

I think there is a package there that could be put together with imagination, which then ultimately would be widened, just as the Canada-U.S. Free Trade Agreement was, to embrace other countries once we had pioneered it.

**MR. STORER:** I feel that there is a way to package some of the trade liberalizing initiatives, such as getting rid of nuisance procedures at the border like rules of origin, and using these improvements to brand the package as being security-enhancing. What you can do is reallocate people from doing one low-value function to another high-value function that enhances security. This might be the way to achieve both deeper integration and greater security and I think that would probably be a good way to go forward.

**MS. MARTIN:** Any final questions?

**DR. KING:** I wanted to ask Larry Herman and our friends on the panel, did you favor the arbitration of disputes under that treaty?

**MR. HERMAN:** Sure. Absolutely.

**DR. KINGS:** How about the U.S., what do you think, Gary?

**DR. HUFBAUER:** Would I favor it? By all means I would favor it. Whether it would come, I do not know. There is a pushback against legal procedures.

\textsuperscript{89} See generally, Taylor, \textit{supra} note 46 (discussing possible long-term solutions to replace the current border measures, specifically an “external perimeter”).
DR. KING: Is that a barrier if we do not arbitrate our disputes under the treaty?

DR. HUFBAUER: Well, yeah. As you know, Henry, better than I, there are many ways of doing arbitration, but I think when you do not have some kind of dispute-settlement mechanism, the words remain basically words, and they do not have a bite.

MR. STORER: I would like to see it come in to almost the same way that antitrust or competition law, actual precedent-making in court decisions.

MR. HERMAN: I am sorry, but on this dispute settlement, one of the problems with the NAFTA is that there is no permanent dispute settlement process.

DR. HUFBAUER: Right.

MR. HERMAN: It is ad hoc. You could envision institutionalizing NAFTA dispute settlement, have a permanent NAFTA court, judges who have tenure, they can sit in Washington. I do not even care if they sit in Ottawa, they can sit in Washington. They can deal with all the NAFTA disputes, Chapter 11, Chapter 9, and Chapter 20, but you could also institutionalize that body to deal with security-related issues where there is a dispute subject to all the national security and sovereignty issues. But there will be things that will have to be settled by an independent arm's-length body on some of the securities issues, and it can be part of the same process.

DR. HUFBAUER: What about a court?

DR. HUFBAUER: Well, I think what Larry has outlined is very close to a court. You may not want to give it that particular name. You may want to call it a commission, and you can put very distinguished people on it: retired appellate court judges and people of equivalent distinction. It would command a lot of respect.

MS. MARTIN: Well, please join me in giving a warm round of applause for the panelists.

(Session concluded.)