



Canada-U.S. Relations

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Summary

Relations between the United States and Canada, though generally close, have undergone changes in tenor over the past three decades. During the 1980s, the two countries generally enjoyed very good relations. The early 1990s brought new governments to Ottawa and Washington, and although Canada's Liberal Party emphasized its determination to act independently of the United States when necessary, relations continued to be cordial. In early 2006, a minority Conservative government assumed power in Ottawa. It was regarded as being more philosophically in tune with the George W. Bush Administration than the Liberals were; some observers believe that this compatibility helped facilitate bilateral cooperation. The election of President Obama in November 2008 signaled a new chapter in U.S.-Canada relations; unlike President Bush, Obama is quite popular in Canada.

The two North American countries continue to cooperate widely in international security and political issues, both bilaterally and through numerous international organizations. Canada's foreign and defense policies are usually in harmony with those of the United States. Areas of contention have been relatively few, but sometimes sharp, as was the case in policy toward Iraq. Since September 11, the United States and Canada have cooperated extensively on efforts to strengthen border security and to combat terrorism, particularly in Afghanistan. Both countries have also been active participants in the U.N.-sanctioned NATO mission in Libya.

The United States and Canada maintain the world's largest bilateral trading relationship, one that has been strengthened over the past two decades by the approval of two major free trade agreements. Although commercial disputes may not be quite as prominent now as they have been in the past, the two countries in recent years have engaged in difficult negotiations over items in several trade sectors, including natural resources, agricultural commodities, and the cultural/entertainment industry. The most recent dispute has centered around the Buy America provision of the 2009 economic stimulus law. However, these disputes affect but a small percentage of the total goods and services exchanged. In recent years, energy has increasingly emerged as a key component of the trade relationship. In addition, the United States and Canada work together closely on environmental matters, including monitoring air quality and solid waste transfers, and protecting and maintaining the quality of border waterways.

Many Members of Congress follow U.S.-Canada environmental, trade, and transborder issues that affect their states and districts. In addition, because the countries are similar in many ways, lawmakers in both countries study solutions proposed across the border to such issues as federal fiscal policy and federal-provincial power sharing.

This report begins with a short overview of Canada's political scene, economic conditions, security and foreign policy, and environmental initiatives, focusing particularly on issues that may be relevant to U.S. policymakers. This country survey is followed by several summaries of current bilateral issues in the political, international security, trade, and environmental arenas. The questions following each summary are designed as potential inquiries to Canadian officials to promote thought and discussion among policymakers.

Contents

Overview.....	1
Canada’s Domestic Scene.....	2
Background and Current Political Situation.....	2
National Unity.....	5
Foreign and Security Policy Issues.....	6
U.S.-Canada Security and Foreign Policy Issues.....	7
Economic and Trade Issues.....	16
Budget Policy.....	16
Energy.....	17
Bilateral Trade Issues.....	18
Environmental Issues.....	21
Canada and Afghanistan.....	22
Issue Definition.....	22
Background and Analysis.....	22
Status of the Issue.....	23
Questions.....	24
Canada’s Arctic Sovereignty Claim.....	24
Issue Definition.....	24
Background and Analysis.....	24
Status of the Issue.....	26
Questions.....	26
Inter-American Cooperation.....	26
Issue Definition.....	26
Background and Analysis.....	27
The Organization of American States.....	27
Haiti.....	28
Palestinian Statehood.....	29
Status of the Issue.....	29
Questions.....	29
Border Security Issues.....	30
Issue Definition.....	30
Background and Analysis.....	30
Western Hemisphere Travel Initiative.....	31
Border Infrastructure and Personnel.....	32
Status of the Issue.....	32
Questions.....	33
Border Security: Trade and Commercial Concerns.....	33
Issue Definition.....	33
Background and Analysis.....	34
Action Programs and Initiatives.....	34
Status of the Issue.....	35
Questions.....	36
Immigration and Refugee Policies.....	36
Issue Definition.....	36
Background and Analysis.....	36

Status of the Issue	38
Questions	39
Canada's Free Trade Agreement Agenda	39
Issue Definition	39
Background	40
Status of the Issue	41
Questions	41
Participation in the G-20	42
Issue Definition	42
Background and Analysis	42
Status of the Issues	43
Questions	44
North American Cooperation on Competitiveness and Security	44
Issue Definition	44
Background and Analysis	45
Status of the Issue	46
Questions	46
Canada's Financial System	46
Issue Definition	46
Background and Analysis	47
Questions	49
Buy American Provisions	49
Issue Definition	49
Background and Analysis	49
Status of the Issue	51
Questions	51
U.S. Imports of Canadian Softwood Lumber	51
Issue Definition	51
Background and Analysis	52
Status of the Issue	53
Questions	54
Country of Origin Labeling	54
Issue Definition	54
Background and Analysis	55
Status of the Issue	55
Questions	56
The Canadian Steel Sector	57
Issue Definition	57
Background and Analysis	57
Status of the Issue	59
Questions:	60
Intellectual Property Rights	60
Issue Definition	60
Background and Analysis	60
Status of the Issue	62
Questions	62
Electric Reliability, Trade, and Access to Renewable Power	62

Issue Definition	62
Background and Analysis	63
Reliability	63
Trade and Renewable Energy Development	64
Status of the Issues	65
Questions	65
U.S. Energy Security and Canadian Oil Sands	65
Issue Definition	65
Background and Analysis	66
Status of the Issue	67
Questions	67
Keystone XL Pipeline	68
Issue Definition	68
Background and Analysis	68
Status of the Issue	69
Questions	69
Natural Gas Pipeline from Alaska	70
Issue Definition	70
Background and Analysis	70
Status of the Issue	71
Questions	72

Contacts

Author Contact Information	73
Acknowledgments	73

Overview¹

Relations between the United States and Canada, though generally cordial, have undergone several changes in tenor over the past three decades. The 1980s and early 1990s were marked by an increasingly close partnership, whose milestones included the mid-1980s “Shamrock Summits” (named after the Irish heritage shared by the two countries’ leaders, Brian Mulroney and Ronald Reagan), the 1989 U.S.-Canada Free Trade Agreement, and the 1994 North American Free Trade Agreement. To many Canadians, however, Ottawa seemed at times to have drawn a bit *too* close to Washington, DC, with Canada casting itself too willingly in a secondary role.

In 1994, one Canada watcher observed that in the foreign policy arena, Canada “politely distances itself from the United States” in certain ways. In an interview that year, the newly elected Liberal Prime Minister Jean Chrétien summed up his view of the bilateral relationship: “We like each other. I just don’t want Canada to be perceived as being the 51st state of America.” Many believe, however, that this initial show of mild reserve was intended for domestic consumption, and that Canada and the United States in fact continued to enjoy excellent relations. Chrétien and President Bill Clinton are said to have had congenial meetings; they focused on areas where the two countries were able to reach agreement, including environmental issues, cooperation on border measures, and technology projects.²

In February 2001, President George W. Bush met with Chrétien. The two leaders discussed energy, missile defense, and trade. After September 11, however, economic and environmental issues often took a back seat to joint efforts to improve security, both at home and abroad. Canada became involved in the crisis at the outset, and has cooperated closely with the United States in efforts to combat international terrorism.

Nevertheless, Chrétien did not establish with President Bush the same rapport that he had enjoyed with Clinton. Differences over a number of issues tended to strain relations. The Bush Administration inherited some long-standing trade disputes, most notably over wheat and softwood lumber, and Canada and the United States were on different sides of several international issues, including the U.S. withdrawal from the ABM treaty and the International Criminal Court. But it was over security-related matters, particularly defense spending, Iraq, and missile defense, that the two governments had their sharpest differences. Despite these controversies, Canada and the United States continued to work together on a number of fronts to thwart terrorism, including strengthening border security, sharing intelligence and expanding law enforcement cooperation. The Canadian government passed a new anti-terrorism act, and Canada has contributed significant military assets to the NATO-led coalition in Afghanistan.

Paul Martin, who became prime minister in December 2003, met several times with President Bush. At the January 2004 Summit of the Americas, the two leaders discussed several topics and came to agreement on Canadian eligibility to bid on reconstruction contracts in Iraq and on the ground rules for U.S. deportation of Canadian citizens. In April 2004 in Washington, DC, Martin and Bush met once more and talked about a variety of issues, from terrorism to the “mad cow”

¹ Prepared by Carl Ek, Specialist in International Relations; and Ian F. Fergusson, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

² “Canada Narrows Its Foreign Policy Goals to Focus on Trade.” By Charles Trueheart. *Washington Post*. November 17, 1994. p. A44. “Don’t Take Canada For Granted.” By Tad Szulc. *Parade Magazine*. February 20, 1994.

crisis. In November 2004, during President Bush's first official visit to Canada, missile defense, border security, and global "hot spots" were on the agenda. Although bilateral tensions heated up in 2005 over the issues of missile defense and softwood lumber, Canada's government and private citizens responded promptly and generously to assist the United States after Hurricane Katrina.³

In February 2006, after a come-from-behind election victory, the Conservative Party assumed power as a minority government, and Stephen Harper became Canada's 22nd Prime Minister, the first Conservative to lead the country in 12 years. Observers believed that Harper's government was somewhat more politically compatible with the Bush Administration in many areas. However, although the policy orientation of Harper's Conservatives may be similar to that of the Republicans in Washington, differences still arose on certain issues, particularly those that touched upon matters of perceived sovereignty. For example, on January 26, 2006, days before his inauguration, Harper sharply took exception to comments made earlier by U.S. Ambassador to Canada David Wilkins and asserted Canada's sovereignty over the so-called Northwest Passage, the frozen arctic region that global warming may turn into a waterway linking Asia and Europe.⁴

The election of Barack Obama in November 2008 signaled a new chapter in U.S.-Canada relations. Unlike President Bush, Obama has been quite popular in Canada—a January 2009 public opinion poll put the new American president's approval rating in Canada at 86%; polls conducted in September 2009 and November 2010 showed that Obama enjoyed continued popularity among Canadians. Some believe that this favorable view may be facilitating the Harper government's cooperative efforts with the United States. In addition, although Harper has a more conservative orientation than Obama, both leaders are pragmatic in their approach to solving public policy problems, and observers believe the bilateral relationship will continue to be collaborative and productive. On February 19, 2009, renewing a tradition broken in 2001 by President Bush, Obama made Canada his first official foreign visit. He and Harper focused on trade, climate change, and Afghanistan, among other issues; in September 2009, Harper met with Obama at the White House. Harper traveled to Washington to meet with Obama again in February 2011; the two leaders agreed to the establishment of a U.S.-Canada Regulatory Cooperation Council and issued a Declaration on a Shared Vision for Perimeter Security and Economic Competitiveness.⁵

Canada's Domestic Scene

Background and Current Political Situation

The Liberal Party, in power since 1993, was by 2003 being commonly referred to as "Canada's natural ruling party."⁶ Maintaining a Liberal majority appeared to be a safe bet at that time, but in

³ "Bush Launches Bid To Repair US-Canada Ties." *Agence France-Presse*. November 30, 2004.

⁴ "Harper Tells U.S. To Butt Out On Plans For Defending Canada's Arctic." *The Canadian Press*. January 26, 2006.

⁵ "Obama Makes Overtures to Canada Prime Minister." *New York Times*. February 20, 2009. "Obama's Popularity Higher Than Ever In Canada: Poll." *National Post*. September 20, 2009. "Obama May Be Slapped By U.S. Electorate, but Canada Still Claps: Poll." *The Canadian Press*. November 4, 2010. "PM and U.S. President Obama Announce Shared Vision For Perimeter Security and Economic Competitiveness Between Canada and the United States." Web site of the Canadian Prime Minister's Office. February 4, 2011. <http://www.pm.gc.ca/eng/media.asp?category=1&featureId=6&pageId=26&id=3931>

⁶ "Welcome To Their Nightmare: Finally, a Reason To Start Paying Attention To Politics Once Again." *Globe and Mail*. December 8, 2003.

February 2004 the “sponsorship scandal” erupted. Canada’s Auditor General issued a report stating that, under a program intended to build support for Canadian unity, the Chrétien government had funneled C\$100 million in public funds for dubious contracts to Québec advertising firms associated with the Liberal party.⁷

The Liberals’ standing in the polls plummeted, and the opposition parties strengthened. To the right of the Liberals, two conservative parties had merged under a new leader, Albertan Stephen Harper. And to the left, the New Democratic Party (NDP) likewise had recently elected a dynamic party chief, Jack Layton.

In June 2004 elections, the Liberals, despite losing seats in the House of Commons, won a plurality and formed a minority government. In November 2005, the Liberals lost a confidence vote, and snap elections were held on January 23, 2006. This time, the Conservatives won a plurality, and governed until May 2011 as a minority. Some analysts cautioned that the Tory victory did not necessarily represent a “paradigm shift” to the right in Canadian politics; they noted that the Conservative party won only 37% of the popular vote. Because past minority governments have been relatively short-lived, Harper kept one eye on the next elections. In addition, Harper relied upon the *ad hoc* support of the other three parties to ensure passage of the various items on his legislative agenda. Many believe that is why he advocated fairly centrist policies.⁸

However, Harper has been willing to challenge public opinion over Afghanistan, where the Liberal government deployed troops in 2002. In 2006, he won a narrow vote in parliament to keep Canadian troops in Afghanistan for two additional years. Harper initially characterized the mission as humanitarian in nature and also asserted that it was in Canada’s national interest to demonstrate its ability to play a leadership role internationally. But as Canadian operations shifted from peacekeeping to counter-insurgency and casualties mounted, public support diminished. Canadian troops ended their combat role there in July 2011.

Canada’s October 2008 elections did little to change the makeup of parliament. The Conservatives, who reportedly anticipated a weakening in future support, called the elections in hopes of capturing a majority. However, the Tories emerged only with a somewhat stronger plurality.

In November 2008, a budget bill put forward by the Conservatives precipitated a political crisis; the spending plan proposed, among other things, the elimination of federal funding for political parties. The opposition parties, which would have been severely affected by the plan, rebelled and were poised to vote down the government—ostensibly because Harper had failed to put forward a stimulus package that would respond to the economic downturn. Harper withdrew his proposals and, to avoid the no-confidence motion, prorogued (suspended or recessed) the session of parliament until January 2009; the shutdown was sharply criticized by many.⁹

⁷ “Canada: Martin on the Ropes in Funding Scandal.” *Oxford Analytica*. February 25, 2004. February 23, 2004.

“Canada’s Premier Acts to Counter Scandal.” By DeNeeen L. Brown. *Washington Post*. February 17, 2004.

⁸ “Interview: Stephen Harper.” *Maclean’s*. March 6, 2006. “Conservatives To Govern From Political Center.” *Oxford Analytica*. January 24, 2006. “Harper’s Five Easy Pieces.” *Economist*. April 8, 2006.

⁹ “Canadian Leader Shuts Parliament To Avoid No-Confidence Vote, Angering Many.” *New York Times*. December 6, 2008.

During this time, the Liberal party named public intellectual Michael Ignatieff as their new leader. Some believed that when Parliament returned in January, he would seek to bring down the government and force new elections. However, he declined to do so, reportedly choosing instead to support the government's stimulus program (see below) and to consolidate the party's strength rather than challenge the Conservatives immediately.¹⁰

In the fall of 2009, many believed the Harper government might face a no-confidence vote, particularly when public criticism was touched off by questions over how forthcoming the government had been during inquiries over official knowledge about the turnover by the Canadian military to Afghan authorities of prisoners who were subsequently abused and reportedly tortured. On December 30, 2009, Harper prorogued parliament until early March. Harper's spokesperson explained the move as one necessary to give the government the time to "recalibrate" and "consult" over its budgetary policies. However, other observers argued that Harper sent the legislature home in order to avoid confrontation over the detainee controversy. The second prorogation in roughly a year's time prompted harsh criticism by the opposition parties, as well as scattered protests around the country.¹¹

However, an uptick in the economy helped Harper, whose party also benefited from a "bounce" from the success of the Vancouver Winter Olympics. In addition, the government's handling of aid to Haiti in the wake of the January 2010 earthquake earned praise. On the negative side of the ledger, Harper was faulted for two seemingly unnecessary prorogations, and also for not carrying out the institutional changes (including reform of the Senate and of the electoral process) that he promised during his late 2005 campaign and early in his tenure.

Some analysts in 2010 believed that the political stalemate might permit the Harper government to serve until the next general federal elections, set for October 2012. However, on March 25, 2011, the Conservatives lost a no-confidence vote that was ostensibly based on a contempt of parliament ruling that the government had underestimated the costs of prison construction and military fighter procurement; however, some observers maintain that the budget was the main point of contention.¹²

Elections were held on May 2, 2011; it was the fourth time Canada had held elections in seven years. But unlike the last three, which returned minority governments, this one resulted in significant changes for all of the national parties: first of all, the Conservatives managed to capture a comfortable majority of 166 seats in the 308-seat parliament, up from 144. In second place was the NDP, which wound up with 103 seats, almost triple the 36 seats they had held before. The Liberals won just 34 seats, down from 77, making them the third-largest party for the first time in the nation's history. The separatist BQ was reduced from 48 down to just 4 seats—causing it to fall below the threshold for official party status. Finally, the Green Party managed to win one seat—another first.¹³

¹⁰ "The Liberals Try a New Leader," *The Economist*, December 13, 2008.

¹¹ "Harper Goes Prorogue." *The Economist*. January 9, 2010. "Improved Poll Numbers Not Enough To Entice Ignatieff Into Spring Election." *Canadian Press*. January 28, 2010. "Conservatives Secure 10-Point Lead: Poll." *National Post*. April 12, 2010. "Stalled Institutional Reform Hurts Harper." *Oxford Analytica*. March 9, 2010. "Stimulus Has Boosted Growth, Harper." *Oxford Analytica*. April 14, 2010.

¹² "Canada: Country Report." *Economist Intelligence Unit*. April, 2011. p. 11.

¹³ Data from Canadian Parliament's website, updated August 2011:
[http://www.parl.gc.ca/Parlinfo/Files/Parliament.aspx?Item=1924d334-6bd0-4cb3-8793-
cee640025ff6&Language=E&MenuID=Lists.Parliament.aspx](http://www.parl.gc.ca/Parlinfo/Files/Parliament.aspx?Item=1924d334-6bd0-4cb3-8793-cee640025ff6&Language=E&MenuID=Lists.Parliament.aspx)

In explaining the results, observers note that many Canadians reportedly had become comfortable with Harper's personality and leadership style. In addition, Harper has generally avoided divisive social issues and has instead succeeded in positioning his party more toward the center—a technique that had been used by the Liberals between 1993 and 2006. Harper's trump card, however, was the economy (see below). Since the mid-1990s, both Liberal and Conservative governments had run budgetary surpluses, leaving the government in a good position to introduce limited stimulus measures during the global economic crisis, from which Canada emerged in better shape than most other developed countries.

The Liberals are reportedly attempting to rebuild their campaign coffers and are preparing for the next leadership race (Ignatieff resigned shortly after the elections). The NDP will not likely be as effective an opposition party as the Liberals—many of the incoming class of MPs are young and/or relatively inexperienced, and, more importantly, the party lost its charismatic leader, Jack Layton, to cancer in August 2011.

Harper struck a conciliatory note on election night, saying “[w]e are intensely aware that we are and must be the government of all Canadians, including those that did not vote for us.” His new Conservative majority government likely will re-focus on its budget priorities, which include the elimination of the federal deficit by 2015. It also hopes to pass several law enforcement measures and continue to promote the production and export (mainly to the United States) of Alberta's tar sands oil.¹⁴

National Unity

For more than four decades, an emotional debate has raged over the status of French-speaking Québec, Canada's second-largest province geographically and home to about one-quarter of its population. Many Québécois are concerned that their language and culture will be overwhelmed by the rest of English-speaking Canada. Some believe that their society may only be preserved if Québec separates from the rest of Canada and forms an independent country. A 1980 referendum on “sovereignty-association” for Québec was defeated 60%-40%.

In October 1994 elections, after the provincial Liberals had governed Québec for several years, the province once more elected the separatist Parti Québécois (PQ). The victorious PQ held a referendum on sovereignty on October 30, 1995. Québeckers essentially voted on whether they wished to continue to remain a part of Canada, or strike off on their own. The vote went 50.6% to 49.4% in favor of keeping the country whole. The wafer-thin margin shocked federalists and separatists alike. More than a decade later, the country is still affected by the impact of what has been called a “near-death experience.”

In 2003, Québec voters turned out the PQ and replaced them with the Liberals, led by Jean Charest. A former leader of the Progressive Conservatives at the national level, Charest is a committed federalist, which rules out another sovereignty referendum during his tenure. In the early part of his first term, Charest lost some support when he attempted to reduce the economic role of the provincial government; those efforts prompted strong protests from the powerful public service unions. Some Québec-watchers assert that Charest learned from this experience and changed his tactics. In elections held in 2007 and 2008, the Liberals won a plurality, and a

¹⁴ “Harper Finally Wins Majority As NDP Surges Into Opposition.” *Globe and Mail*. May 2, 2011. “A Conversation With the Prime Minister.” *Policy Options*. June-July, 2011. p. 6.

majority, respectively; Charest has retained his spot as premier. The next provincial election must be held by November 2013; there is reportedly some speculation, however, that Charest may wish to exploit turmoil within the opposition parties and the losses of the BQ and call a vote earlier — perhaps in the fall of 2011. In addition, a recent poll showed the Liberals had regained popularity and drawn even with the PQ in support.¹⁵

Since the debate began in the 1960s, the United States government has assiduously sought to remain officially neutral on the issue of Québec, continually repeating the three-point “mantra” that the United States enjoys excellent relations with a strong and united Canada; that the Québec question is an internal issue that is for Canadians to decide; and that the United States does not wish to interfere with Canada’s domestic matters. However, some analysts detected a slight “tilt” on the part of Clinton Administration toward the federalists during the 1995 referendum campaign. If, at some future date, Québec eventually *does* leave the confederation, the U.S. government will be faced with difficult political and economic questions.

Foreign and Security Policy Issues

As a middle power, Canada has exercised a somewhat disproportionate influence in world affairs, chiefly through its active participation in international organizations, including the G-8, G-20, and the Asia-Pacific Economic Cooperation forum. From 1998 to 2006, Canadian diplomat Louise Frechette served as Deputy Secretary General of the United Nations, and from 1996 to 2006 Canadian Donald Johnston was Secretary General of the Organization for Economic Cooperation and Development. The president of the International Criminal Court from 2003 to 2009 was Judge Philippe Kirsch from Canada. The first head of the U.N. War Crimes Tribunal was Canadian Louise Arbour.

Canadian military officers have also been tapped for leadership positions in international organizations and coalitions. In June 2005, Air Force General Ray Henault was named head of NATO’s military committee, a post he held until 2008. Canadian generals are currently commanding the military and police training operations in Afghanistan. And in March 2011, Lieutenant-General Charles Bouchard became head of the allied military operations in Libya.¹⁶

Canadians are proud of the active role played by their military as international peacekeepers. Since the United Nations first dispatched an armed peacekeeping contingent to help defuse the Suez Crisis in 1956, Canada has participated in numerous U.N. peacekeeping operations, from Cyprus and the Sinai, to Bosnia, Rwanda, Somalia, and Afghanistan. As of August 2011, nearly 3,000 Canadian Forces personnel were participating in international operations in Afghanistan, the Caribbean, the Middle East, and Africa. An autumn 2010 survey showed that 52% of Canadians “believe traditional peacekeeping is the proper role for our men and women in uniform.”¹⁷

¹⁵ “PQ’s Troubles Boost Charest.” *Globe and Mail*. June 13, 2011.

¹⁶ “Canada Moving Into Role As Leader Overseas.” *Vancouver Sun*. March 28, 2011.

¹⁷ *Canada and International Peacekeeping*. By Joseph T. Jockel. Center for Strategic and International Studies/Canadian Institute of Strategic Studies. Washington, DC, 1994. Canadian Forces Operations. Canadian National Defence web site. Updated August 23, 2011. <http://www.forces.gc.ca/site/operations/index-eng.asp> “Canada Must Stand On Guard.” *Winnipeg Free Press*. October 27, 2010.

As with other countries in the 1990s, Canada's military was subject to dual pressures. In Ottawa's view, the collapse of the Soviet Union and the Warsaw Pact reduced the military threat, making it more difficult for the government to justify sustaining historic spending levels on defense. Leaders believed that the country's large debt early in the decade necessitated funding cutbacks in most areas of government, including defense. However, relative to its NATO allies, Canada had devoted only a modest share, about 2% of GDP, of its budget to defense spending during the 1980s and 1990s. That percentage declined even further, from 2.01% in 1990 to 1.1% in 2005; among the 26 NATO members, only Luxembourg and Iceland (which has no armed forces) spent a lower percentage. Canada's meager military budget irked some within the alliance, particularly the United States.¹⁸

After the round of cutbacks in the 1990s, the number of active personnel in Canada's armed forces tumbled from 87,000 in 1989 to 52,000 in 2004, the 56th largest in the world. The Canadian forces also were strapped for resources to replace aging equipment. This trend disturbed many, and there were numerous warnings published. In March 2002, a Canadian Senate committee called for increased defense spending to counter the threat of international terrorism; it also recommended that personnel levels be increased and that more resources be provided to the Canadian Security Intelligence Service. A November 2002 Senate report recommended boosting troop levels to 75,000 and restructuring the armed forces. A brace of studies in the fall of 2003 likewise called for changes in force restructure and procurement practices and for increases in manpower and budgets. A news report characterized one of the studies as concluding that "Canadian Forces are teetering on the edge of irrelevance." In September 2005 the Senate published yet another report, which called for a doubling of spending on defense.¹⁹

Recent Canadian governments appear to have heeded these messages. As of March 2011, there were approximately 66,000 regular force members and 34,000 reserves. In addition, Canada's defense spending has been trending upward. The budget tabled in February 2005 contained the largest military spending increase in two decades: C\$12.8 billion—roughly equal to the entire 2005 military budget—spread over five years. The Harper government's first budget added C\$5.4 billion in military spending over the next four years. The 2007 budget confirmed the previous year's spending increase, and the 2008 budget sought to ensure continuity through the Canada First Defence Strategy, which is set to provide for yearly increases of 2% beginning in 2011-2012. The government budget for the armed forces in 2008-2012 will average around C\$20 billion annually. However, due to budget retrenchment, the rate of growth of military spending is expected to slow.²⁰

U.S.-Canada Security and Foreign Policy Issues

According to the U.S. State Department, "U.S. defense arrangements with Canada are more extensive than with any other country." Former Canadian Ambassador to the United States Michael Kergin referred to the defense relationship as being "intermestic" in nature.²¹

¹⁸ "Spend More On Military, U.S. Envoy Urges Ottawa." *Toronto Star*. February 25, 2004.

¹⁹ "Armed Forces Hobbled, Report Says." By Daniel LeBlanc. *Globe and Mail*. December 3, 2003. "Senators Sounding Alarm On Defence." *The Gazette*. October 3, 2005.

²⁰ *The Military Balance, 2011*. International Institute for Strategic Studies. Defence and Budget 2005—Highlights. DND website. http://www.forces.gc.ca/site/reports/budget05/summ05_e.asp.

²¹ United States Department of State. Bureau of Western Hemisphere Affairs. *Background Note: Canada*. June 1, 2011. "Remarks to the Center for Strategic and International Studies." February 28, 2005.

Over the past century, U.S.-Canadian defense cooperation has been close. In 1940, President Franklin D. Roosevelt and Prime Minister McKenzie King established the Permanent Joint Board on Defense, which formalized bilateral consultation on military matters and is still in operation. In 1949, the two countries were founding members of NATO. During peacetime, military cooperation has occurred chiefly in the context of bi- and multinational organizations.

NORAD

In 1958, Canada and the United States signed the North American Aerospace Defense Command (NORAD) agreement. The continental air defense pact monitors U.S. and Canadian airspace and encourages joint efforts in aerospace technologies. In the wake of the September 11 terrorist attacks, there were discussions of deepening military cooperation along the NORAD model, in the context of the newly created U.S. Northern Command, to include land and sea forces. But some Canadians were concerned that such a move might impinge upon Canada's sovereignty, and in August 2002, the Canadian government announced that its land and sea forces would not be participating in the command. In December 2002, however, the two countries signed a new accord creating a binational planning group (BPG) based at NORAD to coordinate responses to terrorist attacks and other crises. The BPG issued its final report in March 2006; the panel put forward numerous recommendations, including that the two countries develop a common security vision and improve interoperability through joint military planning, training, exercises, and information sharing. In August 2004, Canada and the United States amended NORAD to permit it to share information on incoming ballistic missiles. Ottawa and Washington also agreed to expand the scope of the agreement to encompass nautical surveillance.

In February 2008, the commanding generals of U.S. Northern Command and of its Canadian counterpart, Canada Command, signed a binational Civil Assistance Plan. Under the plan, the armed forces of each country, after appropriate consultation with civilian authorities on both sides of the border, may come to the support of the other country's military in the event of civil emergencies such as floods, earthquakes, or the effects of a terrorist attack. In May 2011, NORAD leaders noted that changes in the Arctic—specifically, ice melt and commercial development—would likely lead to a need for increased activity in the high north.²²

Missile Defense

Ottawa long debated whether it should participate in the U.S. ballistic missile defense (BMD) system. Some analysts expressed reservations over the plan, in the belief that it might spark a new arms race, while others reportedly preferred to keep Canada's options open. Parliament held hearings on the issue, but no official policy was enunciated. Finally, in May 2003, Canada said that it would enter into discussions with the United States; a Canadian military affairs journalist described Canada's likely negotiating goals: "Canada wants the anti-missile shield run by NORAD—in effect, giving Canada equal status in protecting North America and a finger on the

²² "Continental Divides." By Sydney J. Freedberg, Jr. *National Journal*. March 23, 2002. "Leading academics Examine Risks Inherent In Closer Military Co-operation With the United States." *Canada NewsWire*. April 26, 2002. "Canada Won't Join Norad-Like Land-Sea Force. By Rick Mofina." *Ottawa Citizen*. August 15, 2002. September 12, 2005. Binational Planning Group. Final Report. March 13, 2006. <http://www.canadianally.com/BPGFinalReport.pdf> U.S. Northern Command website: <http://www.northcom.mil/news/2008/021408.html> "NORAD Commanders Say Melting Ice and Energy Development Will Make Arctic Busier." *Canadian Press*. May 7, 2011.

trigger. Ottawa wants a share of the industrial benefits and access to secret technologies, all while paying little or nothing. And it continues to insist that space not be weaponized.”²³

On February 24, 2005, the Canadian government said that it would not participate in BMD. However, Canada’s ambassador to the United States had pointed out earlier that the two countries had already agreed to allow NORAD to share information with U.S. BMD commands. U.S. officials expressed puzzlement and disappointment with the announcement, noting that Canada had sent signals that it would likely sign on. Polls showed that a majority of Canadians, particularly Québeckers, opposed BMD, leading some analysts to suggest that domestic political pressures may have guided the decision. In late February 2006, Canada’s Defense Minister said that the Harper government likely would review the missile defense issue if asked to do so by Washington. Any final decision on participation, he added, would be subject to a parliamentary vote. In April 2008, U.S. Air Force General Gene Renuart, head of NORAD, was quoted as having said that all incoming intelligence concerning missile threats was shared with Canada.²⁴

Joint Strike Fighter

In February 2002, Canada agreed to participate in the further development of the U.S.-led multinational Joint Strike Fighter (JSF, or F-35) program, contributing \$150 million over a 10-year period. In December 2006, it was announced that the Canadian government had committed an additional C\$500 million for the development of the aircraft. Canada has reportedly agreed to consider purchasing the new fighters to replace its own fleet of CF-18 planes when they are retired in 2017, and has earmarked nearly C\$4 billion for the new planes. In June 2007, the Department of National Defense announced plans to form a new office to evaluate Canada’s future air defense requirements. Canada appeared reap rewards from its participation; as of June 2007, Canadian firms had won 150 JSF contracts worth about \$160 million. In addition, Canadian defense companies stand to benefit from the Pentagon’s plans to purchase additional F-35s. In July 2010, Defense Minister MacKay confirmed that the government planned to spend C\$9 billion on the acquisition of 65 F-35 aircraft. The opposition Liberals criticized the decision, arguing that it should have been reviewed by parliament first, while the New Democrats maintained that the radar-evading F-35 may be more airplane than Canada needs. In recent months, the media have also faulted the purchase, pointing to large cost overruns. During a January 2011 visit to Canada, former U.S. Defense Secretary Robert Gates urged Canada to proceed with its planned procurement of the aircraft.²⁵

²³ “Shoot Down Defence Dreamers.” By Paul Koring. *Globe and Mail*. June 25, 2003.

²⁴ “Canada and the U.S. Missile Defense System.” Dwight M. Mason. *CSIS Hemisphere Focus*. January 9, 2004. “Martin and the Politics of Missile Defense.” *Globe and Mail*. May 1, 2004. “Martin’s Move Irritates U.S.” By Sean Gordon. *Toronto Star*. February 24, 2005. “Minister Backs U.S. Missile Plan.” *Toronto Star*. February 24, 2006. “Canada Kept In Loop At NORAD About All Missile Threats.” *Ottawa Citizen*. April 10, 2008.

²⁵ “Canadian Firms Big Winners In U.S. Jet Project.” *National Post*. April 21, 2006. “Canada Commits Up To \$500 Million to the Development of CF-18 Replacement.” *The Canadian Press*. December 13, 2006. “New Office To Assess Canada’s Fighter Needs.” *Defense News*. June 18, 2007. Forces Tag \$3.8B To Buy Advanced Jets. *Ottawa Citizen*. June 27, 2007. “Canada’s Defense Chief Rejects Criticism of F-35 Jet,” *New York Times*. July 17, 2010. “Costs Rocket for Canada’s Jet Fighter,” *Toronto Star*. May 20, 2011. “Canada’s F-35s: Engines Not Included” *Ottawa Citizen*. April 17, 2011. “U.S. Calls On Canada to Stick With F-35,” *Globe and Mail*. January 27, 2011.

NATO

Canada has been engaged in the debate over NATO's future. It supported the 1999 and 2004 rounds of enlargement and announced that it would participate in the NATO Response Force, which the alliance agreed to at its November 2002 Prague summit. At the April 2008 Bucharest summit, Canada endorsed the addition of Croatia, Albania, and Macedonia; in addition it supported the proposal to offer Membership Action Plans to Georgia and Ukraine. Finally, as noted above, Ottawa has maintained troops in Afghanistan since 2002, and its military leaders have served in a command capacity. In April 2003, then Foreign Minister Graham, along with the Dutch and German governments, requested that NATO take over command of ISAF.²⁶ In a 2009 speech in the UK, Canadian Defense Minister Peter MacKay cautioned that NATO was being tested in the crucible of Afghanistan, and urged more equitable burden sharing.²⁷

Although it has no troops stationed in NATO territory in Europe, Canada in recent years contributed several hundred troops to the NATO-led Stabilization Force (SFOR) in the Balkans. Canada also supplied 200 troops to NATO's mission in Macedonia. Canada cooperated "wing-to-wing" with the United States in *Operation Allied Force*, the NATO campaign of air strikes against targets in Serbia and Kosovo, contributing 18 CF-18 fighter aircraft and providing two rotations of approximately 1,500 troops each to KFOR. In addition Canada has supported non-NATO peacekeeping operations; it has provided 600 to the initial U.N. peacekeeping mission in East Timor and has also sent 500 troops to maintain stability in Haiti. In 2011, former Secretary of Defense Robert Gates lauded Canada for its contributions to the alliance missions in Afghanistan and Libya.²⁸

Afghanistan

Canada was one of the first countries to join the military operation in Afghanistan; its participation dates back to October 2001. Along with British, Dutch, Danish, and U.S. troops, Canadian forces have been serving on the front line in the combat operations to counter attacks by al Qaeda and Taliban fighters. Much of the time, Canada maintained approximately 2,800 troops in the country. A total of 157 Canadians, including one diplomat, have died in Afghanistan. In 2005, Canada launched a Provincial Reconstruction Team mission in Kandahar. Ottawa also has provided humanitarian and reconstruction assistance to Afghanistan. Canada is among the top five donors to the country, and has pledged C\$1.9 billion through 2011 in reconstruction and development assistance.²⁹ As noted above, Canada ended its combat role there in July 2011.

²⁶ "NATO Umbrella Sought." By Allan Thompson. *Toronto Star*. April 4, 2003. "NATO Sees Key Role For Canada In Afghan Security." *Reuters*. May 6, 2003. CRS interview of Canadian government official, May 7, 2008.

²⁷ NATO's Future At Stake In Afghanistan: MacKay. *Ottawa Citizen*. February 16, 2009.

²⁸ Current Operations. Canadian Expeditionary Force Command website. Updated April, 2009. <http://www.comfec-efcom.forces.gc.ca/pa-ap/ops/index-eng.asp> "Canada Punches Above Its Weight In NATO: U.S. Defence Secretary," *Montreal Gazette*. June 11, 2011.

²⁹ DND website: http://www.forces.gc.ca/site/newsroom/view_news_e.asp?id=1703. "Canadian Development Assistance In Afghanistan: Current Projects." Government of Canada website. January 31, 2008. http://www.canada-afghanistan.gc.ca/cip-pic/afghanistan/library/afgh_security-en.asp "Canada's War in Afghanistan Is Over." *National Post*. August 8, 2011.

Libya

On March 18, the Harper government committed approximately 650 troops, including air, sea, and land forces, to assisting the U.N.-sanctioned NATO mission to protect the civilian population in Libya. Canadian CF-18 fighters patrolled the no-fly zone and conducted a disproportionately large number of air strikes, and the frigate *HMCS Charlottetown* came under fire from Qadhafi loyalists, but suffered neither damage nor casualties. In late March, a Canadian general was appointed commander of NATO military operations in Libya. On September 1, 2011, at an international conference on Libya held in Paris, Prime Minister Harper announced that Ottawa was lifting sanctions on Libya, and declared that Canada would “be a part of the military mission until it reaches its conclusion.” Some analysts argued that Canada took part in the mission in order to demonstrate its continuing commitment to the North Atlantic alliance, and to reinforce Canada’s traditional leadership role in U.N. peacekeeping missions. According to public opinion polls, there is strong public support for Canada’s participation.³⁰

Haiti

Canada and the United States have worked closely together over the past 17 years with the U.N. mission in Haiti, where a contingent of the Canadian armed forces, along with members of the Royal Canadian Mounted Police, took the reins from departing U.S. forces who had helped restore the democratically elected government in Haiti in 1994. In 2004, after the Aristide government stepped down in the face of armed rebellion, Canada joined the United States and France in providing peacekeepers to the U.N.-authorized Multinational Interim Force sent to the troubled island; Canada dispatched helicopters and nearly 500 troops. In February 2008, then-Canadian Foreign Minister Bernier traveled to Haiti, where he announced that Ottawa’s total multiyear aid package would be raised to C\$555 million. In the wake of the turmoil over food shortages, he called for international donors to harmonize their assistance during an April 2008 donor conference. Haiti is the second-largest recipient (after Afghanistan) of Canadian development assistance. Canada’s former Governor General, Michaëlle Jean, who was born in Haiti, traveled to the island in January 2009; she visited several development projects, and met with government and civil society leaders. Jean returned to visit following the January 12, 2010, earthquake that devastated the country. At an international donor conference held at the United Nations on March 31, Canada made a two-year pledge of C\$400 million in humanitarian and reconstruction assistance, making it the largest per capita provider of aid to Haiti. Canada employs a “whole-of-government” approach in supporting Haiti, involving the Defense and Foreign Affairs Departments, the Canadian Border Services Agency, the Royal Canadian Mounted Police, and Correctional Services Canada.³¹

³⁰ “Dispatch: Canadian Support For the Libya Intervention.” Stratfor. March 28, 2011. “Libya Mission Will Include Canada Until End, PM Vows.” *CBC News*. September 1, 2011. “Libya: New Development.” Foreign Affairs and International Trade Canada web site. September 1, 2011. “Canada: Country Report.” *Economist Intelligence Unit*. April, 2011. “Canada Contributed a Disproportionate Amount To Libya Air Strikes: Sources.” *National Post*. August 25, 2011.

³¹ “Canada Pledges \$555 Million In Aid To Haiti.” *Reuters*. February 24, 2008. Canada Participates In Harmonization Efforts In Haiti. News Release. Foreign Affairs and International Trade Canada. April 23, 2008. ‘I Can Feel the Strength of the People,’ Jean Says. *National Post*. March 30, 2010. Canada Pledges \$400 million To Haiti. *Ottawa Citizen*. April 1, 2010. Canada’s Role In Haiti. *Globe and Mail*. April 3, 2010. Government of Canada web site, last modified January 1, 2011. http://www.canadainternational.gc.ca/haiti/engagement/whole_of_government-pangouvernementale.aspx?view=d

Iraq

Canada was disinclined to expand the so-called war on terrorism beyond Afghanistan to Iraq. In September 2002, during a meeting in Detroit with President Bush, Chrétien reaffirmed Canada's preference for a U.N. mandate, a stance that strongly reflected Canadian public opinion. Washington later requested of Ottawa specific military commitments in the event of a conflict with Iraq, but no definitive answer was given. Over the following months, the government's statements on Iraq were characterized by the media as imprecise and at times contradictory, an apparent attempt to keep options open. But in the House of Commons on March 18, 2003, Chrétien stated unequivocally that "Canada will not participate." The Bush Administration expressed disappointment with the decision.³²

Washington subsequently requested that Canada assist in the reconstruction of Iraq by sending troops or military police. Ottawa responded by offering 150 members of its Disaster Assistance Response Team, a non-traditional military unit consisting of security, engineering, and medical personnel. Canada also provided funding in a number of areas, including humanitarian and reconstruction aid, support for elections, and police training. The Canadian International Development Agency pledged C\$300 million (2003-2010) in assistance to Iraq. In January 2004, Canada announced that it would cancel Iraq's \$564 million debt.³³

Cuba

Cuba has been another issue where the two countries have not always seen eye-to-eye. For decades, Canada has maintained normal diplomatic relations with Cuba, and has maintained relatively extensive business links: Canada is Cuba's third-largest trading partner and its number one source of tourists. Because of this ongoing commercial relationship, Canadian government officials publicly criticized a U.S. law (the Cuban Liberty and Democratic Solidarity Act, P.L. 104-114) that seeks to apply indirect pressure on the Castro regime by permitting Cuban Americans to file lawsuits against foreign firms that use Cuban property that was expropriated by the Castro regime. U.S. supporters of the Cuba embargo have been critical of Canadian mining companies and hotel chains that do business with the island nation. Canadians, who are sensitive to being perceived as America's "junior partner," object that the law amounts to the United States forcing its foreign and commercial policies upon other countries. In 2003, after the Castro government handed down draconian prison terms to 75 political dissidents, Ottawa expressed official disapproval. The transfer of Cuba's presidency from Fidel to Raul (temporary in 2006, permanent in 2008) prompted vigorous debate in the Canadian press over what policy Ottawa should adopt toward Cuba.³⁴ In April 2009, the Obama Administration announced that it would ease restrictions on family travel and remittances to Cuba and allow greater telecommunications links with Cuba. The decision was welcomed by Ottawa; Peter Kent, Minister of State of Foreign

³² "Well, Maybe" *Economist*. September 28, 2002. "PM Scolds McCallum On Canada's Role In Iraq." By Shawn McCarthy and Daniel Leblanc. *Globe and Mail*. January 16, 2003. "Bravos Greet Chrétien." By Tim Harper. *Toronto Star*. March 18, 2003.

³³ "Iraq: Canada's Commitment." Canadian International Development Agency web page: <http://www.acdi-cida.gc.ca/iraq#1> Updated May 24, 2007.

³⁴ See, for example: "Castro's Resignation Unlikely To Change Canadian-Cuban Relations, Experts Say." *The Canadian Press*. February 19, 2008. "Don't Support Castro's Island Prison." *National Post*. February 19, 2008. "With Fidel Castro Gone, U.S. Hawks Will Look North." *Toronto Star*. February 20, 2008. "The Autumn Of the Patriarch." *Ottawa Citizen*. February 23, 2008.

Affairs for the Americas, commented that “the election of the Obama Administration has given real momentum to the sort of change that Canada has been encouraging for a long time.” A planned trip by Kent to Havana in May 2009 was cancelled, reportedly because Kent had said that he planned to address the human rights issue during his trip, and because Prime Minister Harper had referred to himself as an “anti-communist conservative.” The trip was re-scheduled, and Kent traveled to Cuba later in the year. In mid-2010, relations were strained over the case of a teenaged Canadian traveler detained for three months in Cuba. The 19-year-old, who suffered injuries when the vehicle he was driving was sideswiped by a pickup truck, was held by Cuban authorities under threat of a jail sentence. He was allowed to return in early August.³⁵

International Criminal Court

The International Criminal Court (ICC) is another issue on which the two countries differ. Canada has long been a leading advocate of the U.N.-sponsored tribunal, while some U.S. policymakers have opposed U.S. participation on the grounds that it might make U.S. military personnel vulnerable to politically motivated prosecution by hostile regimes. In May 2002, the Bush Administration declared that the United States would not support the ICC; the same day, then-Canadian Foreign Minister Bill Graham declared that he was “extremely disappointed” with the U.S. decision. In a U.N. speech four months later, Graham faulted the United States “for its ‘ad hoc and unilateral pursuit’ of the prosecution of crimes against humanity.”³⁶

Border Security

In the wake of the attacks on New York and Washington, U.S.-Canadian relations came to the fore. In particular, the issue of U.S.-Canada border security was brought into sharp focus. The issue first became a matter of urgent concern in December 1999, when U.S. border officials, acting on a tip from Canadian authorities, stopped Ahmed Ressam at the U.S.-Canadian border as he was attempting to smuggle explosives into the United States; it was later discovered that Ressam had planned to bomb the Los Angeles airport, and that he had received terrorist training from Al-Qaeda in Afghanistan.

Despite the fact that none of the 19 September 11 hijackers entered from Canada, the attacks sparked renewed debate over Canadian laws regarding the treatment of immigrants seeking refugee status or political asylum.³⁷ By February 2002, Ottawa had already made “steps to tighten immigration and refugee policies, including more rigorous screening of people who claim refugee status and stepped up detentions and deportations of claimants suspected of being security risks.”³⁸

³⁵ “Unreformed Tyranny.” *Globe and Mail*. November 23, 2009. “Cuba To Give Canada Expanded Air Access With Island To Boost Tourism.” *Canadian Press*. January 15, 2010. “Cuba’s Tainted Image,” *Toronto Star*. August 4, 2010.

³⁶ “Canada Raps U.S. Rejection Of World Criminal Court.” By David Ljunggren. *Reuters*. May 6, 2002. “U.S. Rift With Allies On World Court Widens.” By Julia Preston. *New York Times*. September 10, 2002.

³⁷ In April 2009, U.S. Department of Homeland Security Secretary Janet Napolitano raised concerns when she averred that some of the 9/11 terrorists had crossed over from Canada. “Napolitano’s Comments About Canada’s Border Spark Diplomatic Kerfuffle.” *The Canadian Press*. April 21, 2009.

³⁸ “Al-Qaida In Canada?” CBSNEWS.com. April 25, 2002. “Canada Alters Security Policy To Ease Concerns of U.S.” By Clifford Krauss. *New York Times*. February 18, 2002.

Some American policymakers pointed to the Ressam case as proof that the United States must tighten its borders with Canada. Skeptics, however, note that such measures might seriously impede commerce by creating long delays at border crossings, and that determined terrorists and criminals would at best be inconvenienced, not stopped, in traversing the two countries' 5,500-mile border. About 70% of U.S.-Canada merchandise trade crosses the border by truck; many of these shipments are "just-in-time" deliveries; their delay at border crossings can seriously disrupt manufacturing in the United States and Canada.³⁹ Both sides have strong incentives to strengthen security but keep goods flowing.

Since the September 11, 2001, attacks, Ottawa and Washington have taken numerous steps, separately and jointly, to improve border control. In December 2001, they signed the Smart Border declaration that aims at improving security and efficiency at border crossings; the agreement lays out a 30-point (since increased to 32-point) list of areas of joint activity, ranging from pre-clearance of goods (the FAST program) and people (NEXUS), to biometric identifiers, to infrastructure improvements. The cooperation covers crossings by air, land, and sea traffic. In December 2002, the two nations signed the Safe Third Country agreement, intended to permit coordination of refugee and asylum policy.

The two countries also cooperate extensively on law-enforcement activities around the border. Since 2002, U.S. Immigration and Customs Enforcement (ICE) and Royal Canadian Mounted Police (RCMP), along with partner agencies in each country, have established 15 Integrated Border Enforcement Teams (IBETs) operating at 24 locations at and between U.S.-Canadian ports of entry. The IBETs are binational, multi-agency, intelligence-led enforcement teams focused on identifying, investigating, and interdicting common national security threats and criminal activity. Between 2005 and 2010, RCMP and U.S. Coast Guard agents also participated in the Shiprider pilot program, allowing fully cross-trained and cross-designated agents from each country to conduct joint enforcement exercises along international waterways. The countries signed an agreement to expand and extend Operation Shiprider in 2009, but the agreement has not yet been approved by the Canadian Parliament and no such operations were underway as of September 2011.

In February 2011 the United States and Canada signed the Beyond the Border declaration describing their shared visions for a common approach to perimeter security and economic competitiveness. The 2011 agreement focuses on information sharing and joint threat assessments to develop a common and early understanding of the threat environment; infrastructure investment to accommodate continued growth in legal commercial and passenger traffic; integrated cross-border law enforcement operations; and integrated steps to strengthen shared cyber-infrastructure.

The Western Hemisphere Travel Initiative (WHTI), a provision of a 2004 U.S. law requiring travelers passing between the two countries to present a passport, a NEXUS card, or an equivalent secure, approved document, at the border came into effect on June 1, 2009. The Department of Homeland Security (DHS) has worked with the Canadian government to develop an alternative document that is secure, inexpensive, and would be carried anyway—for example, a driver's license containing enhanced biometric information. Currently, such enhanced licenses are being issued by the provinces of British Columbia, Manitoba, Ontario, and Québec, and by

³⁹ "Delays at the Canadian Border Eat Up Trade." By John Stark. *AP*. February 1, 2003.

the states of Michigan, New York, Vermont, and Washington. In March 2011, GAO reported a greater than 95% compliance rate with WHTI requirements in FY2010.⁴⁰

Canada's custom service stepped up the purchase of high-tech X-ray equipment, and U.S. and Canadian customs agents are working together, inspecting containers at several Canadian and U.S. seaports. Border security personnel levels have also been beefed up, and Integrated Border Enforcement Teams have been established in high-priority regions. Canada also has set up an Air Transport Security Authority, which, among other activities, is responsible for pre-board screening.

In 2004, the Canadian government created a Department of Public Safety and Emergency Preparedness, a counterpart to the U.S. Department of Security (DHS), and a Border Services Agency. Recent Canadian federal budgets have contained new monies for security-related priorities such as intelligence, maritime and cyber security, threat assessment, and emergency response.

Canada has taken other actions beyond the realm of border security, including freezing terrorists' assets, broadening the scope of terrorist activities punishable by law, extending police investigative powers, introducing legislation that would put restraints on fund-raising activities by extremist organizations, expanding cooperation between the FBI and the RCMP, and increasing outlays for countering nuclear, biological, and chemical weapons attacks.⁴¹

In early June 2006, Canadian police conducted a series of raids in the Toronto area, arresting 18 individuals. The arrests were made in accordance with the Anti-Terrorism Act passed late in 2001. The group reportedly had discussed attacking several possible targets, including power plants, a Canadian military base, the Toronto Stock Exchange, and other prominent sites. The plan involved having some members of the group detonate truck bombs while another group reportedly would storm the parliament and capture hostages. Prime Minister Harper was said to have been a key target. Most of the suspects were in their teens or early 20s. All were either Canadian-born or had immigrated to the country at an early age. They had a variety of backgrounds; some were students, some held jobs, and some were unemployed. Many were from middle class backgrounds, and few of them had criminal records. Of the Toronto 18, seven admitted guilt and four were convicted. Charges against the other seven were stayed or dropped.⁴²

U.S. officials claimed that the arrests proved that Canada's law enforcement and intelligence services were doing an excellent job of ensuring security. An FBI spokesperson said there was "no imminent threat" to the United States stemming from the Toronto operation. However, some U.S. Members of Congress claimed that Canada maintains lax immigration and asylum policies, and that the arrests demonstrated that stricter controls over the U.S.-Canada border are in order. The incident prompted close consultations between U.S. and Canadian policymakers and law enforcement officials. The operation has not arisen as a domestic political issue in Canada, but it

⁴⁰ U.S. Government Accountability Office, *Border Security: DHS Progress and Challenges in securing the US Southwest and Northern Borders*, GAO-11-508T, March 30, 2011, p. 6, <http://www.gao.gov/new.items/d11508t.pdf>.

⁴¹ For another brief overview of efforts to secure the U.S.-Canada border, see Joint Counter-Terrorism Initiatives. By Melissa Radford. Border Facilitation: Products and People. By June Dewetering. Both in *Canada and the United States: Shared Interests and Concerns*. Canadian Library of Parliament. January, 2009. http://www.parl.gc.ca/information/library/PRBpubs/prb0834_00-e.htm

⁴² "Recent Terrorism-related Cases in Canada," January 24, 2011, <http://www.cbc.ca/news/canada/story/2011/01/21/f-terror-cases-quickfacts.html>

has renewed debate about Canada's immigration practices, its commitment to a multicultural environment, its security measures, and the presence of its troops in Afghanistan.⁴³

In a late August 2010 sting operation known as Project Samosa, the RCMP and the Canadian Security and Intelligence Service (CSIS) seized bomb-making materials and arrested six men suspected of conspiring to commit acts of terrorism and to transfer funds to insurgents in Afghanistan. Authorities stated that the detainees, who were said to be mainly educated professionals, are believed to have received training in Afghanistan or Pakistan. One of the detainees was a contestant on the "Canadian Idol" television show in 2008.⁴⁴ Three of the men were charged with conspiracy and other offenses; two of them have been released on bail.⁴⁵

Economic and Trade Issues

The Canadian economy experienced a shallower recession and has recovered faster than the United States since the trough of the great financial crisis. Canada officially exited the recession in the 1st quarter of 2010. After dropping by 2.8% in 2009, Canadian gross domestic product (GDP) grew by 3.2% in 2010 and the *Economist Intelligence Unit* and *IHS Global Insight* expect the economy to expand by 2.4% and 2.3%, respectively, in 2011.

In contrast to the United States, the Bank of Canada has raised interest rates three times—to a 1% target rate—to constrain demand. This interest rate, along with sustained commodity prices, led to the Canadian Dollar flirting with parity with the U.S. dollar for much of 2010, and remaining above parity through the first eight month of 2011. The unemployment rate, which hit a generational low of 5.8% in January 2008, peaked at 8.7% in August 2009, and gradually fell back to 7.5% by the second quarter of 2011.⁴⁶ Canada recorded its first current account (CA) deficit in nine years in the fourth quarter of 2008, and the collapse in trade due to the great recession led to a CA deficit of \$36 billion for 2009 as a whole. While the volume of trade recovered in 2010, the CA deficit remained at about 3% of GDP in 2010.

Budget Policy

While Canada is heavily dependent on the world economy, and thus easily affected by it, some Canadian policymakers believed that the country was in a relatively better position to ride out the economic downturn. After all, Canada had profited handsomely from the resources boom that only began to wind down the summer of 2008. Also, Canadians were reassured by its comparatively more regulated banking system, which was able to avoid the worst excesses of the U.S. financial meltdown. However, Canada could not long avoid the effects of the collapse of the U.S. housing market, the woes of the U.S. automotive sector, and the seizing up of credit markets

⁴³ "Canada's Terror Sweep Grabs Spotlight in U.S." *Canadian Press*. June 3, 2006. "U.S. Praises Canada On Terror Arrests But Critics Blast Immigration Laws." *Canadian Press*. June 4, 2006. "Terrorists In Toronto: Is Canada Safe? Are We?" By Tanya Primiani and Christopher Sands. *CSIS Commentary*. Center for Strategic and International Studies. June 20, 2006. "The Toronto Terror Plot." *Economist*. June 10, 2006.

⁴⁴ "Third Terror Suspect was Canadian Idol Contestant," *Toronto Star*, August 26, 2010; August 27, 2010. "Canada Arrests Show Affluence Is No Bar To Militancy," *Oxford Analytica*. August 27, 2010. "Few Details Given As 4 Canadians Are Held In Terrorist Plot," *New York Times*. August 28, 2010.

⁴⁵ "Recent Terrorism-related Cases in Canada," January 24, 2011, <http://www.cbc.ca/news/canada/story/2011/01/21/f-terror-cases-quickfacts.html>

⁴⁶ Economic data are from Economist Intelligence Unit, wire service reports, and Statistics Canada.

worldwide. Canada entered into recession in the first quarter of 2009 and would not emerge from recession until a year later.

Canada's Stimulus Program

Following the reconvening of parliament in January 2009, the government introduced a C\$258.6 billion budget, which called for C\$40 billion in stimulus spending and tax cuts for FY2009-FY2011. The stimulus consists of a package of income tax cuts, employment insurance (EI) benefit extensions, job retraining, 'hard' infrastructure spending, tax credits for home renovation, retrofits for social housing, and investments in First Nation's health programs.⁴⁷ In all, the C\$40 billion represents a stimulus of about 1.5% of GDP in the first year and 1.1% in the second year. Increased spending represents approximately 72% of this package and tax cuts contribute the remaining 28%. The March 2010 budget allocated the remaining C\$19 billion in stimulus.

The 2009 budget also marked a return to deficit spending for Canada after 12 successive budgets in balance or surplus. The 2009 budget contemplated a deficit of C\$34 billion the first year, and predicted a total of C\$81 billion in borrowing over five years before the budget was expected to return to surplus in 2013. The March 2010 Budget revised upward the 2009 deficit to C\$53.8 billion, proposed a C\$49.2 billion deficit in 2010, and envisaged the budget returning to balance in 2015 with a total C\$158.4 billion increase in the national debt. The most recent budget of March 2011 moved the date of budget balance up to 2014.⁴⁸ The Harper government plans to return to budget balance by winding down the stimulus measures, targeted spending reductions, and identification of additional opportunities for administrative savings. The government has pledged not to raise taxes and not cut transfer payments to individuals or equalization payments to the provinces. Opposition leaders have expressed skepticism that the budget could return to balance through economic growth and with the scope of spending cuts envisioned in the budget.

The return to deficit spending, while acknowledged as necessary by most of the political spectrum to combat the severe economic recession, was not undertaken lightly. Prior to the "austerity" budget of 1995, Canada had racked up 27 straight years of deficit spending. At its peak in 1996, Canada's public debt represented 101.6% of GDP, and government sector spending reached 53.6% of GDP in 1993. Realizing this course was unsustainable, the Liberal government of then Prime Minister Jean Chrétien and his Finance Minister Paul Martin embarked on a financial austerity plan using such politically risky measures as cutting federal funding for health and education transfers, applying a means test to those eligible for Seniors Benefits, and cuts in defense. A nationwide goods and services tax was introduced to help close the gap. Under this budget discipline, the government submitted a balanced budget in 1998 and a political consensus emerged not to resort to deficit spending, at least until 2009.

Energy

Canada is the United States' largest supplier of energy—including oil, uranium, natural gas, and electricity—and the energy relationship has been growing.⁴⁹ Canada is the world's fifth-largest

⁴⁷ "Tories to Aggressively Implement Budget Spending Measures," *The Hill Times*, February 2, 2009.

⁴⁸ Understanding Flaherty's Deficit Promise, June 6, 2011, http://www.canadianbusiness.com/blog/business_briefings/29137--understanding-flaherty-s-deficit-promise

⁴⁹ See CRS Report R41875, *The U.S.-Canada Energy Relationship: Joined at the Well*, by Paul W. Parfomak and Michael Ratner.

petroleum producer, and its reserves are believed to be the third largest in the world only after those of Saudi Arabia and Venezuela; Canada's sources of oil include traditional and offshore wells and, increasingly, Alberta's oil sands.⁵⁰ In 2010, the value of U.S. petroleum and natural gas imports from Canada reached \$82.2 billion from \$63.7 billion in 2009. Canada provides 22% of U.S. crude oil imports and supplies 85% of U.S. natural gas imports.⁵¹ Canada is particularly valued because it is considered a reliable source of energy, as it is not a member of OPEC. The two countries are also cooperating on the development of pipeline construction projects. China has shown interest in Canada's oil sector, and has recently bought stakes in the Alberta's oil sands projects. Canada also a net exporter of electricity to the United States, and the North American electricity grid is closely interconnected.

Bilateral Trade Issues

The United States and Canada enjoy the largest bilateral commercial relationship in the world; total two-way cross-border trade amounted to over \$1.3 billion per day in 2010. Over the past twenty years, U.S.-Canada trade relations have been governed first by the 1989 U.S.-Canada Free Trade Agreement and, subsequently, by the 1994 North American Free Trade Agreement. These agreements, along with the conclusion of the Uruguay Round of multilateral trade negotiations and the creation of the World Trade Organization, contained mutual concessions on commercial trade barriers, and, more importantly perhaps, established binding dispute settlement mechanisms. While these agreements have resolved some of the sharp differences from the past, questions regarding the effectiveness of dispute resolution mechanism remain.

Meanwhile, several trade issues—some old, some new—have yet to be completely resolved. Many of these disputes involve long-running battles over agricultural commodities or natural resources, including softwood lumber and farm goods. Some analysts attribute the longevity of these conflicts to the inherent incompatibility of the two countries' different natural resource and agricultural programs, others to the political sensitivity of the commodities under negotiation.

Softwood Lumber

A 1996 agreement restricting Canadian lumber exports to the United States expired in March 2001. Shortly thereafter, the U.S. Commerce Department launched countervailing duty and anti-dumping investigations; in May 2002, the International Trade Commission (ITC) found that Canadian imports threatened to injure U.S. industry, and Commerce applied 27% (later reduced) duties on Canadian softwood. Canada challenged the agency decisions under NAFTA and in the WTO.

After several years of inconclusive and sometimes conflicting litigation, the two sides announced that they had struck a seven-year agreement on softwood on April 26, 2006. As part of a complicated formula, the United States will allow unlimited imports of Canadian timber when market prices remain above a specified level; when prices fall below that level, Canada will

⁵⁰ U.S. Energy Information Administration (EIA), Country Analysis Brief: Canada, April 2011, <http://www.eia.gov/countries/cab.cfm?fips=CA>

⁵¹ 2009 statistics from U.S. International Trade Commission <http://dataweb.usitc.gov>

impose export taxes and/or quotas. In addition, the United States will return to Canada a large majority of the duties it had collected.⁵²

The implementation of the softwood lumber agreement has not been without controversy. As the depressed housing market has reduced demand for softwood lumber, the market price has been under the level (\$355 thousand board feet) in which export taxes must be charged. The United States and Canada resorted to arbitration over the use of adjustment mechanisms to calculate the quotas used for eastern Canadian lumber. The arbitral panel sided with the United States, and after Canada did not implement the panel's recommendation, the United States levied a 10% tariff on the affected lumber to recoup the compensation awarded by the arbitral panel in April 2009. In January 2008, the United States also requested arbitration over six provincial forest sector assistance programs in Québec and Ontario, programs that the United States believes contravene the anti-circumvention provision of the SLA.

The Obama Administration has also sought arbitration under the SLA over timber grading practices in British Columbia. They claim that the BC government has changed its classification procedures for timber and has been grading an increasing amount of its cut as salvage Grade 4 lumber. For its part, Canada attributes this increase to an infestation of mountain pine beetles and rejects the assertion that this policy represents a subsidy for Canadian producers.

Country of Origin Labeling

The 2002 Farm Bill required retailers to provide country-of-origin labeling (COOL) for fresh produce, red meats, seafood, and peanuts. The requirements for seafood were implemented on September 30, 2004, but COOL requirements for other products were delayed until September 30, 2008. The 2008 Farm Bill, The Food, Conservation, and Energy Act of 2008 (P.L. 110-246), reaffirmed this timetable and added goat meat, chicken, ginseng, pecans, and macadamia nuts as covered commodities. A final rule was issued on January 15, 2009, effective March 16, 2009. In November 2009, the WTO established a dispute settlement panel to hear challenges to COOL from Canada and Mexico. Canada claims the rule is a non-tariff barrier that has led to a steep drop in beef and hog shipments to U.S. processors.

Buy American Stimulus Provisions

The Buy American provision of the American Recovery and Reinvestment Act of 2009 (ARRA, §1605, P.L. 111-5) states that no funds shall be appropriated for building projects or public works projects unless all the iron, steel, and manufactured goods are made in the United States. This provision was subject to three discrete waivers: (1) applying this policy would not be in the public interest; (2) the iron, steel, or manufactured products are not produced in sufficient quantities or of a satisfactory quantity in the United States; or (3) the inclusion of the applicable U.S. products would increase the cost of the overall project by more than 25%. The Senate added language to ensure that the provisions are applied in a manner consistent with U.S. trade obligations.

With regard to Canada, the United States has undertaken government procurement obligations under the World Trade Organization's (WTO) Agreement on Government Procurement (AGP)

⁵² "U.S. Gets a Lift In Lumber Fight With Canada." By Ian Austen and Clifford Krauss. *New York Times*. August 31, 2005. "Conservative Government Wins Softwood Truce." *Globe and Mail*. April 28, 2006.

and under the North American Free Trade Agreement (NAFTA). The AGP is a plurilateral agreement that only binds those WTO members that agreed to undertake obligations under it. Furthermore, the AGP only applies to the sectors and the procurement agencies that the national government (and sub-national government agencies) includes in its schedule of national commitments. NAFTA contains similar commitments on the national level, but excluded sub-national entities.

Both the United States and Canada have undertaken extensive obligations to open their government procurements at the national level under both agreements. However, because Canadian provinces never signed up to the AGP, as had 37 U.S. states, regulations implementing the ARRA excluded Canadian firms from bidding on ARRA-financed contracts that are tendered by the U.S. states.⁵³ In February 2010, the United States agreed to permit Canadian firms to bid on sub-federal ARRA contracts in return for a Canadian commitment to sign its provinces up to the AGP, which it did by notice to the WTO on March 19, 2010. In addition, both parties committed themselves to begin negotiations reciprocally to expand commitments for market access in procurement between the two countries.⁵⁴

Intellectual Property Rights

In 2011, the U.S. Trade Representative again listed Canada on its Special 301 report on intellectual property rights protections to the priority watch list for intellectual property rights protections.⁵⁵ The priority watch list indicates that the listed trading partner has problems with respect to IPR protection, enforcement, or market access for persons relying on intellectual property and that these problems merit “increased bilateral attention.” In this designation, Canada joins such notorious IPR violators as China and Russia. The United States again urged Canada to implement the World Intellectual Property Organization’s Copyright treaty, which has been signed but not ratified by Canada.⁵⁶ The United States also expressed concern about trade in pirated and counterfeit goods in Canada, and urged greater enforcement and “deterrent-level” penalties for IPR infringement. The United States urged Canada to adopt tougher border security measures to crack down on this trade, including allowing for the seizure of pirated and counterfeit goods by customs agents without a court order. The government introduced a new Copyright Modernization Act (C-32) in June 2010, but it died on the order paper with the dissolution of the 40th Parliament and has not—as yet—been reintroduced in the new Parliament. This legislation was intended to bring Canadian copyright law into conformance with the WIPO Internet treaties and allow for some format shifting and fair-dealing (fair-use) exceptions, but would prohibit the circumvention of digital protection measures. It also would have clarified the rights and responsibilities of internet service providers for infringement of their subscribers.⁵⁷

⁵³ Office of Management and Budget, “Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009, April 3, 2009. pp. 160-166.

⁵⁴ “U.S.-Canada Announce Buy American Deal, Provinces to Sign GPA,” *Inside U.S. Trade*, February 12, 2010.

⁵⁵ United States Trade Representative, 2011 Special 301 Report, p. 27. Available at http://www.ustr.gov/webfm_send/2841.

⁵⁶ The WIPO Copyright treaty updates existing copyright protections for Internet and other electronic media.

⁵⁷ “Bill Would Update Canadian Copyright Act To Respect Needs of Digital Age, Official Says,” *International Trade Reporter*, June 10, 2010.

Environmental Issues

The United States and Canada, which share a common border that stretches 5,500 miles, cooperate extensively on environmental matters. Since they signed the Boundary Waters Treaty in 1909, the two countries have, through the International Joint Commission, worked together on protecting and maintaining border waterways, especially the Great Lakes. In 1978, the two signed the Great Lakes Water Quality Agreement.

In 2002, Canada ratified the Kyoto Agreement; in 2006, however, the government announced that emission targets had been exceeded. The Harper government has established a goal of cutting greenhouse gas emissions 20% by 2020. To do so, the government proposes numerous measures, including increased reliance on hydro- and nuclear power, and revised regulations for the oil sands industry.

The long feud over Pacific salmon—one of the more prominent bilateral disputes in recent years—had both environmental and commercial aspects. Canada contended that American fishermen were taking more than their equitable share of the migratory fish; the United States, on the other hand, maintained that its fishing was in accordance with the 1985 Pacific Salmon Treaty (PST) and with sound conservation practices. After a pause, talks resumed in 1997, and the two sides finally reached an accord in 1999; both countries are monitoring implementation of the agreement.⁵⁸ The so-called Annex IV fisheries regimes of the PST were renegotiated in 2008.

One area of contention concerns the diversion of the naturally overflowing waters of Devils Lake, in North Dakota. For flood-control purposes, the state has constructed a channel that diverts excess water ultimately to the Red River, which flows northward. Manitobans have objected to this solution, arguing that the lake water contains toxic chemicals from agricultural runoff; they are also concerned that the introduction of alien species of aquatic life may disturb the ecological balance and endanger recreational fishing in Lake Winnipeg, into which the Red River empties. The Canadian government has requested that the case be referred to the International Joint Commission. In April 2006, after meetings between senior environmental officials of the two governments, the United States agreed to install a permanent filtration system at the Devils Lake outlet. However, this filtration system, estimated to cost \$15 million, has not been installed. In February 2008, the North Dakota Supreme Court found that the state had acted improperly in changing certain environmental standards for the water released from the lake's outlet. At this time, the channel operates intermittently, subject to North Dakota health regulations. Meanwhile, Manitoba has offered to address the issue of a 30-mile border road that acts as a dike, trapping water in northeastern North Dakota, if North Dakota installs the filtration system at the Devils Lake Channel. North Dakota's governor demurred, maintaining that the two issues are unrelated.⁵⁹

Other environmental problems the two countries have dealt with in recent years include secondary wastewater treatment, control of predator fish and other invasive species introduced into the Great Lakes by ocean-going vessels, and sustainability of the St. Lawrence Seaway. In

⁵⁸ CRS Report RL30234, *The Pacific Salmon Treaty: The 1999 Agreement and Renegotiated Annex IV*, by Eugene H. Buck.

⁵⁹ "Devil Down South." *The Economist*. July 16, 2005. "Little-Known White House Office Negotiates Devils Lake Dispute." *AP*. September 5, 2005. "U.S. Promises Devils Lake Filter, But Water May Flow Before Installation." *Canadian Press*. April 25, 2006. Manitoba Scores Partial victory In Water Dispute With North Dakota. *The Canadian Press*. February 22, 2008; "ND governor to Manitoba: No deal on water dispute," *Fargo Forum*, May 8, 2009.

addition, the United States and Canada concluded a hazardous waste trade agreement in 1986; more recently, transboundary shipments of solid waste, particularly from Ontario to Ohio, Michigan, and other U.S. states, have been under review, and have been the subject of legislation in the U.S. Congress. The two countries have continued the long-standing debate over the ecological impact of possible development in Alaska's Arctic National Wildlife Refuge. Finally, the two sides continue to monitor the progress of the 1991 Canada-United States Air Quality Agreement. On January 7, 2003, Canadian and U.S. officials announced a new Joint Border Air Quality Strategy; under the initiative, pilot programs to reduce air pollution will be developed involving stakeholders at the state, provincial, and local levels.

Canada and Afghanistan⁶⁰

Issue Definition

Canada has participated in military operations in Afghanistan from the outset of the conflict in the fall of 2001. In early 2002, Ottawa deployed troops to Kandahar. However, as the mission changed focus from peacekeeping to counter-insurgency operations involving combat and casualties, Canadian public support declined. Parliament approved legislation requiring Canada to end its combat role by July 2011, and for all troops to be withdrawn by the end of that year. In the fall of 2009, a long-running scandal erupted when it was alleged that Canadian troops had turned over insurgent prisoners to Afghan officials, who subsequently tortured the detainees. The Obama Administration has expressed support for a continued role in Afghanistan by Canada. In late 2010, the Canadian government announced that, among other measures, it would maintain a sizeable military training contingent in Afghanistan through 2014.

Background and Analysis

Canada was one of the first countries to join the U.S.-led military operation in Afghanistan. In October 2001, the Canadian government launched Operation Apollo, in support of Operation Enduring Freedom. Nearly 900 infantry troops and approximately 40 members of Canada's Special Forces unit, Joint Task Force 2, served in the initial combat in Afghanistan. Canadian forces—about 2,800 during most of their deployment—served on the front line in combat operations in southern Afghanistan to counter attacks by al Qaeda and Taliban fighters. It was the fifth-largest national contingent. Canadian troops operated without national combat operational restrictions ("caveats"). Canada has suffered among the heaviest casualties proportionally of the NATO coalition member states; a total of 157 Canadians, including one diplomat, have been killed in Afghanistan.

In addition to infantry troops, Canada contributed a helicopter squadron and Operational Mentor and Liaison Team (OMLT) trainers; in addition, Royal Canadian Mounted Police are assisting the Afghan National Police. In August 2005, Canada established a Provincial Reconstruction Team in Kandahar in the volatile southern part of the country. Ottawa also has provided humanitarian and reconstruction assistance to Afghanistan, which is the number one recipient of Canadian foreign aid. Canada is among the top five donors to the country, and pledged C\$1.9 billion (about \$1.9

⁶⁰ Prepared by Carl Ek, Specialist in International Relations; Foreign Affairs, Defense, and Trade Division.

billion) through 2011 in reconstruction and development assistance. Canada also shared the leadership of Regional Command-South with the Netherlands and the UK.

As Canadian military operations in Afghanistan shifted from peacekeeping to counter-insurgency, public support for Canada's presence diminished. However, Prime Minister Harper was willing to challenge public opinion over Canada's participation in Afghanistan; he relied upon an approach that emphasized training Afghan troops to replace departing Canadians. In 2006, he won a narrow vote in parliament to keep Canadian troops in Afghanistan for two additional years. Harper initially characterized the mission as humanitarian in nature and also asserted that it was in Canada's national interest to demonstrate its ability to play a leadership role internationally.

In the fall of 2007, Harper appointed an advisory panel to review options on the mission. The commission found that the troop presence was justifiable and that the mission should be maintained until 2011, but recommended that Canadian forces be withdrawn unless NATO allies stepped up their contributions. This became the basis of a compromise between the Liberals and Conservatives. Harper declared that Canadian troops would be withdrawn unless other NATO countries provided an additional 1,000 troops. At the April 2008 NATO summit in Bucharest, France and the United States announced that they would commit 800 additional troops.

Canada's Afghanistan mission was thrown into the national spotlight in November 2009, when a Foreign Ministry whistleblower publicly alleged that, in 2006 and 2007, Canadian forces had turned combatant prisoners over to local Afghan authorities, who subsequently tortured the detainees; Foreign Affairs Minister Peter MacKay and other officials denied the charges, but later backtracked somewhat. The controversy, which generated considerable public interest, continued into mid-2010.

In November 2010, Canada's Ministers of Foreign Affairs, Defense, and International Cooperation announced that the Afghan mission would be extended until 2014. They outlined a new role for Canada to help promote security, stability, and self-sufficiency in Afghanistan, and stated that it would focus on four areas: education and health of children and youth; promoting security and rule of law; supporting regional diplomacy; and providing humanitarian assistance. Toward that end, the ministers said that up to 950 Canadian troops would be provided to help train the Afghan National Army, and up to 45 Canadian civilian law enforcement officers to help develop Afghan police forces. The ministers declared that the estimated cost of these various initiatives from 2011-2014 would be approximately C\$700 million.

An April 2010 public opinion survey indicated that 39% of Canadians polled supported the Afghanistan mission, down from 59% in mid-2006. An August 2010 poll showed that 53% of Canadians opposed the war, but that just 43% believed that Canadian participation had been a mistake. In November 2010, a poll showed 42% approved Canadian soldiers remaining in a training capacity, while 48% preferred complete troop withdrawal.

Status of the Issue

In March 2010, U.S. Secretary of State Hillary Clinton said during a visit to Ottawa that she hoped Canada would continue its presence in Afghanistan after 2011, suggesting "a training role instead of a combat role, a logistics-support role instead of front-line combat." Some observers noted that the Obama Administration and NATO officials had privately expressed concerns that the withdrawal of Canadian troops might prompt other allies to bring their troops home.

As noted above, the Canadian government in late 2010 extended the country's mission in Afghanistan through 2014—albeit in a training, rather than a combat capacity. Canadian troops ended their combat role in July 2011.

Questions

1. Please describe Canada's new role in Afghanistan. Will Canadian military trainers be accompanying Afghan troops on patrols? If so, under what rules of engagement will the Canadian troops operate?
2. How did the Obama Administration respond to the Canadian government's announcement that it would remain involved in Afghanistan?
3. Do you believe that Canada's decision to extend its mission in Afghanistan might influence the policies of other allies?

Canada's Arctic Sovereignty Claim⁶¹

Issue Definition

Scientists have forecast that, by 2030 or earlier, global warming will reduce the Arctic ice pack in Canada's northern archipelago sufficiently to create a "northwest passage" that will permit commercial ship traffic through the summer months. If created, a northwest passage would significantly reduce transit distances for commercial ships operating between certain ports. It could also be used by commercial fishing or cruise ships, ships supporting Arctic scientific research or resource exploration, or military vessels. The presence of ships in the passage could require the establishment and enforcement of shipping lanes and other rules for ensuring safe ship operations, add to existing demands for maritime search and rescue capabilities, and create a risk of environmental damage to the Arctic. The use of the passage by foreign military ships might be viewed as creating potential security risks to Canada (and the United States). Successive Canadian governments have maintained that such a passage would be an inland waterway, and would therefore be sovereign Canadian territory, subject to Ottawa's surveillance and regulation. The United States, the European Union, Japan, and others assert that the passage would constitute an international strait between two high seas.

Background and Analysis

Arctic sovereignty has been an issue for Canada for decades. In 1985, a U.S. icebreaker, the *Polar Sea*, caused an uproar in Canada when it traversed the waters of the northern archipelago without first seeking permission. Afterward, Washington and Ottawa came to an agreement in 1988 under which the United States pledged to notify Canada when its ships would transit the region, and Canada agreed to grant its consent. In recent years, however, the question over who, if anyone, would have control over the regional waters has intensified as scientific consensus has grown that the melting of the polar icecap will open up a Northwest Passage during the summer months.

⁶¹ Prepared by Carl Ek, Specialist in International Relations; Foreign Affairs, Defense, and Trade Division.

The debate over the Northwest Passage has commercial, environmental, and security considerations. The opening of a channel of water during the summer months through Canada's 36,000-island arctic archipelago would cut shipping routes between Europe and Asia by 3,000-4,000 miles, saving time and fuel costs. However, many Canadians are concerned that unfettered maritime traffic through the region could result in serious environmental hazards ranging from the catastrophe of an oil spill to more cumulative pollution caused by ocean dumping of ballast and garbage by transiting vessels. In terms of security, the Canadians are concerned that recognition of the passage as international waters would result in free access to naval warships and submarines, including, for example, those of Russia and China.

Canada seeks recognition of its sovereignty over the entire area, among other reasons, because of a strong national identification with its northern regions. Ottawa argues that it has a historical claim based on centuries of Inuit inhabitation—of the islands and of the ice extending from them. From a practical standpoint, Canada wishes to have the ability to enforce protection of the fragile arctic ecosystem and to ensure sustainable commercial fishing practices. In addition, the Canadians want there to be no doubt that they have rights to the region's abundant natural resources, including oil, natural gas, minerals, and precious metals.

The Harper government has been seeking to bolster Canada's sovereignty claim by maintaining and expanding the "Northern Strategy" launched by his Liberal predecessors. The most visible part of Conservatives' plan has been the establishment of a stronger military presence. In July 2007, Harper announced plans for the construction of 6-8 armed, medium-sized icebreakers to patrol the north. The following month, he traveled to Resolute Bay, Nunavut, and announced plans to construct a winter warfare training center and deep-water port in the region. He declared that "Canada's new government understands that the first principle of Arctic sovereignty is: Use it or lose it." Some Canadians, however, have criticized Harper for seeking to militarize the debate.

The prospective passage raises jurisdictional questions. Canadians maintain that it would be an internal waterway and would likely require all vessels to register with their coast guard's vessel traffic reporting system. They contend that this would facilitate possible search-and-rescue missions, and would dissuade ships bearing contraband from sailing through the region. There is general agreement that the natural resources in the region are Canadian; the debate concerns free transit rights. Analysts note that the U.N. Convention on the Law of the Seas calls for the right of transit passage "between one part of the high seas ... and another part of the high seas." In addition, some analysts believe that the recognition of the Northwest Passage as a Canadian inland waterway would set an international precedent that might be viewed as applicable elsewhere in the world. Other governments could echo Canada's sovereignty claim and prohibit the passage of U.S. naval ships, as well as of oil tankers bound for the United States; the Straits of Malacca and Hormuz have been cited as examples. Others, however, such as former U.S. Ambassador to Canada Paul Cellucci, argue that it would be in the interests of U.S. national security if Canada were to manage and police shipping through the straits.

Several possible solutions have been put forward. Some argue that Canada could achieve its objectives through regulations approved by the U.N. International Maritime Organization. Also, it has suggested that NORAD and the Arctic Council might be able to coordinate cooperative patrolling of the passage. Others—though not the United States—have proposed that the countries bordering the Arctic adopt an agreement prohibiting military, residential, or commercial use of the region, as was done for Antarctica in 1959. Finally, some believe that a renewed and updated version of the 1988 U.S.-Canada agreement would suffice.

Status of the Issue

The Bush Administration did not make a major issue of a potential future northwest passage. On January 9, 2009, the White House issued National Security Presidential Directive 66, entitled Arctic Region Policy. The document reiterated the Administration's stance regarding Canada's sovereignty claim, stating that "the Northwest Passage is a strait used for international navigation." Some analysts believe that the Obama Administration is unlikely to reverse this stance, and that, for the time being, Ottawa and Washington will continue to "agree to disagree." However, Canadian analysts have argued that the debate over who should manage the straits will intensify if ships carrying hazardous materials or illegal immigrants are discovered in the region. The government has emphasized its commitment to the Arctic through frequent visits by government officials; Prime Minister Harper made his fifth annual trip to the north in August 2010. Also that month, Foreign Minister Lawrence Cannon announced a new "Statement on Canada's Arctic Policy," which reaffirmed the government's commitment to Canada's sovereignty, to economic and social development, to environmental protection, and to empowerment of the peoples of the region. The statement also emphasized the government's intention to negotiate settlements to long-standing boundary disputes with the United States and Denmark. Because it has been highlighted as a priority area for the Harper government, this issue will likely continue to be the subject of bilateral discussions between U.S. and Canadian policymakers.

Questions

1. Several governments have taken issue with Canada's assertion of sovereignty over the Arctic waters. Do any foreign countries support Canada on this question? Has the Canadian government offered a legal precedent for its claim?
2. If Canada were to win recognition of its sovereignty over the passage, how might it regulate shipping traffic through the straits?
3. What might be the security, economic and environmental consequences for the United States if Canada were to win its sovereignty claim? If the passage were to be declared international waters?

Inter-American Cooperation⁶²

Issue Definition

In 2007, Prime Minister Harper declared that the Americas are a critical foreign policy priority for Canada, and committed to deepening and broadening Canada's engagement in the region. Since then, Canada has sought to expand its presence throughout the region while reinforcing bilateral ties and strengthening regional organizations. The Conservative government's current objectives for the hemisphere closely align with those of the Obama Administration, with both countries

⁶² Prepared by Peter Meyer, Analyst in Latin American Affairs; Foreign Affairs, Defense, and Trade Division.

advancing policies designed to reinforce democratic governance, increase economic prosperity, and enhance regional stability and security.

Background and Analysis

Although Canada has long been active in the region, its commitment to sustained engagement in inter-American relations is relatively recent. Throughout the 20th century, Canada forged strong diplomatic and commercial ties with many Latin American and Caribbean countries. Nevertheless, it generally did not consider the region to be a top foreign policy priority. Authoritarian governance and widespread poverty fueled negative perceptions of the region and led Canada to focus its attention elsewhere. According to a number of analysts and former officials, Canada was also reluctant to engage extensively in hemispheric affairs out of concern that it could be drawn into disputes with the United States, which had traditionally played a dominant role in the region.

Canada began to reexamine its role within the Western Hemisphere as the Cold War drew to a close and Latin American and Caribbean countries opened their markets and reestablished democratic governance. In 1989, the Progressive Conservative government of Brian Mulroney (1984-1993) completed a full cabinet review of its position in the hemisphere and declared that inter-American cooperation was integral to Canada's interests. Canada became a full member of the Organization of American States (OAS) in 1990, where it has been a leader in democracy promotion efforts and one of the drivers of the Summits of the Americas process. Canada also sought to expand commercial ties in the region by pursuing trade liberalization. In 1994, Canada entered the North American Free Trade Agreement (NAFTA) with Mexico and the United States, and participated in the initiation of negotiations over a hemispheric Free Trade Area of the Americas (FTAA). Although the FTAA negotiations were effectively abandoned in 2005, Canada continued to pursue bilateral trade agreements with many countries in the region.

Since taking office in 2006, Prime Minister Harper has sought to reinvigorate Canada's engagement in the hemisphere. He created a new Minister of State of Foreign Affairs position with special responsibility for the Americas. He also placed a renewed emphasis on trade, signing agreements with Colombia, Honduras, Panama, and Peru, and pursuing negotiations with several other nations. Within the OAS, Canada continues to support efforts to strengthen democratic governance. It also is encouraging the organization to better define its priorities and become more effective and accountable. Additionally, Canada has provided substantial amounts of assistance to support economic and political development efforts in Latin America and the Caribbean. In fiscal year 2009-2010, Canada provided over C\$807 million (about U.S.\$811 million) in bilateral and multilateral aid to the region. Selected issues in Canada's hemispheric relations are discussed below.

The Organization of American States

Although Canada remained outside of the OAS for many years, it became a permanent observer in 1972 and a full member in 1990. Canada is currently the second-largest financial contributor to the OAS after the United States, with an assessed contribution of C\$11.4 million (about U.S.\$11.5 million) in 2010. Canada also provides additional voluntary contributions to support activities such as electoral observation missions and consultations with civil society. The Harper government's emphasis on effective, results-oriented multilateralism has led it to support efforts to improve the organization's governance. Canada is providing funding to introduce results-based

management at the OAS, and chairs a working group seeking to improve the priority-setting process and accountability of the organization.

Since becoming a full member of the OAS, Canada has taken a particular interest in advancing democratic governance in the hemisphere. One of its first initiatives was to create the Unit for the Promotion of Democracy, which focused on strengthening democratic institutions and observing elections. Canada was also instrumental in the drafting of the Inter-American Democratic Charter, a document signed by all 33 participating member states asserting that all peoples of the Americas have a right to democracy and their governments have an obligation to promote and defend it. Canada joined with the rest of the member states in voting to invoke the charter and suspend Honduras from the OAS following the June 2009 ouster of that country's president. After Honduras held elections in November 2009, Canada quickly recognized the new government and pushed to end the OAS suspension, which was ultimately lifted in June 2011.

Haiti

Although Canada has few historic ties to Haiti, it has worked closely with the United States and Latin American and Caribbean partners to support stability and development efforts in the country over the past 17 years. As part of a U.N. mission in 1994, a contingent of the Canadian armed forces and members of the Royal Canadian Mounted Police assumed control from departing U.S. forces who had helped restore the democratically elected government of Jean-Bertrand Aristide. In 2004, after the Aristide government stepped down in the face of armed rebellion, Canada joined the United States and other partners in providing peacekeepers to the U.N.-authorized Multinational Interim Force (MIF). Canada initially deployed nearly 500 troops to the MIF, and has continued to participate in the Brazilian-led U.N. Stabilization Mission in Haiti (MINUSTAH). Following the January 2010 earthquake that devastated Haiti, Canada temporarily dispatched over 2,000 armed forces personnel to assist in security and humanitarian relief efforts. It currently has 172 police and military personnel serving in MINUSTAH.

In addition to assisting in security efforts, Canada has sought to foster development in Haiti. Haiti receives over 40% of Canada's aid to Latin America and the Caribbean, and is currently the second-largest recipient (after Afghanistan) of Canadian development assistance world-wide. Although Canada initially budgeted C\$555 million (about U.S.\$558 million) in assistance for Haiti between 2006 and 2011, the country's total aid for the period has already exceeded C\$1 billion (about U.S.\$1.005 billion) as a result of additional pledges following the massive 2010 earthquake. Canadian aid to Haiti concentrates on democratic governance, private sector development, health, basic education, gender equality, and environmental sustainability, with an emphasis on building the Haitian state's core institutions. The country sits on the steering committee of the Interim Haiti Recovery Commission and is a voting member of the Haiti Reconstruction Fund, both of which assist in coordination of reconstruction efforts. Canada has also been a leader in debt relief efforts. It forgave C\$2.3 million (about U.S.\$2.31 million) in loans to Haiti in September 2009, and was one of the first countries to call on the international community to forgive Haiti's debts in the aftermath of the earthquake. In June 2010, Canada paid off C\$33 million (about U.S.\$33.2 million) in Haitian debt to the international financial institutions, becoming the first of the G20 countries to fulfill its pledge and pay off its share of Haiti's debt.

Palestinian Statehood

Over the past year, a growing number of Latin American countries have recognized Palestine as an independent state. Eighteen nations in Latin America and the Caribbean now recognize an independent Palestine, with 13 of those nations having granted recognition to the Palestinians since Brazil did so in December 2010. There has been considerable variation among the countries, however, with some recognizing the (pre-Six-Day War) 1967 borders between Palestine and Israel and others calling for borders to be set through further negotiations. Many of the nations that have recognized Palestine have indicated that they did so out of frustration with the stalled peace process and in hope that recognition could advance negotiations toward a two state solution to the conflict. Most of Latin America is expected to support the Palestinians' efforts to obtain statehood at the U.N. General Assembly in late September 2011.

Canada, like the United States, supports a two state solution for Israel and Palestine that is arrived at through negotiation by both parties. The Conservative government has indicated that it views recognition of an independent Palestine and the Palestinians' efforts at the U.N. General Assembly as premature and counterproductive. According to press reports, Canada has been lobbying smaller countries to oppose Palestinian statehood at the United Nations, and the Harper government's positions on Israel-Palestine issues contributed to its failure to secure a two-year term on the U.N. Security Council for 2011-2012.

Status of the Issue

Despite Prime Minister Harper's efforts to boost engagement with the countries of Latin America and the Caribbean, Canada's presence and influence in the region remains limited. Total two-way trade between Canada and the region increased over 40% between 2006 and 2010 to \$49.2 billion. This represents a small portion of Canada's global trade relations, however, as Latin American and Caribbean countries are the destination of only 3% of Canada's exports. Similarly, while Canada's total aid to the region is substantial, it is heavily concentrated in Haiti and a few Andean nations. An internal evaluation of Prime Minister Harper's Americas strategy that was released in early 2011 by the inspector general of the Canadian Foreign Affairs Department found that Canada's influence with individual nations in the region is uncertain, as high-level visits and announcements have raised hopes but concrete action has been slow. The evaluation also noted that the strategy lacked direction, coordination, and funding.

Questions

1. How have Canada's relations in the hemisphere changed as a result of Prime Minister Harper's Americas strategy? What are the primary objectives of the strategy? What do you consider to be the strategy's major successes thus far?
2. How would you assess the current direction of the OAS? How are Canada's reform efforts within the organization proceeding?
3. Canada has committed substantial personnel and resources to Haiti over many years. What is your assessment of the reconstruction efforts since the earthquake? How well are the efforts of international donors and the Haitian government being coordinated? What progress has been made in the reform and rebuilding of Haiti's educational system, for which Canada has taken on a

leadership role among donors? What do you foresee as Canada's level of involvement in Haiti in the coming years?

4. What do you think is behind the recent wave of governments in the region recognizing Palestine? Have Canadian officials raised the issue of Palestinian recognition with any Latin American or Caribbean officials?

Border Security Issues⁶³

Issue Definition

Border security has emerged as an area of public concern, particularly after the September 11, 2001, terrorist attacks. Since 2001, the United States and Canada have attempted to balance adequate border security with the facilitation of legitimate cross-border travel and commerce. In the wake of statutory and administrative steps to enhance border security and tighten enforcement, concerns persist with respect to the potential for terrorists and criminals to exploit the border. Moreover, there continues to be interest with respect to the adequateness of infrastructure and personnel at the U.S.-Canadian border and ports of entry.

Background and Analysis

The United States and Canada have taken various measures to better secure the shared border while simultaneously preventing disruption to the flow of people and trade. These efforts include a series of U.S. laws since 2001 to increase the number of enforcement personnel at the U.S.-Canadian border and to strengthen border screening technology. The USA PATRIOT Act of 2002 (P.L. 107-56) authorized the Attorney General to triple the number of border patrol personnel and immigration inspectors along the northern border and authorized additional technological improvements and equipment for the northern border. The Enhanced Border Security and Visa Reform Act of 2002 (the Border Security Act; P.L. 107-173) similarly authorized additional personnel, technology, and infrastructure improvements. The Trade Act of 2002 (P.L. 107-210) required 285 additional customs inspectors for the northern border in FY2003. And the Intelligence Reform and Terrorism Prevention Act of 2004 (IRTPA, P.L. 108-458) authorized an increase of 2,000 Border Patrol agents per year for FY2006-FY2010, while stipulating that 20% of the increases in agent manpower be assigned to the northern border.

The United States and Canada also have a long history of binational collaboration around border security. Such efforts date back to February 24, 1995, when the two countries signed a joint accord, *Our Shared Border*, followed by the 1999 *Canada-U.S. Partnership Forum* (CUSP). Shortly after the 9/11 attacks, the United States and Canada signed a joint statement of cooperation on border security and migration that focused on the detection and prosecution of security threats, the disruption of illegal migration, and the efficient management of legitimate travel. The agreement produced a 30-point plan (later updated to 32 points) commonly referred to as the "Smart Border Accord," signed on December 12, 2001. The points include coordinated law enforcement operations, intelligence sharing, infrastructure improvements, improvement of

⁶³ Prepared by Marc R. Rosenblum, Specialist in Immigration Policy, Domestic Social Policy Division.

compatible immigration databases, visa policy coordination, common biometric identifiers in travel documents, prescreening of air passengers, joint passenger analysis units to screen for high risk travelers, and improved processing of refugee and asylum claims, among other things.

As part of the Smart Border Accord, the countries have established 15 Integrated Border Enforcement Teams (IBETs) since 2002, operating at 24 locations at and between U.S.-Canadian ports of entry. The IBETs are binational, multi-agency, enforcement teams led by U.S. Customs and Immigration Enforcement and the Royal Canadian Mounted Police (RCMP). Based on shared intelligence, the IBETs focus on identifying, investigating, and interdicting common national security threats and criminal activity that seek to exploit the international border.

Between 2005 and 2007 and in 2010, the countries also implemented a pilot program called Shiprider, which placed fully cross-trained, cross-designated RCMP and U.S. Coast Guard agents on law enforcement vessels operating along certain international waterways, and allowed agents from each country to conduct joint enforcement activities on both sides of the border. The Obama and Harper Administrations signed a framework agreement to extend and expand Shiprider, but implementation of the agreement awaits authorizing legislation in the Canadian Parliament.

Two additional agreements related to border security have been signed since the Shiprider Agreement. In July 2010, the countries signed an Action Plan for Critical Infrastructure intended to strengthen the safety, security, and resilience of critical shared infrastructure through an enhanced cross-border approach focused on partnerships, information sharing, and risk management. And on February 4, 2011, President Obama and Prime Minister Harper signed a joint declaration describing their shared visions for a common approach to perimeter security and economic competitiveness: the *Beyond the Border* agreement. The 2011 agreement focuses on information sharing and joint threat assessments to develop a common and early understanding of the threat environment; infrastructure investment to accommodate continued growth in legal commercial and passenger traffic, including through an integrated entry-exit system to use admissions data from each country to track exits from the other; additional integrated cross-border law enforcement operations; and steps to strengthen shared cyber-infrastructure.

Western Hemisphere Travel Initiative

In addition to its provisions related to border personnel, the Intelligence Reform and Terrorism Prevention Act of 2004 required the Secretary of Homeland Security, in consultation with the Secretary of State, to develop and implement a plan to require a passport or other secure document or combination of documents for all travelers entering the United States. Commonly referred to as the Western Hemisphere Travel Initiative (WHTI), this provision requires American and Canadian nationals (and other foreign nationals) to present an approved travel document to enter the United States.

The Department of Homeland Security (DHS) and the Department of State (DOS) final rule for WHTI took effect on June 1, 2009. The final rule requires that U.S. citizens present an approved secure document that denotes identity *and* citizenship at the land border. This rule ends the previous practice of accepting driver's licenses and birth certificates as proof of identity and citizenship at the border. Approved documents include passport books, passport cards, and trusted traveler cards (such as Secure Electronic Network for Travelers Rapid Inspection, NEXUS, and the Fast and Secure Trade programs), while additional provisions are made for military identification, tribal cards, and for certain special groups of travelers. Additionally, four states have entered into agreements with DHS to issue enhanced driver's licenses (EDLs) that include

citizenship information and are valid for WHTI purposes: Michigan, New York, Vermont, and Washington. Four Canadian provinces also issue EDLs for Canadian citizens that are valid for WHTI purposes: British Columbia, Manitoba, Ontario, and Québec.

Prior to its implementation, WHTI fostered much debate in Canada as well as in the United States, as some observers voiced concerns that the increased documentation requirements at the border may suppress travel between the two nations. Yet a GAO review in March 2011 found that Customs and Border Protection's (CBP) public outreach campaign had led to a greater than 95% compliance rate with WHTI requirements throughout FY2010.

Border Infrastructure and Personnel

The U.S.-Canadian border between Washington State and Maine spans about 4,000 miles, includes vastly different types of terrain, and is the site of about 150 ports of entry, including 20 major land ports of entry. In 2010, a total of 5.4 million trucks, 26,000 trains, 116,000 busses, and 28.9 million passenger vehicles entered the United States through northern border ports according to the U.S. Bureau of Transportation Statistics—numbers which exceed analogous data for the U.S.-Mexican border for trucks and trains, while passenger traffic is higher on the southern border.

Under legislation passed since 2001, the U.S.-Canadian border has received increased attention throughout the post-9/11 period. A total of 2,263 Border Patrol agents were posted in northern border sectors in FY2010, up from just 340 in FY2001, along with 3,734 CBP inspectors at ports of entry (as of FY2009), up from 1,550 in FY2001, and additional ICE agents and others assigned to the IBETs, as discussed above. These increased deployments represent substantial growth in border enforcement personnel, but lag slightly behind the goals established by the USA-PATRIOT Act and the IRTPA (i.e., to triple the number of inspectors at northern border ports of entry and to place one in five new Border Patrol agents on the northern border). Some Members of Congress have raised concerns about staffing levels at northern border ports of entry and whether CBP resources have been shifted from the U.S.-Canadian to the U.S.-Mexican border.

Status of the Issue

The U.S. and Canadian governments continue to implement the provisions in the Smart Border Accord and the 2011 *Beyond the Border* lays out an ambitious agenda for deeper cooperation. The countries have expanded the NEXUS trusted traveler program to 19 border crossing locations, 33 marine reporting locations, and 8 Canadian pre-clearance locations. The countries continue to explore the feasibility of creating additional joint facilities at agreed upon ports of entry and sharing of information through interoperable technology. Since 2004, they have taken steps to share passenger information on high-risk travelers en route to either country through a joint risk-scoring scheme and shared “lookout” data. How the countries will implement additional principles outlined in the Beyond the Border Agreement, such as more deeply integrated cross-border law enforcement efforts and an integrated biometric entry-exit system, remains to be seen.

Yet CBP and other observers still consider the U.S.-Canadian border to be the locus of a wide range of security threats, including transnational terrorist entities present along both sides of the U.S.-Canadian border; criminal enterprises focused on illegal drugs, firearms, tobacco, intellectual property, and currency; and vulnerabilities related to migration, agriculture, and transnational health issues. Based on CBP's current measure for assessing border security—which

is in the process of being replaced—the agency considered only 69 of the nearly 4,000 miles of the U.S.-Canadian border to be under an acceptable level of control, according to a 2010 GAO report. And while the countries collaborate closely to combat these threats, fully cross-designated enforcement based on the Shiprider model remains on hold pending the Canadian Parliament’s approval of the 2009 agreement.

Questions

1. The WHTI made significant changes to the documentary requirements needed to enter the United States. What steps has the Canadian government taken to ensure that Canadian citizens are aware of these changes? Will Canada develop its own version of the passport card for Canadian citizens? Will additional Canadian provinces begin issuing EDLs?
2. In recent years, a number of different technologies, including the US-VISIT entry-exit program, have been implemented at northern ports of entry. With the advent of these technologies as well as the WHTI, the demand for improved screening and passenger processing infrastructure is critical. What measures has the Canadian government taken to enhance border infrastructure? Are there additional collaborative efforts that could be undertaken to alleviate some of the pressure on busy ports of entry? How can the United States and Canada make progress on an integrated entry-exit system?
3. The Smart Border Accord calls on the two countries to develop approaches to move customs and immigration inspection activities away from the border. While such an approach is already present at Canadian airports, there has been interest in expanding it to areas away from land ports of entry. What is the Canadian government doing to facilitate this objective? What are the prospects for implementing pre-clearance pilots for travel through land ports?
4. When will authorizing legislation be considered that would allow full implementation of the Shiprider Agreement governing joint enforcement along U.S.-Canadian waterways? What are the prospects for expanding the program to include integrated land-based law enforcement programs?

Border Security: Trade and Commercial Concerns⁶⁴

Issue Definition

The aftermath of the terrorist attacks on the United States on September 11, 2001, increased scrutiny of the Canadian border as a possible point of entry for terrorists or for weapons of mass destruction. The potential for economic disruption that closing the border would cause has spurred cooperation between the United States and Canada to improve border security in an atmosphere conducive to continued and expanded commerce. This brief details commercial considerations in U.S.-Canadian border security discussions.

⁶⁴ Prepared by Ian F. Fergusson, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

Background and Analysis

The issue of border security is linked to the increased integration of the United States and Canadian economies. This integration has been aided by several trade agreements, culminating in the North American Free Trade Agreement of 1994 (NAFTA). These trade agreements not only eliminated tariff barriers between the two nations, but also reoriented Canada's industrial structure towards the United States. Industries in each country are now able to produce goods for a larger continent-wide market, and productivity has increased through increased economies of scale and specialization. Such specialization led to increased bilateral trade, much of it in intermediate products. This integration has, in turn, led to industrial practices such as "just in time" parts procurement that depend on a relatively open border.

The volume of economic activity across the border underscores the extent of economic integration between the United States and Canada. Despite the global economic downturn, the United States and Canada continue to have the largest trading relationship in the world with over \$1.3 billion per day in goods and services crossing the border in 2010. In that year, Canada purchased 19.4% of U.S. exports and supplied 14.7% of all U.S. imports. The United States supplied 50.4% of Canada's imports of goods in 2010 and purchased 74.9% of Canada's merchandise exports; two-way trade with the United States represents 36% of Canadian GDP. In 2009, the Ambassador Bridge and Detroit-Windsor Tunnel complex that links Detroit, Michigan and Windsor, Ontario was the largest trade link in the world with more than 3,200 daily truck crossings totaling more than \$72.3 billion per year.

Action Programs and Initiatives

Several initiatives to increase security of the border without impeding the flow of commerce were implemented under the Security and Prosperity Partnership (SPP), which in turn expanded on previous bilateral efforts by the United States and Canada, including the Smart Border Action Plan of December 2001 consisting of four pillars: the secure flow of people, the secure flow of goods, a secure infrastructure, and coordinated enforcement and information sharing. The pillar concerned with the flow of goods consists of initiatives on harmonized commercial processing, supply chain management, clearance away from the border, joint or shared facilities, enhancement of information sharing, and infrastructure improvements.

The U.S. Bureau of Customs and Border Protection's *Customs-Trade Partnership Against Terrorism (C-TPAT)* and the Canadian Border Security Agency's *Partners in Protection Program* are supply-chain security initiatives in which companies undertake audit-based compliance measures to enhance security along the supply chain. Goods shipped under these programs are eligible for preclearance away from the border.

The *Free and Secure Trade (FAST)* is a joint harmonized commercial processing initiative at 21 border locations, which provides for dedicated inspection lanes to goods carried by approved lower-risk shippers, to goods purchased from pre-authorized importers such as C-TPAT, and to goods transported by pre-authorized drivers and carriers. A complementary program (NEXUS) to expedite the secure movement of people has also been established for frequent travelers who have undergone security clearances on both sides of the border.

Another objective of the border security efforts has been the screening of goods entering North America. The ongoing U.S. *Container Security Initiative (CSI)* is designed to pre-screen high risk containers entering the United States at overseas ports of departure. Under the SPP, the three

countries will develop common screening methods and technology, establish criteria to identify high risk cargo, and harmonize cargo information technology. Preclearance and prescreening is a possible first step in the creation of a North American security perimeter, a concept whereby clearance occurs at the first point of entrance rather than at the final border.

Finally, President Obama and Prime Minister Harper signed the Beyond the Border declaration on February 4, 2011, committing both nations to a shared vision of perimeter security and economic competitiveness. While specifics of this vision remain under negotiation, they include common threat assessments, trade facilitation measures, integrated cross-border law enforcement, and measures to enhance critical infrastructure and cybersecurity.

Status of the Issue

Land preclearance away from the border by U.S. and Canadian customs agents working in each other's territory is an issue that has proven controversial, primarily due to concerns about sovereignty. Joint U.S.-Canada customs teams already operate in the CSI ports of Halifax, Montreal, and Vancouver, as well as Newark and Seattle-Tacoma, although the visiting agent serves only an advisory role with no enforcement powers. The SPP calls for negotiations on a U.S.-Canada preclearance agreement with implementation of two pilot sites, the Peace Bridge (Buffalo, NY-Fort Erie, ON) and the Thousand Islands Bridge (Alexandria Bay, NY-Landsdowne, ON). However, these negotiations were suspended on April 26, 2007. A 2008 GAO report cited disagreements over arrest authority, fingerprinting practices, and the right of individuals to withdraw an application to enter the United States while at the preclearance station. The Obama Administration reviewed this decision, but in August 2009 Secretary Napolitano announced that negotiations to construct a preclearance site adjacent to the Peace Bridge would not be reopened.

A second issue is the ability of the transportation infrastructure to cope with increased security measures. The aging condition and limited capacity of the land border infrastructure preceded the terrorist attacks. For example, the Ambassador Bridge and the Detroit-Windsor Tunnel, which together carry 25% of total U.S.-Canada cross-border traffic, both opened in 1930. Approaches to the crossings, often city streets, have been criticized as inadequate to the commercial needs of the 21st century. This issue affects the efficient implementation of security measures. The FAST system provides for dedicated lanes at land border ports for expedited preclearance. However, these lanes will not save time if the FAST participant cannot access this lane due to congestion or delays at the points of access. The SPP completed a pilot program that attained a 25% improvement in border crossing times at the Detroit-Windsor gateway in December 2005, yet the aging and adequacy of the border infrastructure may affect whether such improvements are sustainable.

There are two competing plans to build additional bridge capacity over the Detroit River to ease truck congestion on the Ambassador Bridge. One proposal involves building a new span adjacent to the Ambassador and has been put forward by the private owner of the bridge. A competing proposal, the Detroit River International Crossing (DRIC), would be built approximately 2 miles south of the Ambassador between Zug Island in Detroit and the Brighton Beach area of Windsor. The DRIC proposal is supported by the Canadian government, which believes a new span should not be privately held. To this end, then-Canadian Transport Minister John Baird offered to loan the state of Michigan \$550 million to fund its share of the new bridge, the total cost of which is expected to be \$5.3 billion. Incoming Michigan Governor Rick Snyder endorsed the construction of the bridge in January 2011, and a bill creating a bridge authority is awaiting consideration by the Michigan legislature. Meanwhile, the owner of the Ambassador Bridge, the principal

opponent of the new crossing, has brought a North American Free Trade Agreement (NAFTA) investor-state dispute over his contention that the proposed rival bridge would divert traffic (and tolls) from his bridge.

Questions

1. Is Canada doing enough to secure the border against the transit of terrorists or weapons of mass destruction? Do Canadians think that the United States has placed too much emphasis on securing the northern border against terrorists to the detriment of efficient trade relations?
3. Are Canadian business and government officials concerned that another terrorist-related border shutdown could cause the relocation of business to the United States or dampen the attractiveness of Canada as a recipient of foreign investment?
4. How important is building a new Detroit-Windsor bridge to cross-border trade? The owner of the Ambassador Bridge has offered to assume the cost of building a twin span adjacent to the current bridge. Why not let him?
5. Do you believe aspects of the Beyond the Border declaration threaten Canadian sovereignty? How has the Canadian government communicated the specifics of the negotiations to legislators or to average Canadians?

Immigration and Refugee Policies⁶⁵

Issue Definition

Should the United States be concerned that Canada's immigration and refugee laws and policies pose a threat to its national security?

Background and Analysis

Although Canada does not have country or worldwide immigration quotas, the government does establish annual targets. Between 2004 and 2010, Canada accepted between 235,000 and 282,000 new permanent residents annually. In this same period, an average of between 90,000 and 100,000 persons were accepted annually as temporary workers. New arrivals as permanent and temporary residents total more than 1% of the entire Canadian population. Asian countries, such as China, India, Pakistan, and the Philippines, are heavily represented at the top of the list of countries from which Canada's immigrants come, but no one nation dominates. Iran is the only country adjacent to the Middle East that recently has been in the top 10. Morocco is the only North African country in this group. Security checks are conducted by federal authorities. Because Québec, however, has an agreement with the federal government that allows it to select immigrants intending to settle in that province, Québec's system adds a second screening process for its applicants. Québec also has addressed security concerns by adjusting its programs for

⁶⁵ Prepared by Stephen F. Clarke, Senior Foreign Law Specialist, Global Legal Research Center, Law Library of Congress.

recruiting immigrants. The federal government and Québec use point systems for assessing independent applicants that were changed 10 years ago to attract more highly skilled and educated immigrants, regardless of whether they had arranged employment or not. Under this system, Canada has long accepted a much higher percentage of independent immigrants and a much lower percentage of family class immigrants than the United States. A decision to give priority to the processing of certain applicants who have arranged employment drove the balance of the skilled worker category even higher relative to family class immigrants, to a ratio of approximately 2.3:1 in 2010.

One notable feature of Canadian immigration is that nearly three-quarters of the persons accepted settle in the three largest cities: Toronto, Montreal, and Vancouver. This tendency, combined with the high rate of immigration, has raised some concerns about destructive “diaspora nationalism” emerging in these concentrated communities. The 2006 arrests of a group of Muslims who had been raised in Canada and had planned attacks in southern Ontario fueled this concern. However, this problem is not unique to Canada and opposition to immigration has not been voiced nearly as loudly or as forcefully in Canada as it recently has been in parts of Western Europe. In fact, immigration is still generally viewed as an opportunity for growth in what would otherwise be a declining population.

The Canadian policy for asylum applicants is a far more contentious issue within the country than immigration, not so much for its negative effects within Canada, but because it generally is believed to invite fraud and abuse. Between 1998 and 2004, refugee claims began at around 25,000, rose to a high of about 45,000, and ended back down at approximately 25,000. In 2007, the number of refugee claims was approximately 29,500, but it rose again to nearly 38,000 in 2008 before falling again to 22,000 in 2010. The acceptance rate has consistently been somewhat higher than in the United States. In 2006, 47% of the refugee applications processed were accepted. In 2008, that figure reportedly rose to 58%, but has since declined to previous levels. Of particular concern to Canadian officials prior to 2005 was the fact that approximately 40% of the overall total claimants and some 70% of port-of-entry claimants had entered Canada through the United States. Canada is attractive to asylum applicants because it detains few undocumented refugee claimants pending independent identification and because the federal and provincial governments grant immediate assistance to applicants who have yet to substantiate their claims. The majority of Canada’s refugee claimants arrive in Canada without any documents and are allowed free entry into the country, even though it is clear that many disposed of the documents they had before coming to Canada. Canada is also attractive to refugee claimants because it does not often detain undocumented arrivals. The result is that there has been an increase in the human smuggling of refugee claimants, which the government has introduced a bill to combat.

Several U.S. television programs that have portrayed the Canadian refugee system as extremely liberal have received considerable attention in Canada. Most of these segments have mentioned cases of terrorists from the Middle East who did or may have entered Canada as refugees with the intention of launching attacks against U.S. targets. The most prominent of these cases is that of the “millennium bomber.” Ahmed Ressaam was captured in 1999 while crossing the border with explosives that he planned to set off at Los Angeles International Airport on January 1, 2000. Also highlighted have been the cases of suspected terrorists who have remained in the country for many years while fighting their way through a very lengthy appeal process. In 2002, the Supreme Court of Canada ruled that two persons linked to terrorist organizations could be deported to countries where they might face torture, when security concerns so require. One of these individuals was returned to Iran fairly quickly, but the other continued fighting his extradition to Sri Lanka.

Media coverage of the Canadian refugee system has elicited a wide range of responses. While a number of Canadian commentators agree that the United States has good reason to fear that Canada's refugee policies can be easily employed by terrorists to enter North America, others contend that terrorists are more likely to use other means to enter both Canada and the United States. Many analysts point out that the refugee system essentially has been used for "queue jumping" by enterprising persons who might not qualify under Canada's immigration laws. Proponents of this view are exasperated by repetitions of the well-refuted myth that the September 11 hijackers came from Canada and question how great the security risk to the United States can be if a significant number of claimants are coming to Canada from this country.

In December 2002, the United States and Canada signed a Safe Third Country Agreement to allow immigration officials in both countries to require most persons seeking asylum at a border crossing to go back and present the claims in their respective countries. This type of agreement had been called for in the Action Plan to the Smart Border Declaration signed in the aftermath of the September 11 attacks in the United States. Implementation of the Agreement was delayed by the lengthy and complicated process for drafting and approving appropriate regulations in the United States, but it finally went into force at the beginning of 2005. In 2007, a judge of the Federal Court of Canada held that the law implementing the Agreement was unconstitutional, based on his finding that the United States does not fully comply with international conventions on refugees. However, in 2008, the Federal Court of Appeals upheld the Safe Third Country Agreement, in a decision the Supreme Court of Canada decided not to review in February 2009.

Although the Safe Third Country Agreement aims to limit asylum shopping and the filing of multiple claims, it is limited in scope and subject to several major exceptions. One major limitation is that it only covers the presentation of claims at land border crossings. Airport and marine facilities are not covered except in very limited circumstances. The agreement also contains broad exceptions for relatives, including relatives of other asylum seekers, and it allows the parties to "examine any refugee status claim made to that party where it determines that it is in the public interest to do so." Statistics show that the number of refugee claims presented at border crossings in Canada declined by approximately 40% in the first half of 2005, and fewer than 20,000 total claims were filed for the entire year. Although the data would suggest that the Safe Third Country Agreement had a dramatic immediate impact, it also has been noted that claims presented at airports, which are not subject to the agreement, initially were down about 25%. Thus, the Safe Third Country Agreement appears to have gone into effect during a period in which the number of refugee claims already was declining. Since then, refugee claims have increased again.

Status of the Issue

One long-standing problem in Canada is that deportation is a very complicated and lengthy process. The number of persons deported has been growing, but Canada's Auditor-General found in May 2008 that the government did not know the whereabouts of approximately two-thirds of the over 60,000 persons who were subject to deportation or removal orders. Included in this group are persons who were found to be inadmissible on the grounds of criminality. While the Auditor-General was critical of the situation, she did not find that the missing persons constituted a clear national security risk.

At the end of March 2010, the Minister of Citizenship, Immigration, and Multiculturalism declared that "Canada's asylum system is broken" and announced plans to reform it. In June 2010, Parliament enacted the Balanced Refugee Reform Act, which aims to reduce the 19 months

it now takes to process the average refugee claim and the 4.5 years it now takes to remove the average failed refugee claimant. The goals are to have refugee claims heard within 60 days of being presented and removals of persons found not to be entitled to refugee protection carried out in less than one year. Since this act is not to come into force until June 2012, it remains to be seen whether the government's reforms will be more successful than previous attempts.

Questions

1. Could the Safe Third Country Agreement have had a broader application and apply to persons making applications for refugee status within the country?
2. Are the reported cases of terrorists and high-risk persons entering North America through legal means a sign of a potentially much greater threat?
3. Why do Canadian and U.S. officials maintain different detention policies in the case of undocumented refugee claimants?
4. What steps does the Canadian government intend to take to keep track of persons subject to deportation or removal orders?
5. Why does the government believe that the Balanced Refugee Reform Act will succeed in its objectives when so many previous efforts over the past thirty years have failed?
6. What steps does the government plan to take to combat human smuggling of refugee claimants?

Canada's Free Trade Agreement Agenda⁶⁶

Issue Definition

While the current Doha Round of multilateral World Trade Organization (WTO) negotiations remains stalled, regional and bilateral free trade agreements (FTA) have become a prominent, if controversial, feature of the world trading system. In the past, the United States was relatively more aggressive in pursuing FTAs, while Canada emphasized multilateral trade liberalization to supplement liberalization with its predominant partner, the United States, first through the U.S.-Canada FTA and subsequently through the North American Free Trade Agreement (NAFTA). This trend has shifted with Canada negotiating to conclude several FTAs, while in the United States, proposed FTAs with Colombia, Panama, and South Korea await congressional consideration in an uncertain environment.

⁶⁶ Written by Ian F. Fergusson, Specialist in International Trade and Finance; Foreign Affairs, Defense, and Trade Division

Background

After concluding the U.S.-Canada FTA in 1988 and expanding it to include Mexico in 1994, both countries made the new WTO the cornerstone of further trade liberalization. While both countries concluded FTAs, political rationales were often paramount. For example, close ties prompted both countries to conclude FTAs with Israel. Canadian attempts to establish a greater role in Latin America were reflected in FTAs with Chile (1997) and Costa Rica (2002). Negotiations were started with the European Free Trade Area nations (Norway, Switzerland, Iceland, and Liechtenstein) in 1998, with Singapore and with the Central American Four (El Salvador, Guatemala, Honduras, Nicaragua) in 2001, and with South Korea in July 2005. However, none of these negotiations yielded an agreement during the Liberal governments of Jean Chrétien and Paul Martin. Moreover, the importance of such agreements was overshadowed by the overwhelming volume of Canadian trade that continued to be conducted under NAFTA, with the United States continuing to account for the bulk of that trade.

In 2001, the George W. Bush Administration embarked on a new trade strategy known as “competitive liberalization.” This policy pushed forward trade liberalization simultaneously on bilateral, regional, and multilateral fronts. It was designed to spur trade negotiations by liberalizing trade with countries willing to join FTAs, and to pressure other countries to negotiate multilaterally. A pending agreement with Jordan, negotiated with the Clinton Administration was passed by Congress in 2001. Under trade promotion authority (TPA) passed by Congress in 2002 and in effect until 2007, FTAs were negotiated and approved by Congress with Chile, Singapore, Australia, Morocco, the countries of the Central American Customs Union and Dominican Republic (Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic), Bahrain, Oman, and Peru. In addition, negotiations were conducted with the nations of the South African Customs Union (SACU) (Botswana, Lesotho, Namibia, South Africa, and Swaziland), the United Arab Emirates, Malaysia, and Thailand, but they resulted in no agreement. Negotiations with Colombia, Panama, and South Korea were concluded under TPA, but they have yet to receive congressional consideration. Currently, the Obama Administration’s trade policy has stressed enforcement of existing trade agreements rather than negotiating new ones. The one exception has been the launch of the Trans-Pacific Partnership (TPP) talks among the United States, Australia, Brunei, Chile, New Zealand, Peru, Singapore, and Vietnam.

The Conservative government of Prime Minister Stephen Harper, first elected in 2006, has placed greater emphasis on negotiating regional and bilateral FTAs. Existing negotiations with EFTA were concluded in January 2008, resulting in an agreement that was approved by Parliament in January 2009 and received Royal Assent in April 2009. Negotiations with Peru and Colombia were initiated in June 2007. An agreement was signed with Peru in May 2008, which was approved by Parliament in June 2009 and received Royal Assent later in the month. Negotiations with Colombia were concluded in November 2008, and was approved by Parliament and received Royal Assent in June 2010. The Canada-Colombia FTA went into effect on August 15, 2011. An FTA with Jordan was concluded in August 2008 and was introduced in the 40th Parliament on March 24, 2010. However, this legislation died on the order paper and has not—as yet—been reintroduced in the 41st Parliament. In addition, an FTA was signed with Panama in 2010, but has yet to receive Parliamentary consideration. In general, the Conservative and Liberal parties have voted to approve these agreements, but have been opposed by the labor-influenced New Democratic Party (NDP) and the Québec-separatist Bloc Québécois.

In addition, negotiations have been started with Morocco, the Dominican Republic, India, Ukraine, and the nations of CARICOM, and are continuing with South Korea, Singapore, and the

Central American Four. With South Korea, issues familiar to U.S. negotiators, such as market access for beef and non-tariff barriers in the auto sector, are complicating the talks. Canada continues to express interest in the TPP, but reportedly has encountered resistance from New Zealand and the United States over its dairy supply management policies.

In May 2009, Canada and the European Union (EU) agreed to launch FTA negotiations, and eight rounds of negotiations have occurred thus far. This negotiation is significant in that it raises issues of concern to countries at a similar level of development and with relatively low tariffs. Issues that have been flagged include the regulation of professional services, temporary entry for business workers, and provincial participation in government procurement agreements.

Agreement on this latter point may become easier following the U.S.-Canada agreement on Buy American provisions in the U.S. economic stimulus. (See related section on “Buy American Provisions.”) Negotiations on agriculture likely will prove challenging, as both sides will likely seek to protect sensitive sectors, yet negotiations on traditional sticking points such as the EU’s desire to protect geographic indications and Canadian supply-management policies reportedly have not been precluded.

Status of the Issue

The Conservative government’s new enthusiasm for negotiating FTAs was expressed by then International Trade Minister Peter Van Loan on April 23, 2010. Canada is pursuing FTAs “with a vigor right now because we’re a trading country, our businesses need it, our workers need it, our prosperity depends on it, so we’re going to make it happen for Canada and not simply depend on the WTO.” While in some ways this policy resembles the “competitive liberalization” policy undertaken by the George W. Bush Administration, it remains to be seen whether agreements resulting from such negotiations, will increase trade flows and lessen the dependence of Canada on the U.S. market. It also remains to be seen whether Canada will retain its traditional engagement in the WTO.

Questions

1. How controversial is the Canadian government’s trade policy? Does the public approve of further trade liberalization? How does the continuing decline of the Canadian manufacturing sector affect public attitudes towards free trade generally?
2. Do you think the emphasis on negotiating bilateral and regional FTAs complements or weakens the multilateral trading system? Does this policy reflect a lack of confidence in the ability to conclude the WTO Doha Round, or that Canada will not benefit much from a Doha agreement?
3. In the United States, labor and human rights concerns have delayed the passage of the proposed Colombia FTA. How evident are such concerns in Canada? Has the implementation of the Canada-Colombia FTA given Canadian firms a “leg up” in competing with their U.S. counterparts in that market?
4. Should Canada actively try to join the TPP negotiations? Would joining the TPP advance the objective, promoted by successive Canadian governments, of expanding Canada’s role in the Asia-Pacific region? Is Canada prepared to address liberalization of its dairy supply management programs?

Participation in the G-20⁶⁷

Issue Definition

The Group of 20, or G-20, is a group of 19 major advanced and emerging-market countries (Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom, and the United States) plus the European Union (EU). The G-20 is considered the premier forum for leaders, finance ministers, and central bank governors to gather to discuss and coordinate economic policies. Canada is generally supportive of multilateralism; it has even been stated that one Canadian politician remarked that Canadians “have a lasting and visceral commitment to multilateralism which is ingrained and endemic to the Canadian character.” In this vein, the Canadian government is extensively involved in the G-20 process. It hosted a G-20 summit (meeting of G-20 countries at the leader level) in Toronto in June 2010.

Some believe that the G-20 is facing an identity crisis. After rising to prominence during the global financial crisis of 2008-2009, it has been argued that the G-20 has failed to deliver on or reach concrete agreements in recent meetings. In the fall of 2011, there will be various meetings among G-20 finance and labor ministers in the lead-up to the annual G-20 summit in Cannes, France, on November 3-4, 2011. The French government’s original aim for the summit was reform of the international monetary system. Analysts believe that the G-20’s focus will turn to the continuing crisis in the Eurozone and the possibility of a double dip recession in the United States.

Background and Analysis

The G-7/G-8, the G-20, and the Financial Crisis

Since the mid-1970s, leaders from the Group of 7, or G-7 (Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States), a small group of advanced economies, have gathered annually to discuss and coordinate financial and economic policies. Over time, the G-7 focus on macroeconomic policy coordination expanded to include a variety of global and transnational issues, such as the environment, crime, drugs, AIDS, and terrorism. In the late 1990s, Russia was included in the G-7 discussions on non-economic issues, creating the G-8.

The G-20 was formed in the late 1990s, after the Asian financial crisis in 1997-1998 illustrated economic interdependence between developed and emerging-market countries, and that emerging markets were too important to exclude from international economic discussions. The G-20 remained a less prominent forum than the G-7 until the onset of the financial crisis in fall 2008, when the G-7 leaders decided to meet as the G-20 leaders to discuss and coordinate policy responses to the crisis. In September 2009, the G-20 leaders announced that the G-20 would henceforth be the premier forum for international economic coordination, supplanting the G-8’s role as such.

⁶⁷ Prepared by Rebecca M. Nelson, Analyst in International Trade and Finance, and James K. Jackson, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

Since the global financial crisis, a central focus of the G-20's work has been on financial regulatory reform. The G-20 leaders have pledged to expand the transparency of complex financial instruments, strengthen and harmonize capital standards, reassess banker compensation, regulate all systemically important financial institutions, regulate credit rating agencies, and combat illicit financial activities, among other commitments. The G-20 leaders have made commitments on a variety of issue areas, including fiscal and monetary policy coordination; increasing the resources of the International Monetary Fund (IMF); creating a framework to monitor and coordinate economic policies to address global imbalances; and reform of international financial institutions to reflect the growing importance of emerging markets in the global economy, among other areas.

Analyzing the G-20's Success

Some argue that the role of the G-20 as an effective steering body of the international economy may be diminishing. At the height of the crisis, the G-20 coordinated sizeable fiscal stimulus across countries, laid out plans for financial regulatory reform, and coordinated a tripling of IMF resources. As the financial crisis has faded, the G-20 has failed to reach this same level of coordination. For example, there is concern that momentum behind financial regulatory reform is fading, G-20 pledges to conclude the World Trade Organization (WTO) Doha Development Round of multilateral trade negotiations have failed to materialize, and progress on the new framework for coordinating economic policies across countries (the Framework for Strong, Sustainable Growth) is slow and to date has not helped correct the global imbalances that many believe contributed to the onset of the global financial crisis. Other initiatives that G-20 members have attempted to push forward have not resulted in consensus. For example, the Canadian government tried, unsuccessfully, to push for a G-20 agreement on a bank tax in the June 2010 summit in Toronto.

Others argue that the G-20 serves as an important institution in the international economy. They argue that the G-20 is a critical forum for discussing major policy initiatives across major countries and encouraging greater cooperation, even if agreement on policies is not always reached. They also argue that it serves as a useful institution for setting the agenda at other international organizations, such as the Financial Stability Board (FSB) and the IMF. They also argue that having the G-20 policy-making infrastructure in place is important for timely international responses to future crises.

Status of the Issues

France holds the rotating chair of the G-20 in 2011. As part of these duties, France is hosting the annual leader summit and various meetings among finance ministers and other lower level officials. French President Nicolas Sarkozy had indicated early in France's leadership position in the G-20 that the November 2011 summit would focus on reform of the international monetary system. This is a broad topic that could encompass a number of issues, such as exchange rate volatility, global imbalances, reserve currencies, and foreign exchange reserves. France's website for the Cannes summit also states that the summit will focus on strengthening financial regulation, combating commodity price volatility, supporting employment, fighting corruption, and promoting development.

However, recent events could play a large role in shaping the G-20 agenda for November 2011. There are continuing concerns about the global economy due to weak economic performance in the United States and the continuing debt crisis in the Eurozone. Some analysts blame the weak

state of the global economy on the “vacuum of leadership” at the global level, and they believe that the G-20 needs to step up and play a stronger leadership role on the difficult economic issues facing many advanced economies. Additionally, there is speculation that the G-20 could also focus on taxes on international financial transactions, an initiative put forward by some Eurozone leaders in response to the Eurozone debt crisis.

Questions

1. Weak economic performance in the United States and the ongoing debt crisis in Europe have increased uncertainty about the global economic recovery. How could or should the G-20 help respond to these ongoing challenges?
2. In 1999, the Canadian House of Commons passed a resolution directing the government to enact a tax on financial transactions in concert with the international community. What are the Canadian government’s current views on an international transactions tax, as recently proposed by some European leaders?
3. How does the Canadian government view the current effectiveness of the G-20? Are there reforms to the G-20 that Canadians support to increase the G-20’s effectiveness?
4. What are the major policy objectives of the Canadian government in the G-20 process? As the crisis fades and the G-20 broadens its scope to issues such as climate change, what should the focus of the G-20 be going forward?
5. Like the United States, Canada is a member of both the G-7/G-8 and the G-20. How should the G-7/G-8 process tie in with the G-20 process? Do recent consultations among G-7/G-8 finance ministers about the Eurozone debt crisis suggest that the G-7/G-8 still has an important role to play in the international economy?

North American Cooperation on Competitiveness and Security⁶⁸

Issue Definition

How can the United States improve cooperation with its North American neighbors on issues related to trade, transportation, and security? How are the United States, Canada, and Mexico currently cooperating on improving competitiveness, promoting economic growth, and enhancing security in North America? Should the three countries continue cooperating trilaterally or would separate, bilateral cooperation efforts with Canada and Mexico be more effective due to the different issues facing each country?

⁶⁸ Prepared by Angeles Villarreal, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

Background and Analysis

The United States, Canada, and Mexico have made efforts since 2005 to increase cooperation on security and economic issues through trilateral summit meetings and through the former initiative under President George W. Bush called the Security and Prosperity Partnership of North America (SPP). The most recent trilateral summit took place at the North American Leaders' Summit in August 2009 in Guadalajara, Mexico. President Barack Obama, Canadian Prime Minister Stephen Harper, and Mexican President Felipe Calderón met to discuss issues related to prosperity and security in North America. The three leaders renewed their commitment to regulatory cooperation by instructing ministers in the three countries to build upon previous efforts, develop focused priorities, and form a specific time line. The three countries confirmed their commitment at an October 2009 meeting of the Free Trade Commission (FTC).

The first North American Leaders' Summit took place on March 23, 2005, in Waco, TX; this was followed by several trilateral summits in Mexico, Canada, and the United States. The March 2005 summit resulted in the announcement of the trilateral SPP initiative. The main goal was to increase and enhance prosperity in the United States, Canada, and Mexico through regulatory cooperation. The SPP was endorsed by all three countries, but it was not a signed agreement or treaty and, therefore, contained no legally binding commitments or obligations. At best, it could have been characterized as an endeavor to facilitate communication and cooperation across several key policy areas of mutual interest. Although the SPP built upon the existing trade and economic relationship of the three countries, it was not a trade integration agreement as many critics claimed, and distinct from the existing North American Free Trade Agreement (NAFTA).

Efforts to increase North American regulatory cooperation generally have followed the recommendations of special working groups created under the SPP. Some recommendations have included (1) increasing the competitiveness of North American businesses and economies through more compatible regulations; (2) making borders smarter and more secure by coordinating long-term infrastructure plans, enhancing services, and reducing bottlenecks and congestion at major border crossings; (3) strengthening energy security and protecting the environment by developing a framework for harmonization of energy efficiency standards and sharing technical information; (4) improving access to safe food and health and consumer products by increasing cooperation and information sharing on the safety of food and products; and (5) improving the North American response to emergencies by updating bilateral agreements to enable government authorities from the three countries to help each other more quickly and efficiently during times of crisis.

On economic issues, North American cooperation efforts have focused on increasing information sharing, harmonization of standards, productivity improvement, reductions in the costs of trade, and enhancement of the quality of life. The three countries have also addressed the need to enhance North American competitiveness through compatible regulations and standards that would help them protect health, safety and the environment, as well as to facilitate trade in goods and services across borders.

On security issues, efforts have focused on cooperative activities undertaken by each country on protecting citizens from terrorist threats and transnational crime, while promoting the safe and efficient movement of legitimate people and goods. Some of the work in this area has been organized along three broad themes: (1) external threats to North America; (2) streamlined and secured shared borders; and (3) prevention and response within North America. The three countries also have cooperated on policies that facilitate the efficient entry of legitimate cargo

while simultaneously ensuring that a sufficient level of security and scrutiny is applied to deny the entry of illegitimate cargo.

Some critics of North American cooperation efforts contend that it has been an attempt to create a common market or economic union in North America. Others have contended that past efforts under the SPP were contributing to the creation of a so-called “NAFTA Superhighway” that would link the United States, Canada, and Mexico with a “super-corridor.” Proponents of North American competitiveness and security cooperation view the initiatives as constructive to addressing issues of mutual interest and benefit for all three countries. Business groups generally support increased North American cooperation and believe that it is necessary to enhance the competitiveness of U.S. businesses in the global market.

Although the SPP has not continued under the Obama Administration, the United States continues to cooperate with Canada and Mexico on security and prosperity. Since the last trilateral summit that was held in Mexico in August 2009, President Obama has met separately with Prime Minister Stephen Harper and Mexican President Felipe Calderón on various occasions. These meetings have included discussions on increasing security as well as economic competitiveness, job creation, and prosperity.

Status of the Issue

The United States, Canada, and Mexico have made progress in recent years in addressing issues related to North American competitiveness and security. The Obama Administration has affirmed its commitment to continue past efforts on North American cooperation but under a different approach from the SPP framework. The 2009 North American Leaders Summit and the former SPP have served as mechanisms to increase communications among North American trading partners on issues of mutual interest, but because there are no binding agreements, their role in improving prosperity and security has been limited.

Questions

1. How effective has North American cooperation been in improving competitiveness through its focus on intellectual property rights protection and regulatory harmonization? What other steps can be taken by the three countries to improve competitiveness of U.S. businesses?
2. How effective has North American cooperation been in improving safety, security, and the flow of goods and services among NAFTA partners? What other steps could be taken in these areas?

Canada’s Financial System

Issue Definition

Canadian banks on the whole weathered the 2008-2009 financial crisis better than banks in the United States and Europe. Nevertheless, Canada’s financial system was buffeted by the financial crisis as equity and housing prices fell and as economic growth slowed as a result of the downturn in global trade. Are there lessons to be learned from Canada’s banking system, which has proven

to be somewhat more immune to the financial troubles that have brought down better known banks?

Background and Analysis

Canada's financial system proved to be more resistant to the failures and bailouts that marked systems in the United States and Europe. No Canadian financial institution failed or required public capital injections. Nevertheless, the financial crisis and global economic recession battered the Canadian economy in ways that are similar to those in the United States and in Europe. According to the International Monetary Fund (IMF), the Canadian economy contracted by -2.5% in 2009, before rebounding to a positive growth rate of 3.0% in 2010. Forecasts for 2011, however, indicate that Canada's economy will grow at an annual rate of 2.3%. The vast economic and financial linkages between Canada and the United States means that Canada is feeling the impact of the slowing U.S. economy.

Much of Canada's economic recovery is attributed to low interest rates and a \$33 billion fiscal stimulus package—one of the largest among advanced economies—over two years in infrastructure spending, tax decreases, worker retraining, housing, and aid to struggling industries. In addition, the federal government pumped additional liquidity into the economy by purchasing insured mortgages. In April 2009, the Bank of Canada lowered the nation's key interest rate to 0.25%. A drop in commodity prices caused the Canadian dollar to fall relative to the U.S. dollar, which improved the cost competitive position of Canada's exports. In relative terms, Canada's fiscal outlook is among the best in the G-20.

According to the Bank of Canada, major risks to Canada's economic recovery are (1) global sovereign debt issues associated with some European countries that potentially could raise borrowing costs for Canadian banks; (2) the risk that global financial imbalances arising from large current account (exports and imports of goods, services, and income) imbalances could be disorderly and create sharp adjustments to exchange rates and other financial asset prices; (3) a protracted recovery in other major economies will be a drag on economic growth; (4) low interest rates could encourage excessive risk taking; (5) high levels of indebtedness among Canadian households leave them vulnerable to economic and financial shocks. Although Canadian banks are not highly exposed to public or private entities in Greece, Italy, Spain, or Portugal, Canadian banks are exposed to banks in Europe and the United States that are themselves highly exposed to the four countries. This high level of financial linkages could amplify shocks throughout the global financial system.

The IMF has concluded that Canada's financial system is highly mature, sophisticated, and well-managed. In addition, the system is characterized by strong prudential regulation and supervision, stringent capital requirements, low risk tolerance, a well-designed system of deposit insurance and arrangements for crisis management and resolution of failed banks, a well-regulated and conservative mortgage market, and comprehensive mortgage insurance coverage. Supervisory responsibility for the financial sector in Canada is divided among the federal government, the provincial governments, and among a group of agencies within the federal government. The federal government is responsible for supervising all banks, federally incorporated insurance companies, trust and loan companies, cooperative credit associations, and federal pension plans. Provincial governments are responsible for supervising securities dealers, mutual fund and investment advisors, credit unions, and provincially incorporated trust, loan, and insurance companies. As a result, there are 13 regulatory authorities, each administering a separate set of securities laws and regulations.

Within the federal government, the Financial Institutions Supervisory Committee (FISC) acts as the chief coordinating body that sets regulatory policy and supervises financial institutions. The Committee is comprised of the Department of Finance of the Ministry of Finance and four independent government agencies: the Office of the Superintendent of Financial Institutions (OSFI); the Bank of Canada; the Canada Deposit Insurance Corporation; and the Financial Consumer Agency of Canada (FCAC). All of these agencies report to the Minister of Finance, who is responsible to the Canadian Parliament. The Bank of Canada is responsible primarily for conducting monetary policy by setting interest rate targets and adjusting the supply of credit. The bank also serves as the key component in the payments system by providing a check clearing function, and it serves as the traditional lender of last resort. The Office of the Superintendent of Financial Institutions plays a key role in Canada's financial supervisory scheme by supervising all domestic banks, branches of foreign banks operating in Canada, trust and loan companies, cooperative credit companies, life insurance companies, and property and casualty insurance companies.

The financial system is dominated by five large banking groups (Royal Bank of Canada, TD Canada Trust, Bank of Nova Scotia, Bank of Montreal, and Canadian Imperial Bank) that account for about 60% of total assets. In comparison, foreign banks account for about 4% of assets. The low representation by foreign banks is attributed to the "widely-held" rule for large banks that limits the concentration of bank share ownership and, therefore, reduces the scope for mergers and for foreign entry through acquisition. Canada's financial legal framework has allowed Canadian banks to concentrate on their low-risk, profitable domestic retail banking activities (services provided to individuals including: deposits, savings accounts, mortgages, credit cards, etc.), leaving large domestic borrowers to conduct their wholesale banking activities (services provided to corporations, governments, and other entities) abroad. Canada's insurance sector is dominated by three large domestic groups, which account for over 80% of the assets in this sector. The securities sector is marked by large Canadian, as well as U.S. and UK securities firms.

Unlike the United States and some European countries, subprime mortgages account for less than 5% of Canadian mortgages, which sharply limited Canada's direct exposure to the meltdown that occurred in the subprime mortgage market. In addition, Canadian law requires that all bank-held mortgages above a loan-to-value ratio above 80% be insured, which has curtailed the securitization of mortgages by banks in Canada. In addition, prepayment penalties and the lack of interest deductibility reduces the demand for long-term mortgages, so the maturity of most mortgages does not exceed 5 to 10 years.

Canada's financial supervisory system and regulatory structure have proven to be less susceptible to the bank failures that have loomed in the United States and Europe. Nevertheless, Canada's approach has a number of drawbacks. Canada's system of regulating securities markets at the provincial level means that regulations regarding market participants and investor protection differ by province and that the nature, structure, and powers of the provincial regulators also vary. In addition, the conservative, risk-averse approach employed by Canada's banks shielded the banks from some of the current financial turmoil, the approach also reduces efficiency in the market and reduces competition. Acquisitions of Canadian banks is significantly impeded by the rule that bank stocks be widely held and mergers are effectively prohibited. With reduced competitiveness pressures, Canadian banks maintain low-risk balance sheets at the expense of greater innovation and more efficient capital allocation. This approach also means that financing for small firms and venture capital for potentially high-growth companies is sharply reduced.

Questions

1. There is much to admire about the Canadian banking system, but do the differences in the size and the scope of the U.S. and Canadian financial markets reduce the importance of the Canadian system as a model for the United States to follow?
2. Are there aspects of Canada's federal supervision of its banking system that could serve as a model for bank supervision by the United States?
3. Canada's approach to financial supervision concentrates the majority of that responsibility in an authority that is separate from the central bank. Is this an approach that the United States should consider as it evaluates the effects of changes it has made to its own regulatory structure?

Buy American Provisions⁶⁹

Issue Definition

The Buy American provision of the economic stimulus package, officially known as the American Recovery and Reinvestment Act (P.L. 111-5), requires that iron, steel, and manufactured goods used in the construction of public works projects funded by the act be made in the United States. This provision was widely criticized by U.S. trading partners, including Canada, based on the fear that the act, if not outright inconsistent with U.S. international trade obligations, would set a precedent that could provide the excuse for a cycle of "creeping protectionism" by other nations. However, some analysts note that the relationship between government procurement and the world trading system has always been tenuous, and that disciplines on government procurement have not been as rigorous as those on other trade practices.

Background and Analysis

The Buy American provision of the ARRA states that no funds may be appropriated for building projects or public works projects unless all the iron, steel, and manufactured goods are made in the United States. The act provides three discrete exceptions for cases in which a federal agency administrator finds that (1) applying this policy would not be in the public interest, (2) the iron, steel or manufactured products are not produced in sufficient quantities or of a satisfactory quantity in the United States, or (3) the inclusion of the applicable U.S. products would increase the cost of the overall project by more than 25%. In the case of (1), the public interest waiver has been used to invoke the authority granted to the President to waive discriminatory purchasing requirements for signatories of the WTO Agreement on Government Procurement (AGP) contained in the Trade Agreement Act of 1979 (§301, P.L. 96-39). In the case of (3), this cost differential is at variance with the general differential of 6% applicable to most federal contracts, 12% in cases of small business or minority set-asides, or 50% for most Department of Defense procurements. If any of these provisions are waived, the agency head must publish a justification

⁶⁹ This section was written by Ian F. Fergusson, Specialist in International Trade and Finance; Foreign Affairs, Defense, and Trade Division.

for the waiver in the *Federal Register*. Finally, the Senate added language to insure that the provisions are applied in a manner consistent with U.S. trade obligations.

The United States and Canada both are signatories to the World Trade Organization's Agreement on Government Procurement (AGP), which came into effect in 1996. Unlike most of the Uruguay Round agreements which make up the WTO system, the AGP is plurilateral in that it only binds those nations that have accepted it. Currently, there are 39 signatories to the agreement, predominantly developed and middle-income countries.

The AGP commits signatories to practice the principles of national treatment and most-favored-nation treatment in the laws, regulations, practices, and procedures concerning government procurement. In this context, national treatment means that a signatory will provide no less favorable treatment to another party's products, goods, and suppliers than its own in its government procurement process, nor will the signatory discriminate between the products, services and suppliers of other parties under most-favored-nation principles. The agreement also provides procedures to insure transparency, including detailed operating rules on the procurement process of the signatory, a challenge procedure by which a rejected bid can be independently and impartially reviewed, and recourse to WTO dispute settlement provisions in cases where the parties cannot resolve their differences.

The AGP only applies to the sectors and the procurement agencies that each government includes in its schedule of national commitments. Each member's schedule lists the national and sub-national agencies as well as other entities that participate, exceptions within those units, and the threshold value for procurement tendered under its obligations. Both the United States and Canada have undertaken extensive obligations to open their government procurements at the national level under both agreements. Thus Canadian firms may bid on ARRA-related federal procurement under the provisions of the AGP. Thirty-seven U.S. states as well as other government entities such as the Tennessee Valley Authority and the Port Authority of New York and New Jersey have made commitments under the AGP. Threshold values do apply for AGP contracts; projects valued under approximately \$7.8 million for construction projects are not covered under the AGP. While Canada has undertaken obligations for several of its crown corporations such as Canada Post and the St. Lawrence Seaway Authority, the 10 provincial governments and 3 territorial governments have not undertaken any obligations under the AGP.

Likely for this reason, the Office of Management and Budget (OMB) excluded Canada from the list of countries to which U.S. states participating in the AGP have international obligations under the AGP. This meant that for state and local projects funded by federal money from the stimulus bill, there was no obligation to treat Canadian firms in a manner consistent with U.S. obligations under the AGP. Thus, Canadian firms would be ineligible to bid on contracts for iron, steel, and manufactured products procured for public works projects undertaken by state and local governments using federal stimulus money.

Each schedule also contains interpretations and exceptions. For example, federal funds distributed to the states for mass transit and highway projects are excluded. This reflects the Buy American provisions of the Surface Transportation Act of 1982 (P.L. 97-424) and the Urban Mass Transit Act of 1964 (P.L. 88-365). In addition, twelve states exclude the procurement of construction-grade steel, motor vehicles and coal from their obligations under the AGP and states have excluded other products and services as well. Canada has exempted certain of its procurement activities from coverage under the AGP such as shipbuilding and repair, and urban rail and urban transportation equipment, including specifically all project related materials of iron or steel.

Status of the Issue

Some Canadian industries were reportedly hard-hit by the Buy American provisions, especially those firms that comprise part of an integrated supply chain. In addition, there had been several anecdotal reports in the Canadian press that U.S. contractors and suppliers are increasingly choosing to source domestically in order not to be hassled with complying with Buy American provisions even in cases where procuring from Canadian firms would be consistent with ARRA. As a result, the United States and Canada started negotiations to resolve this dispute in August 2009. The resulting agreement, which became effective on February 16, 2010, waives the Buy American provisions for Canadian firms bidding for ARRA contracts tendered from 7 federal programs in the 37 states that participate in the AGP until September 30, 2011. This agreement will only affect procurement tenders yet to be awarded; this action will not reopen existing contracts. As a result of the agreement, Canada's provinces and territories became signatories to the AGP by notice to the WTO on March 19, 2010, opening procurement opportunities to U.S. firms. The agreement also commits the parties to begin negotiations reciprocally to expand commitments for market access in procurement between the two countries. The ability of Canadian firms to benefit from the immediate terms of the agreement may depend on the value of the stimulus projects that have yet to be awarded.

Questions

1. Did the initial exclusion of Canadian firms from bidding on certain state stimulus projects funded by the U.S. government impact firms in your riding? Did such firms pressure the government in negotiating the resulting agreement? On balance, do you think that more open bilateral procurement would help or hinder firms in your district?
2. Is free trade in government procurement resulting from economic stimulus measures realistic? Should taxpayers have the expectation that money spent on economic stimulus measures be used to bolster the domestic economy? Are there any Buy Canadian provisions in stimulus program spending?
3. Given the reluctance of Canadian provinces to sign on to the AGP in the past, what role did the initial exclusion of Canadian firms from certain stimulus funding play in changing the game? Did the provinces have other reasons for reexamining their participation in the AGP?

U.S. Imports of Canadian Softwood Lumber⁷⁰

Issue Definition

The U.S. lumber industry has long argued that imports of subsidized Canadian lumber were injuring U.S. producers. In May 2002, after the U.S. lumber industry filed antidumping and countervailing petitions to restrict imports, agency determinations of Canadian subsidies, dumping, and injury to the U.S. industry led to a duty of 27% (later reduced) on most Canadian

⁷⁰ Prepared by Ross W. Gorte, Specialist in Natural Resources Policy, Resources, Science, and Industry Division, and Jeanne J. Grimmett, Legislative Attorney, American Law Division.

softwood lumber imported into the United States. Canada challenged these findings under NAFTA and before the WTO. Negotiations led to a seven-year Softwood Lumber Agreement in 2006 with Canadian export charges depending on U.S. lumber prices, and the United States revoked the countervailing and antidumping orders. On February 26, 2009, a tribunal found that four Canadian provinces had violated the Agreement in calculating 2007 quotas; the United States rejected the Canadian offer of compensation, and on April 15, 2009, the United States began collecting 10% *ad valorem* duties from the four provinces to compensate for the 2007 breach.

Background and Analysis

U.S. lumber producers have long expressed concerns about imports of subsidized Canadian lumber. The current lumber agreement is termed Lumber IV, because it is the result of the fourth dispute since 1981, with various findings of subsidy levels and agreements in the previous disputes.

Tension between the United States and Canada over softwood lumber trade may be inevitable. Both countries have extensive forest resources, but vastly different population levels and development pressures; vast stretches of Canada are still largely undeveloped, while less area in the United States (outside Alaska) remains relatively pristine. These differences have led to divergent forest policies. In Canada, 90% of the forests are owned by the provincial governments, which have allocated and priced timber to encourage development of the extensive timber reserves and settlement of unpopulated areas. In the United States, 58% of timberlands are privately owned, and private markets dominate the allocation and pricing of timber. U.S. federal and other government-owned forests are regionally important, but the timber is typically sold in a competitive market.

U.S. lumber producers assert that subsidies have given Canadian producers an unfair advantage in the U.S. market. Canadian provincial stumpage fees (for the right to harvest trees) are asserted to be subsidized, leading to lumber prices that are less than their fair market value. The provinces generally use leases and administered fees to allocate and price timber. Administered fees are unlikely to match market values, but determining whether the fees are below market values has been controversial, because of differences in tree species, sizes, and grades; in measurement systems; in requirements on harvesters; in environmental protection; and in other factors.

Log export restrictions in British Columbia are also alleged to be subsidies, because they assure more supply (less competition for timber and thus lower costs) for Canadian producers. Evidence from the U.S. Pacific Northwest, where private logs can be exported but public timber cannot, indicates substantially higher prices for exported logs.

Injuries to U.S. lumber producers are difficult to establish decisively, although the U.S. International Trade Commission (ITC) has found injury every time it has examined the issue. Canada's share of the U.S. lumber market has risen substantially, from less than 7% in the early 1950s to more than 33% since the mid-1990s. Under the 1996 agreement, the quantity of imports continued to rise, but the market share was relatively stable. The impact of restrictions on U.S. lumber prices is not easily estimated, but restrictions have probably put upward pressure on prices.

Status of the Issue

In 2001, after the 1996 U.S.-Canada softwood lumber agreement expired, the U.S. Coalition for Fair Lumber Imports filed countervailing duty and antidumping petitions, asking the DOC to investigate Canadian imports again. The Department of Commerce issued final determinations of subsidies on March 22, 2002. On May 3, 2002, the ITC determined that the U.S. lumber industry was threatened with material injury by Canadian imports. A duty averaging 27% was imposed on May 22, 2002.

Canada challenged each of the agency determinations under the North American Free Trade Agreement (NAFTA) and in the World Trade Organization (WTO). The NAFTA panels largely supported the Canadian positions. The WTO proceedings resulted in mixed decisions. Canada was also concerned that the US\$5 billion in estimated duties on softwood lumber collected by the United States would eventually be distributed to U.S. lumber producers under the Continued Dumping and Subsidy Offset Act (Byrd Amendment). Canada obtained a U.S. court decision, however, holding that the Byrd Amendment did not apply to Canadian lumber imports.

On April 26, 2006, a tentative seven-year Softwood Lumber Agreement, with an optional two-year renewal, was announced to resolve the dispute. The United States revoked the countervailing and antidumping duty orders and returned about US\$4 billion to the importers of record. The remaining deposits (about US\$1 billion) were split evenly between the members of the Coalition for Fair Lumber Imports and jointly agreed-upon initiatives. Canada is collecting export charges ranging up to 15%, depending on a weighted average lumber price, or up to 5% with volume restraints. A surge mechanism would raise export charges if a Canadian region's exports exceed its allocated share. Lumber from logs harvested in the Atlantic Provinces, Yukon, Northwest Territories, or Nunavut is exempt from the export charges. Disputes are to be resolved through bilateral consultations, non-binding mediation, or binding arbitration in the London Court of International Arbitration (now LCIA).

U.S. interest groups have questioned whether Canada is faithfully implementing the agreement. The 2008 farm bill (P.L. 110-246) included a provision (§3301) establishing a softwood lumber importer declaration program to verify and reconcile data on softwood lumber imports. In August 2007, U.S. officials requested a ruling from the London Court of International Arbitration (LCIA) on export quota volumes and export tax levels. In March 2008, the Court ruled that Canada had violated the export quota volumes for Manitoba, Ontario, Québec, and Saskatchewan for the first six months of 2007, but was not required to collect taxes related to export surges from Alberta and British Columbia during that period. To comply with the above ruling, an LCIA tribunal issued a decision that Canada must collect an additional 10% *ad valorem* export charges from the four provinces until C\$68.26 million (US\$54.8 million) had been collected on February 26, 2009. The U.S. Trade Representative rejected the Canadian offer of a compensation payment of US\$36.66 million, and on April 15, 2009, began collecting 10% duties on lumber from the four provinces.

U.S. lumber producers and some Members of Congress, including Senators Max Baucus and Olympia Snowe, have urged the Administration to seek consultations under the SLA over certain timber pricing practices in British Columbia. They claim that the BC government has been classifying an increasing amount of its cut as salvage Grade 4 lumber and charging less for it than better grades, resulting in a subsidy for Canadian timber processors. Canada attributes this increase to an infestation of mountain pine beetles, but U.S. producers dispute this, claiming that BC has changed its grading procedures and producers are heating lumber prior to grading,

resulting in greater cracks and defects. In October 2010, the USTR announced consultations with Canadian officials, but the unsuccessful negotiations led the USTR to file a request for arbitration in the London Court of International Trade on January 18, 2011. The case is pending.⁷¹

Questions

1. The current dispute over U.S. imports of Canadian lumber has persisted for nearly 30 years. Do Canadian producers have a significant cost advantage because of Canadian timber practices and/or subsidies? Should Canadian practices be modified to enhance competition for timber? Do the systems and situations vary sufficiently to warrant different responses to each Canadian province? What might be the environmental consequences of various possible changes?
2. The 2006 agreement terminated the duties, returned most of the money collected, and established price-dependent export charges on Canadian lumber. What changes are needed by 2013 to assure that the recent duties, challenges, and litigation are not repeated when the agreement expires? What happens if some of the provinces make appropriate changes and others do not?
3. Are the current oversight mechanisms sufficient to assure implementation of the agreement that is acceptable to all parties? Are there ways to provide adequate and timely data to identify possible violations (deliberate or unintentional) and thus the delay and cost of arbitration and subsequent remedies? What approaches are feasible to compensate communities and workers for injury from weak lumber markets without providing subsidies to the lumber industry? What unilateral U.S. enforcement measures might be acceptable to Canada under the agreement?

Country of Origin Labeling⁷²

Issue Definition

Mandatory country-of-origin labeling (COOL) in the United States for specified agricultural products took effect on March 16, 2009. This was the culmination of a near decade-long legislative effort to arrive at an accommodation that addresses the concerns of competing interests. U.S. food retailers are now required to label the country of origin for fresh produce (fruits and vegetables), meats, nuts, and seafood, among other products. Canada and Mexico are major suppliers of live cattle and hogs that are fed in U.S. facilities and/or processed into beef and pork in U.S. meat packing plants. As the U.S. meat processing sector geared up to implement COOL, U.S. imports of Canadian and Mexican cattle and of Canadian hogs noticeably declined. Both countries expressed concern that this development adversely affected their livestock sectors. Not satisfied with the outcome of consultations held with U.S. officials on their concerns, Canada and Mexico pressed their case using the World Trade Organization (WTO) dispute resolution process. Press accounts report the WTO dispute panel handling this case has accepted both countries' arguments that COOL violates international trading rules.

⁷¹ "U.S. Holding Off on Softwood Lumber Complaint, to Meet with Canada September 1," *Inside U.S. Trade*, August 27, 2010.

⁷² Prepared by Remy Jurenas, Specialist in Agricultural Policy, Resources, Science and Industry Division.

Background and Analysis

Under the Tariff Act of 1930, as amended, most unprocessed agricultural commodities had long been exempt from requirements that every import be clearly marked to indicate country of origin for the “ultimate purchaser.” However, provisions in the 2002 farm bill (Section 10816 of P.L. 107-171) require that retailers covered by the Perishable Agricultural Commodities Act (i.e., those which deal in at least \$230,000 per year in produce—fresh and frozen fruits and vegetables) begin to provide such information. Other covered commodities specified in the 2002 farm bill were: ground and muscle cuts of beef, lamb and pork; seafood; and peanuts. Labeling is not required if these commodities are ingredients in processed foods, or if they are sold in dining-out settings.

Passage of the initial COOL provisions in 2002 did not end debate over the value and efficacy of mandatory COOL, particularly with regard to meats. COOL opponents argued that record-keeping and verification costs will far exceed any perceived economic benefits to producers; that smaller-sized farms and firms will have the most difficulty with compliance; that little evidence exists showing consumers actually want labeling; and that COOL is a protectionist policy that undermines free trade. Supporters countered that compliance would not be nearly as burdensome as some large industry groups and USDA have portrayed it; that studies show U.S. consumers, if offered a clear choice, will pay extra for fresh foods of domestic origin, thereby strengthening demand and prices for them; and that consumers have a right to know where their foods were produced. They pointed out that all but two of the North American cases of “mad cow” disease (*bovine spongiform encephalopathy*, or BSE) occurred in Canadian-born cattle, yet the United States is permitting the import of large quantities of Canadian beef and cattle. (COOL opponents argue that country of origin labeling is a matter of marketing, not food safety, and that food safety concerns are best addressed through science-based regulation.)

Initially scheduled to take effect on September 30, 2004, Congress postponed COOL implementation until September 30, 2008, for all but seafood, because of ongoing debate. Some issues were addressed in talks held among key players during consideration of the 2008 farm bill, and incorporated into Section 11002 of the final law (Food, Conservation, and Energy Act of 2008, P.L. 110-246). These provisions retained the implementation schedule, and added other commodities (chicken, goat meat, ginseng, pecans, and macadamia nuts) to its coverage. However, several new types of label categories were created that are intended to facilitate and simplify compliance in specifying the country or countries of red meat products. For all covered commodities, the amended law also seeks to ease recordkeeping and verification requirements, and to lower non-compliance penalties.

Status of the Issue

Following enactment of the amended COOL provisions, USDA moved quickly to issue rules to implement them. The August 2008 interim rule for meat labeling requirements generated the most controversy, in large part because of the steps that U.S. feeding operations and packing plants would have to adopt to segregate, hold, and slaughter foreign-origin livestock (e.g., Canada and Mexico) from U.S. livestock. With U.S. bilateral trade agreements with Canada and Mexico having led to free trade in livestock and resulted in a more integrated North American livestock sector, imports of live cattle and hogs from both countries became subject to mandatory COOL. On December 1, 2008, Canada filed a request for formal WTO consultations on COOL with the United States, expressing concern about changes in normal livestock trade flows in reaction to the

interim rule and questioning COOL's legality under international trade rules. Bilateral consultations were held twice, but failed to resolve differences. On October 7, 2009, Canada requested the establishment of a WTO dispute settlement panel to review its claims. On November 19, 2009, the WTO agreed to establish a panel to examine this and Mexico's nearly identical case on COOL. This panel met twice to hear each country's arguments, and is expected to release its final report in mid-November 2011.

Canada asserts that COOL is inconsistent with several WTO-related trade commitments, including those providing that imports must be treated no less favorably than products of domestic origin; that laws on marks of origin should not damage imports, reduce their value, or unreasonably increase their cost; and that laws, rules, and procedures on country of origin should not themselves create or disrupt international trade. Canadian officials stated that the COOL requirements are "so onerous" that Canadian exporters of cattle and hogs were discriminated against in the U.S. market. U.S. officials regretted that the consultations did not resolve Canada's concerns, and stated their belief that U.S. implementation of COOL provides consumers with information that is consistent with WTO commitments. They noted that countries had agreed that country of origin labeling was legitimate policy long before the WTO was created, and that other countries (including Canada) also require goods to be labeled with their origin.

The WTO panel's confidential interim report, according to various press articles, sides with Canada and Mexico, finding that COOL violates international rules governing technical barriers to trade. These press accounts reported the panel found that these U.S. labeling requirements discriminate against imports of livestock and create more obstacles to trade than are necessary to inform consumers as intended by the law. Once the report is made public, the United States likely will appeal its findings, which would keep this issue in play for several months to come. If the reported findings are upheld by the WTO appellate body, COOL opponents may use the opportunity to seek legislative changes as Congress considers the 2012 farm bill. Proponents in turn can be expected to vigorously defend a policy they worked for more than a decade to secure.

Questions

1. Reports in meat trade publications have suggested that the final COOL requirements have strained marketing relationships between Canadian and U.S. livestock producers and meat processors. How much has this tension altered trade between the United States and Canada, and, if so, in what way? What economic adjustments if any have occurred in Canada's beef and pork sectors in response to the decrease in Canadian cattle and hog exports to the United States? What other market developments have affected the beef and pork sectors in both markets?
2. In general, how has COOL affected the composition and economic viability of both the cattle/beef and hog/pork sectors in North America?
3. How does Canada's country of origin labeling program for agricultural commodities and food products compare to that implemented under the U.S. COOL program? Is it a voluntary or mandatory program?

The Canadian Steel Sector⁷³

Issue Definition

The impact of the global economic downturn and the financial crisis that erupted in the summer of 2008, along with the lingering effects and a slow recovery, have had substantial negative effects on most manufacturing industries, including the North American steel industry. An earlier slump in steel, which occurred in the 1990s, led to numerous bankruptcies and takeovers of many U.S. and Canadian steel makers. Almost all of the major steel makers in Canada are now foreign owned, so decisions to close or idle plants or reduce production in Canada (but not elsewhere), inevitably affect national economic and political interests.

Pittsburgh-based U.S. Steel moved to idle many of its Canadian operations in 2009 when steel orders fell precipitously. The Canadian government, the United Steel Workers, and local steel manufacturer(s) took legal actions against it under the Investment Canada Act. The Canadian government alleges that U.S. Steel is not abiding by commitments it made under the act when it acquired the Canadian steelmaker, Stelco, in 2007. Legal proceedings are still ongoing.

Background and Analysis

During the 1990s and the first decade of the 21st century, many U.S. and Canadian steel companies experienced a downturn that led to a major restructuring and reorganization of the North American steel industry. In 2009, the Canadian steel industry looks very different than it did in 2000. The major integrated steel producers, including Dofasco, Stelco, and Algoma Steel, are now owned by international companies. Dofasco was acquired by Luxemburg-based Arcelor in 2006. At about the same time, Arcelor agreed to merge with Mittal Steel of Rotterdam. Dofasco is now a subsidiary of ArcelorMittal, the world's largest steelmaker. In 2006, Mittal Steel acquired several Stelco subsidiaries and U.S. Steel purchased the remaining part of Stelco, which was renamed U.S. Steel Canada Inc. Algoma Steel was purchased by Essar Steel of India in 2007, and operates as Essar Steel Algoma Inc.

The Canadian minimill steel sector also went through a restructuring process. Minimills produce steel from scrap metal in electric arc furnaces (EAFs). In 2002, the Canadian firm, Co-Steel, merged with Ameristeel, the North American subsidiary of Gerdau S.A., of Brazil. Gerdau's North American operations were renamed Gerdau Ameristeel and are based in Tampa, FL. Gerdau Ameristeel is the second-largest minimill steel producer in North America after U.S.-based Nucor. In 2008, Russia's Evraz Inc. S.A. acquired another major Canadian minimill steel maker, IPSCO Canada.

The North American steel industry struggled from 1997 through 2002. In March 2002, President Bush imposed safeguards in response to surging imports of steel. One goal of safeguards was to effect a restructuring of the domestic steel industry. To a great extent, that restructuring has been achieved. There are now two dominant players among integrated steel mill companies in the United States and North America, and two clear market leaders among the minimill producers. Moreover, the leading North American and global producer, Mittal Steel, in 2006 acquired the

⁷³ Prepared by Rachel Tang, Analyst in Industrial Organization & Business; Resources, Science, and Industry Division.

global number-two producer, Arcelor. The recovery of pricing power in the domestic industry may be attributable to industry consolidation, as well as to rising global demand spurred, in large part, by China. Ironically, the establishment of industry pricing power, plus the rise of global demand and steel prices and the falling exchange rate of the dollar, have also made establishment of new production facilities in the United States an attractive proposition. After the removal of safeguards, steel prices generally moved upward through August 2008, when the benchmark price of hot-rolled steel reached nearly \$1,200 per metric ton (MT)—up from \$222 per MT in 2002.

Starting in September 2008, the global economic crisis caused steel production and prices to fall precipitously. Like many other industrialized countries, the impact of market downturn was felt by all the major steel consuming sectors in Canada—automotive, construction, manufacturing, appliance, and energy. Furthermore, given the overall difficult economic environment, the steel export market was also lackluster.

In 2009, the United States, Canadian steel's biggest export customer, suffered a major setback: U.S. crude steel production dropped more than 36% from the 2008 production level to 58 million metric tons, with steel mills running at a capacity utilization rate slightly over 50%. During the first half of 2009, the overall capacity utilization rate in U.S. steel mills lingered in the low to mid-40% range.

Canadian steel production also experienced a sharp drop in 2009, to approximately 9 million MT of crude steel, nearly 40% less than the 15 million MT produced in 2008. In 2009, steel-making capacity utilization rate in Canada was about 43%. Pittsburgh-based U.S. Steel moved to idle much of its Canadian operations in March 2009, largely because of low demand for steel. Affected U.S. Steel plants in Canada included the flat-rolled steel plant in Hamilton, Ontario, known as the Hamilton Works, and Lake Erie Works in Nanticoke, Ontario. Some of its U.S. operations were also affected by the crisis. U.S. Steel met strong resistance from the Canadian government and the local United Steelworkers union (USW), which raised questions about why more facilities in Canada were affected than in the U.S. On May 5, 2009, Canadian Minister of Industry Tony Clement sent a demand letter to U.S. Steel under Section 39 of the Investment Canada Act (ICA), asking the company to comply with its undertakings (its alleged contractual commitments):

When U.S. Steel acquired Stelco Inc. in 2007, it committed to a series of undertakings regarding, among others, capital expenditures, research and development and production," Mr. Clement said. "I am concerned by the actions of U.S. steel in cutting operations in Canada and by the impact this have on its workers. While I recognize that these are challenging economic times, we expect the company to live up to its commitments.

A demand letter is the first step in the enforcement process under the Investment Canada Act. If a company is found in violation of the act, it could be forced to sell its Canadian operations or pay fines of C\$10,000 per day. U.S. Steel had 10 days to respond to the letter, but noted that "since all of the communications between the Minister and U.S. Steel on this subject are required to be confidential under the Investment Canada Act, we cannot comment on the substance of those communications." (*American Metal Market*, "Canada taking USS to court over closings," July 20, 2009.)

In July 2009, after reviewing U.S. Steel's response, the Canadian government took U.S. Steel Corp. to the Federal Court of Canada, asking the Court to order appropriate measures to remedy the situation.

In 2010, the steel sector in the United States and Canada showed measurable recovery from the previous year, but production level and capacity utilization were still below those of the pre-recession year of 2007.

Status of the Issue

U.S. Steel moved to file a challenge to the Investment Canada Act (ICA) in November 2009, claiming that certain provisions of the law violate its constitutional rights. Among them is the stipulation that companies that fail to comply with promises made under the ICA must pay fines or must divest their assets, but are not given a chance to mount a proper defense. It also argued that the penalty of C\$10,000 a day was akin to criminal punishment. The Canadian government is seeking the dismissal of U.S. Steel's challenge and "is trying ... to force U.S. Steel to either operate its Canadian assets or sell them to a party that will operate them." (*American Metal Market*, "Canada fights USS legal challenge," December 15, 2009.)

On April 15, 2010, U.S. Steel Canada announced that USW local union 8782 had ratified a three-year labor contract for employees at U.S. Steel Canada's Lake Erie Works. The deal will allow U.S. Steel to restart production at the facility based on improving steel demand. Production at Hamilton Works had restarted earlier.

On April 28, 2010, U.S. Steel Canada announced that it has entered into an agreement to sell its bar mill and bloom and billet mill at its Hamilton Works to Max Aicher (North America) Inc., a wholly owned subsidiary of Max Aicher GmbH & Co. KG of Germany. Max Aicher had previously entered into talks to purchase the bar and bloom mills in 2007, prior to their purchase by U.S. Steel. Max Aicher (North America) Inc. officially took ownership of the bar and bloom mills in November 2010.

In June of 2010, Federal Court ruled in favor of the Canadian government, upholding a portion of the Investment Canada Act being challenged by U.S. Steel as unconstitutional. U.S. Steel, subsequently, appealed the decision. On July 26, 2010, a federal appeals judge in Canada ruled that the case by the Canadian government against U.S. Steel Corp. can proceed, allowing the battle for control of Canadian steelmaking operations to continue. This marks the first time in history that the Canadian government has sued a company for not living up to employment and production promises made earlier in exchange for federal approval of a foreign investment.

On November 7, 2010, about 900 workers were locked out of U.S. Steel Canada's plant in Hamilton, after talks over issues such as pensions had made little progress. No negotiations took place between U.S. Steel and USW Local 1005 since the November lockout. On June 8, 2011, The workers represented by the USW local union 1005 in Hamilton, Ontario, moved to block the Burlington Canal Lift Bridge leading into the city's port in an effort to prevent two vessels carrying steelmaking coke from leaving the area. But the effort didn't push U.S. Steel to the bargaining table. The locked-out USS workers later left port after a Canadian court issued injunctions against the union on June 10, 2011.

In early September of 2011, U.S. Steel reportedly called for a meeting with the union. The meeting has been arranged by a provincial mediator and is scheduled to take place on September 13, 2011. This is the first positive development since the lockout that has cost the local economy more than \$25 million in lost U.S. Steel wages alone, according to *The Hamilton Spectator*.

Questions:

1. To what extent can American investors be assured that economic and market conditions that affect their Canadian businesses will not be subject to legal action under the Investment Canada Act?
2. With the significant restructuring of the North American steel sector after 2002, the collapse of global steel markets in 2008 and 2009, and the slow if not stagnating recovery in 2010 and the early half of 2011, should the U.S., Canadian, and Mexican governments begin discussions on a common steel policy that will protect the North American market from import surges?
3. Do you believe that the Investment Canada Act is working appropriately? Does the perception that an act regulating foreign investment and business operations is a tool of industrial policy cause you any concern?

Intellectual Property Rights⁷⁴

Issue Definition

The United States contends that Canada's protection and enforcement of intellectual property rights (IPR) are inadequate and do not meet international standards. Protection and enforcement of IPR are important to bilateral relations because of the high levels of trade between the two countries. U.S. stakeholders have expressed concern about the levels of counterfeiting and piracy in Canada, as well as the transit of IPR-infringing products across Canada's borders. Areas of bilateral engagement on IPR include Canada's reform of its copyright regime and IPR enforcement system.

Background and Analysis

Canada and the United States have entered into a range of international commitments on IPR. Bilateral commitments on IPR exist in the North American Free Trade Agreement (NAFTA). As members of the World Trade Organization (WTO), both countries are signatories to the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), which sets minimum standards for IPR protection and enforcement. Both countries also have ratified the WIPO Copyright Treaty and WIPO Performance and Phonograms Treaty (the "WIPO Internet treaties"), which focus on IPR protection and enforcement in the digital environment. Canada ratified the WIPO Internet treaties in 1997, but remains one of few developed countries that has not brought its laws into compliance with the treaties. The United States implemented the WIPO Internet treaties in 1998 through the Digital Millennium Copyright Act (DCMA) (P.L. 105-304). In addition, Canada and the United States are among the nearly 40 countries that negotiated the Anti-Counterfeiting Trade Agreement (ACTA), a new international IPR agreement which would build on the TRIPS Agreement. ACTA negotiations were concluded in 2010. Following the legal verification of the ACTA text, negotiating parties, including Canada and the United States, are to

⁷⁴ Prepared by Shayerah Ilias, Analyst in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

submit the proposed agreement to their respective authorities to undertake relevant domestic processes for its approval.

One key area of U.S. concern is Canada's domestic copyright regime. The Canadian government periodically has attempted to overhaul its domestic copyright regime to bring its domestic law in line with international standards, including the WIPO Internet treaties. Some copyright-based industry and other groups assert that Canada does not sufficiently combat online piracy or the circumvention of technological measures that protect copyrighted works. Others, including consumers and Internet service providers (ISPs), call for greater exceptions to copyright for educational, research, and other purposes to promote the free flow of information and innovation. In June 2010, the Canadian government introduced the Copyright Modernization Act (Bill C-32) to amend the current copyright law, calling the new bill a "common sense balance between the interests of consumers and the rights of the creative community." The introduction of Bill C-32 was preceded by public consultations conducted by the Canadian government on the proposed reforms to Canada's copyright law. Among its provisions, Bill C-32 would have:

- incorporated the WIPO Internet treaties into domestic law;
- introduced provisions prohibiting the circumvention of technological protection measures ("digital locks");
- clarified the roles and responsibilities of ISPs for the copyright infringements of their subscribers;
- included a "notice and notice" provision (a copyright holder notifies the ISP that a subscriber has made available or accessed content without authorization, and the ISP passes on the notification to the subscriber, but takes no subsequent action to remove the content);
- permitted the copying of legally obtained content onto other devices provided it does not circumvent digital locks ("format shifting");
- provided expanded "fair dealing" exceptions—a concept similar to "fair use" in the United States—for education use, parody, and satire; and
- lowered statutory damages in cases of non-commercial infringement from \$500-\$20,000, as in current Canadian law, to \$100-\$5,000.

Bill C-32 failed to advance in the 40th Parliament, which ended in March 2011. The Canadian government may reintroduce the bill in the 41st Parliament, which began in June 2011. Previous copyright reform bills, introduced in June 2008 (Bill C-61) and June 2005 (Bill C-60), also failed to advance before prior dissolutions of Parliament.

Another key area of bilateral engagement is Canada's enforcement of IPR. Presently, the Canada Border Services Agency (CBSA) is not authorized to seize products at the border that are believed to be pirated or counterfeit without a court order, which requires detailed information. The United States contends that this lack of *ex-officio* authority limits the effectiveness of IPR enforcement in Canada. The United States also contends that the enforcement penalties imposed by Canada do not serve as sufficient deterrents for future IPR infringement.

Status of the Issue

In 2011, the Office of the U.S. Trade Representative (USTR) continued to place Canada on its Special 301 “Priority Watch List” (PWL), a designation of criticism for a country’s inadequate IPR protection and enforcement. The USTR cited ongoing issues with Canada’s copyright reform and IPR enforcement efforts at the border, among other IPR issues. In addition to Canada, the USTR designated 11 other countries on the PWL in 2011: China, Russia, Algeria, Argentina, Chile, India, Indonesia, Israel, Pakistan, Thailand, and Venezuela. The USTR first placed Canada on the PWL in 2008. Canada previously had been on the “Watch List,” the mildest category of criticism for a country’s IPR regime, since 1985. Some supporters of Canada’s IPR regime assert that the Special 301 process is overly industry-driven and that Canada’s piracy rates are significantly lower than those of other countries on the PWL. Some industry groups maintain that Canada’s placement on the PWL accurately reflects inadequacies in Canada’s IPR regime. The United States and Canada remained engaged on key bilateral IPR issues.

Questions

1. What issues have arisen in developing legislation to implement the WIPO Internet treaties? What is Canada’s vision of a fair and balanced copyright law? How could Canada’s implementation of the WIPO Internet treaties differ from the DCMA?
2. What measures is Canada currently taking to address trade and transshipment of pirated and counterfeit goods? What steps can Canada undertake to improve IPR border and domestic enforcement? What can the United States do to assist Canada in improving IPR enforcement?
3. How does Canada view the U.S. Special 301 process? How does the Special 301 process and Canada’s continued placement on the Priority Watch List affect bilateral relations? If passed, to what extent might the Copyright Modernization Act affect Canada’s placement on the Special 301 list?
4. What steps has Canada taken to promote international protection and enforcement of IPR? What are the opportunities and challenges that Canada sees in the proposed ACTA?

Electric Reliability, Trade, and Access to Renewable Power⁷⁵

Issue Definition

The electric power grids of the United States and Canada are physically connected. Consequently, electric power reliability problems can easily cross the international border. This was demonstrated by the 2003 power blackout, which originated in Ohio and eventually spread into eastern Canada and the northeastern United States. The United States and Canada are therefore mutually dependent for the reliable operation of their common electric power systems. The

⁷⁵ Prepared by Richard Campbell, Specialist in Energy Policy; Resources, Science, and Industry Division.

interconnected grid also creates opportunities for trade and joint expansion of the use of renewable power.

Background and Analysis

There are three components of electric power delivery: generation by power plants, transmission over long-distances by high voltage power lines, and final delivery at low voltage by distribution lines. The transmission lines that constitute the North American power grid cross state and international boundaries. The U.S. and Canadian grids are, in fact, inextricably linked:

- At the broadest level of organization, the North American grid is divided into regional “interconnections” within which power moves freely (the links between the regions are very limited). The large Eastern and Western Interconnections cover most of the contiguous United States and the heavily populated regions of Canada.
- At the level of major transmission lines, the Canadian grid has evolved by building south from heavily populated areas to connect with U.S. generation and load. Consequently, while the grid in the conterminous United States is a web crisscrossing the lower 48 states, the Canadian backbone system consists of north-south lines closely linked to the United States. More electricity actually moves north and south between the United States and Canada than east and west between Canadian provinces.
- In terms of system reliability, as discussed further below, the North American Electric Reliability Corporation (NERC) has responsibilities for the reliable operation of the power grid in both countries. Three of the eight regional reliability entities through which NERC performs much of its work extend from the United States into Canada and cover that nation’s entire southern tier.

Reliability

In reaction to the 2003 blackout, the Energy Policy Act of 2005 (P.L. 109-58) required the Federal Energy Regulatory Commission (FERC) to designate an Electric Reliability Organization (ERO) charged with ensuring the reliability of the bulk power system, largely by issuing mandatory reliability standards. In 2006 FERC selected NERC for this role (NERC is an industry organization whose reliability recommendations had been voluntary prior to its designation as the ERO). NERC’s members include Canadian power companies and it has memoranda of understanding (MOU) with Canadian provinces and the Canadian federal government to help coordinate reliability activities. However, NERC does not have the same statutory authority in Canada as in the United States. The MOU between the Canadian National Energy Board (NEB) and NERC recognized NERC as the ERO for the Canadian part of international transmission lines but not for lines located entirely within Canada’s borders (which are under provincial, not federal, regulation). NERC currently has agreements with most Canadian provinces that make, or will make in the future, NERC’s reliability standards mandatory and enforceable.

Transmission capacity and congestion issues that can impair reliability and increase power costs exist in the United States and Canada, and the solution is often to construct new transmission capacity or enhance existing facilities. Many transmission projects are under construction or planned in both nations. However, transmission planning and construction in the United States

and Canada face similar challenges, particularly for long-distance projects. These challenges include permitting and siting approvals that often involve multiple jurisdictions, and finding the funding for the large investments in transmission (and power generation) that will be needed to meet demand growth. Two international transmission projects of note include

- The planned Montana-Alberta Tie Line project, which would be the first transmission link between that state and province. This is a 214-mile, US\$213 million project that is expected to facilitate the export of wind power from both regions and improve transmission system reliability. The project is being partially financed by funding provided by the American Recovery and Reinvestment Act.
- A proposed high capacity transmission line to ship up to 1,200 megawatts of hydroelectric power from Québec to New England. Although this project has received preliminary approval from the U.S. Federal Energy Regulatory Commission, its future is uncertain because declining power prices in the United States (linked to low natural gas prices) may make the project uneconomical for the Canadian partner in the venture, the large utility Hydro-Québec.

Another Canadian project, the Northwest Transmission Line planned for northern British Columbia, may eventually connect southeastern Alaska to part of the Canadian power system.

Trade and Renewable Energy Development

The United States is a net importer of electricity from Canada, and the imports have recently been increasing, from 17.7 terawatt-hours (Twh) of net revenue purchases in 2006 to 32.2 Twh in 2008 and 33.2 Twh in 2009. From the U.S. perspective, while these imports can be locally important (e.g., in New York and New England), on a national basis they are very small, equivalent to 0.8% of total U.S. electric power generation (3,951 Twh) in 2009. Electricity trade is more significant from Canada's standpoint. Canada generated 575 Twh of electricity in 2009. Total revenue sales of power to the United States in 2009 of 51.1 Twh were therefore equivalent to 9% of domestic supply, and revenue purchases from the United States of 17.9 Twh were equivalent to 3% of domestic supply. Canada typically exports 6% to 10% of its total electricity generation to the United States.

The United States relies on coal for about half its electricity production, while Canada derives about 75% of its electricity from "clean energy" sources (i.e., hydropower, nuclear and wind energy). Electricity trade between the countries is likely to become intertwined with renewable energy development and transmission planning issues. Both nations currently have policies for the increased use of renewable power. The United States and Canada have established a "Clean Energy Dialogue" (CED) to facilitate the development of low carbon energy sources. Elements of the CED include, among other things, collaboration on expansion and modernization of the North American transmission grid to improve reliability and facilitate trade in low carbon power; advancement of smart grid technology; and development of electricity storage technology.

Canadian sources of renewable power may have the potential to reduce the need to build new, long-distance transmission projects (which can take up to a decade or more to permit and construct) in the United States. For example, imports of hydropower from Québec into New England and New York, using new but relatively short power lines, have been suggested by the transmission system authorities in those regions as an alternative to building power lines to Midwestern wind farms. However, as discussed above, one of these projects has been thrown into question by declining natural gas and power prices. Disputes at the state or provincial level can

also complicate energy project development. The future potential development of unconventional gas resources (i.e., from coal bed methane and tight shale formations) in both the United States and Canada could have a major impact on technology and energy choices in both countries.

In the United States, the intersecting issues of renewable power development, transmission system expansion and reliability, and long-standing difficulties in multi-state permitting of new projects, has spurred suggestions for new regulatory and planning processes. The planning element of some proposals envisions creating transmission “master plans” on a wide geographic scope to facilitate renewable energy development and other purposes. While these proposals are limited to planning within the United States, they will inevitably have an impact on Canada because of the grid connections and the much larger size of the U.S. power system.

Status of the Issues

NERC and FERC are continuing a process of developing and implementing mandatory reliability standards for the grid, with cybersecurity a growing concern. In Canada, the National Energy Board is reportedly working with provincial authorities on implementation of mandatory reliability standards, although it is not clear if in all cases these will be the same as the NERC standards or whether NERC will function as the ERO in every province.

Questions

1. Will Canadian federal and provincial regulators approve and enforce NERC electric reliability standards? Without identical standards in the United States and Canada, the reliability of the electric power system could be reduced.
2. Given that the United States and Canadian power grids are integrated, what steps should be taken to coordinate transmission planning and development of smart grid protocols? Is this an area for NERC to establish a formal leadership role?
3. To what degree is Canada interested in exporting renewable power to the United States, or importing renewable energy from this country, rather than reserving these resources for domestic consumption?
4. How can the United States and Canada effectively resolve energy development issues that may involve both federal and state/provincial authorities? Given the likelihood for increasing energy integration, should a formal body be instituted to oversee energy trade and energy security issues?

U.S. Energy Security and Canadian Oil Sands⁷⁶

Issue Definition

Canada ranks as the United States’ number one source of imported crude oil and thus plays an important role in U.S. energy security. Canada’s oil sands make up an increasing proportion of its

⁷⁶ By Robert Pirog, Specialist in Energy Economics, Resources, Science, and Industry Division.

petroleum production, and Canada's oil sands producers continue to look to the United States as the major market for their heavy oil exports. Of the approximately 2.0 million barrels per day (mbd) of crude oil Canada has exported to the United States in 2010, approximately 50% is delivered to the Midwest. This region's current capacity to process this type of crude oil, and planned refinery expansion coupled with possible new refinery construction, places it in a position to receive increased heavy oil exports from Canada. Another possibility for processing additional Canadian heavy oil is expanded capacity in refineries along the U.S. Gulf coast.

Although U.S. refinery capacity is forecast to increase from 17.7 mbd in 2011 to nearly 19.0 mbd in 2030—a 1.3 mbd increase, the deteriorating economics of the refining industry may bring these projections into question. Since 2009, the U.S. refining industry has been characterized by plant closures and divestiture. Actual, as well as projected, capacity expansion may not be enough to keep up with Canada's projected increase in oil sand production, especially if the investment climate continues not to warrant expansions to include upgrades for heavy oil processing. Canada is also pursuing additional refinery capacity for its heavier oil. Refinery expansions based on the use of heavy oils will have environmental effects, and Congress will continue to face controversy over the balance between energy security and the environment. In addition, investment and production plans are likely to be altered by the reduced demand for petroleum products associated with the ongoing effects of the economic recession that began in the last quarter of 2007.

Another possible impediment to expanded heavy oil use is Section 526 of the Energy Independence and Security Act of 2007 (P.L. 110-140) that prohibits federal procurement of an alternative or synthetic fuel “unless the contract specifies that the lifecycle GHG emissions are less than or equal to such emissions from the equivalent conventional fuel produced from conventional petroleum sources.” The provision is intended to ensure that federal agencies are not spending taxpayer dollars to promote new fuel sources that will exacerbate global warming, and would apply to fuels derived from “oil sands,” which are currently associated with producing higher greenhouse gas emissions than fuels derived from conventional, lighter crude oils.

Background and Analysis

When it comes to future oil supplies, Canada's oil sands will likely make up a larger share of U.S. oil imports. Oil sands account for nearly 50% of Canada's total oil production, and oil sand production is increasing as conventional oil production declines. Since 2004, when production from a substantial portion of Canada's oil sands were deemed economic, Canada has been ranked second behind Saudi Arabia in proved oil reserves. Canada has over 175 billion barrels of reserves and a total of over 300 billion barrels of potentially recoverable oil sands (an attractive investment under high oil price conditions, demonstrated by the billions of dollars already committed to Canadian development). Canadian crude oil exports (from oil sands and conventional petroleum sources) were about 2 mbd in 2010, of which 99% went to the United States. Canadian crude oil accounts for about 22% of U.S. crude oil imports, and about 13% of all U.S. crude oil and petroleum products supplied. U.S.-based oil companies are major investors in Canadian oil sands. The infrastructure to produce, upgrade, refine, and transport oil from Canadian oil sand reserves to the United States is already in place although additional pipeline capacity is planned. Oil sands production is expected to rise 3.6 mbd by 2030.

Greenhouse gas “emissions intensity” (CO₂/barrel) from oil sands are significantly higher than that from conventional oil production. Canada's federal government classifies the oil sands industry as a large industrial air pollution emitter and expected it to produce half of Canada's growth in greenhouse gas (GHG) emissions in 2010. Reducing air emissions is one of the most

serious challenges facing the oil sands industry. Between 1995 and 2004, the oil sands industry reduced its emission intensity by 29% while oil production rose. Overall, CO₂ emissions have declined from 0.14 tons/barrel (bbl) to about 0.08 tons/bbl since 1990. However, Alberta's GHG goals of 238 megatons of CO₂ in 2010 and 218 megatons CO₂ in 2020 are not expected to be met.

Status of the Issue

New refinery capacity that would accommodate heavier crude from Canadian oil sands is being challenged in Indiana, Michigan, South Dakota, and elsewhere. Some of these expansions or new refineries are several years away from operation. A BP refinery upgrade and expansion in Whiting, IN, expected to be completed in 2011, is progressing, but faces lawsuits from environmental groups. A new \$10 billion refinery in Union County, SD, being planned to process heavy crude from oil sands, would be the first new refinery in the United States in over 25 years. Environmental groups continue to promote standards for low-carbon emission fuel and oppose the permitting of these refinery projects on the basis that processing heavy crude from Canadian oil sands would generate much higher greenhouse gas emissions than from conventional petroleum sources.

Another impediment to expanded use of Canadian heavy oil in refineries in the United States is the growing opposition to the construction of the Keystone XL pipeline, which is designed to deliver up to 900,000 barrels per day of Canadian crude oil to new refining capacity that is expected to be built in the U.S. Gulf Coast region. Opposition to the project in the United States centers on the inherently high carbon emissions of liquids derived from oil sands, while Canadian opposition is focused on likely job losses associated with the export of unprocessed crude oil. Unions in Canada claim that processing the crude oil in Canada, and exporting finished products like gasoline and diesel fuel to the United States, would create thousands of high-paying jobs for Canadian workers.

Questions

1. What changes are necessary to significantly reduce the environmental footprint of heavy oil from Canadian oil sands?
2. How much capital investment in pipeline and refinery infrastructure is needed to support increased crude oil imports from Canada?
3. What would be the impact on U.S. federal and defense fuel procurements if Section 526 restrictions remain in place on fuel produced from Canadian oil sands?
4. After the drop in oil prices from over \$100 per barrel and the continuing effects of economic recession, how likely is it that Canadian oil sands development will be slowed because of revised investment strategies by the major oil companies?

Keystone XL Pipeline⁷⁷

Issue Definition

In September 2008, TransCanada (a Canadian company) applied to the U.S. Department of State for a permit to cross the U.S.-Canada international border with the Keystone XL pipeline project. If constructed, the pipeline would carry crude oil produced from the oil sands region of Alberta, Canada, to U.S. Gulf Coast refineries. Because the pipeline would connect the United States with a foreign country, it requires a Presidential Permit issued by the State Department. Although similar pipelines from Alberta have been approved in recent years, the permitting process for the Keystone XL pipeline has become highly controversial. Members of Congress have expressed support for the proposed pipeline's potential energy security and economic benefits while others have expressed reservations about its potential environmental impacts. Though Congress has no direct role in permitting the pipeline's construction, it may have an oversight role stemming from federal environmental statutes that govern the pipeline's application review process.

Background and Analysis

In 2010, Canada was the largest supplier of imported petroleum to the United States. Of the 11.8 million barrels per day (Mbpd) the United States imported last year, Canada supplied 2.5 Mbpd (22%), more than the combined imports from the next two largest suppliers—Mexico and Saudi Arabia. Pipeline infrastructure for Canadian petroleum exports to the United States has been growing rapidly in support of this trade. Five major pipelines with a combined capacity of 3.3 Mbpd currently link Canadian petroleum producing regions to markets in the United States. Two of these pipelines, Alberta Clipper and Keystone, with a combined capacity of just under 0.9 Mbpd (26% of the total) began service last year. The permit application for Keystone XL, which would add an additional 0.8 Mbpd of capacity, is in the final stages of review by the U.S. State Department. If approved and constructed, Keystone XL would bring Canada's total U.S. petroleum export capacity to over 4.1Mbpd, enough capacity to carry over 34% of U.S. petroleum imports in 2010. Given that Canada actually supplied the United States 2.5 Mbpd in 2010, large increases in Canadian supply will ultimately be possible, although the industry anticipates significant excess pipeline capacity for the next decade. In addition, several large pipeline projects are proposed within the United States to increase movements of Canadian petroleum to key U.S. market hubs, including refineries in the Midwest and on the Gulf Coast that employ complex technology in order to process "heavy" crude oils like those from Canada, Mexico and Venezuela.

The recent expansion of petroleum pipelines from Canada, particularly Keystone XL, has generated considerable controversy in the United States. Proponents of the pipeline, including Canadian government agencies, petroleum industry stakeholders, and pipeline construction workers, have based their public interest justifications primarily on increasing the diversity of the U.S. petroleum supply and on expected economic benefits to the United States, including near-term job creation associated with pipeline construction and operation. Some contend that the Keystone XL project would secure growing Canadian oil supplies for the U.S. market, which

⁷⁷ Prepared by Paul Parfomak, Specialist in Energy and Infrastructure Policy; Resources, Science, and Industry Division.

could offset imports from less dependable foreign sources. They also claim that if oil sands output cannot flow to the United States, infrastructure to export it to Asia will likely develop. Opponents to the Keystone XL pipeline project, primarily environmental groups and affected communities along the route, object to the project principally on the grounds that it supports “dirty” Canadian oil sands development, that a potential spill could pose a risk to groundwater, that alternative pipeline routes avoiding the large Ogallala Aquifer have not been fully considered, and that it promotes continued U.S. dependency on fossil fuels. Arguments criticizing the greenhouse gas emissions of oil sands production, generally, are based to some degree on the assumption that limiting pipeline capacity to U.S. markets may limit output from Canada’s oil sands. Some opponents also argue that, given the excess capacity anticipated in the existing Canadian petroleum pipelines noted above, additional pipelines are not needed.

Status of the Issue

Pursuant to the National Environmental Policy Act (NEPA), the State Department issued a Final Environmental Impact Statement (FEIS) favorable to the proposed Keystone XL pipeline on August 26, 2011. Issuance of the Final EIS marked the beginning of a 90-day review period for a National Interest Determination during which the State Department will consult with other relevant federal agencies. The State Department will also host public hearings to gather additional comments on whether granting the permit application would be in the national interest. The State Department expects to make a final decision regarding this permit by the end of 2011. The North American-Made Energy Security Act (H.R. 1938) would direct the President to issue a final order granting or denying the Presidential Permit for the Keystone XL pipeline by November 1, 2011. Whatever the State Department’s decision, legal challenges appear likely.

Questions

- 1) Will the State Department approve the Keystone XL pipeline?
- 2) How might the development of the Keystone XL pipeline affect the regional availability and price of petroleum products in North America?
- 3) What are the prospects for new Canadian pipelines to Pacific markets and how might the Keystone XL pipeline affect those?
- 4) Would the Keystone XL pipeline, added to the other recently constructed oil pipelines from Canada, require special safety or environmental oversight?
- 5) How might oil supplies from the Keystone pipeline affect U.S. oil imports from other countries?
- 6) What could be the nature and timing of regional economic affects associated with the pipeline’s construction?

Natural Gas Pipeline from Alaska⁷⁸

Issue Definition

Congress has been encouraging the development of large natural gas reserves discovered at Prudhoe Bay, AK, for over 40 years. Principal among its policies has been promoting the construction of a natural gas pipeline from the Alaska North Slope to the lower-48 states. Beginning with the Alaska Natural Gas Transportation Act of 1976, and continuing through the Alaska Natural Gas Pipeline Act of 2004, the federal government has repeatedly affirmed a national need for an Alaska natural gas pipeline. The Obama Administration has continued that support. In remarks to the press during his first month in office, President Obama described an Alaska gas pipeline as “a project of great potential” (as quoted by the *Anchorage Daily News*, February 11, 2009).

While it has been on the drawing board for decades, on and off, interest in an Alaska natural gas pipeline revived around 2000 because of accelerated growth in U.S. natural gas demand, price volatility in the natural gas market, and the increased importation of liquefied natural gas (LNG) from overseas. Moreover, many industry analysts expected a U.S. policy of carbon dioxide control could further increase natural gas demand for electric power generation and, possibly, transportation fuel. These factors led both U.S. and Canadian officials to restart the process of Arctic natural gas pipeline development. Important milestones in this activity were Alaska’s August 2008 award to TransCanada Pipelines Ltd., a Canadian company, of a license to build a natural gas pipeline from Prudhoe Bay to the lower-48 states and the concurrent announcement of a competing pipeline proposal along a parallel route. Because an Alaska natural gas pipeline to the lower-48 states would pass through Canada, the involvement of Canadian agencies would be essential for the pipeline’s success. However, Canada has been pursuing its own Arctic natural gas pipeline projects as well, most notably the proposed Mackenzie Valley pipeline.

Background and Analysis

Arctic Alaska has substantial natural gas resources. The U.S. Geological Survey (USGS) estimates that conventional natural gas reserves on Alaska’s North Slope potentially exceed 100 trillion cubic feet (Tcf), over four times the total annual gas consumption of the United States. The agency’s assessment of undiscovered conventional gas resources across the entire Arctic region concluded that over 1,600 Tcf of additional natural reserves gas remains to be found, with a significant share located under U.S. territory. The USGS also estimates that the North Slope, specifically, may contain up to 158 Tcf of technically recoverable natural gas in the form of methane hydrates. Taken together, these vast natural gas resources—both proven and anticipated—in Arctic Alaska have been the motivation for a natural gas pipeline to supply Alaskan natural gas to the lower-48 states.

A key step in advancing an Alaska gas pipeline project was the inclusion of \$18 billion in federal loan guarantees for such a pipeline in the Alaska Natural Gas Pipeline Act of 2004 (P.L. 108-324). In 2007, Alaska passed the Alaska Gasline Inducement Act (AGIA), laying out a process to

⁷⁸ Prepared by Paul W. Parfomak, Specialist in Energy and Infrastructure Policy; Resources, Science, and Industry Division.

encourage expedited construction of a natural gas pipeline from Alaska's North Slope to gas markets in Alaska and the lower-48 states and providing up to \$500 million in matching funds, thereby reducing the developer's financial risks. Following passage of the AGIA, developers advanced two major competing proposals for an Alaska natural gas pipeline:

- **TransCanada Pipelines Ltd. (TransCanada)** and Foothills Pipe Lines, Ltd., have proposed a pipeline under the AGIA process that would connect with the existing TransCanada Alberta network at the Alberta hub. The original capacity of this pipeline would be between 4.5 to 5.0 billion cubic feet per day (Bcf/d). According to FERC staff, it would be expandable to 5.9 Bcf/d through the use of greater compression only, and, therefore, at relatively low added cost. ExxonMobil, one of the three major Prudhoe Bay natural gas producers, joined with TransCanada in June 2009 to develop this project. The developers reportedly anticipate project costs between \$32 billion and \$41 billion (2009 dollars) with an in-service date of 2020.
- **BP and Conoco Philips (Denali)**, two of the three major Prudhoe Bay natural gas producers, have proposed a 4.0 Bcf/d pipeline project outside the AGIA process (and, thus, ineligible for the \$500 million in state funds). The BP-Conoco Philips "Denali" Pipeline would follow a route similar to that of the TransCanada project to the Alberta hub. The developers' most recent cost estimate for the project is \$35 billion (2009 dollars) with initial service in 2020.

An Alaska natural gas pipeline project would have important implications for Alaska's economy. By one estimate the net present value of state and local government earnings from such a project could exceed \$29 billion over its lifetime. New natural gas royalty revenue could offset future declines in ongoing oil royalties from mature North Slope oil fields, which have accounted for 85% of the state's unrestricted general fund, on average, since 1977. Development of an Alaska natural gas pipeline to the lower-48 states would also create many new jobs throughout the nation in support of, or resulting from, the pipeline's construction.

Coincident with U.S. promotion of an Alaska pipeline, the Canadian government has been interested in developing an all-Canadian Arctic natural gas pipeline to U.S. markets. The main proposal has been a new pipeline from the Mackenzie River Delta to the existing natural gas pipeline network in Alberta. Initially, developers also proposed transporting Alaska's North Slope gas through a spur pipeline connecting to the proposed Mackenzie pipeline, but the Alaskan connection was rejected by a Canadian government inquiry report in 1974, three years before President Carter also rejected this option. The current configuration of a stand-alone pipeline to Alberta is similar in design to the Alaska gas pipeline proposals, albeit smaller in capacity (1.2 Bcf/d) and lower in cost (\$15 billion) with a projected in-service date of 2016.

Status of the Issue

Through 2010, the Denali and TransCanada pipelines were proceeding along similar tracks. However, in May 2011, Denali's developers announced the discontinuation of their pipeline project due to insufficient customer support. TransCanada officials reportedly maintain that their project is still active and on pace to seek a pipeline certificate in 2012. Despite these assurances, some industry analysts are skeptical that the TransCanada pipeline could ultimately prove viable when the Denali pipeline did not. The TransCanada and Denali pipeline projects had been competing and mutually exclusive proposals, each backed by different North Slope producers. To

reduce project costs and improve the likelihood of success, some key policy makers had been encouraging the various developers to come together on a single pipeline project. Given that the Denali project has been terminated, producer cooperation on TransCanada's pipeline may now be a greater possibility. Whether BP and Conoco Phillips, having discontinued their Denali project, would seek to join Exxon in the TransCanada project, is an open question. In March 2011, Canadian authorities provisionally approved the Mackenzie pipeline project, although some analysts believe it may not be constructed without new government subsidies for the same reasons the Denali project was cancelled.

Many potential obstacles to an Alaska gas pipeline remain at this time, especially the project's economics. Since passage of P.L. 108-324, the combination of new shale gas supplies and reduced growth in gas demand due to the recent U.S. economic downturn have caused natural gas prices to plummet. While demand for natural gas will likely rebound as the U.S. economy resumes its growth, independent gas producers assure strong lower-48 domestic natural gas supplies for the foreseeable future. The U.S. Energy Information Administration projects U.S. shale gas production will nearly triple from 2009 to 2035, continuing to put downward pressure on gas prices. In such a price environment, there are ongoing concerns as to the cost-effectiveness of an Alaska gas pipeline, with long-term pipeline economics a constantly moving target.

Questions

1. How likely is Canada to proceed with development of the Mackenzie pipeline?
2. With recent changes in the long term lower-48 natural gas supply outlook due to new shale gas development, under what market conditions might Arctic natural gas supplies be competitive?
3. Will pipeline developers seek new government subsidies or other forms of financial support?
4. If developers decide to proceed with an Alaska natural gas pipeline project, how effective will cooperation be with Canadian authorities for the Canadian section of the pipeline?
5. To what extent might the partly competing natural gas pipelines, once completed, diminish the economic viability of each other?
6. What percentage of the gas delivered by the Mackenzie pipeline is likely to be used by the Canadian oil sands development, and therefore, not become available to U.S. markets?
7. How might the development of Arctic gas influence future LNG imports to, or exports from North America (and vice versa)?

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