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Reaching a Tipping Point? Effects of Post-9/11 Border Security on Canada's Trade and Investment

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Reaching a Tipping Point? Effects of Post-9/11 Border Security on Canada's Trade and Investment
by *Danielle Goldfarb*

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Preface

In this report, the Conference Board of Canada summarizes findings of the most extensive analysis to date on the effects of border security policies on Canada–U.S. trade and possible effects on investment. Based on almost 60 in-depth interviews, existing literature and extensive statistical analysis, the Board's findings challenge common wisdom about the cumulative effects of the post-9/11 border security environment on Canadian economic interests. In response to identified policy failures and successes, the Board proposes solutions for advancing Canada's economic and security interests. The report is a joint project of the Conference Board's Centre for National Security and International Trade and Investment Centre.

The companion technical report to this paper, *Tighter Border Security and Its Effect on Canadian Exports* by Michael Burt, is available at www.conferenceboard.ca.

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EXECUTIVE SUMMARY

Reaching a Tipping Point?

Effects of Post-9/11 Border Security on Canada's Trade and Investment

At a Glance

- Contrary to common wisdom, the cumulative effect of post-9/11 border security policies has not reduced Canadian export volumes to the U.S.
- However, the post-9/11 border security environment has resulted in important new costs of crossing the border for many companies.
- In the long term, these costs could make Canada a less attractive location from which to buy parts or in which to invest.
- Conversely, governments and businesses that view the post-9/11 border environment as an opportunity for seamless access to the U.S. might position Canada as a preferred point of access to North America.

Maintaining and enhancing secure, predictable, barrier-free access to the United States economy has been a long-standing objective of Canadian leaders. This report assesses whether new border security policies adopted in the wake of the terrorist attacks of September 11, 2001, jeopardize that access.

Drawing on an extensive statistical analysis and almost 60 interviews, the Conference Board finds that, contrary to common wisdom, the post-9/11 border security environment has not had an immediate or prolonged effect on Canadian export volumes to the U.S. Moreover, border delays have been significantly reduced from the delay problems that were common in the first few years after 9/11.

Companies that need to get their goods to market are doing whatever they must to do so and absorbing the extra costs.

While export volumes have not changed, the post-9/11 border security environment has increased the costs of trading across the border for many companies. These costs include the direct costs of complying with border security policies. They also include more indirect costs such as changes in the way some companies trade cross-border. For example, some companies are shifting away from preferred border crossings, setting up additional warehouses on the U.S. side of the border, and finding that some trucking companies decline cross-border routes. These new costs, together with the fact that export volumes have not declined yet as a result of post-9/11 border security policies, suggest that companies that need to get their goods to market are doing whatever they must to do so and absorbing the extra costs.

Some companies, however, view participation in the new border security programs as an opportunity and a competitive advantage. They find the upfront costs result in reduced waste, cost savings over time and more efficient border crossings. And recent infrastructure and staffing changes that took place after interviews had been conducted may reduce some of the costs companies reported.

With increased competition from large developing economies, the high Canadian dollar and the fact that both countries trade in highly similar goods, even small increases in border-crossing costs could cause those who produce in or source from Canada to hit a "tipping point." That is the point at which the advantages of locating production in the far larger U.S. market and avoiding the border entirely outweigh the advantages of locating parts of production in Canada. While these location changes may not happen in the short term, as contracts expire over time, such costs are likely to influence longer term decisions to source from and invest in Canada or elsewhere.

Post-9/11, risk-based border security programs are not yet fully realizing their efficiency benefits. This is due to infrastructure constraints and a lack of alignment between Canadian and U.S. programs. If governments remedy these and related problems, and businesses view these costs as opportunities, rather than tipping the balance away from investing in Canada, the new border environment could represent an opportunity for Canada to become a preferred place for companies wanting to access North America.

CHAPTER 1

Introduction

Chapter Summary

- Canada has a strong interest in predictable, barrier-free access to the U.S. market and in improving security, both as an end in itself and as a precondition for trade.
- Now that some time has passed since 9/11, this report assesses any persistent economic effects of border security-related policies introduced since that event.
- The report is based on extensive statistical analysis and almost 60 in-depth interviews, and carefully distinguishes effects due to post-9/11 border security from other factors.

Maintaining and enhancing secure, predictable access to the United States economy has been a long-standing objective of Canadian leaders. It motivated Canada to pursue a bilateral free trade agreement with the U.S., followed by the North American Free Trade Agreement (NAFTA). And it drove Canada's response to the new U.S. security environment as a result of the terrorist attacks of September 11, 2001. That day, the U.S. effectively embargoed its own economy by virtually shutting down its borders. It later adopted a series of new security requirements, many of them at border crossings.

Ottawa's response was to promote a risk-based approach to border security under the Canada–U.S. Smart Border Accord, with the aim of improving both security and efficiency. For example, the two countries established the Free and Secure Trade (FAST) program, aimed at fast-tracking cargo that had pre-qualified as secure. An implicit Canadian goal in pursuing these policies was arguably to ensure that the U.S. views Canada as a trusted security partner. (Accurate or not, the perception that Canada does not share the U.S. view of security threats can translate directly into U.S. policy decisions, such as stricter border controls.) That trust, in turn, should enable legitimate cross-border traffic to enjoy relatively predictable, efficient access to the other side of the border. There has also been a growing understanding on both sides of the border that security is a precondition for trade and further trade liberalization.

An implicit Canadian goal in promoting a risk-based approach to post-9/11 border security was arguably to ensure that the U.S. views Canada as a trusted security partner.

Since the attacks of 9/11, the U.S. and Canadian governments have implemented many joint and unilateral border policies. A number of years have now passed since 9/11, allowing business and government time to transition to new policies. This report asks whether the cumulative effects of these policies has had sustained effects on that long-standing Canadian objective of barrier-free access to the U.S. market. In particular, it assesses whether the post-9/11 border environment has taken a toll on Canada's long-term economic interests. This includes whether a more security-conscious border has diluted some of the benefits of access to the U.S. achieved under the Canada–U.S. free trade agreement.

While physical security is an important national goal, this report does not examine directly whether post-9/11 border policies have improved security outcomes. Instead, it provides a yardstick of economic costs against which leaders and citizens can weigh security and other public interest objectives. The intention is to help those responsible for new or existing security programs to determine how best to meet security and other goals while enhancing efficiency aims.

This report is one of the most extensive analyses to date of the economic effects of post-9/11 border security policies, combining a detailed quantitative analysis with the results of almost 60 interviews. The analysis carefully distinguishes, where possible, the effects of the post-9/11 border security environment from border problems that existed before September 11, 2001, or that are independent of the effects of 9/11. Pragmatic recommendations for Canadian policy-makers and business leaders flow from this analysis. The report examines the implications for goods, while future Conference Board research will consider the repercussions of the post-9/11 security environment for services and people movements.

CHAPTER 2

Setting the Context

Chapter Summary

- Predictable, secure access to the U.S. market raises Canadian living standards.
- Secure access also matters because much trade is time-sensitive and because the two countries make goods using inputs from both sides of the border.
- Small increases in cross-border trading costs can make it less attractive to invest in Canada as a place from which to serve the North American market.

WHY SECURING AND ENHANCING ACCESS TO THE U.S. MATTERS

To understand the effect of the post-9/11 environment on Canadian interests, it is critical to understand first the importance of access to the U.S. market. Secure, predictable, barrier-free access to the U.S. matters greatly for Canadians' well-being. For one, access to the U.S. provides Canada with far greater growth prospects than if the country were confined to selling to its relatively small domestic market. Goods exports to the U.S., for example, accounted for about a quarter of Canada's gross domestic product in 2006.[1] The evidence shows that access to the U.S. has substantially improved Canadian living standards beyond what they would otherwise have been. In particular, the Canada–U.S. free trade agreement, though imperfect, improved access to each other's economies. As tariff barriers fell, manufacturing plants increasingly specialized in certain parts of the production process.[2] Canadian plants specialized in what could be done most efficiently on the Canadian side of the border and traded for goods that could be made more efficiently in the U.S. Specialization, in turn, led to a massive, permanent, long-term productivity increase, translating into higher living standards for Canadians.[3]

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1 This number is likely somewhat overstated because a) trade data capture the total value of a good each time it crosses the border, even if only a small amount of value was added since the last time that good crossed the border; and b) statistics on Canadian exports to the U.S. may inadvertently include goods shipped through the U.S. to final destinations outside the U.S. For a larger discussion of the accuracy of Canada's trade statistics with the U.S. and the rest of the world, see p. 6 in Danielle Goldfarb and Kip Beckman's *Canada's Changing Role in Global Supply Chains*, International Trade and Investment Centre (Ottawa: The Conference Board of Canada, 2007).

2 John Baldwin and Wulong Gu, *Responses to Trade Liberalization: Changes in Product Diversification in Foreign- and Domestic-controlled Plants*, Micro-economic Analysis Division (Ottawa: Statistics Canada, 2005).

3 Daniel Trefler, "The Long and Short of the Canada–U.S. Free Trade Agreement," *American Economic Review*, 94, 4 (2004), pp. 870–95. Trefler finds that the agreement led to some short-term displacement but significant longer term manufacturing productivity gains for Canada.

As well, large parts of Canada's trade rely on secure, predictable access to the U.S. economy. Many manufacturing industries manage their inventories using just-in-time systems, in which, within hours of an order, inputs or final goods made in Canada enter supply chains on the U.S. side of the border or are delivered to U.S. customers. Uncertainty at the border would force companies to carry more inventory, reversing any increased competitiveness of just-in-time logistics. Other Canadian exports, such as fresh seafood from the Maritime provinces and fast-decaying medical isotopes, are also highly exposed if they can not get to their destinations quickly.

Goods often cross the border repeatedly as value is added at each production stage. Even small increases in border security costs are magnified as parts cross the border multiple times.

Moreover, secure and predictable access is critical because both countries make goods using inputs from the other, often within the same company. Over one-third of Canada's 2002 export value was import content,[4] most of it from the U.S. And Canadian parts exports to the U.S. over the last 15 years have moved up and down in concert with final goods imports from the U.S. to Canada, with the same holding true for the reverse.[5] For example, Ontario can only increase its exports of cars if it simultaneously increases its imports of car parts. So restricting materials in either direction affects production on both sides.

And the Canada–U.S. border does not just provide access to the U.S. market, but is also an important point of access to the rest of the world. Major U.S. companies are global, and Canadian exports to other destinations such as Mexico often travel through the U.S., while U.S. exports to destinations such as Europe travel through Canada. Non-North American investors can use Canada as a base to access the large North American marketplace. In sum, Canadian leaders appropriately place high priority on securing and enhancing predictable access to the U.S. market for numerous good reasons.

WHY SMALL CHANGES IN TRADING COSTS MATTER

If post-9/11 security measures have imposed new costs of border crossing, this could have important economic consequences for Canada. Canada–U.S. trade is highly sensitive to even small changes in the costs of trading across the border for several reasons. For one, investors will always be biased toward locating production in the larger U.S. market rather than in Canada, particularly if Canada's access to that market is uncertain or imperfect.[6] So an increase in the cost of crossing the border or any related uncertainty raises the cost of production in Canada and exacerbates the bias toward investing in the larger market.

Goods often cross the border repeatedly as value is added at each production stage. Even small increases in border barriers such as border security costs are magnified as parts cross the border multiple times. This further magnifies the bias toward investing strictly in the larger market rather than on both sides of the border to serve the North American market.

Also, Canada and the U.S. trade similar types of goods across their border, with over 70 per cent of our exports and imports within the same industries.[7] This means that goods are highly substitutable for each other. Though some exports—natural resources products, for example—can only be produced in Canada, many U.S. or globally manufactured goods can substitute for Canadian ones.

4 Glen Hodgson and Anne Park Shannon, *Mission Possible: Stellar Canadian Performance in the Global Economy*, The Canada Project, Final Report, Volume I (Ottawa: The Conference Board of Canada, 2007), p. 16.

5 Danielle Goldfarb and Kip Beckman, *Canada's Changing Role in Global Supply Chains*, International Trade and Investment Centre (Ottawa: The Conference Board of Canada, 2007).

6 Richard Harris, "FDI and FTA with Uncertain Market Access." In L. Eden and W. Dobson (Eds.), *Governance, Multinationals and Growth* (Northampton, MA: Edward Elgar Publishers, 2005), pp. 155–74.

7 Foreign Affairs and International Trade Canada, *Seventh Annual Report on Canada's State of Trade: Trade Update—2006* (Ottawa: June 2006), p. 45.

Moreover, Canadian companies face competitive pressures beyond North America. The rise of large developing countries such as China has led to intense global competition. Added to this are pressures from the rapid appreciation of the Canadian dollar over the last few years. In such a highly competitive environment, company location decisions may be sensitive to even small cost changes.

Small changes in border crossing costs might not change decisions to buy inputs from a particular location in the short term. Indeed, companies have other reasons for locating in Canada (e.g., lower labour costs than in the U.S., skilled workforce). Contracts are usually fixed for several years, as well. But in such a highly competitive global environment, sourcing and location decisions are dynamic. Over the medium term, when contracts come up for renegotiation, companies might decide to shift production from one location to another or not locate new plants in Canada.

If crossing the border becomes too costly or uncertain, or is even perceived to be so, the advantages of locating production in the smaller market to serve the larger one disappear. This makes it harder for Canada to attract investment, not only from the U.S. but also from other countries. There are anecdotal reports that post-9/11, some manufacturers have demanded that their parts producers locate on the U.S. side of the border, closer to product assembly. Producers can entirely avoid crossing the border by making their complete product in the U.S. and selling it in that large internal market or by moving production somewhere else entirely. If producers were previously sourcing from Canada, that was presumably the location with the lowest input costs. Producing elsewhere as a result of new border crossing costs signifies that producers are willing to absorb higher input costs—and reduced competitiveness—to avoid the reduction in competitiveness they would have to absorb by crossing the border.

In such a highly competitive global environment, sourcing and location decisions are dynamic.

Small increases in border costs, therefore, can negatively affect not only Canada's trade performance but also its investment results. Of course, the relative importance of cost changes varies by industry (which will be explored further later on). Given the importance for Canada of securing predictable access to the U.S. market, and the sensitivity of Canada–U.S. production to small changes in costs of trading across the border, the way in which the two countries approach security matters. Security rules that reduce predictability and increase the costs of crossing the border essentially dilute the potential gains for Canada from operating in the North American economic space.

CHAPTER 3

Effects of the Post-9/11 Border Security Environment on Trade Volumes

Chapter Summary

- The Conference Board's statistical analysis shows that the post-9/11 border security environment did not change Canada's export volumes to the U.S., holding all other factors constant.
- This was true even for the most border-sensitive products and across individual border crossings.
- The post-9/11 border security environment has likely had no effect on import volumes either.

After 9/11, Canada and the U.S. introduced a number of new border security policies. These included policies to separate pre-approved—and therefore low-risk—cargo from unknown cargo and to provide advance notice of shipment details before they reached the border. (See box "The Alphabet Soup of Post-9/11 Border Security Policies" for a brief description of the main policies.) New policies continue to be introduced, including the U.S. initiative to require everyone entering the U.S. from Canada to carry a passport or other approved identification such as a FAST card.

This paper does not evaluate the effectiveness of each of these policies, but instead looks at the cumulative effect on trade of the post-9/11 border security environment. In addition to explicit security policies, this "environment" includes other elements such as infrastructure investments and the behaviour of border officials.

After 9/11, Canada and the United States introduced a number of new border security policies. But what has been the actual cumulative effect of these policies on Canadian economic Interests? What does this mean for Canada's future access to the U.S. market?

The image of trucks lined up for miles at the Canada–U.S. border on September 11, 2001, fuels the perception that post-9/11 border security policies have been harmful to Canadian economic interests. But what has been the actual cumulative effect of these policies on Canadian economic interests? And what does this mean for Canada's future access to the U.S. market? This chapter examines the effect on export and import volumes, while the next chapters examine the effect on costs of trading.

The Alphabet Soup of Post-9/11 Border Security Policies

Since 9/11, the Canadian and U.S. governments have introduced a number of new or modified programs. They include (and are described below in greatly simplified form):

- Free and Secure Trade (FAST): The umbrella term for the voluntary Canadian and U.S. programs that are intended to fast-track pre-approved cargo across the Canada–U.S. border.
- Customs-Trade Partnership Against Terrorism (C-TPAT): The prerequisite to join the U.S. version of FAST and import into the U.S. The program requires securing all activities along import supply chains. Companies undergo a security audit by U.S. customs officials in order to qualify.
- Customs Self-Assessment (CSA): One of the prerequisite programs to be a FAST-approved importer into Canada. Companies are risk-assessed, and then benefit from streamlined accounting and payment processes for all imported goods. Canadian importers who are both CSA- and PIP-approved (see below) qualify for FAST. By April 2007, only 21 importers had signed up for this program.
- Partners in Protection (PIP): Another prerequisite program to be a FAST-approved importer into Canada. PIP requires importers to self-assess company security, including physical facilities and employees. Neither CSA nor PIP requires an audit, unlike C-TPAT.
- U.S. Food and Drug Administration (FDA) prior notice: Importers must give FDA officials prior notice of two hours for food imported into the U.S.
- Advance notice: The requirement to submit cargo manifests one hour or more in advance of the shipment's physical arrival at the border, in order to conduct risk assessments prior to arrival.
- Automated Commercial Environment (ACE): This U.S. program makes it mandatory to submit advance notice through electronic notification (rather than fax) and standardizes the process to require one set of data for all agencies.
- Advance Commercial Information (ACI): This Canadian program requires electronic submission of pre-arrival cargo manifests to customs officials in advance. It is currently in place for marine and air cargo and will be implemented for rail and truck cargo by 2012.
- Animal and Plant Health Inspection Service (APHIS) fee: APHIS is a sub-unit of the U.S. Department of Agriculture. In early 2007, APHIS started charging user fees for all boats and planes entering the U.S. from Canada. The stated aim is to recover the costs of increased inspection aimed at preventing diseases and bioterrorism. As of June 2007, APHIS will also collect user fees for inspections of commercial trucks (US$5.25 per crossing or US$105 annually) and rail cars (US$7.75 per crossing) entering the U.S. from Canada. The fee will be integrated with existing U.S. customs border crossing fees that are currently US$100 per truck annually. The fee does not exclude FAST-approved loads.
- Vehicle and Cargo Inspection System (VACIS): This is a giant x-ray machine that aims to identify contraband, stowaways and weapons of mass destruction hidden in rail cars, containers or truck trailers on both sides of the border.

EFFECT ON EXPORT VOLUMES

Following an explosion in Canada–U.S. trade over the 1990s, Canada's real exports to the U.S. were essentially flat in the post-2000 period. Was this lack of growth due to post-9/11 security policies? The Conference Board conducted an extensive statistical analysis to answer this question. The detailed results and methodology are published in a companion Conference Board technical report by Michael Burt entitled *Tighter Border Security and Its Effect on Canadian Exports*. In essence, the results do not support the contention that post-9/11 security policies have had either an immediate or a prolonged effect on Canada's export volumes to the United States. Any changes in export volumes post-9/11 appear to be due to factors other than the cumulative effect of border security measures. This was true even for the most border-sensitive of exports and at almost all border crossings. (For more detail, see box "The Effect of Tighter Border Security on Export Volumes: Statistical Analysis.")

The Effect of Tighter Border Security on Export Volumes: Statistical Analysis

In a separate technical analysis, The Conference Board of Canada assessed whether the increased security that took place after 9/11 has had either a temporary or lasting effect on the flow of exports crossing land borders into the United States from Canada. The analysis carefully isolated for the effects of the post-9/11 border security environment on export volumes rather than the effects of other factors, and examined trade volumes from 1988–2005 on a quarterly basis.

The Board's analysis accounted for the effects of conditions particular to specific commodities or regions. For example, to assess the effect of border security policies on fish exports to the U.S., the examination controlled for U.S. fish consumption rather than a more general measure such as U.S. gross domestic product. The Board's estimation also excluded the effects of price shifts, including the appreciation of the Canadian dollar since 2003, ensuring that export changes would reflect changes to volumes rather than inflation. This contrasts with another study that found a negative effect of post-9/11 security policies on Canada's exports to the U.S., controlling for other factors. That study did not exclude the effects of price shifts, controlled for general economic conditions rather than commodity-specific conditions and used a shorter time frame.[1] Such research may therefore have incorrectly attributed to post-9/11 security policies what are in reality export changes due to inflation or conditions specific to certain commodities or regions.

The Conference Board analysis is also more extensive than previous research, analyzing the effects of post-9/11 security policies on total export volumes, as well as the effects specific to major border crossings and major goods categories. In some cases the analysis also examined exports by a specific product category at a specific border crossing. (See Exhibit 1 for a map of the key border crossings and their relative export volumes, and Table 1 for a listing of the top goods that cross at the top five border crossings.)

The statistical analysis did not find evidence that tighter border security measures had an effect on the volume of Canada's exports to the United States. For total exports, and at the level of border crossings (with the exception of Fort Erie in Ontario), there was no evidence of a significant temporary or sustained decline in trade volumes due to the post-9/11 border environment. In the case of Fort Erie, subpar regional performance in the U.S. Northeast appears to have contributed to reduced trade volumes at that crossing point. Another contributing factor was substitution away from Fort Erie in favour of other border crossings in southern Ontario. However, these factors cannot explain all of the reduction. It is therefore likely that security measures are at least partially responsible for the diminished traffic through Fort Erie.

For the examination of the effect of the post-9/11 border security environment on specific products, the results suggest that post-9/11 border security did not affect volumes of any specific products. Interestingly, declines in television and telecommunications equipment exports showed up as not being explained by factors other than border security post-9/11—and therefore one might conclude their volumes fell as a result of border security post-9/11. However, the export declines likely represent the effects of the tech bust and subsequent global restructuring of the telecommunications industry—two factors that could not be easily captured in our model—rather than the effects of post-9/11 border security. For more details, please see *Tighter Border Security and Its Effect on Canadian Exports* by Michael Burt.

1 Steven Globerman and Paul Storer, *The Impacts of 9/11 on Canada–U.S. Trade*, Border Policy Research Institute, Research Report #1 (Bellingham, WA: Western Washington University, 2006).

EFFECT ON IMPORT VOLUMES

We focus on export volumes and costs in this report because this is the focus of public and media concern. But given that Canada depends on imported U.S. parts and other U.S. goods to maintain its living standards, it is important to look at imports too. We started by doing a similar analysis to the statistical analysis on exports described earlier. That exercise did not result in a sufficiently robust model as did the analysis of exports, so any results would not be meaningful.

However, we may be able to infer the likely effects on imports from our export results. We would expect any effect of post-9/11 border security policies on imports to show up through a major effect on export volumes, and it does not. As well, several other studies have found that if post-9/11 security policies had any negative trade effect, it was more pronounced on Canada's exports to the U.S. than on its imports from the U.S.[1] Since we find no effect on export volumes, it seems highly unlikely that we would find a negative effect on imports. Therefore, we can tentatively infer that the post-9/11 security environment has likely had no effect on import volumes.

1 For example, see Globerman and Storer.

Table 1

Total Exports at the Five Busiest Border Crossings, by Top Products, 2005
(per cent)

	Windsor Bridge	Sarnia	Fort Erie	Lacolle	Emerson
Auto parts	17	9.5	5.5	1.2	3.7
Autos	31.7	15.4	19.9	0.2	0
Fish	0.2	0.1	0	0.2	0.3
Inorganic chemicals	0.2	1.3	0.5	0.8	0.5
Lumber	0.2	1.3	1.0	2.8	2.2
Newsprint	0.5	2.0	1.1	3.7	1.9
Office machines	1.0	0.5	2.7	1.2	0.4
Organic chemicals	0.3	1.9	0.9	0.9	0.2
Other chemicals	0.8	1.3	1.1	1.3	0.4
Other paper	0.7	1.4	1.1	2.6	1.4
Rubber and plastics	2.3	5.0	3.7	2.5	2.8
Telecommunication equipment	1.4	0.6	2.4	2.1	0.9
Other	43.7	59.7	60.1	80.5	85.3

Sources: The Conference Board of Canada; Statistics Canada.

Exhibit 1
Key Border Crossings

Note: The size of each circle represents the relative magnitude of Canadian exports to the U.S. at each crossing.

Exports to U.S., 2005
($ billions)

Border crossing	Exports
Windsor bridge/tunnel*	83.2
Sarnia	56.6
Fort Erie/Niagara Falls*	49.3
Lacolle	16.8
Emerson	12.7
Pacific Highway	11.8
Lansdowne	9.1
North Portal	6.6
Philipsburg	6.0
Woodstock	2.3

*These crossings have been combined to simplify presentation.
Source: Statistics Canada.

CHAPTER 4

Effects of the Post-9/11 Border Security Environment on Trade Costs and Benefits

Chapter Summary

- For many companies, the costs of trading across the Canada–U.S. border have increased as a result of the post-9/11 border security environment.
- Exporters dependent on access to the U.S. have likely absorbed at least part of these extra costs.
- Some companies view the chance to be fast-tracked across the border in exchange for security improvements as a competitive advantage, though the benefits are not yet fully commensurate with the upfront costs.
- Delays have been reduced from the immediate post-9/11 period.

The previous chapter found that post-9/11 security policies do not appear to have changed trade volumes. But has the new security environment imposed significant new costs of trading across the border, or, contrary to common wisdom, yielded significant efficiency benefits?

To answer this question, the Board interviewed or surveyed almost 60 Canadian companies and associations that use the border regularly or whose members cross regularly. (See box "Companies, Associations and Border Officials Interviewed or Surveyed.") These included companies from different regions of the country and from a cross-section of sectors, including autos, auto parts, chemicals, forestry and paper, furniture, seafood, household products, and rail and truck carriers. Select government officials with border responsibilities were also interviewed. The interviews took place over the fall of 2006. They examined the effects of trading in both directions, though interviewees were often more concerned with southbound trade.

Evidence from these interviews and the Conference Board's empirical analysis referred to in the previous chapter suggests that post-9/11 border security policies have increased a number of costs of trading across the Canada–U.S. border. Some interviewees reported that the new policies carried important benefits, but that these had not yet been fully realized.

Post-9/11 policies have not changed trade volumes, but may have increased trade costs.

In this chapter, we first examine the direct costs and benefits of complying with new security policies. Then we examine indirect costs such as delays and changes in trading behaviour.

Companies, Associations and Border Officials Interviewed or Surveyed

The Conference Board of Canada wishes to thank the following organizations for taking the time to share their experiences and perspectives:

COMPANIES

Bombardier

Cavalier Transportation Services Inc.

CN Rail

Cooke Aquaculture Inc.

CP Rail

DaimlerChrysler Canada Inc.

D.B. Kenney Fisheries Ltd.

Dow Chemical Canada Inc.

Erb Transportation Solutions Inc.

Ganong Chocolates

High Liner Foods Incorporated

IBM Canada Ltd.

Linamar Corporation

Magna International, Inc.

NorFalco Sales Inc.

NOVA Chemicals Corporation

Palliser Furniture Ltd.

Purolator Courier Ltd.

RAM Contract Carriers Ltd.

Reimer Express Lines Ltd.

Shell Chemicals Canada Ltd.

3M Canada

Tolko Industries Ltd.

Unilever Canada

West Fraser Timber Co. Ltd.

Yanke Group of Companies

ASSOCIATIONS AND OTHERS

Armstrong Trade and Logistics Advisory Services Inc.

Automotive Parts Manufacturers' Association

Bridge and Tunnel Operators Association

British Columbia Trucking Association

Canadian Chamber of Commerce

Canadian Chemical Producers' Association

Canadian Council of Chief Executives

Canadian Manufacturers & Exporters

Canadian Society of Customs Brokers

Canadian Trucking Alliance

Can-Am Border Trade Alliance

Canola Council of Canada

Forest Products Association of Canada

Niagara Falls Bridge Commission

Ontario Chamber of Commerce

Ontario Trucking Association

Original Equipment Suppliers Association

Railway Association of Canada

Sarnia and Lambton Chamber of Commerce

Windsor Chamber of Commerce

GOVERNMENT OFFICIALS

Blue Water Bridge Authority

Buffalo-Fort Erie Public Bridge Authority

Canada Border Services Agency

Canadian Consulate (Buffalo)

Canadian Consulate (Detroit)

Department of Foreign Affairs and International Trade

Ontario Ministry of Economic Development and Trade

Public Safety and Emergency Preparedness Canada

Transport Canada

DIRECT COSTS OF POST-9/11 SECURITY CHANGES

What are the direct costs of meeting post-9/11 security measures, and how significant are they? Many companies reported these costs were high, while some large companies reported they were only marginal. Out of 22 companies that fully answered this question, 15 reported overall cost increases that they believed were a result of the post-9/11 security environment. These included production, freight or transportation cost increases. Nine companies out of 22 reported cost increases due directly to complying with border security policies. Companies incur transportation and freight insurance costs every time they cross a border. By contrast, many policy compliance costs are one-time or infrequent costs such as security assessments.

Of the 15 companies that reported overall cost increases due to the post-9/11 border security measures, 13 reported a rise in transportation costs, 10 reported a rise in freight insurance costs, and three reported a rise in production costs. Improvements to infrastructure and staffing at the border since the interviews were conducted in the fall of 2006 may mitigate some of these costs.

Some companies voluntarily increased their direct policy compliance costs by meeting extra security requirements to qualify for the programs that fast-track their cargo across the border. (See box "One Company's Investments to Qualify for Faster Border Clearance.") The Free and Secure Trade, or FAST, program and its component programs have the laudable policy goal of separating and fast-tracking pre-approved, low-risk cargo. This enables border officials to focus on unknown-risk traffic. To qualify for these programs, importers are responsible for securing their supply chains. The interviews suggested that most large importers exert pressure on their suppliers and truck drivers to be compliant as well, or lose their business.

HOW SIGNIFICANT ARE THE COSTS TO PARTICULAR INDUSTRIES?

Unfortunately, most companies were not able or willing to divulge specific estimates of the cost effects of the post-9/11 policies. We are therefore not able to provide a comprehensive assessment of the relative costs by industry. We can, however, draw from the interviews and other data sources to put together a tentative picture of those industries likely to be most affected.

To start, some companies said that the enrolment and compliance requirements for programs to fast-track cargo across the border were not overly onerous. Others—particularly those that carry higher-risk materials across the border—estimated that their transportation costs had increased by about one-quarter. Transportation costs are often a small component of overall costs. However, some interviewees noted that their relative importance in investment decisions has increased due to higher security compliance measures and costs.

One Company's Investments to Qualify for Faster Border Clearance

Companies must make security investments to qualify for programs that aim to fast-track goods across the border. One company interviewed by The Conference Board of Canada undertook the following changes:

- Purchased new technology
- Retrained staff
- Assessed security requirements
- Upgraded the employee and visitor ID system
- Prepared a procedure manual for conforming to new border programs
- Developed an employee awareness program
- Upgraded existing exterior lighting
- Upgraded or installed closed-circuit television capabilities
- Repaired faulty access control (e.g., better locks)
- Created new fencing
- Created a restricted area for drivers that did not allow them access to the plant
- Improved surveillance
- Hired a third-party security consultant to audit plants and third-party warehouses to ensure each location would comply with customs requirements

Most Canadian companies we interviewed said they had to internalize the extra costs. This is because they compete directly with U.S. manufacturers that can choose to locate their production entirely within the U.S. market and not face border-crossing costs at all. So companies can not pass on higher prices to their consumers to offset the new costs or they will lose business. The costs, therefore, hit Canadian companies' profit margins directly. The costs appear to be borne in part by manufacturers and in part by their carriers.

Canadian companies have had to internalize the extra costs of post-9/11 border security changes, reducing their profit margins.

To get a better sense of how important these costs are, we took a brief look at the trucking industry, one of the industries that is likely to be most affected by border policies. Profit margins for trucking companies have generally been healthy over the past number of years, but these margins primarily reflect trucking within Canada rather than isolating for the effect of cross-border trucking activity.

To calculate the cost effect on the portion of transborder activity, we take Statistics Canada data on trucks for hire, combined with Transport Canada data on the share of trucking revenue from transborder activity. Transport Canada also estimated in a 2005 study that the annual costs for the trucking industry of U.S. border security measures ranged from \$179 million to \$406 million.[1] We assume that the middle of this range is a reasonable cost estimate. Applying the share of trucks for hire and the share of trucking revenue from transborder activity to revenue data from Statistics Canada reveals that the costs of the new border security environment may be equivalent to about 2 per cent of transborder trucking revenues, or about 1 per cent of total trucking revenues. This could be a bit of an overestimate since delays are a key cost factor in Transport Canada's estimate, and as the next section will describe, delays have fallen since that study was completed. Other changes to revenue, such as the appreciation of the Canadian dollar, may play a bigger role. Even so, assuming that truckers must absorb a large part of the post-9/11 border security costs themselves, this could still be quite important because average profit margins in the trucking industry ranged from 5 to 8 per cent in the post-2000 period. Even small cost changes could have large effects on behaviour, including where to place future investment, as we discussed earlier. Deeper analysis would need to confirm this tentative result.

The costs of the new border security environment may be equivalent to about 2 per cent of transborder trucking revenues.

Beyond trucking, the costs of crossing the border are not uniform across other industries. For example, border-crossing costs appear to be higher for food-exporting companies than for others. (See box "Food Exporters Face a 'Deeper' Border.") Some industries also seem likelier to be hurt more than others because of increased costs of crossing the border. (See box "Industries Most Likely To Be Hurt by Post-9/11 Trading Costs.")

1 DAMF Consultants Inc. and L-P Tardif and Associates Inc., *The Cumulative Impact of U.S. Import Compliance Programs at the Canada/U.S. Land Border on the Canadian Trucking Industry* (Ottawa: Transport Canada, 2005).

Food Exporters Face a "Deeper" Border

Food-exporting companies may bear higher costs of crossing the border than others in the current border environment. For instance, requirements to notify border officials of impending shipments two hours in advance (compared with one hour in advance for non-agricultural shipments) have imposed an extra cost on Nova Scotia and New Brunswick fish and seafood exporters that provide fresh fish to Boston.

Another factor food exporters face—one which existed prior to 9/11—is that U.S. Food and Drug Administration inspectors only work daytime hours. This requires food exporters to reschedule loads for daytime hours only. This rescheduling can add costs and service delays both to food shipments—many which are perishable and therefore time-sensitive—and to all other freight on those loads.

Agricultural product exporters—or their carriers—also characterize the border as "deep." What they mean is that truckers carrying agricultural products must see multiple agencies at the border. For example, carriers of meat products crossing from Canada to the U.S. must report to U.S. customs officials, the U.S. Department of Agriculture and the U.S. Food and Drug Administration. There are few links between these agencies in their operations at the border. This sometimes results in major delays and fines when agencies misplace paperwork, drivers hand paperwork in to the wrong agency, or the carrier forgets to report to one of the agencies. Interviewees report that border officials do not inform drivers that they need to report to other agencies. The decision to cross-authorize customs officials to inspect and release certain agricultural goods likely mitigates these problems. However, this does not yet apply to all goods.

In principle, there may be a rationale for food exporters having to conform to different standards, since food products have greater potential to harbour diseases and carry different risks than do some other types of traded goods. However, it does not make sense to have higher costs without greater safety or security gains. Greater coordination between agencies at the border—and allowing drivers to report to one border official who can address all three agency concerns—would better meet both safety and efficiency objectives.

Industries Most Likely To Be Hurt by Post-9/11 Trading Costs

Which companies are most likely to be hit hardest by post-9/11 costs of trading across the border? Which are those where small increases in costs might swing important future location decisions? We rank the following goods exports categories (at the NAICS 4-digit level) as most likely to be at risk if the post-9/11 security environment makes it more uncertain or onerous to cross the border. Our criteria are export intensity (export volumes as a share of shipments) and truck transportation dependency.[1] We also exclude those activities that are linked to raw materials extraction and are unlikely to be mobile.

1. Motor Vehicle Manufacturing
2. Basic Chemical Manufacturing
3. Computer and Peripheral Equipment Manufacturing
4. Resin, Synthetic Rubber, and Artificial and Synthetic Fibre Manufacturing
5. Rubber Product Manufacturing
6. Seafood Product Preparation and Packaging
7. Electrical Equipment and Component Manufacturing

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1 Ideally, we might use company and sector profit margins. Unfortunately, it is not easy to isolate the effects on profit margins resulting from cross-border activities only.

BENEFITS OF COMPLYING WITH POST-9/11 SECURITY CHANGES

Are the costs of complying with these programs commensurate with the resulting efficiency benefits? The programs' aims are to secure supply chains and fast-track cargo across the border. Some companies said they joined to reap the expected benefit of being able to fast-track their cargo. Many, however, mentioned that they enrolled in the programs primarily to protect their competitive positions. One company, in particular, joins "all security programs available in order to have [its] profile known to Customs," noting that "in the event of another 9/11 incident, only true security partners will be allowed to resume their cross-border activities and will be the first in line." In other words, companies enrol in these programs as insurance policies in the event of a major border disruption.

COMPLIANCE AS A COMPETITIVE ADVANTAGE

Some companies reported that they experienced improved efficiency and competitiveness from changes they made to comply with new security requirements. Others reported that complying with FAST requirements has led to improved internal systems, including significant savings on back-office processing costs. And others told the Conference Board that requirements to pre-notify border officials of their arrival have made the border process more efficient. Some companies also told the Conference Board that in areas where FAST works, it works well. They cited the Blue Water Bridge at Sarnia, Ontario, for example, as one such border crossing. Border officials also treat FAST drivers as trusted security partners, companies reported.

THE FAST LANE IS SOMETIMES AS SLOW AS THE REGULAR LANE

Many reported that the FAST program has failed to consistently meet its stated aims of getting pre-approved cargo quickly across the border. Where FAST works, it works well, but does not do so consistently at some border crossings and at peak hours. A number of interviewees reported that truckers often use non-FAST lines even if they are FAST-certified. This is because FAST lanes are not available at all border crossings or are sometimes not any faster than non-FAST lanes. A number of interviewees also reported that the FAST lanes did not work well, in particular at the Ambassador Bridge and at the Queenston–Lewiston crossings in Ontario.

Where FAST works, it works well, but does not do so consistently at some border crossings and at peak hours.

If congestion leading up to the border crossing extends beyond the start of the FAST lane, FAST-certified drivers and trucks must wait in the same volume of traffic as those that are not FAST-certified, nullifying the benefits of these programs. Interviewees cited lack of infrastructure on the Canadian side of the border and not enough Canadian customs officials as weak links in the process. Some of the benefits of the program can not be realized given the current state of infrastructure, they noted.

After Conference Board interviews had been completed, however, governments made a number of infrastructure improvements, such as adding a fifth lane at the Queenston–Lewiston crossing, new booths at the Ambassador Bridge and new truck lanes at the Peace Bridge. These changes, combined with moving to electronic rather than paper documents, will hopefully ensure the costs of investing in FAST are more in line with the actual benefits in the future.

Another reason FAST may not yet be meeting its intended objectives is that the U.S. and Canadian programs that are requirements to get into FAST and were supposed to be harmonized are not actually harmonized. This means that companies that want to ship their goods through FAST in both directions must meet two different sets of requirements. There does not appear to be a compelling policy reason for two different programs given that the two countries presumably are aiming to meet the same policy objectives of improving both security and efficiency. Government efforts to harmonize these programs are underway.

INDIRECT COSTS OF THE POST-9/11 BORDER SECURITY ENVIRONMENT

In addition to the direct costs of complying with new border security policies, companies may have to deal with more indirect costs as a result of the new border security environment.

COSTS OF BORDER-CROSSING DELAYS

Delays and the associated uncertainty can be costly. Time spent delayed at the border is time spent not driving, thus increasing transportation costs. Delays force companies to build in large buffer times between loads. Companies may also carry higher inventories as a buffer against delays, which cancels out the increased competitiveness just-in-time logistics provide. Delays may also render products useless, as in the case of fresh fish exports. Delays raise costs not only once, but each time an item crosses a border.

The public perception is that delays at the border are common post-9/11. A number of earlier studies reported increased delays in the post-9/11 period, and a Transport Canada 2005 study found that border delays were the costliest element of complying with border policies.[2]

To evaluate delays due to post-9/11 border security policies, this report combines evidence from interviews and data on border wait times.[3] Again, we try to separate out delays due to post-9/11 security policies from border congestion that was a problem long before 9/11. Delays, in this report, include anything that delays shipments, such as border lineups and inspections. Interviewees noted that significant delays were a feature of cross-border trade in the 2001–04 period. However, a number noted that, by mid-2006, delays had been drastically reduced.

Delays raise costs not only once, but each time an item crosses a border.

Delays that remain are reportedly worse for travel into the U.S. than into Canada, though a number of interviewees pointed to a lack of Canadian customs officials, particularly during early morning shifts, as being a problem, along with the lack of clarity regarding their mandate: security versus duty and data collection. Delays were also reportedly worse for Ontario border crossings—where the majority of trade crosses (see Exhibit 1 for a map of border crossings)—than for other locations, though interviewees also noted that a lack of U.S. customs officials created congestion problems at some crossings in British Columbia and Manitoba. Some respondents noted that variability in delays was still a problem.

April 2007 data on border-crossing wait times for regular (non-FAST) lanes from the Canada Border Services Agency show that there were few delays in either direction that month. The exception was during rush hours in

2 Transport Canada (2005).

3 The Conference Board's statistical analysis of the effects of the post-9/11 security environment on export volumes referred to above would not capture delays directly. This is because the analysis used quarterly data, which would not distinguish between exports that arrived on time and those that arrived hours or days later than scheduled—as long as they arrived within the same quarter.

both directions, though more so into the U.S. Even then, rush hour delays were generally less than 30 minutes for most crossings. The Blue Water, Peace and Ambassador bridges in Ontario occasionally had delays as long as 60 minutes crossing into the U.S. So the most recent data confirm that delays for non-FAST lanes are not problematic most of the time, but are still problematic at peak times and at some border crossings.

Why Fewer Delays Overall?

Some interviewees said delays have dropped because truck volumes are only now reaching pre-9/11 levels. But as the Conference Board's companion statistical analysis to this report (*Tighter Border Security and Its Effect on Canadian Exports*) found, truck volumes have been flat due to reasons such as the auto sector slowdown rather than border security policies. Since truck volumes were essentially flat during 2002 and 2003 when delays were common and continue to be flat when delays are less common, truck volumes alone do not seem to explain why delays are less common.

Interviewees suggested that delays are less common because of physical infrastructure improvements such as seven additional U.S. inspection booths at the Ambassador Bridge in Windsor; new access lanes at the Blue Water Bridge in Sarnia, Ontario; an additional lane at Queenston–Lewiston at Niagara Falls, Ontario; and a new bridge being built at St. Stephen, New Brunswick. They also noted that more border agents and new border policies post-9/11 contributed to the delay reduction.

Contrary to perception, long border delays are not a serious problem at most crossings. Moreover, by 2007, delays fell relative to the immediate post-9/11 period.

However, delays could be down for more negative reasons. There is strong evidence from both our statistical analysis and our interviews that due to post-9/11 policies, trucks have shifted away from their preferred crossings to other border crossings. They are also crossing at different times than what they previously considered optimal. We explore further the evidence and consequences of this later in this report.

Overall then, contrary to perception, long border delays are not a serious problem at most crossings. Moreover, by 2007, delays fell relative to the immediate post-9/11 period, and for both positive and negative reasons. Delays may be even less of a problem once the move to electronic processing of border documents is fully operational, as some interviewees pointed out.

COSTS OF CHANGED DELIVERY PATTERNS

The evidence suggests that while companies have not yet changed their trade volumes, the way they go about trading may have changed. In anticipation of another terrorist attack, or unpredictability at the border, some companies have established warehouses on the U.S. side of the border in addition to storing inventory on the Canadian side. This nullifies the benefits of just-in-time inventory management, a system that allows companies to ship goods just before they are needed and keep inventories and related costs low.

Some companies are also incurring extra costs to ship goods well ahead of time to guarantee their on-time arrival. Other changes include drivers refusing to take on cross-border routes or charging a premium for cross-border routes. Other companies have started charging "empty mile rates," that is, for the cost of driving an empty or partially empty truck across the border to get a U.S. shipment and return it to Canada. According to interviewees, these practices were common prior to the Canada–U.S. free trade agreement, but virtually disappeared after the signing of that agreement only to re-emerge in the post-9/11 period.

As well, as noted earlier, many truckers are shifting their cargo from their previously favoured border crossing to another crossing, or from a particular crossing time to an off-peak time, or from shipping by truck to shipping by rail. These could represent losses of efficiency if truckers are now crossing at a less optimal crossing than previously. Truckers also spend increased time idling to ensure they allow at least one-hour advance notice for their cargo manifest to arrive at the border before the goods themselves arrive.

As our interviews were conducted in the fall of 2006, it is possible that improvements since then have reduced these less efficient trading behaviours, thereby mitigating the indirect costs as a result of the post-9/11 border security environment.

COSTS OF MOVING POLICY TARGETS AND UNCERTAINTY

A further cost results from the tendency of governments to announce new border security policies and then change or add to them. This has been a feature of much border security policy-making in the post-9/11 period. As one interviewee noted, "Just when you thought that you understood the requirements and are in compliance, the bar gets raised." The number of policy changes in such a short period of time makes training and compliance difficult.

For example, carriers and shippers that have already made large investments in FAST and the advance notification rules in order to be fast-tracked across the border, now face new U.S. Department of Agriculture border-crossing fees. (See APHIS fee discussion in box "The Alphabet Soup of Post-9/11 Border Security Policies.") This means that they are subject to the same set of rules as those who have not been pre-approved. Companies will be less inclined to invest in fast-tracking programs if they know they may not see significant benefits.

This policy-layering creates uncertainty. As discussed earlier, uncertainty is more problematic for time-sensitive Canada–U.S. trade than are known costs or delays. It also penalizes those who moved early to comply with new rules or to undertake extra security measures to qualify for border fast-tracking. Policy-makers aiming to improve both security and efficiency would presumably want to reward rather than penalize these early adapters.

Border officials add further uncertainty with what interviewees called inconsistent treatment at different border crossings. Interviewees noted that "the border is more inconsistent" post-9/11. They said that rules are inconsistently applied, with differences at different border crossings. This makes it difficult for companies to train drivers and staff.

Companies will be less inclined to invest in fast-tracking programs if they know they may not see significant benefits.

Another key uncertainty raised as a major concern for many interviewees across a variety of sectors was the question of what would happen if another significant attack or other event causes a major border disruption. Some businesses told us that they lack confidence that investments they make in securing their supply chains under FAST or meeting other security requirements will pay off, though the U.S. has announced that those who are FAST- and NEXUS-approved will continue to cross the border in the event of another border closure.

These types of uncertainties impose more significant costs on goods that depend on predictable, secure market access.

CHAPTER 5

Policy and Business Implications

Chapter Summary

- In time, higher border costs could lead companies to locate in the U.S. instead of Canada.
- Conversely, with the right investments, Canada could position itself as a preferred point of access to North America.
- Canadian governments should mitigate costs by, among other actions, investing to ensure FAST delivers full benefits and minimizing new border rules.
- Businesses should view new costs as opportunities and establish plans for sensitive supply-chain elements in the event of an attack.

Post-9/11 border security measures have not affected export volumes directly; delays have declined; and some companies view the new border security policies as a source of competitive advantage, making border crossing smoother. But the evidence also clearly demonstrates that a number of companies have changed the way they go about trading and are bearing important new costs of trading across the border. Companies that need to get their goods to market appear to be doing whatever they must to do so, at higher cost and, therefore, reduced margins. Some of these costs are one-time; others are ongoing.

Policies have been layered on top of one another, creating uncertainty. Any uncertainty is a real disadvantage for Canada, which must overcome the natural bias for companies to invest in the much larger U.S. market. Governments can mitigate any policy-induced uncertainty, but may not be able to entirely eliminate the uncertainty associated with what might happen in the event of another attack. Some uncertainty was perhaps understandable in the first few years of transition post-9/11, as authorities needed to see what works and what does not. But enough time has elapsed since 9/11 that this transition period should be over, and authorities should be able to provide a stable and consistent border environment.

Any uncertainty is a real disadvantage for Canada, which must overcome the natural bias for companies to invest in the much larger U.S. market.

REACHING A TIPPING POINT?

WILL INVESTMENT SHIFT AWAY FROM CANADA?

One could argue that if export volumes have not changed, these new trade costs must be relatively unimportant. But we do not know which investors have already decided not to make new investments in Canada due to higher border costs. As well, contracts are fixed in the short- to medium-term. For example, auto companies usually sign five-year contracts with their suppliers. So the implications of a cost increase would only kick in at the end of the contract cycle. At that time, companies sourcing or investing in Canada would decide whether these new costs are sufficiently high to tip their decision toward sourcing or investing elsewhere.

This scenario is even more likely in the current economic environment where new and challenging competitive pressures have emerged post-9/11. Specifically, competition from large, rapidly growing developing countries in industries in which Canada has had a comparative advantage in the past is putting significant downward pressures on prices and margins. Obvious examples of these industries are pulp and paper, wood products, furniture, autos and auto parts, and telecommunication manufacturing products. Added to this new competitive landscape is the more than 40 per cent appreciation in the Canadian dollar vis-à-vis the U.S. dollar since 2003. For export-intensive industries, this currency appreciation reduces their revenues in Canadian dollars since their main competitors are in the U.S. market.

Even small increases in the costs of accessing the U.S. market could tip the balance away from investing in Canada, as discussed earlier. Further, small and medium-sized businesses may shy away from growth opportunities in the U.S. market due to the post-9/11 border security environment. These costs may offset some of the benefits of increased access to the U.S. market under the Canada–U.S. free trade agreement. They could dilute the potential benefits for Canada from operating in the North American economic space.

Given the long-term horizons for investment decisions, we may not yet have observed the full economic repercussions of the post-9/11 border security environment.

. . . OR CAN CANADIAN LEADERS SEIZE THIS AS AN OPPORTUNITY?

Canadians—and Americans—benefit from a border that effectively catches criminals while facilitating legitimate activities. Canadian leaders could seize the new border environment and security imperatives as opportunities to make Canada a seamless, secure, and possibly preferred, point of access to North America and the world.

The right public and private border security investments have the potential to increase, rather than decrease, the efficiency of cross-border movements. Moreover, by improving security, leaders reinforce economic interests, which thrive in a stable, secure operating environment.

What Government Leaders Should Do

To allow companies to minimize trading costs and maximize economic and security benefits of the new border environment, Canadian governments should:

Provide one-stop access and act as information brokers: Deciphering the alphabet soup of different new border programs, their requirements and their connections with each other is not easy, particularly for smaller companies. One Canadian government contact point should be responsible for liaising with industry on customs compliance and security issues. Post-9/11 border security programs and their relationships with each other are not easy to understand, and new programs come into play regularly. The government contact point should be responsible for identifying, listing and explaining all current and upcoming federal, provincial and state requirements for border crossing and trading between Canada and the U.S. As far as this author can determine, no such list exists. This information broker role is critical to create predictability and to help companies—particularly smaller ones—adapt to the changed environment.

It is critical to create predictability to help companies adapt to the changed environment.

Ottawa should also work with the U.S. to ensure that truck drivers need only report to one border official who can address rules for multiple agencies. U.S. customs officials can already inspect and release certain agricultural goods under the U.S. *Bio-Terrorism Act*, so this change would simply extend that provision. Ensuring a more coordinated response would better meet both safety and efficiency objectives and prevent lost trade due to, for example, food spoilage.

Enable FAST to deliver benefits commensurate with costs: In principle, the post-9/11 border security programs to pre-approve and fast-track low-risk cargo should improve both efficiency and security outcomes. In practice, FAST does not yet seem to deliver fully on either front. The potential is there, however. To get companies to enrol in the face of large upfront costs, governments must ensure companies can reap benefits as soon as possible.

This means harmonizing or mutually recognizing Canadian and U.S. FAST program requirements, investing in infrastructure to avoid congestion in the approaches to the FAST lanes, and possibly creating a FAST-only border crossing. A joint Canada–U.S. working group is working toward making these programs more compatible. Governments in jurisdictions that gain more from cross-border trade should arguably bear greater costs for infrastructure investments.

Provide adequate resources on the Canadian side: The common perception is that U.S. security policies are responsible for any cross-border cost increases. But the Conference Board's interviews demonstrated that there are a number of contributing factors within full Canadian control. For one, Ottawa should address the lack of Canadian customs officials during early morning shifts, a key contributor to delays. For another, Ottawa and the affected provinces need to provide adequate resources—leveraging private sector funds as well—to build an additional crossing at Windsor–Detroit.

Take the pressure off the border: Policy-makers should take a hard look at what activities absolutely must take place at the border, what activities can take place at first entry into North America or before getting to the border, and what activities do not need to take place at all. The focus should be on attaining security and efficiency goals, not on the border as an end point. After all, the point is not to make the border more secure, but to make Canadian and American societies more secure and prosperous. The border itself may not be the most efficient or appropriate place to best meet these goals. For example, U.S. officials could be stationed on the Canadian side of the border and pre-clear goods for entry to the U.S. (While this is mandated in the Security and Prosperity Partnership, at the beginning of May 2007, the U.S. Department of Homeland Security broke off talks regarding moving U.S. customs officials to Canadian soil at the Peace Bridge linking Ontario and New York.) Canada and the U.S. might also increase their joint work to more thoroughly scrutinize cargo at entry points into North America. The two countries could then institute a more random or intelligence-based check for non-pre-approved cargo at the Canada–U.S. border.

Duties are no longer a relevant element of industrial policy, particularly as goods are increasingly complex with parts from multiple countries.

Canada might also eliminate some border functions and non-security related trade obstacles. For example, why continue to have companies and government spend time and energy determining if duties need to be paid and having border officials collecting duties? Though the Canada–U.S. free trade agreement eliminated most duties between Canada and the U.S., duties still exist on goods from other countries, requiring a statement of the good's origin at the border to determine whether it qualifies for duty-free treatment. Duties are no longer an important source of government revenue nor a relevant element of industrial policy, particularly as goods are increasingly complex with parts from multiple countries. Import duties on inputs used by Canadian companies penalize company competitiveness.

Canada might also mitigate the effects of border security costs by eliminating regulatory differences between Canada and the U.S. where regulatory goals are similar, an initiative that is part of the Security and Prosperity Partnership. Such differences add complexity to manufacturing without leading to better public interest outcomes.

Minimize new or layered rules and uncertainty: Canada should limit the introduction of new border security rules to ones where the expected security benefit justifies the economic, social and other costs. Ottawa should encourage Washington to do the same. This includes working to eliminate or reduce new U.S. border-crossing charges that are used to fund inspection of agriculture but are charged on all companies that cross the border, including companies that have invested in the prerequisite programs for FAST.

Ideally, Canada and the U.S. should coordinate or mutually recognize any existing and new policies, except in areas where policy goals differ between the two countries. Canada should work with the U.S. to minimize the complexity and layering of border policies, and to effectively make use of technology to simplify policy compliance. Governments should ensure that companies that joined border programs early on can transfer their eligibility to any new systems. Policies should be transparent and announced long in advance of implementation.

Offset border uncertainty: Canada's government should adopt non-border-related policies that could improve the competitiveness of Canadian companies in order to mitigate any disadvantages created by perceived or actual increased costs of access to the U.S.

Prepare for the possibility of another 9/11: Federal, provincial and municipal officials, as well as their U.S. counterparts, should have a clear plan for border resumption and priority-setting in the event of another catastrophic event. This plan should be clearly communicated to companies that cross the border.

What Business Leaders Should Do

To minimize trading costs and maximize economic benefits of the new border environment, business leaders should:

Accept some cost increase as the price for market access: The reality is that businesses today must make security investments to participate in the U.S. market. And it may be appropriate for them to incur some increased cost if it ensures them better access to that market. Of course, businesses should not invest in security at all costs.

View the new border environment as an opportunity: Some companies are successfully using the new border security requirements to reduce waste and costs, improve security, and establish themselves as trusted partners in the eyes of border officials. In their view, these investments have given them more predictable access to the U.S. market and improved their competitive position.

Consider carefully whether to wait for FAST benefits or get pre-approved: Benefits have not fully materialized for these programs and upfront costs are high, especially for smaller companies. But not getting pre-approved could jeopardize a company's competitive position over the long term. Smaller businesses might want to wait until benefits are truly commensurate with costs.

Develop a plan in the event of another attack: Companies should establish flexible contingency plans for the most sensitive elements of their supply chains, to ensure they can respond quickly to a wide range of threats. The plan should take into account the reality that the government may not have such a well-defined plan.

The reality is that businesses today must make security investments to participate in the U.S. market.

With suitable investments of the sort described here, border crossing could conceivably be smoother and more secure than it might otherwise be, allowing Canada and its companies to position itself as an attractive place for the world to enter North America. Without such investments, border crossing could become more costly and unpredictable, eating away at the competitiveness of Canadian companies over time and tipping the balance away from investment in Canada.

CHAPTER 6

Conclusions

Chapter Summary

- The post-9/11 border security environment has not reduced Canadian exports to the U.S. or led to delays in recent years.
- However, the new environment has increased the cost of access to the U.S. market and to some degree changed the way companies trade across the border, which could reduce investment in Canada aimed at serving the U.S. market.
- With appropriate public and private investments, Canada could maximize the economic and security benefits of the post-9/11 border reality.

This analysis demonstrates that the post-9/11 border security environment did not affect Canadian export volumes to the U.S. and that delays are reduced. Other studies that have found important export effects or delays may have incorrectly attributed to post-9/11 policies what should have been attributed to other factors.

It is clear, however, that the post-9/11 border security environment has changed the way many companies go about trading across the border. Companies are bearing important new costs of cross-border trade, ranging from the direct costs of complying with new policies, to more indirect costs such as greater uncertainty, to operating warehouses on both sides of the border. Companies that need to get their goods to market appear to be doing whatever they must to do so.

In the highly competitive global operating environment, even small new border costs can have important negative economic consequences.

This new border security environment poses challenges for a country like Canada. Investors will, all else being equal, tend toward locating production in the larger U.S. market. If new border-crossing costs make access to the U.S. market more difficult, this tendency will be heightened. In the short term, there may be no effect on exports, but as contracts expire and companies consider new investments, these new costs will factor into longer-term decisions to source from and invest in Canada. In the highly competitive global operating environment, even small new border costs can have important negative economic consequences, and could dilute some of the benefits for Canada of operating in the North American economic space. It is important to recall that this competitive environment is stiffer than ever given the high Canadian dollar and the new competition firms face from rapidly growing, large, developing countries.

The new border security environment also offers opportunities for Canada. Programs to separate pre-approved and trusted cargo from unknown-risk cargo can be powerful tools to improve both security and efficiency. Where FAST works, it works well, and some companies view it as a competitive advantage that has allowed them to reduce waste and be recognized as trusted security partners at the border. But these programs are not fully realizing their benefits. Interviewees told us that FAST-approved drivers often elect to use regular lanes, for example. If FAST programs were implemented effectively across all border crossings, Canada could become a more attractive place for global companies to access North America.

To enable secure, predictable access to the U.S. market, Canadian governments must keep new rules simple and predictable and inform businesses of both Canadian and U.S. rules through a one-stop portal. They should also work with the U.S. to mutually recognize Canadian and U.S. border policies for FAST and possibly create a FAST-only border crossing. Adequate investment in border infrastructure and manpower on the Canadian side of the border is also critical. Canadian policy-makers should reassess their priorities (for example, should border officials be responsible for collecting duties?) and have a clear plan for border resumption in the event of another 9/11.

Companies, on the other hand, should develop a flexible plan to protect the most sensitive parts of their supply chains in the event of another attack. They might need to accept some upfront border security cost increase as the price for secure market access, but they should view that cost as an opportunity to ultimately invest in and improve their competitive position. Some companies interviewed in this report saw their upfront security-program costs as an opportunity to reduce waste, improve their systems and ensure they are viewed as a trusted security partner at the border. Still, smaller businesses might hold off on signing up for FAST until the benefits are commensurate with the costs.

Governments must keep new rules simple and predictable.

These government and business changes would represent a positive start toward minimizing trade costs, increasing predictability, and maximizing the economic and security benefits of the post-9/11 border reality.

APPENDIX A

Related Products and Services

International Trade and Investment Centre

The Centre's main aim is to help Canadian leaders better understand what global economic dynamics—such as global and regional supply chains—mean for public policies and business strategies. It promotes informed dialogue on Canada's global economic role and proposes solutions for improving Canada's future trade and investment performance. For more information on the International Trade and Investment Centre, go to www.conferenceboard.ca/ITIC/

The Centre for National Security

The Centre brings together senior executives from a variety of organizations with national security mandates. These public and private sector executives work together to improve the detection of threats, coordination and interoperability of response, the free movement of low-risk people and trade, and communication with the public. For more information on the Centre for National Security, go to www.conferenceboard.ca/CNS/

Tighter Border Security and Its Effect on Canadian Exports

This report uses statistical methods to assess the impact tighter border security has had on Canada's exports to the United States. Export flows are examined in a variety of ways, including aggregate exports, exports by port and exports by commodity. After accounting for economic growth in the United States and relative prices between the two countries, the study finds little evidence that tighter border security has reduced export volumes. This study is a companion technical report to *Reaching a Tipping Point?*

Facing the Risks: Global Security Trends and Canada

Over the next 15 years the world will grow increasingly complex, creating new opportunities but also new security risks. This report outlines potential risks and suggests approaches for addressing them.

Adopt a More Strategic Approach to International Trade

At a time when international business and trade is becoming vastly more competitive, Canada needs to become much more strategic in its approach to international trade and related investment. The central challenge is how best to secure and maintain our position in the global value chains of companies in the U.S. and around the world.

If We Can Fix It Here, We Can Make It Anywhere: Effective Policies at Home to Boost Canada's Global Success

This report discusses five types of barriers that Canada can control—including labour mobility, infrastructure restrictions, and regulatory differences between provinces—as well as some of their likely effects.

Canada's Changing Role in Global Supply Chains

Companies are reorienting along global and regional supply chains. This report looks at how Canada fits into global supply chains and where others fit into Canadian production—and what it means for decision-makers.

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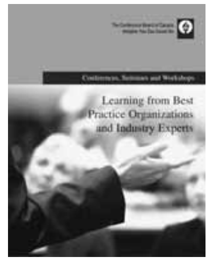

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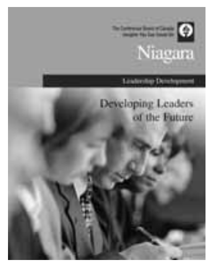

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The Conference Board of Canada
255 Smyth Road
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Tel. 1-866-711-2262
Fax 613-526-4857
www.conferenceboard.ca

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845 Third Avenue, New York NY
10022-6679 USA
Tel. 212-759-0900
Fax 212-980-7014
www.conference-board.org

The Conference Board Europe
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Tel. +32 2 675 54 05
Fax +32 2 675 03 95

The Conference Board Asia–Pacific
2802 Admiralty Centre, Tower 1
18 Harcourt Road, Admiralty
Hong Kong SAR
Tel. +852 2511 1630
Fax +852 2869 1403

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Tel. 613-526-3280 • *Fax* 613-526-4857 • *Inquiries* 1-866-711-2262

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