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## Canada-U.S. Relations

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January 2, 2014

**Congressional Research Service**

7-5700

[www.crs.gov](http://www.crs.gov)

96-397

## 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 enjoyed 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 it thought necessary, relations continued to be cordial. In early 2006, a minority Conservative government led by Stephen Harper assumed power in Ottawa. It was regarded as being more ideologically in tune with the George W. Bush Administration than the Liberals had been; some observers believe that this compatibility helped facilitate bilateral cooperation. This cooperation has continued with the election of President Obama in November 2008, despite the differences in the two leaders' governing philosophies.

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, 2001, the United States and Canada have cooperated extensively on efforts to strengthen border security and to combat terrorism, particularly in Afghanistan. Both countries were also 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 three 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 intellectual property rights. The most recent clash 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 trans-border 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 an 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. policy makers. 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 policy makers.

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## Overview<sup>1</sup>

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 51<sup>st</sup> 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.<sup>2</sup>

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

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

<sup>2</sup> “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.

and Bush met once more and talked about a variety of issues, from terrorism to the “mad cow” 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.<sup>3</sup>

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 22<sup>nd</sup> 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, DC, 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 the U.S. Ambassador to Canada 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.<sup>4</sup>

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. 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, many observers believe both leaders are pragmatic in their approach to solving public policy problems, and that the bilateral relationship will continue to be collaborative and productive. On February 19, 2009, renewing a tradition broken in 2001 by President Bush, President 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, DC, to meet with Obama again in February and December 2011; the two leaders agreed to the establishment and implementation of a U.S.-Canada Regulatory Cooperation Council and issued a Declaration on a Shared Vision for Perimeter Security and Economic Competitiveness. Prime Minister Harper was in Washington, DC, again in April 2012 to attend a North American summit meeting with President Obama and Mexican President Felipe Calderon.<sup>5</sup> In recent months, however, disagreements have emerged over the issues of energy/environment (approval of the Keystone XL pipeline) and intellectual property rights.<sup>6</sup>

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<sup>3</sup> “Bush Launches Bid To Repair US-Canada Ties.” *Agence France-Presse*. November 30, 2004.

<sup>4</sup> “Harper Tells U.S. To Butt Out On Plans For Defending Canada’s Arctic.” *Canadian Press*. January 26, 2006.

<sup>5</sup> “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>.

<sup>6</sup> “Obama Risks Relationship, Former Ambassador Says.” *Toronto Sun*. July 30, 2013. “Obama’s Pick for Ambassador to Canada Faces Senate Grilling.” *Globe and Mail*. December 11, 2013.

## Canada's Domestic Scene

### Background and Current Political Situation

The Liberal Party, which took power from the Conservatives in 1993, was by 2003 being commonly referred to as “Canada’s natural ruling party.”<sup>7</sup> Maintaining a Liberal majority appeared to be a safe bet at that time, but in early 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.<sup>8</sup>

The Liberals’ standing in the polls plummeted, and support for 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 had been relatively short-lived, Harper kept one eye on the next elections. In addition, Harper relied upon the *ad hoc* support of Canada’s other three political parties to ensure passage of the various items on his legislative agenda. Many believe that is why he advocated fairly centrist policies.<sup>9</sup>

However, Harper was 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, but a large contingent has remained in a training capacity.

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.

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<sup>7</sup> “Welcome To Their Nightmare: Finally, a Reason To Start Paying Attention To Politics Once Again.” *Globe and Mail*. December 8, 2003.

<sup>8</sup> “Canada: Martin on the Ropes in Funding Scandal.” *Oxford Analytica*. February 25, 2004. February 23, 2004. “Canada’s Premier Acts to Counter Scandal.” By DeNee L. Brown. *Washington Post*. February 17, 2004.

<sup>9</sup> “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.

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.<sup>10</sup>

During this time, the Liberal party named public intellectual Michael Ignatieff as their new leader. Some believed that when Parliament returned in January 2009, 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 and to consolidate the party's strength rather than challenge the Conservatives immediately.<sup>11</sup>

In the fall of 2009, many believed the Harper government might face a no-confidence vote in parliament, 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.<sup>12</sup>

However, an uptick in the economy helped Harper, whose party also benefited from a "bounce" from the success of the February 2010 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.

On March 25, 2011, the Conservatives lost a no-confidence vote, presumably over a contempt of parliament ruling that the government had underestimated the costs of prison construction and of military fighter aircraft procurement; however, some observers maintain that the budget was the main point of contention.<sup>13</sup>

The no-confidence motion prompted Canada's most recent elections, held on May 2, 2011; it was the fourth time Canadians had gone to the polls in seven years. But unlike the last three elections, 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

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<sup>10</sup> "Canadian Leader Shuts Parliament To Avoid No-Confidence Vote, Angering Many." *New York Times*. December 6, 2008.

<sup>11</sup> "The Liberals Try a New Leader," *The Economist*, December 13, 2008.

<sup>12</sup> "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.

<sup>13</sup> "Canada: Country Report." *Economist Intelligence Unit*. April, 2011. p. 11.



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 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 Bloc Québécois (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 a seat—another first.<sup>14</sup>

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. 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.

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.” After five years of running a minority government, conservatives now had greater latitude to pass the kind of legislation they wanted to. But observers noted that they still needed to steer somewhat toward the middle—with an eye toward maintaining control of parliament after the next elections.

The Conservatives pushed several proposals through parliament, including repeal of the Canadian Firearms Registry, elimination of the government's role in the Canadian Wheat Board, a strengthening of the criminal code, and a reduction in election subsidies for political parties. Following the 2011 census, the government added 30 new seats to the House of Commons (thereby increasing the number of seats to 338) in order to reflect population changes. The Prime Minister has also continued to call for reform of the by-appointment Senate. Harper's government will also continue to assert its sovereignty in the Arctic, and to promote the production and export (mainly to the United States) of Alberta's oil sands petroleum.<sup>15</sup> Since the elections, the Harper government has maintained its focus on fiscal retrenchment, employment, energy, and trade issues. For example, on October 18, 2013, the government announced that it had concluded a free trade agreement with the European Union (see below).

In 2012, Ottawa was preoccupied with the so-called “Robocall” controversy. In February 2012—nine months after the elections—two journalists alleged that campaign operatives for the Conservatives had sent computer-generated recorded telephone messages to registered opposition voters, directing them to incorrect polling stations. Elections Canada (the Canadian equivalent of the Federal Election Commission) investigated the claims, and in May 2013 a federal court ruled that fraud had been involved in the calls. The controversy, along with other factors, has caused the Conservatives to slump in the polls. The party's standing also suffered from an ongoing, high-profile scandal involving charges of improper usage of official expense accounts by several Conservative Senators—an activity that also allegedly involved the former chief of staff of the Prime Minister's office.<sup>16</sup>

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<sup>14</sup> 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>.

<sup>15</sup> “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.

<sup>16</sup> “Delayed Reaction.” *The Economist*. March 3, 2012. “Tories Accused of Minimizing Robo-calls Controversy.” (continued...)

In April 2013, the Liberals elected Justin Trudeau, son of former Prime Minister Pierre Trudeau, as party leader. He has proven to be popular, leading Harper in an August 2013 poll on all but economic issues.<sup>17</sup> However, although the Conservatives currently trail the Liberals in public opinion surveys, the next elections are not scheduled to be held until the fall of 2015. A continued strong economy could boost Harper if voters lean toward pocketbook issues. In addition, some observers argue that Canadians are weary of elections; at 61.4%, turnout for the last vote was the third lowest in history. Voter participation may therefore play a key role in the next election.

## National Unity

For more than four decades, an emotional debate has waxed and waned 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 provincial 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. Nearly two decades 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 was a committed federalist, which ruled 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 asserted that Charest learned from this experience and changed his tactics. In elections held in 2007 and 2008, the Liberals won a plurality, and a majority, respectively; Charest retained his spot as premier. However, in September 3, 2012, provincial elections the PQ returned to power as a minority government, under the leadership of Pauline Marois.<sup>18</sup> In a recent CROP poll taken in Québec, 44% of those surveyed said they favored independence for the province, while 56% were opposed.<sup>19</sup>

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(...continued)

*Globe and Mail*. March 30, 2012. "Numbers Add Up To Trouble For Tories." *National Post*. March 23, 2012. "Systemic Approach to Voter Interference 'Extremely Worrisome': Trudeau." *The Canadian Press*. May 24, 2013. "Robocall Court Ruling 'Should Bolster' Reform; Former Elections Canada Chief." *The Canadian Press*. May 25, 2013. "Was There More to 2013 Than the Senate Scandal? Not Much." *Toronto Star*. December 23, 2013.

<sup>17</sup> Trudeau, Harper Seen as Polar Opposites Politically, Mulcair Squeezed: Poll. *Canadian Press*. August 29, 2013.

<sup>18</sup> "The Nationalists Are on the Rise": Pollster; Forum Research Survey; PQ Would Romp To Landslide Victory If Provincial Election Were Held Today" *Montreal Gazette*. March 27, 2012. "The Separatists Are Back." *The Economist*. September 8, 2012.

<sup>19</sup> Poll Shows Growing Support for Parti Quebecois. *CTV News*. December 11, 2013.

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 would be faced with difficult political and economic questions.

## Foreign and Security Policy Issues

The Canadian Ministry of Foreign Affairs and International Trade lists several policy priorities for the period 2013-2014:

- implementing the Global Commerce Strategy, with a special focus on emerging markets (including China, India, and Brazil);
- contributing to effective international governance and security, and to the promotion of human rights;
- further strengthening of ties with the United States through cooperation in the areas of border management, trade, investment, energy (particularly with regard to oil sands), and the environment; and enhancing Canada’s involvement in the hemisphere;
- increasing engagement, both political and commercial, in Asia;
- enhancing the role of Canada’s consular services in ensuring the safety of Canadians abroad;
- exercising sovereignty in the Arctic; and
- playing a leading role in international activities to fight poverty and provide humanitarian assistance, focusing particularly on food security, the well-being of children, sustainable growth, and private sector partnerships.<sup>20</sup>

As a middle power (the population in July 2013 was just under 35 million), 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

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<sup>20</sup> Priorities for 2013-2014. Foreign Affairs, Trade, and Development Canada. Modified June 25, 2013. <http://www.international.gc.ca/departement-ministere/priorities-priorites.aspx?view=d>.

NATO's military committee, a post he held until 2008. And in 2011, Lieutenant-General Charles Bouchard was head of the allied military operations in Libya.<sup>21</sup>

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 December 2013, more than 625 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."<sup>22</sup>

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 that 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.<sup>23</sup>

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 56<sup>th</sup> 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 Canadian Senate published yet another report, which called for a doubling of spending on defense.<sup>24</sup>

Both Liberal and Conservative Canadian governments appear to have heeded these messages. As of March 2013, Canada's armed forces had increased to approximately 66,000 regular force members and 31,000 reserves. Canada's defense spending increased during the second half of the last decade; the budget tabled in February 2005 contained the largest military spending increase in 20 years: C\$12.8 billion—roughly equal to the entire 2005 military budget—spread over five

<sup>21</sup> "Canada Moving Into Role As Leader Overseas." *Vancouver Sun*. March 28, 2011.

<sup>22</sup> *Canada and International Peacekeeping*. By Joseph T. Jockel. Center for Strategic and International Studies/Canadian Institute of Strategic Studies. Washington, DC, 1994. Canadian Operations. Canadian National Defence web site. Updated December 19, 2013. <http://www.forces.gc.ca/en/operations-abroad-current/index.page>. "Canada Must Stand On Guard." *Winnipeg Free Press*. October 27, 2010.

<sup>23</sup> "Spend More On Military, U.S. Envoy Urges Ottawa." *Toronto Star*. February 25, 2004.

<sup>24</sup> "Armed Forces Hobbled, Report Says." By Daniel LeBlanc. *Globe and Mail*. December 3, 2003. "Senators Sounding Alarm On Defence." *The Gazette*. October 3, 2005.

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 provided for yearly increases of 2% beginning in 2011-2012. The government budget for the armed forces in 2008-2012 averaged around C\$20 billion annually. However, due to budget retrenchment, military spending over the next few years is expected to remain fairly flat. In addition, Canada unilaterally halted its contribution to two NATO air surveillance programs, and may cancel, delay, or reduce its planned purchase of F-35 fighter aircraft (see below). Jane's estimates Canada's defense spending at 1.053% of GDP for 2013, and forecasts it to fall to 0.884% of GDP by 2017, as GDP grows and defense budgets stay relatively unchanged.<sup>25</sup>

## U.S.-Canada Foreign and Security Policy Issues

For a variety of practical and historical reasons, Canada's relations with the United States have always been a key priority. The two countries share a 5,500-mile border, a common language, and cultural similarities, as well as vital interests in the international realm. Trade between the two countries well exceeds \$1 billion per day; however, Canada's dependence on exports to the United States has prompted several governments to attempt to expand and diversify its international commerce.

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.<sup>26</sup>

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

<sup>25</sup> *The Military Balance, 2013*. International Institute for Strategic Studies. Defence and Budget 2005—Highlights. DND website. [http://www.forces.gc.ca/site/reports/budget05/summ05\\_e.asp](http://www.forces.gc.ca/site/reports/budget05/summ05_e.asp). IHS Jane's Sentinel Security Assessment – North America. Defense Budget Overview. Updated November 1, 2013.

<sup>26</sup> United States Department of State. Bureau of Western Hemisphere Affairs. *U.S. Relations with Canada*. August 23, 2013. "Remarks to the Center for Strategic and International Studies." February 28, 2005.

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.<sup>27</sup>

### *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 in 2003, but no official policy was enunciated. 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 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."<sup>28</sup>

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.<sup>29</sup> Nevertheless, some Canadian policy makers continue to make the case for their country participating in the U.S. ballistic missile defense program.<sup>30</sup>

<sup>27</sup> "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.

<sup>28</sup> "Shoot Down Defence Dreamers." By Paul Koring. *Globe and Mail*. June 25, 2003.

<sup>29</sup> "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.

<sup>30</sup> See, for example: "Colin Kenny: The Case for Missile Defense." *National Post*. September 16, 2013.

## 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 additional funding 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 to 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. 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. However, in early 2012, it was reported that the government was contemplating delay or cancellation of the purchase. Associate Defense Minister Julian Fantino told a parliamentary defense committee that "we have not as yet discounted the possibility, of course, [of] backing out of the program." He later clarified that the government might purchase fewer than 65 of the deep strike fighters, and that "this government will adapt our plans as necessary to maintain this acquisition within the existing budget." In December 2013, it was announced that Canadian firms could garner nearly \$10 billion in contracts over the life of the F-35 program.<sup>31</sup>

## NATO

According to Canada's Foreign Affairs Ministry, "Canada's priority for NATO is to ensure that the Alliance remains modern, flexible and agile and thus able to face the threats of today and those arising in the future. This goal drives all of Canada's efforts on NATO transformation, reform and partnerships with non-NATO countries."<sup>32</sup> According to IHS Jane's, "it is clear that the Harper government sees Canada's role in NATO as central to its foreign and security policy."<sup>33</sup>

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

<sup>31</sup> "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. "Ottawa Having Second Thoughts on F-35 Jets." *Globe and Mail*. March 14, 2012. "Tories Say F-35 Jets Will Come, Eventually." *Toronto Star*. March 17, 2012. "Stealth-Fighter-Benefits." *The Canadian Press*. December 10, 2013.

<sup>32</sup> Canada in NATO. Foreign Affairs, Trade and Development Canada web site. Updated April 29, 2013. <http://www.international.gc.ca/nato-otan/index.aspx?lang=eng>.

<sup>33</sup> Canada: External Affairs. Jane's Sentinel Security Assessment – North America. Accessed December 20, 2013.

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.<sup>34</sup> 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.<sup>35</sup>

Although it has no troops stationed in allied member states 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 (Kosovo). In addition Canada has supported non-NATO peacekeeping operations; it provided 600 personnel to the initial U.N. peacekeeping mission in East Timor and 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.<sup>36</sup>

In March 2012, however, it was reported that, as a part of its wide-ranging budget retrenchment efforts, the Canadian government had notified the alliance that it would halt its participation in the NATO Airborne Warning and Control System (AWACS) and the Alliance Ground Surveillance (AGS) program; the government estimates savings at C\$90 million.<sup>37</sup>

## *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 served 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 158 Canadians, including one diplomat, have died in Afghanistan. In 2005, Canada launched a Provincial Reconstruction Team mission in Kandahar. Canada ended its combat role in Afghanistan in July 2011; however, a sizeable contingent of troops (950 as of October 2013) will remain until 2014 to help train Afghan national security forces. Ottawa also has provided considerable humanitarian and reconstruction aid to Afghanistan; in 2011-2012, the Canadian International Development Agency (CIDA) disbursed C\$127.4 million in development and humanitarian assistance.<sup>38</sup>

<sup>34</sup> "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.

<sup>35</sup> NATO's Future At Stake In Afghanistan: MacKay. *Ottawa Citizen*. February 16, 2009.

<sup>36</sup> Current Operations. Canadian Expeditionary Force Command website. Updated April, 2009. <http://www.comfec-ecfcom.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.

<sup>37</sup> "Canada Bails Out of NATO Surveillance Programs." *National Post*. March 19, 2012.

<sup>38</sup> DND website: <http://www.forces.gc.ca/en/operations-abroad-current/op-attention.page?>. Afghanistan: Overview. Government of Canada website. updated July 9, 2013. <http://www.acdi-cida.gc.ca/acdi-cida/ACDI-CIDA.nsf/En/JUD-129153625-S6T>.



## Libya

In March 2011, 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. 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 was strong public support for Canada's participation.<sup>39</sup>

## 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, 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. In June 2013, the Harper government announced that it would send 34 troops to assist in stabilizing Haiti before the hurricane season, and in August, Canada's Minister of International Development visited the island nation.<sup>40</sup>

<sup>39</sup> "Dispatch: Canadian Support For the Libya Intervention." Stratfor. March 28, 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.

<sup>40</sup> "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 March 12, 2013. [http://www.canadainternational.gc.ca/haiti/engagement/whole\\_of\\_government-pangouvernementale.aspx?view=d](http://www.canadainternational.gc.ca/haiti/engagement/whole_of_government-pangouvernementale.aspx?view=d). Minister Paradis Visits Haiti to Assess Progress and Challenge. Canadian Foreign Affairs Ministry web site. August 28, 2013. <http://www.acdi-cida.gc.ca/acdi-cida/acdi-cida.nsf/eng/ANN-828134040-NQY>.

## *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, Prime Minister 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.<sup>41</sup>

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.<sup>42</sup>

## *Cuba*

Cuba has been another issue where Canada and the United States 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 Castro (temporary in 2006, permanent in 2008) prompted vigorous debate in the Canadian press over what policy Ottawa should adopt toward Cuba.<sup>43</sup> 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,

<sup>41</sup> "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.

<sup>42</sup> "Iraq: Canada's Commitment." Canadian International Development Agency web page: <http://www.acdi-cida.gc.ca/iraq#1>. Updated May 24, 2007.

<sup>43</sup> 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.

Minister of State of Foreign 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. In February 2013, Canadian Foreign Minister Baird met with his Cuban counterpart to discuss bilateral cooperation on trade, investment, and tourism—in 2012, Canada was the source of an estimated 1 million tourist trips to Cuba.<sup>44</sup>

## *China*

Relations between Canada and China were somewhat cool during the early years of the Harper government, when Ottawa criticized Beijing’s human rights practices and conferred honorary citizenship on the Dalai Lama.<sup>45</sup> Observers argue that a turning point occurred in late 2009, when Prime Minister Harper, reportedly responding to the Canadian business community, made his first trip to China; Premier Wen Jiabao publicly chided the Canadian Premier for not having visited sooner. Today, the Canadian Government’s web site characterizes bilateral cooperation as “strong,” noting that several ministries “have productive cooperation programs and memoranda of understanding with their Chinese counterparts, and hold regular exchanges ... .” During a July 2011 visit to Beijing, Foreign Minister John Baird declared that relations between the two countries had “entered a new era,” and described China as a “friend” and “ally.” Prime Minister Harper traveled to China a second time in February 2012. During the visit, he signed 20 commercial deals worth C\$3 billion, as well as a declaration of intent on a long-pending investment protection agreement. Foreign Minister Baird returned to China in July and October 2013. In November 2013, the Canadian media noted that Prime Minister Harper had yet to meet with President Xi Jinping, and speculated that various trade and human rights issues might have created strains in the bilateral relationship.<sup>46</sup>

## *Border Issues*

Even before the September 11, 2001 (9/11), Al Qaeda attacks on New York and Washington, DC, U.S.-Canadian border security was a key issue for both countries. Border security first became a matter of urgent concern in December 1999, when U.S. officials, acting on a tip from Canadian

<sup>44</sup> “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. “Canada, Cuba Look to More Economic Cooperation.” *Agence France Presse*. February 16, 2013.

<sup>45</sup> Canada: Country Report. *Economist Intelligence Unit*. August, 2011. p. 11. Canada/China: Harper Trip Raises Hoes For Relations. *Oxford Analytica*. December 2, 2009.

<sup>46</sup> Canada—China. Government of Canada web site: [http://www.canadainternational.gc.ca/china-chine/bilateral\\_relations\\_bilaterales/index.aspx?lang=eng&menu\\_id=2](http://www.canadainternational.gc.ca/china-chine/bilateral_relations_bilaterales/index.aspx?lang=eng&menu_id=2) Accessed December 20, 2013. ‘New Era’ For Canada and China, Baird Says. *National Post*. July 21, 2011. Baird Embraces China As ‘Friend.’ *Globe and Mail*. July 19, 2011. “Harper’s China Visit Ends with Panda Pact.” CBC News. February 11, 2012. <http://www.cbc.ca/news/world/story/2012/02/11/harper-china-saturday.html> “PM Yet To Meet China’s President.” *Ottawa Citizen*. November 20, 2013.

authorities, stopped Ahmed Ressay at the border as he was attempting to smuggle explosives into the United States. It was later discovered that Ressay 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 9/11 hijackers entered from Canada, the 2001 attacks sparked renewed debate over Canadian laws regarding the treatment of immigrants seeking refugee status or political asylum.<sup>47</sup> By February 2002, Ottawa had taken “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.”<sup>48</sup>

Skeptics question whether determined terrorists and criminals can reliably be prevented from traversing the two countries’ 5,500-mile border. And efforts to strengthen border security must be balanced against competing pressures to facilitate legal travel and trade by preventing long delays at border crossings. About 80% of U.S.-Canada merchandise trade crosses the border by truck; and many of these shipments are “just-in-time” deliveries, so that crossing delays can seriously disrupt manufacturing in both countries.<sup>49</sup> International tourism is also a key export for both countries, and each represents the other’s number one tourism market.<sup>50</sup> Thus, both sides have strong incentives to strengthen security, and to keep goods and travel flowing.

Particularly since the 9/11 attacks, Ottawa and Washington have taken numerous steps to improve border security, including through a series of bilateral agreements. In December 2001, they signed the Smart Border declaration that aimed at improving security and efficiency at border crossings. The agreement laid out a 30-point (since increased to 32-point) list of areas of joint activity covering air, land, and sea crossings, ranging from pre-clearance of goods and people, to biometric identifiers, to infrastructure improvements. 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.

In February 2011, President Obama and Prime Minister Harper signed the Beyond the Border declaration, which described 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.

This vision was fleshed out by the *Beyond the Border Action Plan*, released during a meeting of the two leaders on December 7, 2011. It set out goals and progress metrics related to:

- harmonized cargo screening under the “cleared-once, accepted twice” principle,

<sup>47</sup> In April 2009, U.S. Department of Homeland Security Secretary Janet Napolitano raised concerns when she averred that some of the 9/11 terrorists crossed over from Canada. “Napolitano’s Comments about Canada’s Border Spark Diplomatic Kerfuffle.” *The Canadian Press*. April 21, 2009.

<sup>48</sup> “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.

<sup>49</sup> Canadian Government Fact Sheet: A Unique and Vital Relationship, modified, June 2, 2011,

<http://www.canadainternational.gc.ca/can-am/offices-bureaux/welcome-bienvenue.aspx?lang=eng&view=d>.

<sup>50</sup> U.S. Department of Commerce, International Trade Administration, *Canadian Travel to the United States 2011*, Washington, D.C., December 2012; Canadian Tourism Commission, *Delivering Value for Canada’s Tourism Businesses Through Innovation and Efficiency*, Vancouver, B.C. 2013.

- joint inventories and gap analysis related to travel and trade threat assessments and border surveillance,
- automated biographic and biometric data sharing,
- an integrated entry-exit system,
- enhanced pre-clearance of goods and travelers, and
- expansion of interoperability among law enforcement and deployment of cross-designated personnel.<sup>51</sup>

Substantively, policies related to the Canada-U.S. border encompass trade and travel facilitation as well as law enforcement activities. For lawful border crossers, the Western Hemisphere Travel Initiative (WHTI) has required since June 2009 that all travelers present a secure travel document. The Department of Homeland Security (DHS) has worked with the Canadian government and with certain U.S. and Canadian states and provinces to develop enhanced driver's licenses that meet WHTI requirements; a March 2011 GAO report found a greater than 95% compliance rate with such requirements.<sup>52</sup> In addition to cooperating on WHTI, the two countries have worked to expand their trusted commercial trucker program (the Free and Secure Trade [FAST] program) and their trusted traveler program (NEXUS, not an acronym).

Joint border-area law enforcement programs consist primarily of Integrated Border Enforcement Teams (IBETs) and the Shiprider Program. The IBETs are binational, multi-agency, intelligence-led enforcement teams focused on identifying, investigating, and interdicting common national security threats and criminal activity at 24 locations at and between U.S.-Canadian ports of entry. The Shiprider program allows fully cross-trained and cross-designated agents from each country to conduct joint enforcement exercises along shared international waterways.

In addition to these programs, Canada's customs service has stepped up the purchase of high-tech X-ray equipment, and U.S. and Canadian customs agents are working together to inspect containers at several Canadian and U.S. seaports. 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. DHS, and a Border Services Agency.

Away from the border, Canada has taken related actions, 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.<sup>53</sup> Canadian police and security officials arrested 18 individuals on terrorism-related charges in June 2006 (the so-called Toronto 18) and 6 men in another terrorism-related incident in August 2010 (a sting operation known as

<sup>51</sup> *United States-Canada Beyond the Border Action Plan*, December 2011, available at <http://www.dhs.gov/xlibrary/assets/wh/us-canada-btb-action-plan.pdf>.

<sup>52</sup> 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>.

<sup>53</sup> 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](http://www.parl.gc.ca/information/library/PRBpubs/prb0834_00-e.htm).

Project Samosa). These incidents did not emerge as major domestic political issues within Canada, but they renewed debate within the United States about Canada's immigration practices, its commitment to a multicultural environment, its security measures, and the presence of its troops in Afghanistan.<sup>54</sup>

## Economic and Trade Issues

The Canadian economy experienced a shallower recession and has recovered faster from the 2008 global economic crisis than the United States. However, both economies until recently remained sluggish. Both economies are on track to achieve 1.7% growth in 2013 according to the *Economist Intelligence Unit* and *IHS Global Insight*. These forecasters expect Canada's GDP to grow by 2.2% and 2.4% in 2014, and for U.S. growth to achieve growth of 2.6% and 2.5%, in 2014.

### Economic Growth

Canada's economy began to grow again in 2010 following the global financial crisis of 2008. However, GDP has been slowing from the robust level of 3.4% in 2010 to an estimated 1.7% in 2013. Several factors likely contributed to this slow growth, including the end to the boom in commodities on which Canada's economy disproportionately depends; the sluggishness of the U.S. economy; and the retrenchment of government spending. Growth has been dependent on personal consumption, especially in the still-buoyant housing sector, but business investment and export growth remain elusive. 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 7.1% by August 2013.<sup>55</sup>

### Budget Policy

After racking up 27 straight years of deficit spending prior to the "austerity" budget of 1995, Canada's public debt reached a peak of 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. That year, faced with the fallout of the global financial crisis, the Conservative government of Prime Minister Stephen Harper introduced a budget which financed a package of stimulus spending and tax cuts, but which also reintroduced deficit spending to the Canadian polity. Since then, government policy has been one

<sup>54</sup> See for example, "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; "Recent Terrorism-related Cases in Canada," January 24, 2011, <http://www.cbc.ca/news/canada/story/2011/01/21/f-terror-cases-quickfacts.html>; "Few Details Given As 4 Canadians Are Held In Terrorist Plot," *New York Times*. August 28, 2010.

<sup>55</sup> Economic data and forecasts are from the Economist Intelligence Unit, IHS Global Insight, Global Trade Atlas, and Statistics Canada.

of retrenchment, with the aim of returning the budget to balance with an C\$800 million surplus forecast by 2015, coincidentally an election year.

## Monetary Policy

In contrast to the United States, the Bank of Canada (BOC) has raised interest rates three times—to a 1% target rate—to constrain demand—until September 2010. This accommodative stance has been made possible by the virtual absence of inflation, but it has also contributed to a housing boom and personal consumption boom that is just beginning to decelerate. This, in turn, has led to record Canadian household indebtedness with the debt-to-disposable income ratio reaching 165.6% in 2013. Yet, the BOC is reluctant to raise interest rates and risk increasing debt-service costs to the consumer and slowing consumer spending. The Bank's 1% interest rate has also helped the Canadian dollar (loonie) maintain its value near parity, although the value of the loonie has been dropping against the U.S. dollar throughout 2013, from 0.9952 per U.S. dollar at the beginning of 2013 to 1.063/US\$ on December 23, 2013.

## Energy

Canada is the United States' largest supplier of energy—including oil, uranium, natural gas, and electricity—and, until recently, the energy relationship has been growing.<sup>56</sup> Canada is the world's fifth-largest 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.<sup>57</sup> In 2012, the value of U.S. petroleum and natural gas imports from Canada reached \$103.4 billion, up from \$65.2 billion in 2009. This figure largely represents increases in the value and quantity of crude oil exports from Canada. However, due to the domestic shale gas boom, Canada's exports of natural gas have been dropping since 2010. Canada provides 22% of U.S. crude oil imports and supplies 82.6% of U.S. natural gas imports.<sup>58</sup> Canada also is a net exporter of electricity to the United States, and the North American electricity grid is closely interconnected. Canada is particularly valued because it is considered a reliable source of energy, as it is not a member of OPEC. However, the main new pipeline project to bring Canadian oil to the United States—the Keystone XL—remains stymied, with the State Department yet to make a determination as to whether it may proceed. China has shown interest in Canada's oil sector, and has recently bought stakes in the Alberta's oil sands projects. Partly as a result of the Keystone XL impasse, the Canadian federal government has been advocating the construction of a pipeline through British Columbia to export oil to Asia. Like the Keystone XL, this route has drawn opposition from environmentalists, but also from First Nations tribes, over whose land much of the pipeline would be constructed.

## Bilateral Trade Issues

The United States and Canada enjoy the largest bilateral commercial relationship in the world. Over the past 20 years, U.S.-Canada trade relations have been governed first by the 1989 U.S.-

<sup>56</sup> See CRS Report R41875, *The U.S.-Canada Energy Relationship: Joined at the Well*, by Paul W. Parfomak and Michael Ratner.

<sup>57</sup> U.S. Energy Information Administration (EIA), Country Analysis Brief: Canada, December 2012, <http://www.eia.gov/countries/cab.cfm?fips=CA>.

<sup>58</sup> 2009 statistics from U.S. International Trade Commission <http://dataweb.usitc.gov>.

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 and investment 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. In addition, both nations are fully engaged in negotiating preferential trade agreements, together in the Trans-Pacific Partnership negotiations, and separately with the European Union.

The volume of economic activity across the border underscores the extent of economic integration between the United States and Canada. The two nations continue to have the largest trading relationship in the world, with nearly \$1.7 billion per day in goods crossing the border in 2012. In that year, Canada purchased 18.9% of U.S. exports and supplied 14.4% of all U.S. imports. The United States supplied 50.6% of Canada's imports of goods that year and purchased 74.5% of Canada's merchandise exports; two-way trade with the United States represented nearly 34.0% of Canadian GDP. While the United States had a trade deficit with Canada of \$31.4 billion in 2012, the United States would have registered a trade surplus without Canadian imports of crude oil.

Meanwhile, several trade issues—some old, some new—have yet to be completely resolved. Many of these disputes involve long-running disputes 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***

Trade in softwood lumber traditionally has been one of the most controversial topics in the U.S.-Canada trading relationship. Currently, trade in softwood lumber is governed by a seven-year agreement (SLA)—reached in 2006 and since extended for two years to 2015—restricting Canadian exports to the United States. After a prior agreement expired in March 2001, 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 current agreement was reached. 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 impose export taxes and/or quotas. In addition, the United States will return to Canada a large majority of the duties it had collected.<sup>59</sup>

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) at which export taxes must be charged. The United

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<sup>59</sup> "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.



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. In January 2011, the LCIA found certain of these programs breached the SLA, and Canada began imposing additional charges on lumber from Quebec and Ontario for the duration of the agreement.

Most recently, the Obama Administration sought arbitration under the SLA over timber grading practices in British Columbia (BC). The U.S. government claims that the BC government 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. An arbitral panel dismissed the U.S. claim in July 2012.

### *Country of Origin Labeling*

Provisions requiring country-of-origin labeling (COOL) of meat, fish, fresh fruits, vegetables, and various nuts were contained in the 2002 farm bill (P.L. 107-171), as amended by the 2008 farm bill (P.L. 110-246). Rules implementing country-of-origin labeling took effect on March 16, 2009. These laws have been especially controversial in the meat industry as domestic livestock producers and some consumer groups favor the law, while meat processors and livestock exporters from Canada and Mexico oppose the provisions as protectionist. In 2010, both Canada and Mexico challenged the provisions at the World Trade Organization (WTO). A WTO dispute settlement (DS) panel found COOL to be inconsistent with WTO agreement rules on two grounds: (1) it violates national treatment by treating imported livestock less favorably than domestic livestock, and (2) it fails to meet the legitimate objective of providing information to consumers on the origin of meat products. The U.S. appealed the ruling to the WTO Appellate Body, which upheld Canada and Mexico's claim on national treatment, but found that COOL did meet a legitimate objective in providing information to consumers. The WTO Dispute Settlement Body adopted the reports on July 23, 2012. In response, the U.S. Department of Agriculture released a new rule which required that labels show the location of each production step and prohibited the mixing of meat products from different origins. On September 25, 2013, the WTO established a compliance panel at the request of Canada and Mexico to determine the consistency of this rule with the previous DSB rulings.

### *Buy American 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 quality 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's) Agreement on Government Procurement (GPA) and under the North American Free Trade Agreement (NAFTA). The GPA is a plurilateral agreement that only binds those WTO members that agreed to undertake obligations under it. Furthermore, the GPA 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 GPA, 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.<sup>60</sup> 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 GPA, 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,<sup>61</sup> although it is unclear if these negotiations have actually taken place.

### *Intellectual Property Rights*

In 2013, the U.S. Trade Representative listed Canada on its Special 301 report on intellectual property rights protections as a "watch list" country for intellectual property rights protections, an improvement from previous years when Canada was designated a "priority watch list" country.<sup>62</sup> This improvement largely reflects Canada's passage of the Copyright Modernization Act in November 2012, which implemented the World Intellectual Property Organization's Copyright treaty.<sup>63</sup> The act is analogous to the U.S. Digital Millennium Copyright Act (DCMA, P.L. 105-304). The act allows for some format shifting and fair-dealing (fair-use) exceptions, but prohibits the circumvention of digital protection measures. It also clarified the rights and responsibilities of Internet service providers for infringement of their subscribers.

In its 2013 Special 301 report, USTR 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 report also noted Canada's regulatory process with regard to appeals to adverse pharmaceutical products approval decisions and with the Canadian judiciary's interpretation of utility in pharmaceutical patents. U.S. pharmaceutical manufacturer

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<sup>60</sup> Office of Management and Budget, "Updated Implementing Guidance for the American Recovery and Reinvestment Act of 2009, April 3, 2009. pp. 160-166.

<sup>61</sup> "U.S.-Canada Announce Buy American Deal, Provinces to Sign GPA," *Inside U.S. Trade*, February 12, 2010.

<sup>62</sup> A "Priority Watch List" is a heightened designation of criticism for a country's allegedly inadequate IPR protection and enforcement, while the "Watch List" reflects a milder category of criticism. United States Trade Representative, 2011 Special 301 Report, p. 46. <http://www.ustr.gov/sites/default/files/05012013%202013%20Special%20301%20Report.pdf>.

<sup>63</sup> The WIPO Copyright treaty updates existing copyright protections for Internet and other electronic media.

Eli Lilly has sought arbitration through the NAFTA Chapter 11 investor-state dispute settlement mechanism over the Canadian judiciary's use of the promise doctrine in evaluating utility.

## 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, mainly by increasing reliance on hydro- and nuclear power, and by increasing carbon abatement in the oil sands, but it has also declared that it would coordinate its greenhouse emission strategy with the United States. In December 2011, Canada announced that it was withdrawing from the Kyoto Protocol, after having declined to take on a second phase commitment in June 2011. The controversy of the Keystone XL pipeline is in large measure due to environmental opposition to the development of the oil sands, as is opposition to the Pacific gateway pipeline through British Columbia.

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.<sup>64</sup> The so-called Annex IV fisheries regimes of the PST were renegotiated in 2008.

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 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.

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<sup>64</sup> CRS Report RL30234, *The Pacific Salmon Treaty: The 1999 Agreement and Renegotiated Annex IV*, by Eugene H. Buck.

## Canada and Afghanistan<sup>65</sup>

### 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 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 158 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 have assisted 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 considerable humanitarian and reconstruction aid to Afghanistan; in 2011-2012, the Canadian International Development Agency (CIDA) disbursed C\$127.4 million in development and humanitarian 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.

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<sup>65</sup> Prepared by Carl Ek, Specialist in International Relations; Foreign Affairs, Defense, and Trade Division.

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 Canadian troops would be provided to help train the Afghan National Army, and Canadian civilian law enforcement officers to help develop Afghan police forces. The ministers declared that the estimated cost of these various initiatives from 2011 to 2014 would be approximately C\$700 million.

## 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, Canada ended its combat role there in July 2011; however, Canadian troops (620 as of December 2013) will remain until 2014 to help train Afghan national security forces. In December 2011, it was reported that Canadian Foreign Affairs Minister John Baird said that Canada would provide C\$100 million per year to Afghanistan between 2011 and 2014.

## Questions

1. Please describe Canada's new role in Afghanistan. Are Canadian military trainers accompanying Afghan troops on patrols? If so, under what rules of engagement are Canadian troops operating?
2. Do you believe that Canada's decision to extend its mission in Afghanistan has influenced the policies of other allies?

# Canada's Arctic Sovereignty Claim<sup>66</sup>

## 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 costs and transit distances for commercial ships operating between certain ports. It could also be used by commercial fishing or cruise vessels, 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 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.

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

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<sup>66</sup> Prepared by Carl Ek, Specialist in International Relations; Foreign Affairs, Defense, and Trade Division.

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, have 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 been 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

On January 9, 2009, the outgoing Bush 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." The Obama Administration has been operating under the policy directive. For the time being, Ottawa and Washington may 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. In mid-2011, then 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 (the latter was partially resolved in November 2012). The government has emphasized its commitment to

the Arctic through frequent visits by government officials; Prime Minister Harper marked his eighth annual tour of the northern region in August 2013. 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 policy makers. In May 2013, Canada assumed the two-year revolving chairmanship of the Arctic Council, and declared that sustainable economic development benefiting indigenous peoples in the High North would be a priority; a U.S. official subsequently stated that the Council should not diminish its focus on science and research as priorities. In early December 2013, it was reported that Foreign Minister Baird had asserted that Canada should seek to claim the North Pole as part of its extended nautical border.

## 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?
4. In May 2013, Canada assumed the rotating, 2-year chairmanship of the Arctic Council. Does the Harper government intend to use this position to assert its claim of sovereignty over the Northwest Passage?
5. Please discuss examples of bilateral scientific and security-related cooperation between Canada and the United States in the High North.

## Border Security Issues<sup>67</sup>

### Issue Definition

U.S.-Canadian border security has emerged as an area of public concern, particularly since the 9/11 terrorist attacks. The United States and Canada attempt to balance adequate border security with the facilitation of legitimate cross-border travel and commerce. Generally, the countries have worked to strike this balance collaboratively, through a series of agreements governing bilateral border issues; and they continue to work together on core border issues including the management of border flows and travel documents, joint law enforcement, and a new integrated entry-exit system. Within the United States, some people remain concerned about the potential for terrorists and criminals to exploit the border and about the adequacy of infrastructure and personnel at the U.S.-Canadian border and ports of entry.

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<sup>67</sup> Prepared by Marc R. Rosenblum, Specialist in Immigration Policy, Domestic Social Policy Division.



## Background and Analysis

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. (The border between Canada and Alaska spans an additional 1,500 miles.) According to the U.S. Bureau of Transportation Statistics, in 2012, northern border ports admitted about 5.6 million trucks, 28,500 trains, 108,000 busses, and 33 million passenger vehicles—numbers which exceed analogous data for the U.S.-Mexican border for trucks and trains, while passenger traffic is higher on the southern border.

### *Western Hemisphere Travel Initiative*

The Intelligence Reform and Terrorism Prevention Act of 2004 (IRTPA, P.L. 108-458) required the Secretary of Homeland Security, in consultation with the Secretary of State, to develop and implement a plan to require all travelers (i.e., including American and Canadian citizens) to use a passport or other secure document when entering the United States. (Prior to that time, U.S. and Canadian citizens were permitted to use driver's licenses and birth certificates to prove their citizenship, and certain travelers were admitted based on an attestation of citizenship.) Under the so-called Western Hemisphere Travel Initiative (WHTI), in effect since June 1, 2009, travelers must present an approved secure document, including a passport book, passport card, trusted traveler card (i.e., a NEXUS (not an acronym) or Free and Secure Trade (FAST) card), or certain other documents for military personnel and certain other special groups. Four states (Michigan, New York, Vermont, and Washington) and four Canadian provinces (British Columbia, Manitoba, Ontario, and Québec) issue enhanced driver's licenses that are also valid for WHTI purposes.

Prior to its implementation, WHTI fostered concern in both countries that the increased documentation requirements could suppress U.S.-Canadian travel, but no such effect has been observed. A Government Accountability Office (GAO) review in March 2011 found CBP's outreach campaign had led to a greater than 95% compliance rate with WHTI requirements in FY2010. And an October 2011 GAO report singled out WHTI technology that facilitates inspections at land borders as one of seven government-wide "successful major acquisitions."

### *U.S.-Canada Border Agreements*

The United States and Canada have a long history of collaboration around border security. Such efforts date 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, intelligence sharing, infrastructure improvements, compatible immigration databases, visa policy coordination, biometric identifiers in travel documents, prescreening of air passengers, joint screening for high risk travelers, and improved processing of refugee and asylum claims, among others. In July 2010, the countries signed an Action Plan for Critical Infrastructure intended to strengthen the safety, security, and resilience of critical shared infrastructure.

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 agreement describes four key areas of cooperation: efforts to identify and address threats before they reach the U.S.-Canadian perimeter, trade facilitation, integrated cross-border law enforcement, and critical infrastructure and cybersecurity.

On December 7, 2011, President Obama and Prime Minister Harper released the *Beyond the Border Action Plan*, which includes a concrete steps to be taken within each of these areas, along with deadlines and metrics for measuring progress toward each goal. The plan is most ambitious with respect to trade facilitation, calling for a harmonized approach to cargo screening under the principle of “cleared one, accepted twice.” Additional provisions related to border security include, among others: plans for joint inventories and gap analyses for intelligence work related to travel and trade threat assessments and border surveillance; automated biographic and biometric data sharing to verify traveler identities and to share risk assessments and watchlist information; an integrated entry-exist system so that the record of a land entry into one country can be used to establish an exit record from the other; broader pre-clearance programs for goods and travelers; and the expansion of integrated law enforcement efforts including interoperable radio systems and the deployment of cross-designated law enforcement officers. In December 2012, the two countries published the first *Beyond the Border Implementation Report*. It described progress in several areas related to border security, discussed in the remainder of this section.

### ***Border Management***

In the post-9/11 period, border “thickening” arguably has added to border delays, raised transportation costs, and depressed bilateral flows of people and goods. Several elements of the *Beyond the Border Agreement* seek to counter these trends. Under the agreement, the countries conducted a joint intelligence inventory and gap analysis and a joint risk assessment in 2012, and they issued common standards for the collection and use of biometric data. These steps build on a program, in place since 2004, to share passenger information on high-risk travelers en route to either country through a joint risk-scoring scheme and shared “lookout” data.

With respect to trade facilitation, most of the first year progress consisted of establishing planning committees, conducting joint training, and publishing joint studies. The countries expanded benefits for NEXUS and FAST trusted travelers and commercial truckers, and expanded the programs to 19 border crossing locations, 33 marine reporting locations, and 8 Canadian pre-clearance airports. Additional pilot programs have been established for advanced review and certification of binational trade entries and for automatic clearance of certain cargo arriving at Canadian seaports and being shipped by truck or rail to the United States.

### ***Joint Law Enforcement***

Three collaborative law enforcement programs exist along the U.S.-Canadian border. As part of the Smart Border Accord, the countries have established 15 Integrated Border Enforcement Teams (IBET), operating at 24 locations along the border. The IBETs are binational, multi-agency, enforcement teams including representatives from U.S. Customs and Immigration Enforcement (ICE), U.S. Customs and Border Protection (CBP), the U.S. Coast Guard, Canada Border Services Agency (CBSA), and the Royal Canadian Mounted Police (RCMP), along with

municipal, state, and provincial governments and law enforcement agencies. IBETs share intelligence to identify, investigate, and interdict common national security threats and transnational criminal activity.

Second, beginning in 2007, ICE expanded its Border Enforcement Security Task Force (BEST) program to the U.S.-Canada border. The BEST program also emphasizes information sharing to combat cross-border crime, and brings in a larger number of federal, state, provincial, local, and tribal stakeholders from both sides of the border, all under ICE leadership. U.S.-Canadian BEST task forces currently operate in Blaine, WA; Seattle, WA; Detroit, MI; Buffalo, NY; and Massena, NY.

Third, since 2005, the countries have operated the Shiprider program, which places fully cross-trained, cross-designated RCMP and U.S. Coast Guard agents and officers on law enforcement vessels operating along certain international waterways. The agents conduct joint enforcement activities on both sides of the border, under the command of a U.S. or Canadian officer (based on the ship's location south of north of the border). The Obama and Harper Administrations signed an agreement in 2009 to extend and expand Shiprider, which had previously operated as a pilot program; and expansion of the program was identified as a point in the *Beyond the Border Action Plan*. The Canadian parliament passed legislation permanently authorizing the Shiprider program in June 2012, and the U.S. Coast Guard and RCMP signed a finalized Shiprider agreement in June 2013.

In addition to these programs, the U.S.-Canada Cross Border Crime Forum, which includes the Secretary of Homeland Security, the Attorney General, and the Canadian Ministers of Public Safety and Justice, provides a regular meeting place for the top law enforcement officials from both countries to discuss cross-border criminal activity and to coordinate their responses.

### *Integrated Entry-Exit System*

One notable result of the Beyond the Border agreement has been the integrated entry-exist system pilot program. The purpose of the program is to permit the United States and Canada each to track people *exiting* through border ports by sharing data—which each country already collects—on people *entering* the other country (i.e., the United States uses Canadian entry data to track exits, and vice versa). For the United States, the collection of such exit data fulfills part of the Department of Homeland Security's (DHS's) requirement, pursuant to Section 110 of the Illegal Immigration Reform and Immigrant Responsibility Act of 1996 (IIRIRA, P.L. 104-208, Div. C), as amended, to complete an automated entry and exit control system that collects records of all alien arrivals and departures.

The first phase of the pilot program ran from September 2012 to January 2013, and consisted of the exchange of biographic travel records (i.e., names, birthdates, and other travel document information) for third country nationals and permanent residents (i.e., for persons other than U.S. or Canadian citizens) at four designated ports of entry. According to the Canadian-U.S. report on the program, Canada was able to reconcile 94.5% of U.S. entries (i.e., Canadian exits) with Canadian immigration databases, and the United States was able to reconcile 97.4% of Canadian entries (i.e., U.S. exits). Based on these results, the countries initiated phase 2 of the pilot program in June 2013, during which biographic information is being exchanged for third country nationals and permanent residents at all automated POEs on the U.S.-Canada border. During phase 3, scheduled to begin in June 2014, biographic information also will be exchanged for U.S.

and Canadian citizens traveling between the two countries. Current plans do not call for the program to collect and share *biometric* traveler data (e.g., fingerprints, digital photographs).

### ***Border Infrastructure and Personnel***

A series of U.S. laws since 2001 have increased the number of enforcement personnel at the U.S.-Canadian border and strengthened 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 to make technological improvements and acquire additional equipment. The Enhanced Border Security and Visa Reform Act of 2002 (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 IRTPA 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.

A total of 2,206 border patrol agents were posted in northern border sectors in FY2012, up from 340 in FY2001, along with 3,668 U.S. Customs and Border Protection (CBP) inspectors at ports of entry, up from 1,550 in FY2001. 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.

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. Michigan Governor Rick Snyder endorsed the construction of the bridge in January 2011, but a bill creating a bridge authority was rejected by a Michigan state Senate committee in October 2011. In June 2012, Prime Minister Harper and Governor Snyder announced an agreement to build the bridge using solely Canadian funds with a Canadian entity responsible for the design, construction, and operation of the bridge. On April 12, 2013, the U.S. State Department approved a permit to build the bridge allowing construction to proceed. Construction may start in 2014.

## Status of the Issue

The *Beyond the Border Action Plan* lays out an ambitious agenda for deeper cooperation under the “cleared-once, accepted twice” principle. The plan’s first *Implementation Report* describes progress within each area related to border security; but most of these initial steps consist of research, reporting, and information exchange. Implementing the next stages of integrated border management and law enforcement may present ongoing challenges for both countries.

Moreover, while the Beyond the Border plan responds to long-standing concerns about inefficiency at the border, CBP and other observers still consider the U.S.-Canadian border to be the locus of a wide range of security threats. A 2010 joint assessment by CBP, Canada Border Services Agency, and the Royal Canadian Mounted Police highlighted threats associated with 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. A 2013 study by the Canadian Macdonald-Laurier Institute found particular problems associated with illegal tobacco smuggling, and a nexus between tobacco smuggling and other organized crime concerning illegal drugs, weapons, and human trafficking.

## Questions

1. The United States and Canada judged phase 1 of the integrated entry-exit pilot program to be a success, and phase 2 testing began in June 2013. Is the integrated *biographic* program a workable building block for satisfying the *biometric* entry-exit system mandate in U.S. law? How will Canada and the United States address privacy concerns during phase 3 of the program, when all travelers’ records (i.e., including those of U.S. and Canadian citizens) will be shared between the two countries?
2. The Beyond the Border agreement calls on the two countries to move customs inspection activities away from the border under the principle of “cleared once, accepted twice.” This approach currently is limited mainly to Canadian airports and a pair of pilot programs involving rail and truck shipments to the United States. What is the Canadian government doing to facilitate pre-clearance and pre-inspections for travel through land ports? What safeguards will be in place to protect the integrity of pre-cleared truck shipments? How will common perimeter programs address differences between U.S. and Canadian attitudes about privacy protections and civil liberties, and differences in how the countries define certain criminal offenses?
3. With Canada’s permanent authorization of the Shiprider program and the finalized Shiprider agreement signed in June 2013, what plans do the two countries have to expand the program to additional locations? Does the successful implementation of the Shiprider program argue in favor of cross-designation of certain land-based law enforcement officers? Some Members of Congress have raised concerns about staffing levels at the northern border, which remain slightly behind statutory goals; would cross-designation be an appropriate strategy for meeting these requirements?

# Canada's Free Trade Agreement Agenda<sup>68</sup>

## Issue Definition

Regional and bilateral free trade agreements (FTA) have become a prominent, and to some, 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 as Canada has negotiated an FTA with the European Union and has joined the Trans-Pacific Partnership (TPP), a proposed FTA being negotiated among the United States, Australia, Brunei, Chile, Malaysia, New Zealand, Peru, Singapore, and Vietnam.

## Background

After concluding the U.S.-Canada FTA in 1988 and expanding it to include Mexico in 1994, both the United States and Canada 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 (EFTA) nations (Norway, Switzerland, Iceland, and Liechtenstein) in 1998, with Singapore and 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 by 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. Long pending agreements with Colombia, Panama, and South Korea concluded under TPA were approved by Congress in October 2011. While the Obama Administration’s early trade policy stressed enforcement of existing trade agreements rather than negotiating new ones, it is now negotiating the two largest regional FTAs in U.S. history: the proposed TPP and the proposed

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Trans-Atlantic Trade and Investment Partnership (TTIP) between the United States and the European Union.

The Conservative government of Prime Minister Stephen Harper, first elected in 2006, has placed greater emphasis on negotiating regional and bilateral FTAs. The Harper government has concluded and put in effect agreements with EFTA, Peru, Colombia, Jordan, and Panama. Canada signed an FTA with Honduras on November 5, 2013, which awaits ratification by Parliament. 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 the Dominican Republic, India, Japan, Morocco, Ukraine, and the nations of CARICOM, and are continuing with South Korea and Singapore. 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.

Along with the United States, Canada is negotiating a Trans-Pacific Partnership among 12 nations of the Asia-Pacific. Canada, along with Mexico, joined the negotiations in July 2012 after intensive bilateral talks with other TPP members designed to assess Canada's willingness to negotiate an ambitious and high standard agreement. While the negotiations remain confidential, several nations including Australia, New Zealand, and the United States, are seeking greater access to Canada's supply management restricted dairy and poultry sectors. Along with these countries, Canada likely is seeking greater access to the restricted beef and grain markets of Japan. In addition, the United States may be seeking additional commitments on intellectual property rights, and Canada may be seeking U.S. commitments on government procurement and the application of Buy American policies. Both may be seeking greater access to the service markets of other TPP countries. TPP leaders were aiming to conclude the negotiations in 2013, but the trade ministers made clear after their meetings in Bali from December 7-10, that the negotiations remain ongoing. The ministers stated that they identified potential "landing zones" for remaining issues, and will meet again in January 2014.

After nearly 4½ years, Canada and the European Union (EU) announced an agreement in principle to a Comprehensive Economic and Trade Agreement (CETA) on October 18, 2013. It is Canada's most ambitious proposed trade agreement since NAFTA, and it has raised issues of concern to countries at a similar level of development and with relatively low tariffs. The results of these negotiations could presage the Trans-Atlantic Trade and Investment Partnership (TTIP) talks between the United States and the European Union. The agreement is expected to be ratified by 2015. While the final text is still being prepared, provisions of the agreement include:

- Full elimination of non-agricultural tariffs with transition periods for autos, and ships (Canada).
- Cumulation of rules-of-origin for autos to reflect integrated nature of North American auto market. Both sides agree to work for greater harmonization of auto standards.
- Agriculture tariffs to be largely eliminated after transition periods; 92.8% of Canadian agriculture tariffs lines and 93.5% of EU agriculture tariff lines will be eliminated. Additional tariff-rate quotas (TRQ) would be available for certain agriculture products: a TRQ of 17,000 metric tons for high quality EU cheese in Canada; a TRQ of 50,000 metric tons of non-growth hormone Canadian beef in EU.

- No additional EU market access in the Canadian supply-managed dairy or poultry sectors.
- Broad coverage across all sectors for services market access.
- Coverage of temporary movement of professionals and intra-corporate transferees and mutual recognition of professional qualifications.
- Government procurement: each side has granted the other the most favorable and comprehensive market access of its respective FTAs.
- Canada agreed to measures to strengthen its intellectual property regime for pharmaceuticals.
- Investor-state dispute mechanism available to investors from both parties. Provisions to insure transparency and to allow for early dismissal of frivolous claims.

## Status of the Issue

The Conservative government's enthusiasm for negotiating FTAs was well expressed by then-International Trade Minister Peter Van Loan back in 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 Harper 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. What should Canada seek to achieve in the TPP negotiations? Now that Japan has joined the TPP and South Korea may seek to join, are bilateral FTA talks between Canada and those two countries still relevant? Would joining the TPP advance the objective, promoted by successive Canadian governments, of expanding Canada's role in the Asia-Pacific region?
5. Canada and the European Union have announced a Comprehensive Economic and Trade Agreement. What aspects of the agreement are particularly favorable to Canada? In what areas would Canada have to undertake additional commitments? Should Canada and Mexico be a part of the TTIP agreement given the integrated nature of the North American economy?



# North American Cooperation on Competitiveness and Security<sup>69</sup>

## Issue Definition

How can the United States improve cooperation with its North American neighbors on issues related to economic competitiveness, 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 focus more on trilateral cooperation or are separate, bilateral cooperation efforts with Canada and Mexico potentially more effective due to the different issues facing each country?

## Background and Analysis

The United States, Canada, and Mexico have been partners in the North American Free Trade Agreement (NAFTA) since 1994 and benefit from a broad and expanding trade relationship. Since 2005, the three countries have also made efforts to increase cooperation on economic and security issues through various endeavors, most notably by participating in trilateral summits known as the North American Leaders' Summits. The first North American Leaders' Summit took place on March 23, 2005, in Waco, Texas, and was followed by several trilateral summits in Mexico, Canada, and the United States. A notable outcome of the first summit was the former, trilateral initiative known as the Security and Prosperity Partnership of North America (SPP) to increase security and enhance prosperity in the United States, Canada, and Mexico. While the SPP is no longer an active initiative, current bilateral efforts pursued by the Obama Administration to enhance cooperation with Canada and Mexico have built upon the accomplishments of the working groups formed under the SPP. 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. Opponents of the former SPP were critical of this effort, claiming that it was an attempt by some to create a common market or economic union in North America.

## Trilateral Cooperation

The most recent North American Leaders' Summit was hosted by President Barack Obama on April 2, 2012, in Washington, DC, at the White House where he met with Canadian Prime Minister Stephen Harper and Mexican President Felipe Calderón to discuss the economic well-being, safety, and security of the three countries. After the meeting, the leaders issued a joint statement in which they renewed their commitment to North American cooperation in the following key areas of interest: protection and enforcement of intellectual property rights (IPR); enhancement of collective energy security, including the safe and efficient exploration and exploitation of resources; advancement of the goals of the Energy and Climate Partnership of the Americas and enhancement of electricity interconnection in the Americas; support of efforts to advance a lasting global solution to the challenge of climate change; and the recognition of the

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importance of adopting the Budapest Convention on Cybercrime. In addition, the leaders announced the North American Plan for Animal and Pandemic Influenza (NAPAPI) to strengthen North America's response to future animal and pandemic influenza events.

Most efforts to increase cooperation, either through trilateral or bilateral endeavors, generally have followed the recommendations of special working groups created after the first North American Leaders' Summit. These recommendations 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.

### **Bilateral Cooperation**

The Obama Administration has engaged in efforts with Canada and Mexico to increase regulatory cooperation, enhance border security, promote economic competitiveness, and pursue energy integration primarily through bilateral initiatives. For example, in February 2011, President Obama and Canadian Prime Minister Harper announced the Beyond the Border Action Plan: A Shared Vision for Perimeter Security and Economic Competitiveness declaration, establishing a new long-term partnership whereby the two countries work in partnership within, at, and away from the border to achieve enhanced security and accelerate trade. In addition to this action plan, the two leaders created a U.S.-Canada Regulatory Cooperation Council to improve alignment of regulatory approaches.

In February 2012, the United States and Mexico announced the first two-year work plan for the High-Level Regulatory Cooperation Council (HLRCC) to help align regulatory principles, an effort similar to the U.S.-Canada Regulatory Cooperation Council. The United States and Mexico also have a bilateral initiative for border management under the Declaration Concerning Twenty-first Century Border Management that was announced in 2010. The United States also has pursued other cooperative efforts with its two neighbors in areas such as education, telecommunications, and transportation infrastructure planning.

### **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 under a different approach from the Bush Administration's SPP framework. The 2012 North American Leaders' Summit has served as a mechanism 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 effectively has the United States pursued North American cooperation in the border initiatives with Canada and Mexico or in the regulatory initiatives? What other steps can be taken by the three countries to improve competitiveness of industries in the region?
2. How successful has North American cooperation been in improving safety, security, and the flow of goods and services among NAFTA partners? What have been the actual results of the numerous initiatives launched under the SPP? Has the emphasis on border security caused delays in border crossings or transportation of merchandise?

## Canada's Financial System<sup>70</sup>

### 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. Canada's economy is also feeling the effects of the European sovereign debt crisis, slow growth in export markets, and household indebtedness. 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. Canada's economy is estimated to have grown by 1.7% in 2012, but some forecasts for 2013 indicate that economic growth could slow slightly to 1.6%. The vast economic and financial linkages between Canada and the United States mean that Canada is affected by the performance of the 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.

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According to the Bank of Canada, major risks to Canada's economic recovery during the near term are (1) global sovereign debt issues associated with some European countries, fragmented financial systems in Europe, and weaker than expected growth in Europe potentially could raise borrowing costs for Canadian banks; (2) weak global demand that dampens global economic recovery and prolongs the financial system's vulnerability; (3) the low interest rate environment that can lead to distortions in financial markets as investors search for high-yielding assets and assume greater risk; and (4) high levels of indebtedness among Canadian households that 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.

In recent years, Canadian banks have increased their ability to withstand adverse shocks by increasing the level and quality of their capital in line with the Basel III guidelines, and they have improved their liquidity management. Despite these improvements, Canada's financial system would be affected by (1) weak global demand for exports that would tend to raise the rate of unemployment; and (2) an increase in the level of volatility in global financial markets and a decline in market confidence due to a slowdown in global economic growth that could result in higher funding costs for Canadian banks and higher costs for loans and tighter lending conditions in Canada.

In 2013, Canada implemented a number of reforms of the financial system, including:

- Implementing Basel III capital rules for banks and a capital surcharge for six systemically important banks;
- Establishing a credit-rating assessment group (CRAG) to reduce the Bank of Canada's (BOC's) reliance on external credit ratings by evaluating the credit risk of assets and other financial exposures that the BOC manages on behalf of the Canadian government;
- Establishing a central counterparty for corporate securities (repurchase agreements) and new international risk management standards for systemically important financial market infrastructures;
- Implementing a resolution and recovery framework for major banks;
- Adopting International Financial Reporting Standards (IFRS) and Auditing Standards for banks and life insurance companies;
- Making progress toward meeting the international agreement to have all over-the-counter derivatives cleared through central counterparties; and
- Working toward adopting a single securities regulator to reduce compliance costs, simplify the monitoring of systemic risk, and facilitate coordination with other agencies and policy intervention.

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 separate sets 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 reduce 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. Acquisition 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. In concert with other advanced economies, Canada is moving to provide greater oversight of the over the counter (OTC) derivatives market by developing central counterparty services and a central clearing of standardized OTC derivatives contracts.

## Questions

1. 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 potentially 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?

## Canada's Supply Management Programs for Dairy, Poultry, and Eggs<sup>71</sup>

### Issue Definition

Canada uses supply management to support its dairy, poultry, and egg sectors. Its main features (1) provide price support to producers based on their production costs and return on equity and management, (2) limit production to meet domestic demand at the cost-determined price, and (3) restrict imports to protect against foreign competition. The Canadian government has supported producers' decisions to use this approach for more than 40 years, and succeeded in limiting imports of these products in negotiating the U.S.-Canada Free Trade Agreement, its multilateral commitments in the Uruguay Round's Agreement on Agriculture, and for the most part in its bilateral free trade agreements. Canada's interest in participating in the Trans-Pacific Partnership (TPP) trade negotiations has renewed calls from interest groups in the United States and New Zealand for Canada to open its borders to imports of these products. While Canadian dairy, poultry, and egg producers generally oppose trade liberalization, others argue that Canada should consider making concessions so that other Canadian economic sectors can benefit from export openings negotiated in the proposed TPP with the growing Asian economies.

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<sup>71</sup> Prepared by Remy Jurenas, Specialist in Agricultural Policy, Resources, Science and Industry Division.

## Background and Analysis

According to the World Trade Organization, Canada in recent years has introduced an agricultural policy framework that includes a number of business risk management measures designed to partially compensate producers for revenue or income losses arising from low commodity prices, increased production costs, reduced production, or natural disasters. However, the supply management systems for dairy, poultry, and eggs “remain unchanged.”

National bodies and provincial commodity marketing boards, granted statutory powers by the federal and provincial governments, control the supply management systems for these commodities. At the national level, the amount of each commodity that producers can market is controlled by a quota system. Imports of each commodity are limited by tariff rate quotas. These allow a specified amount to enter annually under Canada’s trade commitments at little or zero duty, but apply a very high tariff on imports above the specified level or quota amount. Both tools work together to control the supply of each commodity, but the objective is to ensure that producers receive a price that guarantees them a return that covers their production costs. The quota is set to balance supply with demand at that price, and is frequently adjusted to ensure that this balance is achieved. Producers of these commodities must participate in their respective supply management systems, with farm-level production subject to individual quota limits that can only be sold into permitted marketing channels.

Supply management for dairy is divided into a nationally-managed system for industrial milk (used to manufacture dairy products such as cheese and butter) and provincial-level systems for the marketing of fresh milk. The Canadian Milk Supply Management Committee (CMSMC) oversees the national system for industrial milk. It is chaired by the Canadian Dairy Commission (CDC), a federal agency that provides a framework for federal-provincial participation. The CMSMC determines the national domestic supply of industrial milk and allocates this volume among provinces.

The Farm Product Council of Canada (FPCC) oversees four national marketing agencies for poultry (chicken and turkey) and eggs that seek to balance the interests of stakeholders from producers to consumers. These agencies (Chicken Farmers of Canada, Turkey Farmers of Canada, Egg Farmers of Canada, and Canadian Hatching Egg Producers) are managed by representatives primarily from provincial commodity boards plus a few members representing processors and consumer associations. The provincial commodity boards regularly consult with their stakeholders to determine their poultry and egg needs. This information is used to set the national production level, which the agencies implement under a quota order that the FPCC must approve. Each provincial board allots its share of each quota to registered producers, and negotiates producer selling prices with processors.

Producers of these commodities point out the benefits of the supply management approach, which they say has significantly reduced price volatility. The stability of prices over time, combined with the guarantee that covers production costs, has served to provide income support. Others point out that these features have resulted in the lack of market orientation for these commodities, as the value of supply management has become capitalized, or incorporated, into the value of the quota. In other words, those who hold quota (i.e., renting it out) benefit more than the producers themselves. Public debate on the future of supply management has gained momentum in the last few years, but Canada’s government remains steadfast in supporting this policy which benefits the producers of these three commodities and those provinces in which they are concentrated.

## Status of the Issue

In October 2012, Canada joined other countries already negotiating the proposed TPP. Attention since has focused on how Canada's supply management systems for dairy, poultry, and eggs could be affected by this prospective trade agreement. Leading up to this announcement, Prime Minister Harper stated that Canada will not negotiate this issue in order to gain entry, and remained non-committal on how supply management would be handled if Canada is welcomed as a TPP participant. He stated that Canada expects to negotiate and debate "all manner of issues" if it were to join the TPP. If that occurs, he said Canada would attempt to "promote and to defend [its] interests not just across the economy, but in the individual sectors as well." President Obama, when asked whether Canada would have to drop supply management in order to join the TPP, reportedly only hinted in his response that Canada may have to make some adjustments in this area.

Though U.S. firms export dairy and poultry products to Canada, the import quotas in place under supply management have significantly limited access to this next-door market. Now that Canada is a TPP participant, the National Milk Producers Federation (NMPF), representing U.S. dairy farmers and dairy cooperatives, and the U.S. Dairy Export Council, representing this sector's export interests, want to secure complete free access for U.S. dairy exports into Canada, among other TPP objectives. Both groups also want to see U.S. negotiators tackle outstanding and proposed non-tariff measures that have limited, and could limit, access for U.S. fluid milk and cheese in the Canadian market.

One sign of the pressures that Canada's TPP negotiators face is the negative reaction expressed by its dairy producers to the preferential access for specialty cheeses that Canada provided to the European Union (EU) in their free trade agreement concluded in October 2013. The Dairy Farmers of Canada stated it will not support this deal, claiming that subsidized cheese from the EU will displace domestic production of its fine artisan and local cheeses that the industry has worked hard to develop. Acknowledging that "minor compromises" were made that will affect the cheese sector, Harper stated his commitment to compensate producers for any losses and highlighted that his government "kept the principle and the basis of the supply management system." Earlier, an NMPF official commented that the cheese market access granted the EU "falls far short" of what U.S. dairy producers seek to obtain from Canada in the proposed TPP.

## Questions

1. Most of the support for Canada's supply management systems is concentrated in Ontario, Quebec, and the Maritime provinces. What would be the internal politics associated with completely changing these systems or modifying them to allow for increased imports of dairy and poultry products from the United States and other TPP countries?
2. How strong is support among other Canadian economic sectors for maintaining Canada's supply management programs?
3. Could Canada ensure that the objectives of supply management (stable prices and income support to producers) are met if additional imports are allowed? Please elaborate on why or why not this would be the case.



## Country of Origin Labeling<sup>72</sup>

### 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 addressed 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. As the U.S. meat processing sector geared up to implement COOL, U.S. imports of Canadian cattle and hogs noticeably declined and have remained below pre-2009 levels. Concerned that this development adversely affected their livestock sectors, Canada along with Mexico pressed their case using the World Trade Organization (WTO) dispute resolution process. The WTO panel handling this case found that COOL with respect to meat labeling violates international trading rules. The United States appealed these findings, but the WTO appellate body largely upheld them and called on the United States to bring COOL into compliance with all WTO findings.

### 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 of COOL 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.)

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

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 Food, Conservation, and Energy Act of 2008, P.L. 110-246. These provisions retained the implementation schedule, and added other commodities (chicken meat, goat meat, ginseng, pecans, and macadamia nuts) to its coverage. However, several new types of label categories were created to facilitate and simplify compliance in specifying the country or countries of red meat products. For all covered commodities, the amended law also eased recordkeeping and verification requirements, and lowered non-compliance penalties.

## Status of the Issue

Following enactment of the amended COOL provisions, the U.S. Department of Agriculture (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 took to segregate, hold, and slaughter foreign-origin livestock (e.g., from 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 resulting in a more integrated North American livestock sector, imports of live cattle and hogs from both countries became subject to mandatory COOL. In December 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. In October 2009, Canada requested the establishment of a WTO dispute settlement (DS) panel to review its claims. In November 2009, the WTO agreed to establish a panel to examine this and Mexico's nearly identical case on COOL.

Canada asserted 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 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.

In November 2011, the WTO Dispute Settlement (DS) panel found that COOL treats imported livestock less favorably than like U.S. livestock (particularly in the labeling of beef and pork muscle cuts), and does not meet its objective to provide complete information to consumers on the origin of meat products. The panel reached these conclusions by examining the economic effects of the measures taken by U.S. livestock producers and meat processors to implement COOL, and by accepting arguments that the labeling of meat, indicating where the multiple steps of livestock birth, raising, and slaughtering occurred, is confusing.

In March 2012, the United States appealed the DS panel's report to the WTO Appellate Body (AB). In June 2012, the WTO's AB upheld the DS panel's finding that the COOL measure

discriminates against imported Canadian cattle and hogs, and imported Mexican cattle, but reversed the finding that COOL does not fulfill its legitimate objective to provide consumers with information on origin. The Obama Administration welcomed the AB's affirmation of the U.S. right to adopt labeling requirements to inform consumers of the origin of the meat they purchase. Participants in the U.S. livestock sector had mixed reactions, reflecting the heated debate on COOL that has occurred over the last decade.

To meet the May 23, 2013, deadline for the United States to comply with the adopted WTO finding, USDA issued a final rule requiring that labels show where each production step (i.e., born, raised, slaughtered) occurs and prohibiting commingling of muscle cut meat from different origins. COOL's supporters applauded the final rule for providing consumers with specific and more useful information on origin. Domestic opponents decried the rule, arguing that it is more discriminatory than the previous rule and imposes additional recordkeeping burdens on processors and retailers, and in turn, additional costs on consumers. In July 2013, COOL opponents filed suit to stop USDA from implementing the final COOL rule. The U.S. District Court in D.C. will next hear arguments from all sides in early January 2014.

Canada and Mexico expressed disappointment with the final rule, and argue that it does not bring the United States into compliance with its WTO obligations. In August 2013, Canada and Mexico requested that a WTO compliance panel be created to determine if the final COOL rule complies with WTO findings. Formed in late September, this panel is now considering all three countries' arguments. Depending on the outcome of the compliance ruling(s), possible appeals, procedural timelines, and whether or not the case progresses to the retaliation phase and arbitration, the WTO COOL case may not be concluded before 2015.

Opponents have signaled their intent to use the current farm bill conference to seek to repeal or amend COOL to address their concerns about the final rule and to head off the prospect of trade retaliation if the WTO compliance panel rules against the United States. Supporters of the USDA rule argue that U.S. policy makers should not act prematurely to consider any changes to COOL, until the WTO compliance phase runs its course.

## Questions

1. Reports in meat trade publications have suggested that the COOL requirements have strained marketing relationships between Canadian and U.S. livestock producers and meat processors. 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? To what degree have other market developments (e.g., exchange rates, impact of the economic recession, meat exports to third markets) affected the beef and pork sectors in both markets?
2. 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?
3. What impact, if any, does COOL have on the availability of livestock for slaughter in the United States, and in turn, on the U.S. price of beef and pork?

# Intellectual Property Rights<sup>73</sup>

## Issue Definition

The United States remains concerned about Canada's protection and enforcement of intellectual property rights (IPR)—legal rights in various forms (e.g., copyrights, trademarks, and patents) to protect innovations and encourage creative output. The treatment of intellectual property is important to U.S.-Canada relations because of the value of intellectual property to the two national economies, as well as their high levels of bilateral trade and integration of supply chains. U.S. stakeholders express concern about 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 efforts to reform its copyright and IPR enforcement systems.

## Background and Analysis

Canada and the United States have entered into a range of IPR commitments. Multilaterally, they are signatories to the 1995 World Trade Organization (WTO) Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS Agreement"), which sets minimum standards for the protection and enforcement of various types of intellectual property. In 1997, both countries ratified the World Intellectual Property Organization (WIPO) Copyright Treaty and Performance and Phonograms Treaty ("WIPO Internet treaties"), which focus on IPR protection and enforcement in the digital environment. The United States implemented the WIPO Internet treaties in 1998 through the Digital Millennium Copyright Act (DMCA) (P.L. 105-304). In contrast, Canada did not act upon the treaties until November 2012, when it enacted the Copyright Modernization Act (Bill C-11). This followed legislative efforts in Canada over multiple years to overhaul the country's copyright regime to bring domestic law in line with international standards. Canada's prior lack of passage of a bill to implement the WIPO Internet treaties was a major sticking point in bilateral relations.

At the regional level, IPR commitments exist in the North American Free Trade Agreement (NAFTA). Canada and the United States also are participating in negotiations on a Trans-Pacific Partnership (TPP) free trade agreement (FTA), which feature discussion on IPR issues such as digital copyright enforcement, pharmaceuticals, and trade secrets. Canada may wish to join the U.S.-EU negotiations of a Transatlantic Trade and Investment Partnership (TTIP) FTA, which is in early stages, but also expected to address IPR issues. However, prospects for the future expansion of TTIP negotiation parties are unclear. In addition, Canada and the United States participated in negotiations on the Anti-Counterfeiting Trade Agreement (ACTA), an international agreement intended to build on the TRIPS Agreement. ACTA negotiations concluded in 2010, but the agreement's entry-into-force is uncertain, given the European Parliament's rejection of it in 2012 amid widespread protests by advocates of Internet free speech. ACTA requires formal approval by six parties in order to enter to force; to date, Japan is the only party that has submitted a formal instrument of approval. Nevertheless, the U.S. *2013 Trade Policy Agenda* highlights ACTA entry-into-force as a top U.S. trade priority. While the EU initially sought to have ACTA-like provisions in the Canada-EU Comprehensive Economic and Trade Agreement

<sup>73</sup> Prepared by Shayerah Ilias Akhtar, Specialist in International Trade and Finance, Foreign Affairs, Defense, and Trade Division.

(CETA), concluded in October 2013, these provisions were ultimately dropped following the European Parliament's opposition. It is possible that ACTA-like provisions could be incorporated into the proposed TPP.

Bilaterally, a key area of 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 Canada's ability to effectively enforce IPR. The United States also contends that the enforcement penalties imposed by Canada do not serve as sufficient deterrents for future IPR infringement. In October 2013, the Combating Counterfeit Products Act (Bill C-8) was reintroduced in the Parliament to bolster Canada's IPR enforcement. The bill would provide Canadian customs officials with *ex-officio authority* to seize pirated and counterfeit goods at the border, among other things. Some stakeholders considered Bill C-8 as a way for Canada to implement the enforcement standards of ACTA.

U.S. concerns with Canada's IPR system are reflected in the "Special 301" report annually published by the Office of the U.S. Trade Representative (USTR). In 2013, USTR moved Canada from the Special 301 "Priority Watch List" (a designation of criticism for a country's inadequate IPR protection and enforcement) to the "Watch List" (a milder category of criticism) because of positive developments, particularly Canada's enactment of legislation to bring its copyright laws in compliance with the WIPO Internet treaties and introduction of legislation designed to strengthen IPR border enforcement. At the same time, USTR cited the continued problem of pirated and counterfeit goods entering the integrated supply chain between the two countries, as well as issues with Canada's administrative process for appeals of the regulatory approval of pharmaceutical products. USTR also noted concern about Canadian courts' recent decisions regarding the heightened "utility" requirement for pharmaceutical patents. U.S. pharmaceutical companies argue that such decisions contribute to an uncertain business environment in Canada. For example, one U.S. pharmaceutical company challenged Canada under NAFTA's Chapter 11 investor-state dispute settlement mechanism, based on a Canadian court's decision to invalidate the company's patent. Canada had been identified on the Priority Watch List since 2008, and previously had been on the Watch List since 1985. Some defenders of Canada's IPR regime assert that the Special 301 process is overly industry-driven, while some industry groups maintain that Canada's Special 301 placements reflected material inadequacies in Canada's IPR regime.

## Status of the Issue

While Canada's passage of the Copyright Modernization Act and the introduction of the Combating Counterfeiting Products Act in the Parliament are viewed as positive developments, the United States remains concerned about Canada's IPR environment, such as in the areas of border enforcement and treatment of patents. Prospects for ACTA's overall entry-into-force remain uncertain, but Canada and the United States remained engaged on IPR issues in the TPP negotiations.

## Questions

1. What progress has been made in implementing the Copyright Modernization Act? How could Canada's implementation of the WIPO Internet treaties differ from the DCMA?

2. What steps has Canada taken to promote international IPR protection and enforcement? What are Canada's top IPR priorities in its FTA negotiations? How does Canada view new and emerging IPR issues and challenges, such as the protection and enforcement of trade secrets?
3. What are the opportunities and challenges that Canada sees in ratification of the ACTA? What is Canada's status with respect to ratification of the ACTA?
4. What measures is Canada currently taking to address trade and transshipment of pirated and counterfeit goods? What steps can Canada take to improve IPR border and domestic enforcement? How could the United States support Canada's efforts?
5. Please describe Canada's approach to patent law and recent judicial decisions regarding requirements for patent validity. What are the implications for Canada's innovation and investment climate?
6. How does Canada view the U.S. Special 301 process? How does the change in Canada's placement from the Priority Watch list to the Watch List affect Canada-U.S. trade relations?

## Electric Reliability, Trade, and Access to Renewable Power<sup>74</sup>

### 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 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 over low voltage distribution lines to end-users. The transmission lines that constitute the North American power grid cross state and international boundaries. The U.S. and Canadian electricity grids are linked by physical ties and operational economics:

- At the broadest level of organization, the North American grid is divided into regional "interconnections" within which power moves freely (the links among 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.

<sup>74</sup> Prepared by Richard Campbell, Specialist in Energy Policy; Resources, Science, and Industry Division.

- 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 among 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 the latter'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 electricity 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 (MOUs) 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. NERC's standards also cover critical infrastructure protection (including measures to enhance the cybersecurity of the grid).

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. A few international transmission projects of note include:

- The Montana-Alberta Tie Line (which entered service in September 2013) was the first transmission link between that state and province. It is a 214-mile, US\$213 million merchant project, which will facilitate the development and export of wind power in both regions. It is also expected to improve transmission system reliability. The project received a US\$161 million loan under the American Recovery and Reinvestment Act (P.L. 111-5).
- The Northern Pass project is 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. However, the U.S. Department of Energy continues to hold public scoping meetings in affected communities along the U.S. route as part of the federal permitting process.

Other transmission projects include the Minnesota Power-Manitoba Hydro agreement to accommodate sales of hydropower to the United States, and the Champlain Hudson Power Express, a merchant line to bring hydropower and wind power from Québec to the New York City area.

Authorities in both Canada and the United States are monitoring space weather. The Sun is entering an especially active period for solar storms. Northern latitudes are more susceptible to extreme space weather caused by solar storms. These storms could induce geomagnetic induced currents which can adversely affect bulk power system components such as transformers, or cause voltage instability and power system collapse.

## Trade and Renewable Energy Development

The United States is a net importer of electricity from Canada, and imports had been increasing, from 42.7 terawatt-hours (Twh) in 2006 to 50.3 Twh in 2007 and 56.0 Twh in 2008. Imports briefly decreased from 51.8 Twh in 2009 to 44.4 Twh in 2010, but have rebounded to 51.4 Twh in 2011 and 57.9 Twh in 2012. 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 1.3% of net U.S. electric power generation (approximately 4,106 Twh) in 2011. Electricity trade is more significant from Canada's standpoint. Canada generated 595 Twh of electricity in 2012, with exports to the United States representing about 10% of Canada's domestic generation.

The United States relies on coal for about half its electricity production, while Canada derives about 75% of its electricity from non-fossil fuel sources (i.e., hydropower, nuclear, and wind energy). The United States and Canada have both proposed regulations to address greenhouse gas (GHG) emissions from fossil fuel-based power generation. Canada plans to produce 90% of its electricity from "non-emitting" sources such as hydro, nuclear, clean coal (i.e., coal plants capable of carbon capture and storage), or wind power by 2020. 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, at least 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 potential development of new 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.

In June 2013, Canada lost an appeal at the World Trade Organization (WTO) in a ruling on incentives the province of Ontario had established for the production of renewable electricity. Japan and the European Union (EU) brought the case over a “feed-in tariff” which offered above-market prices for electricity supplied by renewable energy, but only offered the premium to firms that bought most of their equipment locally. The appeal decision revised some of a ruling in late 2012 in which Japan and the EU had won most of the case, leaving in place the key finding that Ontario’s incentives were illegal because they discriminated against foreign firms. A spokeswoman for Canada’s federal trade ministry said the government would work with provincial authorities to respond to the WTO’s final ruling. Ontario will have to bring its rules in line with the WTO rules or risk trade sanctions. The United States filed a third-party submission supporting the claims that Ontario’s program violated WTO rules, and has a similar WTO complaint pending against India for local content preferences which are alleged to impact U.S. suppliers of thin films used in solar photovoltaic modules.

## 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. Proposed regulations to address greenhouse gas emissions in both Canada and the United States may create increased demand for renewable electricity, even with the increasing production of natural gas. Legislation is currently being discussed in the U.S. House of Representatives to update and streamline the permitting process for cross-border energy infrastructure projects, which is currently based upon several presidential executive orders.

## Questions

1. Will all Canadian federal and provincial regulators approve and enforce NERC electric reliability standards? Without compatible 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. 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 bi-national body be instituted to oversee energy trade opportunities and energy security issues?
4. How might Canadian and U.S. regulatory initiatives to reduce GHG emissions impact plans for increasing Canadian exports of renewable electricity to the United States, rather than reserving these resources for domestic consumption?

## U.S. Energy Security and Canadian Oil Sands<sup>75</sup>

### 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 petroleum resources, and Canada's oil sands producers continue to look primarily to the United States as the major market for their oil exports. Of the approximately 3.1 million barrels per day (mbd) of crude oil Canada has exported to the United States during the first half of 2013, almost 60% is delivered to the Midwest. This region's capacity to process increasing volumes of Canadian crude oil is limited in the near term. However, planned refinery expansion coupled with new refinery and infrastructure construction may place the region in a position to receive increased oil exports from Canada in the longer term. Another possibility for processing additional Canadian oil is expanded access to refineries along the U.S. Gulf coast, which is likely to require expanded pipeline capacity.

Although U.S. refinery capacity is forecast to increase from about 17.3 mbd in 2013 to nearly 19.0 mbd in 2030—a 1.7 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 to accommodate heavy oils are likely to have environmental effects, and Congress may continue to face controversy over the balance between energy economic and environmental goals. In addition, investment and production plans are likely to be altered by the reduced demand for petroleum products in the United States, associated with high prices and the ongoing effects of the economic recession that began in the last quarter of 2007.

Another possible impediment to expanded Canadian oil use is Section 526 of the Energy Independence and Security Act of 2007 (P.L. 110-140), which 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

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<sup>75</sup> By Robert Pirog, Specialist in Energy Economics, Resources, Science, and Industry Division.

would apply to fuels derived from “oil sands,” that some associate with the production of higher levels of greenhouse gas emissions than fuels derived from conventional, lighter crude oils.

## Background and Analysis

When it comes to future oil supplies, production from 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 was deemed economic, Canada has been ranked third behind Saudi Arabia and Venezuela in proved oil reserves. Canada has about 175 billion barrels of proved 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 over 3.1 mbd during the first half of 2013, of which 99% was directed to the United States. Canadian crude oil accounts for about a third of U.S. crude oil imports, and about 17% of all U.S. crude oil and petroleum products supplied during the first half of 2013. 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, and may be needed. Oil sands production is expected to rise to about 3.6 mbd by 2030.

Greenhouse gas “emissions intensity” (CO<sub>2</sub>/barrel) from oil sands has been identified as being 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, CO<sub>2</sub> 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 CO<sub>2</sub> in 2010 and 218 megatons CO<sub>2</sub> 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 planned for Indiana, Michigan, South Dakota, and elsewhere. Some of these expansions or new refineries are several years away from operation. The \$3.8 billion BP refinery upgrade and expansion in Whiting, IN, originally with an initial expected completion in 2011, is 95% complete and the new, expanded distillation facility opened in July 2013. A new \$10 billion refinery in Union County, SD, being planned to process heavy crude from oil sands, continues to face legal challenges. 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 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 such as 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, and in what timeframe, 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. As a result of the supply bottlenecks and resultant price discounts on Canadian crude oil, how likely is it that Canadian oil sands development will be slowed because of revised investment strategies by the major oil companies?

## Keystone XL Pipeline<sup>76</sup>

### Issue Definition

In September 2008, TransCanada (a Canadian company) submitted its first application 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 petroleum produced from the oil sands of Alberta, Canada, to a market hub in the United States for further delivery to 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. Some 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, to date, has had no direct role in permitting the pipeline's construction, it has an oversight role stemming from federal environmental statutes that govern the pipeline's application review process. Legislative proposals have sought to assert direct congressional authority over permit approval.

### Background and Analysis

Canada is the largest supplier of imported crude petroleum to the United States. Of the 8.5 million barrels per day (Mbpd) the United States imported in 2012, Canada supplied 2.4 Mbpd (28%), more than the combined imports from the next two largest suppliers—Mexico and Saudi Arabia.

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<sup>76</sup> Prepared by Paul Parfomak, Specialist in Energy Policy; Resources, Science, and Industry Division.

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 Mbd 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 Mbd (26% of the total) began service in 2010.

The permit for Keystone XL, which would add an additional 0.8 Mbd of import capacity, was denied by the U.S. State Department in January 2012. However, TransCanada subsequently proceeded with development of the Keystone XL segment connecting Cushing, OK, to the Gulf Coast as a stand-alone project not requiring a Presidential Permit. TransCanada also reapplied to the State Department for a Presidential Permit to build the northern, cross-border segment of Keystone XL. If ultimately approved and constructed, Keystone XL would bring Canada's total U.S. petroleum export capacity to over 4.1 Mbd, enough capacity to carry over 48% of U.S. crude petroleum imports in 2012. Given that Canada actually supplied the United States 2.4 Mbd in 2012, large increases in Canadian supply will ultimately be possible, although much of the increased crude supply could be destined for foreign markets. In addition, several large pipeline projects are proposed within the United States to increase movements of Canadian petroleum to and from 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 trend of expanding petroleum pipelines from Canada, particularly Keystone XL, has generated considerable controversy in the United States. Proponents of the Keystone XL, 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 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 environmentally sensitive areas in Nebraska 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 incremental capacity anticipated in other Canadian petroleum pipelines and through increasing oil shipments by rail, the Keystone XL project is not needed.

### **Status of the Issue**

On January 18, 2012, the State Department denied the original Keystone XL permit, citing insufficient time under a 60-day congressional deadline to obtain all the necessary information to assess the project. On February 27, 2012, TransCanada announced that it would proceed with development of the Keystone XL in two segments as stated above. The company filed a new Presidential Permit application in May 2012 for the northern segment of the Keystone XL project. The southern segment of the original Keystone XL proposal has since been completed.

A final State Department decision on the re-filed Keystone XL permit application appears unlikely before 2014 due to extensive environmental review under the National Environmental Policy Act (NEPA). President Obama has stated that he would grant the Presidential Permit “only if this project doesn’t significantly exacerbate the problem of carbon pollution.” Congress may act to influence this decision in the meantime. The Energy Production and Project Delivery Act of 2013 (S. 17), the Keystone for a Secure Tomorrow Act (H.R. 334), a bill to approve the Keystone XL Pipeline (S. 582), the Northern Route Approval Act (H.R. 3), and the Job Creation Act of 2013 (H.R. 2674) would all effectively approve the Keystone XL Pipeline. The Strategic Petroleum Supplies Act (S. 167) would suspend sales of petroleum products from the Strategic Petroleum Reserve until the pipeline is approved.

## Questions

1. Will the State Department approve the reconfigured 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 or Atlantic markets and how might the Keystone XL pipeline affect those?
4. To what extent should 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 effects associated with the pipeline’s construction?
7. What are the market and safety implications of increased oil imports by rail if Keystone XL is not constructed?
8. What are the climate implications of Keystone XL and how would the project affect U.S. and Canadian efforts to reduce their emissions of greenhouse gases?

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