Are Anti-Terrorist Regulations Trumping Commerce in North America?

By James E. McConnell

Are the U.S. government's new antiterrorism policies and regulations for cross-border commerce serving, in effect, as non-tariff barriers? If so, are they trumping the long-standing objective of maintaining a relatively open and easily crossed international border between the U.S. and Canada?

What are the principal costs involved in complying with the new security mandates? And, what are the likely strategic responses of American and Canadian companies to these new security regulations when it comes to decisions related to supply line logistics, direct investments, and the location of production?

Security Spending Considerably Up

During late August and early September 2004, a postal survey was distributed to over 400 business executives located in Southern Ontario and Western New York. The results provide some insights into the above questions.

More than 75 percent of Canadian respondents indicated that new security compliance requirements have created negative export effects compared to only 25 percent among U.S. respondents.

Security budgets for Canadian and U.S. companies have increased by an average of 39 percent between 2001 and 2004. While the firms in Western New York have experienced the largest increases in relative terms (64 percent), average security spending as a proportion of total sales has been almost three times higher among firms in Southern Ontario for both time periods.

On average, Canadian exporters indicated that they are currently spending 2.7 percent of their total revenues on security-related compliance, compared to 1 percent for the American companies. For a typical Canadian exporter with total sales to the United States of US $10 million, current security expenditures amount to approximately US$270,000 (a US$64,000 increase over 2001). This estimate corresponds quite closely with data supplied by the Ontario Chamber of Commerce, which estimates the average cost per firm of complying with the new regulations at roughly C$135,000. Most of these costs can be traced to shipment delays at the Canada-U.S. border.

Canadians More Heavily Impacted

Comparatively speaking, the survey reveals that Canadian firms have been more heavily impacted by the new security regulations in terms of several impact categories, including negative export effects, increased import prices, additional security compliance costs, and trade disruptions (e.g., traffic diversions). More than 75 percent of Canadian respondents indicated that new security compliance requirements have created negative export effects compared to only 25 percent among U.S. respondents. Most of these effects can be traced to various types of border delays and logistics-based irritants. As a result, close to one third of the Canadian respondents believe that the new security measures are trumping trade, compared to only 22 percent of the American executives.

Border Delays and the Effect

When asked to identify the major increases in the cost of doing business across the Canada-U.S. border that result directly from the new government security regulations, executives on both sides of the border focus upon the loss of transit time through abnormal border-crossing delays, increased costs passed down from transport carriers and shipping companies, reduced customer service, lower profits, increased security-related insurance costs, increased inventory requirements, higher storage and warehousing costs, and disruption of just-in-time logistics systems.

While Canadian firms appear to be suffering disproportionately in terms of reduced profits, lower productivity, increased insurance and inventory costs, traffic diversion, and just-in-time disruptions vis-à-vis the American businesses, the data confirm that on both sides of the border the small and medium-sized enterprises with total sales of less than C$25 million are arguably the most negatively impacted.

Trade Diversion Likely

One of the principal objectives of the survey was to determine the extent to which the new border-security measures may be influencing the longer-term strategic business decisions of the executives involved in cross-border commerce. Of particular concern are the likely impacts upon supply chain re-configuration and the location of production or warehousing facilities.

The survey documented a number of possible strategic responses that the respondents are considering for the future. For example, executives were asked to indicate the likelihood that their companies will substitute higher-cost suppliers located in North America for lower-cost suppliers located elsewhere in the world in order to minimize security-related costs.

Such trade diversion might occur, for example, if a Canadian firm decides to switch its sourcing of components from a low-cost manufacturer in China to a higher-cost producer in Canada or the U.S. to avoid the security-related hassles of importing goods from overseas.

Relocation Possibilities

Almost one-quarter of the respondents (28 percent of the Canadians and 14 percent of the Americans) indicated that they are very or somewhat likely to accept trade diversion in order to minimize security-related constraints. Moreover, when asked if their companies are likely to relocate all or some of their production capabilities now located outside of their home country back into their home country to minimize security-related concerns, only 8 percent of the executives indicated that they are very or somewhat likely to make such a decision, with another 24 percent uncertain about such a move. In contrast, some 10 percent of the executives indicated that they are very or somewhat likely to transfer their current home-based production and/or warehousing facilities across the border into the neighboring country so that they can eliminate cross-border difficulties.

Importance of Delivery Times

As the global economy of intra-firm trade and just-in-time deliveries is increasingly dependent upon open markets and borders, international competition is increasingly based upon the efficiency of supply chains and distribution systems. Speedy and reliable delivery of goods and business services is a matter of value added, not just cost reduction; hence, it is imperative that business transactions across the U.S.-Canada border be carefully managed so that the risks of possible terrorist threats are reduced, while at the same time disruptions to cross-border commerce are minimized.

Negative Impacts Exists

This report reveals that the new security regulations are clearly having a negative impact on the cost of doing cross-border business, and that these costs may produce the undesirable effects of trade diversion, import substitution, and/or related consequences (e.g., company downscaling, international outsourcing, or market exit). As Canadian exporters face an appreciating domestic currency and as American importers try to cope with a declining US dollar, adding new security-related costs to their international business operations will presumably not help their international competitive positions. ■

James E. McConnell is associate director of the Canada-U.S. Trade Center at the University at Buffalo. Readers may contact him at geojem@buffalo.edu.

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