



# UNFINISHED BUSINESS: A NAFTA STATUS REPORT



**MARY R. BROOKS  
STEPHEN KYMLICKA**



The AIMS Atlantica Ports Series # 1



Charles Cirtwill and Ian Munro

Series Editors



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## **Atlantic Institute for Market Studies**

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The Atlantic Institute for Market Studies (AIMS) is an independent, non-partisan, social and economic policy think tank based in Halifax. The Institute was founded by a group of Atlantic Canadians to broaden the debate about the realistic options available to build our economy.

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- a) initiating and conducting research identifying current and emerging economic and public policy issues facing Atlantic Canadians and Canadians more generally, including research into the economic and social characteristics and potentials of Atlantic Canada and its four constituent provinces;
- b) investigating and analyzing the full range of options for public and private sector responses to the issues identified and acting as a catalyst for informed debate on those options, with a particular focus on strategies for overcoming Atlantic Canada's economic challenges in terms of regional disparities;
- c) communicating the conclusions of its research to a regional and national audience in a clear, non-partisan way; and
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# ABOUT THE SERIES

## The Atlantica Ports Series

Atlantica is a region broadly composed of the Atlantic provinces, south-shore Quebec, the northern tier of New England states, and upstate New York. These territories have a number of characteristics in common – similar demographics, diversity, and migration; a shared history; and interrelated transport issues. These common qualities have led to common public policy interests.<sup>1</sup> The dominant container port in Atlantica is the Port of Halifax, while on a tonnage basis, the largest port in Atlantica is Canso, a significant energy hub. The ports of Saint John and Come-by-Chance are also significant players in the energy transfer business.

Ports provide a key service in the transportation network that moves goods from producer to consumer. All goods and network connections do not have the same needs, however, and so the strategy of any port must be tailored to realistic trade flows. The Atlantica Ports Series takes a comprehensive look at the existing flows, industries, and services that surround Atlantica and asks: What opportunities exist for Atlantica ports to increase volumes? One option would be for industry surrounding the ports to grow. This background paper focuses on several technical considerations for increased trade, especially with the United States.

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<sup>1</sup> For further information, please see <<http://www.atlantica.org>>.

# ABOUT THE AUTHORS

## **Dr. Mary R. Brooks**

Dr. Mary R. Brooks holds the William A. Black Chair of Commerce at Dalhousie University, Halifax, NS, Canada. She was Membership Secretary and Treasurer of the International Association of Maritime Economists from 1994-98 and a Director of the Halifax International Airport Authority from its inception in 1995 to January 2004. She currently chairs the Committee on International Trade and Transportation, Transportation Research Board, Washington, DC and is a Member of the Chartered Institute of Logistics and Transport.

Her most recent work includes: *Short sea shipping on the east coast of North America: An analysis of opportunities and issues* (with J.R. Hodgson and J.D. Frost, for Transport Canada, 2006); *NAFTA and Short Sea Shipping Corridors* (AIMS, 2005); *To Review Certain Recent Developments in International Shipping Policy* (a research contract with J. R. Hodgson for Transport Canada, 2003); *Maritime Transport* with K. J. Button and P. Nikamp (published by Edward Elgar, 2002); “NAFTA and Transportation: A Canadian Scorecard” in *Transportation Research Record 1763* (2001); and *Sea Change in Liner Shipping: Regulation and Managerial Decision-Making in a Global Industry* (published by Pergamon Press, 2000).

Dr. Brooks received her undergraduate degree from McGill University (1971), her MBA from Dalhousie University (1979) and her PhD in Maritime Studies from the University of Wales (1983).

## **Stephen Kymlicka**

Stephen Kymlicka is a Senior Policy Analyst at the Atlantic Institute for Market Studies with responsibilities for the Atlantica and Transportation portfolios.

Prior to coming to AIMS, he ran an MIS and Management consulting firm in Regina for several years, growing the company to 27 employees. Over nearly 20 years, he has worked or consulted for agriculture, oil and gas, chemicals, mining and insurance companies as well as NGOs and several government departments. Among his managerial missions, he has led strategic planning efforts in the public and private sectors.

In addition to his work with AIMS, Stephen teaches International Business and Corporate Strategy at Dalhousie University. He earned an MBA from Dalhousie University and a BSc from St. Francis Xavier University.

Stephen lives in Halifax with his wife and 2 children.

# EXECUTIVE SUMMARY

Atlantica has always been home to firms that exported to the world. Lumber, fish, apples, peat and gypsum are just a few of the region's commodities that still serve the world. On a manufacturing level, Atlantica used to make railway tracks, glassware, even automobiles for export. As time went on some of these industries went away and some were replaced. In many cases, such as Michelin, and Pratt and Whitney, firms took materials from around the world and produced new goods, again for export.

Recently, Atlantica has seen the re-emergence of home grown industries – often knowledge based – in the areas of aquaculture, education and information technology. While these firms are important contributors to the regional economy, they do not produce large volumes of goods for export by rail or ship.

This paper examines the question of whether an opportunity for port-led industry growth exists by looking at recent changes in Canada's trade relationship with the United States. Specifically, it looks at cost reductions made available through technical harmonization under the North American Free Trade Agreement (NAFTA), rules of origin in the NAFTA, dispute resolution in the NAFTA and recent bilateral initiatives.

It is clear that what new progress is to be made must begin with a new commitment at the local and regional level. While national governments have a central role, even an obligation, to act as facilitators in this effort, state and provincial governments must see that regional standards act as trade barriers. If the political will is lacking at this level then progress is difficult if not impossible. The key conclusion of this paper is that further efficiencies could be negotiated and would help; however, the easy wins appear to already have been implemented.

Further progress is possible through direct bi-lateral or tri-lateral negotiation. Where regulatory change can accompany operational security improvements, hope remains. We recommend the following:

***Recommendation #1:*** That provinces and states within Atlantica pursue resolution of standards issues on a local or regional basis. That the federal governments in Canada and the United States act aggressively in their role as facilitators of this state and provincial coordination effort. That, additionally, Canada pursue resolution of standards issues internationally through the Transportation Border Working Group as opportunities arise.

***Recommendation #2:*** That efforts to encourage industrial expansion and manufacturing focus on existing opportunities and an effort to improve the general understanding of the advantages that already exist for value-added production and export.

***Recommendation #3:*** That Canada and the United States complete border infrastructure projects (especially those in Atlantica) as quickly as possible.



**Recommendation #4:** *That Canada pursue policies to level the transportation environment with the United States. This could include levelling of corporate taxation, levelling of fuel taxation, removal of the 25 percent tariff on purchased ships, adjustments to coast guard rates to reflect use and easier access to private capital within the port system.*

# INTRODUCTION

The dominant vehicles for removal of technical barriers to trade with the United States have been the Canada US Trade Agreement and North American Free Trade Agreement (the NAFTA).<sup>2</sup> The phased-in removal of tariff and investment restrictions on January 1, 1994, brought immediate and longer-term cross-border opportunities. It has been more difficult to remove non-tariff barriers, to agree on the details of the rules of origin, and to address unforeseen consequences (and opportunities) arising from the dispute-resolution process. This paper examines each of these items with an eye to untapped opportunities and finds no low-hanging fruit.

We also find that the business environment could be improved. Some non-tariff barriers remain and the transportation business environment is not a level playing field. Progress on these issues through bi-national or tri-national institutions has been minimal in recent years, as national attention has focused on security in the wake of 9/11. However, many of these barriers are under state and provincial jurisdiction and opportunities exist for regional solutions. As such, the paper closes by making some policy recommendations that would improve the trading environment, making cross-border businesses more competitive.

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<sup>2</sup> Between Canada and the US, the Canada-US agreement was more critical but the NAFTA extended these gains to Mexico and so is the focus of this paper.

# STANDARDS

The writers of the NAFTA understood that there were many non-tariff barriers to trade; hence they formed several committees under Chapter 9, “Standards Related Measures”, with a mandate to resolve these in a timely way. This chapter first details how these were set up, what their mandate was, what their mandate became, and the current state of affairs. It then looks for any opportunities that have arisen or could arise in the future.

## History and Structure

The first two articles of Chapter 9, Article 911 and Article 912, simply state that the three countries will work together. Article 913 creates a committee of the three nations to resolve technical-standards issues. Paragraph 5 specifies that this committee will be advised by four subcommittees (and any other group it feels that it needs):

- Land Transportation Standards Subcommittee
- Telecommunications Standards Subcommittee
- Automotive Standards Council
- Subcommittee on Labelling of Textile and Apparel Goods

Each subcommittee had its initial mandate. In the case of the Land Transportation Standards Subcommittee (LTSS), deadlines ranging from six months to six years were given for each item. Article 914 provides that, where appropriate, subcommittees can form non-binding consultative groups. The rest of this section will focus on the Land Transportation Standards Subcommittee.

Recognizing the fundamental relationship of technology to the standards in question, on March 30, 1995, the NAFTA partners signed a *Memorandum of Understanding (MOU) on Science and Technology Cooperation in the Field of Transportation*.<sup>3</sup> By mid-1995, the LTSS had reorganized itself as five working groups (known as LTSS Working Groups 1 through 5):

1. Compliance and Driver and Vehicle Standards,
2. Vehicle Weights and Dimensions,
3. Traffic Control Devices for Highways,
4. Rail Standards, and
5. Hazardous Materials Standards;

and five consultative groups (known as LTSS TCG 1 through 5):

1. Cross-Border Operations and Facilitation,
2. Rail Safety and Economic Issues (which became part of LTSS Working Group 4 in 1995),
3. Automated Data Exchange,
4. Science and Technology, and

<sup>3</sup>*Initial Five-Year Plan for Increased Cooperation in the Field of North American Transportation Technologies*, <[http://www.tc.gc.ca/pol/en/report/Truck\\_Plenary/English/TCG4\\_Attachment.htm](http://www.tc.gc.ca/pol/en/report/Truck_Plenary/English/TCG4_Attachment.htm)>

## 5. Maritime and Ports Policy.

Plenary meetings were held yearly to report progress. The intent was to have all the work done by 2000, and some groups succeeded. The last meeting was held in San Antonio in May 2002. Each country published a NAFTA Resource Manual for commercial motor carriers as the end result.<sup>4</sup> Although there have been no trilateral meetings of the LTSS since then, each party has kept its part of the LTSS as an implementation body.<sup>5</sup>

It was about this time that the trilateral relationship evolved into two bilateral ones. Canada had pushed for its Smart Border Accord with the United States late in 2001, and, since the United States was striving to deal with security issues, it resulted in a divided approach; for the United States, the issue on the northern border was mainly security, whereas that on the southern border was the need to control immigration as well as security. In 2002, Canada and the United States formed the Transportation Border Working Group (TBWG) to take on bilateral issues.

### Accomplishments

The minimum age agreed upon for a motor carrier driver<sup>6</sup> is 21 and, in March 1994, Canada and Mexico recognized each other's commercial driver's licences (CDLs). An *Emergency Response Guidebook* was published in 2000 (and a new version in 2004) and has been translated into nine languages.

There were several other agreements of varying scope, including, for example, one on drivers' log books. The parties agreed "to develop a common format and contents for a North American logbook for recording drivers' hours of service, and agreement on safety performance information each country will require from motor carriers."<sup>7</sup> Today, several computer programs and books have driver logs with the same core fields, but there are some differences (for example, some allow for multiple-vehicle units and free-form remarks). Some programs try to incorporate rules and thus become country-specific. For example, driver hours of service are different in Canada and the United States. Another agreement is on the sharing of driver medical records. In addition, there have been several bi-national agreements but differences between Canadian and American regulations remain. For example, Canada "has no substance use testing legislation/regulations".<sup>8</sup>

### Data Collection and Comparison

<sup>4</sup> The 162-page Canadian version can be found at <<http://www.tc.gc.ca/pol/nafta-alena/en/resource-manual/adobe/English.pdf>>. The federal site says that the "Crossing International Borders – A Trucker's Guide", and "Road Signs and Rules: A Trucker's Guide" chapters are available from the Ontario Trucking Association, but they are not on the OTA site. The 130-page US version can be found at <[http://www.dot.gov/nafta/CB\\_REQ\\_ENG.pdf](http://www.dot.gov/nafta/CB_REQ_ENG.pdf)>, and the 71-page Mexican version at <<http://www.dot.gov/nafta/mexico-english.pdf>>.

<sup>5</sup> See, for example, the Web site of the Canadian Vehicle Weights and Measures group at <<http://www.comt.ca/english/programs/trucking/nafta.html>>. The desire of the states to be at the US table can be seen at <<http://www.ncsl.org/statefed/econdev.htm#NAFTA>>.

<sup>6</sup> In practice, the minimum age is dictated by the insurance companies and is at least 23.

<sup>7</sup> <<http://ai.volpe.dot.gov/CarrierResearchResults/TextFiles/march2000.txt>>.

<sup>8</sup> Ibid.

One can infer from the documentation that, in 1994, there was very little data sharing between NAFTA jurisdictions, and so there was very little basis on which to secure agreement. Today, this is no longer true. Through a variety of mechanisms, each jurisdiction now collects, stores, and shares base data on the vehicle, its safety compliance, and the driver (including medical conditions).<sup>9</sup> In Canada, driver and vehicle data are disseminated electronically via the InterProvincial Record Exchange (IRE) system run by the Canadian Council of Motor Transport Administrators (CCMTA). This system is linked to similar systems in the United States so that records can be accessed by the other jurisdiction.<sup>10</sup> Canadian federal authorities have access to both driver and vehicle information through the Canadian Police Information Centre (CPIC). Most Canadian and American jurisdictions share carrier registration information (and prorated registration fees) electronically under the International Registration Program (IRP) and through the Commercial Vehicle Registration System (COVERS) operated by the American Association of Motor Vehicle Administrators (AAMVA). That said, it appears that the available data are not fully used by most US states.<sup>11</sup>

Policy regulations have been tabulated to aid in clarifying the vehicle dimension and registration requirements for a route – albeit with some effort. The intent of the NAFTA process was policy harmonization based upon the differences in this tabulation but this work seems largely undone.<sup>12</sup>

Though not connected with the NAFTA, there are port state control data exchange agreements that share data on ships entering territorial waters, the operator of each, its inspection and deficiency records, and so on. These agreements arose from each nation's interest in protecting its coastal waters from substandard shipping. Both Canada and the United States take part in inspection programs similar to the ones first promulgated by the founding signatories to the Memorandum of Understanding on Port State Control, signed in Paris in 1982. The MOU covers safety of life at sea, prevention of pollution by ships, and living and working conditions on board ships. Since it was signed, several other regional groups of port states have developed, each with similar policies. Canada is a signatory to both the Paris and Tokyo MOUs, whereas the United States has chosen to adopt the principles of port state control but not membership in the various MOUs, preferring to design and manage its own program and remain an observer at international PSC meetings. This has not prevented the two countries from exchanging data and co-ordinating their activities.

### **Standards Harmonization**

The biggest problem appears to be that many of the matters that remain in discussion between Canada and the United States are under provincial or state jurisdiction, and that harmonization

<sup>9</sup> <<http://www.tc.gc.ca/pol/nafta-alena/en/plenaries/plenary-2001/tcg-3.htm>>. According to the notes from the 2001 Plenary, both the United States and Mexico have systems (modules) that collect this information, but Mexico has been slow to share the data with insurers because of privacy legislation protecting motor vehicle records. See <<http://www.insurancejournal.com/news/national/2002/12/09/24811.htm>>.

<sup>10</sup> Private communication. See also <<http://www.idsysgroup.com/ftp/DLID-Security.pdf>>.

<sup>11</sup> Presentation to the US Treasury Department by AAMVA, November 2005, <<http://www.aamva.org/Documents/comMCSHVUTFinalComment010406.pdf>>.

<sup>12</sup> In fairness, it should be said that some items were intentionally left off the table. For example, regulatory differences in rail safety were deemed immaterial.

within a country is as difficult as it is across national borders. In Canada at least, there are agreements for mutual recognition of registration. For example, a truck registered in Quebec is allowed to do business in Saskatchewan.

One crucial outstanding issue for the trucking industry is insurance. The Canadian solution is that an American-registered truck can buy private intermediary insurance (that is, a Canadian company buys the American policy for the duration of the trip.) This intermediary policy is recognized everywhere in Canada. American insurers have similar fronting plans available to Canadian truckers operating in the United States. The NAFTA tri-national Insurance Working Group (a subsidiary of the Financial Services Committee) was formed in 2001 to find trilateral solutions.

A non-binding set of vehicle weights and dimensions was published in 2002 as part of the Resource Manual mentioned above. In Canada, the responsibility for integrating standards fell to the Council of Ministers of Transportation (COMT), which had been working on Canada-wide standards. Memorandums of Understanding from this group were issued in 1988, 1991, 1994, 1997, 2004, and most recently, in August of 2005.<sup>13</sup> These represent minimum standards accepted by all jurisdictions. However, significant differences exist beyond these standards.

In the United States, responsibility for compliance falls to the branches of the Department of Transportation, usually the Federal Highways Administration (FHWA) or the Federal Motor Carrier Safety Administration (FMCSA). The effort to achieve compliance has been inconsistent, and some changes in regulations have been withdrawn.<sup>14</sup> The 2001 Plenary session concluded that regional solutions may be possible.<sup>15</sup> Canada also has made progress on standardizing vehicle safety regulations for carriers.<sup>16</sup>

Perhaps worse, with the evolution of technology, the 2002 document on vehicle weights and measures is now out of date and acts as an obstacle to the harmonization of standards. Innovations like long combination vehicles, or “road trains”, need to be appealed to each jurisdiction (provinces and states) for approval and the result is liable to be differing regulations.<sup>17</sup>

<sup>13</sup> <<http://www.comt.ca/english/programs/trucking/MOU%202005.pdf>>.

<sup>14</sup> In one case, FHWA, having received mixed feedback, disallowed the change, arguing that non-compliance with the NAFTA does not materially affect the goal of removing barriers to trade. <<http://www.epa.gov/fedrgstr/EPA-IMPACT/2004/October/Day-26/i23966.htm>>. In 2002, FMCSA tried both to comply (removing mandatory US safety auditors who inspected foreign vehicles) and not to comply (allowing trucks domiciled in Mexico to operate in the United States) by using environmental arguments. On 16 January 2003, the US Court of Appeals for the Ninth Circuit ruled against FMCSA and ordered it to go back and write the regulations again properly. In the case about safety auditors, FMCSA complied. See <<http://www.epa.gov/fedrgstr/EPA-IMPACT/2003/October/Day-02/i24979.htm>>. However, on the larger issue, FMCSA announced “scoping” meetings (<<http://www.epa.gov/EPA-IMPACT/2003/October/Day-08/i25618.htm>>), to be concluded by December 2003. Since then FMCSA has been silent.

Scoping is a way of avoiding compliance if the changes are not material to trade. The EPA can conduct meetings to scope out the impact if there is debate about this. In practice, this is a stalling tactic for those who have a vested interest in the status quo – in this case, the Teamsters.

<sup>15</sup> <<https://www.tc.gc.ca/pol/nafta-alena/en/plenaries/plenary-2001.htm>>.

<sup>16</sup> <[http://www.ccmta.ca/english/pdf/safety\\_rating\\_knowlesreport.pdf](http://www.ccmta.ca/english/pdf/safety_rating_knowlesreport.pdf)>.

<sup>17</sup> See presentations to the meetings of the Canadian Task Force on Vehicle Weights and Dimensions Policy at <<http://www.comt.ca/english/programs/trucking/meetings.html>>.

## Technology

Also dated is the range of technology addressed. In 1994, vehicle information systems were simply a collection of inconsistent systems storing data on vehicles, people, and attributes that would affect licensing (that is, registration history, accidents, traffic offences, safety inspections, and so on). Today there is much more consistency on these issues (see above), but there are still great disparities in the definitions of cargo (for example, containers). It would seem that the lead on cargo technology is being taken by the Intelligent Transportation Systems (ITS) initiative – which is inherently national and not a NAFTA creation, although Canada and Mexico have sister organizations.

In addition to the Commercial Vehicle Registration System (COVERS) and InterProvincial Record Exchange (IRE), the Americans have embarked upon the Commercial Vehicle Information Systems and Networks (CVISN) Model Deployment Initiative and PRISM (the Performance and Registration Information Systems Management program) administered by the Federal Motor Carrier Safety Administration (FMCSA). The good news is that FMCSA has been able to obtain a high degree of compliance. The bad news is that because the United States has embarked on these initiatives outside of AAMVA, Canadians have been left out.<sup>18</sup>

## Hazardous Materials

The NAFTA gave each country six years to comply with UN regulations on hazardous materials. In 1994, the United States and Canada were already in compliance. Since then, UN regulations have changed and both the United States and Canada have kept pace although the fact that implementation is not identical indicates a lack of commitment by the two governments to the concept of regulatory convergence. Though Mexico has made many strides towards conformity, in 2002 there were still outstanding exceptions.<sup>19</sup> There is little evidence of further harmonization since 2002.

## Opportunities

The question of opportunities is more difficult to evaluate. On the surface, the LTSS found ways to work around the most serious regulatory barriers to trade. More investigation, however, shows that many carriers are not prepared for the border, and devising work-arounds at the last minute has created considerable delays. There is hope that ITS (Intelligent Transportation Systems) will solve many of these problems. The United States is putting its faith in the introduction of Automated Commercial Environment (ACE), which it intends to implement on the Canadian border in 2007, having tested it at the Blaine, WA port of entry in 2005. Ontario has taken similar measures, in the form of the Intelligent-Border project, but it may be years before the system is in operation (ACE took over four years to develop). Nevertheless, the Intelligent Border project team believes that the following benefits are possible:

<sup>18</sup> <<http://www.fmcsa.dot.gov/facts-research/facts-figures/analysis-statistics/prism.htm>>.

<sup>19</sup> <<http://hazmat.dot.gov/regs/intl/nafta.htm>>.

- condition monitoring and forecasting
- traveller information services
- traffic and construction management
- electronic payment
- fleet management
- balanced demand among crossings
- vehicle tracking
- pre-processing of paperwork<sup>20</sup>

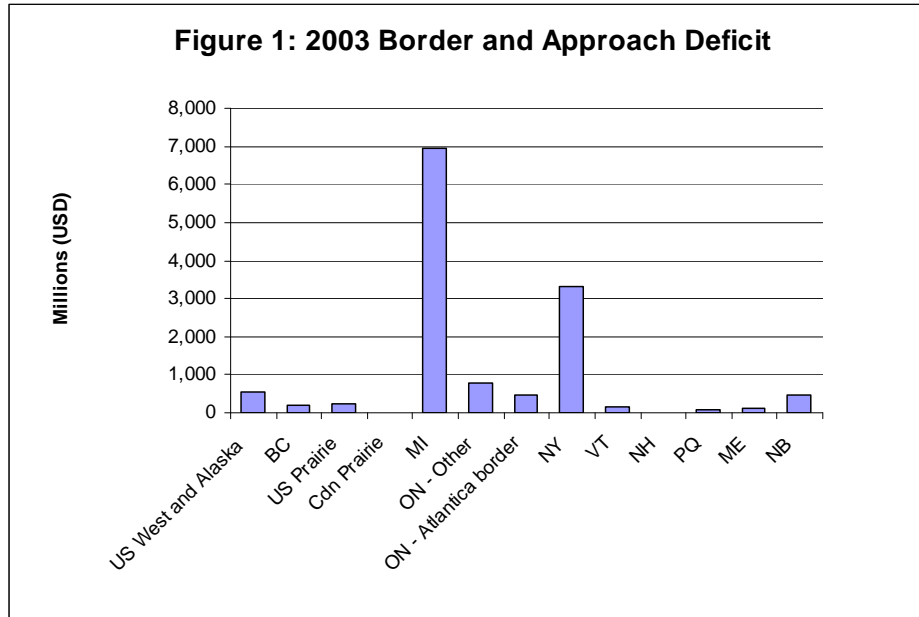
Not included in the NAFTA per se are the resources needed for the smooth processing of traffic. The Transportation Border Working Group – a collaboration of the United States Department of Transport and Transport Canada – had some success in collecting and disseminating border information, such as vehicle counts, technology and inter-operability requirements, infrastructure needs, contact information, and so on. However, their 2003 Compendium enumerated 224 needed border-related infrastructure projects valued at over US\$13.3 billion. It is of note that 52 percent of the border and approach projects representing 35 percent of the value are connected to Atlantica.<sup>21</sup>

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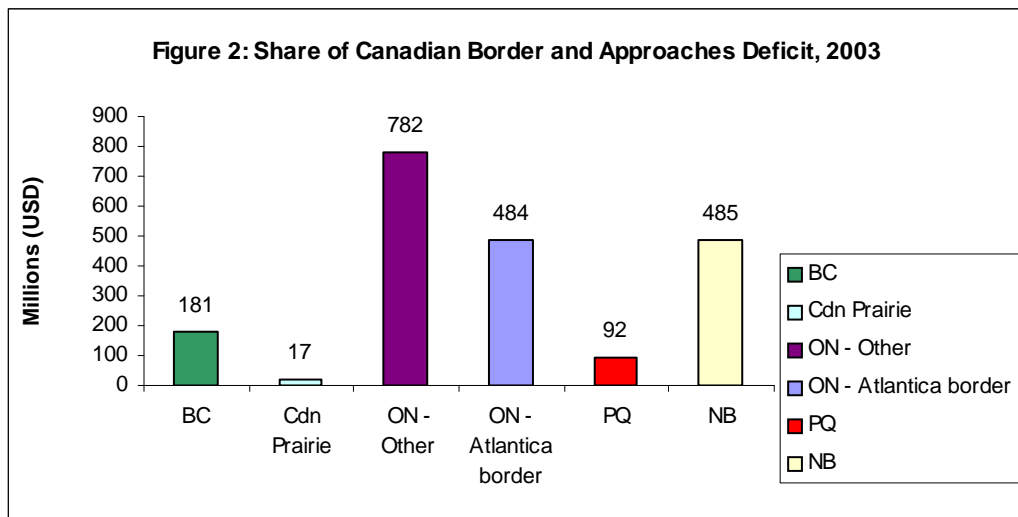
<sup>20</sup> <<http://www.intelligentborder.ca/WorkshopSeriesIIPackage.pdf>>.

<sup>21</sup> New York State Department of Transportation, *Border Infrastructure Compendium: 2003 and Beyond*, for the Canada – US Transportation Border Working Group, December 2003; available at <<http://www.fhwa.dot.gov/uscanada/studies/compendium2003/finalrpt2003.pdf>>. The benefit calculation for Atlantica is understated as it makes the unreasonable assumption that no corridor projects in Ontario service the Atlantica border. The TBWG data, however, do not allow a breakdown of the corridor costs.





The obvious message is the enormous infrastructure deficit on the US side of the border in Michigan, but also in New York at Buffalo/Lewiston, Massena and Champlain. The distribution of the Canadian \$2 billion obligation is seen below. The Ontario figures are substantially inflated with bridge costs, making the deficit of the New Brunswick border facilities and approaches even more distressing.



<sup>21</sup> New York State Department of Transportation, Border Infrastructure Compendium: 2003 and Beyond, for the Canada – US Transportation Border Working Group, December 2003; available at <<http://www.fhwa.dot.gov/uscanada/studies/compendium2003/finalrpt2003.pdf>>. The benefit calculation for Atlantica is understated as it makes the unreasonable assumption that no corridor projects in Ontario service the Atlantica border. The TBWG data, however, do not allow a breakdown of the corridor costs.

and the rapid institution of pre-clearance facilities. There seems some hope that the Free and Secure Trade (FAST) program, together with shared customs facilities, may expedite some crossing of low-risk goods.<sup>23</sup> Canada's House Standing Committee on Foreign Affairs and International Trade echoed the recommendation for more infrastructure at the border and greater capacity generally.<sup>24</sup>

Transport Canada lists several institutions that are helping to create opportunities (see Appendix 1). Perhaps there are too many as, unfortunately, the trilateral organizations have not produced much in recent years. Although several bilateral organizations have a strong data collection component, none has vehicle standards as part of its mandate. Since many of the outstanding items are under provincial or state control, there may be an opportunity for regional cross-border solutions.

### Outstanding Items

There remain outstanding regulatory barriers to trade even though the institutions that can make the necessary changes exist. However, there appears to be little appetite for resurrecting the LTSS as a policy forum, and a successor to LTSS has not been created. The related Web sites in both Canada and the United States do not have concluding write-ups. It is as though the participants had gone to lunch and never returned. In fairness it should be said that the subcommittees, which were faced with a short time for implementation, restricted the scope of their work to matters on which they believed they could make real progress. Many of the outstanding items pertained to data exchange or safety, and it may have been thought those could be more easily changed through informal processes. Whatever the circumstances, the work is still unfinished.

The focus appears to have shifted from standards to infrastructure and border management. This shift can be seen in the emphasis of the Transportation Border Working Group on infrastructure, data sharing, and security. Solutions emerging from the ITS initiative may solve only some of the issues in future; you cannot share a database if you define the fields differently, and equivalence in definition often requires harmonization of regulations.

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<sup>23</sup> Standing Senate Committee on Foreign Affairs, *Uncertain Access: The Consequences of U.S. Security and Trade Actions for Canadian Trade Policy*, June 2003, <<http://www.parl.gc.ca/37/2/parlbus/commbus/senate/com-e/fore-e/rep-e/rep04jun03-e.htm>>.

<sup>24</sup> *Elements of an Emerging Markets Strategy for Canada*, June 2005, <<http://www.parl.gc.ca/infocomdoc/38/1/parlbus/commbus/house/SINT/report/RP1824118//faaerp15/faaerp15-e.pdf>>.

# RULES OF ORIGIN

The point of signing a free trade agreement is to allow the products and services of a country greater access to the partner country. What constitutes the product of a country is defined by rules of origin.

## History and Structure

The technical and restrictive rules of origin are stipulated in Chapter 4 of the NAFTA.<sup>25</sup> They include general rules as well as specific rules for particular industries (for example, automotive goods), states of production (for example, intermediate goods or spare parts), and packaging.

To be considered a good that originates within a NAFTA country (and hence receive favourable treatment under the NAFTA), the good must have been wholly produced or created within a NAFTA country *and* must

- a. have used materials that were deemed to have originated within a NAFTA country or
- b. have fulfilled regional content requirements<sup>26</sup> *and* used materials that originated elsewhere but underwent a tariff classification change within a NAFTA country or have met other requirements laid out in the Annex.

Despite appearances, this is not circular thinking. Originating material and a NAFTA good are two separate concepts. With some exceptions, originating material is considered wholly NAFTA-produced if foreign content is less than 7 percent.<sup>27</sup>

The “other requirements” in b) would be applied mainly when a bundle of parts remains a bundle of parts, though a more complete one. This is often the case in the auto sector although the conditions are complex and consume much of Chapter 4.

The basic rule for regional content is over 60 percent value by transaction or 50 percent value by cost. (See Appendix 2.) The primary problems with the rules of origin are:

(a) their complexity and (b) the paperwork required in order to document the origin every time the product crosses a NAFTA border. This erodes the competitive advantage of finished, globally sold products that attempt to leverage the benefits under the NAFTA of continentalized production, in which each component of a finished product is tooled, and each

<sup>25</sup> A “how-to” guide for rules of origin exists at <[http://www.itintl.com/howto/Guide\\_to\\_NAFTA.php](http://www.itintl.com/howto/Guide_to_NAFTA.php)>.

<sup>26</sup> Exceptions are made for items in Chapters 61–63 of the harmonized tariff system. However, these exceptions appear to be aimed at correcting shortfalls of the harmonized tariff system rather than creating new rules. The content regulations are the same. For the record, these are: “Chapter 61, Articles of apparel and clothing accessories, knitted or crocheted; Chapter 62, Articles of apparel and clothing accessories, not knitted or crocheted; and Chapter 63, Other made up textile articles; sets; worn clothing and worn textile articles; rags”. See <<http://www.usitc.gov/tata/hts/bychapter/index.htm>>.

<sup>27</sup> The exceptions are largely related to foodstuffs (for example, 10 percent milk solids in dairy products), although there is also provision for integrated circuits and trash compactors.

sub-assembly assembled, at the location within the NAFTA region where expertise or wages are most favourable.

The net cost method is required for a variety of common sense rules (for example, when transaction cost is zero, when the importer and exporter are related, or in the case of parts bundles or motor vehicles<sup>28</sup>). Allowable costs are the traditional Cost of Goods Sold (for example, excluding costs of marketing, administration, or after-sales support). Also disallowed in calculating NAFTA contribution is the addition of packaging or packing materials. Materials valuation is either determined by the Customs Valuation Code or calculated with all indirect costs excluded (for example, freight, taxes, and cost of spoilage). Obvious work-arounds, such as creating over 50 percent local content through dilution of a foreign material, are disallowed. In short, the rules are tight, complex, and onerous.

### Opportunities

When the Canadian dollar was worth 62 cents US, economies for pre-processing may have existed and not been exploited. Because of the rise of the dollar over the past two years, many of these opportunities that may have existed three years ago are now likely lost. However, sellers of primary agricultural products, seafood, wood products, and so on, in Atlantica have not always explored value-added opportunities and it may well be that these still exist. An illustration of an opportunity that may exist, but not as a result of the rules of origin, is the addition of exotic inlays (with wood obtained from non-NAFTA countries) to high-end maple furniture for the luxury furniture market in the United States.

Recently, Kunimoto and Sawchuk (2006) calculated that administrative compliance with the rules of origin regulations adds one percent to the cost of exports. They recommended a widening of use of Most Favoured Nation status to reduce tariffs to zero (thus negating the need to calculate content) or, alternatively, liberalizing the rules of origin through a reduction in required NAFTA content. Since content requirements exist primarily to aid domestic manufacturers, the value of the requirement diminishes as more manufacturing goes offshore. They pointed, for example, to the Canada-Chile free trade agreement, which has content requirements approximately half of those in the NAFTA.

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<sup>28</sup> Cars go by cost largely because of the interchangeability of makes and models. Content requirements appear to work off a rolling average. There are different cost-method thresholds for buses.

# DISPUTE RESOLUTION

“[The] NAFTA Secretariat administers the NAFTA dispute resolution processes under Chapters 14 (Financial Services), 19 (Antidumping and Countervailing Duty final determinations) and 20 (General) of the NAFTA and has certain responsibilities related to Chapter 11 (Investment) dispute settlement provisions.”<sup>29</sup>

There has never been a Chapter 14 challenge. Most of the cases before panels administered by the NAFTA Secretariat are contesting agricultural tariffs or dumping practices. Although a few cases, notably softwood lumber and agricultural subsidies (for example, Canadian wheat by virtue of the Canadian Wheat Board or American corn syrup by virtue of farm subsidies) get a great deal of press, 98 percent of trade between Canada and the United States takes place smoothly.<sup>30</sup> The Atlantic provinces already operate under a different stumpage system than the rest of Canada, and their softwood enters the United States free of countervailing duty.<sup>31</sup> For Atlantica, it seems clear that the prize is to ensure the continued free flow of the 98 percent of trade not in dispute.

According to International Trade Canada (ITC), other priority trade issues for Canada with the United States include the following:

- Pursue a coordinated North American approach to both the regulatory and trade aspects of the current BSE challenges...
- Address concern over implementation of country-of-origin labelling provisions [in the *Farm Act*] to Canada-U.S. agricultural trade...
- Continue implementing the Canada-U.S. Smart Border Action Plan to build a secure and efficient border that is open for business but closed to terrorists.
- Continue to monitor changes to US electricity regulations and/or energy legislation to ensure that any reliability standards in the electricity sector are developed jointly by Canadian and US authorities.
- Continue to increase awareness in the United States that discriminatory minimum renewable energy provisions at the state level run counter to our shared energy security and environmental objectives.
- Continue to work with U.S. Immigration, Canadian business and within the NAFTA Temporary Entry Working Group to further facilitate the cross-border movement of business people.<sup>32</sup>

<sup>29</sup> <<http://www.pict-pcti.org/courts/NAFTA.html>>.

<sup>30</sup> <<http://www.state.gov/r/pa/ei/bgn/2089.htm>>.

<sup>31</sup> <<http://www.dfait-maeci.gc.ca/eicb/softwood/faq-en.asp>>. Atlantic Canada is, however, included in the anti-dumping investigation undertaken by the US government.

<sup>32</sup> <[http://www.dfait-maeci.gc.ca/tna-nac/2004/5\\_04-en.asp](http://www.dfait-maeci.gc.ca/tna-nac/2004/5_04-en.asp)>.

According to the Office of the US Trade Representative (USTR), priority trade issues for United States with Canada include the following:

- supply-managed products (dairy, margarine, cheese snack foods, processed egg foods, fresh fruits, and vegetables<sup>33</sup>)
- American grain exports
- wine and spirits
- Canadian support of Canadian wheat through the Canadian Wheat Board
- Canadian labelling requirements for vitamin and mineral fortification
- softwood lumber
- communications (CRTC)
- film and publishing investment
- ratification of World International Property Organization (WIPO) Copyright Treaty<sup>34</sup>

Notwithstanding these issues, Canada's House of Commons Standing Committee on Foreign Affairs and International Trade (Subcommittee on International Trade, Trade Disputes and Investment) recommended restrictions in the use of challenges under the NAFTA.<sup>35</sup> In the context of opportunities for Atlantica, dispute resolution would appear to be a distraction rather than an avenue to enhanced trade. One note of caution about the possible resolution of the softwood lumber dispute is that since the Atlantic provinces are exempt from countervailing duties, any agreement that allowed a tariff would hurt the region's forestry industry.

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<sup>33</sup> Canada's agricultural supply management is protected under NAFTA, but the World Trade Organization (WTO) has ruled against it. This issue has much larger implication in say, Quebec; however, the Atlantic provinces are not immune. For example, in 1996 Atlantic Canada produced over 418 million litres (5.8 percent of Canada's output) of the milk sold to dairies. See

<<http://atlas.gc.ca/site/english/maps/economic/agriculture/agriculture1996/dairycattlebycd1996/1>>.

<sup>34</sup> The complete list can be found at

<[http://www.ustr.gov/assets/Document\\_Library/Reports\\_Publications/2004/2004\\_National\\_Trade\\_Estimate/2004\\_NTE\\_Report/asset\\_upload\\_file483\\_4741.pdf](http://www.ustr.gov/assets/Document_Library/Reports_Publications/2004/2004_National_Trade_Estimate/2004_NTE_Report/asset_upload_file483_4741.pdf)>. Canada is a signatory to the different WIPO agreements; however, they have not been ratified.

<sup>35</sup> *Dispute Settlement in the NAFTA: Fixing an Agreement Under Siege*, May 2005, <<http://cmte.parl.gc.ca/Content/HOC/committee/381/faae/reports/rp1856888/faaerp09/faaerp09-e.pdf>>. Although it also recommended using dispute-resolution challenges as a way of discouraging protectionist legislation elsewhere.

# A LEVEL PLAYING FIELD

Although not given a high profile, some significant differences in opportunity between Canadian and American transportation players, while not barriers to trade, per se, often create a less than level playing field. The following are some examples:

**Dredging:** In the United States, responsibility for dredging lies with the Army Corps of Engineers under Federal funding financed by the Harbor Maintenance Fee. This fee is collected from all imports and domestic cargo arriving at US ports. In Canada, ports that require dredging must provide the capital themselves.<sup>36</sup> This has been especially important recently when the United States has deemed several ports to be of strategic importance for the rapid deployment of troops. In these cases, not only has dredging been paid for, but the addition of roll-on, roll-off capabilities has been deemed eligible for public financial support.

**Access to capital:** In the United States port authorities can offer a wider range of financial instruments for amassing capital. These include junk bonds and tax-free municipal bonds. Canadian Port Authorities are limited by the terms of their letters patent to raising only those funds that can be financed by the available revenue stream, a limit not conducive to the significant capital expansion expected to be necessary to meet the port congestion forecast for the intermediate future.

**Cabotage Restrictions:** The NAFTA did not remove cabotage restrictions in any of the modes. All transportation operators are required to be domestic companies and to use national employees if they carry freight between points within a single NAFTA country. These restrictions impose a financial penalty on the buyers of transport services because the market of the seller remains protected. In other words, these restrictions limit access to markets by what may be more efficient transportation; in 2004, the US International Trade Commission ranked the *Jones Act* (the legislation implementing maritime cabotage) as the second-most costly trade barrier.<sup>37</sup>

Lastly, it has been shown that there are taxation discrepancies – in capital cost allowances, payroll taxes, municipal property taxes, and corporate income taxes – between the jurisdictions, some of which favour American-based transportation companies and some of which favour Canadian operators. Unfortunately, the last substantive evaluations of these differences were made in anticipation of the National Transportation Act Review Commission in the 1990s. A separate 1997 study, which made several simplifying assumptions, gave different domestic taxation rates.

<sup>36</sup> Though it is possible to get federal funding assistance, in practice it is politically difficult.

<sup>37</sup> Quoted in the *Cato Handbook for Congress*, available at <[http://www.cato.org/pubs/handbook/hb109/hb\\_109-64.pdf](http://www.cato.org/pubs/handbook/hb109/hb_109-64.pdf)>.

**Figure 3: Canada-U.S. Effective Tax Rates on Costs for Large Transportation Businesses**

Canada			United States		
Labour %	Capital %	Total %	Labour %	Capital %	Total %
3.2	39.5	8.3	0.4	14.3	2.5

*Source: Canada (1997)*

Although double taxation is not allowed in the Canada-U.S. Tax Treaty, this is a simplistic view. In fact, Collins and Shackelton have documented the differing tax treatment of multinationals versus domestic firms by home country and found, for example, that U.S. multinationals are taxed more heavily than U.S. domestic firms – however these data are not broken down by industry sector.<sup>38</sup> With continuous declines in corporate tax rates in the United States, the very dated research on fiscal imbalances between Canada and the United States as it applies to the transportation sector is no longer of value and should be revisited.

<sup>38</sup> Collins and Shackelton (2003)



# CONCLUSIONS

There is little doubt that removal of trade barriers through the NAFTA has resulted in increased trade between Canada and the United States. While the NAFTA has improved the business environment generally, there have not been any new significant opportunities for firms in Atlantica in recent years. Nonetheless, there remain opportunities to grow trade through further initiatives.

The NAFTA brought a concerted effort to standardize technical transportation standards that served as non-tariff trade barriers. It could be argued that the negotiators resolved 20 percent of the problems that are at the root of 80 percent of the barriers. Although many industry spokespersons have argued the benefits of further standardization, for example, in truck weights and dimensions, little progress has been made. Since the events of September 11, 2001, national governments appear to have focused on streamlining border processing through information technology, which also brings security benefits. Unfortunately, as with the efforts of the LTSS under the NAFTA, the easy wins with this approach do not require a resolution to the outstanding harmonization issues. Further optimization of global supply chain networks, however, will need greater harmonization, but it must capture the imagination of politicians at the state and provincial level if the opportunity is to be seized.

***Recommendation:*** *That provinces and states within Atlantica pursue resolution of standards issues on a local or regional basis. That the federal governments in Canada and the United States act aggressively in their role as facilitators of this state and provincial coordination effort. That, additionally, Canada pursue resolution of standards issues internationally through the Transportation Border Working Group as opportunities arise.*

Although the NAFTA has made it easier for Canadian goods to enter US markets, the rules of origin are so stringent that there are no easy “mass customization” wins for Canadian manufacturers that would like to use Atlantica as a “near-shore” service point for foreign goods destined for the US market. A case might have been made several years ago that the comparatively low Canadian wages were attractive; however, the rise in the Canadian dollar has offset that advantage. Special Economic Zones (SEZs) do not represent similar value as elsewhere in the world since Canada already has the NAFTA, and customs remission and drawback programs, thereby reducing SEZs to an administrative benefit. It would seem that the best opportunities are for value-added manufacture of existing commodities, such as wood furniture, opportunities that have always existed.

***Recommendation:*** *That efforts to encourage industrial expansion and manufacturing focus on existing opportunities and an effort to improve the general understanding of the advantages that already exist for value-added production and export.*

There is no doubt that both Canada and the United States benefit greatly from mutual trade. The US\$13.3 billion border infrastructure gap identified by the TBWG clearly hurts all of us. For those in Atlantica, the fact that 35 percent of the need is regional, far in excess of the region's national participation in NAFTA trade, dramatically underlines the neglect of the two federal governments and the barriers to regional industry.

***Recommendation:*** *That Canada and the United States complete border infrastructure projects (especially those in Atlantica) as quickly as possible.*

Lastly, trade is hurt by the added costs to transportation companies domiciled in Canada. It may be possible to make the region more attractive by levelling of the transportation industry environment with the United States.

***Recommendation:*** *That Canada pursue policies to level the transportation environment with the United States. This could include levelling of corporate taxation, levelling of fuel taxation, removal of the 25 percent tariff on purchased ships, adjustments to coast guard rates to reflect use and easier access to private capital within the port system.*

# APPENDIX 1

## *Bilateral Canada – US Organizations and Trilateral Organizations*<sup>39</sup>

### **Bilateral Organizations**

- Airport Pre-clearance Agreement
- Bilateral Aviation Safety Agreement (2000)
- Bi-National Marine Security Compliance and Enforcement Working Group
- Border Information Flow Architecture Working Group (BIFAWG)
- Canadian-American Border Trade Alliance (Can/Am BTA) (Note: The Can/Am BTA is strictly a non-governmental private sector stakeholder advocacy organization)
- Canada-US Air Transport Agreement
- Canada-US Ontario-Michigan Bi-national Transportation Partnership
- Canada-US Transportation Border Working Group (TBWG)
- Canada-US Transportation Security Co-operation Group (with the TSA)
- ENTERPRISE Shared Pool Fund (Collaborative efforts to further develop and demonstrate ITS)
- FAA Working Group on the US Standard for Terminal Instrument Procedures (TERPS)
- International Mobility and Trade Corridors (IMTC)
- Joint Canada-US study on future infrastructure needs of the Great Lakes – St. Lawrence Seaway navigation system
- NASA Space Shuttle Emergency Landing Site Contingency Plan; Co-ordination with NASA and United States Department of State and US Embassy
- National Transportation Commission for ITS Protocol (NTCIP)
- North American Aerospace Surveillance Council (NAASC)
- Ontario-Michigan Border Working Group (OMBWG)
- Sharing of information and experience on short-sea shipping
- TC/FAA communications over issues concerning regional certification of radio band frequencies and coordination of transborder commercial operations
- TC/FAA Regional Cross Borders Transportation Summit (annual event)
- Transport Canada National Civil Air Transportation System Shut Down Plan Development – Co-ordination with Federal Aviation Agency (FAA)
- Transportation Research Board, Freeway Operations Committee – exchange of technical information on Intelligent Transportation Systems (ITS)
- Upper Midwest Freight Corridor Study – investigation of freight activities in corridor between Minnesota and Ohio

### **Tri-lateral Organizations**

- NAFTA Land Transportation Standards Subcommittee Transportation Consultative Working Group # 1 (LTSS # 1) – Cross Border Operations and Facilitation.
- NAFTA Land Transportation Standards Subcommittee Working Group # 2 – vehicle weight and dimension (VW&D) harmonization
- NAFTA-LTSS Transportation Consultative Group (TCG) Working Group # 2 (rail safety and economic issues)
- NAFTA – TCG 5 (marine policy and safety issues)
- North American Aviation Trilateral (NAAT)
- Tri-national Technical Safety Committee (Canada, United States, and Mexico) and Steering Committee

<sup>39</sup> Canada School of Public Service, 2004, *Building Cross-Border Links: A Compendium of Canada-US Government Collaboration*; <<http://dsp-psd.pwgsc.gc.ca/Collection/SC103-6-2004E.pdf>>.

## APPENDIX 2

### *Rules of Origin Formulae*

Transaction Value Method

$$RVC = \frac{TV - VNM}{TV} \times 100$$

Where:

RVC is the regional value content, expressed as a percentage;

TV is the transaction value of the good adjusted to an FOB basis;

and

VNM is the value of non-originating materials used by the producer in the production of the good.

Net cost method:

$$RVC = \frac{NC - VNM}{NC} \times 100$$

Where:

RVC is the regional value content, expressed as a percentage;

NC is the net cost of the good; and

VNM is the value of non-originating materials used by the producer in the production of the good.

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