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The Border Papers

Steer or Drift?

Taking Charge of Canada-US Regulatory Convergence

Michael Hart

In this issue...

A "tyranny of small differences" between Canadian and US regulations is causing wasteful duplication, added costs and myriad frustrations for businesses and consumers on both sides of the border. Convergence and cooperation are required. Canada should steer the process to its advantage.

The Study in Brief

The potential benefits of greater regulatory convergence between Canada and the United States have been well-documented. At issue: reducing the "tyranny of small differences" in Canadian and American regulations that is frustrating businesses, adding costs, and stymieing the benefits of further economic integration.

In June 2005, the Canadian, US, and Mexican governments agreed that they would develop "a trilateral Regulatory Cooperation Framework by 2007 to support and enhance existing, as well as encourage new cooperation among regulators." Progress, however, has been glacial. The default option has been to stay on the very Canadian path that has gradually emerged: cooperation if necessary but not necessarily cooperation. This *Commentary* argues that the time has come for Canadians to decide whether they will stay the default course or opt for a more strategic, top-down approach of deliberately steering and determining the pace of this process.

Operating in a small, export-dependent economy next door to the world's most vibrant economy, Canadian suppliers and regulators alike have learned the benefits of Canada-US regulatory cooperation. The result has been an inexorable drift toward ever-greater convergence. This trend is unlikely to change, but Canadians can take steps to harness it and ensure that it develops in ways that bring greater benefits and more control than is currently the case.

As a first step, the two governments should change the current practice of discretionary cooperation at the federal level to a mandatory process of information exchange, consultation, and even coordination. The aim should be to advance a jointly agreed mandate to improve regulatory outcomes, eliminate duplication and redundancy, reduce regulatory differences between the two countries, and effect a North American approach to regulation. Much of this mandatory cooperation can be implemented on the basis of existing institutions and be focused on priority sectors. Its most critical results will be experience and mutual confidence.

This program of regulatory cooperation should form part of a larger vision; one in which both countries share a commitment to the creation of the necessary legal framework and institutions that will govern accelerating cross-border integration and ensure that both Canadians and Americans enjoy its benefits.

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As the fledgling Conservative government in Ottawa picks its priorities for dealing with Washington, there is an important dimension to the relationship that should not be overlooked: cross-border regulatory cooperation. While the tone of Canada-US relations has been set in recent years by high-profile trade disputes, political posturing, and foreign policy differences, cross-border regulatory cooperation has emerged as a hot topic in Ottawa and, to a lesser extent, Washington policy discussions. At issue: reducing the "tyranny of small differences" in Canadian and American regulations that is frustrating businesses, adding costs, and stymieing the benefits of further economic integration.

The potential benefits of greater regulatory convergence have been well-documented on both sides of the border.[1] In September 2004, Canada's External Advisory Committee on Smart Regulation (EACSR) advised the federal government that "Canada must be more strategic in its regulatory relations with trading partners. A key irritant for industries is the proliferation of minor differences between Canadian and American regulations, given an increasingly integrated North American market." It continued, "Minimizing these differences would remove wasteful duplication and reduce costs for consumers, industry and government" (EACSR 2004, 11).

In a similar vein, the Independent Task Force on the Future of North America, sponsored by the US Council on Foreign Relations, urged governments in its May 2005 report to adopt a "North American" approach to regulation (CFR 2005). On cue, the continent's three governments agreed in June that they would develop "a trilateral Regulatory Cooperation Framework by 2007 to support and enhance existing, as well as encourage new cooperation among regulators" (Canada 2005, 15).[2]

The default option in addressing cross-border regulatory convergence has been to stay on the very Canadian path that has gradually emerged: cooperation if necessary but not necessarily cooperation. As was made evident in the discussions leading to the report of the EACSR, however, a growing number of voices argue that Canada has much to gain, and little to lose, from a much more active, comprehensive program of Canada-US regulatory cooperation. They contend that the time has come for Canadians to decide whether they will stay the default course or opt for a more strategic, top-down approach of deliberately steering and determining the pace of this process. This *Commentary* explores the rationale for a take-charge approach and the elements required to make it work to Canadians' benefit.

I would like to thank Fred Carter, whose MA thesis originally inspired me to pursue work on regulatory convergence. Since then, a succession of graduate students have assisted in the research and my colleague, Bill Dymond, has ensured that the analysis and prescriptive work moved together in proper sequence.

1 Studies sponsored by OECD, as well, have traced both the extent and nature of the modern regulatory state and promoted an international best-practice approach to regulatory reform (OECD 1999 and 2002).

2 In the interest of full disclosure, I contributed a paper to the EACSR (Hart 2003) and participated as a member of the CFR Task Force. For a discussion of the broader context for Canada-US regulatory cooperation, see Hart (2004a).

The Changing Face of Regulatory Cooperation

Cross-border regulatory cooperation, of course, is not new. Progress over the past 60 years in the development of international norms and disciplines has significantly reduced regulatory barriers to trade in goods and services. Nevertheless, an explosion in quality-of-life regulations has led to ever-growing demand that a wide range of products and production processes be tested and certified to exacting requirements. An equally broad range of services can only be supplied following onerous and often repetitive qualification and certification requirements.

Compliance with different national and sub-national rules, together with the repetition of redundant testing and certification of products, processes, and providers for different markets, raises costs for manufacturers and providers operating in an integrated market. Complex and lengthy product- or provider-approval procedures can slow down innovation, frustrate new product launches, operate to protect domestic producers from foreign competitors, and create a drag on competitiveness, productivity, investment, and growth.

The Fraser Institute estimates that Canadian federal and provincial governments introduce more than 4,500 new or amended regulations every year while the Canadian Federation of Independent Business estimates that Canadian business annually spends C$33 billion, or 2.6 percent of Canada's GDP, in complying with this profusion of regulatory activity.[3] Similar orders of magnitude in the United States underline the critical importance of regulations to modern life and suggest the need to consider the economic impact of subtle cross-border differences.

Canadians and Americans look to their governments to pursue largely similar goals and objectives in their regulation of the market and in managing risk. Canadians may insist that they want to remain a distinct entity north of the US border, but they also expect many of the things that Americans demand and they look to government to ensure that they get them. The differences in regulatory requirements that thus emerge are more likely to be matters of detail and implementation than of fundamental design. (See Box 1 for examples.) Nevertheless, the regulatory differences that persist and new — often small — differences that emerge in regulatory design, objectives, implementation, and compliance procedures, impose costs and maintain distortions that undermine Canada achieving its full economic potential.

The regulatory "output" in both countries may be roughly identical, but the United States disposes of much larger regulatory resources than does Canada; as a result, its regulatory "input" is roughly 10 times that of Canada. Common sense suggests that Canada can both reduce its costs and gain superior results by

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3 In its latest survey (Jones and Graf 2001), the Fraser Institute indicated that between 1975 and 1999, over 117,000 new federal and provincial regulations were enacted, an average of 4,700 a year. It estimated administrative costs to have reached $5.2 billion by 1997/98, compliance costs $103 billion, and "political" costs (regulation-related lobbying) $10.3 billion, adding up to the equivalent of more than 12 percent of Canadian GDP. The CFIB (2005) estimate of $33 billion is limited to business compliance costs. Such estimates are at best an inexact science but do provide an indication of orders of magnitude. The federal government's Policy Research Initiative is looking at better ways to measure the extent and costs of Canada's regulatory regimes.

Box 1: *The Tyranny of Small Differences*

Differences between Canadian and US requirements are often small and incidental to their intended effect, the result more often of history and accident than deliberate differentiation. Once in place, however, they attract powerful interests benefiting from these differences. A few examples illustrate the point:

- In Canada, anti-theft immobilizers are required on all new vehicles; in the United States, lower cost entry-level vehicles are exempt.
- In Canada, cheese-flavoured popcorn must contain no more than 49 percent real cheese; in the United States, no less than 53 percent.
- In Canada, fortified orange juice is classified as a drug; in the United States, it is classified as food.
- In Canada, deodorants containing aluminum require a Drug Identification Number; in the United States, they do not.
- In Canada, certain anti-allergy drugs are available over the counter; in the United States, they require a prescription.
- In Canada, combined sleep and pain aids require a prescription; in the United States, they are available over the counter.
- In Canada, notaries public must be lawyers; in most US jurisdictions, they are not.

aligning itself more deliberately with the United States and benefiting from the much larger US regulatory effort in selected areas, from drug approvals to environmental standards. Canada's smaller resource level also translates into higher relative enforcement costs. Hopkins (1992) and Winston (1993) estimated that, on a per capita basis, the United States spends only about half of what Canada spends on regulatory compliance. In both cases, Canadians would benefit from higher levels of cooperation and greater acceptance of the virtues of convergence.[4]

Canadian and US experience in forging cooperative regulatory strategies has generally been positive. For example, the North American food safety system, reflecting the highly integrated nature of food production in the two countries, is deeply dependent on cooperation among officials on both sides of the border.[5] It is also not difficult, however, to find examples of sectors and regimes where there is room for more cooperation. Regulatory differences in the financial services, transportation, telecommunications, securities, competition, professional accreditation, drug approval, and similar areas suggest that there is considerable

4 Efforts to estimate the economic and commercial benefits to Canada from regulatory cooperation remain at an early stage. The federal government's Policy Research Initiative reports one such study (2004) based on a cash-flow analysis of the benefits of cooperation in approval for five classes of drugs and chemical substances. The results suggested an 8.2 percent gain in net income for Canadian producers, based on a 10.7 percent gain in the value of new product sales and a 4.8 percent gain in rate of return for new products.

5 The system was on full display to address the BSE scare caused by two instances of mad cow disease found in Alberta and Washington. Attempts by Japan to require segregation of Canadian and US meat products indicated the difficulty of segregating these because of the extent to which the industry is integrated and authorities have developed an integrated regulatory regime.

scope for exploring ways and means to reduce unnecessary duplication and divergence in regulatory design and compliance requirements.[6]

Historically, regulatory cooperation between Canada and the United States has been driven by natural forces, similar to the market forces that have deepened and accelerated integration between the two countries. In most instances, it is the natural result of officials with similar responsibilities and shared outlooks seeking support and validating relationships to pursue them. As a result, they have developed a dense network of informal cooperative arrangements to share information, experience, data, and expertise with a view to improving regulatory outcomes, reducing costs, solving cross-border problems, implementing mutual recognition arrangements, establishing joint reviews and common testing protocols, and more.[7]

Virtually all such regulatory cooperation takes place below the political radar screen. The issue that has now arisen is whether this piecemeal, incremental approach best serves Canada's regulatory and economic development interests. As George Haynal, a former senior Canadian diplomat, observes: "a process of policy convergence is already well in train … The question is less whether we need to negotiate new instruments to further the process, but whether the public realm is capable of keeping up with emerging forces pushing us into deeper integration" (Hart 2000, 6). The European Union (EU) determined in the mid-1980s that it had to adopt a comprehensive, top-down approach to reducing regulatory divergence among its member states in order to gain the full benefits of a single, integrated market. Is it time for Canada to consider a similar effort to get more out of cross-border regulatory convergence with the United States?

Deepening Cross-Border Integration

Discussion of cross-border regulatory cooperation is taking place against the background of accelerating and deepening integration of the Canadian and US markets. Proximity, history, technology, opportunity, and policy have combined to create deep and irreversible ties between Canadians and Americans. Despite occasional bursts of anti-American sentiment, Canadians, in their daily choices of what to buy and consume, prefer goods and services produced in North America. The result is a total of some $1.9 billion in goods and services traded across the border on a typical day, adding up to nearly $680 billion in 2004. On a per capita basis, every Canadian bought about $9,150 worth of US-exported goods and services, while every American bought about $1,340 worth of Canadian-exported goods and services. By 2004, US firms had a $239 billion stake in Canada and Canadian firms had about $191 billion invested in the United States (International Trade Canada 2005). In 2003 — the latest year for which comparable figures are available — Canadian-owned firms in the United States sold about $324 billion in goods and services; American-owned firms in Canada reported sales of $555 billion (Cardillo 2002, Marth 2003, Statistics Canada 2005, and US Bureau of

6 As this paper went to press, the government indicated that it was embarking on enhanced efforts to integrate drug approval regimes. See *National Post* (2006).

7 Anne-Marie Slaughter describes the broader, global manifestation of this kind of networking in considerable detail in Slaughter (2004).

Economic Analysis). Not surprisingly, a growing share of the trade between Canada and the United States now takes place wholly within a firm or between related firms that are part of integrated networks. As US business economist Stephen Blank notes:

> Ottawa and Washington talk about the world's largest bilateral trading relationship. But we really don't trade with each other, not in the classic sense of one independent company sending finished goods to another. Instead we make stuff together; … [we] share integrated energy markets; dip into the same capital markets; service the same customers with an array of financial services; use the same roads and railroads to transport jointly made products to market; fly on the same integrated airline networks; and increasingly meet the same or similar standards of professional practice. (Blank 2005.)

This deepening bilateral integration is a subset of global integration: an ongoing process that has accelerated in recent years due to both technological breakthroughs and policy developments. The direction has been the same for many years and is neither threatening nor undesirable. It is driven by the day-to-day decisions of Canadians and Americans about what to buy, where to invest, how to organize production, where to vacation, and more.

Governments have little control over the pace and direction of this integration, but they do have an important influence on its shape through their regulatory and other decisions. The challenge is to manage this integrative process on a mutually beneficial basis. In effect, regulatory cooperation is the next frontier for cross-border economic negotiations and the key to reducing the continuing negative impact of border administration on Canada's economic development. Its success will make a critical contribution to securing the prosperity and well-being of Canadians and to ensuring that they can enjoy the full benefits of an integrated North American economy.

Cross-Border Regulatory Convergence, Differences, and Economic Impacts

In any well-functioning modern industrial economy, regulations are ubiquitous.[8] They serve a welter of public purposes, from ensuring safety and social welfare to reducing abuses of power and ameliorating market failure. The effective operation of the market, for example, is critically dependent on the existence of a supporting framework of rules, regulations, and institutions such as private property, the courts, and more.[9] Rising living standards have amplified demand for such social

8 Tony Campbell, former chief of regulatory reform for the federal government, reports that his group identified 145 discrete regulatory programs in effect at the federal level in the mid-1980s. In addition, there are countless more operating in each of the 10 provinces and three territories, some complementary or additional to federal programs, others duplicating federal efforts (Campbell 1991, 4).

9 There is no basis for the popular criticism that markets and governments operate in opposition to each other. See, for example, Rosenberg and Birdzell (1986) for a discussion of the critical role of rules and institutions in the economic development of western Europe and North America.

priorities as higher levels of health, safety, reliability, environmental protection, human rights, and access to information, all of which rely on regulations. Like earlier economic regulation, much of this regulatory activity can have profound effects on cross-border trade and investment, pointing to the need to consider cooperative approaches aimed at reducing the trade distorting impact of differential regulation.

In the widest sense, regulations encompass a diverse set of instruments by which governments set requirements on firms and citizens. Regulations can include laws, formal and informal orders, and subordinate rules issued by all levels of government, and rules issued by non-governmental or self-regulatory bodies to which governments have delegated regulatory powers.[10] Regulations fall into three categories: economic regulations, which intervene directly in market decisions such as pricing, competition, market entry, or market exit; social regulations, which protect public interests such as health, safety, the environment, and social cohesion; and administrative regulations, such as paperwork and administrative formalities through which governments collect information and intervene in individual economic decisions (OECD 1997).

In most OECD countries, legislatures and officials, at national and sub-national levels, are engaged in a continuing process of rule making and adaptation. The vast majority of rules created by this dynamic process reflect similar policy objectives but diverse regulatory styles, legislative practices, institutional assignments, and implementation experiences. In the final analysis, however, many of these differences are marginal in their regulatory outcomes,[11] particularly between Canada and the United States, but annoying and even dysfunctional in their economic impact. The need to produce multiple versions of the same good, for example, can increase design and production costs, and prevent firms from enjoying the economies of scale that would flow from producing to satisfy a single globally accepted standard. For companies exporting to multiple markets, the promise of "one standard, one test, accepted everywhere" has become increasingly attractive.[12]

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10 Regulations are the means by which governments translate broad social and political goals into manageable tasks to achieve specific outcomes. It is how bureaucracies implement policies by translating the political goals of legislators into manageable tasks for officials. The secret to good regulatory practice thus often lies in appropriate definitions of goals and objectives. When goals are poorly defined, regulations become task driven, expensive, and not well received. Governments routinely add to the corpus of regulations, sometimes to good effect, but just as often to little purpose other than the political symbolism of being seen to be doing something about an intractable problem. Regulators, in turn, face the unenviable task of translating broad legislative intent into effective regulatory practice. The challenge of modern governance is to maintain a balance in the constant ebb and flow of regulatory demands, capacity, and effective delivery. An important contributor to meeting this challenge is learning from others, working with others, and cooperating with others. For excellent introductions to the difference between effective and ineffective regulation, see Sparrow (2000) and Wilson (1989).

11 Outcomes refer to the actual, measurable outcomes intended by regulation, such as real reductions in risk (as measured by lives saved, injuries avoided, and quality of life improvements). It does not refer to the act of regulation itself, seen by some as an outcome demonstrating Canadian sovereignty and distinct values.

12 The EACSR concludes "as it pursues a more robust international regulatory cooperation agenda, the Committee believes the government should also limit the number of specific Canadian regulatory requirements. This step would reduce the cumulative impact of unique regulatory....

Not all economic sectors, of course, are affected equally by the international dimension of regulatory diversity. Highly export-oriented firms, such as those in the telecommunications and forestry sectors, have a greater interest in international convergence than import-competing sectors. The nature of products (e.g., undifferentiated commodities versus goods and services with unique attributes) and the basis upon which they compete (e.g., price versus quality or performance) also have important implications for the role different regulations will play. Not surprisingly, therefore, sector-by-sector discussions about regulatory issues often yield the most satisfactory results in reducing unnecessary and costly barriers to trade.[13]

Economic Impacts

Despite progress in the development of international norms and disciplines, regulatory barriers to trade in goods and services remain a serious potential impediment to cross-border exchange. For suppliers of goods, the proliferation of diverse standards and regulatory requirements has been accompanied by a growing demand that, as a precondition of sale, compliance with standards be demonstrated through independent inspection, testing, or certification procedures. Such procedures are carried out either by the regulatory authority of the importing country or, increasingly, by quasi-public or private bodies operating on their behalf. For service providers, the need to demonstrate competence and reliability to multiple regulatory bodies can severely limit their mobility and capacity to specialize and develop innovative products.

From the firm perspective, the impact of similar but differentiated regulatory regimes can influence investment decisions. For small- or medium-sized firms, which lack subsidiaries or an established presence in foreign markets, the cost of acquiring knowledge of, and access to, another country's regulatory regime can effectively dissuade them from attempting to develop that market altogether. Furthermore, the imposition of arcane and burdensome standards, testing, certification, and accreditation requirements can be used effectively to frustrate imports and shelter domestic companies from competition.

Little systematic research has been done on the economic costs and harmful trade effects of differing regulations nor is there prima facie evidence that regulations are necessarily economically harmful or trade distorting. Indeed, there is much evidence that well-conceived regulations can be trade-promoting and facilitating.[14] There is also no evidence to suggest that regulatory competition is

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footnote 12 cont'd

.... requirements on international commerce. This does not mean compromising Canada's ability to meet its social and environmental objectives. International cooperation does not mean lower standards. Rather, the emergence of global markets and the need to cooperate in managing international problems means that country-specific solutions are increasingly less effective. They are becoming a smaller and smaller percentage of the stock of regulations" (EACSR 2004, 19).

13 The EACSR devotes more than a third of its report — 55 out of a total of 145 pages — to annexes analyzing sector-specific issues, using these annexes effectively to make the larger point that while the details may differ, the fundamental issues are the same from sector to sector.

14 As has been frequently pointed out by analysts of market economics, the successful operation of markets is critically dependent on the presence of supporting laws and institutions. Proponents of market-based reforms of economic regulation do not seek a retreat of the state but a refocusing of the state's activities to matters that ensure the efficient and beneficial operation of markets.

necessarily harmful, although the costs of duplicative efforts may render such competition less helpful than some of its advocates assert. In a Canada-US context, in particular, regulatory competition is likely to impose a higher burden on Canadian-based producers than on their US counterparts.[15] Unlike efforts to reduce and even eliminate tariffs and quotas, whose harmful effects are well-documented, governments' international approach to regulatory-related issues has been to isolate the problems they may raise and address these with measures to reduce or eliminate their trade-distorting effect.[16]

Differences in Standards Related to Compatibility

Sorting out who does what varies among societies with different perspectives on the role of government and of the market. Should governments, for example, set compatibility standards or only ensure that private bodies do not set them in a manner to protect private interests or restrain trade? Is it a matter of safety or quality, or one of compatibility? Problems of trade-inhibiting differences in product standards related to compatibility are generally well disposed of either as a result of market forces or the work of international standardizing bodies such as the International Standards Organization, the International Electrotechnical Commission, or the Codex Alimentarius — the Food and Agriculture Organization's code on food safety standards. US analyst Alan Sykes notes that "both theory and experience suggests that market incentives to eliminate undesirable incompatibilities are often powerful and that much will be accomplished when the private sector is left to its own devices. Collective action problems and competitive imperfections, however, are a source of potentially important market failures" (Sykes 1995, p. 36). Those that do distort trade tend to fall into two broad categories: those that predate efforts to create international standards (e.g., left- vs. right-hand drive vehicles) and those that were deliberately established to promote proprietary technologies (e.g., VHS vs. Beta video-tape technologies or Apple vs. Microsoft computer operating systems). Neither category is easily susceptible to efforts to eliminate differences.

Differences in Standards Related to Quality or Safety

Problems of trade-inhibiting differences in standards related to quality or safety are a different matter. These often involve matters of social and other preferences, either embedded in law or in national practice. Here it is important to distinguish between differences that are critical and those that can be met on the basis of achieving similar objectives. Three principles can be used to mitigate differences: using the least restrictive means available; applying the standard on a non-discriminatory basis; and promoting the use of equivalence and mutual recognition provisions for differing standards or assessment procedures that meet

15 A good example of regulatory competition gone awry was Canada's misguided decision to go metric in the 1970s, ostensibly to enhance prospects for trade with Europe. The result has been a major, and expensive, difference between Canada and its principal economic partner, and no perceptible increase in trade with Europe. Going metric would only have made sense in concert with the United States.

16 For a fuller discussion of the economics of standardization and regulation, see Sykes (1995, 27-56). Useful discussions on changing regulatory issues can also be found in Doern, Hill, Prince, and Schultz (1999), Doern and Reid (2000), and Sparrow (2000).

similar or equivalent objectives. The WTO Agreements on Technical Barriers to Trade and on Sanitary and Phyto-Sanitary Measures, for example, have already made significant progress in enshrining these principles into enforceable rules governing trade in goods, but they could be refined further and extended more fully to sub-national authorities and private standards-setting bodies. In the services area, the General Agreement on Trade in Services and its annexes provide a good start to creating a framework within which to address problems created by regulatory differences affecting trade in services. Similar provisions in regional agreements seek the same objectives among more limited contracting partners, often with greater effect.

Trade impacts can be divided into two broad categories: those intended to discriminate in favour of local producers; and those that are the incidental result of regulations aimed at other objectives. The first represents the residual elements of traditional trade liberalization negotiations, and includes such measures as remaining tariffs, government procurement restrictions, trade remedy laws, and similar measures. The second involves a wide range of measures that reflect the complexity of modern economies and the response of governments to demands ranging from consumer protection to environmental stewardship and human rights. The trade and investment effects of the first can continue to be addressed with the traditional approach embedded in trade and investment liberalization agreements; the second may require higher levels of cooperation to identify those regulations that no longer serve any useful public purpose, those that can be implemented and administered on a basis that limits or eliminates the impact of differences, and those where differences are profound and important. Only the latter may need to continue to create any substantive barriers to trade, but on a much more limited basis than is often the case today.

Research by the OECD and other institutions indicates that divergent standards and technical regulations in different national markets, coupled with the costs of testing and certifying compliance with those requirements, can constitute between 2 percent and 10 percent of overall production costs (OECD 1996). Similarly, industry surveys and other studies almost unfailingly document conformity testing and certification provisions as a significant, and growing, obstacle to international trade. Not surprisingly, conformity assessment has become an important service industry in its own right, as seen in the rapid growth in the number and size of testing laboratories, certification and quality assurance bodies, auditors, and accreditation organizations in industrialized and developing countries alike.

The European Experience

The European Union (EU) has made the greatest progress in implementing mandatory regulatory cooperation and convergence among its member states. Against a background of nearly half a century of depression and war, European governments, in the 1950s, embarked on an ambitious program of political cooperation and economic integration. Based on the deeply held conviction that countries that trade with each other and have an interest in each other's economic welfare are less likely to go to war or engage in destructive protectionist strategies,

western European governments pursued policy-induced economic integration.[17] Over the course of the past five decades, the European integration movement has steadily expanded from the original six to 25 member states, plus association arrangements with neighbours, potential members, and former colonies.

Simultaneous to the widening of the EU, formerly called the European Community, member governments steadily deepened its impact on integration. The 1958 Treaty of Rome committed members to implement the four freedoms: free movement of goods, services, capital, and people. Implementation of the free movement of goods was effected by removing intra-European tariff and non-tariff barriers and by adopting a Common External Tariff and a Common Agricultural Policy. This was accomplished by the original six members by 1968 and became a condition of entry for all subsequent members. The free movement of the other factors of production, however, proved a much more daunting challenge. In effect, it required a high degree of convergence in the regulatory regimes that are at the heart of the modern welfare state and that, either directly or indirectly, operate to segment national markets and frustrate integration.

From a Customs Union to a Single Market

In response to the slow pace in fully implementing all four freedoms, the European Commission undertook a number of studies leading to a White Paper in 1985 on the operation of the common market and adoption of the Single European Act (SEA) in 1986. The SEA identified more than 280 separate initiatives that would need to be pursued in order to create a better functioning, fully integrated market, many of them involving reform of national regulatory regimes and their integration into Europe-wide regimes. The SEA set out a blueprint and a timetable for pursuing these initiatives. In effect, it transformed the center of gravity of the European integration movement from one relying on trade measures to achieve political and security objectives to one using regulatory means to realize commercial and economic ends. While the political and security goals remained important, as demonstrated in the EU's extension to former Soviet bloc countries, commercial and economic objectives had by the 1980s assumed a much larger role in their own right.

A critical concept underpinning European integration had been recognition of the principle of subsidiarity: regulations should be designed and implemented at the lowest level of government possible. Complementing this principle was the objective of harmonizing regulatory goals across the EU, leaving their design and administration to the local level. Experience by the 1980s, however, indicated that both harmonization and subsidiarity had their limitations. There had been slow progress toward a single market and continued discrimination in promoting national over European interests. A number of spectacular failures in ensuring the safety of the European food supply added further momentum to the need to take an EU-wide approach to many regulatory regimes, as did a number of decisions by the European Court of Justice.

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17 Noted Jean Monnet (1978), the father of European integration, in one of the most-quoted passages from his Memoirs: "There will be no peace in Europe if States reconstitute themselves on a basis of national sovereignty. … European States should form themselves into a federation or a 'European entity' which would make them a joint economic unit."

Box 2: *Features of a Typical Mutual Recognition Agreement*

- Coverage of the agreement, including general objectives, principles, and obligations.
- Scope of testing and accreditation procedures mutually accepted by the parties to the MRA.
- Criteria for identifying competent, acceptable laboratories and certifiers in each country.
- Provisions for information exchange, joint monitoring, and dispute resolution.
- A commitment by government authorities in each country to oversee the performance of conformity assessment organizations and, if necessary, terminate their accreditation if they fail to maintain technical competence (safeguard).
- Provisions to extend the agreement's scope, duration, or number of participants.

Over the past 20 years, the EU has made significant progress in implementing the Single Market program on the basis of a two-pronged strategy: the development of Europe-wide regulations where necessary; and a much more aggressive use of mutual recognition where they are not. (Box 2 highlights features of a typical mutual recognition agreement.) Food safety, environmental protection, and competition law are examples of areas subject to EU-wide regulations, developed by the Commission but administered, in whole or in part, by member states. Professional accreditation, road safety, and public security are examples where national regimes remain pre-eminent but for which Commission Directives increasingly effect mutual recognition and basic norms.

Significant progress has been made in realizing the objectives of the SEA. At the same time, as former EU Commissioner for the Internal Market, Frits Bolkenstein, has pointed out, much more remains to be done (Bolkenstein 2004). The momentum injected by the SEA in the 1980s had run out of steam by the end of the 1990s. The derailment of the constitutional treaty project by French and Dutch voters in 2005 underlined the extent to which Europe remains a work in progress. As has been the European experience from the start, for every two steps forward in strengthening and deepening integration, there is at least one step slowing it down. The optimism of the SEA has given way to the pessimism of the post-constitution era. Efforts to maintain European commitment to creating a stronger internal market, however, continue.

One of the most challenging initiatives has been to ensure the freedom of movement of people. The ability of workers to live or work in any member state continues to face many obstacles, from professional or technical accreditation to border formalities. The Commission has adopted initiatives encouraging the mobility of workers, notably by recognizing qualifications for professions and technical workers. An important breakthrough came, however, with the negotiation of the Schengen Accord among most, but not all, members of the EU. Schengen participants have agreed to remove all border formalities, creating a single customs and immigration regime. Under its terms, freedom of movement applies to all, regardless of nationality. Arrangements for tourists, asylum seekers, and legal immigrants from non-member countries are included in the Accord, the main aim of which is to standardize procedures throughout the Schengen area. Police continue to operate on their own national territory, in ports and airports,

but closer cooperation on measures to combat terrorism, smuggling, and organized crime have made controls at external borders more effective.

Effective pursuit of the SEA has resulted in the development of an EU-wide regulatory regime to which all member states must adhere. The 2004 enlargement negotiations, for example, revolved largely around the capacity of the 10 new applicants to fully implement the *acquis communautaire*, the detailed construction of rules that now governs the conduct of affairs within the Union. The task Europeans set for themselves, of course, was considerably more complex than that facing Canadians and Americans. Market forces and high levels of cross-border cooperation have resulted in much more convergence in North America than was the case in Europe as late as the 1980s, where it was necessary to overcome differences among 25 countries with different histories, institutional structures, legislative styles, and regulatory traditions. The excessive, even minute, regulation of standards in Europe is, in part, the natural result of using regulations to standardize the rules of 25 countries with different histories, traditions, mindsets, constitutions, and polities, rather than letting the market sort it out.

The EU Institutional Imperative

Critical to progress in European regulatory convergence has been creative interaction between intergovernmental negotiations and supranational implementation and enforcement. To that end, Europeans have relied on an institution-rich environment to effect their integration objectives. The Treaty of Rome created an intergovernmental Council of Ministers as the supreme decision-making body, but assigned the execution of its decisions to an independent European Commission, which, in turn, would be the guardian of the Treaty and the source of much of the Council's legislative activity. An independent European Court of Justice would ensure compliance with the Treaty and resolve conflicts about its interpretation. A European Parliament would assure broad public accountability for European legislation and administration.

As experience was gained in implementing the original treaty, and new obligations were added, the institutional structure was enlarged and made more workable. To the Council of Ministers, the architects added a Council of Europe, in effect, the Council of Ministers meeting at the level of heads of member-state governments. Decisions by the Council evolved from consensus — and its implied veto by any member — to weighted majority voting. To the Court of Justice, they added a Court of First Instance to give EU firms and citizens direct access to European dispute settlement, and a Court of Auditors to oversee the proper management of the EU's financial affairs. To the Commission, they added a European Economic and Social Committee, a Committee of the Regions, a European Ombudsman, a European Investment Bank, and a European Central Bank, each with Europe-wide responsibilities and the resources to carry them out. The Parliament evolved from an appointed body with limited consultative responsibilities to a popularly elected body with oversight and legislative authority. Jean Monnet, one of the chief architects of European integration, noted 30 years ago that, "nothing is possible without men; nothing is lasting without institutions" (Monnet 1978, 304-5). True to his vision, European leaders have paid

considerable attention to his maxim. It is difficult to conceive of the EU's evolution without the large role played by institution building.

The European approach was fully consistent with the economic and security needs identified in the 1940s and 1950s and the reality of more than two dozen fully independent states. Many of these had long traditions of keeping their markets closed to each other and a wide range of ingenious devices to meet this goal. It also reflects the capacity of governments with strong central executives responsible to multi-party parliaments to enter into and manage cooperative strategies. None of the member states is governed on the basis of a much more decentralized, congressional-presidential system, with all of its built-in checks and balances. With the exception of Germany, all are unitary states with full authority vested in the national government. When European leaders meet to iron out differences, they are fully competent to enact and implement the results of their discussions. Finally, it reflects the European tradition of giving direct effect in domestic law to international treaties.

NAFTA and Its Limitations

It took more than 30 years and a high level of will, cooperation, and institution-building to create the *acquis*. This experience is wholly different from that in North America. Rather than the push of government action, Canada-US integration has been driven largely by the pull of market forces: proximity, consumer choice, investment preference, and firm behaviour. Government policy has been largely responsive, motivated by efforts to resolve problems generated by market-driven integration. Rather than seeking deeper integration, governments only gradually accepted the need to facilitate it by addressing problems experienced by private traders and investors. The result is a much more piece-meal and less deliberate approach to rule-making and institution-building. Unlike in Europe, the governmental response in North America has been prompted by commercial and economic considerations and has been at pains to keep geo-political and security considerations at arm's length in forging new rules and arrangements to address deepening economic integration.

An Institutional Gap

Canada-US integration has also occurred in the absence of an institutional infrastructure for managing this complex, multifaceted relationship. As former Canadian ambassador to the United States, Allan Gotlieb, observes, "the world's largest bilateral economic relationship [is] managed without the assistance of bilateral institutions and procedures" (Gotlieb 2003). There is no body to provide political or policy oversight, no regular meetings between heads of government or foreign or trade ministers, no formal structure of committees looking at the relationship in a coherent and coordinated manner.

The absence of formal structure results from a determined, and largely successful, effort to treat issues in the relationship vertically, rather than horizontally, and to build firewalls to prevent cross-linkages. In part, this method of management derives from Canadian fears that as the smaller partner, Canadian interests would be overwhelmed in any more formal relationship. As former WTO

official Debra Steger points out, "Canadians … are worried about invasion of our public policy autonomy by the Americans." In part, it originates in the US system of governance that makes coherence and coordination in both foreign and domestic policies extraordinarily difficult to achieve on a sustained basis. As well, in Steger's words, "Americans … fear internationalism in all of its forms" (Steger 2004, 80).

The institutional gap is filled by inspired ad hocery. The inter-connected natures of the Canadian and American economies virtually require Canadian and US officials to work closely together to manage and implement a vast array of similar but not identical regulatory regimes, from food safety to refugee determinations. As already noted, officials and, in some cases, ministers have developed a dense network of informal cooperative arrangements to share information, experience, data, and expertise with a view to improving regulatory outcomes, reducing costs, solving cross-border problems, implementing mutual recognition arrangements, establishing joint testing protocols, and more. A recent Canadian government survey identified 343 formal treaties and hundreds of informal arrangements between Canadian and US officials at both federal and state and provincial levels (Mouafo, et. al. 2004). On any given day, dozens of US and Canadian officials at federal, provincial, and state levels are working together, visiting, meeting, sharing e-mails, taking phone calls, etc. Little of this activity, however, is coordinated or subject to a coherent overall view of priorities or strategic goals. Rather, it is the natural result of officials with similar responsibilities and shared outlooks seeking support and relationships to pursue them.

From Free Trade to Market Integration

Initial discussion in Canada looked to the emerging bilateral regulatory agenda as a matter of deepening and extending the NAFTA, for example, through its working groups. This was a misperception. The FTA/NAFTA and the WTO represent the culmination of the postwar trade agenda, consisting of tariff and non-tariff barriers to trade in goods and the newer issues of services, investment, intellectual property, and temporary movement of skilled personnel. They are essentially liberalization agreements erected upon static rule making.[18] One of the lessons from the European experience is that a regional trade instrument, whether a customs union or free-trade agreement, provides an efficient way to accelerate liberalization and promote integration. Reaping the full benefits of integration, however, requires different instruments.

The NAFTA and the WTO have left unresolved a long list of issues, from rules of origin to trade remedy regimes and government procurement restrictions. But in neither Canada nor the United States is there any enthusiasm for devoting the political resources necessary to undertake negotiations to deal with such leftovers. Nor is there is any pressure from the broad business community to move in this direction, largely because the benefits of classic trade liberalization have now been essentially realized between Canada and the United States.

18 See Dymond and Hart (2000) for a discussion of the differences between the trade policy of shallow versus deep integration.

The next stage of negotiations will be bilateral and needs to address the governance of deepening economic integration and accelerating regulatory convergence. Addressing these issues will require a different lens from the one traditionally used by trade-policy practitioners. Doing so successfully, moreover, will ultimately ease dealing with NAFTA's leftovers. While the exact nature of that lens remains to be determined, three of its constituent elements have become clear: crafting a less obtrusive border; promoting greater cross-border regulatory coherence; and enhancing joint decision-making capacity.

A complicating factor in the North American context is the extent of regulatory decentralization. Unlike in Europe where, with the exception of Germany, all member states are governed on the basis of a unitary central government, Canada and the United States have to deal with the reality of two federal governments and at least 65 state, provincial, and territorial governments, each with regulatory responsibilities and authority. In the United States, the Commerce clause in the Constitution provides a basis for some national integration, as does the Agreement on Internal Trade in Canada. However, as a practical matter, effective cross-border regulatory cooperation will require strategies that pay due attention to the federal character of the two countries.[19]

Some of the initial discussion about the implications of deepening cross-border integration assumed that Mexico, by virtue of the NAFTA, would necessarily be part of any discussion between Canada and the United States to craft new arrangements. The translation of the two bilateral Smart Border initiatives of 2001 into the 2005 trilateral Security and Prosperity Partnership (SPP) has bolstered the view that the template for regulatory cooperation is trilateral. This assumption does not stand up to scrutiny. There is no automatic link between membership in an FTA and the need to address a new range of issues, nor does the SPP require a trilateral approach on all fronts. Indeed, it specifically recognizes the prospect of a two-speed approach to various issues, from security to regulatory cooperation. Mexico is now just one of a number of free-trade partners shared by Canada and the United States. Mexico is no more a natural member of Canada-US regulatory cooperation arrangements than Chile, the Central American countries, or Singapore.

Despite rather grand ambitions 10 years ago that the NAFTA would give rise to a three-country North American economy, the reality is quite different. Instead, NAFTA governs two robust bilateral trade and investment relationships; Canada-Mexico trade and investment remains at miniscule levels. Even if Mexico were interested in joining negotiations for new arrangements, the political economy of the negotiating issues in the United States is not the same for Canada and Mexico. Both relationships have long histories and have economic and political importance for the United States but they have followed divergent paths and responded to different imperatives. In sum, the question of Mexican participation in any discussion of regulatory cooperation is not one that Canada needs to, or should,

19 I explore some of the ramifications of the need for federal-provincial cooperation in Hart (1999). The EACSR also devotes a section (pp. 26-30) to the need for federal-provincial cooperation and the need to develop a national approach to international regulatory cooperation.

resolve. It is up to Mexico to demonstrate that it has needs and ambitions similar to those of Canada and the United States.[20]

Next Steps

Reaping the full benefits of deepening cross-border economic integration will require that Canada and the United States address three fundamental, and interrelated, challenges: reducing the impact of the border; accelerating and directing the pace of regulatory convergence; and building the necessary institutional capacity to implement the results of meeting the first two challenges. Each of these will prove difficult and solving the problems associated with either of the first two will prove illusory without addressing the other two.

Border Administration

The first challenge is to address the increasingly dysfunctional impact of border administration. This *Commentary* is not the place to discuss in detail the critical role of border administration in frustrating cross-border integration, except to flag its importance and point to the close relationship between border administration and regulatory convergence.[21] The intensity of the cross-border relationship is apparent from the 36,000 trucks and 400,000 people who cross the border every day. Nevertheless, even after 15 years of "free" trade, the Canada-United States border continues to bristle with uniformed and armed officers determined to ensure that commerce and interaction between Canadians and Americans complies with an astonishing array of prohibitions, restrictions, and regulations. The list of rules and regulations for which the border remains a convenient, and even primary, enforcement vehicle has grown, rather than diminished, since the implementation of free trade, particularly in response to the new security realities created by 9/11.

Given the extent of cross-border integration, the two governments have taken steps to address border congestion, but with limited results to date. Efforts to make the border less intrusive and more efficient were integral to the 1996 Shared Border Accord, the 1999 Canada-United States Partnership Forum, the 2001 Smart Border Accord, and now the 2005 Security and Prosperity Partnership.[22] These initiatives, however, have been limited by the decision to work within the confines of existing legislative mandates and by the lack of a strategic framework. Creating

20 Gary Hufbauer and Jeff Schott (2004 and 2005) offer a different perspective, one increasingly not shared among Canadian and some US analysts. The problems inherent in Canada-Mexico cooperation in addressing issues with the United States are discussed in Goldfarb (2005).

21 Other papers in this series address various aspects of border administration, including Robson and Goldfarb (2003).

22 Political pressure to be seen to be doing something disposes bureaucrats and ministers to artfully repackage earlier efforts in order to create new "announcables." Students of this phenomenon would do well, for example, to study the evolution of these four initiatives. Each promised concerted action at the level of the executive branch of government to address a series of border-related problems within existing legislative frameworks. All four shied away from any commitments that might lead to new treaty-level obligations that would require legislative approval. More may not have been politically feasible, but it is unrealistic to expect substantive results without a willingness to invest in more robust projects that might require legislative implementation.

such a framework, investing in infrastructure and in technology (both at ports-of-entry and the corridors leading to such ports), and targeting resources toward pre-clearance programs for goods, vehicles, and people are critical components of any comprehensive effort at improving the management of the border and reducing its commercial impact. Ultimately, the objective should be to create a border that is considerably more open and less bureaucratic, within a North America that is more secure. If Canadians and Americans want a smarter and less intrusive border between them, they will also need to cooperate to create a more secure perimeter. The result should be a more open, more prosperous, and more secure continent.

Regulatory Cooperation

A key component to trimming border congestion lies in meeting the second challenge: reducing the impact of regulatory differences between Canada and the United States. As the Canadian Council of Chief Executives points out, "most of the administrative costs and delays at the border come not from the need to assess customs duties, but from myriad rules and regulations that are simply convenient for governments to handle at the border" (CCCE 2001). As Europeans learned, regulatory cooperation and reducing border formalities are two sides of the same coin. There may be a long tradition of pragmatic, informal problem solving between the regulatory authorities of the two federal governments, as well as among provincial and state governments, but all now need to ask how much regulatory enforcement should be exercised at the border and how much can be exercised behind the border. More fundamentally, as regulatory cooperation and convergence proceed, they need to ask whether they are ready to proceed to a more formal, treaty-based process of regulatory cooperation aimed at eliminating, to the largest extent possible, what has been characterized as the tyranny of small differences. By eliminating those differences, much of the rationale for border administration disappears.

The default option in addressing regulatory convergence between Canada and the United States has been to stay on the very Canadian path that has gradually emerged: cooperation if necessary but not necessarily cooperation. The results have not been uninteresting: Canadian jurisdictions align their regulatory goals and objectives with those of their US counterparts, and work with US regulators in many areas, but maintain sufficient regulatory autonomy to chart their own path. The result is two very similar but autonomous regulatory regimes involving extensive duplication and redundancy. The extent of regulatory convergence and cooperation is largely determined by bureaucratic agendas and preferences. Broader goals, from economic development to regulatory efficiency, remain of secondary importance. This default position also avoids confronting the two related issues: the border and institutional capacity.

The External Advisory Committee on Smart Regulation concluded that this model was inadequate to address Canada's needs and recommended a proactive approach. It recognized that Canada is "enmeshed in a dense web of international relations," but wondered "whether the government's international regulatory activity is well aligned with national priorities and whether resources are being put to best use" (EACSR 2004, 17). It also questioned the value of maintaining "parallel processes and structures" (EACSR, 20) and the extent of duplication

between Canada and the United States. It recommended that the federal government "include international regulatory cooperation as a distinct part of Canadian foreign policy … and should develop a strategic policy framework for international regulatory cooperation" (ibid., 19). Given the extent of Canada-US cooperation and the depth of cross-border integration, it further recommended that "North America should be the primary and immediate focus of the federal government's international regulatory cooperation efforts" (ibid., 22). To that end, it specifically recommended that:

> the federal government should work to: achieve compatible standards and regulation in areas that would enhance the efficiency of the Canadian economy and provide high levels of protection for human health and the environment; eliminate small regulatory differences and reduce regulatory impediments to an integrated North American market; move toward single review and approval of products and services for all jurisdictions in North America; and put in place integrated regulatory processes to support key integrated North American industries (e.g. energy, agriculture, food) and provide more effective responses to threats to human and animal health and the environment. (EACSR, 22.)

The External Advisory Committee also recognized two analytical traps that continue to appeal to some Canadians:

- Canadians can align their regulations with those in the United States to the extent they collectively judge it to be desirable on their own and do not need to complicate this process by tying it to a bilateral program; and
- Canadians should make a strategic judgment of where they want to be competitively, and then decide whether it is best to achieve that by being the same, being better, or being different.

While there is a superficial appeal to both points, experience suggests a unilateral approach is less likely to yield the desired result: reducing the impact of the border on Canadian trade and investment patterns. This goal will not be achieved in the absence of US confidence that Canada's regulatory regime is substantively equivalent to its own, a confidence that will require its active engagement. The existence of an agreed bilateral program, even one that may require Canada to adapt and adjust much more than the United States, has the additional clear advantage of bringing political pressure to bear on a process that would otherwise become too easily captive of bureaucratic agendas. The prime objective of such a program would not be to promote regulatory convergence for its own sake, but to enhance the performance of the Canadian economy by reducing barriers to reaping the full benefits of North American economic integration. In the words of the EACSR, "Canada must take a more deliberate and strategic approach to regulatory cooperation …. Otherwise, it may face social, environmental and economic performance well below its potential" (EACSR, 21).

The government has broadly accepted the recommendations of the EACSR. In the context of the Security and Prosperity Partnership adopted by the Presidents of the United States and Mexico and the Prime Minister of Canada in Waco, Texas in March 2005, it took important steps to move the agenda along. It has appointed

a group in the Privy Council Office (PCO) to pursue the path charted by the EACSR. Additionally, the federal government's Policy Research Initiative (PRI) has dedicated resources to considering ways and means to implement the EACSR recommendations. What has emerged to date is a commitment to what might be characterized as accelerated incrementalism. The result is a higher level of awareness of US regulatory developments among Canadian policy makers, leading to enhanced opportunities to align Canadian regulatory policy with developments in Washington. What is missing is a strong political commitment to regulatory cooperation and a plan to put it into effect. Not surprisingly, the pace in implementing this program has been glacial.

The current Canadian approach also appeals to American regulators, who have to date exhibited little appetite for more. The US decision-making system is extraordinarily resistant to centralized control and, thus, a very difficult target for more than piecemeal, regulator-to-regulator cooperation. The US President, for example, may appoint the Commissioners to the Securities and Exchange Commission, but once in office, they act fully independently of his direction. Nevertheless, in both Washington and Ottawa, efforts at regulatory reform and streamlining have gained a growing number of adherents. Congress in 1980 established an Office of Information and Regulatory Affairs (OIRA) in the Office of Management and Budget (OMB). As well, successive presidents have, through Executive Orders, set out the basis for OIRA to provide systematic, centralized review and appraisal of all federal regulations. Much of this effort has been coordinated with broader international initiatives, particularly at the OECD. Canadian efforts parallel those in the United States. Since 1978, Canadian federal regulatory activity has been subject to a constant, comprehensive, centralized process of review, housed initially in the Treasury Board and subsequently in the PCO, with a view to eliminating duplication and redundancy and promoting best international practices. The guiding policies developed in both capitals for rule making and review are remarkably similar in tone and intent and reflect the high level of ongoing discussions at the OECD and bilaterally.[23] A sound foundation has, therefore, been created for a more formal program of cross-border regulatory cooperation and even coordination. To go to the next level, however, the two governments will need to adopt a program leading to an enforceable agreement, and the institutional capacity to make it work.

A critical first step will be for Canada to develop a comprehensive database of federal and provincial regulatory programs that includes a first approximation of their US equivalents and the extent of differences. This is a step that can only be taken within government. Scholars and analysts in universities and non-governmental institutions command neither the resources nor access to the required information. Similar to the study organized by the Canada School of Public Service to map the extent of bilateral networks (Mouafo et al. 2004), the federal government needs to build such a database. With such an inventory in hand, it will be possible to select priority sectors and engage US officials in the next step of designing a joint program of guided regulatory cooperation in priority sectors.

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23 See, for example, Canada (1999) and United States (2002).

A good place to start such a bilateral program is to take advantage of existing reporting requirements and use them as a basis for systematic exchanges of information and consultations. In Canada, all federal regulatory authorities are required to prepare an annual report to Parliament on their plans and priorities, and responsible ministers must make an annual performance report to Parliament. In the United States, the OMB makes an annual Report on the Costs and Benefits of Federal Regulations and OIRA prepares, semi-annually, The Unified Agenda of Federal Regulatory and Deregulatory Actions. These regular reporting requirements provide excellent gateways for bilateral consultations aimed at promoting more systematic regulatory cooperation. Such consultations can strengthen confidence in each other's regulatory regimes and be used to identify areas ripe for efforts to remove differences, move toward mutual recognition, consider joint decision-making, and implement other strategies aimed at creating an approach more consonant with the reality of deepening cross-border economic integration.

Given the extent of regulatory programs in both countries and the specific nature of each regime, such horizontal efforts will need to be complemented by sector-specific obligations to consult and seek to remove differences and enhance compatibility on a cross-border basis. Both governments already require regulators to ensure that regulations comply with international commitments; adding a requirement to ensure cross-border compatibility is not an onerous additional commitment. In both countries, regulatory developments are also subject to extensive public comment and consultation, offering opportunity for wide public input. Again, without adding any major new burdens, the two governments can require, before regulatory authorities publish a Notice of Proposed Rulemaking in the US Federal Register or similar notifications in the Canada Gazette, that officials consult with their US or Canadian counterparts with a view to ensuring that any new or amended regulations meet their joint commitment to reduce differences and enhance compatibility.

Some of the more challenging regulatory differences are set out in the detailed policies, processes, and procedures of individual regulatory programs. These often develop over time as officials interpret and implement regulations. In many instances, agreement on goals and benchmarks should provide room for some cross-border differences at this level. Nevertheless, efforts to achieve deeper regulatory convergence will need to pay attention to this dimension. This could involve, for example, a requirement that regulators report on their commitment to reducing difference and enhancing compatibility not just when they introduce new regulations or amend existing ones, but also throughout the regulatory "life cycle."

As a further step toward promoting convergence and reducing differences at the federal level, both governments can add new decision rules in their regulatory policies. Canada's 1999 Regulatory Policy, for example, requires that regulatory authorities, in developing or changing technical regulations, ensure that they comply with existing international obligations, as well as the Agreement on Internal Trade. It also requires that the benefits outweigh the costs, and that alternative means to address the problem have been considered. US regulatory

policy similarly requires cost-benefit analysis, consideration of alternative means, and due deference to international best practice and obligations.

It would not be difficult to add an additional decision rule requiring bilateral consultation and a positive determination that any differences with analogous regulations in the other jurisdiction serve an important and unavoidable public purpose. Both Canada and the United States, for example, could require a mandatory section to this effect within their respective Regulatory Impact Analysis (RIA) statements that are published with each proposed new or amended regulation. As the External Advisory Committee pointed out, "information-sharing and decision-making measures should be designed to help countries build confidence and trust in each other's regulatory and decision-making processes. They should also help us to recognize that each country's regulatory standards, processes and decisions produce similar results" (EACSR, 21). In addition, sector-specific strategies, as described in the next section, can be developed as experience is gained and more detailed appreciations emerge of regulatory differences in these sectors.

Both sets of obligations can be made subject to review by the Auditor General in Canada and the Government Accounting Office in the United States. Both agencies, in their audit and review functions, regularly audit the effectiveness of existing regulatory regimes in meeting their objectives and in their cost effectiveness. Again, the two governments could agree to give these two agencies an additional mandate to include in any such audits and reviews, assessments of cross-border compatibility, and efforts to remove the "tyranny of small differences."

Initially, the two governments should build confidence and gain experience at the federal level, but given the federal structure of the two countries, the sooner they engage provincial and state regulatory authorities in a similar process of mandatory information exchange and consultations, the sooner the two countries will arrive at a "North American" approach to meeting their regulatory goals and objectives. Because of the large number of jurisdictions involved, this is an area that will require some creative decision rules as well as institutions to make them work. Fortunately, as at the federal level, extensive regional networks of collaboration already exist between Canadian and US regulators. Any successful federal strategy on economic integration and regulatory convergence will need to both complement and take advantage of these existing cross-border institutions.

Thus, without the need to enter into a massive negotiating process, the two governments can put in place a process that builds on existing cooperation and domestic rule-making requirements and creates a framework within which differences will, over a period of years, become increasingly marginal. In setting up such a framework, the two governments can agree to a 10-year target, at the end of which they will agree to enter into discussions on how to address remaining differences and consider ways and means to effect a more open border.

Institutional Capacity

Integral to any progress in addressing the governance of deepening integration is the need to build sufficient institutional capacity and procedural frameworks to reduce conflict, and provide a more flexible basis for dynamic rule making and

adaptation for the North American market as a whole. It may well be necessary to consign traditional aversion to bilateral institution building to the dustbin and look creatively to the future. While the European model of a complex supranational infrastructure may not suit North American circumstances, there are lessons Canadians and Americans can learn from the EU experience.

Rather than seeking to create structures where none is needed, the two governments should focus upon the functions that need to be performed for the efficient governance of deepening integration. They should establish new institutions only where current arrangements are unsuitable. To some extent, these aims could be met by making creative use of existing Canada-US cooperative arrangements, by investing officials in agencies on both sides of the border with new responsibilities, or by building on existing models that have worked well. As described above, much of the enhanced consultation and information exchange suggested can be performed on the basis of existing institutions and informal networks.

The two governments could, for example, stipulate that the Canadian Border Services Agency and the US Customs Service coordinate their efforts to ensure efficient administration of third-country imports. Similarly, an appropriate understanding could be reached requiring the Canadian Department of Transport and the US Department of Transportation to coordinate their efforts to ensure highway safety; before enacting any new rules and regulations, for example, mandatory coordination efforts would focus on ensuring compatible outcomes and mutual recognition of each other's approaches to the same problem. A good basis for this kind of cooperation already exists in both the informal networks among officials, and in the relatively minor differences in regulatory approach. What is missing is an agreed mandate to resolve differences and a more formal institutional framework with authority to ensure mutually beneficial outcomes. Establishing a bilateral commission to supervise efforts to establish a more coordinated and convergent set of regulations governing all customs or transportation matters could prove critical to providing the necessary momentum and political will.

Both governments maintain separate, but similar, approval procedures for therapeutic drugs, reaching almost identical conclusions, albeit within different time frames. The two parallel regimes offer a prime example of the External Advisory Committee's view that in some instances, "Canada and the United States should go beyond aligned regulatory frameworks and identify where they could move toward integrated regulatory institutions and processes" (EACSR, 22).[24]

Adapting these existing procedures to operate to the benefit of both countries could involve commitments to more sharing and mutual recognition strategies, with the aim of reducing duplication and overlap but maintaining the capacity to address unique circumstances that may arise in one country or the other. Adopting a first-to-approve rule as a default position, for example, would lead to constructive regulatory competition, particularly if it includes a safeguard provision for sensitive issues. Establishing a joint commission to supervise the transition to a more integrated regime, and to provide continuing oversight

24 The Committee provides a more detailed assessment of the prospect for greater integration of the drug approval regimes in the two countries in its sectoral annexes (EACSR, 79-88).

thereafter, would ensure that both governments maintain a voice in the therapeutic drug approval process.

Food safety is similarly invested with a high degree of cooperation. The Canadian Food Inspection Agency (CFIA) and Health Canada as well as the US Animal and Plant Health Inspection Service (APHIS), Food Safety Inspection Service (FSIS), and Food and Drug Administration (FDA) work closely together on the basis of hundreds of agreed protocols and understandings. Much of this, however, lacks the status of domestic law or international treaties, and any problems need to be resolved at the level of the Minister and Secretary of Agriculture. Enshrining current levels of cooperation into a bilateral accord and assigning supervisory responsibility for the continued adaptation of its implementation to a Joint Food Safety Commission would greatly enhance both consumer and producer confidence in the two governments' commitment to governing what is, de facto, an integrated market.

In both countries, labour mobility is hampered by provincial and state labour laws and delegated professional accreditation procedures. The NAFTA put in place a modest process to permit temporary entry for business and professional visitors and mutual recognition of professional accreditation. The latter has been hampered by the conflict of interest inherent in a system of self-regulation. As the EU learned, a more centralized approach is required to overcome conflicts of interest and bureaucratic inertia. From architects and accountants, to doctors and dentists, there remains considerable scope for enhancing mutual recognition arrangements. An important step toward breaking the logjam would be to appoint a bilateral task force to develop model mutual recognition arrangements for consideration by state and provincial accreditation bodies.[25]

Much can be achieved on the basis of existing networks of cooperation, with the addition, as necessary, of specific joint or bilateral commissions in instances where existing networks are inadequate. More will be achieved, however, if the two governments commit to the establishment of a limited number of bilateral institutions with a mandate to provide them with the necessary advice and information to effect a more integrated North American approach to regulation. As noted by the Independent Task Force on the Future of North America, "effective progress will require new institutional structures and arrangements to drive the agenda and manage the deeper relationships that result" (ITFFNA, 30). An independent Canada-US Secretariat with a mandate to drive the agenda and report annually to the President and Prime Minister on progress could, for example, prove critical to overcoming bureaucratic inertia. Similarly, a Joint Advisory Board to the President and Prime Minister could contribute some creative drive to the development of new bilateral initiatives. As numerous studies have demonstrated, regulatory agendas are prone to capture, geared to serving the narrow interests of regulator and regulatee. Bilateral initiatives limited to regulatory authorities are unlikely to prove immune from this reality. Regular review by an independent advisory board of progress in implementing a bilateral program of "guided" regulatory convergence could thus prove a valuable addition in keeping the program focused on broader objectives.

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25 I examine the pros, cons, and challenges of greater cross-border labour mobility in Hart (2004b).

Box 3: *Steps Toward Regulatory Convergence: Medical Devices*

In both Canada and the United States, the use of medical devices — from needles and catheters to MRI machines and artificial knees — is subject to stringent approval procedures to ensure their safety and efficacy. In both countries, the federal governments are the principal regulators and both seek to ensure that consumers have timely access to safe, effective, and high-quality medical devices and are shielded from risk arising from their use. In Canada, such devices are licensed by the Therapeutic Products Directorate of Health Canada, while in the United States, the Center for Devices and Radiological Health in the Food and Drug Administration performs the same task. The two regulators are considered among the most stringent or conservative in the world. Approval procedures in both countries are very similar, involving:

- Classification of products into levels of potential risk. Class I products in both countries require licensing to manufacture and distribute, but are considered to present minimal risk and are not individually screened and licensed if similar products already exist in the market. Class II devices require pre-market approval and more stringent testing of their safety and efficacy.
- Class III in the United States and Classes III and IV in Canada are the most sensitive products and involve extensive testing for safety and efficacy before they can be licensed for use. These products are also subject to more intensive post-market reporting requirements and periodic inspection and review of both the product and the manufacturer.
- Licensing for manufacturers of Class I products and the review process for new Class II products are reasonably timely in both countries. Class III and IV products, however, take much longer and for more complicated devices much longer than the target of 180 days in the United States and 60 (Class III) and 75 (Class IV) in Canada.
- Extensive consultation with regulators in other jurisdictions is a routine part of the regulatory process and the outcome of approval and licensing procedures in the two countries is very similar. Manufacturers in both countries complain of slow, costly, and overly bureaucratic approval procedures.

The similarity is in part the product of frequent, detailed bilateral consultation and collaboration. It is not difficult, therefore, to envisage a program that would lead to higher levels of cooperation providing for mutual recognition, joint testing, and common approval protocols. Reaching such an agreement could involve the following steps.

- Step One: reach a common understanding on the classification of products into either three or four classes, and on definitions of what is covered by each class.
- Step Two: reach a common understanding on regulatory goals and of testing and approval procedures for each class of products.
- Step Three: extend mutual recognition to each other's testing and licensing of Class I and Class II products and their manufacturers.
- Step Four: review progress and experience in licensing to jointly agreed regulatory goals and procedures for the more sensitive classes of products.
- Step Five: extend mutual recognition to each other's testing and licensing of all products and their manufacturers, with responsibility remaining with the regulator of the country of manufacture for individual products.
- Step Six: review periodically and resolve problems in implementing the mutual recognition protocols.

The end result would be a system that would subject manufacturers and innovators to one rather than two regulatory procedures. In order to safeguard an orderly transition but ensure progress, the two governments could appoint a high-level Commission to supervise implementation of the steps toward a mutual recognition regime. Continued need for such a commission could be reviewed once the system is in full operation.

Compatibility, Not Harmonization

The operating goal of such a program should be to seek greater compatibility and complementarity in goals, design, and outcomes, rather than harmonization. This can be accomplished through sharing of information, strengthened networks, agreed safety valves, greater use of mutual recognition and analogous instruments, development of appropriate machinery and institutions to enhance mutual confidence and facilitate information sharing, and, ultimately, joint decision making. (Box 3 provides an example of how regulatory convergence might work for medical devices.)

Despite populist notions to the contrary, US regulatory requirements are often more stringent than those in Canada. More to the point, bilateral regulatory convergence is more likely to involve adoption of best practices than reliance on the lowest common denominator. Furthermore, as noted earlier, differences between Canada and the United States are less a matter of goals and objectives than of ways and means. The challenge is less a matter of agreeing on goals and desirable outcomes than of recognizing mutually acceptable ways of achieving the same outcomes.

To take one politically salient example, US responses to environmental degradation, from carbon emissions to water pollution, are often ahead of Canadian efforts.[26] Notes George Hoberg: "as a result of policy integration through emulation, common science and technology, and shared values and politics, environmental policy in Canada and the United States has witnessed a substantial amount of convergence" (Hoberg 1997, 384). But, as Nancy Olewiler points out, Canada's "kinder, gentler route to improving the environment … also means that Canada may not be moving as fast as it could toward reaching environmental targets" (Olewiler 2003, 619). A coherent program of cross-border cooperation is thus likely to strengthen Canadian regulatory outcomes, even one that will require Canada to do much of the heavy lifting and adjustment.

The security and well-being of its citizens stand at the very pinnacle of any government's responsibilities. Regulations affecting everything from food safety to the quality of the environment are central to fulfilling these responsibilities. Governments must think carefully, therefore, about any initiatives that may compromise their ability to discharge them. Canadian experience in negotiating international rules and pursuing regulatory cooperation, both multilaterally and bilaterally, suggests that there is no inherent conflict between these responsibilities and such rule making and cooperation.

Nevertheless, vested interests can mount emotional campaigns questioning the extent to which regulations made jointly with others can respond to Canadian responsibilities. Fortunately, it is not difficult to refute such claims. Canadians, for example, routinely travel in the United States, comfortable in the reliability of US safety regulations. They eat and drink in the United States on the same basis as they do at home. If they are sick, they often can and do rely, at considerable

26 Former Prime Minister Martin's efforts to score political points at the December 2005 Montreal UN meeting on climate change by berating the US failure to listen to the voice of "global conscience" on global warming prompted the media to do some digging and discover that the United States, despite its refusal to sign on to the Kyoto Protocol, had made substantially more progress than Canada in meeting its notional Kyoto targets. See, for example, *Globe and Mail* (2005).

expense, on US medical advice and US-approved drugs. From almost any perspective, Canadians have few, if any, qualms about the goals and efficacy of US regulations when in the United States. There are few other countries about which Canadians routinely exhibit such confidence. The reason is simple: as noted earlier, Canadian and US regulatory regimes are, in almost all respects, closely aligned. The differences are matters of detail that may matter to individual regulators, but have little import to residents in either country.

Conclusion

The Canadian and US economies have become intertwined in response to demands by Canadians and Americans alike for each other's products, services, capital, and ideas. These demands are creating jobs and wealth across many sectors and accelerating the forces of mutually beneficial integration. Whatever the homilies about the value of independence, there is no sentiment that the government should interfere in private business and investment decisions to change the logic of resources, geography, and private choice that underpin economic integration. The framework of rules and institutions developed over the past 70 years have worked well to facilitate and govern this process of "silent," market-led integration. However, the continued presence of a heavily administered border and of similar but differentiated regulatory regimes still undermines the ability of firms and individuals alike to reap the full benefits of deepening integration.

Operating in a small, export-dependent economy next door to the world's most vibrant economy, Canadian suppliers and regulators alike have learned the benefits of Canada-US regulatory cooperation. The result has been an inexorable drift toward ever-greater convergence. This trend is unlikely to change, but Canadians can take steps to harness it and ensure that it develops in ways that bring greater benefits and more control than is currently the case.

The two governments have committed to developing a framework for regulatory cooperation. Such a framework should, initially, change the current practice of discretionary cooperation at the federal level to a mandatory process of information exchange, consultation, and even coordination. The aim should be to advance a jointly agreed mandate to improve regulatory outcomes, eliminate duplication and redundancy, reduce regulatory differences between the two countries, and effect a North American approach to regulation. Much of this mandatory cooperation can be implemented on the basis of existing institutions and be focused on priority sectors. Its most critical results will be experience and mutual confidence. Once experience is gained with this framework, the two governments should proceed to negotiating a treaty enshrining the principles of regulatory cooperation and establishing a modest institutional capacity to give it effect.

This program of regulatory cooperation should form part of a larger vision implementing a joint commitment to the creation of the necessary legal framework and institutions that will govern accelerating cross-border integration and ensure that both Canadians and Americans enjoy its benefits. In Allan Gotlieb's words, we need to develop "… a more comprehensive North American community of

law. It would create agreed rules and procedures applying to all significant aspects of the movement of people, goods and services across our border. Such a community of law, inspired by the European model, could lead to a full-scale customs union, embracing a common security perimeter, common standards affecting all commerce, joint tribunals to adjudicate disputes, and, in time, complete freedom of movement of people" (Gotlieb 2004, 8).

Commitment to such a program obviously will have implications that go beyond trade and commercial considerations. Some Canadians, for example, are concerned that growing convergence might drag them into applying US geopolitical trade barriers that are inimical to Canadian values and interests. Others worry that further trade and commercial integration could undermine federal and provincial governments' ability to nurture Canadian culture and identity. Still others fear that further negotiations could require Canada to share its resources and leave Canadians without adequate capacity to ensure that they benefit from these assets. Some Canadians are suspicious that governments' approach to healthcare, education, regional development, and other defining policies could be compromised.

These are serious concerns to which there are serious answers. Some of these fears relate more to the forces of proximity than to the nature of the rules in place to manage the process of deepening integration. Canadians can do little about the fact that they live next door to the world's largest, most energetic economy. However, the negotiation of better rules can provide an improved basis for managing the frictions created by proximity and ensure that Canadians are able to reap the full benefits of their geography. Other concerns are matters that would need to be addressed with care in the negotiation of any terms and conditions that would apply. Like Canadians, Americans also have worries that must be addressed. As in the 1985/87 CUFTA negotiations, the essence of any negotiation involves resolving such issues and finding mutually acceptable compromises. The two governments must engage each other, analyze the issues as they emerge, and determine what can be accommodated and what cannot.

Face-to-face meetings between Prime Minister Stephen Harper and US President George Bush, such as the session on March 30-31, 2006 in Cancun, Mexico, are an opportunity for Harper to signal the end of the strained relations that had developed between the Bush Administration and the governments of his two predecessors. By the end of 2005, the Bush Administration's irritation with Canada had reached the point of indifference to a growing array of Canadian concerns. An important step toward a more constructive relationship will involve developing a common agenda of mutually beneficial cooperative projects. As this paper has argued, an active program of regulatory cooperation fits the bill admirably. Certainly, the case for such a program is sufficiently compelling to warrant close attention to the issues involved by analysts both inside and outside government. Similarly, now is also a good time for business leaders to sharpen their pencils and do the homework necessary to strengthen the case for cross-border regulatory cooperation.

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