



HOUSE OF COMMONS  
CANADA

## **GETTING BACK TO BUSINESS**

### **Sixth Report of the Standing Committee on Industry, Science and Technology**

**Susan Whelan, M.P.  
Chair**

**November 2001**

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# **THE STANDING COMMITTEE ON INDUSTRY, SCIENCE AND TECHNOLOGY**

has the honour to present its

## **SIXTH REPORT**

Pursuant to Standing Order 108(2), the Standing Committee on Industry, Science and Technology proceeded to a study on the consideration of the economic impact on Canada of the September 11, 2001 terrorist attacks. After hearing evidence, the Committee has agreed to report to the House as follows:





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## CHAIR'S FOREWORD

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On September 11, 2001, the world witnessed a series of horrific terrorist attacks directed at targets in the United States of America. On that day, four jetliners were commandeered by Muslim extremists for suicide missions; two planes targeted the World Trade Center in New York and another plane targeted the Pentagon in Washington, D.C. An attack against another target (possibly the White House) was thwarted by passengers on the fourth plane; that plane crashed in a field southeast of Pittsburgh. Some evidence suggests that there were likely more acts of terrorism planned but aborted by the immediate grounding, or diversion to Canada, of all civilian aircraft in U.S. airspace on that day. Although a final or official tally of the loss of human life has not yet been made, it is known that approximately 4,000 people, including 24 Canadians, perished in these barbaric acts.

The terrorists aimed their hostilities directly at American symbols or centres of commerce, military power and democratic office; however, it is more accurate to conclude that it was the freedom of the democratic world that was under assault on that day. Indeed, by no other means have so many innocent lives of peoples of different countries, nationalities and faiths ever been lost in a single day, and never have so many families and friends from across the globe been forever touched by terrorism.

Although the economic losses suffered cannot compare to the magnitude of human losses, the House of Commons Standing Committee on Industry, Science and Technology nevertheless feels that it is important to turn to the task of measuring the economic impact on Canada of the September 11 events and ensuing bioterrorism attacks. Recognizing that the Government of Canada has begun to take immediate remedial action, the Committee's work is intended to assist the federal government in devising a coherent long-term plan for arresting the adverse economic shock set in motion by these acts of violence and for responding effectively to the new security threat. More specifically, the Committee's mission is to anticipate the many, but not necessarily obvious, economic consequences of terrorism and to counsel governments, regulators and their agencies on how to effectively respond to the post-September 11 security-conscious environment in a way that minimizes any further adverse impacts on the Canadian economy.

With these objectives in mind, the Committee organized several intensive meetings with many of Canada's business leaders, representatives from industry umbrella associations — the ones most directly affected by the economic shock that followed the tragedy — and representatives from the United States. Their messages were clear and forthright; interestingly, a general consensus was reached on the need for increased military and anti-terrorist spending by the federal government that is financed by reduced and deferred spending on lower priority items. Such a plan, it is believed, would ensure that the Government of Canada does not fall back into deficit, thus restoring consumer and investor confidence for a general economic recovery in early 2002. At the same time, the

message from the business community was clear that the adoption of new security measures must not impede the flow of goods and people across the Canada-U.S. border.

I would like to thank those who participated in our hearings process and who shared their insights with us. I am confident that the public will agree that this report reflects both its concerns and common Canadian values and priorities in the post-September 11 security-conscious environment.

Finally, the Committee would like to dedicate this work to the memory of those who lost their lives at the World Trade Center, the Pentagon and in a field outside Pittsburgh, Pennsylvania, on September 11, 2001.

## **LIST OF RECOMMENDATIONS**

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- 1. That the Government of Canada establish a high-level bilateral ministerial summit between Canada and the United States on border issues, spanning security, trade facilitation and immigration concerns, with the objective of developing a comprehensive and coordinated long-term management plan for Canada-U.S. border crossings.**
- 2. That the Government of Canada include, in its upcoming budget statement, plans with the United States regarding security, for example, the coordination of immigration and customs policies, procedures and information sharing, as well as the expected costs of such initiatives.**
- 3. That the Government of Canada develop and fund an infrastructure program to improve the highways linking Canada's existing border crossings as well as modern off-site inspection areas and access roads, and that these facilities and crossing points be equipped with enhanced security technologies.**
- 4. That the Government of Canada immediately implement, using the best available technology, a comprehensive paperless pre-approval system for all "just-in-time" commercial shipments.**
- 5. That the Government of Canada, as part of its discussions and negotiations with the United States, include the proposal to conduct Canadian customs inspections in the United States and U.S. inspections in Canada ("reversal of inspections").**
- 6. That the Government of Canada expedite discussions and negotiations with the United States to reactivate modern customs and immigration procedures, such as NEXUS, CANPASS and other pre-approval programs, which may include biometric technologies and the creation of shared-information systems.**
- 7. That the Government of Canada's upcoming budget provide for an increase in customs and immigration personnel.**
- 8. That the Government of Canada ensure that the Canadian Food Inspection Agency, and other stakeholders responsible for ensuring the safety and security of the food supply, receive adequate resources to carry out their work. Resources should be directed at all levels of the supply chain from production through inspection**

and delivery of food. The expenditure associated with these resources should not be subject to cost recovery.

9. That the Government of Canada carefully examine the viability of Canada's air transport industry.
10. That the Minister of Finance, in his next budget statement, confirm national security and border trade as the Government of Canada's number one priority at this time and back this commitment with needed expenditure initiatives.
11. That the Minister of Finance, in his next budget statement, confirm the Government of Canada's commitment to the five-year tax reduction program it set out in Budget 2000.
12. That the Government of Canada continue a fiscal strategy of developing a two-year rolling plan, backed by a contingency reserve, using conservative economic assumptions to deliver a federal budget that does not contemplate a return to a deficit.
13. That the Government of Canada continue the practice of retiring its debt by an amount that is not less than the funds available in the contingency reserve at the end of each fiscal year.
14. That the Government of Canada impose spending limits and, if necessary, cutback on low-priority spending in the budget plan should economic fundamentals weaken beyond expectations, or should additional external shocks require greater-than-anticipated national security spending, and begin to threaten the desired fiscal balance.
15. That the Government of Canada work with the private sector and community leaders to provide broadband services to areas of the country that do not currently have broadband access on a region-by-region basis. Regions to be connected first should be those areas in which it is unlikely that the private sector, on its own, will provide broadband services. In this manner, northern and rural areas will not be disadvantaged any further.
16. That the Government of Canada consider increasing appropriations to certain government departments, agencies and programs (the Industrial Research Assistance Program, the Technology Partnerships Canada program, the National Research Council of Canada and the Canadian Space Agency), as described in the Committee's fifth report.

# INTRODUCTION

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In the aftermath of the terrorist attacks of September 11, 2001, on the United States, indirect economic shocks to many business networks, airline companies and airport infrastructure, travel agencies and tourist centres have rippled from so-called “Ground Zero” in the heart of New York City’s financial district to the rest of the continental United States. These shocks have also migrated northward and across the border to Canada, eastward and across the Atlantic Ocean to Europe, and have now made it to the farthest reaches of the Asia-Pacific region. Although each ripple has dissipated as it extends further across the globe from its origin, it will be the policy response to security concerns of each nation, and their international institutions, that will ultimately determine the perennial economic impacts of international terrorism in the years to come. Moreover, the economic consequences of these policy responses will likely be shared more equally across the world than the economic impacts directly associated with the carnage of September 11 that disproportionately fell upon the United States. This fact will be particularly true of Canada, which, with the U.S., partakes in the largest and most commercially successful cross-border trade in the world. Indeed, Canada-U.S. border issues need immediate attention and satisfactory resolution.

This report is intended to assist the federal government in devising a coherent long-term plan for arresting the adverse economic shocks set in motion by these desperate acts of violence and for responding effectively to the new security threat. More specifically, the Committee offers counsel to governments, regulators and their agencies on how to effectively respond to the post-September 11 security-conscious environment in a way that minimizes any further adverse impacts on the Canadian economy, in general, and on Canadian industry, in particular.

*Canada’s number one trading partner in the United States is Michigan. Forty-three percent of all U.S.-Canada trade passes through the Michigan-Ontario corridor. We also have the busiest border crossings for both commercial and passenger vehicles. But the problems at our border extend well beyond the border communities, reaching into the heartland of our two nations. Thirty-eight U.S. states, in addition to Puerto Rico, have Canada as their primary trading partner, and half of U.S. exports to Canada are produced in 14 states. [Daniel J. Cherrin, Detroit Regional Chamber of Commerce, 47:12:15]*

*Since September 11, which was a tragic day for humanity, the U.S. has been almost totally focused on security, while in Canada our preoccupation has been very much on trade as well. Theirs, because security is threatened; we, because of our dependence on them in trade, our trade is threatened. [Bill Rowat, Railway Association of Canada, 47:9:25]*

In Chapter 1, the Committee examines estimates of the direct and indirect economic impacts on Canada of the September 11 terrorist attacks, as presented to the Committee by selected experts and to the public through the media by economists and economic forecasting institutions. These estimates or impact assessments are preliminary at best, but nevertheless it is clear from the data that the destruction of the twin towers of the World Trade Center was significant in terms of New York City's capital stock, both physical and human, but was a very small percentage of the capital stock of the U.S. as a whole. At the country level, the greatest economic impact was felt, not on the supply-side of the economy, but on the demand-side, as consumer and investor confidence, both in the U.S. and Canada, plummeted, thereby exacerbating an already faltering North American economy. The economic downturn that began before September 11 thus became more pronounced and will be more protracted than had been originally forecast.

In Chapter 2, the Committee lays out the current predicament of the Canada-U.S. border. With the relative shift in traffic of commercial cargo, and business and leisure travellers from the east-west axis to the north-south axis of the continent in the wake of the Canada-U.S. Free Trade Agreement (FTA), insufficient capital investment in border infrastructure and customs processing equipment has been identified as the primary source of traffic delays at Canada's more important border crossings. This situation predates the September 11 terrorist attacks. Although such delays were grudgingly tolerated before September 11, they have since soared to intolerable levels at a number of border crossings with the new more intensive inspections undertaken by Canadian and American officials. Despite much lower leisure traveller traffic levels and the presence of the U.S. National Guard at the border, the adoption of more security-conscious customs and immigration procedures are producing bottlenecks in commercial traffic. "Just-in-time" manufacturing and delivery systems are being devastated, and the compensating — but very costly — inventory build-ups are eating away at the razor-thin profit margins of integrated North American companies, such as those of the automobile sector. The Committee recommends a new approach and several targeted strategies for providing national security, which will relieve pressure at the border. Congestion will also be reduced with robust investment initiatives in state-of-the-art customs processing equipment, highway access to the border, and border infrastructure. This chapter also addresses the impact of the events of September 11 on the safety and security of Canada's food supply.

Chapter 3 addresses the immediate response of the Government of Canada and its agencies to the events of September 11. These reactions include the stepped-up anti-terrorist intelligence-gathering efforts of the Canada Security Intelligence Service (CSIS); the introduction of Bill C-36, An Act to amend the *Criminal Code*, the *Official Secrets Act*, the *Canada Evidence Act*, the *Proceeds of Crime (Money Laundering) Act* and other Acts, and to enact measures respecting the registration of charities in order to combat terrorism; procedural changes at the border instituted by the Canada Customs and Revenue Agency (CCRA); a government offer of a \$160 million compensation package to the Canadian airline industry; the Bank of Canada's interest rate reduction on overnight chartered bank deposits at the central bank, given the pivotal role it plays in influencing short-term interest rates on chartered bank loans to Canadians and Canadian businesses



and thereby stimulating aggregate demand; and, finally, the Minister of Finance's decision to table the federal budget in December 2001 rather than the customary February period to immediately shore up and restore consumer and investor confidence in Canada.

In the aftermath of the September 11 terrorist attacks and what appears to be a weak North American economy, new budget priorities are the order of the day. In Chapter 4, the Committee provides the government with advice on what should be its priority spending and taxation initiatives, favouring increased national security spending and the adoption of a new "innovation agenda" while remaining committed to the five-year planned tax cuts set out in the budget of 2000. The Committee's approach, which embodies conservative economic assumptions and a built-in contingency fund, is compatible with the prevailing fiscal balance and debt management course, as well as economic stabilization through lower interest rates under an easing of monetary policy.

The shift in the federal government's short-term priorities following the events of September 11 may have an impact on spending in other government programs. In Chapter 5, the Committee addresses the potential impact of the events of September 11 on the federal government's ambitious "innovation agenda," a long-term program designed to help Canada become one of the most innovative economies in the world. The Committee has been heavily involved in providing advice to the government on how the transition to an innovation and knowledge-based economy can best be achieved. In this chapter, the Committee encourages the government to preserve the long-term objectives of its innovation agenda, but to closely examine the priorities and timing of delivery of individual components given the new fiscal reality.

Finally, the Committee reassesses the immediate economic responses to the terrorist shock, puts into context Canada's present situation, and concludes by giving direction to the government for arresting the terrorist threat without shackling Canadian industry.



# CHAPTER 1: THE INITIAL ECONOMIC IMPACTS OF THE SEPTEMBER 11 TERRORIST ATTACKS

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Although the economy was slowing down before the attacks, many direct and indirect negative economic impacts occurred as a result of the September terrorist attacks. These impacts include financial losses to airline companies as a result of their aircraft being grounded, losses to the tourism industry and airlines from decreased travel, layoffs and increased costs in the manufacturing sector as a result of border delays, and a reduction in consumer and investor confidence. The economic effects of the September 11 terrorist attacks were felt immediately in some cases and in other cases the effects may not be felt for some time. Tourism and transportation industries were affected within hours following the attacks due to grounding of aircraft in North America. The manufacturing sector was soon affected as delays at key border crossings increased to up to 18 hours. The resource sector, including mining and forestry, will be affected later as orders for raw materials drop off in response to the economic slowdown and difficulties in trading across the now less-porous, and possibly more trade-protectionist, border. The retail sector has also observed a reduction in traffic flows but, more importantly, a change in consumer behaviour, such as greater price-consciousness among shoppers. Just how much of this change can be attributed to the fear instilled as a result of the terrorist attacks, rather than the preceding slowdown in the economy, is unsure. What is sure is that together these forces are threatening to send the North American economy into recession.

*September 11 obviously had a compounding effect on consumer confidence and built on existing concerns about a weak economy.*  
[Robert J. Armstrong, Association of International Automobile Manufacturers of Canada, 44:10:20]

*The U.S. and Canadian economy, which was already in a fragile state prior to September 11, will retrench further in the near-term. Disruption of activity in a number of sectors will directly undermine GDP in the third quarter, moreover, the accelerating pace of layoff announcements and volatile equity markets will most likely undermine consumer confidence and constrain spending... More pronounced weakness in the U.S. economy will dampen demand for some Canadian exports, which account ... for 37% of our GDP.*  
[Michael N. Murphy, Canadian Chamber of Commerce, 45:15:21]

## **Gross Domestic Product**

The already lowered expectations of growth in the country's gross domestic product (GDP) because of the economic downturn that began prior to September 11 have further diminished since the attacks. Table 1.1 shows the projected growth in GDP

for the second quarter of 2001 through the fourth quarter of 2002. Current estimates are given as well as estimates made before the attacks. In almost every quarter, the current estimates are lower than those made before September 11. According to these figures, current GDP growth estimates will not surpass those of prior estimates until the second half of 2002.

**Table 1.1**  
**Forecast Real GDP Growth for 2001 and 2002**  
**Before and After September 11 — Percent Annualized**

Real GDP Growth	2001			2002			
	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<b>Current Outlook</b>	0.2	-0.2	1.4	2.3	2.7	4.0	4.6
<b>Pre-terrorist Attack</b>	0.2	0.8	1.9	2.5	2.8	4.0	4.4
<b>Difference</b>	0.0	-1.0	-0.5	-0.2	-0.1	0.0	0.2

**Source:** Economy.com

If there is a silver lining in current economic forecasts, it comes from the non-tourism, small business sector, which retains relatively optimistic expectations for the future.

*I think we often see those scary headlines about big business and layoffs, ... and that's serious, and can't be taken lightly. But what we would like to recommend ... is that we do keep it in perspective, because roughly half the economy is not in the see-saw stock market's daily events, and is holding pretty steady in terms of their expectations overall. [Catherine Swift, Canadian Federation of Independent Business, 45:15:45]*

The Committee can only hope that this sentiment will soon diffuse throughout industry and the economy get back on track.

## **Stock Markets**

The economic impacts were also felt in the stock and financial markets but, for reasons of brevity, the Committee draws only from Canada's largest and dominant market, the Toronto Stock Exchange (TSE). The TSE index took a downturn immediately upon the resumption of trading on September 17. On September 10, the TSE index stood at 7344.7 and on September 17 it closed at 6908.0, a drop of 436.7 points or 6%. Since that time the index fell further but as of closing time on November 15 it had rebounded to 7292.9. The October employment report for Canada, and particularly that of the United States affected

Canadian stock values. In fact, the U.S. employment figures for October were worse than expected and probably outweighed the better-than-expected Canadian figures, and thus exerted downward pressure on the TSE index.

## **Employment**

The most recent Statistics Canada labour force survey showed unemployment levels virtually unchanged in October, but down 13,000 from May 2001 when labour market conditions began to weaken. Although overall employment over the month has changed little, an increase in part-time work (+28,000) was offset by a similar decline in full-time employment (-26,000). The unemployment rate thus edged up 0.1 percentage points to 7.3%.

Economists polled by Reuters expected the report, on average, to show the economy shed 26,400 workers in October, with the unemployment rate rising to 7.4% from 7.2% in September. Forecasts ranged from 10,000 to 50,000 jobs lost in October. These figures were better than expected, however, the Canadian dollar continued its long-term slide vis-à-vis the U.S. dollar. Currency traders' rush to the "safe haven" U.S. dollar has resulted in a series of record lows since September 11, with the dollar closing at 62.77¢ U.S. on November 15.

The U.S. unemployment rate in October, on the other hand, was much higher than expected. The unemployment rate jumped half a percentage point to 5.4% from 4.9% in September, representing a loss of 415,000 jobs. This is the highest rate since December 1996. Twenty-five to thirty percent of those losses can be attributed to the massive layoffs in the airline industry.

## **Consumer and Investor Confidence**

The Consumer Confidence Index in the U.S. dropped sharply following the events of September 11 and at one point stood at 85.5, down from 114 in August. This is the lowest level since February 1994.

*The economic outlook is becoming increasingly pessimistic, with consumer sentiment continuing to fall. Widespread layoffs and rising unemployment do not signal a rebound in confidence anytime soon. With the holiday season quickly approaching, there are little positive stimuli on the horizon. [Lynn Franco, Director of The Conference Board of Canada's Consumer Research Centre]*

The Consumer Confidence Index is an important economic indicator because it measures the strength of the demand side of the economy. Paul Krugman, Princeton University economist and *New York Times* columnist, draws comparisons between the "Great Depression" and the effect of September's terrorist attacks on the U.S. economy:

*In the long upward march of American prosperity, there have been occasional setbacks. In the worst of these, from 1929 to 1932, GDP fell by a third. Yet America was no less productive, no less technologically advanced in 1932 than it had been three years before. What happened was that people stopped spending, and the factories that could have been producing found no buyers for their products. It was, in short, a failure of demand rather than supply.*

*If you ask how much the United States economy is capable of producing over the next few months, the answer is mainly determined by the physical realities — the capacity of the factories, the bandwidth of the fiber-optic cables, the size of the work force. If you ask how much consumers will consume and investors invest over the next few months, the answer is determined largely by feelings — what John Maynard Keynes called “animal spirits.” If frightened people decide not to spend, their nervousness can translate into a depressed economy.*  
[Paul Krugman, “The Fear Economy,” *New York Times*, September 30, 2001]

Although the United States has experienced a greater decline in travel and consumer confidence than has Canada or Europe, the same argument applies to the Canadian economy.

*What coming to grips with the tragic events of September 11 and the impact on the economy has done, for us is more what had been a slowdown into a rather accelerated slowdown of the economy and in demand for our products.*  
[Gordon Peeling, Mining Association of Canada, 45:17:00]

Moreover, due to the large role U.S. demand plays in the Canadian economy, Canadians should be concerned with this large decline in consumer confidence in the U.S.:

*Today 62% of the entire volume of manufacturing production in Canada is exported into the United States. So the U.S. is market number one, and any response to September 11 and any recovery that we will see over the next few months will depend on the economic conditions of our major marketplace, the United States.*  
[Jayson Myers, Manufacturers and Exporters of Canada, 45:15:35]

These economic blows did hit Canada and they likely outweighed any additional export potential the country enjoyed from a weak Canadian dollar, as investors sought a “safe harbour” in U.S. dollar-denominated securities. However, the latest news on the U.S. consumer confidence front is encouraging. The ABC/Money Consumer Comfort Index, which is based on a scale of -100 to +100, had risen to +1 by October 3. It sat at -4 on September 9, which was its lowest since March 1997. The index is based on ratings of the economy, personal finances and the buying climate. By October 3, 46% of Americans rated the economy positively (it was 43% before the attacks), 43% rated the buying climate positively (up from 40% before the terrorist attacks) and 62% rated their personal finances positively (a slight gain since September 11). These changes are slight, but they are significant. Indeed, this survey suggests that by early October consumer confidence in the U.S. had not lost ground to that which prevailed on September 11.

## Airlines and Aerospace

The September 11 terrorist attacks had several immediate impacts on the Canadian economy. Air carriers experienced the first impacts with the grounding of aircraft immediately following the attacks. According to the airline, the two-day shutdown cost Air Canada \$100 million and forward bookings are off more than 30%. Analysts are expecting Air Canada to post a loss of \$100 million in the third quarter and \$250 million in the fourth, according to Thomson Financial/First Call. John Lecky, the Chairman of Canada 3000 Inc., had predicted Canada's second-largest carrier could run out of cash by Christmas unless it receives loan guarantees from the federal government. The federal government had offered \$75 million in loan guarantees to Canada 3000 under the condition of it being able to prove solvency so that Canadian taxpayers are not left exposed. The offer was put on hold until an acceptable and workable business plan emerges. However, the airline has since filed for bankruptcy.

One industry official described to the Committee the situation for the airline industry this way:

*Today we released traffic figures for the month of September and they tell a frankly grim story. All the major airports, Montreal, Toronto, Calgary, Vancouver, experienced traffic declines of greater than 30% in September. Toronto had a whopping 37% drop in traffic in September. The traffic levels have stayed 15% to 25% below the North American average for this same time in previous years. We've seen some comeback in domestic, but international and trans-border traffic is frankly still extremely low by normal standards. In Canada, we've already laid off over 11,000 people in the industry and unfortunately I must report to you that more is coming. [Cliff Mackay, Air Transport Association of Canada, 47:9:15]*

The Committee was told of the similarities and differences between today's situation and the situation of ten years ago during the Gulf War. At that time, traffic had dropped precipitously to almost 30% of what was considered normal within a couple of weeks and it stayed that way for about two or three months before it climbed its way back up again. This time, however, "we have seen the same sort of precipitous drop, in some markets even greater, but we're not seeing any recovery. And we don't know how long this is going to last" [Cliff Mackay, Air Transport Association of Canada, 47:9:20].

The downstream industry effects are equally discouraging:

*Travel agencies, during the month of September, were affected 40% to 60% in their business volumes. We're projecting in the last quarter of 2001, business levels, optimistically, of being down 20% to 30%. In the week that followed September 11, at a time when commercial air travel was suspended in North America, travel agencies ... lost approximately \$20 million in revenue, nearly \$16 million in lost commissions, \$3 million in lost service fees and about \$1 million in overtime for increased labour costs. [Randall Williams, Association of Canadian Travel Agencies, 47:15:50]*

The slowdown in the air transport sector has already been felt in the upstream market by companies such as Bombardier. The transportation giant has laid off 3,800 workers, 2,685 of them in Canada. Boeing has announced layoffs in Winnipeg and Arnprior, Ontario, which will see 723 workers (or about one-third of the current labour force) lose their jobs by the end of 2002.

## **Tourism**

Tourism, like the airlines, has been ravaged by the so-called “fear economy.” There is a direct correlation between the slowdown in airline bookings and bookings in Canadian hotels. One industry expert outlined to the Committee the financial impact on his industry of the September tragedy:

*September 11 to September 26, our industry lost \$249 million across Canada. Through to January 31, 2002, we estimate that we're going to lose another \$542 million, or a total of \$791 million by the end of January. Yes these losses are staggering. Some areas have been harder hit than others. Urban convention hotels, airport hotels, destination resorts have borne the brunt of it. [Anthony Pollard, Hotel Association of Canada, 46:15:30]*

The losses, however, extend beyond hotel businesses and include restaurants, bars, convention centres and tourist operations.

## **Manufacturing**

The border delays caused by increased security also exacted a large cost on businesses reliant on trade with the United States. In the wake of the attacks, the delays at major border crossings were as much as 18 hours. In the era of “just-in-time” inventory management, almost any unexpected delay can impose costs on shippers. For example, the Ford Motor Company engine plant in Windsor, Ontario, supplies engines for a plant in Michigan. Four hours after an engine leaves the assembly line in Windsor, it is in a vehicle in Michigan. With the long delays at the Ambassador Bridge border crossing between Windsor and Detroit, both the engine plant in Windsor and vehicle plant in Michigan had to be shut down.

The financial impact of the delays were quantified as follows:

*In the days following September 11, production at automotive plants was disrupted as parts shipments were delayed at the Canada-U.S. border. This disruption was felt on both sides of the border. Parts manufactured in Canada were unable to reach the U.S., and conversely, parts manufactured in the U.S. were unable to reach plants in Canada. The unplanned production loss resulting from parts shortages cost manufacturing facilities approximately \$1 million to \$1.5 million per hour, or about \$25,000 per minute. [Mark Nantais, Canadian Vehicle Manufacturers Association, 44:10:05]*



The importance of the Windsor-Detroit corridor to the manufacturing sector, particularly the automotive sector, cannot be overstated. Thirty-four percent of Canada's trade with the United States crosses the Ambassador Bridge. It is estimated that \$300 million in auto-related goods cross one of the region's three border crossings each day. This figure represents nearly a third of those crossings' daily volume. As a result, border delays can have an adverse effect on the manufacturing sector:

*Continued delays at the border are causing ripple effects industry wide. For example, a delivery of parts delayed by as little as 20 minutes, can cause assembly line shutdowns, pulling trucks off the highways, and incurring increased transportation cost to reroute trucks and/or shipped cargo — by rail, barge, or air. The result has been lost production and millions of dollars in losses in businesses across our two nations.* [Daniel J. Cherrin, Detroit Regional Chamber of Commerce, 47:12:15]

These and other September 11 problems have exacerbated the pre-existing cyclical downturn such that forecast production activities and employment levels in manufacturing for the remainder of this year are not encouraging.

*[M]y crystal ball gazing for the manufacturing sector for 2001 ... [suggests] we'll probably see production fall this year by 7%, and see 85,000 jobs lost in the sector. This is certainly not a trivial amount in terms of lost production and lost jobs.* [Jayson Myers, Manufacturers and Exporters of Canada, 45:15:40]

Clearly, these effects will continue in the mid-term if there is a lingering threat to human security.

## **Retailing**

The retail trade is very susceptible to declines in consumer confidence. Simply put, reduced consumer confidence means reduced spending and fewer retail sales. The evidence so far points to a general downturn in retail sales following September 11, despite non-discretionary item sales having returned to the norm quite quickly. So discretionary spending continues to be depressed and the retail sector is unsure when it will return to normal.

Spending behaviour for discretionary items is more complex than that for non-discretionary items. The retail sector is finding that music sales are down but home electronics sales are doing well. People are also shopping less often but spending more with each trip. Always known as a thrifty people, Canadians are now more focused on purchasing sale items. Retailers often count on customers who frequent their store to purchase a sale item to also purchase other non-sale items. This has been true in the past. Nevertheless, perhaps as a sign of cautious attitudes towards the future economic climate, people are increasingly buying only the sale item for which they came and are then leaving the store.

The outlook for the retail sector is not good in the short and medium term:

*Our members do believe the recovery will be slow. They feel that the first half of 2002 will be flat with only a relatively slow recovery in the second half. As confidence returns, then we will see the economy pick up. They do believe that in 2003 we'll see strong growth. [Peter Woolford, Retail Council of Canada, 49:16:50]*

The longer term outlook is unsure.

# CHAPTER 2: NATIONAL SECURITY AND ECONOMIC SECURITY AT THE BORDER

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## Border Realities

Since September 11, an enormous amount of attention has been paid to the security and trade-facilitating aspects of the Canada-U.S. border. Increased security has led to long crossing delays at many points along the 8,895 km border. Waiting time at major crossings reached 18 hours following the events of September 11. Delays are shorter now but there is potential for further lengthy delays in the future if the procedures for security checks and customs clearance, coupled with the physical capability of some border crossings, remain unchanged.

Human security is the priority of both the American and Canadian governments: “First and foremost, the need of governments everywhere is to ensure the security of our citizens, to ensure the security of our borders as well” [The Honourable Brian Tobin, Minister of Industry, 44:8:35]. However, this public obligation comes with a cautionary addendum: “that security must not come at a cost of losing sight of the important agenda items before governments all around the world or detracting from the basic nature of our society or from our individual freedoms” [The Honourable Brian Tobin, Minister of Industry, 44:8:35].

One of the most important agenda items regarding the border is Canada-U.S. trade. Eighty-seven percent of Canadian exports go to the United States. Bilateral trade with the U.S. amounts to \$563 billion per year. The volume of traffic crossing the Canada-U.S. border is very large; more than 200 million people and 14 million commercial vehicles cross the border each year. More than 12 million vehicles crossed the Ambassador Bridge between Windsor and Detroit, the busiest Canada-U.S. border point, in the year ending December 2000.

*[T]he border between Canada and the U.S. was virtually paralyzed in the days immediately following the terrorist attacks. Then the delays were measured not in minutes, but in hours and often in terms of days. This unprecedented situation created serious problems for industries that rely on just-in-time shipments to keep their assembly lines running, as well as for truckers hauling perishable commodities and livestock. [David Bradley, Canadian Trucking Alliance, 47:9:45]*

*If countries in Europe can figure out how to employ common standards without fear of eroding identity then presumably we can do better in North America. ... Both Canada and the United States must have the confidence in the other [with respect to] safety and security at borders and airports. [Anthony Pollard, Hotel Association of Canada, 46:15:35]*

As previously mentioned, delays are not nearly so onerous now as they were in the few days following the attacks. Several factors explain this improved performance: increased human resources on both sides of the border resulting from the transfer of staff from other locations, increased overtime, and the employment of contract security staff; additionally, traffic volumes are significantly lower than pre-September 11 levels. Commercial traffic is said to have returned to 92% of pre-September 11 levels, but passenger traffic is only at 60-65% of pre-attack levels. With normal traffic volumes, and without U.S. National Guard personnel inspecting vehicles at major crossings, lengthy delays could return. This Committee finds such a possibility disconcerting.

The Committee will offer extensive comments and suggestions below on how these looming problems should be resolved. We will propose a comprehensive plan for providing both human security and economic security to Canadians; balancing these competing objectives will be the order of the day. Furthermore, in the aftermath of the September 11 terrorist attacks, it was discovered that terrorists contemplated the use of crop dusters as a means of delivering their terror. Additionally, concerns were expressed about the vulnerability of Canada's food supply to tampering by terrorists. The Committee, therefore, also addresses issues related to the safety and security of Canada's food supply.

### **Border Delays: Cause and Effect**

At best, border delays are an inconvenience; at worst, they destroy a business. The Committee heard testimony from many industry groups, and they were all very concerned about unexpected delays at the border. Delays lead to increased costs as companies are forced from a "just-in-time" inventory management system to a "just-in-case" system (i.e., additional inventories are carried to deal with unexpected delays at the Canada-U.S. border). "Just-in-time" inventory management requires precise control over the timing of production processes and the movement of intermediate products between plants. The Committee was provided the following anecdote:

*Four hours after an engine leaves Windsor, it's in a Michigan truck. So the border is so important for us because we again ship about a million engines from Windsor into the United States to eight of our fifteen assembly plants. So the four-hour window is a point that we use and when we did have a border issue on September 11, facilities were closed on both side of the border as a result of not being able to get those engines to the marketplace. [Michael Sheridan, Ford Motors of Canada Ltd., 44:11:15]*

The "just-in-case" inventory system, on the other hand, might involve investments in additional warehouses on the opposite side of the border from the parts manufacturer. For example, U.S. auto parts manufacturers that supply U.S. auto assembly manufacturers derive a competitive advantage over Canadian auto parts manufacturers based solely on the inefficiencies in the operations of the border. Adding a warehouse on the U.S. side of the border can attenuate this Canadian competitive disadvantage, but this solution is not without cost.

*If there's a border delay, all of a sudden we need some inventory, and the customer says to us, you had better keep some inventory on hand just in case; you had better open up a warehouse on this side of the border just in case. We now have all these expenses. But our competitors on the other side of the border don't have that expense, so slowly but surely we become less and less competitive. Or they say, maybe the border is going to close, so there's a reliability issue. So slowly but surely again the export part of our production withers, and with that, 66,000 jobs in Canada are at stake. [Gerald Fedchun, Automotive Parts Manufacturers Association 44:10:30]*

The automotive sector claims that these border delays have led to unplanned production losses resulting from parts shortages that have cost manufacturing facilities approximately \$1 million to \$1.5 million per hour or about \$25,000 per minute. These facts clearly force managers to reconsider their business plans:

*In response to concern over border delays, some manufacturers have taken the precaution of increasing inventory levels at their plants by up to 5% due to the cross-border uncertainties, which carry with them significant additional costs. These costs are now deemed a hard operating cost that Canadian plants did not previously incur, and will become one of several factors to be considered in future investment decisions. [Mark Nantais, Canadian Vehicle Manufacturers Association, 44:10:05]*

The tourism industry is also hit hard by delays. In this case, it is believed that the uncertainty surrounding the potential for delays at the border has led many people to simply stay home. In fact, passenger traffic is down more than 40% from pre-attack levels and the reason is simple: "If you don't know what the situation is, you're less tempted to try to cross the border. For business it's obviously vital, but even for people who are crossing the border to shop or dine or visit attractions, they're not going to take the chance..." [Robert Keyes, Canadian Chamber of Commerce, 45:15:30].

Following the hijackings in September, many people fear the prospect of flying. Lingering psychological impacts of the attacks have reduced the number of people choosing air travel as a mode of transportation. Clearly, the government and industry stakeholders must work together to restore confidence in the traveling public. To this end, the Government of Canada has already dedicated more security resources to airports and is investing an additional \$20 million to promote travel within, and to, Canada.

The causes of border delays are numerous. Some delays stem from the security focus in the aftermath of September 11; others are of a long-term nature, stemming from inadequate investment in access infrastructure, antiquated customs and immigration equipment and procedures, and insufficient personnel. The Committee will deal with each in turn.

Given that the United States was a recent victim of terrorism, logic dictates that it tighten security at its borders. Canadians would react in the same way "if the proverbial shoe was on the other foot." But increased inspection without a corresponding increase in

border personnel, equipment and infrastructure is a recipe for disaster. New methods must be found to increase human security, while maintaining or improving the trade-facilitating capability of the border. Although this task is difficult enough, it is compounded by many American misconceptions about Canadian customs and immigration policies and procedures. These misconceptions must be corrected in order that they are not used by U.S. interests to lure business and investment away from Canada. An anecdote provided to the Committee illustrates one of these misconceptions:

*Customs should be a 24-hour operation across the border. We all remember seeing the senator standing up in committee with his orange cone, basically stating to everybody, this is our protection after 10:00 p.m. Obviously that is engraved in the minds of a lot of viewers and the only way we can reduce that or address that would be to have 24-hour border operations across the entire border. [Serge Charette, Customs Excise Union, 49:17:10]*

In 1996, the U.S. Congress passed the Illegal Immigration Reform and Immigration Responsibility Act. Section 110 of this Act called for the creation of an automated entry and exit system on the U.S. borders with Canada and Mexico. This section of the Act was repealed in 2000:

*If section 110 [had not been] repealed in the United States, you would have seen backups at the border for over 100 miles on the Canadian side. It's because section 110 was repealed that our border does run more efficiently and that's the message we're sending to Washington. Immediately after the September 11 attacks the press contacted us about section 110 because ... our office played such an important role in its repeal and they were blaming that [decision for] ... allowing the terrorists to come through our border, but that simply wasn't the case. [The repeal of 110] makes the border more secure, as well as more efficient. [Daniel J. Cherrin, Detroit Regional Chamber of Commerce, 47:12:45]*

In fact, problems do originate on the American side of the border:

*You also have a disconnect between the Congress and the federal agencies where they're not communicating with each other. Each agency is not communicating with each other as well. It's like a territory. Everybody wants to maintain [its] territory. They don't want to be seen as being weak or understaffed or under-resourced. As a result, information is not shared and it's that lack of communication that is causing the problem. Once all the dots are connected, then we could begin acting on the solutions. [Daniel J. Cherrin, Detroit Regional Chamber of Commerce, 47:12:50]*

The Committee expects that the new Director of the Office of Homeland Security in the U.S. will address these concerns.

At the same time, the problem of delays is not new. Prior to September 11, concerns had been expressed that something needed to be done to facilitate crossing the border given the large increase in traffic over the past ten years.

*When one considers that the total level of two-way trade between Canada and United States has increased dramatically over the last ten years and that much of*

*the infrastructure and systems put in place were built for another time, another era, business all across this country, indeed workers all across this country, are looking for a clear signal that the border problem will be addressed in a substantial way and that the fix will not address just the problems that arise in terms of extra security after September 11, but will address the more fundamental issues of an efficient, free flowing Canadian-U.S. border. [The Honourable Brian Tobin, Minister of Industry, 44:8:40]*

The manufacturing sector, in general, and the automotive sub-sector, in particular, insists that long-term solutions must be found and acted upon immediately.

*Aiming to achieve a pre-September 11 level of fluidity is simply not enough. All Canadian points of entry, including those of the U.S. border, ... were already at capacity on September 10. More staff and infrastructure changes at these key border points were already needed, and now we [face] ... the challenge and necessity of increasing the efficiency of low-risk goods passage while heightening security to ensure the safety of Canadians and Americans. [Robert J. Armstrong, Association of International Automobile Manufacturers of Canada, 44:10:25]*

These September 11-related costs along with those imposed on industry for more than a decade now — since the implementation of the FTA — are unacceptable. Long-term solutions to mutual Canada-U.S. issues must be found. A bilateral forum for discussing and finding resolutions to these plaguing problems would be a first step in this direction. The Committee is pleased to hear that the government has already initiated discussions between top-ranking Canadian and American officials on these important issues, thereby conveying the sense of urgency and priority these issues justly deserve. However, the Committee believes that these meetings must be supplemented by formal negotiations and, therefore, recommends:

- 1. That the Government of Canada establish a high-level bilateral ministerial summit between Canada and the United States on border issues, spanning security, trade facilitation and immigration concerns, with the objective of developing a comprehensive and coordinated long-term management plan for Canada-U.S. border crossings.**

Witnesses had many suggestions on what can be done to increase security and reduce delays at border crossings. These suggestions fell into three categories: Canada-U.S. cooperation; border crossing infrastructure and access; and customs and security resources and procedures. We believe that if progress is made in each of these three areas, security will be enhanced sufficiently and trade facilitated such that the pre-September 11 situation will be improved.

### **Canada-U.S. Cooperation**

The major difficulty in dealing with these border issues will be striking a balance between national security and trade or, as the Committee calls it, economic security.

Canada must be alert to challenges to its sovereignty that may arise from new border measures enacted by the United States. Thus, the Government of Canada must ensure any joint plan with the United States to manage border crossings provides balance to both human security and economic security issues.

Many of the border problems existed before September 11. The physical infrastructure of border crossings, as well as the infrastructure supporting customs and security checks, is — and has been for some time — unable to deal effectively with the large increase in border traffic that has occurred over the past decade. The Committee believes that procedures for customs and security checks can and should be changed to improve both security and trade-efficiency of the border. Increased efficiency of existing crossing facilities can be achieved in a number of ways, for example: the adoption of better methods of separating high- and low-risk travellers and cargo; the establishment of pre-clearance for low-risk goods and travellers; the provision of better access and security to existing off-site inspection areas and border crossings; the improvement, where necessary, of roadway connections; and the implementation of new technologies, including biometrics. The objective is to create a secure, but “smarter,” trade-efficient border.

*The bottom line is that both our countries need to work collectively to enhance border security and efficiency by exploiting more intelligent methods to process border examinations and to rethink the traditional models for border management. We both have much at stake in ensuring that our common border remains secure, while allowing for trade to flow freely and run smoothly. We need to make sure that both our countries have sufficient resources to make this happen and that we use those resources wisely. [Daniel J. Cherrin, Detroit Regional Chamber of Commerce, 47:12:20]*

Canadian and American officials are, as we write this report, already engaged in talks concerning mutual security concerns. The Committee approves of these discussions and endorses the principle of cooperation on our common border interests and, therefore, recommends:

- 2. That the Government of Canada include, in its upcoming budget statement, plans with the United States regarding security, for example, the coordination of immigration and customs policies, procedures and information sharing, as well as the expected costs of such initiatives.**

## **Border Crossing Infrastructure and Access**

Many witnesses suggested that the physical crossing infrastructure at the border must be improved. The current infrastructure was built many years ago when the volume of trade and passenger traffic was not nearly as high as it is today. Many witnesses appearing before the Committee identified acute congestion areas as a problem. By way of example, consider the efficiency of Canada’s busiest link to the United States:



*The Detroit-Windsor tunnel is a two-lane facility capable of facilitating over 5,000 vehicles per hour. Due to local infrastructure and resource constraints we have never even come close to 2,000 vehicles per hour. The Ambassador Bridge is a four-lane facility capable of far more ... and they are severely hampered by infrastructure and resources. They in fact are Canada's largest economic link. This story ... is common at all of our busy border crossings. [Gordon Jarvis, Detroit Windsor Tunnel Corporation, 47:12:25]*

The Committee will go into great detail on the matter of pre-clearance facilities or off-site inspection areas and customs procedures below, but, from an infrastructure perspective, access to existing border crossings, be it a tunnel or bridge, is a point of contention.

*[A] lot of the clearance required at the border could be facilitated on properties away from the actual crossing. The traffic would then be facilitated through special lanes or roadways to the bridge which would then allow us to fully utilize the lanes that are crossing between Canada and the U.S. [Gordon Jarvis, Detroit Windsor Tunnel Corporation, 47:12:30]*

Moreover, one overlooked issue by the media and the public is that of the potential for a terrorist attack on a key crossing point between Canada and the United States and its likely impact.

*I ask you to imagine what would happen if we were to lose one of these important links. ... Losing one of these facilities as a result of a terrorist act would be a terrible crime. Having that act cripple our economy when the resources to recover are in plain sight but not available would be an unnecessary catastrophe. [Gordon Jarvis, Detroit Windsor Tunnel Corporation, 47:12:25]*

Thus, the security of these critical border crossings is an equally important matter for concern. The Committee agrees with these assessments and recommends:

- 3. That the Government of Canada develop and fund an infrastructure program to improve the highways linking Canada's existing border crossings as well as modern off-site inspection areas and access roads, and that these facilities and crossing points be equipped with enhanced security technologies.**

### **Customs and Security Resources and Procedures**

The Committee also received suggestions regarding the infrastructure used to conduct customs and security checks on commercial and passenger traffic. Some suggestions involve the use of high technology equipment for identification purposes and for screening commercial loads as well as ideas for restructuring the border crossing and checking facilities in order to increase the efficiency of the clearance process.

*We need electronic processing of customs and immigration forms prior to getting to the border. ... When the truck leaves the Canadian supplier plant, there's an electronic transmission of all customs information to the border point. When the truck arrives, it's already pre-cleared in terms of customs, and it quickly crosses the border with appropriate security clearance. Again, the technology is there. We just need to use it. To make this happen, we need some infrastructure. We need some marshalling yards at the border crossing points that are secure so that things can be inspected there and then go across quickly. [Gerald Fedchun, Automotive Parts Manufacturers Association, 44:10:30]*

If the technologies are already available, then all that remains is to determine how quickly these technologies can be acquired, put on-line and made operational:

*I would guess that, if the technologies and the software required to do all of this are available, then you're looking at a six-month implementation, just on getting the hardware and the technology in place and working, and then you're looking at a period of time to actually get the customers using it, so you're probably looking at one-year implementations. [Gordon Jarvis, Detroit Windsor Tunnel Corporation, 47:13:00]*

Other suggested technologies include giant x-ray and gamma-ray machines that are capable of examining the entire contents of a truck without unloading, transponders that can identify and track a specific vehicle, and retinal scanners to identify drivers and other individuals crossing the border.

Currently, Canada Customs and Revenue Agency (CCRA) does not undertake detailed inspections of all travellers and truck operators and their vehicles that cross the border. This intensity of inspection is simply not feasible at any time. Typically, only a very small percentage of goods and individuals is subject to detailed inspections; i.e., undergoes a secondary inspection in the CCRA's two-tier processing system that separates high- and low-risk travellers and shippers.

Greater separation of traffic based on some definition of high-risk and low-risk was also an idea voiced by several witnesses, particularly those from the automobile or auto parts industries which see themselves as low-risk traffic. They support the idea of pre-clearance before crossing the border. The idea is that with proper technology, individual trucks can be identified as they approach the border; based on that identification, they would be allowed to use a designated lane or crossing point in order to speed up their passage. The low-risk designation would be applied because the trucks are sealed, can be identified once they approach the border area, and all the proper documents can be transmitted to the border before the truck arrives. There could be varying degrees of clearance granted. The very low-risk traffic may be able to cross the border without any impediment. Other higher risk traffic may have to undergo some amount of checking at the border, or at an off-site inspection area — what witnesses refer to when they speak of a marshalling area.

*Efforts to increase physical security and facilitate cross-border trade are best serviced by identifying the risk of the cross-border cargo movement or the traveller. We need to assign our collective inspection and enforcement resources to the higher risk cargo shipments and travellers, while ensuring that our low-risk shipments and travellers can cross the border unimpeded. ... Prior certification of transport drivers and frequent travellers, on a coordinated basis, and linked databases would facilitate the efficient flow of goods in low-risk travellers. Dedicated lanes should be available for these pre-certified peoples and goods. Shared databases should form the basis from which automatic electronic clearance of low-risk goods and people can be facilitated and their border crossings expedited. [Mark Nantais, Canadian Vehicle Manufacturers Associations, 44:10:10]*

Other initiatives such as the Customs Self-Assessment program (CSA) can facilitate the passage of low-risk traffic:

*Initiatives such as the customs self-assessment program, which is designed to facilitate the flow of goods for those companies with significant cross-border traffic, are positive. The CSA provides the opportunity under specific conditions, to obtain pre-arrival clearance privileges and self-assessment customs duties payable. The CSA knowledge about the importer, driver and the carrier ensures that we can designate these shipments as low risk. [Mark Nantais, Canadian Vehicle Manufacturers Association, 44:10:10]*

However, some believe that the CSA has run into problems:

*Unfortunately, the CSA has been delayed in its implementation and a number of alterations have been made that would make it unnecessarily complex and a potentially costly process ... [Mark Nantais, Canadian Vehicle Manufacturers Association, 44:10:10]*

The Committee also believes that other pre-approval pilot projects for “just-in-time” commercial services should be ventured. One project would attempt to reduce congestion at the border and speed up low-risk “just-in-time” shipments by having customs documents processed prior to the commercial vehicle’s arrival at the border. The Committee, therefore, recommends:

- 4. That the Government of Canada immediately implement, using the best available technology, a comprehensive paperless pre-approval system for all “just-in-time” commercial shipments.**

Another suggestion was for a “reversal of inspections,” whereby the U.S. customs agency would inspect persons and vehicles on the Canadian side of the border and Canadian customs inspections would be conducted on the U.S. side; this procedure would help reduce congestion at the border, as it has for many of Canada’s international airports. Many witnesses appearing before the Committee proposed such a change. Indeed, it was the number one point in the seven-point plan advanced by the Bridge and Tunnel Operators Association (BTOA), an association of bridge and tunnel operators across Ontario, Michigan and New York.

*On the issue of reversal of customs and immigration, while it is a popular concept for the crossing authorities, from our standpoint I think it is something that is easy for everybody to visualize. If it becomes the pressure in the pipe to make things change so that we do find the right solution to make these borders work properly, then we're all for it. [Gordon Jarvis, Detroit Windsor Tunnel Corporation, 47:12:30]*

The Committee takes note of the U.S. House of Representatives Ways and Means Committee that has just recently passed a bill to amend the U.S. Customs Border Security Act of 2001, containing Section 131 Report Language defining "Reverse Customs" procedures. The bill authorizes and encourages the Administration, and the Customs Service in particular, to explore an agreement with Canadian officials to increase cooperation at border crossings and to station customs officials from each government on the opposite side of the border for the purpose of inspecting and clearing vehicles before they cross the border.

The Committee agrees that there is merit in this proposal. Whatever sovereignty problems could be associated with this change, they have certainly been overcome at Canada's airports. The Committee, therefore, recommends:

- 5. That the Government of Canada, as part of its discussions and negotiations with the United States, include the proposal to conduct Canadian customs inspections in the United States and U.S. inspections in Canada ("reversal of inspections").**

A pre-clearance program, CANPASS, was already in use prior to September 11. The CANPASS program allowed frequent, low-risk, pre-approved travellers to enter Canada through a dedicated lane. The program was suspended on September 11 and has been reassessed in light of the new security-conscious environment; it has been reinstated in certain locations.

Another program, NEXUS, is a joint Canada-U.S. pilot project that was in operation at the Sarnia-Port Huron Blue Water Bridge crossing; this program was also designed for low-risk, pre-approved travellers entering Canada and the United States. NEXUS used common eligibility requirements, common identification card, etc. between the two countries, but it too was suspended September 11, 2001. Canada's Industry Minister was positive that the NEXUS program, along with the next generation of technologies, may be the best way to get a free-flowing efficient border crossing. The Committee recommends:

- 6. That the Government of Canada expedite discussions and negotiations with the United States to reactivate modern customs and immigration procedures, such as NEXUS, CANPASS and other pre-approval programs, which may include biometric technologies and the creation of shared-information systems.**

With respect to the development of these new technologies and systems, some members of the Committee are concerned about privacy issues related to the sharing of

personal information about Canadians with U.S. authorities. These members are concerned about the opinion that the Privacy Commissioner may have on this issue.

More human resources will be needed to implement the proposed increase in security measures. One witness suggested 1,600 new positions at an annual cost of \$80 million would be needed to properly staff all border crossings. To the Committee, this seems to be merely an extrapolation of current staffing without due consideration to substitutions in favour of newer advanced technologies and for a different managerial approach to joint security and customs issues and procedures. However, the Committee recognizes the amazing increase in border traffic over the last decade and, therefore, recommends:

- 7. That the Government of Canada's upcoming budget provide for an increase in customs and immigration personnel.**

### **Security and Safety of Canada's Food Supply**

Immediately following the terrorist attacks of September 11, the biggest impact on the Canadian agriculture sector was felt at Canada-U.S. border crossings. As security at border crossings was tightened, the time necessary for Canadian exports to clear U.S. customs increased. Canadian agriculture exporters faced some special problems relating to the perishable nature of many agri-food products and to concerns about the welfare of live animals in shipments. The medium- to long-term effects on agriculture and the food supply are less obvious:

*[F]armers are concerned in a number of areas, including changes in import and export regulations ... increased demands on producers in terms of food safety and security, and the effects of a declining economic climate on the agriculture sector.*  
[Brigitte Rivard, Canadian Federation of Agriculture, 47:11:45]

Concerns have been expressed about the security and safety of Canada's food supply following the events of September 11.

*[A]griculture is vulnerable ... after September 11th there was a lot of speculation that there could be use of crop dusters [for biological or chemical warfare], or that to get to a number of people quickly, it would be through the food chain ... [but] we have the processes in place to ensure that the food is being produced safely ... and Canada has one of the most stringent regulatory systems in place in the world ... it has, and deserves, the reputation of [having] the safest food supply in the world.*  
[Brigitte Rivard, Canadian Federation of Agriculture, 47:12:05]

At the level of the producer, the Canadian Federation of Agriculture (CFA) and federal, provincial, university and industry partners are collaborating to develop commodity-specific, food safety plans as part of the "On-Farm Food Safety Program." The CFA is also encouraging the federal government to cover the costs associated with the development

and implementation of product identification and tracing initiatives, which are other important tools in ensuring food safety.

The Canadian Food Inspection Agency (CFIA), in partnership with other federal and provincial agencies and other agri-food stakeholders, helps to protect the food supply. It enforces food safety and nutritional quality standards (established by Health Canada in accordance with the *Food and Drugs Act*), and, for animal health and plant protection, sets standards and carries out enforcement and inspection. It has strategies and systems in place to protect the food supply from animal and crop diseases, environmental hazards and contamination of food products at various stages of production.

The CFIA also has established emergency response procedures aimed at protecting food, plants and animals from accidental or intentional events. In addition, the agency has an emergency food recall system. The Office of Food Safety and Recall carries out food safety investigations and provides a coordinated approach to food recall decision making to enhance the Agency's food emergency response capability.

The Agency is currently evaluating its emergency response plans to ensure that they are sufficient and appropriate in the event of a threat to the agricultural sector. Since September 11, the CFIA has taken the following measures:

- Increased inspection activities of food products, plants and animals at Canada's airports, seaports and land borders;
- Intensified linkages with the Canada Customs and Revenue Agency (CCRA), other border authorities, the U.S. Department of Agriculture and the U.S. Food and Drug Administration, provincial and territorial partners, local police and public health authorities;
- Increased investigations of livestock feed mills and animal auctions to enhance protection of the livestock industry;
- Enhanced biosecurity at labs and initiated stockpiling of materials for testing; and
- Initiated enhanced awareness and security for CFIA staff.

Although all of these measures are essential in light of the events of September 11, they do carry extra costs for members of the agricultural sector. Additionally, the agri-food sector has economic problems that are unrelated to the events of September 11 that still need to be addressed:

*While everyone is more aware of the importance of security, issues that were pressing before September 11 have not gone away. The agri-food sector has been facing a number of challenges, including the effects of this year's drought, and the cumulative impact of a number of years of extremely low prices in certain commodities ...*

*In Whitehorse, federal and provincial agricultural ministers signed onto an action plan to lead agriculture out of crisis management and provide long-term stable funding to safety nets, as well as for environmental and food safety issues. It is a plan the CFA endorses ... we cannot lose sight of the issues and concerns facing Canadian industry [Brigitte Rivard, Canadian Federation of Agriculture, 47:11:45-11:50]*

The Committee wants to make sure that Canada continues to have a safe and secure food supply, and as such it recommends:

- 8. That the Government of Canada ensure that the Canadian Food Inspection Agency, and other stakeholders responsible for ensuring the safety and security of the food supply, receive adequate resources to carry out their work. Resources should be directed at all levels of the supply chain from production through inspection and delivery of food. The expenditure associated with these resources should not be subject to cost recovery.**





## CHAPTER 3: THE FEDERAL GOVERNMENT'S IMMEDIATE RESPONSE

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The tragic events of September 11 are unique and unprecedented. The economic forecasting community cannot recall of a comparable event that would serve as a good guide for projecting the severity and the duration of the economic stimulus set in motion on that day. This is precisely why caution must be observed when evaluating the first chapter's economic forecast. For the same reason, the appropriate policy responses by the private sector and governments are equally uncertain in such situations.

The impacts of natural disasters, such as that of South Florida's Hurricane Andrew in 1992, resemble a terrorist attack because they too involve the localized destruction of a country's physical capital stock. The major differences between the two events being that a hurricane, as a natural phenomenon, does not usually entail the loss of consumer and investor confidence and could at least be partially foreseen so that some preparations could be taken. Criminal acts with a political or social dimension, like the assassinations of the Kennedy brothers and Martin Luther King Jr., are man-made disasters that usually precipitate losses in consumer and investor confidence and, as such, are also a close cousin of a terrorist attack. Both these events share the characteristic that their planning and implementation were well concealed from the policing authorities and the public, and their consequences could not adequately be mitigated pre-emptively. The major difference between these two events, of course, is that an assassination does not entail a loss in the nation's productive capacity or physical capital stock.

After-the-fact responses have been the primary means of dealing with crises brought on by terrorism and they can be divided into two types: immediate reactions, some of which are emergency responses with some element of prior planning; and long-term

*I would suggest ... that Canadian enterprises have been affected on three distinct levels, each of which demands different business and public policy responses. First, there are the one-time shock effects of the terrorist attacks ... Second, there are temporary, cyclical effects of the economic downturn ... Third, there are persistent structural issues of Canadian competitiveness; problems that could be glossed over in better times but are now being brought to a head.*

*Travel-related industries were the hardest hit by the shock effects ... Governments moved quickly to offer airlines compensation for direct event-related losses and to provide back-up insurance for airports. ...*

*The impact of lower interest rates is not immediate, but it is pervasive and it is powerful. Monetary policy ... remains the best way of easing the cyclical problems facing Canadian companies and consumers alike. ...*

*Fiscal policy ... is not the best means of combating the temporary effects of the economic cycle, but it will have a profound impact on Canada's ability to deal with the structural challenges facing Canadian companies in a wide range of industries. [Thomas d'Aquino, Business Council on National Issues, 47:10:40]*

planned policy measures that are meant to correct the situation so that there is no recurrence of such events.

This chapter deals with the former, but is limited to the economic responses that have been mostly directed at providing compensation or restoring consumer and investor confidence. The following chapters are left to assess the longer term responses, which will be directed at stopping terrorist activities in the least intrusive way to commerce and trade, as well as to human rights and freedoms.

## Federal Government's Response

The federal government responded immediately to the September 11 terrorist attacks in a number of ways; responses of various kinds continue. In his appearance before the Committee, Canada's Industry Minister mentioned a number of actions or steps that will lead to action, including financial compensation, taken so far by his Cabinet colleagues. Here is a non-exhaustive list:

*The important tax reductions announced [in October 2000] by my colleague, the Honourable Paul Martin, along with other fiscal and adjustment measures announced after September 11, such as infrastructure announcements and the \$160 million assistance package to the airline industry, will play an important role in the medium-term economic recovery. There has also been a 90-day fixed backstop insurance for airlines and airports and of course, a few days ago, a further \$75 million loan guarantee to Canada 3000.<sup>1</sup> ...*

*In addition, since September 11 the Bank of Canada has lowered its key policy interest rates by 125 bases points for a total reduction of 300 basis points since the beginning of the year. This brings interest rates to their lowest level since 1961 — 40 years. These cuts are intended to stimulate the economy by boosting consumer and business confidence. ...*

*Since September 11 the government has announced new anti-terrorism measures totalling \$290 million, which brings our total new investment in policing and security and intelligence to \$1.8 billion since the 2000 budget. ...*

*In addition, the CCRA is to expedite the sharing of information with the United States Customs Service and, of course, the Prime Minister has created the Cabinet ad hoc committee on security. [The Honourable Brian Tobin, Minister of Industry, 44:8:40]*

Other government decisions taken include:

- an additional \$20 million through the Canadian Tourism Commission to kick-start travel of Canadians, and of Americans from bordering states, within Canada; and

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<sup>1</sup> However, Canada 3000 has since filed for bankruptcy.

- the Business Development Bank of Canada has been instructed to provide qualifying customers the option of postponing principal repayment for up to four months, particularly those engaged in tourism, transportation, wholesale and exports.

The government further acknowledges that other industries will be seeking compensation as a result of the closure of Canadian airspace in response to the events of September 11, including Air Canada which has further requested loan guarantees on its outstanding debt that it believes is no longer financially sustainable. So it has become quite clear to the Committee that the immediate responses of the federal government might end up costing the federal treasury almost \$500 million, not including the lost tax revenues resulting from a more depressed economic activity over the next fiscal year than what would have been the case without the terrorist attacks.

### **Airline and Airport Measures and Government Compensation**

When it became clear what was happening on September 11, Canadian airspace was immediately closed to all but military, police and humanitarian flights. In the following days, the Government of Canada gradually permitted the resumption of domestic, trans-border and international flights, but normal service was delayed even as late as Friday, September 14, as airline companies worked to reposition their aircraft, stranded passengers and staff. Full airline service eventually came back on-line, but air traffic plummeted and has remained at below-normal levels ever since. Box 3.1 provides a chronology of decisions made by Canada's Transport Minister for the month of September.

Industry representatives claim that government compensation for the closed airspace is justified on the basis that their costs cannot be avoided as fast or as easily as their aircraft can be grounded:

*[W]e are an industry which is faced with very high fixed costs. Our aircraft is the single biggest fixed cost. Our supplier relationships and our union agreements build in a lot of costs that are extremely difficult to manage in short-term cyclical situations. The general rule of thumb in the industry is: when you try to save costs, what you do is you park airplanes. You take capacity out of the system. ... But for every 20% of capacity you take out of the system, you really only save 10% because you have a huge ongoing cost ... regardless of whether you fly ... or park the airplanes ... [Cliff Mackay, Air Transport Association of Canada, 47:9:15]*

### **Box 3.1**

## **Closure of Canadian Airspace: Sequence of Events**

The following is a chronology of events and major related announcements following the closure of airspace on September 11, 2001, in response to the terrorist attacks in the United States:

### **Tuesday, September 11**

Immediately following the tragic events in the United States, Transport Minister David Collenette declared that no commercial or private aircraft were allowed to depart Canadian airports until further notice. The only exceptions were military, police and humanitarian flights.

The Canadian aviation system immediately began preparations to accept flights previously destined for the United States that could no longer land in that country. At the time of the terrorist incidents, approximately 500 aircraft were en route to North American airports. More than half these aircraft returned to their points of departure; the remaining 226 continued on to various destinations across Canada.

Security measures were also immediately taken at airports across the country, including evacuation of some areas and deployment of police or security at key access points.

### **Wednesday, September 12**

Minister Collenette announced the lifting of restrictions on domestic air travel within Canadian airspace, and also announced that Canadian airports would operate under heightened security measures. Diverted flights were then released for travel to their original destinations (flights to the U.S. still required clearance from the Federal Aviation Administration).

Heightened security measures announced included increased police presence at major airports, increased passenger screening and enhanced security procedures, including more hand searches of baggage.

### **Thursday, September 13**

Minister Collenette announced that restrictions on international, trans-border and private flights had been lifted. Passenger flights to the U.S. not previously released were also allowed to resume, although many airports in the United States remained closed to trans-border traffic.

### **Friday, September 14**

The Minister removed restrictions imposed on cargo flights — the last of the flight restrictions imposed in Canadian airspace on September 11, 2001.

The Minister emphasized that the return to normal flight operations in Canada continued to be a gradual process. This was especially true for trans-border flights into the United States, where certain airports remained closed.

### **Sunday, September 16**

The last of the 226 flights diverted to Canadian airports was cleared to leave for its final destination.

### **Monday, September 17**

Minister Collenette announced that cockpit doors on all Canadian airline passenger flights, domestic and international, must be locked for the full duration of flights. Transport Canada is also working with the U.S. Federal Aviation Administration and other authorities to improve the security aspects of cockpit design, in particular cockpit doors.

## **Saturday, September 22**

Minister Collenette announced that the Government of Canada would provide a 90-day indemnity for third-party war and terrorism liabilities for essential aviation service operators in Canada to help ensure aviation services can be maintained uninterrupted. This action was taken in response to the decision by international insurers to no longer provide the required levels of war risk liability insurance previously in place.

## **Tuesday, September 25**

Minister Collenette announced that Transport Canada is purchasing a quantity of new, advanced explosives detection systems (EDS) for use at priority Canadian airports. These new systems will supplement explosives detection systems already in use at Canadian airports.

Source: [http://www.tc.gc.ca/releases/nat/01\\_h125e.htm](http://www.tc.gc.ca/releases/nat/01_h125e.htm)

Industry spokespersons further argued that government compensation to individual companies must take into account a number of factors such as:

*[T]he operators in Canada are not operating in a homogeneous market. Just to give you some examples, Air Transat is a leisure carrier. It operates strictly in the leisure market and most of its flights are charter, as opposed to scheduled. It's a matter of public record that they are experiencing significant pressure, from a cash point of view.*

*WestJet, on the other hand, a low-cost, no frills domestic carrier, with almost exclusively short-haul flights, is doing reasonably well in very difficult market circumstances. Its balance sheet is strong and it's in a market niche which is not anywhere nearly as challenged as some of the other markets that other carriers are in.*

*First Air is another example of an airline that is weathering the storm well. It is a regional carrier, primarily in the North, and has a good mix of cargo and passenger facilities, with a relatively low cost structure and is doing reasonably well.*

*Air Canada, on the other hand, ... is facing very significant pressure on the demand side. Fifty per cent of [its] business was in trans-border and international and that market is not coming back. They have done major cuts and they are frankly having to be very aggressive to try to reduce their cash requirements. [Cliff Mackay, Air Transport Association of Canada, 47:9:25]*

Transport Canada arrived at \$160 million in compensation after an examination of financial information provided by Canada's largest carriers, supplemented by a sample survey conducted by the Air Transport Association of Canada. This work placed losses for the airline industry attributable to the closure of Canadian airspace at approximately \$150 million. The government's program also incorporates the cost of administering the compensation and allows for the possibility of larger claims once a full accounting of losses is done.

In terms of Air Canada's request for a government loan guarantee, the Committee agrees with the advice that the government should resist bailing out airline companies suffering from structural rather than September 11-created problems.

*There can be some targeted relief, perhaps, but [s]ome people are hiding behind the smoke of September 11. There were problems going into September 11. If there are new demands on airlines perhaps on security measures and things, then yes but if in terms of bailouts, the answer is no. [Catherine Swift, Canadian Federation of Independent Business, 45:16:35]*

However, the Committee is unsure at this time whether the government's compensation offered to Air Canada, amounting to something more than \$100 million, along with Minister of Transport's two recent decisions that directly affect the company's operations, is sufficient. These two decisions include the elimination of the capital restriction on individual share ownership in the company to no more than 10% of its outstanding stock and the freeing of the company from its job termination obligations following its takeover of Canadian Airlines International Inc. Structural and September 11-created problems are not so easily disentangled. Moreover, although the industry was mostly deregulated more than a decade ago (i.e., Canadian ownership restrictions still apply) and the government wants private-sector solutions to these financial problems, a government loan guarantee should not be dismissed out of hand. Indeed, it may be in the public's long-term interest to provide such a short-term solution; it may be all that is required to ensure the viability of a Canadian-owned national airline company. The Committee, therefore, recommends:

**9. That the Government of Canada carefully examine the viability of Canada's air transport industry.**

In light of the losses incurred by travel agencies, as described in the previous chapter, industry representatives requested that the government establish a fund of \$20 million to which individual agencies could apply for compensation, based on their volume of business during the same one-week period last year. This, they insist, would not be a handout or bailout: "This is compensation for our customers being removed from flights and put in places unknown, and then with us having to try to get them home" [Randall Williams, Association of Canadian Travel Agents, 46:15:55].

A decision by the Minister of Transport is still pending.

### **Canada's Anti-terrorist Plan**

The Government of Canada almost immediately after September 11 adopted its new Anti-terrorism Plan, which has four objectives:

- Stop terrorists from getting into Canada and protect Canadians from terrorist acts;

- Bring forward tools to identify, prosecute, convict and punish terrorists;
- Prevent the Canada-U.S. border from being held hostage by terrorists and adversely affecting the Canadian economy; and
- Work with the international community to bring terrorists to justice and address the root causes of such hatred.

This plan was provided legislative support with the introduction of Bill C-36, An Act to amend the *Criminal Code*, the *Official Secrets Act*, the *Canada Evidence Act*, the *Proceeds of Crime (Money Laundering) Act* and other Acts, and to enact measures respecting the registration of charities in order to combat terrorism, to the House of Commons. The Government of Canada then announced new initiatives that would provide:

- \$10 million in new RCMP funding to increase airport security;
- \$45 million in new funding to enhance integrated policing activities, improve technology, increase protection services and enhance information sharing with other government departments, as well as international and domestic law enforcement agencies; and
- \$9 million to be allocated annually for increased staffing in priority areas.

Together, these new funding initiatives will better equip security agencies to identify and track down any terrorists already in Canada and to keep terrorists from entering the country.

## **Monetary Policy**

Chapter 1 describes two important economic impacts of the terrorist attacks: the destruction or loss of capital stock, both physical and human; and the loss of consumer and investor confidence arising from uncertainty about future terrorist and military events. In economic terms, the former impact is best characterized as posing a supply-side problem, while the latter is a demand-side problem. The destruction of capital stock, like Hurricane Andrew of 1992 or the OPEC oil crisis of 1973, exerts upward pressure on prices, but a loss in consumer confidence exerts the opposite influence on prices. Because the latter impact is far more significant than the former in this case, rising inflation is not a cause for concern, at least in the short run. Both problems, however, unambiguously point to depressed economic activity, actually making the ongoing slowdown much deeper and prolonged than it would otherwise be.

Times such as these dictate more financial liquidity through lower interest rates; a positive economic stimulus is clearly in order. The Bank of Canada immediately realized this situation and moved swiftly (by September 17), as did the U.S. Federal Reserve Board

(U.S. Fed), lowering its key *Overnight Rate* for chartered bank deposits by 1.5 percentage points to 3.5%.<sup>2</sup> As the Bank of Canada put it:

*The tragic acts of terrorism in the United States on 11 September may pose significant challenges to consumer and business confidence in the United States, Canada, and elsewhere. Accordingly, the Bank is taking this action today [lowering its target for the overnight rate by one-half of one percentage point to 3.5 per cent] to underpin confidence and provide further support for economic growth in Canada. The Bank's decision to act outside of its normal schedule of announcement dates reflects the need for prompt action to counteract potential effects on confidence in the aftermath of the extraordinary events in the United States. [Bank of Canada, News Release, September 17, 2001]*

Both the U.S. Fed and the Bank of Canada continued this easing of monetary policy such that Canada's *Overnight Rate*, as of November 1, stands at 2.75%, the lowest it has been in more than four decades.

Small business representatives are hoping that the chartered banks will pass on these favourable credit conditions to small businesses and consumers:

*One of the things we are concerned about, post-September 11, is a tightening, a credit crunch. That's the worst thing that can happen at this time. We're treating this, what happened, similarly to what happened with the ice storm. We've written the banks; we've written to Revenue Canada: let's not hurt cash flow, let's not squeeze at this particular time. If there is a cashflow issue or if communities are having hard times at the border, or if they're with trade and manufacturing and they're late in some of their remittances, let's give them a break ... [Garth Whyte, Canadian Federation of Independent Business, 45:16:00]*

The Committee is confident that the Bank of Canada's strategy of lowering lending rates will be successful in stimulating the economy and that we will see these lower interest rates passed on to consumers and small and large businesses. The Committee is concerned about the insensitivity of credit card interest rates to changes in the chartered banks' prime rates. The Committee will study these matters in a more detailed fashion when it resumes its routine discussions with Canada's chartered banks on small and medium-sized business lending and banking practices.

The Committee, however, would caution people on the limits of monetary policy. In the ordinary conduct of monetary policy, timing is important. The lag between an interest rate cut and the positive economic stimulus it generates is usually thought to be six to nine months. So the actions taken by the Bank of Canada since September will not largely be felt until the second quarter of 2002 at the earliest. However, the Bank of Canada had been lowering interest rates, by as much as 2.5 percentage points, between January and

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<sup>2</sup> The target for the *Overnight Rate* is the Bank of Canada's key policy interest rate. It is the appropriate policy rate for international comparisons — for example, with the target for the federal funds rate in the United States and with the two-week repo rate in the United Kingdom. The target for the overnight rate is the midpoint of a 50-basis-point operating band. The *Bank Rate* is the upper limit of this band.



September 2001 in order to stimulate spending. The prospects for economic recovery sometime in early 2002 are therefore good, assuming that consumers will again join the spending treadmill and investment opportunities of the business sector are sufficiently sound to justify higher corporate debt loads.

### **Federal Budget Statement**

The Minister of Finance has decided to table the federal budget in December 2001 rather than the customary February period to provide an immediate fiscal response to the tragedy of September 11, 2001. A second benefit of an early budget — probably its more important contribution in light of these tragic events — would be to immediately shore up and restore consumer and investor confidence in Canada.



# CHAPTER 4: BUDGET PLANNING: SPENDING PRIORITIES, TAXATION, AND FISCAL BALANCE

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## Economic Context of the December 2001 Budget

In the aftermath of the tragic events of September 11 and an economic retrenchment that threatens to become a recession, it is hard to believe that just one year ago, when the most recent federal budget was drawn up, the economy was moving at full throttle, with a strong engine and a forecast of nothing but open road ahead. At that time, virtually no one, including the Department of Finance, was predicting an economic downturn. Moreover, that a terrorist attack on the North American continent was imminent was also nowhere to be found on most policy-makers' radar screen. Consider the Department of Finance's May 17, 2001, *Economic Update*. It recognized the slowdown of the U.S. economy (but expected a so-called "soft landing" scenario) that would have a restraining impact on the Canadian economy, but also noted "a number of encouraging developments which have helped to offset this weakness." The Finance Minister then predicted \$7.2 billion and \$7.6 billion budget surpluses in fiscal years 2001-2002 and 2002-2003, respectively. The Finance Minister went on to assure the Canadian public that:

*The aforementioned numbers are derived from the average of the total range of private sector forecasts. Let me now use the average of the most pessimistic of the private sector forecasts. Even here — 1.8 per cent growth in 2001 and 2.9 per cent growth in 2002 — the net impact would result in an adjusted budgetary surplus of \$6.2 billion this year and \$5.1 billion next year. In other words, ... despite the economic slowdown ... the \$100 billion in tax cuts is protected. And we will not fall back into deficit. [Department of Finance Canada, *Economic Update*, May 17, 2001, p. 10]*

Clearly, the road to prosperity for Canada became both curved and bumpy. The strong economic fundamentals of a year ago have turned to

*Clearly, in the wake of the events of September 11 every government in the world, certainly the Government of Canada, has had to pause and had to reflect upon its priorities in both the mid and long terms, but in particular in the short term. First and foremost, the needs of governments everywhere is to ensure security of our citizens, to ensure the security of our borders as well. [The Honourable Brian Tobin, Minister of Industry, 44:8:35]*

*I would encourage the government to see as an urgent priority for taking concrete action ... is to establish consumer, investor and business confidence, as well as a secure and trade-efficient border. [Jayson Myers, Manufacturers and Exporters of Canada, 45:15:40]*

weakness, and a recession may be looming. Indeed, Economy.com forecasts a contraction in the Canadian economy of 0.2% (annualized) in the third quarter of 2001 (see Chapter 1) and should this also be the case in the fourth quarter, the Canadian economy will meet the modern-day technical definition of a recession: negative growth in the economy stretching two-quarters. So whether or not the revised forecasts of a weaker economy suggest a deficit, trade-offs in the upcoming budget will have to be made. The Committee now turns to these; rather than providing a detailed budget plan, we will instead make recommendations on the approach to be taken.

## **Spending Priorities and Taxation**

If the slowing Canadian economy did not usher in a new economic context and, therefore, the need to set new budget priorities, the terrorist attacks of September 11 certainly did. On this score, virtual unanimity amongst Canada's business leaders was obtained over what should be the Government of Canada's number one priority at this time: national security. Such a shift in priorities now obliges the government to rearrange its budget accordingly.

*[T]he Canadian government must now reassess its own fiscal plan to ensure that the fundamental priorities of national and international security are met while continuing to encourage the growth of a healthy Canadian economy and society.*  
[Elizabeth McDonald, Canadian Film and Television Production Association, 47:10:40]

There is hidden wisdom in the suggestion that security and economic growth are complementary, where one objective enhances and reinforces the other. National security is a public good in the traditional sense of the word; it is one manifestation of social capital, which itself is an essential input into the economy. Indeed, increased security can translate into less uncertainty, making commerce and trade more profitable. The business community will readily admit that uncertainty is a condition that it actively seeks to avoid. As the past two months have clearly demonstrated, insecurity brought on by terrorism, real or perceived, can have an adverse impact on the economy through lost consumer and investor confidence; it can also send powerful economies, such as those of the United States and Canada, into a tailspin if left unchecked.

Armed with this knowledge, a number of business leaders were adamant that the Government of Canada should push its new national security agenda forward. They even offered specific actions in pursuit of this objective.

*The first priority is that Canada must be inside a North American security perimeter against terrorism and this is for our benefit, not for anybody else's. I want Canada to be the safest place to be in North America. There's a side benefit to that, which is that other people in North America will also be safe. Secondly, Canada needs better screening at our perimeter. Our screening must be the best. No one must be able to say that we're playing second fiddle to that. Everyone must be able to say the Canadian screening system is as good or better than anyone else's and therefore*

*we can rely on the Canadian screening system.* [Gerald Fedchun, Automotive Parts Manufacturers Association, 44:10:30]

Clearly, the federal government's new Anti-terrorism Plan and its decision to compensate selected groups arising from the September 11 terrorist attacks will be costly to the treasury and will eat into the government's current surplus, or lead to deficit if the economy is much worse than perceived. A deficit is certainly not out of the question anymore.

*Above all, we expect that these current essential spending measures will eat up most, if not all, of the current year surplus. In the absence of offsetting cuts and less essential spending, these needs may well push the government into deficit in the next fiscal year. The government may not be able to avoid the deficit for a year or two no matter what it does.* [Thomas d'Aquino, Business Council on National Issues, 47:10:40]

Despite national security and economic growth being complements in the longer term, these objectives may be substitutes, or at least be forced to compete with each other for funding, in the budget. Canada's construction industry explained this in terms of obvious productivity-improving infrastructure investments:

*Often the first thing that goes when governments find their fiscal house somewhat restrained or pressured is capital investments in roads, highways, sewage treatment facilities, and water distribution systems. There are many reasons why this often happens, probably because those investments are investments that may not show a yield except for 20 or 25 years, and that's a very long time. We are concerned that the events of September 11 are causing some governments in Canada to divert their attention away from what is a very ominous threatening problem in this country, and that's our infrastructure deficit.* [Michael Atkinson, Canadian Construction Association, 46:16:55]

However, the short-term budgetary trade-off between national security and productivity-improving investments can be attenuated with sound financial planning, as was expressed by a number of business leaders.

*It continues to be the view of the Chamber that government spending priorities must include those areas that can have a direct bearing on our competitiveness as a nation. Resources put into security and building and maintaining critical infrastructure should continue to be a government focus. Evidence also suggests that successful investment in both physical capital, whether it's machinery and equipment, and human capital, whether it's education and training, as well as basic research and development, are instrumental in raising productivity and overall economic growth. Our submission further details the Chamber's recommendation on how spending should be controlled by imposing an annual cap and by reallocating from lower priorities.* [Michael N. Murphy, Canadian Chamber of Commerce, 45:15:25]

This opinion was echoed by others, one of whom coupled this advice with issues of reforming federal taxation and regulatory regimes with a view to improving Canadian industrial competitiveness:

*This is not a time for massive new spending programs. It is a time to reflect on how we can spend existing resources more effectively. It is a time to look for ways to reshape Canada's tax structure to make our tax burden more competitive without reducing revenue and it's also a time to focus on regulatory issues that can have a powerful impact on growth without the need for new spending.* [Thomas d'Aquino, Business Council on National Issues, 47:10:40]

Industry representatives, however, were steadfast in their support for the planned tax cuts scheduled over the next five years. Indeed, some suggest that there may be room for their widening and deepening across and within more sectors of the economy over the longer term.

*We also think the government should maintain its focus on achieving the \$100-billion-tax-cut program that was in that October 2000 Economic Statement. We believe that those tax cuts should be extended to include the resource sectors.* [Gordon Peeling, Mining Association of Canada, 45:17:05]

And

*We also believe that it is important for the Canadian government to reduce the personal and corporate income tax burden in Canada, building on what has been done by the government over the past few years. This has to be part of a long-term strategy to retain both capital and human talent in Canada. We agree with others in the Canadian business community that the government fiscal course has to be one taken within a framework of fiscal prudence.* [Chris Van Houtte, Aluminium Association of Canada, 46:16:45]

For these reasons, the Committee recommends:

- 10. That the Minister of Finance, in his next budget statement, confirm national security and border trade as the Government of Canada's number one priority at this time and back this commitment with needed expenditure initiatives.**

And

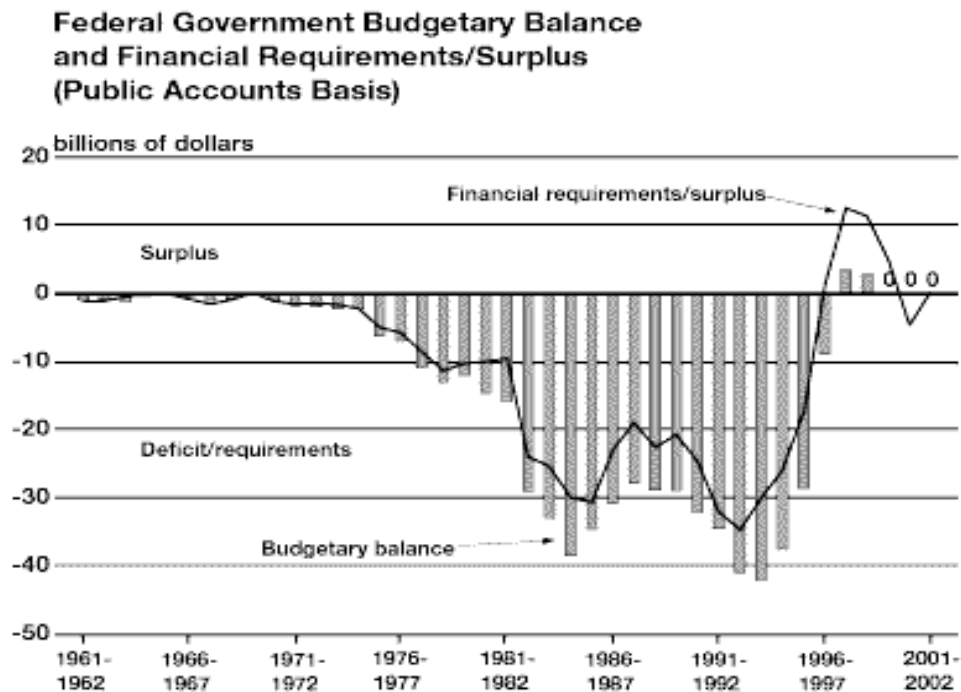
- 11. That the Minister of Finance, in his next budget statement, confirm the Government of Canada's commitment to the five-year tax reduction program it set out in Budget 2000.**

## **Fiscal Policy and Debt Management**

Review of taxation issues and the government's spending priorities have become a ritual of winter in Canada. Over the past few years, every February (last year excepted), the Minister of Finance has set out the government's projected revenues and expenditures

— sometimes called fiscal projections — and the resulting surplus or deficit. This statement contains an overview of the government’s economic and fiscal projections, and also sets out fiscal policy for the period ahead. Key to this planning process is that the government’s adjustments in spending and taxation priorities can be made in the light of longer term trends and, thus, a long-term perspective can have a bearing on tendencies to depart abruptly from the projected fiscal course.

**Figure 4.1**



**Source:** Finance Canada, *The Budget Plan 2000*, February 28, 2000, p. 46.

The two charts provided in this section are extracted from last year’s budget statement. They are a graphic representation of the fiscal and debt management course of past and current governments. From Figure 4.1, we observe that, after periods of large deficits lasting through the 1970s, 1980s and early 1990s, the government has returned to fiscal balance. This much-improved performance underscores the soundness of the government’s fiscal strategy of using two-year rolling plans backed by a contingency reserve and, in turn, provides much credibility to the Finance Minister’s commitment that:

*The Government is not prepared to risk a return to deficits. The benefits of maintaining sound public finances — sustained economic growth, more jobs and higher incomes for Canadians — will not be put at risk. [Finance Canada, *The Budget Plan 2000*, February 28, 2000, p. 45]*

This chosen fiscal course is not simply the current government’s preference; it enjoys wide support from the business community, large and small.

*[T]he Chamber has produced a set of specific recommended proposals in the tax-debt management and program spending areas ... They all are couched, in very important terms with respect to fiscal conditions permitting. ... The underlying theme of this principle, upon which our proposals are built, is a continued affirmation of the very hard work of all Canadians, in the past several years, to move the country away from deficit financing at the federal level. This achievement is now much too important to abandon, and the members of the Chamber urge the government to avoid a return to deficit financing. We believe this can be accomplished as we set priorities for the country and keep a focus on overall Canadian prosperity. [Michael N. Murphy, Canadian Chamber of Commerce, 45:15:25]*

And

*[S]tay the course. ... Right now the most important thing to do in our current economic environment is maintain business and consumer confidence to the maximum degree possible. All Canadians sacrificed a great deal to get rid of the deficit and indeed start paying down debt. Going back into deficit, I believe, ... would not be positive in the least to maintain confidence levels of Canadians generally and not just in the business community. [Catherine Swift, Canadian Federation of Independent Business, 45:15:50]*

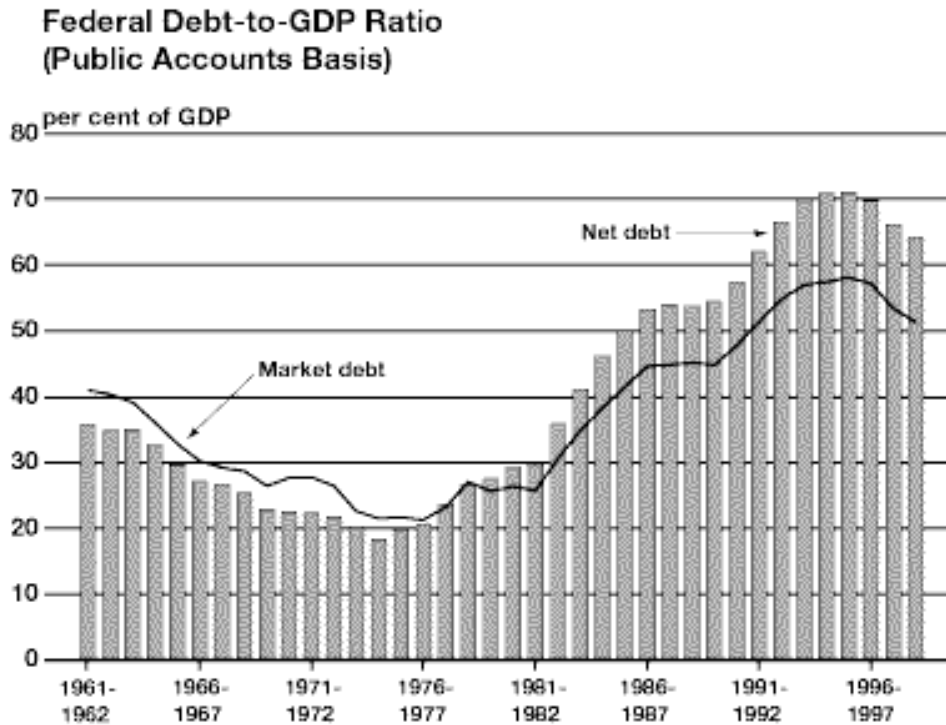
A commitment to not run a budget deficit, as in the present course, makes debt retirement possible. In fact, the stock of federal public debt has declined by \$35.8 billion (\$17.1 billion in the past fiscal year alone) from its peak of \$583.2 billion in 1996-1997 to \$547.4 billion in 2000-2001.<sup>3</sup> This pay down of debt represents an ongoing saving of \$2.5 billion each year in the form of lower interest payments to service the debt. Moreover, the federal debt-to-GDP ratio has dropped to 51.8% in 2000-2001 from its post-war peak of 70.7% in 1995-1996 (see Figure 4.2).

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<sup>3</sup> <http://www.fin.gc.ca/news01/01-078e.html>



Figure 4.2



Source: Finance Canada, *The Budget Plan 2000*, February 28, 2000, p. 48.

These debt-management developments have also received support from the business sector: “We are very pleased and are very supportive of the government in achieving a pay down of the debt. We indeed think that that should still remain a priority for the government going into the future” [Gordon Peeling, Mining Association of Canada, 45:17:05]. Debt reduction continues to receive favour even under the current trying circumstances.

*It must reinforce the plan for debt reduction by clarifying the targets and making stronger commitments to allocate funds for this purpose when surpluses are available. It must limit spending to areas of the highest public priority, particularly those that strengthen the economy and enhance Canada’s long-term international competitiveness. Of course, we do realize that security and defence must be factored into this. [Gordon Peeling, Mining Association of Canada, 45:17:05]*

The Committee is convinced that the government’s current fiscal course has provided more flexibility and maneuverability for dealing with unexpected shocks to the economy, such as the September 11 terrorist attacks. The Committee, therefore, recommends:

12. That the Government of Canada continue a fiscal strategy of developing a two-year rolling plan, backed by a contingency reserve, using conservative economic assumptions to deliver a federal budget that does not contemplate a return to a deficit.

And

13. That the Government of Canada continue the practice of retiring its debt by an amount that is not less than the funds available in the contingency reserve at the end of each fiscal year.

## **Economic Stabilization and Fiscal Policy**

Now that the Committee has established what it believes should be the government's spending and taxation priorities and has further recommended that we continue on the current course of fiscal balance and debt reduction over the next two years, we must address the issue of fiscal actions to be taken should plans go awry. One example would be if the underlying economic assumptions of the budget plan do not materialize or, more succinctly, if our economic fundamentals weaken further than expected. A second example would be if we experience additional external shocks, such as that of September 11, which would require greater-than-anticipated national security spending. In these circumstances, we can take one of three alternative routes: (1) ratchet up government spending to counteract depressed private spending; (2) continue as planned and ride out the economic downturn; or (3) take immediate corrective action by cutting back on budgeted expenditures of low-priority items to stay the course.

Some business advocates argued that additional fiscal stimulus to that which is already planned would be excessive or would risk the credibility of the Finance Minister's plan, which could possibly further weaken consumer and investor confidence.

*In recent weeks we've heard a few scattered calls for massive fiscal stimulus as well. At best, we believe this would be counter-productive; at worst, it would [be] disastrous. First, consumers are benefiting already from the major tax cuts announced by Finance Minister Paul Martin last year. Second, American experience with tax rebates suggests that in the current environment most would be saved rather than spent. Third, the new security-related expenditures the government must make will, in themselves, have an overall stimulative effect.*  
[Thomas d'Aquino, Business Council on National Issues, 47:10:40]

Many industry representatives believe that the current monetary policy in Canada and the United States, along with planned U.S. tax cuts and accelerated government spending, are stimulus enough at this time.

*On the fiscal front, tax stimulus introduced early this year at the federal and provincial level will continue to work through the economy. Increased government spending for security and defence is pending. South of the border fiscal stimulus coming from the increase in U.S. government spending will also play a role in spurring economic growth, including here in Canada. Thus the stage is set for the*

*start of an economic recovery in Canada, possibly as early as the spring or summer of next year, to start. Our expectation, therefore, is for growth in 2002 to average approximately 1.5%, virtually identical to the growth rate expected for our current year.*

*It ... would be ill-timed to add to these monetary and fiscal initiatives ... a direct government stimulus package. Such potentially large government spending initiatives are not needed at this time, and indeed could be counter productive.*  
[Michael N. Murphy, Canadian Chamber of Commerce, 45:15:25]

The Committee agrees and recommends:

- 14. That the Government of Canada impose spending limits and, if necessary, cutback on low-priority spending in the budget plan should economic fundamentals weaken beyond expectations, or should additional external shocks require greater-than-anticipated national security spending, and begin to threaten the desired fiscal balance.**



# CHAPTER 5: THE INNOVATION AGENDA

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## The Government of Canada's Innovation Agenda

One of the government's highest priorities over the past seven years has been the promotion of the transition to an innovation and knowledge-based economy. The last two throne speeches in particular have highlighted the government's so-called "innovation agenda." Prime Minister Chrétien, in his response to the 2001 Speech from the Throne, outlined the government's plans to make Canada one of the most innovative economies in the world. The government has stressed that a major element in achieving this goal is to ensure that Canada's research and development (R&D) effort per capita is amongst the top five countries in the world (Canada is currently in 15th place on OECD scales which measure expenditure on R&D as a percentage of GDP).

The government's innovation plan, as described in the government's response to the Speech from the Throne, has five parts:

1. At least double the current federal investment in R&D by the year 2010. Increased investments will be made in the Granting Councils, Genome Canada, the Canadian Institutes of Health Research, and government laboratories and institutions;
2. Work with the university community to assist universities in securing the resources necessary to fully benefit from federally sponsored research activities;
3. Accelerate Canada's ability to commercialize research discoveries, and to turn them into new products and services;
4. Pursue a global strategy for Canadian science and technology, supporting more collaborative international research; and
5. Work with the private sector to determine the best ways to make broadband Internet access available to all communities in Canada by the year 2004.

*I would strongly encourage the government to proceed with a forward-looking strategic agenda that continues to be centred on innovation and skills. The priorities and the timing of this agenda, however, must be shaped to the times ...*

[Thomas d'Aquino, Business Council on National Issues, 47:10:45]

*[W]ith respect to funding ... the government can actually save money by ... doing it on a project by project basis, particularly in the North where you could use medical services on-line for diagnostic purposes and you can actually cut costs ... on health delivery ... over broadband communications system. ...*

[Linda Oliver, Information Technology Association of Canada, 47:12:00]

Along with the emphasis on innovation, the government also stressed that the success of the “new economy” depends greatly on human talent. As such, the government also indicated that it would place increased resources into ensuring that Canadians have the training and learning tools necessary to prosper in, and contribute to, a knowledge-based economy.

## **Realizing the Innovation Agenda**

The Committee has been at the forefront of promoting an innovation agenda. It has released several reports since 1997 on issues related to R&D funding, innovation and productivity, and made specific recommendations to the government on how the transition to an innovation and knowledge-based economy can best be achieved.

The government has placed a great deal of resources into ensuring that its innovation agenda produces tangible results. For example, in October 2000, the arm’s-length National Broadband Task Force was established to advise the government on how to best make high-speed, broadband Internet services available to businesses and residents in all Canadian communities by the year 2004.<sup>4</sup> The Task Force delivered its final report, *The New National Dream: Networking the Nation for Broadband Access*, to the Minister of Industry, Brian Tobin, in June 2001. In its report, the Task Force emphasized that high-speed broadband will provide the foundation for improved services such as distance learning and tele-health and will give small businesses access to broader markets. The report stresses that all Canadians should have equitable and affordable access to broadband services, and that the government’s focus should be on communities where the private sector is unlikely to deliver these services. It also noted that First Nation, Inuit, rural, and remote communities should be a priority along with public institutions (learning institutions, libraries, health care centres, and public access points).

The federal government considers that the provision of broadband Internet capacity is an urgent and high priority for the innovation economy. The provinces and territories share this opinion. Federal, provincial and territorial ministers responsible for research, science and technology met on September 21, 2001 to discuss principles of action to speed up the transition to an innovation and knowledge-based economy:

*[W]e had a unanimous declaration ... [from] every government of Canada — every province, of every political — stripe saying: high-speed Internet access is one of the defining characteristics and part of the necessary infrastructure of a modern competitive economy. [The Honourable Brian Tobin, Minister of Industry, 44:9:20]*

The federal government is working with provincial and territorial governments to realize the objective of making Canada one of the most innovative countries in the world.

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<sup>4</sup> The Task Force defined high-speed broadband as a high capacity, two-way link between end-user and access network suppliers capable of supporting full motion interactive video applications.

The government has also stressed the importance of the participation of the private sector in achieving this goal.

### **Costs of the Components of the Innovation Agenda**

The national vision and strategy for, and cost of, realizing the innovation agenda is to be detailed in a white paper that is expected to be tabled later this year or early next year. Estimates of costs for implementing the various components of the agenda vary. According to Statistics Canada, the federal government invested \$3.71 billion in science and technology R&D activities (for both intramural performance and extramural funding of R&D) in fiscal year 1999-2000. Given that the government has pledged to double current federal investment in R&D by the year 2010, the final investment would be in the range of \$7 billion per year.

In terms of the broadband component, the National Broadband Task Force estimated the cost of providing broadband services to communities without such access at between \$1.3 and \$1.9 billion. The Task Force estimated that a more ambitious plan would cost approximately \$4.5 billion. The Task Force suggests that these costs would be shared with other stakeholders.

### **Impact of the Events of September 11**

The events of September 11 have changed the short-term priorities of the government. The government is now preoccupied with improving security measures at ports of entry and introducing other counter-terrorism measures. Implementing these measures will be expensive. The government has also made investments in other areas, such as the airline and tourism industries, that were directly affected by the events of September 11.

Increased security measures at the Canada-U.S. border have, unfortunately, impeded the flow of commercial and passenger traffic between the two countries. These delays are having negative consequences on Canadian industries. Maintaining a safe border while ensuring the free flow of goods and people across the border has become the government's main priority:

*[S]ecuring access to Canada's market has got to be everybody's first priority, to keep the economic engine of Canada going, is our first priority. [The Honourable Brian Tobin, Minister of Industry, 44:9:40]*

The government's changing short-term priorities will likely have impacts on spending for other government programs, and the government must choose which programs are the most important. Witnesses appearing at this series of hearings stressed that the government should not go back into deficit in order to fund all of its proposed initiatives.

However, at the same time, witnesses suggested that the government should not abandon its long-term policies and initiatives. In particular, many witnesses stressed that the government's plans for an innovation agenda should not be discarded, but that the timing and exact priorities for this agenda may need to be altered to reflect the new fiscal reality:

*[V]ery important to keep our eye on the longer term issues, the longer term priorities of innovation and competitiveness, in fact, I would argue these are priorities that are more important than ever before. Not just research and development and skills and tax reform and regulatory reform, but also encouraging companies now to manage their businesses in a much more innovative way is going to be extremely important simply to survive the next few months let alone to prosper in the future ... [Jayson Myers, Manufacturers and Exporters of Canada, 45:15:40]*

For the broadband initiative in particular, witnesses pointed out that the "roll-out" plan, and thus the cost, could be spread out over a number of years:

*I'm not quite sure how the broadband task force had proposed to roll it out, but I know that it can be rolled out regionally ... it doesn't all have to be done in the same year ... Our suggestion is to look at the north first, because it's an obvious winner, in terms of government and spending priorities and achieving some objectives for delivery of medical services ... So our recommendation would be to take it in bite-sized pieces, to start, to accomplish something each year, and to live up to the commitment that the government has made. [Lynda Oliver, Information Technology Association of Canada, 47:12:10]*

Although witnesses expressed support for the principle of maintaining an innovation agenda, some witnesses questioned whether the federal government should be investing in the expansion of broadband access to all parts of Canada:

*[T]his is an example of the question we asked our members ... should governments pay for expansion of high speed Internet capacity?... almost three-quarters of our members are not in favour of that particular initiative. [Catherine Swift, Canadian Federation of Independent Business, 45:15:50]*

The Committee is very supportive of the overall federal innovation agenda, but understands that the costs and timing of the initiative may not be immune to the impact of shifting priorities towards Canada's increased security needs. In terms of the broadband component, the Committee recognizes that given the events of September 11, the goal of making high-speed broadband Internet services available to all Canadians by 2004 will be challenging. However, the Committee feels that every reasonable effort should be made to achieve this objective with a minimum of compromise. The Committee therefore recommends:

- 15. That the Government of Canada work with the private sector and community leaders to provide broadband services to areas of the country that do not currently have broadband access on a region-by-region basis. Regions to be connected first should be**



**those areas in which it is unlikely that the private sector, on its own, will provide broadband services. In this manner, northern and rural areas will not be disadvantaged any further.**

The Committee urges the government to consider the recommendations made in the Committee's fifth report, *A Canadian Innovation Agenda for the Twenty-First Century*, to increase funding to certain areas of the country's innovation framework that are in immediate need of funds. This injection of funds would serve as an economic stimulus. As such, the Committee recommends:

- 16. That the Government of Canada consider increasing appropriations to certain government departments, agencies and programs (the Industrial Research Assistance Program, the Technology Partnerships Canada program, the National Research Council of Canada and the Canadian Space Agency), as described in the Committee's fifth report.**



## CONCLUSION

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The terrorist attacks on New York City and Washington, D.C., and the foiled attack that led to the downed plane outside Pittsburgh on September 11 were not only devastating to those who lost their lives, family and loved ones. They were a tragedy for all who believe in a free, democratic and civil society. Their destructive force extended beyond their impact sites, shaking consumer and investor confidence throughout North America and, in turn, propelling an already weak economy further downward. Structural problems in the airline sector and long-time underresourced Canada-U.S. border crossings that had been ignored became immediately exposed.

The government needs to make national security and border trade its prime focus and its first priority in the upcoming budget. Clearly, a more strategic approach to national security must be adopted. Such an approach involves more cooperation within North America; it also involves significant investments in more advanced technologies and infrastructure for customs and immigration control. There will be a hefty price tag associated with these long-term responses, but national security objectives can be met without sacrificing the government's planned tax cuts over the next five years or the "innovation agenda" to be rolled out over the next decade. The sound fiscal policy course set by the Government of Canada over the past several years, along with credible and well-timed monetary policy, has left Canada's financial books in good shape and resilient enough to weather the terrorist shock.

The Committee's recommendations, we believe, offer timely counsel to the Government of Canada and its agencies on how to effectively respond to the post-September 11 security-conscious environment in a way that minimizes any further adverse impacts on the Canadian economy. These

*In times of crisis and confusion, unit of purpose and clarity of message are essential. Canada's efforts must proceed vigorously and visibly, because even the perception that the border might become a more serious barrier will begin influencing business decisions now, decisions about which plants to close, decisions about where new plants will be built. Whatever else we do to improve the business environment in Canada will be undone if we ever allow the 49th parallel to be seen as an impediment to trade and investment over time.* [Thomas d'Aquino, Business Council on National Issues, 47:10:45]

*I think we just have to move forward — business as usual, both in our business and our personal lives. ... [G]overnments at any level, ... they too should move forward — Plan for the best and prepare for the worst. But standing still should not be an option.* [Garth Whyte, Canadian Federation of Independent Business, 46:16:05]

recommendations also advise the government to take bold action in resolving perennial problems of Canada-U.S. border crossings, suggesting a number of critical investments to be made in access infrastructure and highways, and state-of-the-art customs and immigration control equipment, the hiring of new personnel, and the adoption of modern and more strategic customs and immigration procedures. Greater Canada-U.S. cooperation on all of these fronts is also seen as vital to our success in providing national security, as well as economic security, to Canadians in these security-conscious times.

The Government of Canada must work to eliminate any real or perceived border problems in order that Canada continues to be one of the world's safest countries to invest in, to trade with and to visit. Canada needs to ensure that the flow of goods and people across the Canada-U.S. border is not impeded by the adoption of new security measures. The recommendations detailed in this report are intended to make the border more secure and more trade efficient than ever.

## APPENDIX A

# LIST OF WITNESSES AND BRIEFS

Associations and Individuals	Date	Meeting
<p><b>Air Transport Association of Canada</b></p> <p>J. Clifford Mackay, President and Chief Executive Officer</p> <p>Warren Everson, Vice-President</p>	01/11/2001	47
<p><b>Aluminium Association of Canada</b></p> <p>Chris Van Houtte, President</p>	31/10/2001	46
<p><b>Association of Canadian Travel Agents</b></p> <p>Randall Williams, President and Chief Executive Officer</p>	31/10/2001	46
<p><b>Association of International Automobile Manufacturers of Canada</b></p> <p>Robert Armstrong, President</p> <p>Stephen Beatty, Vice-President, Corporate Affairs, Toyota Canada Inc.</p> <p>Art Thomas, Senior Manager, Corporate Affairs, Honda Canada Inc.</p>	30/10/2001	44
<p><b>Automotive Parts Manufacturer's Association</b></p> <p>Gerald Fedchun, President</p>	30/10/2001	44
<p><b>Business Council on National Issues</b></p> <p>Thomas d'Aquino, President and Chief Executive Officer</p> <p>Sam Boutziouvis, Vice-President, International Trade and Global Economics</p> <p>David Stewart-Patterson, Senior Vice-President, Policy and Communications</p>	01/11/2001	47
<p><b>Canadian Chamber of Commerce (The)</b></p> <p>Robert Keyes, Senior Vice-President, International Division</p> <p>Michael Murphy, Senior Vice-President, Policy</p>	30/10/30	45

<b>Associations and Individuals</b>	<b>Date</b>	<b>Meeting</b>
<b>Canadian Construction Association</b> Michael Atkinson, President Jeff Morrison, Director of Communications	31/10/2001	46
<b>Canadian Federation of Agriculture</b> Robert Friesen, President Brigitte Rivard, Executive Director Jennifer Fellows, Farm Policy Analyst	01/11/2001	47
<b>Canadian Federation of Independent Business</b> Catherine Swift, President & Chief Executive Officer Garth Whyte, Senior Vice-President, National Affairs	30/10/2001	45
<b>Canadian Film and Television Production Association</b> Elizabeth McDonald, President and Chief Executive Officer	01/11/2001	47
<b>Canadian Manufacturers and Exporters</b> Jayson Myers, Senior Vice-President and Chief Economist	30/10/2001	45
<b>Canadian Restaurant and Food Services Association</b> Joyce Reynolds, Senior Director, Government Affairs	31/10/2001	46
<b>Canadian Steel Producers' Association</b> Barry Lacombe, President Donald Belch, Director, Government Relations	30/10/2001	45
<b>Canadian Trucking Alliance</b> Ron Lennox, Vice-President, Regulatory Affairs David Bradley, Chief Executive Officer	01/11/2001	47

<b>Associations and Individuals</b>	<b>Date</b>	<b>Meeting</b>
<b>Canadian Vehicle Manufacturers' Association</b>	30/10/2001	44
Mark Nantais, President		
Doug Jure, Special Advisor, Daimler-Chrysler Canada		
Michael Sheridan, Manager, Government Relations, Ford Motors of Canada Ltd		
<b>*Celeris Aerospace Canada Inc.</b>		
Steve Hall, President		
<b>Customs Excise Union</b>	06/11/2001	49
Serge Charette, National President		
<b>Detroit Regional Chamber of Commerce</b>	01/11/2001	47
Daniel Cherrin, Director of Public Policy		
<b>Detroit Windsor Tunnel Corporation</b>	01/11/2001	47
Gordon Jarvis, Director		
<b>Hotel Association of Canada</b>	31/10/2001	46
Anthony P. Pollard, President		
<b>Industry Canada</b>	30/10/2001	44
The Honourable Brian Tobin, Minister of Industry		
Andreï Sulzenko, Senior Assistant Deputy Minister, Policy Sector		
<b>Information Technology Association of Canada</b>	01/11/2001	47
Pierre Boucher, Vice-President, Customer Advocacy Entrust		
Linda Oliver, Executive Director, Government Relations		
* Did not appear/brief only		

<b>Associations and Individuals</b>	<b>Date</b>	<b>Meeting</b>
<p><b>Mining Association of Canada</b></p> <p>Gordon Peeling, President and Chief Executive Officer</p> <p>Dan Paszkowski, Vice-President, Economic Affairs</p>	30/10/2001	45
<p><b>Railway Association of Canada</b></p> <p>Bill Rowat, President</p> <p>Bill Fox, Senior Vice-President, Public Affairs, Canadian National Railway</p> <p>Dennis Apedaile, Senior Advisor, Government Affairs, Canadian Pacific Railways</p> <p>Paul Côté, Chief Operating Officer, Via Rail Canada</p>	01/11/2001	47
<p><b>Retail Council of Canada</b></p> <p>Peter Woolford, Senior Vice-President, Policy</p>	06/11/2001	49
<p><b>Tourism Industry Association of Canada</b></p> <p>Gerry Macies, Director</p>	31/10/2001	46



## **REQUEST FOR GOVERNMENT RESPONSE**

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this report within one hundred and fifty (150) days.

A copy of the relevant Minutes of Proceedings of the Standing Committee on Industry, Science and Technology (*Meetings Nos. 44, 45, 46, 47, 49, 52 and 53 which includes this report*) is tabled.

Respectfully submitted,

Susan Whelan, M.P.  
Essex  
Chair



# Canadian Alliance Dissenting Report

## November 23, 2001

### Introduction

The Canadian Alliance was deeply disturbed by the horrific acts of terrorism against the United States witnessed by the world on September 11, 2001. We recognize how profoundly the U.S. has been affected by these tragedies, and that as a result Canadians have been drawn closer to our southern neighbours. Furthermore, although North America was experiencing the beginnings of an economic slow-down prior to September 11, national priorities have changed significantly as security matters have become so much more important.

The Standing Committee on Industry Science & Technology's report on the Economic Impact of the September 11 terrorist attacks in the United States provides a good overview of the situation facing Canadian industry. However, the Official Opposition believes that testimony provided by the witnesses regarding U.S. security concerns and the implementation of the Liberal Innovation Agenda was not accurately reflected in the report.

### The Canada-U.S. Border

The Canadian Alliance welcomes the report's recommendations for high-level negotiations on the border issue and for post-September 11 security plans to be outlined in the upcoming federal budget. However, we feel that the report does not capture the importance of addressing U.S. security concerns, which was stressed by witness after witness.

*"I think the clear issue here is that the U.S. isn't much interested in talking about the economic impacts of September 11. They're interested in talking about the security impacts of September 11."*

**Stephen Beatty (Vice President, Corporate Affairs, Toyota Canada Inc, Association of International Manufacturers of Canada)**

*"Our attention needs to be focused on ensuring security and providing the U.S. with confidence in Canadian actions while at the same time ensuring that U.S. action to address the consequences of September 11 do not result in border delays potentially affecting Canadian investment and jobs in Canada."*

**Barry Lacombe (President, Canadian Steel Producers Association)**

The Committee report appears to suggest that although the border was a big problem during the early post-September 11 period, it has since returned to near-normal. The recommendations to build more infrastructure such as roads, bridges and tunnels and hire more customs officials fail to understand the overriding theme of the testimony: that

U.S. security concerns must be addressed and in a proactive manner. The failure of the U.S. to reinstate the CANPASS system more than two months after the terrorist attacks is testament to American unease regarding facilitating access through its northern border.

*"The immediate reaction from Canadian officials was that the situation [at the border] would return to normal very quickly. What is even more surprising is that some still believe that this is the case."*

**Serge Charette (National President, Customs Excise Union)**

This is not a time to be complacent and witnesses before the committee were clear that leadership from the federal government is required for this issue to move forward. In fact, the upcoming negotiations on the Canada-U.S. border may be an opportunity to build on NAFTA and make further advancements on continental co-operation. The Canadian Alliance, however, is concerned that the Liberal anti-American tradition and misguided fears of losing sovereignty will send mixed signals to our southern neighbour to the detriment of the Canadian economy.

*"The real loss of sovereignty, in our view, will come from having the U.S. decide unilaterally what the border should look like."*

**David Bradley (Chief Executive Officer, Canadian Trucking Alliance)**

**Recommendation One:** The Canadian Alliance recommends that the federal government take a leadership role and embrace this opportunity to create cross-border cooperation that will satisfy the security and economic concerns of both countries.

### **Reality Check: The Innovation and Security in Perspective.**

The Official Opposition is concerned about the Minister of Industry's approach to the so-called innovation agenda, and in particular the broadband strategy. The only witnesses who expressly supported an immediate post-September 11 implementation of the recommendations of the National Broadband Taskforce were the Minister of Industry and Ms. Linda Oliver representing the Information Technology Association of Canada.

However, many other witnesses testified that since the events of September 11, the priorities for government spending have changed, partially due to the new security requirements and the fact that North America is facing an economic slowdown. Allocating billions of dollars simply to increase the speed of Internet connections in Canada should not be a priority at this time.

*"I would strongly encourage the government to proceed with a forward looking strategic agenda that continues to be centred on innovation and skills. The priorities and timing of this agenda, however, must be shaped to the times. This is not a time for massive new spending programs."*

**Thomas d'Aquino (President and CEO, Business Council on National Issues)**

The Canadian Alliance also believes that the Minister's entire innovation agenda should be brought to the Standing Committee on Industry, Science & Technology in draft form. The Committee heard a number of witnesses who indicated that while they were encouraged by the concept of an innovation agenda, they would approach its method of delivery differently.

*"In terms of the so-called innovation productivity initiatives that have been mentioned already, our members also feel, naturally, one cannot abandon this or neglect it as we go forward but we have proposed for some time now, and we're reiterating today, a number of low-cost initiatives that we can work on to achieve it. It seems whenever we hear about some of these innovation programs they have fairly hefty price tags attached to them."*

**Catherine Swift (President and CEO of the Canadian Federation of Independent Business)**

Therefore, the Canadian alliance has two more recommendations specific to the Liberal Innovation Agenda:

**Recommendation Two:** That the broadband strategy be delayed and reworked to more accurately reflect the priorities of Canadians.

**Recommendation Three:** That the Minister of Industry immediately present the Standing Committee on Industry, Science & Technology a draft of the so-called Innovation Agenda.

### **The Standing Committee on Industry, Science & Technology Canadian Alliance Members**

Charlie Penson, Industry Critic  
James Rajotte, Deputy Industry Critic



## **Bloc Québécois Dissenting Opinion**

While the Bloc Québécois supports most of the observations and recommendations in this report by the Standing Committee on Industry, Science and Technology, it cannot endorse the report as a whole, because the Committee notably refused to tackle the problem of lack of budgetary transparency. Three recommendations seem to be particularly problematic in this regard.

We also wish to add here remarks underlining the necessity for the federal government to invest to revitalize the economy, while taking Quebec's prerogatives into account.

### **Recommendation 11. — Confirmation of the five-year tax reduction program**

The Bloc Québécois believes that a balanced budgetary approach must allow for tax reductions, and these reductions must be targeted. But the federal Finance Minister's tax reduction program does not correspond to this requirement.

The Bloc Québécois would have liked the Committee to urge the Finance Minister to acknowledge the harmful effects of the decisions he has made so far on reduction of the personal income tax burden. Let us recall that the Minister ordered cuts in income and other taxes that targeted very high income earners in particular. As a result of Mr Martin's two most recent budgets, Canadians with incomes of more than \$250,000 have enjoyed over \$9,000 in income tax reductions, while families with incomes in the neighbourhood of \$40,000 have seen their income tax go down by scarcely \$300.

The large surpluses that have been built up in recent years could have been used to give immediate relief to families with incomes of \$40,000 and less, particularly single-parent families with two dependent children. Such families should have been exempt from the obligation to pay a single penny of income tax to the federal government, if the federal government had allowed itself to be guided by a concern for ensuring a certain balance in society rather than by a desire to hand out tax cuts that were primarily a gift for the highest income earners.

### **Recommendation 12. — Contingency reserve**

In the view of the Bloc Québécois, budgetary prudence is absolutely necessary but transparency is even more necessary. But the trend that the budget process in Ottawa has perversely taken has been to transform transparency into a tool for camouflage for the government rather than for information for the people on the state of the federal public finances.

Since 1996, the federal government has accumulated budget surpluses worth on the order of \$35 billion. While everyone should have been delighted to see the government committed to sound management of public finances, we had instead reason for

concern, as we watched the federal government demonstrate its chronic, even deliberate, inability to present realistic and credible budget estimates. For almost 20 years, successive governments in Ottawa have exaggerated the extent of their anticipated deficits, by inflated them artificially, or underestimated the size of their surpluses as the present government is doing. The present government has thus deliberately excluded from any public debate almost \$60 billion of manoeuvring room that the Bloc Québécois, even though we have fewer means at our disposal, has been able to estimate much more accurately. This situation has also helped to accentuate dramatically the current fiscal imbalance with the provinces.

While blurring the true portrait of Canada's public finances in this way, the federal government has also withdrawn substantial financial resources that could otherwise have been allocated to priorities identified by the people, notably through transfer payments for health and education. In this era of surpluses, and because its accounting rules oblige it to do so after a certain time, the federal government must allocate all of its "unforeseen" surpluses to paying down the national debt, which is simply one priority among others.

It is thus vital that the budget process be made more transparent. Prudent management is of course required, with a view to a healthy and balanced budget, but prudence must not be exercised at the expense of the quality of information provided to the people, particularly if that prudence is based on deliberate blindness to reality. It is important to note that we are not opposed to a contingency reserve, but we believe in a budget process that would for example provide for the analysis of revenue and expenditure growth hypotheses by an independent committee.

### **Recommendation 16. — Funding for certain innovative sectors**

The Bloc Québécois recognizes the importance of innovation. In its platform for the election of November 27, 2000, the Bloc placed great emphasis on the sector commonly known as the "new economy" — in other words, an economic order built around development and the use of new technologies, especially the so-called information technologies. This new economic order is one in which education and training, technological innovation and research and development are increasingly coming to occupy a dominant position. Many people would agree that economic prosperity will from now on be closely linked to the development of the new economy.

However, we believe that federal investment in the sectors of science, innovation and research and development must respect the needs and priorities defined by the provinces, and by Quebec in particular. We therefore want to see funding transfers in these sectors that respect the innovation framework chosen by Quebecers.

Lastly, we consider that federal investment in innovation must reflect Quebec's demographic weight, contrary to the usual situation in which Quebec is clearly disadvantaged. Federal investment in research and development, on in fixed assets and stocks is a case in point: in 1998, for fixed assets and stocks, for example, Quebec



received only 17.7% of all federal investment, while it is home to almost 25% of the Canadian population.

### **Recommendation 1. — Bilateral ministerial summit on immigration**

Quebeckers consider that control of immigration is an essential tool to Quebec's development and prosperity. We therefore feel that the Quebec government would not be contented to watch from the sidelines, and that it must be invited to participate actively in the negotiations with the United States about immigration procedures.

### **Assistance for industries affected by the tragic events of September 11**

The Bloc Québécois would have liked the Committee to display more openness to possible federal government assistance for the sectors that were especially hard hit by the tragic events of September 11. Travel agencies and airlines, which are closely intertwined, have asked for help from Ottawa. The economic stabilization plan proposed by the Bloc Québécois in October included, among other provisions, a series of proposals aimed at supporting the airline industry and employment in sectors hit by the general uncertainty and gloom.

It is our contention, however, that businesses should be compensated for problems linked to the event of September 11 and not for pre-existing management or structural problems. Consequently, companies that would like to benefit from federal government support should be prepared to have the latter examine their financial statements and organizational structure. We further believe that assistance must be provided uniformly to all the members of the same industry that request it, and that this assistance, in the case of airlines, must take the form of loan guarantees rather than direct cash transfers.

The Bloc's stabilization plan is both balanced and responsible. It takes into account the federal budget surpluses and the need to oxygenate and stimulate the economy.

In this dissenting opinion, the Bloc Québécois is speaking for a consensus of Quebeckers, who are in favour of transparent budget planning, respect for Quebec's areas of jurisdiction, and vigorous government intervention to revitalize the economy.

Stéphane Bergeron  
MP for Verchères—Les Patriotes and  
Bloc Québécois Industry, Science and Technology Critic



## **Progressive Conservative Democratic Representative Coalition Dissenting Opinion**

The Majority Report is a good overview of the general economic impact felt by Canadian industry as a result of the September 11, 2001 terrorist attacks on the United States. Some of its recommendations, especially for high-level bilateral meetings between the U.S. and Canada, are easily supported and long overdue. Other items, including scaling back the Minister of Industry's broadband expansion plans are simply a reflection of the new budgetary reality. This advice, however, seems to contradict other recommendations that would increase appropriations, something we feel is unacceptable at this time. In addition, some of the other recommendations are too unspecific to force the government to act in the best interests of the Canadian economy. As a consequence, the PC-DR Coalition is submitting this minority report.

Some of the greatest fears in the business community today rest on the worry that stricter border rules will slow economic movement to unprofitable levels. If Canada does not have a clear plan to strengthen border reliability for trade and transport, the United States will impose a "Made in America" system of border control. The Canadian way is to take initiatives, to make proposals, and persuade the superpower next door. The government must not sit on its hands and risk hurting the sovereignty and economic viability of Canada.

### **Public Protection and Border Management Initiative**

Therefore, the PC-DR Coalition developed a specific plan, and while it's open for discussion, it contains three detailed ideas that would protect the lives and property of Canadians, ensure the efficient and secure movement of goods and people into and out of Canada and protect the rights of Canadians. We submit it to the government for its response and implementation:

#### **1. Creation of a new Ministry to be called the Ministry of Public Protection and Border Management, which will take responsibility for the following agencies:**

- Customs Agency
- Immigration (Border Inspection Officers)
- CSIS
- RCMP
- Coast Guard
- A re-established Ports Police
- Communication Security Establishment (Counter-Terrorist Section)

- Office of Critical Infrastructure Protection and Emergency Preparedness

The Mandate of the Ministry will be:

- To protect the lives and property of Canadian citizens;
- Prevent the entry of inadmissible individuals and goods into Canada;
- Ensure the free and efficient flow of legitimate travellers and goods into and out of Canada;
- Enforce the laws of Canada; and
- Co-operate with foreign agencies to detect and prevent terrorist activities and apprehend foreign and domestic terrorists.

## **2. Creation of a bi-national (or tri-national) border management agency.**

- Staffed jointly by representatives of the Ministry of Public Protection and Border Management, their American (and Mexican) counterparts, the agency would monitor the entry of goods and people into and out of the North American continent and across the Canada-US (and US-Mexico) border(s).
- The agency would maintain a computer system that would monitor the arrival and departure of individuals and goods to and from the continent and across the Canada-US (and US-Mexico) border(s).
- Low-risk individuals who wish to participate in an automated pre-clearance program will be issued with an interactive identification card that can be utilized at any airport, seaport or land crossing on the continent, that would expedite their travel with minimal delay.
- Low-risk companies that wish to participate in an automated pre-clearance program will be permitted to utilize standardized Intelligent Transportation System (ITS) technology to ensure that these goods are expedited with minimal delay.
- Through the use of mutually agreed standards and the secondment of personnel to their sister agencies, ensure that the most intense scrutiny of goods occurs as they enter the continent and avoid duplication of effort when goods transit land border crossings.
- Where practicable, the agency would provide pre-clearance of airline passengers overseas.
- Working with the appropriate federal, provincial and state officials, the agency would ensure that there is appropriate infrastructure at airports, seaports and land crossings, to separate low-risk, pre-cleared individuals and goods, from those that are not.

### **3. Creation of new Parliamentary Oversight Committee**

- To ensure that the rights of Canadians are protected, oversight of this new ministry and the new anti-terrorist measures contained in Bill C-36 would be provided by a new parliamentary committee.
- All members of this committee would either be sworn into the Privy Council or take an additional oath of secrecy, that would give them access to classified material.
- Members of this committee would not be allowed to discuss classified material outside the committee, even with their caucus colleagues.
- During in camera meetings, Ministers and representatives of Ministerial agencies would be required to answer almost all questions from committee members.
- Exceptions would include source identification and third party information.
- Committee would also have power to review agency budgets in detail.
- Committee would provide non-classified reports to the House.

These recommendations, while not cast in stone, are the specific and detailed measures the government should introduce to protect Canada's border and ensure the efficient passage of goods and services between Canada and the United States. At a time when Canadians are waiting for us to act in their best interests, we need solid, clear and precise action that will protect Canadian sovereignty and improve economic performance. The PC-DR coalition's recommendations provide a good start for that necessary action.



## MINUTES OF PROCEEDINGS

Tuesday, November 20, 2001  
(Meeting No. 53)

The Standing Committee on Industry, Science and Technology met *in camera* at 3:44 p.m. this day, in Room 536, Wellington Building, the Chair, Susan Whelan, presiding.

*Members of the Committee present:* Stéphane Bergeron, Claude Drouin, Walt Lastewka, Charlie Penson, James Rajotte, Andy Savoy, Brent St. Denis, Chuck Strahl, Paddy Torsney, Joseph Volpe and Susan Whelan.

*In attendance: From the Library of Parliament:* Dan Shaw and Lalita Acharya, Research Officers.

Pursuant to Standing Order 108(2), consideration of the Economic Impact on Canada of the September 11, 2001 Terrorist Attacks.

The Committee resumed consideration of a draft report.

It was agreed — That the draft report be concurred in subject to the Members receiving a copy, as amended, by Wednesday, November 21, 2001 at 5:00 p.m. in order that they may submit changes, as necessary, to the Researchers.

It was agreed, — That the Report be presented (as amended) to the House at the earliest possible opportunity.

It was agreed, — That pursuant to Standing Order 109, the Committee request that the Government table a comprehensive response to this report.

It was agreed, — That the Chair be authorized to make such typographical and editorial changes, including choosing a title, as may be necessary without changing the substance of the draft report.

It was agreed, — That 1000 copies of the Report be printed in both English and French in tumble format.

It was agreed, — That the Committee authorize the printing of dissenting opinions as an appendix to this report, immediately following the signature of the Chair.

It was agreed, — That any dissenting opinions be received by the Clerk no later than Friday, November 23, 2001 at 12:00 p.m.

It was agreed, — That a News Release be issued.

It was agreed, — That a News Conference be held on Tuesday, November 27, 2001 at 10:15 a.m. at the National Press Gallery, 150 Wellington Street, Room 607.

At 5:40 p.m., the Committee adjourned to the call of the Chair.

Normand Radford  
*Clerk of the Committee*