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Widening Competition in North American Freight Transport: The Impact of Cabotage

by Stephen Blank and Barry Prentice

Executive Summary

Despite vast improvements in transportation technology, cross-border transportation remains more costly and less efficient than it should be. One important reason is that while trade in goods has been greatly liberalized over the past decades, trade in transportation services has not. This paper examines cabotage policies, which are pervasive and extensive non-tariff trade barriers that slow down and raise the cost of North America's transportation systems.

The term cabotage is used to refer both to the transport of goods from one point to another within a country and to the requirement that the transport of goods or people from one point to another within a country be carried out by a domestic carrier. In one form or another, cabotage restrictions have been in place for centuries.

Cabotage regulations are usually instituted for political reasons, the most obvious of which is to protect domestic transport routes and the labour that runs them. Security – the strategic importance of transport – has long been another reason. The ownership of the nation's transport fleets has been a defense issue. Moreover, they are woven into a dense network of rules on customs, taxation, and immigration.

The Free Trade Agreement (FTA), the North American Free Trade Agreement (NAFTA), and the Security and Prosperity Partnership (SPP) addressed various trade-related transportation issues, but kept current cabotage regulations in place. Domestic traffic was left in the exclusive domain of national carriers.

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Some forward movement on borders and regulation has occurred recently. In December 2011, President Obama and Prime Minister Harper released the Beyond the Border (BTB) Action Plan, also creating a United States–Canada Regulatory Cooperation Council (RCC) to increase regulatory transparency and coordination between the two countries. The Joint Action Plan encourages regulatory alignment for various transportation systems, but is silent on cabotage. Also, after a 17-year logjam, in 2011 a truck from Transportes Olympic, the first Mexican carrier to be issued operating authority to provide long-haul international cargo services between Mexico and the United States, departed from Nuevo Laredo, Tamaulipas to deliver machinery used for drilling to Garland, Texas.

A frontal assault on all forms of cabotage regulation is attractive but unrealistic at the moment. We should begin with a vision of an efficient, sustainable, and secure North American freight transport system as a foundation for cabotage reform. North America's interconnections and interdependence are critical elements of our economic welfare and global competitiveness. We are unlikely to be able to reform cabotage regulations without a significant level of public understanding of how North America works.

North America will never resemble the European Union, but we can learn from the European experience. "The guiding principle" of the EU Commission's first White Paper on the future development of the common transport policy, published in December 1992, "was the opening-up of the transport market." In 2001 the Commission reported, "Over the last ten years or so, this objective has been generally achieved, except in the rail sector." The complete reduction of cabotage regulation in the various freight sectors remains incomplete. But the vision created by the European Commission continues to be a key element in the liberalization process. We should be much more interested in what the Europeans have done, propose to do in the future, how they are doing it, and their successes and failures in doing so.

This paper makes industry-by-industry suggestions intended to make policy regarding transportation as unrestrictive as policies regarding the goods being transported.

Trucking

Most goods move across North American borders by truck. Cabotage regulations force many freight trucks to travel farther empty, particularly Canadian carriers because most Canadian markets lie within 200 miles of the US border. Under the immigration acts of Canada and the United States, a foreign driver must have a work visa, be a dual citizen, or half-aboriginal by blood in order to legally engage in cabotage, further limiting the potential for competition.

The "Open Prairies Proposal," a pilot project recommendation from a group of Canadian transportation experts, suggests a limited experiment in trucking cabotage. It would allow free trade in freight transport for US and Canadian truckers throughout the Prairie Provinces and several Upper Great Plains states. The proposal could be useful in illustrating the gains that might be achieved from freer trade in transportation, and would be valuable in building on cross-border state-provincial collaboration.

Shipping

Regarding marine transport, changes in cabotage rules, mainly the Jones Act (a piece of US maritime law covering a variety of issues including cabotage), seem unlikely.[1] A revival of short-sea shipping – that is, shipping carried on among Atlantic, Pacific and Gulf of Mexico ports – would allow for better use of North American coastal waterways, reduce interstate congestion, and improve freight transport. Since ending national regulations such as the Jones Act seems unlikely, another approach might be to create a single North American registry (or "flag") for ships that would permit North American ship builders and operators to work on a continental scale. More practicable might be an agreement on mutual recognition of each other's rules which could accomplish much the same as a single registry.

Air

Open Skies Agreements include many freedoms such as unrestricted routes to and from all cities in the country of origin and the partner country and the ability to set fares based on airlines' marketing decisions, but does not give cabotage rights. The implementation of these agreements has led to growth in the airline industry. To maintain the momentum, an integrated North American aviation market could be created.

Institutions

Despite the importance of these issues, no forum in North America now exists to consider these matters, to develop alternative policies, and to marshal support for them. It is time to recreate a Canada-United States (or North American) Chamber of Commerce, or, more directly, a North American Commission on Freight Transportation.

INTRODUCTION

How can we make the North American trading system work better? Experts have put various ideas on the table: Organizing a North American customs union; "thinning" our borders and creating a North American "security perimeter;" doing a better job of harmonizing regulations to eliminate the "tyranny of small differences." These are all important and useful ideas.

The impact of any of these changes, however, would be much diminished if goods don't move easily and inexpensively across our markets. Despite remarkable technological advances in railroads and trucks, the rise of air cargo, and the deregulation of our transport industries, cross-border freight and passenger transport is still less efficient than it should (and could) be. In other words, despite vast improvements in transportation technology, cross-border transportation remains more inefficient and thus more costly than necessary. Creating free trade (or at least freer) trade in transportation services, following the liberalization of trade in goods, would be the appropriate step forward.

This paper examines cabotage policies that undercut the efficiency of our transport services.

What is cabotage?

The term cabotage is used to refer both to the transport of goods from one point to another within a country and to the requirement that the transport of goods or people from one point to another within a country be carried out by a domestic carrier.[2] Historically, it relates to the time, centuries ago, when ships from northern Europe en route to the Mediterranean would stop along the Atlantic coast to drop off and pick up cargo and passengers, making their trips more profitable. In an effort to protect their own sea trade, the Portuguese restricted this practice to vessels that were locally owned and operated.[3] As new modes of transport developed (rail, truck, air), protection from competition in sovereign territory was extended to them.

How much do cabotage regulations cost us?

Efforts have been made to suggest the cost incurred in limiting trans-border trucking[4] and there is more information on the trans-border air passenger industry. But we will see that cabotage regulations are deeply embedded in a wide array of other regulatory systems – customs, taxes, labour markets, and immigration for example. Cabotage regulations affecting road transport, for example, waste fuel and increase congestion and emissions – all raising costs. Transport service providers adjust to these regulations and specific costs disappear into generalized accounting. But, as we shall see, cabotage regulations are pervasive and extensive non-tariff trade barriers that slow down and raise the cost of North America's transportation systems.

Why haven't cabotage regulations been eliminated?

Cabotage regulations are usually instituted for political reasons, the most obvious of which is to protect domestic transport routes and the labour that runs them. Security – the strategic importance of transport – has long been another reason. The ownership of the nation's transport fleets has been a defense issue. Moreover, they are woven into a dense network of rules on customs, taxation, and immigration.

Dealing with cabotage illustrates the difficulty of moving beyond a "free trade" agreement. Much like the physical infrastructure of highways and pipelines, cabotage rules are part of the complex regulatory infrastructure that also must be able to deliver goods and people efficiently. And, just as with physical infrastructure, it has been very difficult to build a coordinated effort among the NAFTA nations (or even between the United States and Canada) to reduce these barriers.[5] The European Union's Common Transport Policy has taken substantial steps to ensure the right to provide transportation services freely within the EU. The need to isolate domestic transport from competition within a trading block of allied countries like Canada and the United States needs to be reconsidered.

I. CABOTAGE AND TRADE LIBERALIZATION

Weren't the Free Trade Agreement (FTA), the North American Free Trade Agreement (NAFTA), and the Security and Prosperity Partnership (SPP) supposed to deal with this? What progress has been made on cabotage in the various trade negotiations over the past years?

The FTA, NAFTA, and SPP

FTA and NAFTA created a bilateral and then trilateral free trade region. The elimination of import customs tariffs was applied to cross-border sales of goods and some services. In the 1980s and 1990s, particularly following the implementation of NAFTA, the cross-border flow of goods in North America increased dramatically.[6] But the cost of trans-border freight transport has not benefited from the healthy competition created in the manufacturing and resource sectors.

While FTA took steps to liberalize access to international transport markets, it retained cabotage regulations on domestic transport.[7] Investment restrictions were lifted and Canadian and American trucking companies consolidated operations in more competitive domestic environments through mergers and acquisitions. Trucking companies were able to exploit the benefits of deregulation in their domestic markets so efficiency gains were reflected in dramatically reduced unit costs for transport within countries.

Deregulation also enabled some carriers to aggressively grow trans-border business. Although they were not able to exploit fully the asset utilization potential or network efficiencies that might have been possible if they could have moved freely across the border, cross-border triangular routes became possible. With triangulation, a front haul (typically earns returns but ends in a less desirable location) and a backhaul (usually loses money as the truck returns empty or less than full from the front haul) situation is transformed into three or more front hauls. A well-known counter-clockwise triangular cross-border route is from Winnipeg to Chicago, on to Toronto, and back to Winnipeg.[8]

NAFTA made substantial changes important to land transportation suppliers. It opened the market for international point-to-point traffic (earlier, goods had to be transferred from Canadian to US trucks and vice versa at the border, just as the same process continued along the US-Mexico border). NAFTA extended many of the gains made for Canadian and US companies in FTA to Mexican firms, albeit through a phased-in approach.

NAFTA did not alter any cabotage regulations. Restrictions on foreign competition continued through customs regulations that pertain to the vehicle and immigration/employment regulations. Domestic traffic would still be in the exclusive domain of national carriers.

Several post-NAFTA Working Groups set up to review these matters achieved some success.[9] But critical issues remained unresolved including free access to neighboring transport services that continue to be blocked by immigration restrictions affecting transportation workers, differences in vehicle weights and dimensions, and customs requirements. Some agreed-upon arrangements – dealing with Mexican trucking, for example – are only now being implemented.

In sum, free trade in transportation services advanced slowly, even with NAFTA. It is true that Open Skies agreements (see page 12) have increased cross-border air competition, but all these treaties have done is to bring air transport up to the level of trans-border trucking prior to NAFTA. As one expert wrote, "[I]f goods have been freed from protectionist barriers, it seems strange that protection for the transportation modes by which these goods are moved should continue... Unfortunately, it remains securely in place."[10]

NAFTA negotiations never strayed beyond the notion of three separate national transportation systems. The agreement provided no commitment to a "North American freight transportation system." It created no institutional arrangements to monitor transportation requirements, identify emerging problems, or suggest possible ways of responding to them. This choice forms a stark contrast with the strategy of the European Commission – to be sure, not always successful – to deliberately use freight transportation systems to enhance integration.[11]

The SPP reiterated much of the earlier NAFTA agenda for transportation, including:[12]

- Explore opportunities for expanding air transportation relations on a bilateral and trilateral basis.
- Facilitate border trade and traffic flows by expanding border infrastructure and cross-border commuter services to enhance trade flows by reducing border delays.
- Enhance short-sea shipping.
- Recognize and harmonize North American motor carrier regulations and standards to improve commercial road transportation efficiency by coordinating, where feasible, vehicle weight and dimension standards and administration.
- Examine the benefits of an intermodal transportation concept for North America.

The SPP agenda mentioned a "North American transportation system," but did not touch on cabotage. In any case, the SPP disappeared amidst fears that it was the portent of a North American Union, and little of its agenda was realized.

Beyond the borders: Regulatory cooperation and Mexican trucking agreements

Some forward movement on borders and regulation has occurred recently. In December 2011, President Obama and Prime Minister Harper released the Beyond the Border (BTB) Action Plan. The "Key Areas of Cooperation" laid out in the Action Plan would create new integrated programs to enhance security and to facilitate trade, economic growth, and job creation. This would be achieved by addressing threats early, improving cross-border law enforcement, developing new infrastructure and cyber-security capacities, and by improving border management.

At the same time, the two leaders directed the creation of a United States–Canada Regulatory Cooperation Council (RCC) to increase regulatory transparency and coordination between the two countries. The RCC section on transportation underlines the familiar commitment to collaborate closely on transportation regulatory issues. The Joint Action Plan encourages regulatory alignment for various transportation systems, but is silent on cabotage.[13]

A second development was a breakthrough on Mexican trucks. This was not as comprehensive as the United States-Canada BTB-RCC, but nonetheless important. In 1994 NAFTA laid out a schedule for implementing its trucking provisions that would have opened the states on the southern border to cross-border trucking competition in 1995 and all of North America in 2000. Full implementation was stalled because of the concerns of US trucking unions and US truck owner-operators. Mexican trucks and drivers might not meet US safety standards and, once operating deep in the United States, Mexican carriers might engage in illegal hauling, threatening US jobs. Mexican truck owners also resisted, fearing that free access would permit larger US firms to establish a dominant position in the Mexican market. Efforts to get Washington to carry out its NAFTA obligations involved intense politicking during several administrations. When a new “demonstration” program was finally scheduled to start in April 2007 that would have permitted 100 Mexican trucking companies to send trucks to destinations within the United States, the program was “defunded” by Congress. In retaliation, Mexico imposed a basket of tariffs.

At last,[14] a July 6, 2011 Memorandum of Understanding seems to have broken through this logjam. On October 21st a truck from Transportes Olympic, the first Mexican carrier to be issued operating authority to provide long-haul international cargo services between Mexico and the United States, departed from Nuevo Laredo, Tamaulipas to deliver machinery used for drilling to Garland, Texas. Mexico responded by lifting its retaliatory tariffs.

Measures contained in the BTB, RCC, and Mexican trucking agreements are important and useful. They have been on the table for years and could (and should) have been put in place long ago. The RCC Mandate is familiar to anyone who has followed suggestions for regulatory harmonization made since NAFTA was first signed. These agreements suggest that concerns about economic development may help reverse the trend toward thickening the North American border that began following 9/11. Perhaps with a thinner border, freight transportation will flow more freely between the North American economies, but with continued cabotage regulation, inefficiencies and constrained competition will make transportation costs a larger barrier to trade than it should be.

II. DIFFERENT FORMS OF CABOTAGE

Cabotage regulations in North America are wide ranging and impose significant restraints on freight transportation. In this section, we examine cabotage in truck transport, shipping, marine containers, and air transport.[15]

Cabotage and truck transport

Most goods move across North American borders by truck.[16] Cabotage regulations are not the only factors that limit more efficient truck transport but they are significant in doing so.

Triangular routes in North America are not always available, so many freight trucks are forced to travel farther empty, particularly Canadian carriers because most Canadian markets lie within 200 miles of the US border. Cabotage regulations make cross-border triangulation difficult because the base of the "triangle" always has to be in the domestic market. This means that more trucks are on the road wasting fuel, worsening congestion (particularly at border crossings), generating unnecessary emissions, and running up costs. Freer movement of trucks would permit more triangulation so that fewer trucks would handle the same amount of freight. This would lower total costs to shippers, as the benefits are passed on by competition and reduce environmental and safety risks.

For all intents and purposes, cross-border truck competition is negligible in domestic markets. A truck returning home can carry domestic goods between the point at which it dropped off its international load and another point in the other country, but that portion of the trip must be "incidental" to an international move. Only one incidental (domestic) move is permitted per international trip and the move must follow a route consistent with the international route of the imported or exported goods. The domestic pick-up and delivery must allow for only "minor deviations" from the international route. In Canada, this is a "repositioning move," and in the United States, a "return trip-outward move."

In the United States, repositioning regulations restrict Canadian tractor-trailers to hauling domestic goods only on "regularly-scheduled" international runs and force them to proceed northward (or "outward") while moving these goods. This has been a source of irritation for Canadian carriers, who complain that US carriers engage in "illegal" east-west cabotage while they themselves can only carry US goods while moving northward. In fact, the source of the difficulty is a lack of strict reciprocity in the letter of the Canadian law.[17]

This all gets tangled in tax and immigration issues as well as competition acts, regulations on foreign ownership of domestic industries, and provincial/state motor vehicle legislation.

Expert Darren Prokop provides a fine example of these extended problems. He notes that talks between the American Trucking Associations (ATA) and Canadian Trucking Alliance (CTA) on liberalizing their country's customs acts reached an agreement in 1995 that would allow for one free cabotage move for every international move. He writes: [18]

> The ATA-CTA proposal stalled in 1997 because of Canada's insistence that US carriers not be exempt from goods and services tax on their cabotage activities within Canada. By contrast, the US government's 12 per cent federal excise tax, not being a value-added tax, would not apply to a Canadian carrier's cabotage activity in the United States. Revenue Canada wished to apply the GST in two ways: First, to the value of the service rendered — which was not a grave concern for the ATA — but, second, to the full market value of the US equipment to be used in cabotage. This would likely have been assessed as a one-time levy at the border. Given that the tax base would be around $500,000 per tractor-trailer, all talk of reform was shelved. The purpose of such a levy would have been to maintain a level playing-field with respect to Canadian truckers, who would have paid GST when buying their rigs. To date, the Department of

> Finance — which is responsible for the *Excise Tax Act* — shows no sign of being amenable to a GST exemption for trucking cabotage. A second GST-related difficulty is that, while US truckers could claim a GST input tax credit on cabotage service, such a credit normally would not be available to them on the value of their equipment. To claim that, they would have to sell their rigs in Canada, which they would almost certainly not do merely to engage in cabotage.

What is particularly impressive here is not only the case, but that the situation continues, after almost 20 years and a huge increase in cross-border trade.

Immigration issues and truck transport

Immigration rules that apply to truck drivers further limit the potential for competition. Under the two countries' respective immigration acts, a foreign driver must have a work visa, be a dual citizen, or half-aboriginal by blood in order to legally engage in cabotage.

Mexican trucks

It should be clear that opening the southern border to Mexican trucks will probably not make an enormous difference as long as strict limitations on access continue to apply. One can bet that Mexican truckers will not be eager to send their best vehicles north from Monterrey to Kansas City, for example, unless they are certain a truck load will be available for the southbound return to Mexico.

Trade impacts are never one-sided. Current cabotage regulations mean that the availability of truck transport biases the trade patterns of the United States' neighbors. Canada tends to trade with the northern states, and Mexico will be more inclined to trade with the southern states. Exporters in the northern US states are denied opportunities for lower cost freight to Mexico, and US exporters in the southern states are made less competitive in the Canadian market. Truck shipments between Canada and Mexico would be more economic if their carriers could transport each other's freight to the United States on their return. Although such freight is international, US immigration and employment regulations block Canadian trucks from carrying Mexican freight to US destinations. This would likely be the case for the Mexican trucks coming to Canada, too.

Cabotage and shipping: Short-sea shipping and marine containers

Discussions of marine cabotage regulation almost inevitably point to the US Jones Act (the Merchant Marine Act of 1920) as an egregious example. The Jones Act covers a variety of maritime issues, including cabotage, stating that cargo may not be transported between two US ports unless it is transported by vessels built and registered in the United States, owned by citizens of the United States, and manned by a US crew. The Jones Act was no policy innovation. In 1817, the US Congress barred foreign-flagged ships from engaging in American coastal trade. This was not new then either. Britain's Navigation Act of 1651 had restricted trade with its North American colonies to British ships.

Canadian policy does not differ in its main intention. Canada's maritime efforts have focused almost exclusively on nurturing a domestic marine transportation capacity, with maritime cabotage regulation a key element in the policy. One key difference is that Canada does not have a Jones Act-esque “built in Canada” regulation, but requires an operator to convert the vessel to meet unique Canadian specifications.[19]

Protection of coastal trade is contrary to the overall liberalized trade intentions of FTA and NAFTA. In the NAFTA negotiations, the Canadian shipping industry hoped to get the United States to agree to a waiver system (like that which exists in Canada to allow a foreign flag ship if no suitable Canadian one is available) and to remove the ownership provisions. The United States rejected this request because it did not want to open maritime transport services to the dispute resolution process that was being set up under the NAFTA, and sought to maintain its ability to engage in retaliatory action under its Foreign Shipping Practices Act of 1988.

In both negotiations the United States was not prepared to relax its national regulatory regime. It defended its protectionist stance by arguing that cabotage regulations are near universal. While many countries do impose cabotage regulation, the scope of US restrictions is almost unparalleled. Nonetheless, in concluding the NAFTA negotiations, all three countries listed marine cabotage as areas which it wanted excluded from the agreement’s coverage.

Short-sea shipping

Better use of North American waterways would improve freight transport. Only 2 percent of US domestic freight among the lower 48 states is moved by sea. A recent report on coastal (short-sea) shipping notes “virtually no coastal shipping for cargo currently exists between US ports in the lower forty-eight states, despite the fact that the interstate highway system is at or near capacity.”[20] Could a revival of short-sea shipping (SSS) create economic value without incurring significant new environmental or security costs?[21] The authors of this report write:

> We must return to the sea to get freight moving. The now underused deep blue highway could provide resilience and improve the environmental performance of the nation’s transportation system. Coastal shipping could complement, not compete with, trucking and rail. This is especially critical given current pressures on the trucking industry, such as rising fuel costs and labor shortages. In our research we have found a growing chorus from numerous and diverse constituencies eager to move freight off the land and onto the water.[22]

There are glimmers of hope for those interested in the removal or rationalization of marine cabotage within the NAFTA area. One is the interest expressed by the three NAFTA countries in the development of short-sea shipping, and another is the memorandum they signed in 2003 to collaborate on examining the future potential of this alternative to all-land transportation. One more is the waiver of Jones Act regulations in the wake of Hurricane Katrina for disaster response purposes and, more recently, for supplying storm-wracked Nome with vital fuel oil. However, enthusiasm must be tempered by the clear expression to-date on the part of Mexican officials that cabotage rules afford Mexican nationals an opportunity to rebuild their small domestic fleet for short-sea purposes, and by US labor and Congressional leaders that the Jones Act is sacrosanct.

Marine containers

The movement of foreign marine containers is guided and constrained by various regulations. In Canada, the liberalization of cabotage regulations on foreign marine containers is more of a success story. Unlike the cabotage issues explored thus far, container cabotage regulations deal only with customs. Container cabotage is also distinct because it affects third party relationships with the NAFTA countries. International ocean carriers that serve North America call on both Canadian and US ports when moving containers around the world. Differences in how the United States and Canada treated the third parties caused the global carriers to treat Canada and the United States as completely separate markets.[23]

The United States had a more liberal container policy than Canada. A foreign container can be used anywhere in the United States for a period of one year providing it is carried on a US owned vehicle. Containers in the United States are regulated as if they are reusable packaging. In Canada, container cabotage regulations more closely resembled the restrictions on foreign trucking. Only one incidental repositioning move was permitted, with no backtracking. Containers were given only 30 days in Canada before being re-exported.

This subject was explored by the Canadian Senate's Standing Committee on Transport and Communications.[24] On December 15, 2009 the Customs Tariff regulations were amended to facilitate cargo container movements within Canada and to harmonize the treatment with the container cabotage regulations of the United States.

The impact of extending freer trade to international marine containers on Canadian shippers or the North American market is yet to be explored, but logic suggests efficiency will be gained.

Cabotage and passenger-cargo air transport

The air transport industry is complex. Like land travel, there are two distinct elements: Passengers and freight. But unlike trucks, buses, and private automobiles, which work independently, a substantial amount of cargo is carried in the bellies of commercial passenger aircraft. There are also dedicated air freight transport industries: Couriers (such as UPS and FedEx) and cargo airplanes. The air cargo industry has grown rapidly globally and in North America in recent years, particularly as a result of the creation of global cross-border supply chains. Finally, while air cargo is a small part of trade by volume or weight, it is very large in terms of value.[25]

The regulation of air cargo in North America has been driven by the requirements of the passenger business. Efforts to produce a separate regime for air cargo have failed globally. We discuss air passenger and freight cabotage issues together in this section.

Open Skies Agreements

The United States moved more aggressively than Canada to liberalize its aviation policies. With the deregulation of its domestic aviation market in 1978, Washington launched an international policy that relied on market forces in areas such as pricing and charters. In the mid-1980s, this was followed by an "Open Skies" policy framework and the conclusion of bilateral agreements with many foreign governments. The Open Skies framework included unrestricted routes to and from all cities in the United States and the partner country. No limits were made on the number of airlines allowed to operate or the number of flights they could offer. Fares could be based on airlines' marketing decisions.

In 1985, Ottawa followed Washington's 1978 action toward deregulating air transport, and in 1995 Canada signed a bilateral "Open Skies" agreement with the United States. The agreement allowed for more liberalized movement of passengers throughout North America. A separate agreement applied to all-cargo services.

The Open Skies Agreement led to a sharp increase in the capacity of scheduled airline services between the two countries, with an increase of 25 percent in the first year alone. But the Open Skies agreement did not give the foreign air carriers cabotage rights for passengers or air cargo. It did not permit airlines from the United States or Canada (or any investors) to establish airlines in the other country or to practice "co-terminalization" (permitting a carrier to deliver goods to more than one airport in the other country).

Co-terminalization

Over the next years, the most important development was the expansion of preclearance for US bound passengers at many Canadian airports and US cargo co-terminalization. In 2005, an updated bilateral Open Skies Agreement permitted both passenger and cargo carriers from either country to enter the other country's territory, make a pick-up, and continue on to a foreign destination.[26] Co-terminalization is now permitted so US carriers can unload cargo in multiple Canadian cities. The agreement permits carriers to operate international, standalone, all-cargo services between the partner's territory and foreign countries and, notably, without any required connection to the carrier's home territory.

Ottawa's 2006 "blue-sky" policy to liberalize air transport between Canada and other countries underlined that there would be no limits on the number of airlines permitted to operate in Canada or on the frequency of service, but it rejected EU-style open competition. "Transport Canada, the agency responsible for airline policy in Canada, states bluntly and clearly what is not included in its policy approach to air-transportation negotiations: 'Under no circumstances will the policy approach include cabotage rights—the right for a foreign airline to carry domestic traffic between points in Canada.'"[27]

In 2006, Ottawa seemed poised to take a further step, raising the idea of a single North American aviation market, including the controversial idea of allowing foreign airlines to service domestic routes. A North American accord would include all three NAFTA countries and would promote competition and give Canadians more air travel options. This vision for an open North American aviation market inched a bit closer in April 2007 when the United States, Canada, and Mexico announced a plan to work toward establishing a Trilateral Open Skies Agreement. The idea crashed a few months later when the Mexican government ruled out such an agreement. The notion has been dormant since then.

III. WHAT SHOULD (CAN) BE DONE?

Cabotage is a difficult issue to manage. Complexity is one reason. In the case of trucking, different regulations can apply to the cargo, the truck (which consists of a power unit and a trailer), to a container (if there is one), and to the driver. Transferring goods from one container or rig to another or moving goods from plane to plane at airports is complicated, as is moving around empty containers. Moreover, cabotage rules are often just one element in a nexus of interconnected regulations. It is not just a matter of permitting Canadian trucks, for example, to conduct point-to-point business in the United States. This would involve tax policy, immigration rules, and safety regulations – and also politics. Cabotage regulations protect national businesses, which are typically profoundly reluctant to open the doors to new competitors.

Nonetheless, the need for reform is widely recognized. The CEO of the Canadian Trucking Association recently stated: "We're not talking about wide-open cabotage, but I think if anyone were to take a step back and look at the situation, and see different rules for trucks and the people who drive them, and restrictions on something as simple as re-positioning an empty trailer, they would realize that this is an area that is crying out for reform."[28]

Various recommendations for reform have been advanced. What can we say about them?

A frontal assault on all forms of cabotage regulation

A frontal assault on all forms of cabotage regulation is attractive. Can we go for the whole banana and seek to move directly to free trade in transportation? Darren Prokop says "[t]he ultimate goal for trade rationalization should be complete removal of all cabotage regulations. Transportation facilitates trade. For North America, complete cabotage reform would result in efficiency gains in terms of an increase in the volume of trade and a lowering of average operating costs for trans-border trucking firms."[29] This is undoubtedly accurate, but it is hard to imagine who, at the moment, would lead this charge.

Industry-by-industry approaches

Air

For example, an integrated North American aviation market could be created. "Under this scenario, Canada's efforts would essentially be channelled towards integration of North American markets similar to that which presently exists within the European Union. The final result would be that carriers in the three countries would have the same rights in each of these countries, giving them total freedom of 'domestic' operation."[30] A 2005 report from the Montreal Economic Institute goes on to say:

In the initial phase, for example, each country could agree to raise foreign ownership levels from 25% to 49%. Limited cabotage could then be introduced as an extension of existing services. For example, an Air Canada flight from Montreal to Chicago could carry American passengers between Chicago and Los Angeles, while an American Airlines flight between Chicago and Toronto could carry passengers between Toronto and Halifax.

In a further step towards this gradual integration, carriers from any one of the three countries could be allowed to serve a neighbour's domestic market through transborder links. For example, WestJet could sell Boston–Seattle seats through Boston–Toronto and Toronto–Seattle flights. Similarly, United Airlines could connect Montreal and Vancouver via Chicago.

Water and short-sea shipping

Regarding marine transport, changes in cabotage rules, mainly the Jones Act, seem unlikely. After a brief flurry of interest in short-sea shipping between 2003 and 2006, attention shifted elsewhere and interest fell sharply. Professor Brooks' extensive review of reports on short-sea shipping on the Atlantic, Pacific, and Gulf coasts reveals a lengthy list of significant policy challenges to developing the industry in addition to cabotage restrictions. Among these, and perhaps critical in terms of dealing with the others, was the absence of a continental mindset that would focus on a wider cost-benefit analysis of possible short-sea shipping activities and, hopefully, raise short-sea shipping a few notches on the North American agenda.[31] A possible approach might be to seek to create a single North American flag or a mutual recognition agreement that would give Mexican, US, and Canadian operators equal opportunity in each country.

Trucks

The "Open Prairies Proposal," a pilot project recommendation from a group of Canadian transportation experts, suggests a limited experiment in trucking cabotage.[32] It would allow free trade in freight transport for US and Canadian truckers throughout the Prairie Provinces and several Upper Great Plains states. The authors write that "a limited North American experiment in cabotage could be of significant value…to other state and U.S. Federal authorities in determining appropriate directions for their reforms," and propose the following minimum conditions for a Canadian/US experiment in cabotage for trucking:

- The experiment should be reversible. Indeed, to prevent the experiment from passively morphing into the status quo, from the onset the mechanism for its termination should be in place.
- Involve large enough areas in both countries to generate detectable effects from allowing cabotage.
- As the experiment would be intended to be limited, the directly affected regions should account for relatively small shares of both economies and populations.

This kind of pilot project could be useful in illustrating the gains that might be achieved from freer trade in transportation. It would be valuable, too, in building on cross-border state-provincial collaboration. The problem, of course, is that we are confronting national regulations and national transportation markets.

Collaboration among trade associations

Another industry-focused approach would encourage collaboration among trade associations. The US and Canadian national trucking associations advanced a joint recommendation that would allow for one free cabotage move for every international move. This came undone over tax problems. The two tried again in 2006, agreeing to work together in a push to allow for greater flexibility in the movement of empty trailers by foreign truck drivers, specifically to allow foreign drivers to reposition empty trailers if they have been disconnected from the power unit that brought them across the border.[33] "By liberalization we mean, if a Canadian driver delivers a loaded trailer in the U.S., he or she should be able to pick up an empty trailer and reposition it to another location. The same would go for a US driver in Canada," said Margaret Irwin, Director of Customs, Immigration and Cross-Border Operations with the ATA. "CTA is looking forward to working with the ATA to advance a common position on the movement of empty trailers by foreign drivers," said Ron Lennox, CTA Vice President of Trade and Security. "Both countries need to move in harmony on this issue, so the result will be fair for both."

Cabotage issues bleed into tax, immigration, and other issues, so complexity is a key constraint to industry level cooperation. Competition is another. Trade barriers may run up costs to the final user, but there are winners as well, at least in the short term. In the airline industry, for example, cooperation is hard to organize among companies that are often desperate for any short-term advantage. In trucking, however, the need for cabotage reform has been recognized, but the old CTA-ATA idea is still under discussion and inefficiency continues. Early in 2011, a senior executive in the Bison Transport trucking firm reported that the company was paying about $40,000 per month to hire US carriers to run its empty trailers about 30,000 unpaid miles for repositioning purposes.[34]

Learn from others

North America will never resemble the European Union, but we can learn from the European experience. “The guiding principle” of the EU Commission’s first White Paper on the future development of the common transport policy, published in December 1992, “was the opening-up of the transport market.” In 2001 the Commission reported, “Over the last ten years or so, this objective has been generally achieved, except in the rail sector. Nowadays, lorries are no longer forced to return empty from international deliveries. They can even pick up and deliver loads within a Member State other than their country of origin. Road cabotage has become a reality. Air transport has been opened up to competition which no-one now questions, particularly as our safety levels are now the best in the world. This opening-up has primarily benefited the industry and that is why, within Europe, growth in air traffic has been faster than growth of the economy.”[35] The complete reduction of cabotage regulation in the various freight sectors remains incomplete. But the vision created by the European Commission continues to be a key element in the liberalization process. We should be much more interested in what the Europeans have done, propose to do in the future, how they are doing it, and their successes and failures in doing so.

On our side of the Atlantic, however, "the opening up of the transport market" has scarcely been on anyone's agenda. Barriers to free trade in transportation, such as cabotage regulations, are found throughout our transport systems and yet successive efforts, from FTA to the RCC, have largely avoided confronting them. As noted, we have little sense of the full cost of cabotage regulations or, more widely, of the cost of barriers to free trade in transportation.

Some incremental successes have been registered, for example in co-terminalization and the movement of containers. But while reform of individual regulations must be pursued, a broad effort to confront these barriers must begin with efforts to heighten public awareness and information.

A North American freight transport system

Following Brooks' comment about a "continental mindset," we should begin with a vision of an efficient, sustainable, and secure North American freight transport system as a foundation for cabotage reform. North America's interconnections and interdependence are critical elements of our economic welfare and global competitiveness. We are unlikely to be able to reform cabotage regulations without a significant level of public understanding of how North America works.

Much work needs to be done, however. Forecasts of individual transport sectors, typically based on straight-line projections of past performance, have been carried out. But one searches in vain for multi-sector, scenario-based analyses of possible transportation developments, for any sense of what an efficient, sustainable, and secure North American freight transport system might look like.[36] To date, whenever opponents raise the cry of lost jobs or dissolving sovereignty, the few officials advancing North American policies beat a hasty retreat.

A North American forum for discussion

Moreover, there is no North American forum for discussing these matters. Those who negotiated NAFTA in 1992-93 were determined to avoid creating anything that resembled "Europe 1992" – the single market. One result is that North America is impressively "institution-lite" and we have failed to fill this gap. Those interested in North America were frustrated by the failure of the SPP project to get off the runway and by the collapse of the North American Competitiveness Council, the private sector entity associated with the SPP.[37] One need not be too cynical to suggest that the RCC will not achieve much more. A few think tanks focused on North American matters (the C.D. Howe Institute and the Institute for Research on Public Policy most noteworthy among them) but their interest in this aspect of free trade has waned in the past years.

The starting point to build support for a policy of free trade in transportation has to be an informed dialogue with governments. It would be unwise to attempt to take on barriers in every industry at once, given the complexity of the situation. Data must be marshaled to reveal the costs incurred in inhibiting more efficient transportation services and gains that might be enjoyed by wider competition. But no forum in North America now exists to consider these matters, to develop alternative policies, and to marshal support for them. The United States-Canada Chamber of Commerce ceased to exist long ago and the influential Canadian-American Committee (and its successor the North American Committee which included representatives of labor and the research communities) collapsed when funding dried up a decade ago.[38] It is time to recreate a Canada-United States (or North American) Chamber of Commerce, or, more directly, a North American Commission on Freight Transportation.[39]

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[1] On the Jones Act (US Merchant Marine Act of 1920), see Mary Brooks. 2008. *North American Freight Transport: The Road to Security and Prosperity.* (Cheltenham, UK: Edward Elgar): pp. 122-129

[2] See the Oxford Dictionary, http://oxforddictionaries.com/definition/cabotage.

[3] Much earlier, the Phoenicians originated the concept (if not the term) when they were the first to restrict foreign vessels from carrying goods among their ports.

[4] See Richard Beilock, Robert Dolyniuk, and Barry Prentice. 2006. "Encouraging Development through Better Integration of U.S. and Canadian Transportation: The Open Prairies Proposal." *Regional Economic Development,* Federal Reserve Bank Of St. Louis, Volume 2(2): 73-86.

[5] See Stephen Blank, Graham Parsons, and Juan Carlos Villa. 2008. "Freight Transportation Infrastructure Policies in Canada, Mexico & the US: An Overview and Analysis." North American Transportation Competitiveness Research Council, Working Paper No. 5.

[6] From 1993 to 2007, trade among the NAFTA nations more than tripled, from $297 billion to $930 billion (including shipments among establishments within the same company). See Gary Clyde Hufbauer and Jeffrey J. Schott "NAFTA Revisited" *Policy Options* (October 2007)

[7] This and the following paragraph are drawn from: Brooks. 2008. *North American Freight Transport: The Road to Security and Prosperity,* 47-49. See also: Mary Brooks. 2000. "NAFTA and Transportation: A Canadian Scorecard." Centre for International Business, Dalhousie University (Research Paper 177). We are beneficiaries of Professor Brooks' extensive work in these areas, but emphasize that she is not implicated in any errors of fact or judgment in this paper.

[8] A clockwise triangular route operates from Atlantic Canada to New York, and home to Atlantic Canada via a load first to Montreal or Toronto.

[9] See "Initial Five-Year Plan for Increased Cooperation in the Field of North American Transportation Technologies" signed by Canada, Mexico, and the United States on June 12, 1998. Available at www.tc.gc.ca/pol/nafta-alena/en/plenaries/plenary_1998/TCG4.htm.

[10] Darren Prokop. 1999. "In 1988 We Freed Trade. Now Let's Free Transport." *Policy Options*: 38.

[11] See European Commission Directorate-General for Energy and Transport. 2009. *A Sustainable Future for Transport: Towards an Integrated, Technology-led and User Friendly System.* (Luxembourg: Publications Office of the European Union, 2009). Available at http://ec.europa.eu/transport/publications/doc/2009_future_of_transport_en.pdf.

[12] Security and Prosperity Partnership of North America, Report to Leaders, June 2005.

[13] UNITED STATES–CANADA BEYOND THE BORDER: A SHARED VISION FOR PERIMETER SECURITY AND ECONOMIC COMPETITIVENESS, Action Plan, December 2011, p. 1

[14] For the full story up to the beginning of 2010, see: John Frittelli. 2010. "North American Free Trade Agreement (NAFTA) Implementation: The Future of Commercial Trucking Across the Mexican Border." Congressional Research Service Report 7-5700.

[15] See the brief but comprehensive paper by Joseph Monteiro and Benjamin Atkinson. 2009. "Cabotage - Are We Ready? How Is It Dealt with in Various Sectors of Transportation in Canada?" Canadian Transportation Research Forum, 44th Conference Proceedings: The Impact of Volatility on Canada's Supply Chains and Transportation.

[16] See Jean-Paul Rodrigue, Brian Slack and Stephen Blank "Transport Corridors in North America", The Geography of Transport Systems http://people.hofstra.edu/geotrans/eng/ch2en/appl2en/ch2a1en.html

[17] Darren Prokop. 1999. "In 1988 We Freed Trade. Now Let's Free Transport." *Policy Options*: 38-39.

[18] Darren Prokop. 1999. "In 1988 We Freed Trade. Now Let's Free Transport." *Policy Options*: 39.Prokop, p. 39.

[19] J. R.F. Hodgson and Mary R. Brooks. 2007. "Towards a North American Cabotage Regime: A Canadian Perspective." *Canadian Journal of Transportation 1*(1). See: Mary Brooks. 2006. "The Canadian Industry" in *The Jones Act Under NAFTA and Its Effects on the Canadian Shipbuilding Industry*, The Atlantic Institute for Market Studies, Research Paper: 5-6; and Mary Brooks. 2008. *North American Freight Transport: The Road to Security and Prosperity.* (Cheltenham, UK: Edward Elgar): 122-129. Note that Canada's punitive customs tariff of 25 percent on non-NAFTA cargo ships was removed in the 2010 federal budget.

[20] Scott G. Borgerson et al. 2008. "America's Deep Blue Highways: How Coastal Shipping Could Reduce Traffic Congestion, Lower Pollution, and Bolster National Security." Institute for Global Maritime Studies: 19.

[21] For a good if slightly dated overview of SSS from the US perspective, see: United States Government Accountability Office. 2005. "Freight Transportation: Short Sea Shipping Option Shows Importance of Systematic Approach to Public Investment." Report GAO-05-768.

[22] Scott G. Borgerson et al. 2008. "America's Deep Blue Highways: How Coastal Shipping Could Reduce Traffic Congestion, Lower Pollution, and Bolster National Security." Institute for Global Maritime Studies: v.

[23] Erica Vido, Dr. Barry Prentice, and Jake Kosior. 2001. "An Assessment of North American Container Cabotage Regulations: The Impact on Canadian Operations." Province of Manitoba**,** Transportation and Government Services.

[24] 2008. Time for a New National Vision - Opportunities and Constraints for Canada in the Global Movement of Goods. Available at http://www.parl.gc.ca/Content/SEN/Committee/392/tran/rep/rep07jun08-e.htm.

[25] The International Air Cargo Association says that air freight constitutes about 2 percent of world trade by volume and about 40 percent by value. By value of goods processed, JFK is the second largest North American port.

[26] 2006. "Liberalization of the Skies: New Canada-US Open Skies Agreement." International Law Office. Available at http://www.internationallawoffice.com/Newsletters/Detail.aspx?r=12036.

[27] Mark Milke. 2010. "Open Skies: What North America Can Learn from Europe." American Enterprise Institute, Regulation Outlook (3): 5.

[28] 2011-09-16. "CBSA signals possible cabotage crackdown." *Canadian Transport and Logistics*. Available at http://www.ctl.ca/news/cbsa-signals-possible-cabotage-crackdown/1000586037/.

[29] Darren Prokop. 1999. "In 1988 We Freed Trade. Now Let's Free Transport." *Policy Options*: 39.

[30] Montreal Economic Institute. 2005. "Towards open skies for airlines in Canada." Economic Note, Regulation Series: 3-4. Available at http://www.iedm.org/files/mai05_en.pdf.

[31] Mary Brooks. 2008. *North American Freight Transport: The Road to Security and Prosperity.* (Cheltenham, UK: Edward Elgar): 132-137.

[32] Richard Beilock, Robert Dolyniuk, and Barry Prentice. 2006. "Encouraging Development Through Better Integration of U.S. and Canadian Transportation: The Open Prairies Proposal." *The Federal Reserve Bank of St. Louis Regional Economic Development 2*(2).

[33] Julia Kuzeljevich. 2006-04-03. "CTA/ATA to jointly pursue cabotage liberalization*." Canadian Transport and Logistics.* Available at http://www.ctl.ca/news/cta-reaffirms-support-for-cabotage-liberalization/1000057081/.

[34] James Menzies. 2011. "Are American carriers flouting Canadian cabotage rules?" *Canadian Transportation & Logistics.* Available at http://www.ctl.ca/news/cabotage-concerns/1000402918/.

[35] Commission of the European Communities. 2001. "White Paper: European transport policy for 2010: Time to decide." Page 6.

[36] See: Stephen Blank with Malcolm Cairns. 2008. "Drivers of Change: Envisioning North America's Freight Transportation System in 2030." North American Transportation Competitiveness Research Council, No. 7.

[37] See: Jeffrey Ayres and Laura Macdonald. Forthcoming 2012. "Democratic Deficits and the Demise of the Security and Prosperity Partnership of North America: The Role of Civil Society." In Ayres and Macdonald (eds), *North America in Question: Regional Integration in an Era of Economic Turbulence*. (Toronto: University of Toronto Press).

[38] The Canadian-American Business Council based in Washington, DC has tried to step into the CAC's shoes, but it has none of the impressive research capacity that distinguished the CAC.

[39] See: Stephen Blank. Forthcoming 2012. "North American Freight Transportation Issues." In Alex Bugailiskis and Andrés Rozental (eds), *Canada Among Nations 2011-2012.* (Kingston, ON: McGill-Queens University Press).