Regionalism Within Multilateralism: The WTO Trade Policy Review of Canada

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1. INTRODUCTION

THE World Trade Organisation's 2003 Trade Policy Review of Canada (WTO, 2003a) begins with praise for Canada's liberal and multilateral policies. Like most reviewers, however, the WTO indicates a number of areas where the subject could benefit from improvement. Specifically, the WTO Review identifies sectors where Canada remains overly protective and raises concerns over Canada's recent inclination to sign bilateral trade agreements. In this paper we focus on the aspects of Canada's trade policies that attracted WTO criticisms. We pay special attention to the regional trading arrangements that Canada has been pursuing and the potential economic harm these may be causing.

The failure to advance the Doha agenda at the World Trade Organisation (WTO) Ministerial meeting in Cancun in September, 2003, has created the perception that the WTO has ceased to be an effective forum of negotiation. A key element to the failure in Cancun was the emergence of a block of developing countries led by Brazil, China and India, who argued that agricultural reform proposed by developed countries was too limited and who resisted formal discussions of the so-called Singapore issues.[1] With multilateral trade liberalisation bogged down, nations have busily negotiated regional trade agreements. Canada is no exception, having already implemented the Canada-US Free Trade Agreement (CUSFTA) and the North American Free Trade Agreement (NAFTA), more recent agreements with Chile, Israel and Costa Rica, with additional agreements in the offing.

[1] See *The Economist* (18 September 2003). The Singapore issues comprise trade and competition policy, trade and investment, transparency in government procurement, and trade facilitation (e.g., customs procedures).

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This paper discusses the WTO Trade Policy Review of Canada in the context of multilateral trade liberalisation being at a 'cross-roads' in large part because developing countries want greater benefits. Section 2 examines patterns and trends in Canadian trade. In this section we discuss tariff treatments for different trade partners and Canada's trade performance with poor countries. Section 3 reviews the economic consequences of preferential trade agreements and the evidence on trade creation and diversion in Canada's primary regional trade agreements. Section 4 discusses NAFTA rules of origin to indicate the difficulty of complying with a growing number of tariff treatments. A concern raised by the Review is the number and duration of anti-dumping (AD) investigations and measures in Canada. In Section 5 we evaluate Canada's use of AD measures in comparison with other users. Agriculture and textile liberalisation has been a focus of WTO liberalisation efforts and Sections 6 and 7 report developments in the agri-food and textile and clothing sectors. We conclude by summarising the important elements of the WTO's 2003 evaluation of Canada.

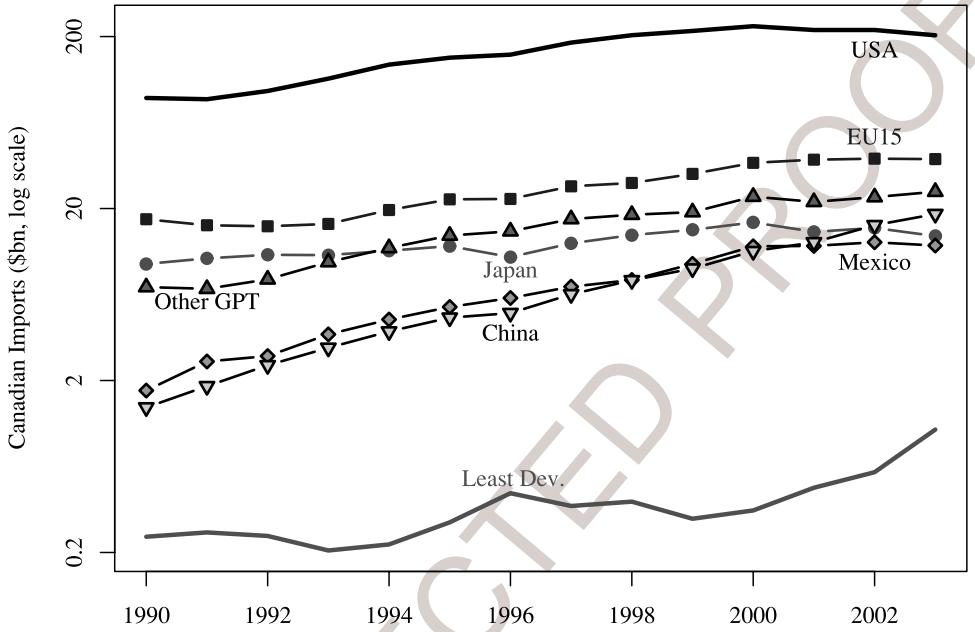
2. CANADA'S TRADE PATTERNS AND TARIFF TREATMENTS

Canada has experienced substantial increases in both imports and exports. Exports and imports of products stood at C$149.0 billion and C$136.2 billion in 1990, respectively, and grew to C$380.8 and C$335.3 in 2003.[2] This corresponds to annual growth of trade of 7 per cent. In 2003, Canadian trade in goods (imports plus exports) summed to 59 per cent of GDP. Almost all of the increase in exports and much of the increase in exports over this period is attributable to greater trade with the United States. Of the C$231.8 billion overall increase in exports, increased exports to the United States accounted for C$215.2 billion (93 per cent), while C$115.5 billion of the C$199.0 billion total increase in Canadian imports (58 per cent) arose from additional imports from the United States. In 2003, the US accounted for 86 per cent of Canadian exports (up from 75 per cent in 1990) and 61 per cent of Canadian imports (down from 64 per cent in 1990). This US trade dependency is the basis for the Review's concern excessively concentrated US trade.

Figure 1 depicts the trends in Canadian imports from various trading partners from 1990–2003. At the beginning of this period, Canada's major sources of imports were the other four members of the so-called Quad: the United States (solid line), European Union (squares, summing imports from the 15 members as of 1995), and Japan (circles). Since the WTO is concerned about providing market access with poor countries, we also show imports from countries to whom

[2] These data are reported in Trade by Product available at <www.strategis.gc.ca>.

FIGURE 1
Canada's Imports From Major Countries and Tariff Treatments, 1990–2003



Canada grants Generalised Preferential tariffs (GPT) and Least Developed Country tariffs (LDCT).[3] Given their rising prominence, we consider GPT countries Mexico (diamonds) and China (inverted triangles) separately from other GPT (triangles) origins. Trade is plotted on a log scale and thus the slopes of the lines correspond to annual growth rates. The figure portrays a general growth in imports from 1990–2000. The growth rates are particularly strong for China and Mexico in the period. After 2000, imports from the US and Japan fall a bit while imports from China, LDCT and other GPT continue to rise. Particularly noteworthy is the near doubling of imports from LDCT countries in 2003, rising from C$586 million in 2002 to C$1.0 billion the following year. This surge corresponds to Canada's decision to eliminate tariffs and quotas on LDCT imports. Imports from Bangladesh rose from C$164 million in 2002 to C$350 million in 2002. The post-2000 growth rates indicate that, while Canadian trade remains strongly oriented to the US, recent trends have reduced this dependency somewhat.

To assess how open a country is to trade, the conventional metric is to examine 'openness', defined as the sum of imports and exports divided by GDP.[4] As noted

[3] Canada grants LDCT to 48 countries.
[4] See, for example, Andrew Rose's recent paper (forthcoming) that argues that WTO members are no more open than non-members.

in the Report (p. vii), Canada scores an impressive 80 per cent on this metric, more than double the openness of the United States. This measure suffers from at least two important defects. First, there is a systematic tendency for large countries (as measured by national income) to have low measured openness relative for any given level of trade barriers. Intuitively, this is because large economies account for a large share of the world's aggregate supply and demand and this makes them appear more insular. Second, because bilateral trade is inversely related to distance, remote countries tend to have lower multilateral trade levels.

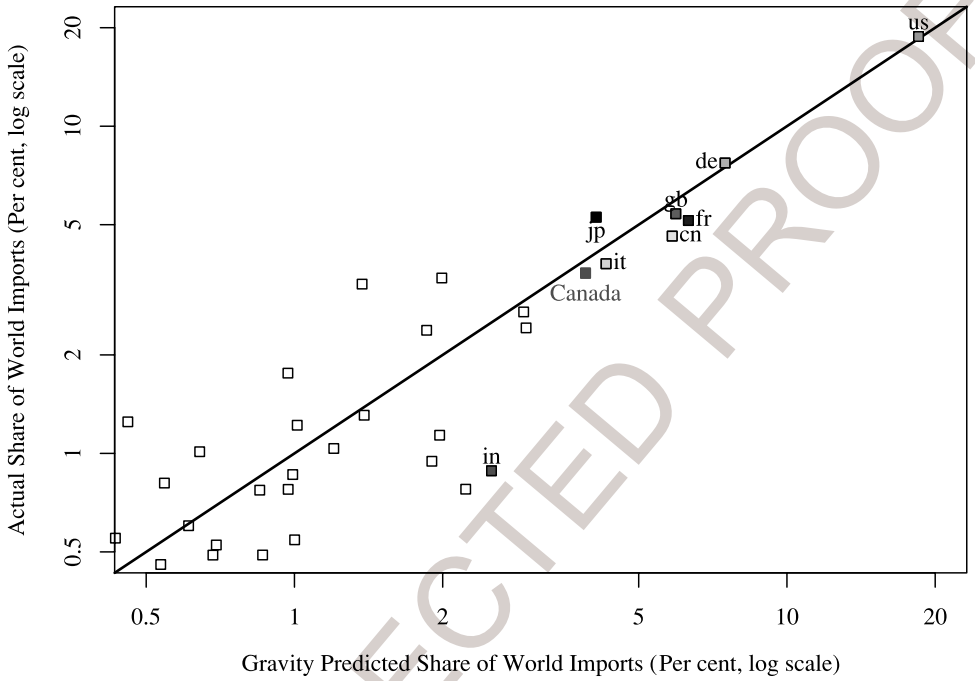
We construct a benchmark of multilateral trade that accounts for size and distance between trading partners. Let imports (M) from country i to country j be given by $M_{ij} = \pi_{ij} Y_j$, where Y_j country j's gross national income (GNI) and π_{ij} is the share of j's demand met by country i producers. This share depends on the size of country i (because larger economies produce more of the goods that consumers demand) and the distance between i and j. Following evidence from estimation of gravity equations we assume bilateral imports are proportional to market size and inversely proportional to distance. To assure that π_{ij} is bounded between zero and one and that market shares reflect size and distance to alternative suppliers, we assume:

$$\pi_{ij} = \frac{Y_i / d_{ij}}{\sum_\ell Y_\ell / d_{\ell j}}, \tag{1}$$

where ℓ indexes the countries (including j) from whom j consumers purchase goods. Summing j's imports, M_{ij}, across foreign sources i gives an expression for j's total imports M_{wj}. Summing across j, leads to total world imports M_{ww}. The variable of interest is country j's share of world imports: M_{wj}/M_{ww}. Using great-circle distances and GNI data for 2002 from the World Bank's *World Development Indicators (WDI)*, we calculate what M_{wj}/M_{ww} should be for each country and compare it to actual shares of world imports (also obtained from WDI).

Figure 2 plots on a logarithmic scale actual import shares against the theoretical benchmark for the set of countries with at least 0.5 per cent of world imports. If all countries imported according to the theory, the points would line up on the 45 degree line. Points below indicate actual imports less than the theoretical prediction. We observe that the theory fits quite well for large countries such as the United States (us), Great Britain (gb) and Germany (de). The same is true for France (fr), China (cn), and Italy (it). India (in) falls far short of the benchmark. Contrary to conventional wisdom, Japan (jp) imports more (5.5 per cent of world) than the benchmark predicts (4.1 per cent). In 2002, Canada accounted for 3.7 per cent of world imports, a much larger share that Canada's share of GNI that year of 2.2 per cent, but less than the 3.9 per cent predicted by the benchmark. The benchmark takes into consideration Canada's small size and proximity to the large US economy and expects higher import shares than simple GNI shares

FIGURE 2
Canada's Imports Relative to the Gravity Benchmark



would indicate. Thus, while Canada has increased imports at a steady rate, this analysis suggests that Canada is no more open to imports than other large countries or what should be expected given its economic characteristics.

An examination of trade by product reveals that Canadian trade is characterised by two-way trade in industrial goods, machinery and automotive products. Table 1 contains two panels showing imports and exports from 1999–2003. The first two rows of each panel report the value of trade whereas the other rows show trade shares by major product.[5] In 2003, industrial goods and materials, machinery and equipment and automotive products accounted for 60.7 per cent of exports and 70.3 per cent of imports. The shares of these products have remained fairly stable over time. Canada's overall trade surplus is accounted for by trade in forest products and energy. Products sold by poor countries, agriculture and apparel and footwear, have small import shares in Canada – 6.3 per cent for agriculture and 2.5 per cent for apparel and footwear. These industries are highly protected and we will see later on, that even for these products, most trade is with the United States.

[5] These data come from Canadian Statistics available at <www.statscan.ca>. Unlike the trade figures reported above, total trade includes 'special transactions trade' and 'unallocated adjustments.'

TABLE 1
Canadian Trade Shares by Product

	1999	*2000*	*2002*	*2002*	*2003*
			Exports		
Exports	$369.0	$430.0	$421.5	$414.3	$401.2
Agricultural and fishing products	6.9	6.4	7.4	7.5	7.3
Energy products	8.1	12.4	13.2	12.0	15.3
Forestry products	10.9	9.9	9.5	9.0	8.6
Industrial goods and materials	16.2	15.8	16.1	17	16.6
Machinery and equipment	24.0	25.6	24.4	23.5	22.2
Automotive products	26.4	22.8	22	23.4	21.9
Apparel and footwear	0.8	0.9	0.9	0.9	0.8
Other consumer goods	3.0	2.8	3.1	3.4	3.5
Special transactions trade	2.0	1.9	1.9	1.9	1.8
Unallocated adjustments	1.7	1.6	1.5	1.6	2.0
			Imports		
Imports	$327.0	$362.2	$350.6	$356.5	$341.4
Agricultural and fishing products	5.4	5.1	5.8	6.1	6.3
Energy products	3.3	4.9	5.1	4.6	5.7
Forestry products	0.8	0.8	0.8	0.9	0.9
Industrial goods and materials	19.0	19.1	19.5	19.3	19.1
Machinery and equipment	33.1	33.9	32.1	29.7	28.8
Automotive products	23.2	21.4	20.7	22.8	22.4
Apparel and footwear	2.1	2.1	2.4	2.4	2.5
Miscellaneous consumer goods	9.2	9.0	9.9	10.6	11.1
Special transactions trade	1.9	1.8	2.0	1.7	1.5
Unallocated adjustments	1.9	1.8	1.8	1.8	1.8

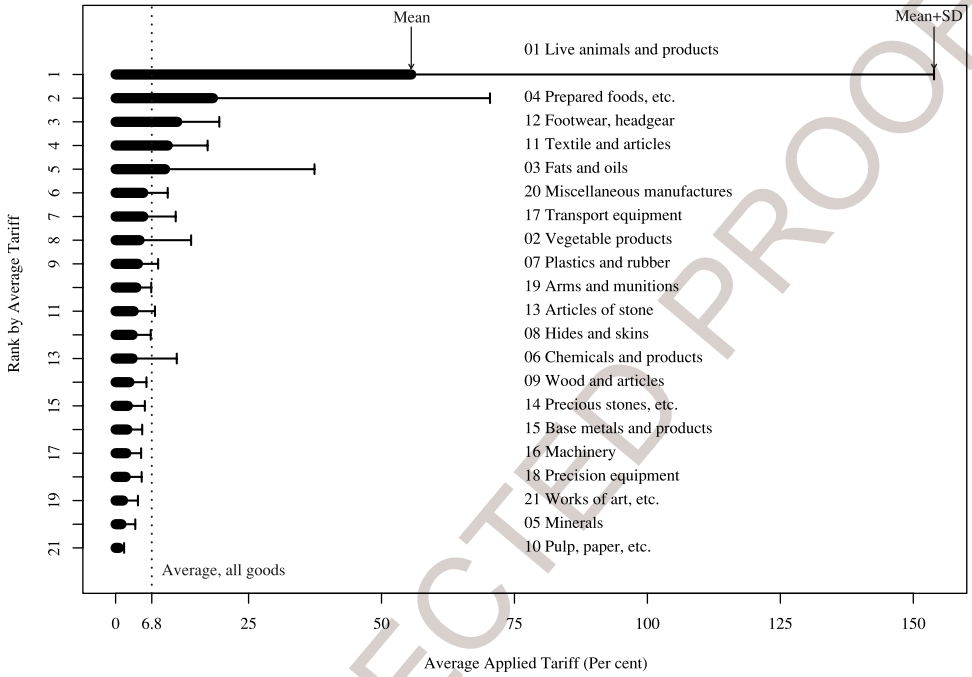
Note:
First row in each panel are in billions of Canadian dollars and the other figures represent share of total product trade.

Source: Statistics Canada.

Trade patterns across goods and countries are partly determined by differential tariffs that Canada applies. Figure 3 shows how Canada's import tariffs vary across two-digit HS product categories by displaying the mean and standard deviation of tariffs within each sector. The vertical dotted line in Figure 3 shows that the average most-favoured nation (MFN) tariff is 6.8 per cent. Sixteen out of 21 sectors have average tariffs below that mean. Tariffs are higher low-skill intensive areas like footwear and textile articles. They reach their peak (314 per cent is the maximum) in the agri-food sectors (01,03,04). The fact that the standard deviation of tariffs in sector 01 (Live Animals and Products) is larger than the mean is remarkable since tariffs are non-negative. It shows the extreme skewness of the tariff distribution in this sector.

Canada extends most-favoured nation tariffs (MFN) to almost every country. However, 'most-favoured nation' is very much a misnomer: Many countries qualify for 'preferential' rates. Canada currently has four regional trade agreements

FIGURE 3
Canada's 2002 Tariffs Vary by Commodity

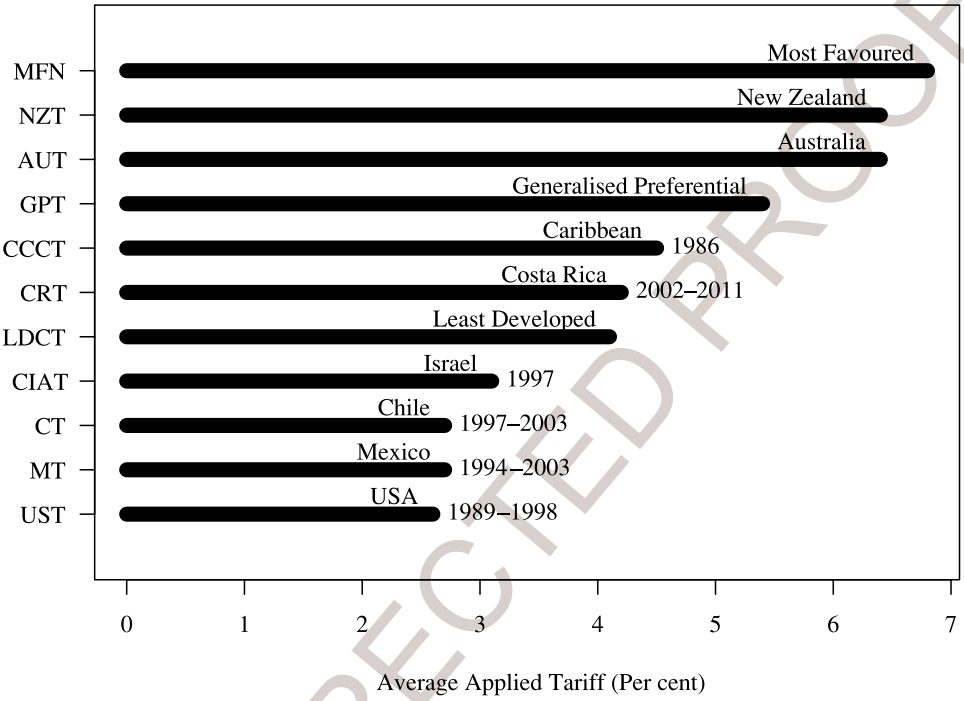


in force. Tariffs were phased out under the the North American Free Trade Agreement (NAFTA) over a 10-year period beginning in 1995. The Canada-Chile Free Trade Agreement (CCFTA) was implemented in 1997 and calls for the complete elimination of tariffs between the countries by 2003. The Canada-Costa Rica Free Trade Agreement (CCRFTA) came into force on 1 November 2002, and tariffs are to be completely eliminated by 2011. Finally, the Canada-Israel Free Trade Agreement (CIFTA) eliminated tariffs when it was implemented in 1997. Canada also unilaterally extends tariff preferences to developing countries through its General Preferential Tariff (GPT) and Least-Developed Country Tariff (LDCT).[6] Other preferential tariff arrangements include the Commonwealth Caribbean Countries Tariff and the New Zealand and Australia Tariff.

Figure 4 displays average Canadian tariffs in 2002 by tariff treatment.[7] The figure also indicates the dates of the phasing out of tariffs under regional trade agreements. At 6.8 per cent, the MFN average is highest (aside from the general tariff rate of 35 per cent applied to goods from Libya, Iraq and North Korea).

[6] In February, 2004, Canada announced it would extend these two tariff programmes for another ten years.
[7] These rates are simple averages across tariff lines as reported in Table III.2 of the review.

FIGURE 4
Canada's 2002 Tariffs Vary by Country of Origin



Tariffs are lowest for regional trading partners and poor countries. Recall that in 2003 Canada eliminated tariffs on goods from the least developed countries. Even though Canada fully phased in its CUSFTA tariff reductions by 1998, the average tariff level on the US remains positive because not all commodities qualified for tariff elimination. In 2002 Canada imposed no duties on US-origin goods for 99 per cent of its tariff items. For the remainder, mainly agricultural products, tariffs were very steep, averaging 225 per cent.

3. WELFARE EFFECTS OF CANADA'S RTAS

In addition to the four existing RTAs – NAFTA, CCFTA, CCRFTA, and CIFTA – Canada is negotiating others. Discussions have been launched for a Free Trade Area of the Americas and for free trade with the Andean Community (Bolivia, Colombia, Ecuador, Peru, and Venezuela), the European Free Trade Association, and the Central America Four (El Salvador, Guatemala, Honduras and Nicaragua), and Singapore.

Canada is not alone in its interest in regional trade agreements. The WTO's *World Trade Report 2003* (WTO, 2003b), reports that 176 RTAs were in force in

2003 with only four WTO members – Hong Kong, Macao, Taiwan, and Mongolia – not party to an RTA. The term used by the WTO, 'regional trade agreements', has become a misnomer. The *World Trade Report 2003* uses the term cross-regional RTAs to refer to free trade areas between countries situated in different geographical areas. From 1996 to 2002, the WTO received notification of 25 cross-regional FTA and estimates that one-third of the RTAs currently being negotiated are cross-regional (*World Trade Report 2003*, p. 51).

Of course, just because other countries are forming RTAs does not necessarily make it right for Canada to form them. Most economists agree that the first-best trade policy is multilateral free trade. However, in the early 1990s, with the prospects for a completed Uruguay round looking doubtful, economists debated the merits of the regional agreements that seemed to be proliferating. The debate was about the second-best: Was a multilateral framework with positive tariff levels better than one where some countries eliminated tariffs on a bilateral basis through regional trade agreements? The debate centred around the question of whether the trade creation generated by reducing tariffs between members outweighs the costs of trade potential being diverted away from efficient third-country producers. Most RTAs also apply rules of origin. These rules, considered in detail in the next section, undermine the ability of exporters to benefit from preferential tariff treatments because compliance with the rules is costly and confusing.

In today's policy context, when many countries again embrace bilateral agreements and the completion of the current (DOHA) multilateral trade round again seems uncertain, it seems worthwhile to revisit that literature and the conclusions it reached. It is now possible to add a consideration of the relevant empirical results.

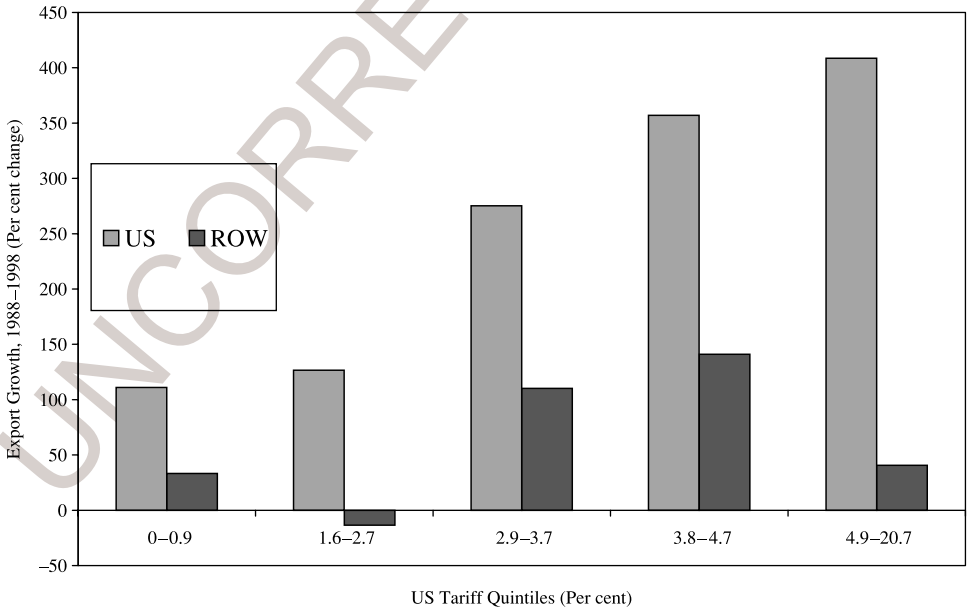
Out of the academic debate arose the concept of 'natural' trading blocs. The idea, developed in Krugman (1991), is that continental trading blocs are natural in the sense that they reinforce trade patterns that emerged as a consequence of non-tariff trade costs. Lower tariffs then leads to much trade creation and little trade diversion. If trade costs within continents were low relative to trade costs between continents, then there will be more intra-continental trade than inter-continental trade. A continental free trade agreement will promote the already substantial trade within continents without much consequence for trade outside the continent (since there was little to start with). Frankel, Stein and Wei (1998) develop a model based on Krugman (1991) in which RTAs improve welfare if inter-continental trade costs exceed a critical level. They use a gravity equation to estimate these trade costs and find that they are not high enough to allow for welfare-improving RTAs.

Trade creation and diversion fundamentally depend on price elasticities. If goods are substitutes and cross-price elasticities between products produced by countries within trading blocs are high, then tariff reductions will generate

substantial trade. On the other hand, trade diversion will be large if cross-price elasticities between member and non-member country goods are high. This basic point is addressed in Krishna (2003) who uses estimated price elasticities to predict trade creation and diversion associated with hypothetical free trade agreements between the United States and various trading partners. Interestingly, he finds no significant relationship between the welfare effects of free trade agreements and distance from the United States. He concludes that free trade agreements between geographically proximate countries are not 'natural.'

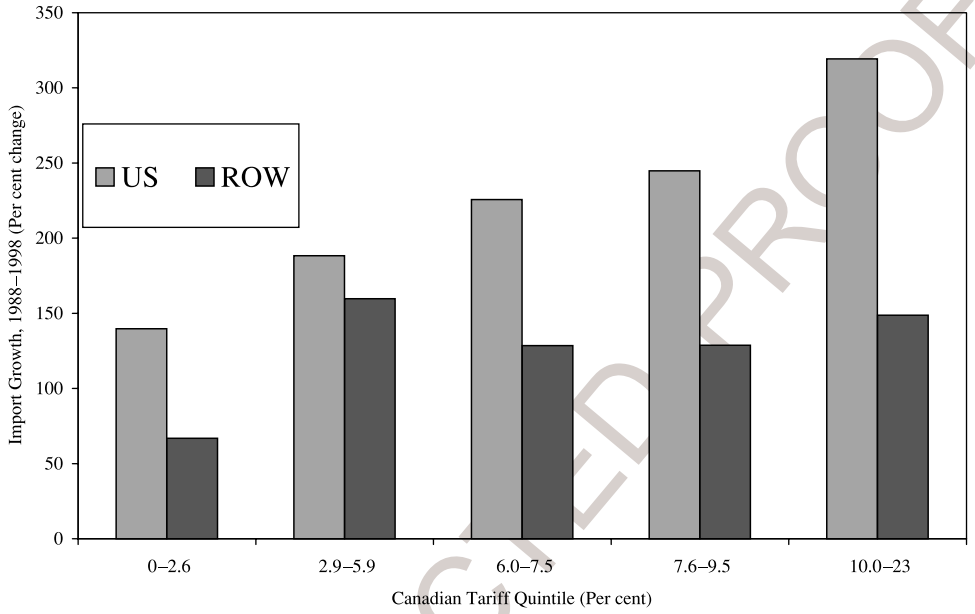
Two studies have examined trade creation and diversion effects of the CUSFTA and the NAFTA. Clausing (2001) uses US import data for highly disaggregated commodities to relate import changes over the 1989–1994 period to tariff changes mandated by the NAFTA. She estimates separate tariff effects for imports from Canada and imports from the rest-of-world (ROW). Positive tariff effects on Canadian imports indicate trade diversion and negative tariff effects on ROW trade reflect trade diversion. Figures 5 and 6 relate the magnitude of tariff reduction under the FTA to the growth in Canadian exports and imports during the implementation period.[8] We group Canadian 3-digit manufacturing industries

FIGURE 5
Canadian Export Growth During CUSFTA Implementation



[8] These figures appear in Head and Ries (2003, p. 187). They were inspired by a similar figure in Clausing (2001) that relates growth in US imports from Canada and rest of world from 1989–94 to different tariff groups.

FIGURE 6
Canadian Import Growth During CUSFTA Implementation



into quintiles according to 1988 tariff levels. Then we sum imports and exports to and from the US and rest-of world (ROW) by quintile groups and calculate the percentage change from 1988–1998. Consistent with Clausing's results, Canadian export growth to the US rises sharply with initial tariffs, suggesting substantial trade creation. No relationship is apparent for exports to ROW. Clausing finds that CUSFTA tariff reductions explain over one-half of the increase in Canadian shipments to the US over the period 1989–94.

Romalis (2004) uses US and EU commodity-level import data to examine trade creation and diversion due to the CUSFTA and the NAFTA. His study differs from Clausing's in a number of ways. Most importantly, he uses a difference in differences estimation technique where changes in EU trade patterns serve as a control when evaluating changes in US trade patterns. His study also includes Mexico and covers a longer time period, 1988–2000. Like Clausing, he finds substantial trade creation. In contrast to her results, his study reveals large trade diversion effects of the RTAs, amounting to about one-third of the trade creation. He explains the failure of Clausing to find trade diversion as a consequence of omitted variable bias. The reason why the US tended to have high growth from ROW in high-tariff industries was that emerging economies such as China increased their exports to all markets during this period. By differencing out the EU import pattern, Romalis intends to control for overall growth in exports of these countries.

4. RULES OF ORIGIN

Canada's trade agreements have never resulted in common external tariffs. As a consequence, they always include rules of origin. In order to qualify for a particular tariff treatment, it is necessary to meet specified rules of origin. The ostensive purpose of rules of origin is to prevent an exporter from using a low-tariff 'backdoor' to introduce goods from countries that would otherwise have been subject to higher tariffs. In practice they have the consequence of limiting the ability of producers in one country to benefit from the tariff preferences built into the agreement.

The obvious way to determine origin in a world where intermediate inputs might be sourced from many different countries is to specify a minimum 'regional value content.' Specifically an agreement could require that some minimum share of the production cost (or ex-factory price) involve domestic inputs including labour. To qualify for tariff treatments other than free trade agreements, Canada requires that a certain percentage of the ex-factory price of the good originate in beneficiary countries. Additionally, it insists that the good be directly shipped from a beneficiary country. The critical value content varies by treatment: it is 50 per cent for MFN treatment, 60 per cent for GPT, and 40 per cent for the LDCT.

Canada's free trade agreements eschew minimum content rules that apply to all goods and instead impose product-specific input requirements. We will consider the NAFTA rules in some detail because they are complex and potentially impose significant distortions. Qualifying as a North American originating good is at once very simple and exceedingly complex. The simple part is the NAFTA 'Certificate of Origin', a one page form that must be presented at customs. In it the exporter certifies that the goods to be imported originate within the three parties to the agreement (United States, Canada and Mexico). He also agrees to provide proof of his claim if audited. He further indicates the criterion he used to determine origin.

Article 401 of the NAFTA sets out four possible criteria that can be used to establish North American origin.[9] Criteria (a) and (c) are the most stringent since they prohibit the use of inputs produced outside of North America. Criterion (d) is intricately worded but seems like it would rarely apply (the good must arrive in disassembled form but nevertheless its assembly must account for over 50 per cent of cost). The main criterion used for products incorporating non-North American inputs ('non-originating materials') is reproduced verbatim in the box below:

[9] <http://www.customs.gov/nafta/docs/us/chap04.html>.

> (b) Each of the non-originating materials used in the production of the good undergoes an applicable change in tariff classification set out in Annex 401 as a result of production occurring entirely in the territory of one or more of the Parties, or the good otherwise satisfies the applicable requirements of that Annex where no change in tariff classification is required, and the good satisfies all other applicable requirements of this Chapter.

Annex 401 is a 243 page document that specifies for every tariff item (8-digit classifications) what inputs must be sourced from within North America in order for the final good to be deemed of North American origin. For some products, such as passenger cars, Annex 401 mandates a regional value content of not less than 50 per cent.[10] For most products, Annex 401 specifies particular tariff classifications of inputs that, if non-originating, make the final good non-originating. To illustrate, we consider the example of televisions. This case is important because Japanese TV makers such as Sony have been eager to supply the North American market with assembly factories located in Northern Mexico.

There are seven different tariff items corresponding to different types of TVs. The most common is probably 8528.12.bb, single picture tube, non-projection, non-high definition, televisions with display diagonals exceeding 14 inches. The rules of origin are shown below:

> A change to tariff item 8528.12.bb from any other heading, except from tariff item 8529.90.dd or 8540.11.aa or more than one of the following: tariff item 7011.20.aa, tariff item 8540.91.aa.

Tariff item 8529.90.dd comprises combinations of the following parts: (a) video intermediate amplifying and detecting systems; (b) video processing and amplification systems; (c) synchronising and deflection circuitry; (d) tuners and tuner control systems; (e) audio detection and amplification systems. Tariff item 8540.11.aa is the most important part of the TV, the cathode ray tube. Tariff items 7011.20.aa and 8540.91.aa are, respectively, the glass cone and the phosphorescent glass panel onto which the cathode emits electrons. Thus for a TV to be deemed North American origin, its most important part cannot be imported, nor can one import two of the important components of that part, nor can one import a set of other specified parts. The rule against importing both cone and glass panel is actually redundant because the rule of origin for cathode ray tubes imposes this same requirement.

[10] Even in this case, the actual rule is not what it appears to be. A footnote in Annex 401 refers to Article 403 which notes that 'Notwithstanding Annex 401' the regional content must rise to 62.5 per cent in 2002.

The NAFTA rules of origin also contain a *de minimus* rule, stating that a good containing non-originating materials that do not satisfy the Annex 401 rules may still qualify as long as those parts constitute less than 7 per cent of the final good's cost. This would certainly not help for a cathode ray tube, though it might matter for the 8529.90.dd list.

The existence of such stringent rules suggests a few possible options. First an exporter could certify itself as North American and hope that it is not called upon to prove the case. Second, a vertical industry cluster can form within the region, allowing for adherence to the rules of origin. Finally, the exporter could opt to just pay the MFN tariffs. In the case of televisions, the MFN tariff in Canada is 5 per cent. Mexico appears to be forming a vertical cluster. James Gerber (2000) reports that 'between 1995 and 2000, the number of cathode-ray-tube manufacturers increased from 2 to 5, television manufacturers grew from 8 to 12, and glass manufacturers from 0 to 2.' Trade data show that the US, which used to source large volumes of cathode-ray-tubes from Japan, now mainly imports them from Mexico.

Rules of origin not only create administrative costs, they may also generate a secondary source of trade diversion. Consider cathode ray tubes which have a MFN tariff of 6 per cent. Since NAFTA allows North American-made goods to enter Canada duty free, the NAFTA can cause trade diversion from a non-member country producing the good, say Japan, to a member country, say Mexico. Suppose, however, that Japan is the low-cost producer even when the tariff is added and thus based on tariff-inclusive prices, Japanese cathode ray tubes are preferable to Mexican ones. Trade diversion may still occur because of the vertical linkage between cathode ray tubes and television. As discussed above, in order to qualify for duty free imports of televisions under the NAFTA, TVs must use cathode ray tubes of North American origin. Thus, a TV producer may choose to purchase Mexican-made cathode ray tubes even if their tariff-inclusive price is higher than Japanese tubes. In this way, trade diversion can be compounded by rules of origin.

The upper bound on the costs associated with complying with rules of origin is the MFN tariff rate. Firms will not spend more on compliance than they gain from qualifying for low preferential tariffs relative to MFN tariffs. In the extreme where compliance costs exceed their benefits, goods enter at the MFN rate and the RTA neither creates nor diverts trade.

5. SAFEGUARDS, ADDS, AND CVDS

Contingency measures authorised under WTO agreements include safeguards, anti-dumping duties (ADDs), and countervailing duties (CVDs). The picture that will emerge is that Canada has targeted these measures at one sector – steel.

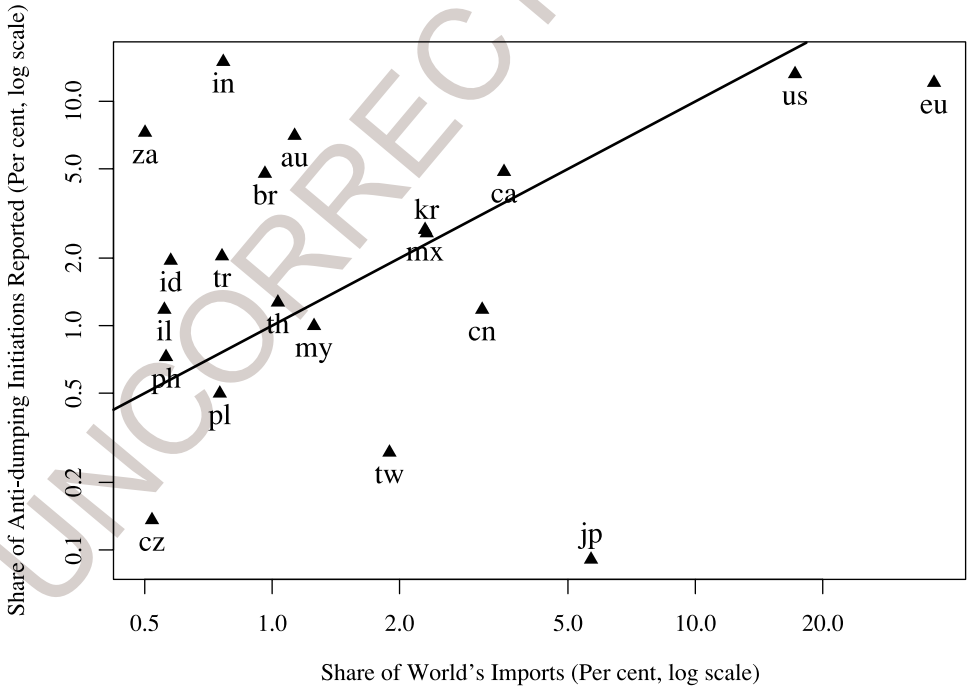
Canada has never used safeguard measures allowed under the WTO Agreement on Trade in Agriculture and the WTO Agreement on Textiles and Clothing.

Only once – for nine steel products in 2002 – has Canada initiated a safeguard investigation. Likewise, countervailing duty investigations do not occur frequently. According to WTO statistics, Canada initiated 12 CVD investigations from 1995 to 2003 (there were 168 initiations in the world over this time period). The Review notes that there has been an increase in CVD investigations in Canada since the last review (6 of 12 cases since 2000). Seven of these investigations resulted in countervailing duties. Six of the seven are on product sector XV 'Base Metals and Articles of Base Metals' that includes steel products.

The application of anti-dumping duties is of greater concern. According to the WTO, Canada has launched 122 of the world's 2,416 investigations since the WTO's inception in 1995. During the same period it was targeted in 25 cases. Canada is clearly a large net user of the measures. This raises the question of whether Canada is an over-user, or under-targeted, or both.

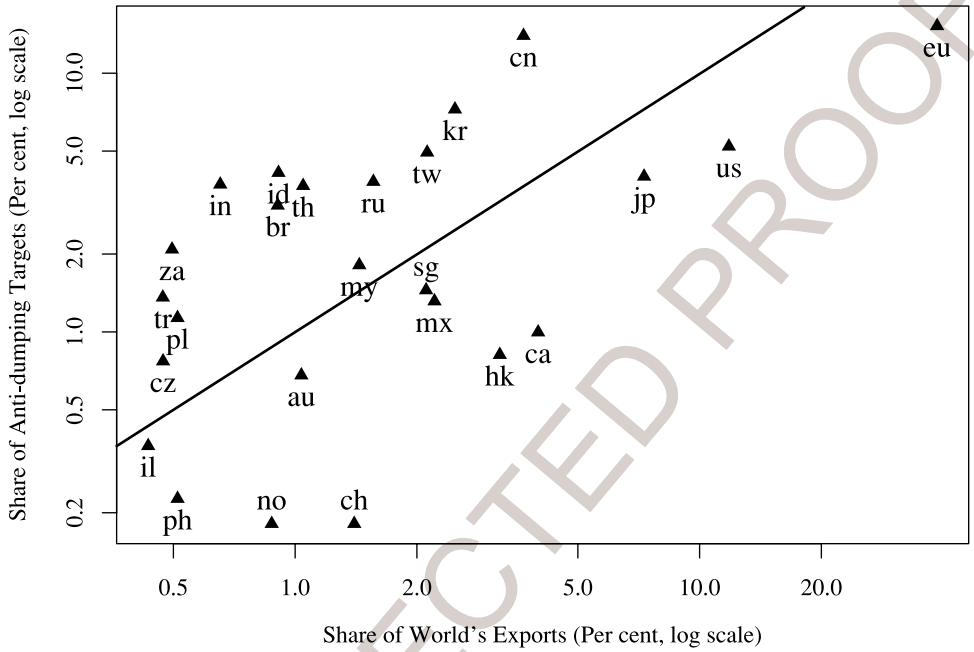
Figures 7 and 8 depict anti-dumping initiations relative to trade cumulated over the period 1995–2002.[11] The idea is that if all countries had the same

FIGURE 7
Who (Over-)Uses ADD? 1995–2002



[11] Trade data are only available through 2002. The figures include only countries that account for more than one half of one per cent of world imports. They are drawn using a log scale so that the two largest economies (the US and European Union) do not compress the other countries into the lower left corner.

FIGURE 8
Who is (Over-)Targeted? 1995–2002

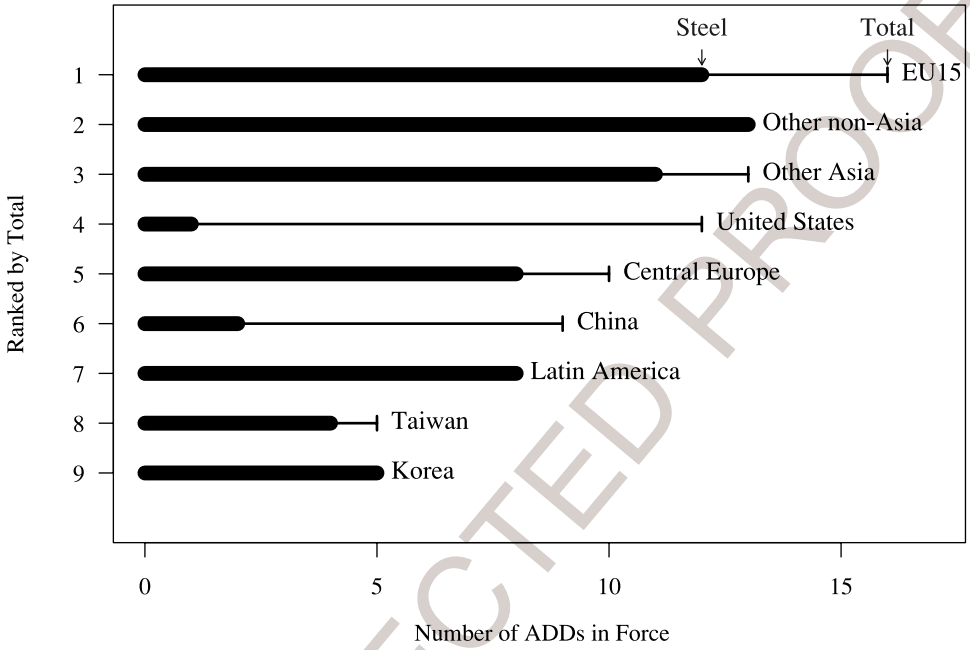


propensity to use ADDs and if targets were chosen in proportion to exports, then ADD use should be proportionate to imports and targeting should be proportionate to exports. The straight line in the upper figure corresponds to equal shares of ADD use and import shares, whereas the line in the lower figure equates targeting shares and export shares.

Countries above the line in Figure 7 may be thought of as over-users. Canada initiates only slightly more anti-dumping cases than one would expect based on it imports. The real outliers turn out to be South Africa (za) and India (za). On the other side, Japan almost never uses ADD despite accounting for over 5 per cent of the world's imports. Figure 8 shows that Canada is notably *under-targeted* relative to its exports. In part this reflects a general tendency of high-income countries to be under-targeted. For example, Switzerland (ch) is hardly ever (4 out of 2,206 cases) targeted despite generating 1.4 per cent of the world's exports. It would also seem that Canada's high propensity for exporting to the US, which Figure 7 shows to be an under-user, also helps. There is little awareness of this in the Canadian press, which depicts Canada as a victim of US anti-dumping policies.

At the time the Review was written, Canada had 91 measures in place. This number exceeds the 72 new measures instituted since 1995 due to the frequent long duration of ADDs in Canada. The Review notes that 9 per cent of the

FIGURE 9
Canada's Anti-dumping Duties at the End of 2001, by Target



measures had been in place for 10 years or more. Another concern of the Review was the increase in anti-dumping usage – 33 new measures were imposed in 2000 and 2001, although this fell off considerably to zero and five in 2002 and 2003. 64 of the 91 measures (70 per cent of the total) in place were on steel products. It should be noted that Canada is not the only country that tends to apply ADDs to steel. 528 of the 1,511 positive determinations globally between 1995 and 2003 are in sector XV. The portion of the base metal sector's measures is 134 of 205 for the US, 71 of 187 for the EU, and 32 of 62 for Mexico.

Which countries bear the brunt of these measures? Figure 9 is a re-expression of data derived from Chart III.4 in the Review showing the existing 91 anti-dumping duties in force in Canada on 31 December 2001, by country and sector. The figure reveals the prevalence of steel cases that account for virtually all measures in place for countries other than China and the United States. With 16 measures, the EU is the number one target.

While the frequent use of anti-dumping duties is a concern to the WTO, there are a couple of factors that mitigate their damage. First, according to the Review, the Canadian International Trade Tribunal estimates that anti-dumping measures affect less than 1 per cent of imports (p. 47). Second, Canada operates a 'prospective system' that allows targeted exporters to raise their export prices to the 'normal' price and avoid import duties. While in most circumstances, exporters

are worse off when they are required to price at a higher level (at the normal price), at least under Canada's system they are able to pocket the difference rather than have a tariff applied that accrues to the host government.

6. AGRI-FOOD

Agriculture policies in Canada are important to study for a couple of reasons. First, this sector was a main source of the impasse in the Cancun meetings where a block of developing countries led by Brazil, China, and India, representing two-thirds of the world's farmers, rejected the EU and US proposed agricultural framework. They objected to the continuation subsidies and trade barriers. Moreover, the limited response by the US and EU on the needs of four Western African countries – Benin, Burkina Faso, Chad, and Mali – for freer trade in cotton, was seen as a lack of concern for the poor. Lacking *quid pro quo* concessions on trade and agriculture, poor countries refused to advance the Singapore issues. Canada, like the EU and US, maintains a number of market distorting programmes in agriculture that impede exports from developing countries.

A second reason to study agriculture is the sector's importance to Canada. According to the Review, the agri-food sector, which includes unprocessed, semi-processed, and fully processed farm products, accounts for 4 per cent of Canadian GDP and while the related distribution, food retail, and food services sector contributed another 4.3 per cent of GDP. The sector is Canada's third largest employer. While trade in agricultural products is small relative to that of manufactures, trade is important to the industry. In 2003 exports totalled C$24.3 and imports C$20.6 billion,[12] making Canada the world's third largest exporter and fifth largest importer. The top exports that year were wheat and oilseeds. Imports were more diversified with wine being the largest item. As is the case with overall trade, the United States takes the largest share – 64 per cent of exports and 62 per cent of imports. Japan was the number two destination, with imports of C$2.3 billion. A few poor countries succeeded in selling relatively small amounts of agri-food into Canada: C$510 million, C$436 million, and C$287 million for Mexico, Brazil, and China. The Review states that 25 per cent of agri-food output was exported in 2001 (up from 15 per cent in 1996), while imports were 15 per cent of output that year.

The WTO Agreement on Agriculture endeavours to lower certain types of agricultural support. It classifies support into three categories. Support that does not distort trade is called 'green box' and is exempt from reductions. This includes some types of direct income support for farmers, environmental protection, and

[12] The 2003 data comes from <ats-sea.agr.ca/stats/stats-e.htm>.

regional development programmes. Subsidies that are accompanied by production limits are termed 'blue box' and are also exempt. Support measures that distort trade such as subsidies and price supports are labelled 'amber box.' Amber box supports are measured as Aggregate Measures of Support (AMS) and WTO members are required to reduce them if they exceed *de minimis* levels set at 5 per cent of agricultural output for developed countries and 10 per cent for developing countries. Canada commited to reduce total AMS from C$5.2 billion in 1995 to $4.3 billion in 2000. According to the review, Canada last notified the WTO about domestic support in 1999 when it was well below its mandated WTO ceiling.

The Review acknowledges that Canada's farm support is low relative to that of other OECD countries. Canada's support relative to GDP is 0.7 per cent, about half the OECD average. Producer support as a per cent of farm receipts was 17 per cent in 2001 compared to the OECD average of 31 per cent. The Review also notes that Canada is shifting away from commodity-specific support and towards income 'safety nets' for farmers. In June 2002, Canada announced C$8.2 billion in new spending under the Agricultural Policy Framework with the goal of improving product quality and business performance in the agri-food sector. A significant amount of the spending will be green box.

Total government spending supporting the agri-food sector was about C$6.2 billion in 2001/02 and the Review notes an upward trend in support. The largest expenditures are federal and provincial income stabilisation programmes (C$2.5 billion) and crop insurance (C$451 million). Both are reported to the WTO as amber box.

Price support programmes raise incomes to farmers without requiring direct government expenditures (the costs are borne by consumers). These are widespread in Canada's dairy sector and have resulted in producer prices for milk being double the world price. Prices for eggs, chicken, and turkey are also set by authorities rather than the market. These commodities account for 25 per cent of total farm receipts. Price supports are complemented by supply management and import restrictions. Producers must purchase production quotas to participate in the domestic market. Import quotas apply to supply-managed commodities subject to small 'in-quota' tariffs. These import quotas often amount to less than 5 per cent of domestic consumption. Hence, the quotas have high 'fill rates.' High (often prohibitive) tariffs apply to imports beyond quota levels. The Review lists complicated in quota tariffs, out-of-quota tariffs, and fill rates for agri-food products in Table IV.1. The tariffs vary according to type of importer and the table reveals out-of-quota tariffs exceeding 200 per cent for milk, chicken, and eggs.

Free trade partners and some other partners are granted special privileges on agri-food sales to Canada. In the case of wheat and barley, US, Mexican, and Chilean producers can export unlimited amounts to Canada duty free. Some

partners are given reserved access to the quotas. As described earlier, these preferential arrangements create trade but also generate inefficiencies associated with trade diversion.

The review notes the important role the Canadian Wheat Board (CWB) plays in Canadian trade. The CWB is a state-trading enterprise that has exclusive authority to handle all wheat, durum wheat, and barley sold for domestic consumption or exported in Canada. With export sales of C$4.2 billion in 2000–01, it is one of Canada's top five exporters. The CWB provides farm support through advance payment and other financing programmes. This support is reported as amber box. The Government of Canada guarantees to the CWB the principal and interest of all credit receivables and lends money to the CWB at lower than market interest rates. This raises the concern that Canada is subsidising exports.

Indeed in 2003, the US took Canada to WTO dispute arbitration, contending that the Canadian Wheat Board discriminated against imports and subsidised exports. On 6 April 2004, the WTO Panel agreed with the US that CWB rules concerning grain handling and transportation violate national treatment. However, it also ruled that the CWB activities conformed with WTO state trading obligations to operate in on a commercial and non-discriminatory basis. The US is appealing the decision.

An area that has drawn much controversy is health standards that restrict food imports. Canada appears to be in full compliance with the WTO's Agreement on Sanitary and Phytosanitary Standards (SPS) which covers food safety measures – Canada has never been a defendant in an SPS dispute at the WTO. Nevertheless, the Review expresses concern about:

> 'the strict use of sanitary and phytosanitary measures by Canada, which could result in barriers or increased costs for exporters from other countries' (p. ix).

The Review notes that Canada made 62 notifications to the SPS committee between 2000 and mid 2002, an increase from the 40 reported in the previous Review. Many were new regulations concerning maximum residue levels for chemicals contained in food. Canada enacted emergency measures in 2000, suspending imports of live animals in countries with outbreaks of foot-and-mouth disease. Imports of live ruminants require a full risk assessment and Canada recognises, when possible, studies done by other NAFTA countries and meat inspection systems of other countries.

Canada faces competing pressures concerning agricultural liberalisation. As a country with an abundance of arable land and a slight net exporter of agricultural products, it stands to gain from worldwide agricultural liberalisation. Canada has been active in demanding adherence to existing WTO agreements: It has been the complainant numerous times in SPS disputes at the WTO, including disputes with the EU concerning hormone treated beef and genetically modified food. On the other hand, Canada can only push liberalisation along gradually as many

agri-food sectors have enjoyed high levels of protection and the elimination of this protection imposes significant costs on a small but politically strong constituency. On balance, Canada realises that its broad interests are served by further agricultural liberalisation and it is committed to the current round of WTO agriculture negotiations.

7. CLOTHING AND TEXTILES

Clothing and Textiles account for 3.3 per cent of manufacturing GDP and 6.9 per cent manufacturing employment. According to the Review, the industries are characterised by small establishment size and extensive outsourcing. The industries have experienced large increases in both imports and exports over the last decade with exports to shipments around 42 per cent and imports at 60 per cent of consumption in 2001. The US absorbs the lion's share of Canadian exports – 93 per cent for Textiles and 96 per cent for Clothing. Imports originate primarily from China and the United States. The only least developed country that supplies Canada to any considerable extent is Bangladesh with a 3 per cent share of imports.

Clothing and Textile trade are governed by the WTO Agreement on Clothing and Textiles (ATC). Imports are restricted by both tariffs and quotas. The Review reports that average MFN tariffs for textiles and clothing will fall to 8.5 per cent and 14.0 per cent, respectively, according to WTO commitments. Duty remission programmes have been in place to lower the costs of imported materials and complement product lines of Canadian clothing producers. Outerwear fabrics, shirt fabrics, outwear clothing, blouses and shirts are eligible for duty remission. One new item – high-quality fabrics – was added to the list since the last WTO review. The total remission was C$32 million in 2001.

On 1 January 2002, Canada commenced phase three of the phasing out of quotas by eliminating quotas on products representing 18 per cent of 1990 imports. The growth rate of existing quotas was raised to 27 per cent. As stipulated by the ATC, the remaining quotas (representing 49 per cent of 1990 imports), will be eliminated on 1 January 2005, when all clothing and textiles will be integrated into the General Agreement on Tariffs and Trade. Canada has never imposed transitional safeguards on textiles and clothing authorised under the ATC. In 2002, Canada did negotiate bilateral restraint agreements with China and Taiwan following China's WTO accession.

In 2001, 49 per cent of clothing imports entered under quotas and Canada was restraining imports of textiles and clothing of 32 WTO members. Table IV.4 of the Review lists 53 country/product combinations with quota utilisation rates exceeding 90 per cent in 2001. Presumably these represent products constrained by the quota that will benefit from their elimination.

Effective from 1 January 2003, Canada has provided 48 Least Developed Countries (LDCs) duty-free and quota-free access to the Canadian market. While the preferential treatment extends to all goods, it is particularly relevant in textiles and clothing, important export products for poor countries. There is already evidence that concessions by Canada have paid dividends – Canadian imports from Bangladesh of clothing and textiles more than doubled from 2002 to 2003. Prior to 2002, Bangladesh was one of the few LDCs that filled their quotas. It seems likely that LDCs would have increased their exports to Canada by even more, were it not for the restrictions on input-sourcing due to rules of origin under the LDCT regime.[13]

Canada's preferential agreements such as NAFTA, CCFTA, and CCRFTA also liberalise trade in textiles. The CCRFTA calls for Canada to eliminate its quantitative restrictions on clothing and textiles originating in Costa Rica. However, under each of these agreements, the 'yarn forward' rule or origin requires that yarn used in apparel must originate within an agreement partner country. Man-made fibre sweaters must have sweaters originating within the region. The Agreements allow specific quota amounts (the Tariff Preference Level) of non-originating clothing and textiles. The Review comments that NAFTA quotas have been mostly filled, suggesting that they have had a binding effect on commerce.

8. CONCLUDING REMARKS

In her summary observations, the Chair of the Review, Mary Whelan, states that:

> . . . adjustments in [Canada's] trade policies have confirmed that its trade regime is amongst the world's most transparent and liberal, notwithstanding barriers to imports in a few albeit important sectors (p. vxvii).

This liberal trading regime has enabled Canada to enjoy high levels of imports and exports and, arguably, maintain economic growth. While Canada's share of world imports exceeds Canada's share of world income, our benchmarking exercise reveals that Canada's import performance is about what might be expected given its size and location. While it is heavily oriented towards the United States, there are some signs of diversification. Since 2000, Canada's trade with the US has declined (in Canadian dollars) while its trade with least developed and other developing countries has risen.

While Canada does indeed impose policies that distort trade, it does not appear to be more protectionist than other similar countries. It has signed a number of

[13] In their study of the Africa Growth Opportunity Act, Mattoo et al. (2003) estimate that US imports from Africa would have grown by nearly five times as much if the exporters had not been obliged to adhere to the strict rules of origin in that agreement.

regional trade agreements but so do most other countries. The evidence to date shows North American free trade has led to substantial trade creation, along with a smaller amount of trade diversion. Canada initiates only slightly more anti-dumping cases than one would expect based on its imports. Protection exists for agri-food products but its agri-subsidies are low relative to other OECD countries. Barriers to trade in textiles are being dismantled and the Least Developed Countries have enjoyed nearly free access to Canadian markets since 2003.

In Canada's report to the Review team, it states:

> The WTO is the cornerstone of Canada's trade policy and the foundation for our relationships with trading partners (p. 152).

Canada continues to make liberalisation efforts in the context of WTO initiatives, including the Doha round. This behaviour suggests that the recent increase in RTA formation and the continuing high level of trade integration with the United States do not signal diminished commitment to the multilateral trading regime.

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