The GATT Secretariat's new trade policy report on Canada draws attention to the growing concentration of Canada's trade (72 per cent in 1990) with the United States. The report points to the advantages for Canada of the free-trade area, as well as to risks inherent in over-reliance on bilateral trade links. From Canada's perspective, the Free Trade Agreement (FTA), building on the Canada-US Auto Pact of 1965, has created channels for increasing intra-industry trade, promoted investment, encouraged new sources of employment, and lifted many long-entrenched protective regulations. However, the report also points out that the FTA has shown up some weaknesses of Canada's industry, considerable segments of which are in the hands of relatively small and inefficient entities. In the past two years, the recession in the United States has also affected strongholds of the manufacturing sector, not least the automobiles industry, and contributed to bilateral trade frictions.

Nevertheless, as noted in the Secretariat's report, Canada's engagement in the Uruguay Round shows that it continues to lay great stress on the GATT system as the foundation of its trading relations, including trade within North America. Canada seeks a strengthened and extended GATT framework as an external anchor for regional integration and to ensure balance between participants of different economic sizes.

Canada's domestic recession has been prolonged and aggravated by developments on world markets for its traditional exports of primary products, including grains, timber and minerals. Canadian producers have been particularly affected by the effects of subsidized competition between the United States and the European Communities in grains; by the
large-scale entry into world markets of metals exports from the former Soviet Union and Eastern Europe; and by world over-capacity in forestry industries, particularly pulp and paper.

The report also traces efforts by the Canadian Government, since the mid-1980s, to streamline domestic regulatory regimes, to improve the basis for federal-provincial co-ordination in important trade-related areas and to open hitherto protected markets to competition. However, the potential effects of these reforms on economic resilience have so far been largely offset by the impact of the recent business downturn.

Given its vulnerability to transatlantic competition in farm export subsidies, Canada, as one of the world's largest and most competitive grains producers, has taken a high profile in the Uruguay Round, with the aim of creating a more open and market-determined environment for trade in crops. The report however notes that in some other agricultural areas, notably the dairy sector, Canada has sought in the Round the right to maintain quantitative restrictions within supply management schemes which protect its producers from international competition. "Although motivated by a perceived need to shield producers from artificially distorted world markets," says the report, "this approach may in turn contribute to perpetuating such distortions, denying opportunities for trade with Canada to more efficient dairy producers and contributing to increasing price fluctuations and adjustment pressures on less protected markets."

The GATT Secretariat's report, together with a report prepared by the Canadian Government, will be discussed by the GATT Council on 10-11 June 1992. This is the second review of Canada since the launching of the Trade Policy Review Mechanism (TPRM) in December 1989. The TPRM enables the Council to conduct a collective evaluation of the full range of trade policies and practices of each GATT member at regular periodic intervals to monitor significant trends and developments which may have an impact on the global trading system.

The current reports, therefore, mainly cover developments during the last two years in all aspects of Canada's trade policies, including domestic laws and regulations; the institutional framework; bilateral, regional and other preferential agreements; the wider economic needs; and the external environment. Attached are summary extracts from these reports. Full reports are available for journalists from the GATT Secretariat on request.

A record of the Council's discussions and of the Chairman's summing-up, together with these two reports, will be published in September 1992 as the complete trade policy review of Canada and will be available from the GATT Secretariat, Centre William Rappard, 154 rue de Lausanne, 1211 Geneva 21.

Since the first review of Canada by the GATT Council, the country has gone through a recession to which both cyclical and structural factors have contributed. Tight monetary conditions in the period 1987-89, aimed at fighting inflation, translated into high real interest rates and an appreciation of the real effective exchange rate. This, in turn, had an impact on trade, investment and growth. The downturn was aggravated by Canada's export commodity structure and its high degree of dependence on one market, the United States. In the same period, more fundamental, long term concerns regarding the cost structure of Canadian industries also surfaced.

Abundantly endowed with natural resources, Canada is a leading world exporter of a variety of metals and minerals, agricultural and forestry products. Natural resource-based products, often at the lower end of the processing chain, continue to account for about half of the country's exports.

Policy-related factors may have hindered the growth of natural resource processing. Some of these are external, including tariff escalation (e.g. on fish and non-ferrous metals) and other obstacles to Canada's exports by trading partners (e.g. subsidized exports of grains). In other cases, however, Canada's production and trade patterns, except with the United States, may continue to reflect its historical bias in favour of import substitution in manufacturing. Although this approach has been gradually abandoned since the mid-1960s, there is evidence that considerable segments of Canada's industry remain in the hands of relatively small and inefficient entities. Motor vehicles, industrial chemicals and telecommunications equipment are notable exceptions.

Bilateral trade agreements, first through the Canada-U.S. Auto Pact of 1965 and, more recently, through the Canada-United States Free Trade Agreement, have strengthened the natural geographic rôle of the United States as Canada's main trading partner (72 per cent in 1990). The pattern of Canada's trade with the United States deviates considerably from that with other regions. Trade in industrial goods, often on the basis of intra-industry and intra-firm trade, is much more significant with the United States than with the rest of the world. In 1990, automotive product shipments to the United States alone represented more than Canada's total exports to all other developed economies.

Both the prominent rôle of resource-based products in Canada's export basket and the Canada-U.S. links in the industrial sector have contributed to the length and severity of the recent recession. Important primary commodity markets slumped, reflecting, inter alia, global overcapacity in the pulp and paper industries, substantial sales of ores and metals from
eastern and central Europe and intense competition in subsidized exports between major grains traders. The U.S. recession, affecting in particular the large North American car producers, spilled over to discourage an earlier and stronger recovery.

Institutional Framework

Provincial sensitivities and regional policy considerations are important elements in the process of policy formulation and implementation in Canada. Under the Constitution, only the federal Parliament is authorized to legislate on the regulation of international and interprovincial trade. However, the provinces have considerable leeway to conduct policies which, although not directed at importation, may affect trade. The absence of clearly defined areas of exclusive federal or provincial competence, and the lack of common notification, coordination and compliance mechanisms in significant areas (e.g. industrial subsidization) have resulted in an intricate network of overlapping federal and provincial policies. Close, and often lengthy, consultations between federal and provincial authorities are necessary on many trade-related issues.

Efforts are being made, both at the federal level and among groups of provinces, to improve the common framework for policy-making. Examples are a recent intergovernmental agreement on beer marketing practices, seeking to eliminate discriminatory practices of provincial marketing boards; a similar agreement on wine, currently in preparation; and steps to harmonize federal and provincial subsidies in agriculture. By contrast, there is no such discipline on industrial subsidization at different levels of government, although the provinces provide about half of all subsidies in Canada.

Progress towards harmonizing disparate provincial policies and clarifying areas of federal and provincial competence has, however, been slow and uneven. In many instances, pressures to preserve traditional policy domains have proved obstacles to rapid reform. The ongoing constitutional debate within Canada has also increased the degree of uncertainty over the country's future framework for production, trade and investment.

Trade Policy Features and Trends

Evolution since the first review

Since the mid-1980s, the Canadian Government has implemented policy reforms aimed at streamlining regulatory régimes and opening protected markets to competition. Among other elements, restrictions on foreign investment have been eased and parts of the telecommunications sector have been deregulated and privatized. Canada's competition law has been overhauled and strengthened. The new federal Goods and Services Tax (GST) has eliminated a number of distortions embodied in the previous sales tax régime.
Given the intensity of Canada-U.S. trade, the current Government has aimed at making bilateral trade relations, based on the Free Trade Agreement, more secure and predictable, and improving conditions for market access. From Canada's perspective, the agreement with the United States has lifted many long-entrenched access barriers and other protective regulations in both goods and services trade. However, third parties may not be able to benefit to the same degree.

The implementation of the Free Trade Agreement since its entry into force on 1 January 1989 has progressed faster than originally scheduled. Tariffs were eliminated on many items in April 1990 and July 1991. Nevertheless, trade frictions have continued to emerge, and recourse to dispute settlement provisions under the FTA has been relatively frequent. A recent dispute over the origin status of cars assembled in Canada highlights the complexity of the rules of origin which, not surprisingly, prove particularly contentious in times of slackening growth and high unemployment. Nevertheless, the existence of the FTA has not prevented the two Governments from having continued recourse to GATT dispute settlement procedures. Indeed, a choice between bilateral and multilateral procedures for dispute settlement is specifically provided for in the Agreement.

The negotiations on a North American Free Trade Agreement (NAFTA) have moved ahead rapidly. Canada, while an active participant in these negotiations, has not apparently acted as a pacemaker. It has, however, been anxious to avoid being placed in an ancillary rôle within a hub and spoke system.

Canada continues to lay great stress on the importance of the GATT-based multilateral trading system as the foundation not only of its trading relations with the rest of the world but also with the United States. Canada seeks a strengthened and extended GATT framework as an external anchor for regional integration and to ensure balance between participants of different economic sizes. In this connection, despite some reservations in sensitive areas of agriculture, Canada remains a strong advocate of multilateral trade liberalization in the Uruguay Round.

Type and incidence of trade policy instruments

Apart from adjustments resulting from the FTA, Canada's complex tariff régime has not undergone any significant reforms since the previous review. It contains a variety of preferential arrangements and tariff relief provisions for specified purposes. The NAFTA negotiations may even create additional layers of tariff preferences and more complex origin regulations, compartmentalizing the structure of Canada's trade relations further. The average applied tariff, based on duties collected across all products and sources, is less than 3½ per cent. However, m.f.n. rates on sensitive items, such as textiles, clothing and footwear, peak at 25 per cent.

The coverage of Canada's General Preferential Tariff has recently been extended to central and eastern European countries. There are no country or product-specific ceilings, despite the existence of provisions allowing
such limitations. Nor have any countries been graduated from the scheme. However, the exclusion of most textiles, clothing and leather footwear limits the benefits of the GPT for suppliers of sensitive products.

Canada continues to operate restrictive régimes in some sectors deemed politically or economically sensitive, including poultry, dairy, textiles and clothing. Access to additional sectors deemed important, for example on cultural or health policy grounds, is limited through such measures as grants and tax benefits for Canadian producers, as well as restrictions on Government procurement.

Provincial support policies include discriminatory marketing and procurement practices by State monopolies, and subsidization. The criteria for granting benefits, for example minimum levels of provincial content, are often vague and, thus, provide considerable scope for discretionary decisions.

While federal assistance to industry has declined in recent years, a variety of new initiatives for technological and industrial promotion have been launched by the provinces. Certain initiatives assisted by the federal Government have apparently been motivated by the perceived need to protect 'strategic' businesses from falling victim to recession. With the exception of the wine sector, the federal Government has not been directly involved in launching support or adjustment programmes in the context of the implementation of the Canada-United States Free Trade Agreement.

Temporary measures

Since late 1988, following the expiry of an action on women's and girls' leather shoes, Canada has applied no safeguard measures under Article XIX of the GATT. Protection for the footwear sector which, as in many industrial countries, is subject to strong import competition, has since rested mainly on high tariffs. However, following an injury determination by the Canadian International Trade Tribunal (CITT) in May 1990, Canada imposed anti-dumping duties on women's footwear at rates between 25 and 90 per cent. The six developing countries affected accounted for almost one-third of Canada's imports of these items in 1989.

Footwear and paper products are the only broad categories made subject to increasing anti-dumping activities in recent years. Overall, the use of such measures has declined considerably, mainly reflecting the introduction of a sunset clause in Canada's anti-dumping law in the mid-1980s. At the end of 1990, anti-dumping measures or price undertakings applied to an estimated 0.6 per cent of domestic shipments by manufacturing industry, compared to over 1 per cent in 1982. In late 1991, Canada maintained six countervailing actions, affecting allegedly subsidized exports from the EC and Brazil.

"Voluntary" export restraints, a possible substitute for GATT-based forms of emergency protection, do not seem to be important in Canada. In the event of trade frictions, Canada continues to prefer recourse to transparent international dispute settlement procedures over informal
arrangements. The main exceptions in industrial products are restraints negotiated with supplying countries under the MFA, and unilateral self-restraints by the Republic of Korea on certain footwear and travel goods. Two further restraints, based on arrangements negotiated in the context of the Tokyo Round, are in force on meat and cheese.

Autonomous restraints by Japan and Korea on motor vehicles seem to have expired in the late 1980s, following the setting up of various assembly operations in Canada. Current duty-remission schemes in the sector are based on individual Memoranda of Understanding with the eligible companies. These memoranda, which are not public, are reported to focus exclusively on company-specific parameters related to trade, investment and employment.

Trade effects of competition policy

Canada's competition policy, as defined by the Competition Act of 1986, aims to ensure economic efficiency through open markets and price-determined adjustment. Collusive business practices, such as conspiracy to restrict trade or bid-rigging, are criminal offences. Abuse of a dominant market position is subject to individual review and may be liable to a cease-and-desist order by the Competition Tribunal. A recent case suggests that the Act can be applied effectively to prevent exclusive supply channels from being abused as entry barriers into the Canadian market. Practices that impinge solely on foreign markets (e.g. export price cartels) are, however, not covered by the Act.

The Competition Act extends to virtually all economic activities in Canada, regardless of the sector or the region concerned. It does not provide legal cover for cartel practices that might be deemed desirable from a social, strategic or cultural point of view. Canadian case law has, however, developed a "regulated conduct defence" which may serve as an exemption for restrictive practices based on valid Canadian legislation; for example, in the telecommunications sector, important parts of which are managed by private monopolies. The defence may also cover voluntary restraint arrangements, involving the Canadian Government, which impinge on the domestic market; however, no such cases have been challenged so far. Business practices in the electricity sector, including rate fixing and procurement decisions by provincial suppliers, are largely outside the scope of federal legislation.

Sectoral trade policies

Canada is one of the world's largest and most competitive grains producers. In a highly distorted international environment, Canadian farmers have found it increasingly difficult to survive. Established support programmes, mainly through transport subsidies and price stabilization schemes, have not fully offset the effects of a continued decline in world cereal prices on farm income.

In 1991, two new safety-net programmes for revenue and income protection were implemented for the sector. In particular, more stable
yield and revenue protection was provided under the Gross Revenue Insurance Plan (GRIP). The scheme is based on a 15-year moving price average, rather than the 5-year period under the previous Western Grain Stabilization Act. While providing greater stability, such a long reference period risks cushioning the sector from changing price trends, and de-linking production incentives from market conditions.

Given its vulnerability to transatlantic competition in farm export subsidies, Canada has taken a high profile in the Uruguay Round. Its aim has been to create a more open and market-determined environment for trade in crops. In some other agricultural areas, however, notably the dairy sector, Canada has sought the right to maintain quantitative restrictions within supply management schemes which protect its producers from international competition. Although motivated by a perceived need to shield producers from artificially distorted world markets, this approach may in turn contribute to perpetuating such distortions, denying opportunities for trade with Canada to more efficient dairy producers and contributing to increasing price fluctuations and adjustment pressures on less protected markets.

Canada does not generally pursue a sector-based industrial policy. Regional concentration and pressures appear, however, to have influenced sector-specific policies in areas such as textiles and clothing, largely located in Quebec.

Canada currently restricts textiles and clothing deliveries from 27 developing countries under bilateral MFA agreements, covering 80 per cent of clothing imports and 10 per cent of textiles imports. Most of such products are also excluded from Canada's GPT. In contrast, all such imports from the United States enjoy unlimited access (like all such products from industrial countries), and tariff preferences under the FTA. Between 1988 and 1990, the U.S. share in textiles imports advanced from 46 to 51½ per cent and, in clothing, from slightly below 6 to close to 9 per cent.

In the context of the Uruguay Round, Canada has announced its intent to reform patent protection for pharmaceuticals. The reforms would put an end to current distortions and discriminations, for example between pharmaceuticals and other products, and Canadian and foreign inventions.

Trade Policies and Foreign Trading Partners

Economic developments in the last two years have shown Canada's sensitivity to external shocks, as the domestic recession has been exacerbated by developments outside Canada's control. The country's mix of primary product exports (grains, timber, minerals) has been particularly affected by the effects of subsidized competition on world markets between the United States and the European Communities in grains; by the large-scale entry into world markets of metals exports from the former Soviet Union and eastern Europe; and by world overcapacity in forestry industries, particularly pulp and paper. In none of these areas is Canada a world price-maker.
The growing concentration of trade with the United States in industrial products has revealed at once the advantages of a free-trade area and the risks of over-reliance on bilateral trade links. The Free Trade Agreement, building on the Canada-U.S. Auto Pact, has created channels for increasing intra-industry trade, promoted investment and encouraged new sources of employment in Canada. However, it has also shown up some of the weaknesses of Canada's existing industrial structure - traditionally protected by substantial tariffs and other, including provincial, barriers to trade - and created strong pressures for adjustment. In the past two years, the recession in the United States has added to the difficulties of Canada's manufacturing sector, not least in the automobiles industry, and contributed to bilateral trade frictions.

Canada's attachment to the multilateral trading system shows that it is conscious of the risks involved in regional arrangements. In the Uruguay Round, it has sought multilateral trade liberalization and has been very active in pursuing a broadly-based agreement to establish a strong, rules-based, multilateral trading system. Canada's rôle in the GATT system would, however, be further strengthened if a number of specific sectoral and regional issues which affect policy-making in trade-related fields could be successfully addressed.

Canadian policy-makers at all levels thus continue to face important challenges. A need for further internal reforms, to reduce economic frictions and create a more transparent and predictable framework for policy formulation, coincides with similar requirements in the multilateral field. Achievements in both areas could be mutually supportive: a more streamlined system of internal policy-making would facilitate Canada's participation in the multilateral trading system, while a strengthened multilateral trading system would reinforce external discipline for Canada's trade régime.
Overview

Trade is vital to Canada's economic well-being. Over a quarter of GDP and some three million Canadian jobs are directly dependent on exports. Imports of technology, machinery, equipment and other industrial inputs are an important contribution to the competitiveness of Canadian producers.

In the mid-1980s the Government adopted an agenda for economic renewal which encompassed major initiatives in tax reform, budgetary deficit reduction, deregulation, privatization, investment development and trade policy.

Tax reform figured prominently in the Government's domestic initiatives. The first phase, involving a broadening of the tax base and a lowering of tax rates, created a tax environment that allows for higher rewards for success. Key objectives were to make the tax system fairer for Canadians and to help Canadian firms compete around the world. The second step, implemented on 1 January 1991, involved the replacement of the manufacturer's sales tax with the Goods and Services Tax (GST). It too served to broaden the tax base and lower tax rates, as well as to remove distortions in the tax system that disadvantaged Canadian firms in exporting or competing against imports.

Trade policy initiatives have included: the negotiation of a comprehensive free trade agreement with Canada's principal trading partner, the United States; participation in the Uruguay Round of Multilateral Trade Negotiations to reduce barriers to world trade and improve GATT trade rules; and initiation of negotiations with Mexico and the United States for a North American Free Trade Agreement. These and other initiatives reflect Canada's commitment to enhancing competitiveness through the reduction of distortions and barriers to the operation of free markets at home and abroad. For example, on 13 February 1992, the Government introduced legislation to unilaterally eliminate tariffs, on an m.f.n. basis, on a range of consumer products. In 1991, imports of these products were valued at about $1 billion.

In October 1991, the Government announced its Prosperity Through Competitiveness Initiative. This initiative extends beyond the traditional economic and trade policy instruments to take a harder look at some of the underpinnings of Canadian competitiveness - learning and skills training, science and technology, capital and investment, the nature of Canada's economic union and improvement in the functioning of the domestic markets, and international business and trade.

On the world scene, the past two years have been marked by political and economic events that have shifted the balance of power and presented unusual challenges for world trade and investment. Quite apart from such events, a few chronic problems continue to haunt world trade, and have...
exacerbated world trading relations over the past two years. Three are of particular concern to Canada - an intensified export subsidy war for agricultural products, unilateralism and managed trade.

Since the last review there has been no easing of the agricultural export subsidy war which continues to depress Canadian incomes in the grains and oilseeds industry. Farm income has declined drastically, with the 1991 levels only about half of 1989. The primary cause of this decline has been the deteriorating price situation in international markets for wheat, with prices in the range of $79 to $95 per tonne being less than those during the 1930s in real terms. This has resulted in record bankruptcies in the farm sector.

With regard to managed trade, all contracting parties should be concerned about ad hoc bilateral arrangements that seek to apportion market shares of selected products or industries. Sector-specific arrangements are generally conceived as transitional measures, but their history suggests that once established, they become institutionalized and extremely difficult to terminate.

These and other trade issues, as well as worldwide economic sluggishness, have contributed to Canada's weakened economy. The Canadian economy, which had been very robust from 1983 to 1989, began to slow early in 1990 and slid into recession in the second quarter. For 1991, Canada's real GDP declined 1.5 per cent.

Trade Policy Objectives and Developments in 1990-91

Given the close links between Canadian economic prosperity and international trade, the Government has steadfastly pursued the following general objectives for trade policy:

- The development of a strong, efficient, productive, competitive, growing and non-inflationary domestic economy;
- Increased per capita wealth to be shared by all Canadians from all regions of the country; and
- The promotion of a more stable and open international trading environment within which competitive Canadian and foreign firms alike are encouraged to plan, invest and grow with confidence.

These broad objectives have been reflected in the specific objectives set out in Canada's three main trade policy initiatives undertaken during the past few years.

Canada has actively participated in the Uruguay Round of MTN, launched in September 1986. An early and successful conclusion of the MTN is Canada's top trade priority. From the outset, Canada pursued five major objectives: to improve market access; to bring agricultural trade under the General Agreement; to develop rules for new issues such as trade in services and trade-related aspects of intellectual property and

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trade-related investment measures; to have fairer and more equitable GATT rules; and to make the GATT's institutional framework stronger.

On 5 February 1991, the Prime Minister of Canada and the Presidents of the United States and Mexico announced their intention to pursue a comprehensive and trade-liberalizing NAFTA. The Canadian approach to the NAFTA negotiations builds on the Canada-United States FTA and is closely co-ordinated with Canada's efforts in the Uruguay Round of MTN. Canada's broad objectives in the NAFTA negotiations are: barrier-free access to Mexico for Canadian goods and services, while developing tariff phase-out provisions and safeguard mechanisms which reflect Canadian import sensitivities; improved access to the United States' market in such areas as financial services and government procurement; improved conditions under which Canadian businesses can make strategic alliances within North America to better compete globally; ensuring that Canada remains an attractive site for foreign and domestic investment; and the establishment of a fair and expeditious dispute settlement mechanism.

Trade Policy Legislation

Canadian trade law is found in four main statutes - the Customs Tariff, the Customs Act, the Export and Import Permits Act and the Special Import Measures Act - that have been in place for many years and in the Canada-United States Free Trade Implementation Act.

The Customs Tariff provides the authority to establish rates of customs duty on imports and sets out those rates in accompanying Schedules. The legislation also provides the authority for levying surtaxes, imposing tariff rate quotas and surcharges on imported goods, and contains provisions for determining the origin of goods, the extension or withdrawal of preferential tariff rates, the rules for direct shipment, the marking of goods, certain duty relief programmes, and duty drawbacks. Canada's Customs Tariff has been based on the Harmonized Commodity Description and Coding System (HS).

The Customs Act provides the legislative authority (for administration and enforcement) required to collect duties and taxes imposed on importations under the Customs Tariff, the Excise Tax Act, the Excise Act and the Special Import Measures Act.

The Export and Import Permits Act provides broad authority to control the import and export of designated products and technologies. It enables the Government to establish an Import Control List, an Export Control List and an Area Control List.

The Special Import Measures Act provides authority for levying anti-dumping and countervailing duties. It embodies the principles contained in GATT Articles VI, XVI, and XXIII, as well as the interpretations of those articles contained in the Anti-dumping Code and the Subsidies/Countervail Code.