Part Two — Trade in Goods

The rules covering trade in goods are the core of any free trade agreement. The six chapters in this part set out the terms and conditions under which goods produced in one country in the free trade area will enjoy access to the other countries.

Chapter Three sets out the basic rules covering national treatment and traditional tariff and non-tariff barriers, such as export and import taxes and quantitative restrictions. Chapter Four describes the critically important rules of origin that make it possible to determine which goods are eligible for treatment under the more liberal tariff provisions of the NAFTA. Two annexes attached to Chapter Three describe the more complex provisions that apply to the automotive and textiles and clothing sectors, including special provisions important to interpreting the rules of origin.

Chapter Five outlines a series of procedural obligations relating to customs administration, which aim to ensure that customs requirements will, to the maximum extent possible, facilitate rather than impede trade flows. Chapters Six and Seven provide a number of rules specific to the energy and agriculture sectors, while Chapter Eight sets out the rules covering emergency safeguard actions. Most of the provisions of these chapters build on existing rights and obligations in the GATT, its codes and ancillary agreements, and the Canada-U.S. FTA.

> *The objectives of free trade agreements should be to free trade, not to manage trade to the detriment of either nonmembers or weaker members. They should be comprehensive in scope, including sectors where protection is most entrenched, and cover the whole range of trade restraints, including tariffs, non-tariff barriers, and procedural protectionism. At the same time, they should exclude more subtle types of protectionism exercised through unduly restrictive rules-of-origin and local content provisions. Such exclusionary features against non-free trade agreement suppliers and investors would lock free trade agreement members into inefficient patterns of specialization and deprive them of badly needed sources of external capital.*
>
> Sylvia Saborio, U.S. Overseas Development Council

Chapter Three
National Treatment and Market Access for Goods

One of Canada's principal goals in the negotiations was to achieve free and secure access to the Mexican market within a clear code of conduct that would ensure that Canadian producers could enjoy the same opportunities as their U.S. and Mexican competitors throughout the free trade area. These goals were largely achieved within the market access chapter.

Article 300 makes the fundamental principle of market access applicable to the provisions of the auto and textiles annexes, and the energy and agriculture chapters.

Article 301 incorporates the basic national treatment obligation of the GATT into the NAFTA. This means that, once goods have been imported into any member country, they will not be subject to discrimination. Such an obligation is an essential part of any agreement eliminating trade barriers, since it prevents their replacement by internal measures favouring domestic goods over imports.

The obligation prevents, for example, any country from imposing internal taxes, such as excise or sales taxes, or regulations and laws respecting purchase and use, which discriminate against imported products. It is thus a guarantee that imported goods from the partner countries will be treated the same as products of domestic origin. This helps producers, traders, investors, farmers and fishermen to plan and invest with greater confidence.

National treatment does not mean that imported goods have to be treated in the same way in the foreign market as they are in their country of origin. For example, Canada can prohibit or restrict the sale of imported firearms, as long as the sale of domestically produced firearms is also prohibited or restricted. Similarly, all goods, imported or domestic, must continue to meet Canadian bilingual labelling, metric measurement and similar requirements.

The NAFTA, like the FTA, clarifies the manner in which the GATT's national treatment obligation applies to measures adopted by provinces or states (article 301). It requires the federal government to ensure that a province or state not discriminate against imported products in measures falling within its jurisdiction.

The NAFTA provides for the elimination of all tariffs on goods that meet the rules of origin set out in Chapter Four (article 302). Tariffs are generally to be eliminated according to one of four major phase-out categories (annex 302.2):

- immediately upon the entry into force of the Agreement on January 1, 1994;
- in five annual steps (1994-1998);
- in 10 annual steps (1994-2003); and
- in 15 annual steps (1994-2008) for a limited number of U.S. goods.

The phased elimination of tariffs between the United States and Canada will continue on the basis of article 401 of the Canada-U.S. FTA. The base rates for calculating the phased elimination on trade with Mexico are those that were in effect on July 1, 1991 for Canada. The base rates generally incorporate the Generalized Preferential Tariff (GPT) for Canada and the Generalized System of Preferences (GSP) for the United States, both of which accord Mexican goods lower tariff treatment than most-favoured nation (MFN) GATT rates. For Mexico, the base rate will be its import duties applied in practice (ranging up to 20 per cent) rather than the much higher rat (up to 50 per cent) established through its GATT obligations. There are also special rules for joint production.

Because Mexico benefits from Canada's GPT, and many products enter Canada under the terms of the Auto Pact, almost 80 per cent of Mexican goods already enter the Canadian market duty-free. Canada included most products in either the immediate or five-year categories and limited 10-year phase-outs to sensitive products.

Chapter Three also includes provisions providing for accelerated tariff elimination, rounding of rates and valuation along lines similar to the FTA.

Tariff Phase-Outs

Mexican Tariffs on Canadian Goods

Immediate	Five-year	Ten-year
fish items	metal articles	furniture
telecommunications equipment	selected machinery	pharmaceuticals
fertilizers and sulphur	parts of electrical eqpmt	toys

Canadian Tariffs on Mexican Goods

Immediate	Five-year	Ten-year
furniture parts	light trucks	apparel
telecommunications eqpmt	machine tools	footwear
machinery and eqpmt	rubber products	toys

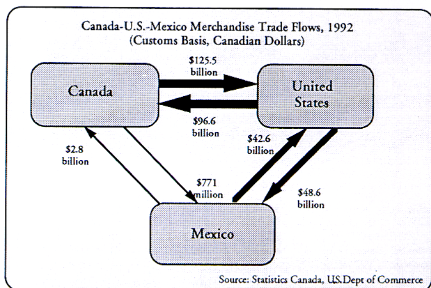
Tariff Acceleration

Canadian firms can adjust rapidly to new competition. Soon after the implementation of the FTA, the Government was petitioned by industry to reduce tariffs more quickly. As a result, Canada and the United States negotiated two supplementary tariff agreements, which accelerated tariff elimination on over 650 tariff items covering more than $8 billion in two-way trade. A third negotiation is in progress. Experience suggests that tariff acceleration is also likely to happen under the NAFTA.

Flows of capital and knowledge are now at least as important as the flow of goods in international exchange. In the past, tariffs and other border measures were the issue. Today, domestic policies are critical in influencing domestic and international investments. The flow of money increasingly transcends all borders. The competition for investment is tough to the point where many countries are opening their economies unilaterally, adopting more open, market-oriented fiscal and regulatory policies.

The Canadian Context:

Canada has not been immune to the process of globalization. Canadian firms have become more integrated into the global economy, while Canadian consumers have been able to choose from an ever widening array of goods and services. Over one quarter of Canada's wealth is now generated by the exports of Canadian goods and services. Canada's future prosperity is thus critically dependent on our continuing capacity for change and adjustment to the influences and demands of the global economy.



Source: Statistics Canada, U.S. Dept of Commerce

Ours is a medium-sized, open and trade-dependent economy. We have always been at the forefront of those advocating that the new international economy be based on clear rules, mutually agreed and fairly administered. The world of the 1990s has led to a more contractual and detailed approach to rule making. In addition to the multilateral framework of rules provided by the General Agreement on Tariffs and Trade (GATT), Canada must also be alert to opportunities that arise on a regional or bilateral basis.

Regional responses to the internationalization of economic activities in Europe and Asia, as well as in the Americas, have presented Canada with a direct challenge. The FTA was the first response to that challenge. The Canada-U.S.-Mexico negotiations built on that achievement.

Article 303 provides a major improvement upon the obligations in FTA article 404 regarding duty drawback and similar programs, such as free trade zones. Under the FTA article 404, Canada and the United States agreed to eliminate the refund of customs duties levied on imported materials and components when these are incorporated into goods exported to each other after January 1, 1994. They have now agreed to revise these provisions by allowing a longer phase-out of existing drawback until January 1, 1996, for Canada-United States trade and January 1, 2001, for Canada-Mexico and United States-Mexico trade. As well, a modified form of drawback will continue to allow Canadian manufacturers to be able to collect a refund equal to the lesser of the duties paid on imported inputs or the duties liable on exports of the final product to the United States or Mexico. In order to qualify for these benefits, Mexico must allow production in its Maquiladora (free trade zones) to be available for domestic consumption, a practice that is now generally prohibited. Drawback remains available for trade with non-NAFTA countries.

Definitions

Quantitative Restrictions (QRs) — Explicit limits or quotas on the physical amounts of particular products, which can be imported or exported during a specified time period, usually measured by volume but sometimes by value. The quota may be applied on a selective basis with varying limits set according to the country of origin, or on a global basis, which only specifies the total limit and thus tends to benefit more efficient suppliers. Quotas are frequently administered through a system of licensing.

Valuation — The appraisal of imported goods by customs officials for the purpose of determining the amount of duty payable. The GATT Customs Valuation Code obliges governments to use the transaction value of imported goods or the price actually paid or payable for them, as the principal basis for valuing goods for customs purposes.

There are three exceptions to the general drawback obligation (annex 303.6):

- Full drawbacks will continue to be permitted on citrus products like lemons and oranges.
- Duties paid on fabric imported and made up into apparel and subsequently exported to the other country can be recovered if the apparel does not qualify for preferential tariff treatment when traded between the United States and Canada. The rules of origin establish quotas for preferential tariff treatment for apparel made up from imported fabrics and/or yarns. Should trade rise above these levels, Canadian manufacturers using imported fabrics and/or yarns will be able to apply for drawback of Canadian duties paid on fabric incorporated into apparel exported to the United States.
- The U.S. sugar re-export program is exempted for exports to both Canada and Mexico.

Articles 304 through 307 build on articles 404 and 405 of the FTA by requiring the elimination of duty waivers or remissions that are based on performance requirements. The Agreement provides for the elimination of waivers wherever they are tied to specific performance requirements, such as production in one country or export to another country. Like

the FTA, a number of specific programs are grandfathered including trade in the automotive sector. Articles 305-307 set out detailed rules for the duty-free temporary admission of goods and other circumstances when, for example, duties are only collected on the value of work done in one country, such as repairs.

Under article 308, the three countries have agreed to reduce, over 10 years, their MFN rates on computers, most computer peripherals and computer parts to match the lowest prevailing rate in any of the three countries.

Market Opportunities: Consumer Products

Imports of consumer products are growing, concentrated in fashion, novelty, high-technology, promotional, specialty and/or low-volume items, leisure and sporting goods.

Some 70 per cent of Mexico's 85 million inhabitants are under 30 years of age. This growing young urban population, enjoying higher incomes generated by enhanced economic conditions, has a marked preference for imported products, as a result of the easing of import restrictions and the favourable image of such products.

Total imports of consumer products reached $7.5 billion in 1991, representing some 20 per cent of total consumption. Good prospects for Canadian business in this sector include jewelry, accessories, apparel, furs, medicinal and pharmaceutical products, soaps and toiletries, toys and games, sporting goods, books, stationery and related products, tableware, gift ware, wood articles and furniture.

Article 309 largely duplicates FTA article 407 incorporating the GATT obligations regarding import and export restrictions. Unless specifically permitted under the Agreement, existing quantitative restrictions (QRs) are to be eliminated. The practical effect is that Mexico will need to eliminate virtually all of its remaining QRs. Remaining exemptions from this general obligation are set out in annex 301.3. For Canada, the annex replicates the provisions of the FTA article 1203 relating to restrictions on the export of logs and unprocessed fish. In order to ensure that there is no erosion of Canada's rights under the GATT article XI to maintain import quotas on supply-managed commodities, the provisions of article 703 in Chapter Seven (agriculture) take precedence over this article.

Article 310 incorporates the FTA article 403 prohibiting the introduction of new customs user fees such as merchandise-processing fees and requiring the phased elimination of existing fees. The U.S. merchandise-processing fee will be eliminated for Canada on January 1, 1994, and phased out for Mexico by June 30, 1999. Canada has no such fees.

The United States and Mexico require that imports be marked with their country of origin. Annex 311 provides for rules regarding marking requirements, thereby providing Canadian producers with greater certainty in meeting these requirements.

Articles 312 and 313 build on the FTA articles 805 and 806. The first requires that the parties eliminate any blending requirements involving imported and domestic distilled spirits. The second concerns the mutual recognition of distinctive distilled products. All three countries

will now recognize Bourbon and Tennessee Whiskey as distinctive products of the United States, Canadian Whiskey as a distinctive product of Canada and Tequila and Mescal as distinctive products of Mexico.

Article 314 duplicates the FTA article 408 regarding export taxes. Neither Canada nor the United States apply export taxes as a matter of general policy. Mexico, however, has made extensive use of such measures as part of its price control regime. Article 314 specifically prohibits export taxes or duties on bilateral trade unless the same tax is applied on the same goods consumed domestically, while annex 314 grandfathers a limited number of existing export taxes related to price controls on food in Mexico.

Definitions: The Tariff

The tariff is the heart of traditional trade policy. It is a tax on imports and sets the rate at which imported goods are taxed. The term tariff usually refers to a list or schedule of articles of merchandise with the rate of duty to be paid to the Government for their import. There are various kinds of tariffs including:

Ad Valorem Tariff — a tariff calculated as a percentage of the value of goods clearing customs, for example, 15 per cent ad valorem means 15 per cent of the value.

Specific Tariff — a tariff levied on the basis of some physical unit, such as so many cents a litre.

Compound Tariff — either a combination of an ad valorem tariff, plus a specific tariff, or a provision that an ad valorem or specific tariff will apply, whichever is higher; also called a "mixed tariff."

Tariff-rate Quotas — application of a higher tariff rate to imported goods after a specified quantity of the item has entered the country at the usual tariff rate during a specified period.

Bound Rates — rates that cannot be increased beyond an agreed level, usually MFN tariff rates resulting from GATT negotiations and thereafter incorporated as an integral part of a nation's schedule of concessions. If a GATT member raises a tariff to a higher level than its bound rate, the beneficiaries of the previously lower rate have a right to retaliate against an equivalent value of the offending country's exports or to receive compensation. Compensation usually takes the form of reduced tariffs on other products that they export to the offending country.

General Tariff — a tariff applied to countries that do not enjoy either preferential or MFN tariff treatment. Where the general tariff rate differs from the MFN rate, the general tariff rate is generally higher.

Tariff Escalation — a situation in which tariffs on manufactured goods are relatively high, tariffs on semi-processed goods are moderate and tariffs on raw materials are non-existent or very low. Such escalation is said to discourage the development of manufacturing industries in resource-rich countries.

Tariff Schedule — a comprehensive list of goods that a country may import and the import duties applicable to each.

Michael Hart, *Trade Why Bother?*; USTR, *A Preface to Trade*

Article 315 is similar to the FTA article 409 and the GATT articles XI and XX. The GATT obligations recognize that circumstances may arise when export restrictions may be necessary. These circumstances include situations of short supply, conservation of natural resources where domestic production or consumption is also restrained and restrictions imposed in conjunction with domestic price stabilization schemes. The article requires that export restrictions for such purposes not disrupt normal trading patterns.

For example, Canadian steel producers use huge quantities of Pennsylvania coking coal because it is both ideally suited to steel making and because its location is cost-effective. Article 315 prevents the United States from arbitrarily cutting off access to this coal unless restrictions are also placed on its use by U.S. producers on a proportional basis. Even then, the United States must use the least disruptive measures so as not to materially alter established patterns of trade.

The NAFTA for the first time establishes a Committee on Trade in Goods (article 316) to maintain broad oversight over all market access issues. This should ease problems that may arise in the administration of this chapter and facilitate the movement of goods throughout the free trade area. Article 318 provides definitions for items, such as advertizing films and customs duties.

Low wages are just not a main source of competitive advantage for the knowledge-intensive industries that play an ever larger role in modern economies. If low wages were the key to investment decisions, the poorer regions of Canada and the United States would account for disproportionate shares of domestic business investment. In fact, relatively low-wage regions of both Canada and the United States generally receive disproportionately small shares of business investment, including manufacturing investment.

Business Council on National Issues

Annex 300-A:
Trade and Investment in the Automotive Sector

For Canada, satisfactory provisions for more liberal trade with Mexico in automotive products that were also sensitive to the requirements of the Auto Pact were a critical objective in the negotiations. Various Mexican auto decrees have essentially closed the Mexican auto industry to foreign competition. Five major vehicle assemblers (General Motors, Ford, Chrysler, Nissan and Volkswagen) participate in the Mexican market but have been largely precluded from rationalizing their production along North American lines. Both parts and assemblers produce in Mexico for the U.S. and Canadian markets. Close to 90 per cent of Mexican automotive imports already enter Canada duty-free under the Auto Pact. Until now, little Canadian or U.S. production has been exported to Mexico.

Under the NAFTA, the closed Mexican market will be opened to North American competition over a 10-year transition period. At the end of the transition period, parts and vehicles produced in Canada will enjoy the same access to the Mexican market as Mexican parts and vehicles have long enjoyed in the Canadian market. Canadian-based firms will be able to participate fully in the Mexican market on a national-treatment basis with "national suppliers" of parts.

Automotive tariffs in Mexico will be phased out on the basis of the following schedule (annex 300-A.2):

- the immediate reduction by 50 per cent of tariffs on passenger automobiles and remaining tariffs phased out in equal steps over 10 years;
- the immediate reduction by 50 per cent of tariffs on light trucks and remaining tariffs in equal steps over five years;
- tariffs on all other vehicles phased out in equal steps over ten years;
- the immediate elimination of tariffs on certain auto parts and duties on other parts phased out over five years with a small portion over 10 years;
- restrictions on the import of used cars will be phased out after 25 years, i.e., over 10 years starting in 2009 and ending in 2019 (annex 300-A.1.4). Canadian restrictions on used-car imports from the United States will be eliminated on January 1, 1994, under the FTA.

The NAFTA introduces a new net-cost-based rule of origin with regional value-content requirements for auto goods (Chapter Four). After an eight-year phase-in, the NAFTA will require a higher level of North American content: 62.5 per cent for autos and light vehicles and

their engines and transmissions, 60 per cent for other vehicles, their engines and transmissions, and other auto parts. In addition, the value of non-NAFTA parts will be traced through the production process to ensure a more accurate calculation of the North American content. The eight-year phase-in will allow producers to make the necessary adjustments in their North American operations over the course of two model cycles to take advantage of the NAFTA's liberalizing trade provisions. The new rules of origin were drafted in part to ensure that the kinds of problems over rules of origin raised in the GM-CAMI and Honda disputes will not recur. GM will be able to import CAMI vehicles into Mexico at preferential tariff rates if these vehicles meet the rule of origin. CAMI will have the same access to the United States as it did under the FTA.

The NAFTA (annex 300-A.2.6) gives Mexican independent parts suppliers an assurance that parts purchases will not fall below the level attained over 1991-92 (plus a percentage for market growth). These safeguards, however, will be phased out after 10 years, while the Auto Pact safeguards (which establish a production-to-sales ratio for vehicles and a Canadian value-added requirement) stay in place.

The Canadian Automotive Industry

The auto industry is one of the biggest industries in North America. It provides employment to more than 225 000 Canadians through manufacturing (137 000) and sales (90 000). It accounts for approximately 4 per cent of Canada's GDP. Auto exports represent 32 per cent of Canadian manufacturing exports.

Its health is critical to the welfare of many other sectors, including steel, textiles, electronics and rubber. As a result of the Canada-U.S. Auto Pact, the industry has operated on an integrated basis in Canada and the United States since 1965, greatly benefiting the economy in central Canada. Canada annually exports 85 per cent of its vehicle production and 90 per cent of its parts production, almost exclusively to the United States. Canada has gained an increased share of Canada-U.S. production in both assembly (increased from 14.5 per cent in 1981 to 17.5 per cent in 1991) and parts (increased from 5 to 11 per cent between 1981 and 1991).

Traditionally, the automotive industry was divided into two main segments: vehicles manufactured by overseas manufacturers and those manufactured within North America. Foreign manufacturers, usually referred to as 'transplants,' from Japan and Korea began operating in Canada soon after the Japanese government and industry agreed to voluntary export restraints in 1981. As a further incentive to foreign investment, the Canadian government set up a production-based customs rebate program, which lowers customs duties by one dollar for every dollar spent on Canadian content. Canadian production, in general, is oriented toward light trucks and passenger cars. Lower labour costs in Canada have also encouraged Canada-based production. In spite of the reorganization of the North American industry and the arrival of transplants, import penetration has, until very recently, been high. In 1990, approximately 31 per cent of vehicles sold in Canada were imported, compared to 11 per cent in 1979. About a third of these were vehicles, usually referred to as 'captive imports,' brought in by the Big Three North American manufacturers — General Motors, Ford and Chrysler.

Annex 300-B: Textiles and Apparel Goods

The Canadian Textile and Apparel Industries

The textile and apparel industries remain a major source of employment in Canada, especially in Montreal, Toronto and Winnipeg. In 1991, the textile industry, which converts man-made and natural fibres into yarns and fabrics for use in manufacturing clothing, upholstery, household linens, etc., employed some 44 500 people in an estimated 1 060 firms. Half of the production is used by industry within Canada, especially clothing manufacturers.

The apparel industry employs some 90 000 people in over 2 000 firms. Apparel production accounts for 18 per cent and 17 per cent respectively of all manufacturing employment in Montreal and Winnipeg. In 1991, total production was valued at over $5 billion of which 10 per cent was exported, mostly to the United States. The industry is characterized by a large number of small firms, which employ less than 50 workers. Canadian apparel exports to the United States have more than doubled since 1988; Canada enjoys a surplus in its trade with the United States. For example, sales of men's suits from Canada into the U.S. market now lead all other countries except Italy.

Apparel imports from Mexico, including from the maquiladora operations, represent only 0.5 per cent of apparel imports into Canada. The Mexican industry produces cheaper, lower-quality items. The Canadian industry is moving into high-quality, designer apparel using computer design and new technology.

While strides in efficiency have been made, the industry remains labour-intensive, making it vulnerable to foreign competition where labour costs are significantly lower. To protect Canadian jobs, the government subjects 90 per cent of low-cost country imports to quotas; Canadian tariffs on apparel imports currently range between 20 and 25 per cent.

Under the FTA, tariff removal on apparel was set at the maximum adjustment period of 10 years (products will become duty-free on January 1, 1998); for textiles, the adjustment period is eight years. The FTA also provided for tariff-rate quotas whereby garments, fabrics and

made-up articles not meeting the rules of origin could still benefit from tariff preferences. Canada approached the NAFTA with two major objectives:

- to ensure that Canada's access to the U.S. market would not be eroded; and
- to provide an appropriate adjustment period before fully opening the market to Mexican competition.

Both objectives were substantially met. Tariff removal with the United States continues at the rates negotiated under the FTA. Full duty drawback has been extended for two years beyond the FTA expiry date of January 1, 1994. In 1996, a partial drawback system (article 303) will be put into place to reduce input costs for Canadian manufacturers who still pay duties on goods exported to Mexico and the United States. Moreover, full duty drawback for Canada-U.S. trade in apparel traded under MFN rates will be maintained indefinitely. Tariff elimination with Mexico will be phased in over 10 years for apparel (duty-free January 1, 2003) and eight years for most textiles (duty-free January 1, 2001). This will give the Canadian apparel industry the longest adjustment period available for any sector under the Canada-Mexico phase-out schedule.

The basic rule is that textile and apparel must be produced from fibre made in a NAFTA country to benefit under the Agreement, the so-called "yarn-forward" rule (for apparel, it is referred to as "triple transformation;" for fabric, it is "double-transformation"). Exceptions to this rule will give some flexibility in special circumstances. The rules of origin in Chapter Four provide for single transformation in a number of cases, and the *"de minimis"* provision of article 405 allows producers to still qualify for the NAFTA tariff preferences under the double and triple transformation rules when their products have small quantities of non-NAFTA yarn and fabric inputs. In addition, annex 300-B sets tariff-preference levels (TPLs), which will allow specified quantities of textiles and apparel cut and sewn in North America to qualify even when they do not meet the rules of origin.

Because of the specialized nature of the Canadian textile and clothing industry, the TPL exceptions to the basic rule address Canadian concerns and interests. Specifically they provide that:

- the U.S. TPL for Canada on yarn is set at a level four times 1991 exports to the United States (to 10.7 million kg);
- the U.S. TPL for Canada on non-wool fabrics and made-up articles is now established at a level nearly three times that of the FTA [from 25 million square-metre equivalents (SME) to 65 million SME];
- the U.S. TPL for Canada on non-wool apparel has been doubled from 42 million SME to 80 million SME (and 88 million SME in 1999), a level twice that of all non-wool garment exports to the United States in 1991; and
- the U.S. TPL for wool apparel will be increased by 6 per cent over five years (from 5.1 million SME under the FTA to 5.3 million SME in 1999 under the NAFTA). This is 60 per cent higher than total Canadian exports of wool apparel to the United States in 1991.

The value of the TPLs has been further enhanced by a "short supply" provision. Apparel made from fabrics or yarns identified as being in short supply will be exempt from the rules of origin. The list of short supply items includes silk, linen, fine-wale cotton corduroy, cotton velveteen, harris tweed and a range of shirting fabrics. A review clause permits the addition of other short supply items.

Section Four outlines the special safeguard that will apply during the transition period for goods falling within the coverage of the annex. Should there be a surge in imports of textile or clothing products causing serious damage to domestic producers, a country may impose a temporary restriction on imports. This right, however, is circumscribed so as not to hurt investors seeking to take advantage of the new opportunities made available by the NAFTA to restructure their operations along regional lines.

The North American Consultative Committee on Labelling for Textile Products has been charged with finding ways to eliminate unnecessary obstacles to textile trade resulting from differences in labelling requirements. Its tasks will include developing equivalent requirements for information on care and fibre content to be included on labels permanently affixed to textile products; finding common acceptable means of attaching labels; defining a common system of size measurement; developing equivalent regulations for fibre-content listing and labelling terminology; and developing a common set of pictograms and symbols.

Canada would have preferred a simpler and more open approach to trade in textiles and clothing. Nevertheless, while the rules of origin are complex and not fully attuned to Canada's specialized production, Canadian producers will still find themselves in a more advantageous situation than under the FTA or the GATT. The quotas have been increased to a significant extent allowing Canada to exploit new market opportunities in both the United States and Mexico. Meanwhile, Section Seven sets out the terms for a five-year review of the rules of origin for textiles and apparel.

Market Opportunities:
Industrial Machinery and Technology

This market is expected to grow steadily over the next five years as Mexican manufacturers strive to improve productivity to compete successfully in domestic and international markets.

Demand for machine tools, metalworking equipment, plastics production machinery and equipment, materials-handling equipment and similar production equipment and technology is expected to exceed $6 billion by 1994, with imports supplying most of the total demand. The success of the Canadian industrial trade fair organized in January 1992, in Monterrey, has given an indication of what the NAFTA may offer to Canadian exporters in this sector.

Chapter Four — Rules of Origin

Rules of origin are an essential part of any free trade agreement. They provide the basis for customs officials to determine whether goods are entitled to the more liberal tariff treatment provided for in the Agreement. Under a free trade agreement, each country maintains its own external tariff, and preferential treatment is extended only to goods "originating" from a member country. In essence, the rules of origin ensure that only goods that have been the subject of substantial economic activity within the free trade area are eligible for the more liberal trade conditions created by the NAFTA.

In drafting the rules of origin, Canada, the United States and Mexico sought to accomplish three basic objectives:

- to provide clear rules that would give certainty and predictability to producers, exporters and importers, and address the problems experienced under the FTA rules of origin;
- to avoid imposing unnecessary burdens on exporters or importers claiming the NAFTA benefits; and
- to ensure that the NAFTA benefits are accorded only to goods that originate in the NAFTA countries and not to goods that are made elsewhere and that undergo only minor processing in North America.

By meeting these goals, by adding greatly improved procedures for avoiding and settling disputes that may arise in the application of the rules, and by committing themselves to develop common regulations to govern the detailed interpretation, application and administration of the rules, Canada, the United States and Mexico will create business confidence in the NAFTA's more open trade conditions. The new rules completely replace the FTA rules.

Article 401 sets out the basic rules on qualifying for preferential treatment. To do so a good must pass the following tests:

- It must be wholly obtained within the free trade area or produced entirely from such materials; or
- If it incorporates inputs sourced from outside North America, the final product must undergo a change of tariff classification, specified in annex 401; or
- Certain goods in specific circumstances must meet one of two North American value-added calculations.

Rules of Origin

This is perhaps the most critical aspect of a free trade arrangement. It describes the provisions used to differentiate between goods made in one country from those made in another for the purpose of calculating the appropriate tariffs.

There are three basic types of goods:

- those wholly originating in one country (for example, potatoes grown in the garden, logs cut in the forest, fish caught in lakes, or oil and gas taken from the ground). These are clearly "originating";
- those made of parts and materials that originate wholly from within the free trade area, such as steel made in Canada using U.S. iron ore, coking coal and various alloys; and
- those goods that incorporate material imported from a third country, i.e., a country that is not a member of the free trade area. For these goods to be considered "originating," the imported material must be transformed within the free trade area into a new and different product.

There are two basic approaches to substantial transformation: subjectively, on a case-by-case basis; or objectively, in accordance with prescribed rules. Both the FTA and the NAFTA adopt an objective, rules-based approach to substantial transformation.

The rules-based approach involves two methods, both of which are used under the NAFTA and the FTA:

- Change in tariff heading: Here the manufacturer is told exactly what changes in imported material must occur for the product to be substantially transformed. The required changes are prescribed on the basis of the chapters, headings and subheadings of the Harmonized System. This approach is simple and straightforward and will apply to most circumstances. In some cases, such as when determining the content of automobiles, an additional content requirement must also be met.
- Content requirement: This means a certain portion of the value of the good must be added within North America. While this method is flexible and allows manufacturers several ways to meet a content requirement, it also obliges them to keep records of costs as proof and requires eligible costs to be specifically enumerated.

In drafting the detailed provisions of these rules, the negotiators significantly decreased the number of goods that will require a value-added calculation. This requirement now applies only to sensitive product categories or where a change of tariff classification test would not be feasible; for example, in cases where the final product and its components are classified under the same tariff heading.

To simplify transactions for goods that are almost wholly of NAFTA-origin materials, the Agreement provides a *de minimis* rule. Under this improvement to the FTA rule, goods that may not meet the change-of-tariff-classification test may still, in most circumstances, qualify as NAFTA-origin goods as long as the value of non-NAFTA materials used in their production is not more than 7 per cent of the value of the finished goods.

Transaction Value vs. Net Cost

Calculating the transaction value method requires that the value of non-originating materials used to produce a product be subtracted from the "transaction" value, i.e., the actual price paid to the producer. The remainder is then divided by the transaction value to obtain the required percentage of North American content — in most cases, 60 per cent.

$$\frac{x-y}{x} = z$$

x = transaction value
y = value of non-North American materials
z = percentage North American content

Calculating the net-cost method begins with the total cost of a good from which a series of ineligible costs — royalties, shipping and packing, sales promotion, marketing — are subtracted to obtain the net cost. The cost of non-North American materials is then subtracted from the net cost, and the remainder is then divided by the net cost to obtain the required percentage of NAFTA content — for most goods, 50 per cent.

$$\frac{(a-b)-c}{(a-b)} = z$$

a = total costs
b = ineligible costs
c = value of non-North American materials
z = percentage of North American content

To avoid burdensome value-added calculations, the Agreement allows importers to choose between the net-cost or transaction-value test. In most instances, manufacturers will prefer the more straightforward transaction-value approach. However, for automotive products, footwear and other goods for which a separate value-content test is required, or for products where the transaction value cannot be calculated (for example, because the importer and exporter are related), the net-cost method must be used.

Special rules have been developed to address the special characteristics of production and trade in the following sectors:

- Automotive products: To qualify for the NAFTA tariff treatment, cars, light trucks and their engines and transmissions must contain at least 62.5 per cent North American content, and other vehicles and parts must have at least 60 per cent North American content, based on the net-cost formula. The higher value requirement — the FTA rule was based on a 50 per cent value requirement — will be phased in over eight years. The value of imported parts and components will be traced through the production chain to improve the accuracy of content calculations. Finally, regional content averaging provisions will give administrative flexibility to automotive parts producers and assemblers. The Agreement provides for a special averaging at the CAMI plant in Ingersoll, Ontario. There is also a special provision that temporarily reduces the required regional content level to 50 per cent, for five years, for investors establishing new plants to produce vehicles not previously made by the producer in the region and, for two years, following a refit of an existing plant to produce a new vehicle.
- Textiles and clothing: Special rules of origin for textiles and clothing are set out in annex 300-B.

The NAFTA explicitly recognizes that a product can qualify for tariff preferences from production occurring in all three countries. Article 404 allows producers to accumulate their production when determining whether a good meets a required tariff classification change or regional value content. Chapter Four also sets out provisions regarding the treatment of spare parts, tools, accessories, and packing and packaging materials when determining the origin of goods, as well as specific conditions for goods that are transshipped through non-NAFTA countries and provisions to prevent circumvention of the rules of origin.

While Chapter Four sets out the rules and conditions for determining whether a good is eligible for the NAFTA tariff preferences, Chapter Five establishes the requirements and procedures for applying and administering the rules of origin. As such, it is an integral part of the rules of origin.

For the transition period, a number of additional rules were developed to provide a basis for differentiating between goods eligible for the FTA tariff levels — most of which will be free by January 1, 1994, and all of which will be free by January 1, 1998 — and the NAFTA tariff levels. These special transitional rules are set out in Chapter Three.

Example of the Harmonized System

Tariff Item	Description of Goods and Codes	Cdn MFN Tariff
62.01	Men's or boys' overcoats, car-coats, capes, cloaks, anoraks (including ski-jackets), wind-cheaters, wind-jackets and similar articles, other than those of heading 62.03:	
	— Overcoats, raincoats, car-coats, capes, cloaks, and similar articles	
	11.00 — of wool or fine animal hair	25.0 %
	12.00 — of cotton	22.5 %
	13.00 — of man-made fibres	25.0 %
	19.00 — of other textile materials	22.5 %
	— Other	
	91.00 — of wool or fine animal hair	25.0 %
	92.00 — of cotton:	
	92.10 — Men's ski jackets, solely of cotton	30.0 %
	92.90 — Other	22.5 %
	93.00 — Of man-made fibre	22.5 %
	99.00 — Of other textile materials	22.5 %

Chapter Five — Customs Procedures

Mechanisms to Facilitate Customs Procedures

Customs Subgroup — exchanges information and consults on technical and administrative aspects. The group has a 60-day deadline to reach agreement on any issues formally notified to it.

Working Group — to facilitate co-operation and consider modifications to the NAFTA on rules of origin, customs procedures, uniform regulations, drawback and country-of-origin markings. It will meet regularly to exchange information and to ensure uniform and consistent interpretation and application. The group has 30 days to reach agreement on issues passed to it by the customs subgroup.

Uniform Regulations — will ensure that the interpretation, application and administration of the rules of origin are consistent throughout the free trade area.

One of the lessons learned from the FTA was that customs administration and the procedures for interpreting, administering and enforcing the rules of origin and dealing with other customs matters must be set out in precise detail. As a result, an entire chapter of the NAFTA is devoted to customs procedures.

Articles 501-4 (certification of origin) set out the certification procedures and record-keeping requirements that will apply within the NAFTA area. Certificates are not required for goods valued at less than US$1 000, although shippers may be obliged to produce an invoice certifying that the goods qualify as originating goods. Records (article 505) must be kept for five years for eligible goods. Verification procedures (article 506) may include written questionnaires or on-site visits. Verifications of regional value content will be based on generally accepted accounting principles as applied in the exporting country. Article 507 assures producers that their records will be kept confidential.

To facilitate trade, business has the opportunity to seek advance rulings (article 509) on the origin of goods for both tariff preference and country-of-origin marking purposes. Review and appeal procedures (article 510) are to be non-discriminatory. Equal treatment is to be applied to all producers and exporters within the NAFTA area, although each country may adapt the right of review and appeal to its own circumstances.

The three nations have agreed to develop uniform regulations (article 511) on the rules of origin and a trilateral working group with a customs subgroup (article 513) will be established to deal with problems of rules of origin, customs procedures, country-of-origin marking obligations and drawback procedures. Specific time periods are laid out to ensure expeditious resolution and implementation.

Market Opportunities: Energy Equipment and Services

Mexico's petroleum production ranks third in the world, with reserves estimated at 45 to 60 billion barrels. Canada, with its leading technology and co-operative business style, is well-placed to seize new procurement opportunities created by the NAFTA as the industry modernizes and looks outside Mexico for modern equipment, technology and services. The industry is fundamental to the Mexican economy.

Petroleos Mexicanos (PEMEX), the state monopoly controlling the exploration, exploitation and distribution of these resources, is one of the largest companies in the world. During the 1980s, much of PEMEX's earning power went to servicing Mexico's crushing debt payments. PEMEX is now catching up after a decade of minimal purchasing, updating and maintenance, and plans to spend as much as $23 billion over the next four or five years on equipment and services. Mexico's demand for electricity is increasing almost 5 per cent annually, and it will need 26 000 MW of capacity by the year 2000.

Mining Equipment and Services

Canada's mining technology is second to none in the world. Mexico is, with some exceptions, years behind recent advances and needs to revitalize this sector. It is restructuring its mining regulations to allow foreign investment and to encourage the adoption of more effective, safe and environmentally sound practices.

Foreign investment amounted to more than $580 million in 1991 matching more than $650 million in Mexican investment. As a result of the improved business climate, Mexican companies have been spending an estimated 30 per cent more on parts and projects each year, totalling some $700 million in 1990.

A study prepared by KPGM-Peat Marwick estimates that a NAFTA would stimulate a 13.2 per cent increase in mining production over its first 10 years, simply from increased economic growth and demand for basic minerals.

Chapter Six
Energy Goods and Basic Petrochemicals

In 1991, Canada exported $16 billion in energy products. Eighty per cent of those exports went to the United States. For Canada, the energy provisions of the FTA ensured that this very significant trade would be based on market principles and would be subject to very few trade restrictions. Recognizing the value of the FTA framework, Canada's key objective, going into the NAFTA negotiations, was to maintain and, where possible, strengthen the FTA rules covering energy trade. In addition, Canada wanted to ensure the disciplines on investment, services and procurement, which affected the energy and petrochemical sectors in Mexico, to put Canadians on an equal footing with Americans.

Chapter Six consolidates the NAFTA provisions relevant to energy and basic petrochemical trade and related regulatory activities. It mirrors all of the key elements of Chapter Nine of the FTA, reproducing the key FTA provisions concerning border measures, energy-specific provisions relating to trade and regulation, including the proportional access provision, as well as energy-specific national security language. Chapter Six also adds new language on energy regulatory measures. Overall, the chapter ensures equal access for Canadian companies to the Mexican market relative to their U.S. competition.

Encouraging Mexico to adopt the FTA framework proved difficult in certain areas, largely because of its constitutional and legal requirements to restrict foreign activity in the energy sector. Mexico has reserved the right to restrict foreign participation in the following activities:

- upstream oil and gas exploration and development;
- refining and processing of crude oil and natural gas;
- foreign trade, storage, distribution and transportation of crude oil, natural gas and basic petrochemicals;
- the supply of electricity as a public service and related generation, transmission and distribution; and
- exploration, exploitation and processing of radioactive materials.

The restrictions on foreign investments in these activities will apply until such time as Mexico voluntarily liberalizes its laws (as provided for in annex III of the Investment Chapter). When that occurs, Canadian investors will have access to any investment opportunities made available through liberalization.

Despite the continued existence of these limitations, the NAFTA contributes to the further removal of investment and trade restrictions associated with secondary and tertiary petrochemicals and establishes new opportunities for Canadian investors in the area of non-utility electricity generation (for example, production for its own use, co-generation and independent power production).

Canada, Mexico and the United States have agreed that governments shall not apply restrictions to imports or exports, except in limited situations consistent with the General Agreement on Tariffs and Trade (GATT), regardless of whether these restrictions are export taxes, import fees, quotas, or minimum or maximum import or export prices. These provisions parallel those applying to all non-energy goods (NAFTA articles 309 and 314). Mexico's acceptance of the obligations on import and export restrictions is conditioned by a special reservation (in annex 603.6) permitting it to restrict foreign trade of certain goods to itself as currently required by the Mexican constitution.

As part of the FTA, Canada and the United States agreed to an energy-specific proportional access obligation (article 904). Like the FTA, the national security obligation (article 607) narrows the range of generally available GATT (article XXI) and NAFTA (article 2102) justifications for invoking measures on national security grounds. The grounds for adopting measures aimed at restricting the import or export of basic petrochemical goods are limited to essentially military situations. Mexico is not subject to any of the rights and obligations created by articles 605 and 607.

Article 606 (Energy Regulatory Measures) is new to the NAFTA and will replace the existing FTA consultation provision (article 905 — Regulatory and Other Measures). It clarifies the obligation on energy regulatory bodies to apply measures consistent with the Agreement's obligations on national treatment, import and export restrictions and export taxes. In addition, Canada, Mexico and the United States have undertaken a best-efforts obligation to ensure that energy regulators avoid the disruption of existing contracts "to the maximum extent practicable" and that they provide for an orderly and equitable implementation when disruptions do occur.

> *Mexico has a vibrant economy. They know that, to compete with the best in the North American market, they must have the best machinery. We can provide them with that.*
>
> William Steel, Damark Packaging Inc.

Chapter Seven — Agriculture

Canadian agricultural producers export more than $13 billion a year to markets around the world, and Canadians consume some $9 billion in imported agricultural products every year. It is no wonder, therefore, that, for years, Canada has been at the forefront of those advocating more open and more predictable conditions for trade in farm products.

Unfortunately, the barriers faced by agricultural products vary greatly from country to country, and most of them are rooted in differing domestic programs and policies aimed at promoting price and income stability. Canada agrees that governments should be able to help stabilize farm incomes but believes this can be achieved without distorting world trade. At the same time, Canada has maintained that only a global framework of rules can effectively bridge these differences and provide a basis for gradually liberalizing and stabilizing world trade in agriculture.

Over the past six years, agricultural trade rules have been a principal focus at the Uruguay Round of GATT negotiations, and significant progress has been made in achieving Canada's goals. Problems remain, however, particularly between the United States and the European Community. Until these are overcome, a satisfactory set of global trade rules on agriculture will remain elusive. In the NAFTA, Canada was able to meet its main objectives.

- There is immediate access (article 703) for most Canadian exports to the Mexican market. The access is equivalent or equal to that enjoyed by the United States. Mexico's import-licensing system, which curbed grain imports, has been eliminated with immediate effects on wheat, barley, potatoes and corn.
- For Canada and the United States, the provisions of Chapter Seven of the FTA will continue as the basis for regulating cross-border trade in agriculture.
- Special transitional measures are maintained for the most sensitive Canadian fruit, vegetables and flowers. Supply management boards for dairy, poultry and eggs are not affected. Special arrangements also apply to sugar and sugar syrup.

The countries will work toward ensuring that subsidies to agriculture, whether they be domestic support measures or government assistance aimed at export sales, will have a minimal trade-distorting effect (article 704).

The three countries have agreed to eliminate all tariffs on agri-food products during the transition period, with the exception of dairy, poultry, egg and sugar products in the case of the Canada-Mexico bilateral arrangement. Canada imports mostly tropical fruits, coffee, fresh

fruits and vegetables out of season; about 85 per cent of imports from Mexico now enter duty-free. Most Canadian tariffs on imports from Mexico will be eliminated immediately or in five years, but some sensitive categories will be eliminated over 10 years. Similarly, Mexico will eliminate some of its agricultural tariffs on imports from Canada immediately (for example, rye, lentils, raspberries and buckwheat), some over five years and some over 10 years.

Mexico will eliminate its import licences for wheat and barley and replace them with tariffs, in the case of wheat, or tariff-rate quotas, for barley, which will be phased out over 10 years. Tariff-rate quota levels for imports will reflect historical performance in the Mexican market by Canadian and U.S. producers. In return, Canada will exclude Mexico from its import-licence requirements for wheat and barley and their products.

The NAFTA Agricultural Tariff Phase-Out

By Canada On Mexican Products

Immediate	Five Years	Ten Years
Pork	Potatoes	Fresh tomatoes
Soya-bean meal	Cabbages	Frozen cauliflower
Alfalfa meal	Raspberries	Baby carrots
Active yeasts	Wheat	Frozen asparagus
Cat or dog food	Barley	Green onions
Coffee	Corn	Cut flowers
Sorghum	Snap beans	Frozen strawberries
		Tomato paste

By Mexico on Canadian Products

Immediate	Five Years	Ten Years
Rye	Mushrooms	Apples
Buckwheat	Peppers	Vegetable oils
Broccoli	Frozen broccoli	Pork
Lentils	Frozen sweet corn	Wheat
Raspberries	Canary seed	Cereal flours
Frozen blueberries		Barley
Beef and cattle		Malt

Canadian agricultural producers will continue to enjoy the same terms of access that they have exploited in the U.S. market and, with the exception of dairy, poultry, egg and sugar products, will be able to compete in the Mexican market on the same terms as U.S. producers. Similarly, Mexico will be able to compete in the Canadian market on the same terms as Canadian and U.S. producers, with the exception of dairy, poultry, egg and sugar products, and certain fruits and vegetables, where Mexico will face a special safeguard regime, during the transition period, based on gradually liberalized tariff-rate quotas.

Most imports of Mexican fresh fruits and vegetables complement Canadian production, arriving when Canadian production is low or non-existent. At the same time, Canadian producers of apples, fresh and frozen berries and frozen potatoes should find new markets in Mexico.

The Agreement establishes a Committee on Agricultural Trade (article 706), which is responsible for monitoring and implementing the agricultural provisions. A working party on agricultural subsidies will meet semi-annually to consider ways to reduce the trade-distorting impact of subsidies and to find means of eliminating or reducing export subsidies (article 705). Various other working groups are established to reduce conflicts arising from trade in agricultural products, including an Advisory Committee on Private Commercial Disputes regarding agricultural goods (article 707).

A separate section (B) deals with rules and disciplines on sanitary and phytosanitary (SPS) measures. Rather than a patchwork of sometimes conflicting disciplines resulting from bilateral and unilateral codification, the NAFTA is based upon the multilateral rules worked out in the GATT. In this sense, they build on the progress, which has been achieved but not yet concluded, in the current GATT negotiations.

Unlike the FTA, which was handicapped by its effort to harmonize two different national standards, the NAFTA establishes clear ground rules under which governments, while keeping to the disciplines, can act in accordance with local conditions. The guiding principle is that measures are in accordance with scientific principles and are based on the appropriate level of protection from risk. In the NAFTA, therefore, the three countries agree to work toward equivalent SPS measures without reducing their particular health-protection standards.

A trilateral Committee on Sanitary and Phytosanitary Measures, meeting at least once a year, will facilitate co-operation on food safety and other sanitary and phytosanitary measures. It will have the authority to set up ad hoc working committees to resolve specific issues and it may seek the advice of the international organizations named in the Agreement, including the Codex Alimentarius Commission, the International Office of Epizootics, the International Plant Protection Convention and the North American Plant Protection Organization.

What They Do — International Agricultural Organizations

Codex Alimentarius Commission — This part of the Food and Agriculture Organization sets international standards for the food and agricultural sector from recommendations developed by independent, internationally recognized experts and extensive consultations.

The International Office of Epizootics — Based in Paris, this office tracks the prevalence of animal diseases, such as blue tongue, brucellosis and hoof-and-mouth disease with a view to minimizing the risk of spreading livestock diseases. It maintains a code to guide quarantine procedures in member countries.

The International Plant Protection Convention — This body sets standards for and tracks the prevalence of disease in plants and other biotics with a view to preventing the spread of plant diseases and pests. Under its umbrella, the North American Plant Protection Organization tracks its requirements within the NAFTA region.

Market Opportunities: Food and Agriculture

Mexico currently imports approximately $5 billion in agricultural and food products. Under the Agreement, Mexico will eliminate import-licence requirements for Canadian grains, including wheat, barley and oilseeds. These import-licence requirements will be replaced with either tariffs or tariff-rate quotas. With the TRQ system, quota levels will increase, and tariffs will be gradually phased out to provide unrestricted access to the Mexican market.

Livestock inventory levels in Mexico reflect conditions of limited arable land, water supplies and an especially acute supply-demand imbalance in the grains and oilseeds sectors. Mexico is not likely to become self-sufficient in livestock or meat in the near future, and there is demand for breeding livestock, pork and other meat products. After the United States and Japan, Mexico is Canada's third-largest customer for pork.

In the past, skim milk powder has been Canada's largest agricultural export to Mexico. In recent years, our exports have declined as skim milk production in Canada now almost matches domestic demand. Now that Mexico is attempting to increase its milk production at home, there are good market opportunities for Canadian suppliers of dairy cattle and genetic material. Imports of dairy breeding stock from Canada totalled about $4.8 million in 1990.

Changes in the eating patterns of Mexicans, due to urbanization and higher incomes, have given Canadian specialty food products (such as cookies and biscuits, frozen potato products and other frozen and microwavable products, bottled water, and convenience and snack foods) a market niche in Mexico.

We have worked very hard to establish our export markets and they are proof again that Canada, as a trading nation, is able to compete, expand and create markets for its products, even from the most remote areas of the country.

K. Lynn Riese, Riese's Canadian Lake Wild Rice

Chapter Eight — Emergency Action

Under the GATT (article XIX) and the FTA (Chapter 11), countries may take emergency action if increased imports cause injury to domestic producers. This concept is carried over into the NAFTA on a basis similar to the FTA, with separate provisions to cover both bilateral actions during the transition period as well as border restrictions applied to imports from all suppliers (global actions).

The bilateral track addresses surges that may result directly from the more liberal trade conditions provided by the NAFTA. If there is a surge in imports causing serious injury to domestic producers, the injured country may take emergency action temporarily to restore protection. To meet concerns about lower wages in Mexico, the standard required to take action will be less stringent than the FTA by allowing action to be taken against Mexican goods on the basis of a threat-of-injury finding (while the FTA limits action against U.S. goods to cases of actual injury). The duration of relief required can also be extended beyond the three-year FTA maximum, either by one year at a lower rate of duty, or until the end of the full transition period through a "soft-landing" recalculation of the duty phase-out schedule at the end of safeguard action. The bilateral provisions of article 1101 of the FTA, however, will remain in effect for trade between Canada and the United States (annex 801.1).

Article 802 specifies the criteria that must be met if a global action is to be extended to a NAFTA member. Under the NAFTA global track, one country's goods shall not be included in another's global border restrictions unless two key criteria are met: exports from that country must account for a substantial share of total imports to the affected country (defined as being among the top five suppliers of the good under investigation during the most recent three-year period), and the annual growth of its exports must be close to or more than the annual rate of growth from all sources. These criteria will ensure the exclusion of a Canadian firm that is a new, niche supplier or where Canada is the traditional, stable supplier. Based on recent trading patterns, this should normally ensure the exclusion of approximately 30 to 35 per cent of Canadian exports to the United States, but only 15 to 20 per cent of U.S. exports to Canada.

Article 803 and its annex lays out detailed procedural obligations. Once a request for emergency action has been initiated by a domestic industry, the appropriate investigating national authority [in Canada, the Canadian International Trade Tribunal (CITT); in the United States, the International Trade Commission (USITC); and, in Mexico, the Ministry of Trade and Industrial Development] gives public notice of the investigation. The NAFTA obliges them to hold public investigative hearings and provide an opportunity for cross-examination by

interested parties. If confidential information is provided, it should be accompanied by an unclassified summary.

In arriving at its decision on injury, the investigating tribunal must consider:

- the rate and amount of the increase in imports of the goods concerned;
- the share of the domestic market taken by the imports; and
- the changes in level of sales, production, productivity, capacity utilization, profits and losses and employment.

In addition, it may consider:

- the changes in prices and inventories; and
- the ability of the firms in the industry to generate capital.

Definitions: Emergency

Serious Injury means a significant overall impairment of a domestic industry.

Surge means a significant increase in imports over the trend for a recent representative base period.

Threat of Serious Injury means serious injury that, on the basis of facts and not merely allegation, conjecture or remote possibility, is clearly imminent.

Part Three — Technical Barriers to Trade

Chapter Nine — Standards-Related Measures

In the complex world of modern technology, product standards and technical regulations are essential. They protect consumers and help producers achieve high quality. For example, life jackets bought in Canada must meet certain life-saving requirements. Similarly, any electrical equipment must conform to safety regulations. Occasionally, standards or safety regulations can also be used to keep out a competitor. To prevent this sort of abuse, the NAFTA contains rules governing the use of standards. Chapter Seven addresses standards in the agricultural sector. This chapter addresses other technical barriers. It also establishes a Committee on Standards-Related Measures to monitor implementation of this chapter and to provide a forum for consultation, and it sets up subcommittees on specific subjects.

The GATT requires that countries not discriminate between domestic and imported goods in applying standards and technical regulations nor use such regulations as disguised barriers to trade. In the Tokyo Round of multilateral trade negotiations (1973-79), an Agreement on Technical Barriers to Trade provided detailed rules of procedure to help countries resolve disputes that could arise in the application of standards. It was based on the principle that no country should be prevented from taking measures to ensure protection of human, animal or plant life as long as they are not applied to cause arbitrary or unjustifiable discrimination between imported or domestic goods.

The FTA amplified these obligations by adding a number of further procedural obligations and advancing the concepts of compatibility and mutual recognition of each other's standards. The NAFTA represents a further step forward. Recognizing that standards are necessary for the protection of consumers as well as the environment and human, animal and plant life generally, the guiding principle is that standards must be non-discriminatory. They should also accord with international practice and the findings of international standardizing bodies, including the International Organization for Standardization, the International Electrochemical Commission, Codex Alimentarius Commission, the World Health Organization, the Food and Agriculture Organization, and the International Telecommunications Union.

What They Do — International Standardizing Bodies

International Organization for Standardization (ISO) — a non-governmental federation of some 90 national standards bodies. Canada is represented by the Standards Council of Canada. Established in 1947, it promotes the facilitation of trade through international standardization. Most of its work is the result of some 200 technical committees, which have, over the years, published more than 8 000 international standards. A further 6 800 international standards are currently under discussion.

The International Electrochemical Commission (IEC) — an independent non-governmental organization that works closely with the ISO in setting standards in the electrical and electronic engineering field. Both the ISO and the IEC work closely with UN organizations, such as the FAO and the WHO.

Codex Alimentarius Commission — an FAO-based organization that sets international standards in the food and agricultural sector.

The World Health Organization (WHO) — an organization, founded in 1946, that develops and disseminates information on drug safety and efficacy, develops standards on pharmaceutical issues and, in co-operation with the FAO and the International Labour Organization (ILO), develops food, chemical and other safety standards.

The Food and Agriculture Organization (FAO) — an organization, founded in 1945, that addresses problems related to food and agriculture, and co-ordinates agricultural and food safety standardization activities.

The International Telecommunications Union (ITU) — an organization, founded in 1865, that is the principal international organization concerned with the management of international telecommunications and associated standards.

Within this framework, the main objective of these articles, therefore, is to ensure that technical standards are applied on a non-discriminatory basis on products — goods and certain services — of Canadian, U.S. and Mexican origin. Where there are differences between national standards, the rules seek to neutralize, to the greatest extent possible, the impact of these differences on trade by promoting compatibility, equivalence, and notification and information exchange requirements.

Rather than seek harmonization between different national standards, NAFTA bases its approach on the principle of compatibility and equivalence. NAFTA countries are encouraged to make their standards, technical regulations and conformity-assessment procedures compatible in order to facilitate trade. In addition, NAFTA establishes a new type of equivalency test, which will allow the three countries to maintain differing regulations, while allowing trade in the regulated products. The exporting countries must show that their regulations meet the importing country's requirements, even when those regulations differ. Article 908 spells out a "conformity assessment" procedure and encourages each country to make its procedures compatible. To build confidence in the other national requirements, the chapter sets out detailed procedures on accreditation, conformity assessment, acceptance of test data, information exchanges and notification.

In January 1993, an initial five-year certification was granted by the U.S. Occupational Safety and Health Administration to the Toronto laboratory of the Canadian Standards Association, a non-profit group of five testing laboratories based in Ontario. The laboratory will now be able to certify that certain products, including heating and cooling equipment, industrial appliances, lighting and electrical equipment meet the more than 360 U.S. health and safety standards. It is the first foreign standards body to be given national recognition in the United States. Underwriters' Laboratories of Northbrook, Illinois, has already been granted Canadian approval to certify that products comply with Canadian standards.

In working toward compatibility, however, there are three guiding principles: safety levels must not be diminished; the rights of each nation to set appropriate standards must not be prejudiced; and international standardization must be taken into account. Over time, as governments and private standards organizations develop agreements leading to the mutual acceptance of test results and certification procedures, the capacity of different standards to frustrate trade should be greatly reduced.

Definitions: Standards

Conformity Assessment Procedure means any procedure used to determine that a technical regulation or standard is fulfilled.

National Treatment means that imported products are required to meet the same regulatory requirements as products of domestic origin.

Make Compatible means making different technical or regulatory requirements either identical or equivalent in effect.

Unlike the FTA, the NAFTA requires the parties to seek to ensure, through appropriate measures, that provincial, state and local governments, as well as non-government standard-setting organizations, comply with the provisions of this chapter. This was negotiated to ease the problems that Canadians had in dealing with U.S. state regulations. The sheer number of standards-setting organizations in the United States at the state and municipal level poses a large potential non-tariff barrier unless procedures are put in place to address problems as they arise. The NAFTA makes significant progress in meeting this requirement.

To promote compliance and avoid disputes, each country must notify the others of its intent to adopt or modify a standards-related measure (article 909). The notice must state the goods or services to be covered and the objective and rationale for the adoption or modification. The other countries must be given ample opportunity to comment. All standards-related measures must be published promptly and sufficient time allowed between publication and implementation to allow producers to become familiar with them. The establishment of enquiry points in each country, such as the Standards Council of Canada, should facilitate access to information about standards and procedures.

A Committee on Standards-Related Measures (article 913) will monitor the implementation of this chapter and facilitate consultation on any issues arising from standards-related measures. It can set up subcommittees and working groups to assist it in its function to facilitate

compatibility and co-operation in standards-related measures. Four standing subcommittees (annex 915) to deal with specific problems are also established.

1. A **Land Transportation Standards Subcommittee** will determine, within two-and-a-half years, standards for truck and bus drivers; within three years, standards for vehicles, including inspections, emissions, environmental pollution; within three years, standards on road signs; within one year, standards for locomotives; within six years, standards on the transport of dangerous goods using the UN Recommendations on the Transport of Dangerous Goods as a basis.
2. A **Telecommunications Standards Subcommittee** will establish a work program within six months on equipment standards.
3. **An Automotive Standards Council** will seek to facilitate compatibility of national standards, keeping in mind the impact on industry integration, extent of barriers to trade, level of trade and extent of disparity.
4. **A Subcommittee on Labelling of Textiles and Apparel Goods** will establish a work program on the harmonization of labelling requirements, including the use of pictograms and symbols, care instructions, fibre-content information and use of national registration numbers.

Exporters and consumers are the principal beneficiaries of this Chapter. Canada's high standards for health, safety and environmental protection are confirmed while, at the same time, procedures have been put in place to tackle the sometimes bewildering array of standards that face Canadian exporters and service providers to the United States, resulting from the highly decentralized approach to standards-setting adopted by the federal and state governments. In addition, these principles will help Mexico raise its standards and adopt a best-international-practice approach to its standards-setting measures. By encouraging the development of compatible standards, Canadian exporters can count on being competitive in a wider range of markets, while the Standards Committee will help to resolve technical problems before they become trade irritants.

Part Four — Government Procurement

Chapter Ten — Government Procurement

Government procurement is the purchase of goods and services by federal, provincial and local governments for their own use. Efforts over the years, particularly since the mid-1970s, to reduce discrimination, have met with some success but still leave significant segments of national procurement markets closed to full international competition.

Both the GATT and the FTA succeeded in opening up a proportion of federal procurement. The Procurement Code concluded during the Tokyo Round of GATT negotiations subjected goods purchases above a value by selected government "entities" — departments and agencies — to rules of non-discrimination. It excluded the U.S. Departments of Energy and Transport and the Departments of Transportation, Communications and Fisheries and Oceans in Canada. Defence Department procurement was also given limited coverage.

The FTA expanded the coverage of the Code by lowering the applicable threshold from US$171 000 to US$25 000. In addition, the FTA included provisions aimed at making the government market more transparent and subject to more stringent procedures to settle disputes. The FTA did not open up provincial, state or local government departments or agencies nor provincially owned public utilities and crown corporations.

In the NAFTA, Canada sought a comprehensive agreement extending national treatment obligations to all levels of government, including crown and parastatal corporations. Mexico appeared equally prepared to conclude a large deal. The continuing inability of the United States to address its legislated exceptions (for example, "Buy America" and "Small Business Set-Asides") precluded such an extensive agreement. While the goods contracts threshold remains at US$25 000 for bilateral Canada-U.S. goods contracts, the NAFTA provides:

- a contract threshold of US$50 000 for goods, services or any combination thereof;
- a threshold of US$6.5 million for construction services;
- for government enterprises (in Canada, 11 named crown corporations), a contract threshold for goods and services of US$250 000 and for construction services US$8 million;

- for the inclusion of the U.S. Corps of Engineers construction market (which, based on current levels, opens a market of approximately US$8.9 billion) and the Rural Electrification Act (which opens a market of approximately US$1.5 billion in telephone equipment purchases) in the entities list; and
- for the addition of parts of the U.S. Departments of Transport and Energy and the Canadian Departments of Transport, Fisheries and Oceans and Communications to the list of entities covered by the Agreement.

Crafting a smaller deal along the lines of the FTA was complicated by the fact that Mexico is not a party to the GATT Procurement Code. Despite this, the negotiators were able to open up a significant proportion of the Mexican procurement market, including its parastatals — crown corporations, such as PEMEX and CFE, and its petroleum and electricity institutions. The NAFTA adds some $58 billion in covered procurement to the $20 billion market already open to competition under the GATT and the FTA. It should be remembered, however, that the total procurement market in the three countries is approximately $US800 billion.

The NAFTA maintains the FTA's explicit rules on the bidding process, but because Mexico is not a signatory to the GATT Procurement Code, a somewhat different and more detailed approach was taken. Rather than affirming rights and obligations under the Code and adding additional provisions, Chapter Ten replicates much of what can be found in the GATT Code as well as the additional provisions of the FTA relating to transparency and procedural obligations.

Further negotiations (article 1024) on liberalization of procurement are to begin no later than 1998 and, depending on progress in the GATT on the Procurement Code, the provinces and states are to be encouraged to participate. Negotiations on electronic transmission of data are also to begin within a year of the NAFTA's implementation.

> *Although enthusiasm for free trade is axiomatic to economists, the truth is that not all the arguments point in that direction.... in most instances these arguments amount to debaters' points: while clever and conceivably valid under some circumstances, they ought not to detain practical-minded people who have little patience for scholastic exercises.... Protectionism's allure stems not from the economics of the national interest, but from the politics of special interests. Politics turns trade policies that are economic turkeys into political peacocks.... It is not that trade restrictions can never benefit a country in principle, it is just that they rarely do so in practice.*
>
> Alan Blinder, Princeton economist

Part Five
Investment, Services and Related Matters

Trade in goods was the key factor leading to the steady integration of the world economy in the postwar years. As trade increased, capital flows and technology exchanges gradually strengthened their roles as agents of integration. Today, the effective production and marketing of both goods and services require that firms have access to global capital and information on the best available terms and that they are able to set up facilities or joint ventures around the world. To meet this objective, it is increasingly necessary that laws and regulations affecting the flow not only of goods and services, but also of capital and technology, enhance the ability of firms to pursue global strategies.

Today, the issues of government policy that are critical to trade and competitiveness are increasingly those that foster an overall hospitable economic climate. More to the point, the focus of policy has shifted from efforts to segment markets (i.e., protect existing investment) to efforts to promote interdependence (i.e., attract new investment by both domestic and foreign investors). In effect, trade policy is becoming more domestic, while domestic policies are becoming more international.

In the years to come, as contentious negotiations increasingly focus on sensitive domestic regulatory schemes (involving such diverse issues as environmental protection, product standards, competition policy, innovation policy, income and price support programs), governments will need to consider the most effective way to negotiate rules consonant with a global economy dominated by global firms operating within and between national economies.

The globalisation of industrial activities and overlaps between industrial and trade policies may necessitate a broader multilateral framework for harmonization of industrial policies. A third phase of internationalization has been reached, which comprises trade, foreign investment and global networking; this globalisation implies a move beyond mere interdependence to the mixing and blending of national economies, largely due to the activities of multinational enterprises. Policy areas, which were previously considered domestic, now have spillover effects on the welfare of other countries and implications for the world trading system.

OECD, *Globalisation of Industrial Activities*, 1992

Consistent with these trends, the FTA, the NAFTA and the GATT Uruguay Round have all begun to address some of the new issues that have arisen as a result of the greater integration of the international economy, such as services, investment, intellectual property and business travel. The chapters in this part and part six reflect emerging consensus on how to structure the new rules. A striking feature of these chapters is the increasing sophistication in approach.

For example, the investment text in the FTA built on earlier bilateral and Organization for Economic Co-operation and Development (OECD) experience and was geared largely to international trade in goods; the early Uruguay Round commitment to limit negotiations to trade-related investment measures gradually gave way to broader considerations. The NAFTA text reflects an expanded outlook and is geared more to the whole range of factors involved in international business, such as trade in goods and services and the transfer of technology and strategic alliances, and covers the conduct of business rather than just investment.

Similarly, the financial services chapter of the FTA involved very specific concessions by each side; the NAFTA chapter completely recasts these obligations and expands them into a set of generic rules with some specific exceptions and concessions. In the years to come, the experience that Canada has gained in negotiating and implementing these new rules will ensure that we can continue to be at the cutting edge, both in taking advantage of emerging opportunities in the global economy and in defining the trade regime of the future.

> *Foes of the FTA were clearly too pessimistic about export prospects and related employment growth in many key industries. In particular, many of Canada's manufacturing sectors seem to have performed remarkably well in the U.S. market under the FTA. And there is absolutely no indication whatsoever that Canada's traditional role as a provider of natural resources to the United States has become entrenched as a result of the FTA. The U.S. market continues, in fact, to be the most dynamic market for Canadian manufacturers of high-value-added, finished goods and business services, despite its recent poor growth performance....*
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> *These industrial sectors are vital to Canada's future economy, and the FTA has allowed Canadian producers to gain export sales — thus supporting employment in these industries as well. Over the long term, it appears that free trade will likely help Canadian industry to wean itself from dependence on the more traditional sectors of the economy. Job losses associated with higher imports that have occurred under the FTA must be put in this context of short-term growth gains in many other industries and against evidence that Canadians are building a higher value-added industrial base for the future.*
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> Daniel Schwanen, "Were the Optimists Wrong on Free Trade?,"
> C.D. Howe Institute *Commentary* No. 37, October 1992