

IV. SECTORAL POLICY PATTERNS AND TRENDS

(1) Overview

1. The regulatory environment governing growth and structural adjustment in Canada has changed significantly since 1994. The NAFTA (1994), the WTO Agreements and the Agreement on Internal Trade (1995) are all aimed at removing barriers to economic integration, both internally and externally. Structural reforms under these Agreements were complemented by an autonomous process of deregulation and commercialization which was inspired, or required, by general efficiency considerations, technical developments (telecommunications), fiscal austerity (elimination of transport subsidies) and the effects on cross-border competition of regulatory reforms in the United States (aviation, telecommunication and other tradeable services). It is difficult to conceive of economic operators not directly exposed to policy changes in recent years, whether in the areas of tariffs, subsidization, government procurement or regulations on interprovincial factor mobility.¹ The economic implications may, however, differ widely between sectors.

2. Overall, the impact of the NAFTA appears to be particularly strong in manufacturing, where tariff elimination coincides with strengthened rules of origin, and in services industries exposed to improved access conditions. In areas such as banking and insurance, the NAFTA paved the way for, and was later "multilateralized" under, Canada's WTO commitments. In agriculture, it was predominantly the new WTO Agreement, combined with budgetary constraints, that helped to redefine the playing field for producers and traders.² Focusing on domestic market integration, the Agreement on Internal Trade is likely to have a more limited impact on external suppliers, although they may share in the benefits of an increasingly flexible and competitive market environment. Such benefits would be further enhanced through broader coverage of basic business sectors, in particular energy.³

3. The sectoral effects of these reforms are, however, difficult to trace and distinguish from macroeconomic influences. While internal activities are currently suffering from weak domestic demand, buoyant exports are bolstering a broad range of trade-oriented sectors, from ailing textiles and clothing industries to Canada's traditional strongholds (forestry, mining, energy and automobiles) and "modern" manufacturing (e.g. information technologies, aerospace).

4. A conspicuous feature of many advanced manufacturing industries is the high share of foreign-owned production plants with a limited research and development base in Canada. Telecommunications remains the only major exception. In many areas, the larger players are complemented by small and medium-sized enterprises that have been able to develop competitive market niches. While capitalizing on certain size-related advantages, such as technical and commercial flexibility, the SMEs generally operate from a limited financial base and may have difficulties in maintaining international supply and marketing channels.

¹The most notable exceptions may be found among cultural industries.

²The fact that supply-managed farm sectors (eggs, poultry and dairy) have so far escaped major changes, contrasting with grains, may be attributed both to regional sensitivities and the absence of fiscal pressure as the cost of support is borne mainly by consumers.

³The Agreement's chapter on energy has remained an empty shell to date (section (3)(iv)).

(2) Agriculture, Food, Fisheries and Forestry

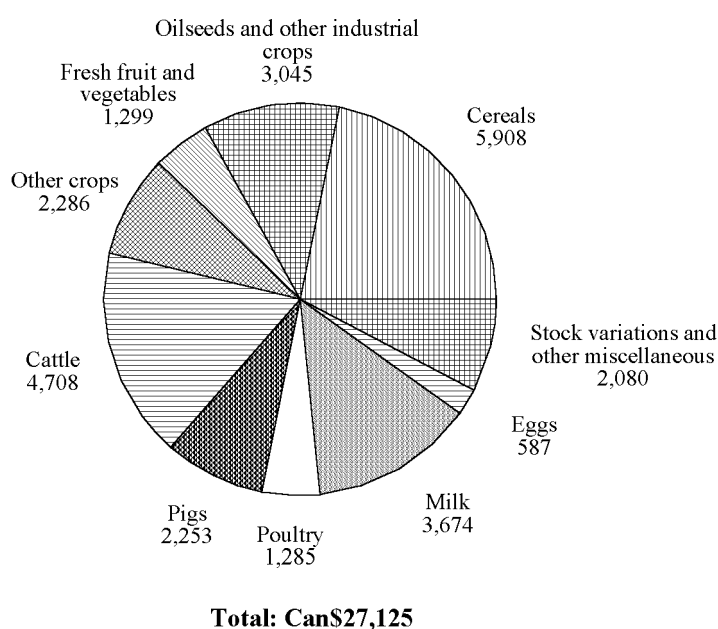
(i) Main features

5. As a net commodity exporter and member of the Cairns Group, Canada has been an active supporter of farm trade liberalization. Apart from its rôle in the Uruguay Round, Canada has frequently used international dispute settlement procedures to remove barriers impeding its exports of agricultural, forestry and fisheries products (Annex II.1). Current priorities include the full elimination of export subsidies and other distortions in world farm trade (Chapter II(2)(i)(b)), corresponding policy initiatives are complicated, however, by the persistence within Canada of State-managed production and marketing structures in several food sectors.

6. Noting that the growth of food exports has been lagging overall exports in recent years, the Government recently launched an Agri-food Trade Strategy. Its goal is to recapture a 3.5 per cent share of world trade, up from 3 per cent at present, and to increase exports from the Can\$15.2 billion recorded in 1994 to some Can\$20 billion by 2000. A major contribution is expected from higher value-added products, notably following the elimination of cereal transportation subsidies. Chart IV.1 shows the current structure of Canadian farm production.

Chart IV.1
Agricultural output at current prices, 1995

Can\$ million



Note: The data cover ISIC categories 111 and 112, and therefore exclude processed food, beverages and tobacco.

Source: Preliminary data provided by the OECD in the context of this report.

7. Federal outlays on agriculture have declined by 20 per cent since the 1994 Trade Policy Review, and further reductions are budgeted until fiscal year 1998-99.⁴ Canada's Producer Subsidy Equivalent (PSE), estimated by the OECD, declined from 42 per cent of the value of production in 1989-91 to 27 per cent in 1995. The Consumer Subsidy Equivalent (CSE) came down from 26 per cent to 15 per cent over the same period. Less intensive government support for farm incomes, as reflected in these figures, is attributable to both higher import prices following the Canadian dollar's depreciation and an ongoing process of autonomous and/or WTO-inspired policy reform. There has been a significant decline in total transfers per farmer (on a full-time basis), contrary to the general trend among OECD countries.⁵

8. Agriculture, food and beverages (the "agri-food" sector) currently represent an estimated 8 per cent of GDP, 12 per cent of exports and 15 per cent of employment. Forestry contributes an additional 3 percentage points to GDP. Contrasting with the fisheries sector, ailing due to dwindling stocks, the forest industry remains a major economic force in most regions of Canada. With exports totalling Can\$39 billion in 1995, nearly twice the 1990 level, the sector made the single-largest contribution to Canada's trade balance.

(ii) Recent developments under the WTO and NAFTA

9. Overall, the WTO Agreements appear to have had a stronger impact on Canadian agriculture than on manufacturing, contrasting with the NAFTA. Notable changes included the phasing out, in 1995, of transport subsidies under the Western Grain Transportation Act, accompanied by a one-time direct payment of Can\$1.6 billion to affected landowners. Transport subsidies formed the largest part of the WTO Total Aggregate Measure of Support, which comprises all domestic support programmes subject to a 20 per cent reduction commitment under the WTO Agreement on Agriculture.⁶ According to the authorities, the AMS for 1995 and 1996 will be significantly below the relevant commitment levels.

10. Also as a result of the Uruguay Round, Canada has converted its non-tariff import quotas and restrictions into a system of 22 tariff quotas covering cereals, dairy products, poultry, eggs and bovine meat (Table IV.1). In-quota imports are subject to relatively low duties while the duties on out-of-quota supplies are bound at prohibitive levels, reflecting the restrictiveness of the quota and licensing schemes they replaced. Tariff quotas apply primarily to imports competing with products subject to supply management systems, which together account for about one quarter of Canada's agri-food production.⁷

⁴OECD (1996).

⁵In contrast to the situation in 1989-91, these transfers, at some Can\$14,000 in 1994, were below the OECD average and amounted to less than half the transfers recorded for Canada's main trading partner.

⁶The Total Aggregate Measure of Support, established in the context of the Uruguay Round negotiations, is an index measure of domestic support, based on a bound Total AMS in 1986-88. It includes market price support for each product, non-exempt payments (support not meeting the exemption criteria of Article 6:5 of the WTO Agreement on Agriculture), and other product or non-product-specific support (e.g. fertilizer subsidies). Canada's maximum allowable AMS is to decline from Can\$5.2 billion in 1995 to Can\$4.3 billion in 2000; the latter amount corresponds to 80 per cent of the aggregate support provided between 1986 and 1988.

⁷Recent actions by a provincial marketing board against farmers found to be selling directly to local cheese producers have further intensified the controversy about Canada's supply management programmes among the farming community.

The United States has challenged Canada's application of out-of-quota duties to its exports as incompatible with the NAFTA (Chapter III(2)(i)(a)), the final panel report is expected to be issued towards end-1996.

Table IV.1
Tariff quotas for agricultural and food products subject to tariffication
(Tonnes and per cent)

Product	Quota volume 1995, tonnes (per cent) ^a	In-quota imports 1995, tonnes (per cent) ^a	Tariff rate 1996		Eligible importers (in-quota supplies)
			In quota	Above quota	
			(per cent)		
Eggs and products	12,822 ^b (3%)	12,535 ^a (> 3%)	18.0	195.0	Shell, liquid and frozen eggs: historical importers (based on past imports), graders, processors, wholesalers and distributors (based on market share). Powdered eggs: processors and further processors (pro-rata basis).
Broiler hatching eggs and chicks	7,949 ^b (> 5%)	8,156 ^a (> 5%)	16.0	270.0	Registered hatcheries (based on market share).
Chicken, live, meat and products	39,844 (> 5%)	51,761 (> 5%)	11.0	270.0	Processors (based on market share), distributors (based on market share) further processors (based on production of import-competing products) and historical importers (based on market demand).
Turkey, live, meat and products	4,467 (4%)	4,700 (4%)	11.0	170.0	Historical importers (based on market share), further processors (based on production of import-competing products) and other importers (based on market demand).
Bovine meat	76,409 (> 5%)	86,563 (> 5%)	0.0	30.0	Processors and retailer-processors (based on processing of non-NAFTA bovine meat) and distributors (based on sales of non-NAFTA bovine meat). ^c
Fluid milk and cream	64,500 (2.4%)	64,500 (2.4%)	16.0	277.0	Personal imports only (up to Can\$20).
Cream	394 (< 3%)	(...) (3%)	16.0	336.0	First-come-first-served for established importers.
Milk, concentrated, condensed	11.7 (0.01%)	11.7 (0.01%)		295.0	One historical importer.
Whey	3,198 (> 5%)	... (> 3%)	17.0	240.0	First-come-first-served for established processors.
Powdered butter milk	908 (1%)	1,055 (1%)	16.0	239.0	One historical importer (only for supplies from New Zealand).
Other milk products	4,345 (...)	2,012 (...)	14.0	310.0	Applicants to the extent of their use of milk proteins.
Yogurt	332 (< 1%)	239 (< 1%)	14.0	273.0	Historical importers based on past imports.
Butter	1,964 (2%)	1,954 (2%)	16.0	352.0	Canadian Dairy Commission (1,200 tonnes reserved for exports from New Zealand).
Cheese	20,412 (> 5%)	20,339 (> 5%)	[4.0]	282.0	Historical importers based on past imports. ^d
Ice cream	347 (0.2%)	308 (0.2%)	14.0	318.0	Historical importers based on past imports.

Table IV.1 (cont'd)

Product	Quota volume 1995, tonnes (per cent) ^a	In-quota imports 1995, tonnes (per cent) ^a	Tariff rate 1996		Eligible importers (in-quota supplies)
			In quota	Above quota	
			(per cent)		
Other dairy	70				
(...)	70				
(...)	14.0	288.0	Processors to the extent of the domestic use as inputs.		
Margarine	4,535 (3%)	87 (< 1%)	16.0	250.0	First-come-first-served (max. 200 tonnes per applicant).
Wheat and meslin	136,130 (3%)	24,036 (< 1%)	0.5	71.0	First-come-first-served. ^e
Wheat products	123,557 (> 5%)	140,951 (> 3%)	6.5	49.0	First-come-first-served.
Barley	239,400 (3%)	11,267 (< 1%)	0.5	66.0	First-come-first-served. ^f
Barley products	11,478 (3%)	8,659 (...)	9.5	75.0	First-come-first-served.

... Not available.

a Share of domestic consumption in 1986-88 (base period).

b Thousand dozen.

c TRQ does not cover supplies from the United States and Mexico; in-quota imports are largely reserved for Australia (42,000 tonnes) and New Zealand (29,600 tonnes).

d 66 per cent of the tariff quota is reserved for EU suppliers.

e Mexican and U.S. supplies enter under NAFTA rates when TQ is filled.

f Mexican supplies enter under NAFTA rates when TQ is filled.

Source: Government of Canada.

11. Like other developed country participants, Canada is committed to lowering its duties on agricultural and food products by an average of 36 per cent over the Uruguay Round implementation period (1995-2000), with a minimum reduction of 15 per cent by tariff line. The average tariff on agri-food products in 1996 was 25 per cent (Chart IV.2).⁸ Canada has not invoked to date the special safeguard clause available under the WTO Agreement on Agriculture.

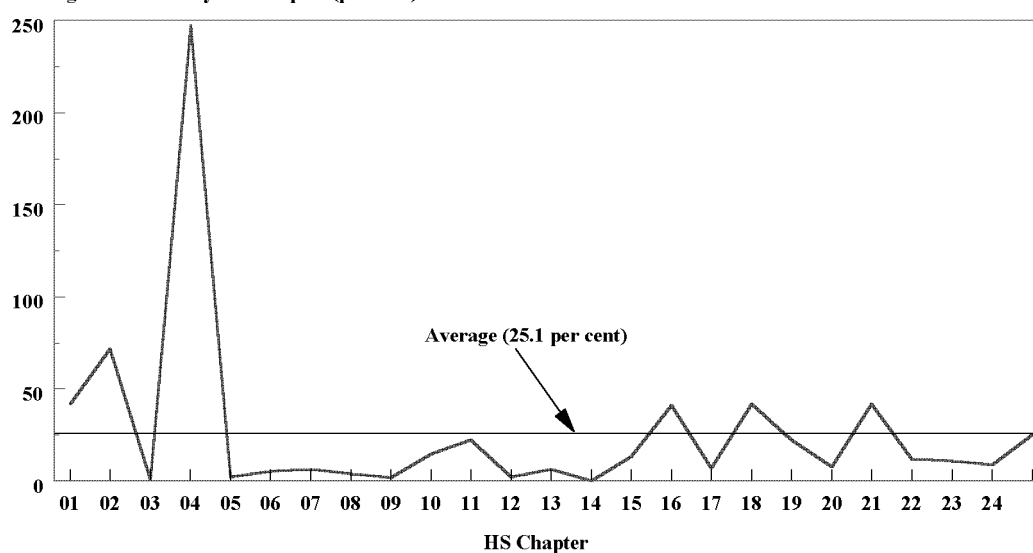
12. Given the prohibitive nature of out-of-quota tariffs, initial quota access implies a significant commercial advantage. The allocation of access entitlements frequently centres on the importers' traditional involvement, adjusted for any change in utilization. Details of the various approaches are shown in Table IV.1. Beneficiaries may sell or rent their shares, subject to approval by the Minister of Foreign Affairs.

13. Export licensing requirements have been introduced to administer access to trading partners' tariff quotas. Quota administration on the export side implies that the resulting rents accrue to Canadian suppliers rather than to importers abroad. The relevant procedures are intended to ensure "orderly export marketing" within U.S. tariff quotas and apply to refined sugar (within a tariff quota of 22,000 tonnes), sugar-containing products (64,709 tonnes) and peanut butter (14,500 tonnes). Quota entitlements are allocated to traditional exporters based on their past shares.

⁸For items subject to tariff quotas, the calculations underlying Chart IV.2 are based on the out-of-quota rates, given that these constitute the decisive import barrier.

Chart IV.2
Tariffs on agricultural products, 1996

Average tariff rates by HS Chapter (per cent)



Chapter	Description
01	Live animals
02	Meat and edible meat offals
03	Fish and crustaceans, molluscs and other aquatic invertebrates
04	Dairy produce, birds eggs, natural honey, edible products of animal origin
05	Products of animal origin n.e.s.
06	Live trees and other plants; bulbs, roots and the like; cut flowers
07	Edible vegetables and certain roots and tubers
08	Edible fruit and nuts; peel of citrus fruit or melons
09	Coffee, tea, mate and spices
10	Cereals
11	Products of the milling industry; malt; starches; wheat gluten
12	Oilseeds and oleaginous fruit; miscellaneous grains, seeds and fruit
13	Lacs; gums, resins and other vegetable saps and extracts
14	Vegetable plaiting materials; vegetable products n.e.s.
15	Animal or vegetable fats and oils and other cleavage products; prepared edible fats; etc.
16	Preparations of meat, or fish or of crustaceans, molluscs or other aquatic invertebrates
17	Sugars and sugar confectionery
18	Cocoa and cocoa preparations
19	Preparations of cereals, flour, starch or milk; pastrycooks' products
20	Preparations of vegetables, fruit, nuts or other parts of plants
21	Miscellaneous edible preparations
22	Beverages, spirits and vinegar
23	Residues and waste from the food industries; prepared animal fodder
24	Tobacco and manufactured tobacco substitutes

Source: WTO Secretariat calculations.

14. Export subsidies have been granted for cereals, oilseeds and dairy products (Table IV.2). Like other developed countries, Canada is committed under the WTO Agreement on Agriculture to reduce export subsidies by 36 per cent and subsidized volumes by 21 per cent for individual products or product groups over the six-year implementation period. According to the authorities, Canada will not grant export subsidies on any products in 1995-96, with the possible exception of skim milk powder and butter.

Table IV.2
Actual exports and export subsidies commitments

Product	Actual spending 1986-90 (Can \$ million)	Outlay commitment 2000-01	Actual exports 1986-88 (^{000 tonnes)}	Export commitment 2000-01
Wheat and products	311.0	199.1	11,205	8,852
Coarse grains	116.4	74.5	4,579	3,618
Oilseeds	59.7	38.2	2,214	1,749
Skim milk powder	48.7	31.1	56.9	44.9
Other milk products	35.2	22.5	38.3	30.3
Incorporated products ^a	31.7	20.3
Cheese	25.4	16.2	11.5	9.1
Butter	17.2	11.0	4.4	3.5
Oilcakes	7.5	4.8	274.4	217
Vegetable oils	3.5	2.2	117.4	92.8
Vegetables	3.1	2.0	101.4	80.1
Total	659.4	421.9

.... Not available.

a Products containing skim milk powder, butter, cheese or other milk products.

Source: Government of Canada.

(iii) Cereals and related products

15. Canada is one of the world's leading producers of cereals, accounting for 24 million tonnes of wheat and 23 million tonnes of coarse grains in 1995. Over 40 per cent of the value of production, estimated at over Can\$10 billion in 1995, is exported; imports are marginal. While cereals have traditionally received the lion's share of Canada's domestic and export subsidies, there has been a significant reduction in recent years. The PSE for wheat declined from 46 per cent in 1989-91 to 18 per cent in 1994; a surge to 24 per cent in 1995 was due mainly to a one-time compensatory payment to landowners.

16. With the abolition of the Western Grain Transportation Act on 1 August 1995 and the attendant termination of transport assistance, Canada has currently over-achieved the reduction commitment for

export subsidies under the WTO Agreement, according to the authorities. Internal support, as reflected in the AMS, is significantly below its base level. The Gross Revenue Insurance Plan (GRIP), a major domestic subsidy programme, was terminated in Saskatchewan; other provinces are considering options for early termination. The GRIP is to be replaced by initiatives focusing on whole-farm incomes, corroborating an overall trend away from product-related stabilization measures.⁹

17. The Uruguay Round has brought no major changes in the operations of the Canadian Wheat Board (CWB). The Board is to remain the sole marketing agent for wheat and barley grown in western Canada for domestic human consumption, interprovincial and international sales. Sales revenues are pooled into a common account and, after deduction of administrative costs, redistributed to farmers in proportion to their deliveries. Some WTO members have raised questions about these operations, implying that the CWB's ability to set producer prices and pool sales revenues unduly enhances its flexibility in export pricing.¹⁰ However, the Government sees no need to change the current system, given its positive contribution to the sector's international bargaining position, risk management (concerning variations in market return) and export competitiveness.

18. In August 1994, Canada signed a memorandum of understanding with the United States governing its bilateral supplies of non-durum and durum wheat.¹¹ The MOU, which took effect on 12 September 1994 for one year, provided for U.S. import tariff quotas on Canadian wheat, with rising tariffs on quantities exceeding specified levels. (White winter wheat, produced outside the jurisdiction of the CWB and not covered by the Western Grain Transportation Act, was not restrained under the MOU.) Both parties also established a Joint Commission on Grains to examine their marketing and support systems, including effects on competition.

19. Among a number of suggestions, the Joint Commission recommended that Canada and the United States eliminate export subsidies and excessive discretionary pricing practices of their institutions.¹² The Commission also called for a modification of domestic agricultural policies to remove trade distorting effects. One of the approaches examined in this context was to expose the CWB to the possibility of profits and losses in the market or act in an equivalent manner, without precluding the use of pooling. Subsequent to this report, the Government established in July 1995 the Western Grain Marketing Panel to discuss the future operation of Canada's grain marketing system. The recommendations made by the Joint Commission and the Panel are currently under consideration.

20. Previous import licensing requirements for wheat, barley and their products were replaced by a tariff quota system under the WTO Agreement on Agriculture (Table IV.1). Quotas are to be allocated on a first-come first-served basis. Imports of wheat and wheat products from the United States and Mexico continue to enter at lower NAFTA rates once the tariff quota is filled. In contrast, any additional imports of U.S. barley and barley products are subject to the m.f.n. out-of-quota rate (barley and barley products were covered by the recent NAFTA Panel; section (ii) above.

⁹OECD (1996).

¹⁰WTO document G/STR/W/8, 28 February 1996.

¹¹According to the Hon. Mr. Roy MacLaren (DFAIT, 1995a), Canada accepted the restrictions "under the threat of a unilateral action under Section 22 of the U.S. Agricultural Adjustment Act".

¹²Canada-United States Joint Commission on Grains.

(iv) Beef, veal and pork

21. Mirroring developments in the grains sector, the external market environment for meat has improved significantly in recent years. While consumption was stagnant between 1990 and 1996, production and exports of beef and veal expanded at an annual nominal rate of 3 and 18 per cent, respectively.¹³ The Producer Subsidy Equivalent for bovine and pig meat declined from 20 per cent in 1989-91 to some 15 per cent in 1995, with virtually no transfers from consumers. The decline reflects lower domestic prices, currency depreciation and, to a certain extent, the termination of the National Tripartite Stabilization Program (NTSP) for the beef and hog sectors. While the reorientation of Canada's transport policy for grains is expected to promote red meat production, primarily in the prairie regions, the authorities consider the ensuing cost effects as too small to have a discernible impact on the North American market.

22. All provinces except Newfoundland continue, with variations, to rely on marketing boards negotiating sales conditions on behalf of hog producers.¹⁴ The boards handle the vast majority of transactions in each province. Although not endowed with specific quotas for supply management, they "have such power that it is implicit in their operations to use a quota system to establish prices".¹⁵ Given the boards' exclusive position, interprovincial differences in price and supply conditions at the input stage are shielded from offsetting arbitrage operations.

23. The 1982 Meat Import Act, which provided the authority to restrict bovine meat imports, was repealed following the Uruguay Round. Canada has established a duty-free tariff quota of 76,409 tonnes of bovine meat for non-NAFTA countries with country-specific allocations for New Zealand and Australia (Table IV.1).¹⁶ Tariff-quota allocation is reserved for retailer-processors and distributors on the basis of their processing or selling (distributors) of non-NAFTA bovine meat in the preceding year. A safeguard action on boneless beef, maintained under GATT Article XIX since July 1993, was terminated at end-1994.

24. The new Cattle Options Pilot Project (COPP), developed jointly by the cattle industry and the Government, is intended to reduce price and exchange rate risks through market-based instruments (option contracts); according to the authorities, the objective is to promote a fully privatized mechanism. Changes in grading and inspection systems are intended to increase the industry's cost contribution; grading services are destined for privatization.

¹³WTO document, IMA/W/9, 10 June 1996.

¹⁴The agencies are: British Columbia Hog Marketing Commission; Alberta Pork Producers Development Corporation; Saskatchewan Pork International; Manitoba Pork Est.; Ontario Pork; *Fédération des Producteurs de Porc du Québec*; New Brunswick Hog Marketing Board; Pork Nova Scotia; Prince Edward Island Hog Commodity Marketing Board.

¹⁵Internal Trade Secretariat (1994). Only small processors are normally allowed to purchase directly from producers.

¹⁶Under supplementary permits, non-NAFTA suppliers may ship additional meat (when the tariff quota for beef has been filled) provided, inter alia, that the import price is no less than the price of similar meat entering the United States.

(v) Poultry and eggs

25. All provinces but Nova Scotia and Newfoundland have signed a National Allocation and Pricing Agreement for the period December 1995 to January 2002. It implements an agreement in principle, concluded in August 1994 by most members of the Canadian Chicken Marketing Agency (CCMA), on a new national quota allocation and pricing system for the chicken industry. The new system is based on a "bottom-up approach" in all provinces, within which provincial producers and processors simultaneously negotiate each processor's requirements at prices acceptable to producers.¹⁷

26. The system is complemented by regulatory mechanisms at the provincial level. In Ontario and Quebec, a committee comprising chicken producers and processors determines prior to each quota period the volume adjustments required in the light of current and expected market conditions. While Quebec and Ontario undertook, on a best efforts basis, to co-ordinate prices of live chicken, other provinces are committed not to undercut these prices less transport costs. Production growth in any province must not exceed a cap of 8 per cent in any two-month production period on a year-on-year basis, with the ceiling to be reviewed annually.

27. High levels of border protection have a long tradition in the sector. Import quotas were introduced in the egg and turkey industries in 1974, and in the chicken and broiler hatching industries in 1979 and 1989. In 1994, imports of chicken and turkey were limited, respectively, to 6.3 and 3.6 per cent of domestic consumption. Under Canada's Uruguay Round tariff quota commitments, 39,844 tonnes of chicken may enter under tariffs of slightly over 11 per cent; additional supplies are dutiable at around 300 per cent. Similarly restrictive conditions apply to imports of turkeys and turkey products (Table IV.1).

28. No country-specific quota allocations have been made under the import régime. Since the inception of the FTA, however, U.S. suppliers of chicken and turkey have been entitled to export in any year, respectively, up to 7.5 and 3.5 per cent of Canada's previous year's production at preferential conditions. This competitive advantage, within an m.f.n. tariff quota, leaves virtually no scope for additional supplies. In 1995, Canada imported 51,761 tonnes of chicken products, considerably more than the corresponding tariff quota; the main supplier was the United States (Table IV.1).¹⁸ The allocation of in-quota supplies to individual importers is being shifted in steps from a régime based primarily on historical quantities to a system relying mainly on current market shares. Eventually, processors and distributors will have access to a larger portion than further processors, the food service sector and historical importers.

¹⁷Production levels for poultry meat and eggs are managed by four national agencies: the Canadian Turkey Marketing Agency, the Canadian Chicken Marketing Agency, the Canadian Broiler Hatching Egg Marketing Agency, and the Canadian Egg Marketing Agency. The Agencies are mandated to set national production quantities and allocate quotas among provincial agencies, but have no powers over imports and exports. Typically, producer prices are established provincially, based on cost-of-production calculations and, according to the authorities, market factors. Regulatory amendments in March 1996 provided for additional industry representation on the boards of the four agencies. The fact that industry organizations, rather than the Federal Government, now appoint directors to the agencies' boards is expected to encourage more balanced decision-making. However, consumer organizations are not represented.

¹⁸Supplementary imports may be allowed, subject to confirmation by the respective chicken and turkey marketing agencies, to prevent shortages, compete with further processed products not subject to export controls or for re-exports.

29. Despite the complex system of government intervention in production and trade, the PSE for poultry declined from 41 per cent in 1989-91 to 15 per cent in 1995, owing largely to exchange rate developments. In contrast, support for the egg industry continues to account for about half the value of production.

(vi) Dairy

30. Assistance for milk producers relies predominantly on high producer prices on deliveries supplied under production quotas (Box IV.1). Excess production, mostly of skimmed milk, is exported. Higher administered prices for industrial milk in 1995 tended to further weaken market orientation in the sector.¹⁹ The price increase coincided with a commitment, in the 1995 Federal Budget, to reduce the Federal Dairy Stabilization subsidy by 30 per cent over 2 years, followed up in the 1996 Budget with an undertaking to phase out this subsidy by 2001-02.

31. Until July 1995, the cost of surplus disposal - mainly through export - was financed through a levy on milk production paid by producers. The levy régime was replaced in August 1995 by a system based on the pooling of revenue from special milk classes (e.g. products facing U.S. competition, products covered by the further Processors Rebate Program and the Butterfat Utilization Program, cheese exports to the United Kingdom and the United States, other exports (evaporated milk, whole milk powder), niche markets, and surplus milk removal).²⁰ The price is highest for specified quantities of fluid milk destined for the domestic market, and falls sharply in other categories of mostly industrial milk. Revenue in all classes is shared among participating farmers. Food processors and exporters continue their activities, using lower-priced milk categories, without a producer-funded rebate from the Canadian Dairy Commission (CDC). The authorities consider the economic impact of these changes to be minimal in the short term, as the price pooling arrangements are geared to maintain producers' income.

32. Dairy exports are carried out by the Canadian Dairy Commission and private companies; the subsidies involved are now limited by Canada's export subsidy commitments. The Dairy Export Assistance Programme, which previously served to bridge the gap between internal support and world market prices, has been abolished. Under NAFTA provisions, subsidized exports to the United States are prohibited, but not to Mexico.

33. On the import side, a total of twelve tariff quotas for dairy products have replaced the past system of quantitative restrictions (Table IV.1). The Canadian Dairy Commission continues to act as the sole importer of butter under the new quota régime.²¹ Butter imports, amounting to 1,964 tonnes or 2 per cent of domestic consumption, are sold to processors and further processors.²² This implies

¹⁹A reduction announced for 1996 would be the first nominal milk price reduction in 15 years.

²⁰Revenue from all classes of milk are to be pooled among producers from Prince Edward Island, Nova Scotia, New Brunswick, Quebec, Ontario and Manitoba. Some features of the pooling system are being phased in over a two-year period from August 1996, including transportation cost pooling and interprovincial quota exchange between Ontario, Quebec and Nova Scotia. Negotiations are ongoing to complete a pooling arrangement among western provinces.

²¹According to the authorities, the CDC's dominant position is based on custom rather than law.

²²Under the old system, import permits were issued by the Department of Foreign Affairs and International Trade when the CDC considered imports necessary to relieve a temporary market shortage.

that foreign exporters are not free to ship to the market of their choice, as they are restricted to supplying only butter for processing. Any out-of quota supplies would carry an ad valorem duty of over 300 per cent.

Box IV.1 Main elements of the internal support régime for milk

Canadian dairy policy is split between the fluid and industrial milk markets. Fluid milk is processed into liquid milk and cream products, while industrial milk is used for a wide variety of products such as cheese, butter, skim milk powder, ice cream and yogurt. While the provinces are competent for fluid milk policies (including licensing of producers, quality control and pricing), the marketing of industrial milk, which involves exports, imports and interprovincial trade, is under joint federal-provincial control. A federal-provincial agreement, the National Milk Marketing Plan, sets out the framework for establishing the national Milk Marketing Quota and its allocation to the provinces. The Canadian Milk Supply Management Committee (CMSMC), chaired by the Canadian Dairy Commission (CDC), oversees the implementation of the Plan. The CMSMC comprises producers and governments of all provinces producing industrial milk. Representatives of national consumer, processor and producer organizations participate as non-voting members.

Domestic production continues to be subject to a national Market Sharing Quota (MSQ) which is set by the CMSMC. The quota defines the amount of milk that can be sold at the domestic price; additional deliveries receive a return based on surplus export activities. The quota is established by estimating the domestic demand for dairy products on a butterfat basis, adding a production and export sleeve and subtracting the expected milk equivalent of imports. Provincial shares of the national quota are determined under the provisions of the Plan; in turn, these shares are distributed to producers according to the individual provinces' quota policies. The MSQ for 1995-96 was estimated at 43.9 million hectolitres, unchanged from the previous dairy year. Quota decisions, on the basis of butterfat demand, result in the production of skim milk powder in excess of national consumption.

34. While Canada's in-quota tariff for milk powder is currently set at 15 per cent, contrasting with out-of-quota duties ranging up to 280 per cent, no quotas have actually been opened for either skimmed or whole milk powder. In other cases (condensed and concentrated milk, powdered butter milk), one historical importer has the exclusive right to in-quota imports. For several categories, designated suppliers, including New Zealand, Australia and the EU, have been reserved quota shares.²³

35. Expert advice may help to advance economic change and overcome lobby resistance. In 1992, the Canadian International Trade Tribunal published an enquiry into the quota allocation system, recommending, *inter alia*, the auctioning of import quotas for cheese, ice cream, yogurt, buttermilk and condensed milk; the setting of ceilings on the shares of individual importers; and the possibility of quota transfer.²⁴ Although the current system hardly reflects these proposals, the authorities have stressed that the CITT report helped to develop and implement the administrative provisions of Canada's tariff quota commitments, devise more market-oriented procedures for quota allocation among importers, and make provision for quota transfer through rent or sale.

²³Following an agreement announced in December 1995, Canada adjusted its reserve for EU cheese from 60 to 66 per cent of the global quota to accommodate EU enlargements since 1979 (accessions of Spain, Portugal, Greece, Sweden, Finland and Austria). In this context, Swiss exporters have complained about a disproportionate reduction in the quantities allocated to the remaining EFTA countries.

²⁴Canadian International Trade Tribunal (1992).

36. While PSE levels for milk came down by 16 percentage points since 1989-91, to an estimated 62 per cent in 1995, they remain the highest among all segments of Canadian agriculture.

(vii) Beverages

37. Compared with developments in other food sectors, the regulatory framework for beverages production has changed relatively little since the 1994 Trade Policy Review. Under the Importation of Intoxicating Liquors Act, liquor boards continue to control sales, imports and transport of alcoholic beverages within all provinces except Alberta. The boards' monopoly is maintained for reasons of public health and morals.²⁵ Canada's trade balance for alcoholic beverages has continued to record a surplus, with exports (mostly of beer) valued at Can\$803 million and imports at Can\$740 million in 1994.

38. Two GATT Panel rulings, banning discriminatory pricing practices by liquor boards, have helped to create competitive conditions on the Canadian beer market. For example, there are no longer any differential mark-ups between imported and domestic beer.²⁶ For wine, all mark-up differentials between blended and imported products were eliminated on 1 January 1995; mark-up differentials between imports and 100 per cent Canadian wine are to be phased out by 1 January 1998.²⁷

39. Imports of alcoholic beverages are mostly subject to specific, compound and mixed duties for which few ad valorem equivalents are available. These were estimated by the authorities to range from 2.4 per cent for beer (beer from the United States enters duty free) and 6 per cent for wine up to 40 per cent for cider in 1995. Imports of alcoholic beverages are in addition subject to excise duties (beer, certain spirits, liquors, and other spirituous beverages); the rates do not discriminate between imports and domestic production. Minimum prices for beer are in effect in all provinces except Alberta, Manitoba, Prince Edward Islands and Saskatchewan.

40. In order to be offered for sale, products must be listed by the provincial liquor boards. Exceptions include Alberta (all alcoholic beverages) and Quebec (beer), where retailing has been liberalized. Suppliers may either use the liquor boards' distribution channels or private services in all provinces except Ontario and Prince Edward Island.

(viii) Fishing and fish products

41. Given its particular sensitivity - for economic, ecological and regional policy reasons - the fisheries sector is subject to various forms of government intervention, from tariffs to production and export licensing, fishing moratoria and financial assistance. Most grants and other support programmes (e.g. via soft loans) are operated at provincial level.

²⁵WTO document G/STR/N/1/Add.1, 10 November 1995. Exports of alcoholic beverages are not regulated.

²⁶According to the authorities, "the retail sales price of an imported product is a function of its landed cost (invoice price, duty and freight), to which are added the applicable mark-up and federal and provincial sales taxes. (...) The mark-up varies by product type and by provincial jurisdiction." WTO document G/STR/N/1/Add.1, 10 November 1995. The two GATT Panels were Canada - Import, Distribution and Sale of Alcoholic Drinks by Provincial Marketing Authorities (1988) and Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies (1992).

²⁷Ontario maintains a minimum grape content requirement for domestic wine, as well as provincial grape purchase requirements for Ontario wineries (Box III.1).

42. M.f.n. tariffs in the sector average 2.9 per cent in 1996²⁸; all fresh fish enters duty-free. The tariffs on unprocessed or semi-processed products (frozen, salted, dried, smoked fish), declined from an average of less than 2 per cent in 1994 to 0.3 per cent in 1996, reflecting Canada's WTO reduction commitments. The corresponding reductions for further prepared fish were from 10 to 7.3 per cent and for prepared fish meals from 17 to 10 per cent. At the end of the Uruguay Round implementation process in 1999, m.f.n. tariffs on preserved sardines, tuna, anchovies and prepared fish meals will still exceed 9 per cent.

43. Canada has reviewed its licensing policy for industrial and ecological reasons. Following decisions by the Northwest Atlantic Fisheries Organization (NAFO), moratoria have been introduced on the fishing of cod and other groundfish in the North Atlantic. In May 1994, Canada amended the Coastal Fisheries Protection Act and regulations to enable enforcement action against stateless and flag-of-convenience vessels fishing on the Grand Bank of Newfoundland outside a 200-mile zone.

44. The dispute with the European Union over allowable catches of Greenland halibut outside this zone was resolved in April 1995. An important element of the conservation agreement was the deployment of independent full-time observers on board vessels fishing in the NAFO Regulatory Area until the end of 1995. At its September 1995 Annual Meeting, NAFO agreed to extend the requirement for observers to all NAFO-member vessels, effective 1 January 1996. Other NAFO measures introduced at the same time include enhanced satellite surveillance, increased inspections, quick reporting and follow-up of infractions, and dockside inspections.

45. Despite such measures, Atlantic groundfish landings are not expected to increase in the near future.²⁹ Total value of landings continued to decrease in 1995 (by 20 per cent from the previous year). The authorities state that the fall in the value of groundfish landing since 1992 was fully compensated by an increase in shellfish landings, and the groundfish processing industry maintained its activity via increased imports.³⁰

46. Commercial salmon fishing on the western coast, while economically more successful in recent years, has also created tensions. A dispute with the United States hinges on alleged overfishing in Alaska. In negotiations since 1994 both parties are seeking to agree on measures that would ensure long-term stock conservation and, at the same time, revitalize salmon fishing.

47. To encourage domestic processing, Canada maintains an export permit requirement for unprocessed Pacific roe herring.³¹

²⁸GPT rates average 2.2 per cent, tariffs on U.S. supplies 0.3 per cent and on Mexican supplies 0.6 per cent. All tariffs on fish and fish products between the United States and Canada are to be eliminated in January 1999.

²⁹As described in the 1994 TPR report, the depletion of stocks may be attributed to both domestic over-fishing by Canadian vessels, encouraged under past incentive schemes, as well as over-fishing in areas beyond Canada's 200 mile zone. GATT (1995).

³⁰Shellfish landings, valued at Can\$ 1.3 billion in 1995, accounted for three quarters of total value of fishery landings in Canada. Most is exported, making Canada the world's fifth largest exporter.

³¹GATT (1995).

(ix) Wood and paper industries

48. The forestry sector remains one of the strongholds of Canada's export industry, recently boosted by currency devaluation and a U.S. construction boom. Approximately one third of the country's timber harvest is used directly for the production of pulp and paper³²; while the remainder consists mainly of primary wood products for construction. Exports of timber and timber products totalled Can\$41.4 billion in 1995, some 70 per cent of which were destined for the United States.

49. Government involvement in the sector, via land ownership, has proved a contentious trade issue. Some 71 per cent of Canada's timber-producing land is owned by the provinces, with logging permits being subject to stumpage fees.³³ U.S. producers have long complained about the comparatively low level of these fees, considered to be tantamount to a subsidy. The issue, as it related to softwood lumber, was settled in April 1996 in the form of a bilateral arrangement providing for an export tax (Chapter III(2)(i)(d)).

50. In the Uruguay Round, Canada agreed with other developed countries to eliminate tariffs on all pulp, paper and paper products by 2004. Current m.f.n. duties on wood and wood products average 2 per cent, but include peaks of up to 12.9 per cent (down from 15 per cent in 1994) on furniture, and 15 per cent on basketwork (down from 17.5 per cent in 1994). Imports of these products from the United States enter duty free, while duties on Mexican imports average less than half the m.f.n. level. Tariff escalation, resulting from duty-free imports of most primary materials, has declined somewhat in the wake of the Round.

51. The Government's forestry policy is aimed at ensuring sustainable development.³⁴ Canada has endorsed the "Criteria and Indicators for the Conservation and Sustainable Management of Temperate and Boreal Forests" (the Montreal Process), and several provinces have adopted new forest management frameworks strengthening ecological criteria.³⁵ The authorities favour the development of international rules defining sustainable forest management, such as the International Forest Convention currently under discussion in the UN Commission on Sustainable Development. The Canadian Standards Association has developed a series of standards for the certification of sustainable forest management; the first certificates are expected to be awarded in 1997.

³²Over 65 per cent of the fibre input in pulp and paper mills comes from wood residues generated by sawmills.

³³Private operators exploit the publicly owned forests under various forms of volume or area-based tenure. According to the authorities, most tenure agreements include forest management tasks and, in addition to payment of stumpage and other fees (e.g. land rents), make the right holder responsible for access to the timber, road maintenance and reforestation. Several provinces have made logging permits subject to local-residence and processing requirements. Exports of raw logs are to be approved by the Department of Foreign Affairs and International Trade.

³⁴As noted in the 1994 TPR report, the growing concern for environmental protection has in some major consumer countries led to initiatives, inspired by non-governmental groups, against clear-cutting and unsustainable forest harvesting.

³⁵Examples include British Columbia's Forest Practices Code, the Integrated Forest Resource Management Plan in Manitoba, and Ontario's Crown Forest Sustainability Act.

(3) Energy(i) Overview

52. Benefiting from its abundant natural resource base - including crude oil, gas, coal, hydroelectricity and uranium - Canada is a major producer, consumer and exporter of energy.³⁶ The energy sector generates 7.6 per cent of GDP, about twice the average of OECD countries, with oil and gas alone contributing some 55 per cent (Table IV.3). While oil and gas production have grown rapidly in recent years, due to both explorations and strong demand from the United States, the electricity industry has been constrained by sluggish domestic demand.

Table IV.3**Main economic features of the Canadian energy sector, 1994**

(Can\$ billion, thousand employees and percentage)

	GDP	Investment	Exports	Imports	Employment (thousands)
Oil and gas	19.3	9.2	16.8	6.6	202
Electricity	13.2	12.0	1.3	0.1	95
Coal	1.0	0.1	1.6	0.4	8
Uranium	1.0	0.3	0.6	0.6	1
Total	34.5	21.6	20.3	7.8	306
(Per cent of national economy)	(7.6)	(16.8)	(9.3)	(3.8)	(2.9)

Source: WTO Secretariat estimates based on information provided by Energy Canada.

53. Over the past decade, most energy markets have gradually become more open and market-based. The deregulation of the oil and gas industries, between the mid- and late-1980s, is currently being followed by a comprehensive review of electricity policies in nearly all provinces. While budget cuts have reduced government subsidies, tariff reductions or eliminations (on crude oil, most refined products, and gas) under the NAFTA have improved the external trading environment.³⁷ Foreign ownership in the energy sector is subject, however, to low review thresholds and, in some instances, restrictions.

54. Under the Canadian Constitution, legislative competence for energy is shared between federal and provincial governments. The provinces own and control the natural resources within their territories, and are empowered to regulate resource development, land-use management, royalties, production, processing, internal transmission and distribution. The Federal Government is responsible for the national policy framework, covering international and interprovincial trade and transport. By the same token, the National Energy Board (NEB), the federal regulator, is mandated to regulate tolls and tariffs for oil and gas pipelines, certify international and designated interprovincial powerlines, and issue licences, orders and permits for the export of oil, gas and electricity.³⁸ Despite increasing co-operation between provincial and federal authorities, trade in energy, in particular electricity, has remained a politically sensitive - and yet unresolved - issue in the context of the Agreement on Internal Trade.

³⁶Canada is running an export surplus in all energy products but uranium, where trade is balanced.

³⁷However, m.f.n. tariffs on energy products were already low in general.

³⁸The National Energy Board, endowed with quasi-judicial powers like all independent federal regulators, reports to Parliament through the Minister of Natural Resources.

(ii) Oil

55. Oil production has grown steadily since the late 1980s, reaching 2.0 million barrels per day (MBD) in 1995. With a share of about 3 per cent in world production, Canada has been a net exporter for more than a decade; in 1995, net exports of crude oil and refined products amounted to 850,000 barrels per day. Multinational companies own most of the country's production and distribution facilities.

56. The increase in oil production in recent years may be attributed to both buoyant demand, especially from the United States, and supply-side factors such as the deregulation of the crude oil sector in 1985 and a drastic reduction in production costs (about 25 per cent since 1990). Deregulation has been accompanied, according to the Government, by the elimination of virtually all direct incentives for energy conservation, fuel switching and petroleum exploration.³⁹ Public involvement in the sector remains essentially confined to R&D and participation in Hibernia, a mega-project off the coast of Newfoundland, which is led and owned by a consortium of Canadian and U.S. companies.⁴⁰ Although committed to the privatization of Petro Canada, pending favourable market conditions, the Government continues to own a significant share of the company (no new initiative has been taken the last TPR).⁴¹ Under the Petro-Canada Public Participation Act, foreign ownership in Petro Canada is subject to a 25 per cent limit of voting shares.

57. The rules governing foreign commercial presence in the industry have remained unchanged since the 1994 TPR. Only Canadian-incorporated companies qualify for the necessary production licence; and investments by NAFTA-based companies continue to benefit from lower (preferential) review thresholds.⁴² While oil exports must be authorized by the National Energy Board, all applications covering periods of less than two years are "routinely and expeditiously" approved, according to the Government.⁴³ However, under a new act of procedures for oil export review, the National Energy Board is to assess whether domestic refiners had an opportunity to purchase the oil on terms comparable to those offered to export customers. Import tariffs are at generally low levels; under the NAFTA, crude oil is traded duty free between Canada and the United States.

(iii) Natural gas

58. Natural gas is Canada's second most important energy export, with the United States as the only destination. Bilateral supplies, amounting to 2.8 trillion cubic feet in 1995, are higher than domestic

³⁹Canadian submission to IEA (1995).

⁴⁰Since 1994, the Federal Government has provided financial assistance to the Can\$5.8 billion project in the form of loan guarantees (Can\$1,074 million), direct contributions (Can\$542 million), equity participation (Can\$216 million) and interest free loans (Can\$66 million). Hibernia is expected to start producing in 1997.

⁴¹Canadian submission to IEA (1995).

⁴²Investment Canada reviews the acquisition of control of a Canadian company by a NAFTA investor only if the relevant assets exceed Can\$167 million; the threshold for non-NAFTA investors is Can\$5 million for a direct acquisition and Can\$50 million for an indirect acquisition.

⁴³The NEB has never received applications for longer-term licences; export contracts are concluded for 30-60 days on average. Under current legislation, licences exceeding two years may be granted only after a public hearing.

consumption (some 2.7 trillion cubic feet). Boosted by improved access to the U.S. market, the number of wells drilled annually more than doubled between 1992 and 1994, exceeding 5,300. Like oil, about 85 per cent of Canada's natural gas originates in the province of Alberta. Under an agreement between the Federal Government and the three gas producing provinces (Alberta, British Columbia and Saskatchewan), domestic and export prices have been deregulated since the mid-1980s.

59. The gas industry consists of a large variety of companies, from large foreign-owned multinationals to small Canadian-owned firms and Crown corporation. The ten largest companies account for 40 per cent of domestic production.⁴⁴ Contrasting with the oil industry, there are no fully integrated conglomerates covering exploration, production and distribution. Gas distribution is mainly in the hands of local, privately-owned monopolies, which are under provincial regulation.

60. As noted in the 1994 TPR report, the National Energy Board authorizes all exports through the issuance of either short-term export orders (up to two years) and long-term licences (up to 25 years). Unlike short-term export orders, which are issued within 24 hours, long-term licences involve public hearings. These include a "complaints procedure", enabling consumers to appeal to the NEB if gas is not available under terms and conditions similar to the proposed exports; an "export impact procedure", intended to determine whether the export is likely to "cause Canadians difficulty in meeting their energy requirements and needs"; and a "public interest determination" where any other relevant factors may be raised. Provincial approval is also required prior to the removal of natural gas from the province.

(iv) Electricity

61. While suffering from weak domestic demand, mainly for cyclical reasons, the electricity industry continues to play an important rôle in the Canadian economy. With a workforce of some 90,000, electricity generation currently represents nearly 3 per cent of GDP. Capitalizing on Canada's natural resources, the sector relies heavily, at some 60 per cent, on hydro power, followed by nuclear energy with close to 20 per cent.

62. Given the pull effects of the U.S. market and the absence of significant trade impediments, bilateral electricity exports matched interprovincial trade, both accounting for about 8 per cent of domestic production in 1994 (Chart IV.3).⁴⁵ However, the attraction of the U.S. market may not alone, without the existence of interprovincial barriers, suffice to explain current supply patterns.⁴⁶

63. The provinces have legislative authority over electricity generation, transmission and distribution. Federal competence is essentially confined to aspects of interprovincial and international trade, and nuclear power. In most provinces, production, distribution and transmission are provided by public

⁴⁴Amoco Canada, Shell Canada, PanCanadian Petroleum, Mobil Oil Canada, Imperial Oil, Petro-Canada, Talisman Energy, Norcen Energy are among the ten largest firms. Canadian ownership on average of these ten firms is 45 per cent.

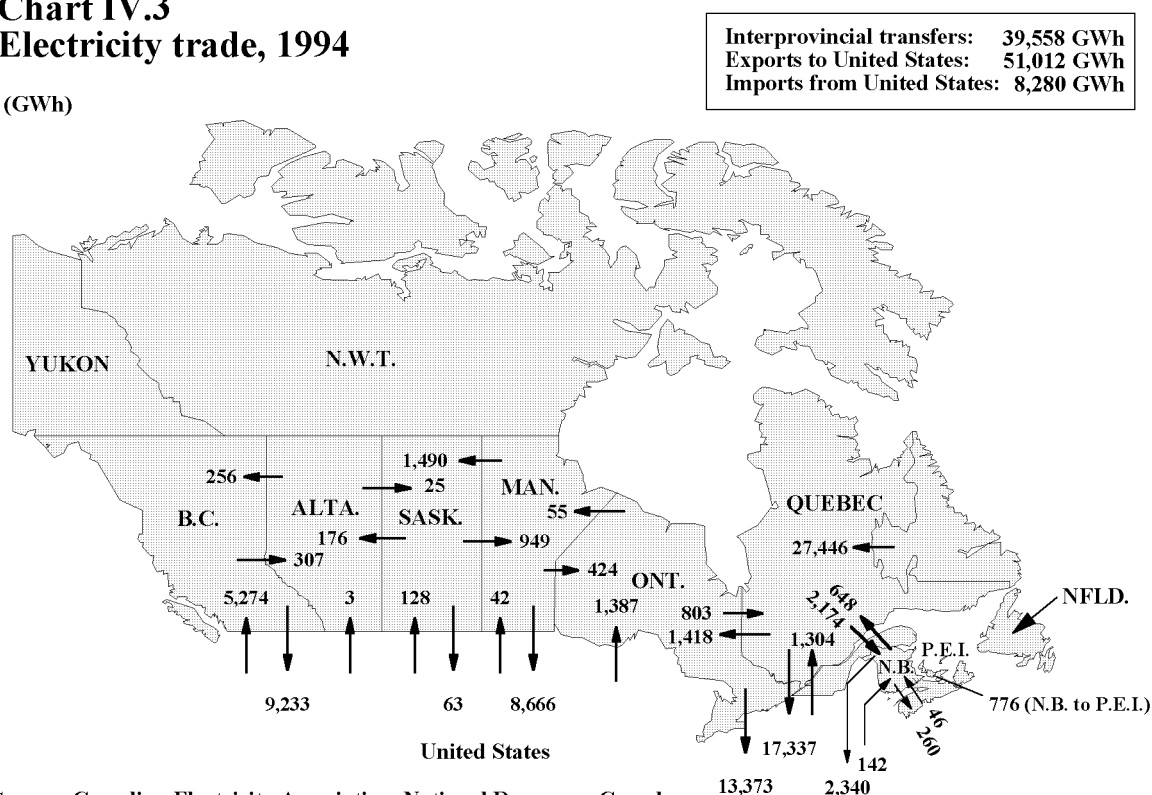
⁴⁵Seventy per cent of Interprovincial electricity trade consists of the transfer from Newfoundland to Quebec of energy produced by the Churchill Falls power plant. These supplies apart, interprovincial electricity trade has tended to decline over the past two decades.

⁴⁶There is some complementarity between the U.S. and Canada's markets, as demand in the United States generally peaks during the summer while demand in Canada peaks during the winter. Canadian suppliers tend therefore to export their surplus to the United States during the summer period.

monopolies which account for over four-fifths of total electricity generation (Table IV.4)⁴⁷; the relevant utilities are regulated by provincial bodies whose mandate generally includes rate approval. Reportedly, some utilities have in the past used their exclusive position to prevent interprovincial purchases.⁴⁸

Chart IV.3 Electricity trade, 1994

(GWh)



Source: Canadian Electricity Association, National Resources Canada.

64. Market segmentation may have encouraged industrial inefficiencies, including through over-investment, and provided scope for price discrimination between customers.⁴⁹ In general, electricity prices have increased more rapidly than the CPI and other energy rates, in particular since the late 1980s (Chart IV.4).⁵⁰ Following deregulation in the United States, many provinces have launched reviews of their electricity systems covering issues such as utility structure, wheeling services and tariff

⁴⁷Self-generation by consumers is permitted and frequently used in Canada.

⁴⁸GATT (1995), p. 145.

⁴⁹In a report submitted to the Minister of Natural Resources in 1994, the National Energy Board estimated the benefits to be drawn from increased interprovincial co-operation at some Can\$23 to 32.5 billion in year 2000, i.e. roughly corresponding to the sector's current annual revenue. National Energy Board (1994).

⁵⁰Increases in electricity rates also reflect rising marginal costs, due to environmental and safety-related investment as well as exploitation in remote areas.

policy, with a view to promoting competition and cost-based pricing.⁵¹ Alberta enacted legislation in 1995, creating a competitive market for electricity generation and opening the wholesale transmission system in the province. In January 1996, British Columbia's public utility opened its transmission system to any third party for wholesale transaction. In June 1996, an expert committee released a report to the government of Ontario recommending structural changes in the electricity sector, including the mobilization of private capital. Quebec is also reviewing its energy policy.

Table IV.4
Institutional structure of electricity production

Province	Electric Utility	Ownership
Newfoundland	Newfoundland and Labrador Hydro	Provincial
	Newfoundland Light & Power Company Limited	Private
Prince Edward Island	Maritime Electric Company Limited	Private
Nova Scotia	Nova Scotia Power Incorporated	Private
New Brunswick	New Brunswick Electric Power Commission	Provincial
Quebec ^a	Hydro-Quebec	Provincial
Ontario	Ontario Hydro	Provincial
Manitoba	The Manitoba Hydro-Electric Board	Provincial
	City of Winnipeg Hydro-Electric System	Municipal
Saskatchewan	Saskatchewan Power Corporation	Provincial
Alberta	Alberta Power limited	Private
	Edmonton Power	Municipal
	TransAlta Utilities corporation	Private
British Columbia	British Columbia Hydro & Power Authority	Provincial
Yukon	Yukon Energy Corporation	Territorial
Northwest Territories	Northwest Territories Power Corporation	Territorial

a In addition, there are some municipally as well as privately-owned and administered power plants.

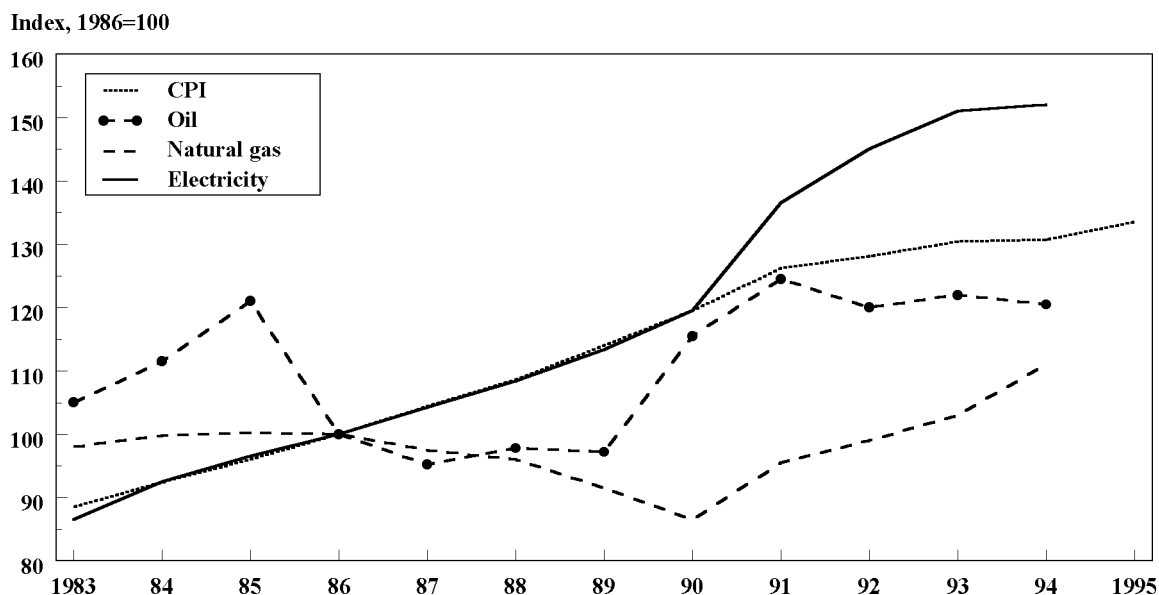
Source: Natural Resources Canada.

65. Although the provinces seem to acknowledge the need for enhanced co-operation, some disagreement persists on its actual form.⁵² In the absence of a compromise, electricity trade has not been included in the Agreement on Internal Trade, despite the economic stakes involved. While an energy chapter was to be negotiated by 1 July 1995, discussions are continuing.

⁵¹Wheeling is the authorized use of transmission facilities by two entities whose facilities are not interconnected in order to sell, purchase or exchange electricity.

⁵²According the National Energy Board: "those utilities and provinces that, by virtue of geographic location, have direct access to external markets in the United States, have a tendency to prefer the status quo. Under the continuation of the existing regime, the utilities would enter into voluntary cooperation activities (...). They tend to oppose any form of mandated solutions to disputes that arise between parties concerning electricity trade, including those that would include mandated federal powers. (...). On the other hand, those utilities and provinces that do not have access to external markets tend to support such solutions". National Energy Board (1994).

Chart IV.4
Price indices, 1983-95



Source: Canadian Electricity Association.

(4) Manufacturing

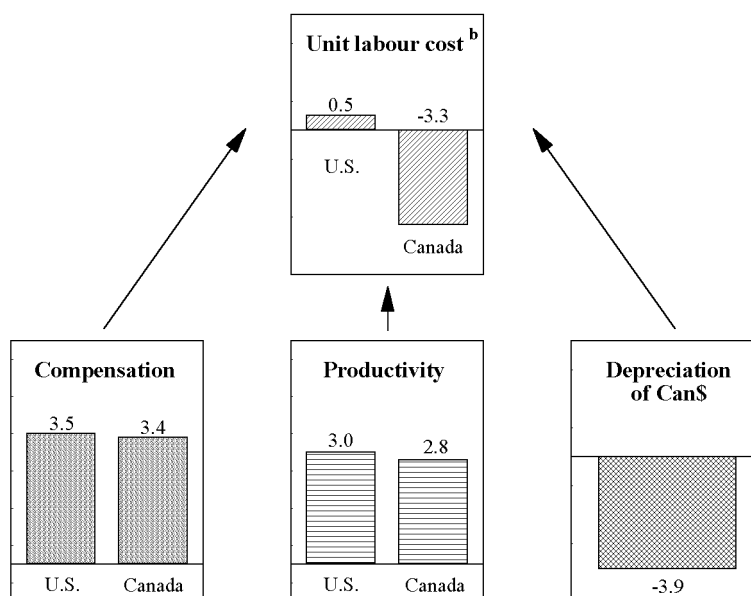
(i) Overview

66. Owing to a surge in exports, the manufacturing sector made the largest contribution to Canada's economic growth in 1994 and 1995. At end-1995, the sector had an export ratio of 51 per cent, with four fifths of shipments destined for the United States. All segments were able to capitalize on increased U.S. demand, "traditional" industries (e.g. automobiles and textiles) as well as modern, technology-based production. Buoyant exports helped to compensate for sluggish domestic demand, particularly in mature industries such as textiles and clothing, where the effects of long-term demographic change coincided with low growth of disposable income. Real output across all manufacturing industries grew by 7 per cent in 1994 and 4.5 per cent in 1995, as against 4.6 and 2.2 per cent, respectively, for GDP.

67. Canada's recent export drive, in particular vis-à-vis the United States, benefited from the combination of the FTA/NAFTA implementation programme with significant gains in competitiveness. Strong currency depreciation vis-à-vis the U.S. dollar between 1990 and 1994 coincided with almost identical wage and productivity trends in both countries, possibly reflecting increased market integration. The resulting improvements in unit labour cost (Chart IV.5) helped to attract investors, especially for assembly operations, from across the border. At the same time, the NAFTA combined an ongoing process of bilateral tariff liberalization with strengthened rules and origin, in particular for textiles and automobiles.

Chart IV.5
Changes in Canadian and United States unit labour-cost, 1990-94^a

Per cent



a Average annual change in nominal terms.
b In Canadian dollars.

Source: Compilation based on U.S. Bureau of Labour Statistics

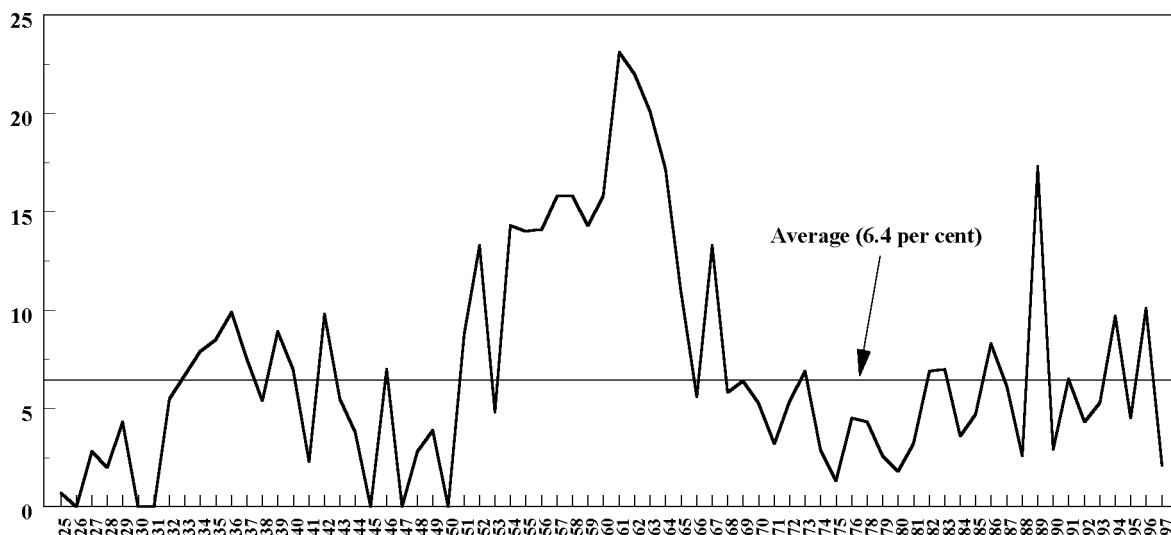
68. Canada's 1996 tariffs on manufacturing imports from the United States average 1.1 per cent.⁵³ Bilateral trade in sectors such as automobiles is duty free or, as in the case of textiles, clothing and computers, subject to very low rates. As described in Chapter III(2)(i), there have also been significant reductions in m.f.n. rates, from an average of 9 per cent in 1994 to 6.5 per cent in 1996. However, high tariffs persists in areas such as textiles and clothing or shipbuilding (Chart IV.6).

69. U.S.-based multinationals account for 90 per cent of the motor vehicles and 60 per cent of the computers produced in Canada. The strong presence of these companies has reinforced the link between trade and foreign direct investment, as about 70 per cent of their exports are conducted on an intra-company basis. Overall, intra-company trade accounts for close to 45 per cent of total Canada-U.S. trade.

⁵³Tariffs on manufactured goods from Mexico average 2.9 per cent in 1996.

Chart IV.6 Tariffs on manufactured products, 1996

Average tariff rates by HS Chapter (per cent)



HS Chapter					
Chapter	Description	Chapter	Description	Chapter	Description
25	Salt; sulphur; earth and stone, etc.	48	Paper and paperboard, etc.	72	Iron and steel
26	Ores, slag and ash	49	Printed books, newspapers, pictures, etc.	73	Articles of iron and steel
27	Mineral fuels, mineral oils, etc.	50	Silk	74	Copper and articles thereof
28	Inorganic chemicals; organic or inorganic compounds of precious metals, etc.	51	Wool; fine or coarse animal hair, etc.	75	Nickel and articles thereof
29	Organic chemicals	52	Cotton	76	Aluminium, etc.
30	Pharmaceutical products	53	Other vegetable textile fibres	78	Lead and articles thereof
31	Fertilizers	54	Man-made filaments	79	Zinc and articles thereof
32	Tanning or dyeing extracts, etc.	55	Man-made staple fibres	80	Tin and articles thereof
33	Essential oils and resinoids; perfumery, cosmetic or toilet preparations	56	Wadding, felt and non-wovens; special yarns; twine, cordage, etc.	81	Other base metals, etc.
34	Soap, organic surface-active agents, washing preparations, etc.	57	Carpets; other textile floor coverings	82	Tools, implements, cutlery, spoons and forks, etc.
35	Albuminoidal substances; modified starches; glues, etc.	58	Special woven fabrics; lace, etc.	83	Miscellaneous articles of base metal
36	Explosives; pyrotechnic products; matches, etc.	59	Impregnated, coated, covered or laminated textile fabrics, etc.	84	Nuclear reactors, boilers, machinery, etc.
37	Photographic or cinematographic goods	60	Knitted or crocheted fabrics	85	Electrical machinery and equipment, etc.
38	Miscellaneous chemical products	61	Articles of apparel and clothing accessories, knitted or crocheted	86	Railway or tramway locomotives, etc.
39	Plastics and articles thereof	62	Articles of apparel and clothing accessories, not knitted, etc.	87	Vehicles other than railway or tramway rolling-stock, etc.
40	Rubber and articles thereof	63	Other made-up textile articles; sets, worn clothing, etc.	88	Aircraft, spacecraft, etc.
41	Raw hides and skins and leather	64	Footwear, gaiters, etc.	89	Ships, boats, etc.
42	Articles of leather, etc.	65	Headgear and parts thereof	90	Optical, photographic, etc. apparatus
43	Furskins and artificial fur; manufactures thereof	66	Umbrellas, walking-sticks, etc.	91	Clocks and watches, etc.
44	Wood and articles of wood, etc.	67	Prepared feathers and down, etc.	92	Musical instruments, etc.
45	Cork and articles of cork	68	Articles of stone, plaster, etc.	93	Arms and ammunition, etc.
46	Manufactures of straw, of esparto, etc.	69	Ceramic products	94	Furniture, bedding, etc.
47	Pulp of wood or of other fibrous cellulosic material	70	Glass and glassware	95	Toys, games, etc.
		71	Natural or cultured pearls, precious or semi-precious stones, precious metals, etc.	96	Miscellaneous manuf. articles
				97	Works of art, antiques, etc.

Source: WTO Secretariat calculations.

(ii) Adjustments in traditional industries

(a) Motor vehicles

Background

70. Canada's motor vehicle industry, the largest manufacturing sector, specializes in assembly operations principally of cars, light trucks and vans, and parts production. In 1995, Canada's 14 assembly plants (of which 12 are located in Ontario) produced 2.4 million units, of which about 90 per cent was sold in the United States.⁵⁴

71. Canada accounts for about 16 per cent of NAFTA light vehicles production (Table IV.5). Reflecting strong intra-company exchange across the Canada-U.S. border, exports and imports are strongly correlated.⁵⁵ The expansion of assembly operations, with relatively shallow domestic supply links, has resulted in an increasing gap between the industry's contribution to trade, 23 per cent of both imports and exports, and its relatively modest 2.2 per cent share in GDP (1995). Important stages of R&D, design and engineering tend to be conducted in the United States, Japan and Europe.

Table IV.5
Selected economic indicators for the North American car industry, 1995

A. Production, employment and car ownership in NAFTA countries

	Canada	United States	Mexico
Production (units)	2,376,839	11,643,956	931,462
Auto OE Mfg. employment	139,000 ^a	991,000	197,900
Vehicles produced per OE employee	17	12	5
Vehicles produced per 1,000 citizens	82	45	10
Vehicles sold per 1,000 citizens	39	58	8

B. Canadian assemblers of light vehicles; production by firm (thousand units)

	Canada	NAFTA	World
General Motors	908	5,516	8,800
Chrysler	540	2,607	2,674
Ford	533	3,697	6,476
GM-Suzuki ^a	194	194	1,709
Honda ^b	106	659	1,750
Toyota ^b	90	472	4,694
Volvo	8	8	447

a Does not include truck bodies and trailers.

c Major expansion under-way.

Source: Industry Canada (1996b).

72. Labour productivity (labour hours per car unit) was 6 per cent higher in Canada than in the United States in 1994. With lower wages, Canada's productivity lead has translated into assembly costs about one-quarter below the U.S. average (1994).⁵⁶ In turn, this has helped to attract investment;

⁵⁴In the same year, parts production (in 554 plants) was valued at Can\$21 billion, 63 per cent of which were exported to the United States.

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⁵⁶Industry Canada (1996b).

in 1995 the motor vehicles assembly and parts industry spent Can\$3.4 billion on construction and equipment, more than three times the 1985 level.

Tariff policy

73. Benefiting from tariff elimination under the 1965 "Auto Pact" with the United States, the number of light vehicles produced in Canada has grown by 183 per cent a year in the last 30 years. Under performance-based duty remission programmes, introduced in the early 1980s, other foreign-based producers were allowed to operate under similar tariff conditions as those available to North Americans under the Auto Pact.⁵⁷ Assembly operations by non-U.S.-based producers have since expanded progressively, but still account for a limited share of overall Canadian production (Table IV.5).

74. The main provisions of the Auto Pact were incorporated in the FTA and NAFTA. However, the FTA and subsequently the NAFTA required the elimination of all production- and export-based duty remission programmes by 1 January 1996 and 1 January 1998, respectively. In 1994, Canada also started reducing its m.f.n. tariffs on automotive original equipment parts, with full elimination achieved on 1 January 1996. M.f.n. tariffs on assembled light vehicles remain at 8 per cent, to decline to 6.1 per cent in 1999 under the Uruguay Round; imports under the Auto Pact are eligible for duty-free treatment. With effect from 1 January 1996, Canada removed the GPT status of cars imported from the Republic of Korea. As an explanation, the authorities cited Korea's strong competitive position in the sector.

75. The NAFTA introduced stricter rules of origin. While under the Auto Pact and FTA, duty-free trade between participants was contingent on a 50 per cent North American content, the threshold is to increase to 56 per cent by 1 January 1998 and 62.5 per cent by January 2002 for passenger cars, light trucks, small buses (transport of 15 or fewer persons), their engines and transmissions. The corresponding level for heavy-duty vehicles, large buses and all other parts will increase to 60 per cent by 1 January 2002.⁵⁸ In addition, a new approach is used to calculate regional content, the "net cost method". While intended to enhance transparency, it may also increase red tape for producers, who are required to trace the origin of components back to the initial production stages.⁵⁹

Financial assistance

76. According to the authorities, since the abolition of the Automotive Component Initiative, there are no subsidy programmes targeted at the industry at federal level. (Under the Initiative, support

⁵⁷The "Auto Pact" provided for a duty-free trade zone between Canada and the United States for finished vehicles and car parts. Eligible producers (the "Big Three") were allowed to import parts and vehicles duty free, subject to local-content requirements (the level of Canadian/U.S. content under the Pact was 50 per cent). With the introduction of duty remission programmes, imports from outside the Auto-Pact area, mainly Japan, could qualify for rebates on exportation. Preferential tariff treatment under the Auto Pact and the remission programmes led to a sharp reduction in tariff incidence for foreign-owned car producers, with duty averages not exceeding 2 per cent at the time when the FTA and NAFTA entered into force. For more details on the operation of duty drawback and remission schemes, see GATT (1995).

⁵⁸For more details of local-content provisions, see GATT (1995).

⁵⁹Rules of origin have been a contentious issue throughout the NAFTA negotiations. Administration costs related to the "net cost method" are said to eliminate a significant portion of the tariff benefits accruing under the NAFTA. Cadsby and Woodsie (1993).

was provided to small and medium-sized producers of vehicle parts.) R&D activities may, however, qualify for attractive investment tax credits. In addition, car producers are eligible for funding via Technology Partnerships Canada (section (iii)(a)).

(b) Textiles and clothing

Recent economic developments

77. While accounting for a limited share of total GDP, the textile and clothing industries represent significant production in certain local areas (Quebec, Montreal, Kingston and Kitchener).⁶⁰ As in many other industrialized countries, the industry has undergone a painful process of restructuring and adjustment. Between 1990 and 1995, import penetration increased from 36 to 51 per cent for textiles, and from 31 to 42 per cent for clothing. Employment fell by about one quarter between 1989 and 1995. The recession of 1990 and 1991 hit some subsectors particularly hard, especially men's and women's clothing. Total output fell by 17 per cent between 1989 and 1993 and has not yet reached pre-recession levels (Chart IV.7).

78. Despite a modest recovery, the industry remains subject to strong competitive pressures from both ends of the market: Asian products in low-priced segments and, increasingly, U.S. products in medium- and higher-priced categories. In response, Canadian producers have achieved significant productivity gains since the 1990-91 recession, mainly through accelerated introduction of labour-saving processes.⁶¹ Industrial modernization is currently more advanced in textiles than in clothing, with investment doubling over the period 1991 to 1995 to Can\$350 million. Despite important job losses, Canada's clothing industry, with 84,000 permanent employees (100,000 in part-time employment), continues to be relatively labour intensive. According to Industry Canada, "an estimated 50 per cent of the workforce in clothing are immigrants who have often limited French or English language capabilities, which limits their flexibility in seeking alternative employment and exacerbates the industry's adjustment problems".⁶²

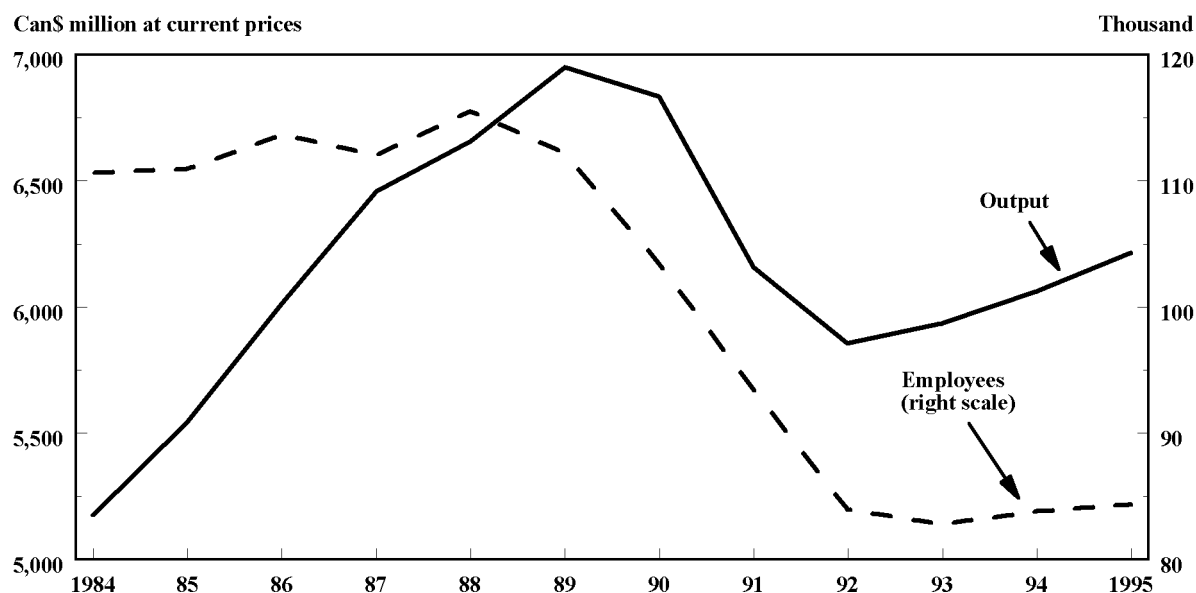
⁶⁰Canada's main textiles products are man-made fibre and filament yarn, wool yarn and woven wool cloth, other spun yarn and woven cloth, knitted fabrics, carpets and household products. With regard to clothing, men's and boys' wear, and women's wear each accounted for about one third of output, while children's wear contributed some 8 per cent (1995).

⁶¹While between 1980 and 1990, labour productivity (real value added per person-hour) grew at annual rates of 2.2 per cent in the textiles sector and 0.7 per cent in clothing (1.4 per cent for manufacturing as a whole), productivity growth rose to 4.9 and 3.4 per cent, respectively, between 1990 and 1993 (3.9 per cent for manufacturing).

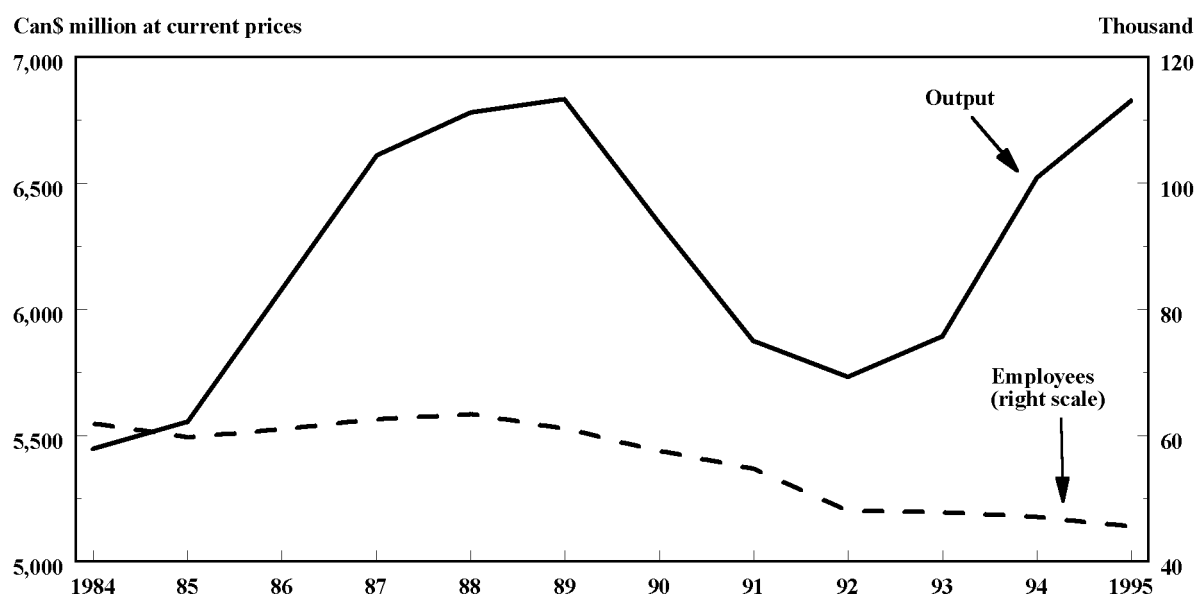
⁶²Industry Canada (1996c).

Chart IV.7
Employment and production in the textiles and clothing industry, 1984-95

A. Clothing



B. Textiles

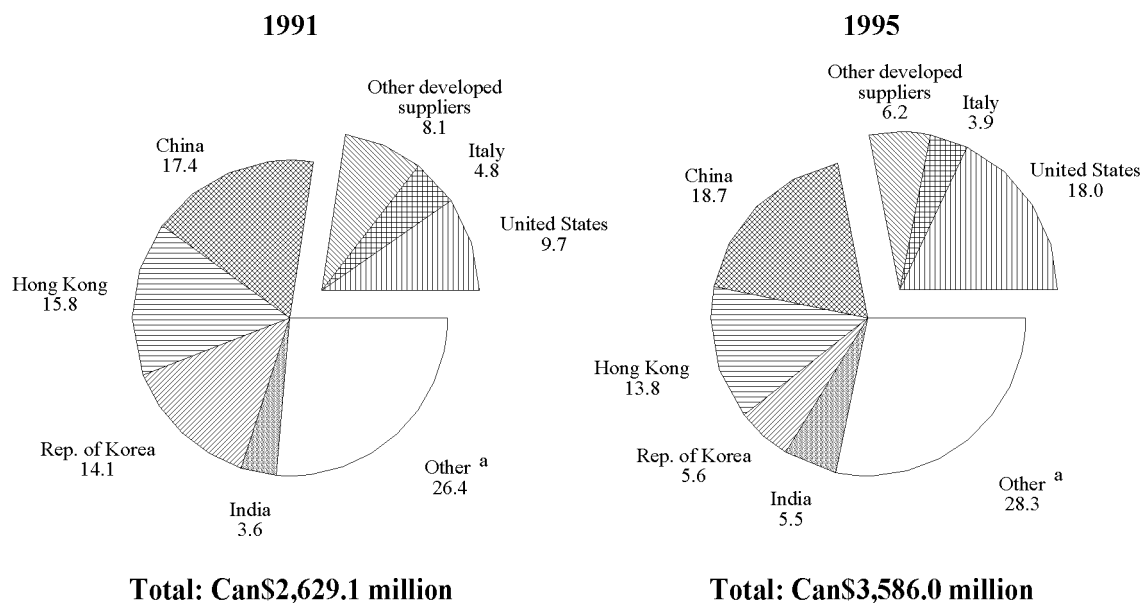


Source: Industry Canada.

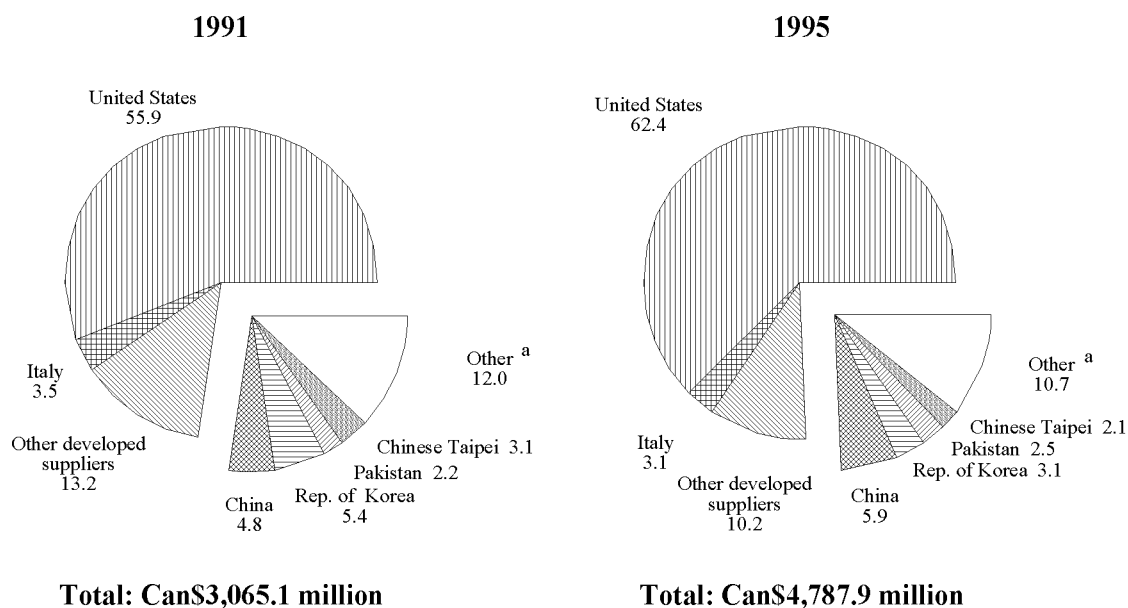
Chart IV.8
Textiles and clothing imports by source, 1991-95

Per cent

Clothing



Textiles



^a Including Eastern Europe.

Source: Industry Canada.

79. Challenged on their home turf, however, both the textile and clothing industries have been able to develop outlets abroad. Owing to quality improvements and greater specialization in higher-value-added products, the export/output ratio increased between 1990 and 1995 from 16 to 33 per cent for textiles and from 5 to 21 per cent for clothing. Most of the growth was achieved in trade with the United States, in the context of rapid bilateral trade expansion.⁶³ The United States, Canada's fourth largest supplier of clothing in 1991, now ranks second, slightly behind China, but ahead of Hong Kong and the Republic of Korea. In turn, according to government statistics, the share of non-US suppliers in Canada's imports of textiles and clothing declined over the period 1991 to 1995 (Chart IV.8).⁶⁴

Access conditions under NAFTA

80. Growing bilateral market integration in part resulted from the implementation of the Canada-United States FTA and the NAFTA. Cyclical and exchange rate factors may have stimulated Canadian exports, but these alone would not suffice to explain the rapid expansion in two-way trade during both the recession and the recovery. Reflecting the ongoing process of bilateral market liberalization, Canada's 1996 tariffs on U.S. textiles and clothing products average 3.1 per cent, as against 15.5 per cent for m.f.n. supplies. (Under the FTA and the NAFTA, tariffs are being eliminated in ten equal instalments as from 1989.) On the export side, Canadian shipments in the sector are currently facing U.S. tariffs of 3.7 per cent on average, about one third of the corresponding m.f.n. rates. An overview of current tariff treatment is given in Tables AIV.1 and 2.

81. Although access conditions to the North American market are to improve over time for currently restricted suppliers, given the MFA phasing-out process, a significant tariff gap is bound to remain.⁶⁵

⁶³Between 1991 and 1995, Canada's bilateral exports of textiles and clothing increased by 142 per cent in value terms (117 in volume), an average annual increase of nearly 25 per cent, while imports from the United States grew by 85 per cent (78 per cent in volume), an annual average of close to 17 per cent. As a result, the share of the United States in Canadian total exports of textiles rose from 72 per cent in 1991 to 83 per cent in 1995, while the U.S. share in imports went up from 34 to 44 per cent. In clothing, the United States currently takes some 90 per cent of Canada's exports.

⁶⁴While in 1991 Canada's total imports of textiles and clothing amounted to Can\$5.7 billion (with a U.S. share of 34.5 per cent), they rose to Can\$8.4 billion in 1995 (with a U.S. share of 43 per cent). Low-cost imports, which increased in absolute terms (from Can\$2.8 billion to 3.7 billion) declined slightly as a share of the total (49 per cent to 44 per cent). Canada's textile and clothing industry, statistical data.

⁶⁵Under the WTO Agreement on Textiles and Clothing (ATC), quantitative restrictions vis-à-vis a number of developing countries and countries in transition, carried over from the former MFA régime, are being progressively phased out as products are "integrated" into the GATT. On the date of entry into force of the WTO Agreement (1 January 1995), Members which had retained the right to use the special safeguard under the ATC, were required to integrate products accounting for no less than 16 per cent of their 1990 import volume; a further minimum 17 and 18 per cent are to be integrated by 1 January 1998 and 1 January 2002, respectively. All remaining products will be automatically integrated at the end of the transition on 1 January 2005. Products from each of four categories - tops and yarns, fabrics, made-up textiles products and clothing - must be included in the first three phases but the choice of the basket of goods to be integrated in each phase is left to the importing Members' discretion. At least 12 months in advance of an implementation stage, Members are required to notify the Textiles Monitoring Body of their precise intentions. Unlike the United States which submitted an integration programme for the full period, Canada (and the European Union) opted for a stage-by-stage approach, so that, according to the Government of Canada, any developments occurring during the period may be taken into account. With integration, any restrictions on the products are eliminated.

From 1998, bilateral trade in textiles and clothing products will be duty free, while Canada's Uruguay Round final bound rates for 2000 average 12.7 per cent.

82. External suppliers of textile inputs (and their domestic processors) are confronted with stricter rules of origin under the NAFTA than under the FTA. For example, the FTA requirement for fabrics to originate in participating countries in order for an article of clothing to qualify for preferences, was extended under the NAFTA to the yarns used for weaving. As Canadian producers have traditionally relied on third-country imports of yarns, the "yarn forward" rule may have a significant impact on their sourcing. However, both the FTA and the NAFTA allow for specified quota amounts of non-originating clothing and textiles to be imported from Canada into the United States. These levels were expanded under NAFTA and have generally (except for woollen apparel) been sufficient to sustain the increase in Canadian exports.

83. As described in Chapter III(2)(i), under WTO and NAFTA provisions, all duty drawback and remission programmes conditional on production, investment or local content have been discontinued or are to be terminated by 31 December 1997.⁶⁶ In compensation, Canada is phasing in autonomous tariff reductions of 26 per cent on frequently used inputs over the period 1993 to 1999. In addition, producers may apply to the CITT for tariff relief in lieu of remission orders in certain circumstances.

The Uruguay Round implementation process

84. Under Articles 2.1 and 3.1 of the WTO Agreement on Textiles and Clothing (ATC), the Government of Canada notified to the Textiles Monitoring Body the quantitative restrictions maintained at the date of entry into force of the Agreement.⁶⁷ The notification includes restraints within bilateral agreements maintained under Article 4 or notified under Article 7 or 8 of the MFA, as well as unilateral restraints maintained under Articles 7 and 8 and not covered by Article 2 (Table IV.6).

85. In October 1994, Canada notified the first list of products for integration into the GATT, representing 16 per cent of its 1990 imports covered by the ATC (555.8 million square metre equivalents). The notification contained the termination of restraints on one item currently subject to quantitative restrictions (work gloves) from seven sources.⁶⁸ To date, Canada has not invoked the transitional safeguard mechanism available to prevent further import surges from causing or threatening to cause serious damage to domestic industry.

⁶⁶The application of duty drawback schemes vis-à-vis the United States was ended on 1 January 1996 and is to be abolished vis-à-vis Mexico in 2001. Canada also decided to offer a partial duty refund procedure for dutiable goods traded under the tariff preference levels within the free-trade area. The duty refund system will be phased out as NAFTA tariff-free access is phased in. Full duty drawback remains for goods traded at full m.f.n. rates of duty.

⁶⁷WTO document G/TMB/N/62, 19 April 1995.

⁶⁸GATT document G/TMB/W/2, 10 October 1994.

Table IV.6
Suppliers of textile and clothing products, July 1996

Restraints under the WTO Agreement on Textiles and Clothing		Restraints with non-WTO Members
Asean	Americas	Bulgaria
Indonesia	Brazil	Cambodia
Malaysia	Costa Rica	China
Philippines	Cuba	Chinese Taipei
Singapore	Dominican Republic	North Korea
Thailand	Jamaica	Laos
	Uruguay	Lebanon
Central and South Asia		Nepal
Bangladesh	Africa	Oman
India	Lesotho	Russia
Pakistan	Mauritius	Syria
Sri Lanka	South Africa	Viet Nam
	Swaziland	
Far East	Central and Eastern Europe	
Hong Kong	Czech Republic	
Macao	Hungary	
Myanmar	Poland	
Republic of Korea	Romania	
Middle East	Slovak Republic	
Qatar		
United Arab Emirates	Mediterranean	
	Turkey	

Source: WTO Secretariat based on WTO Document G/TMB/N/62, 19 April 1995.

(iii) Performance in technically-advanced industries

(a) Background

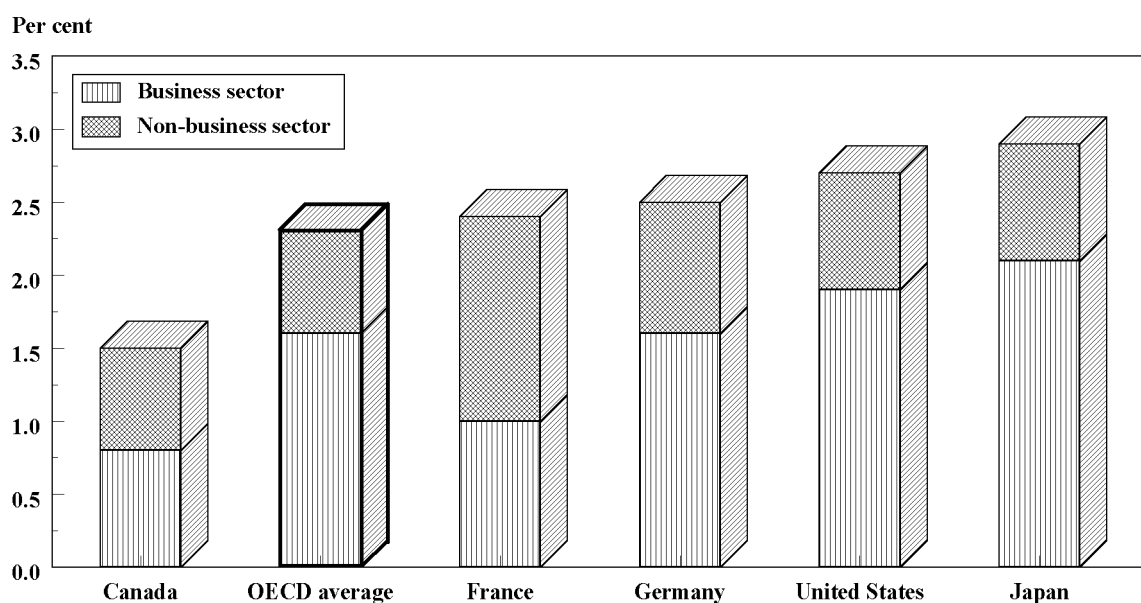
86. Canada's "high-tech" industries are playing an increasingly important rôle in employment, value-added and exports. Manufacturing activities in these industries (information and communications technologies, aeronautics and space industries, robotics, high precision instruments, and biotechnology) currently represent some 5 per cent of GDP, nearly as much as the automobile sector. Telecommunications equipment and aeronautics are the two largest and most integrated segments in terms of their domestic supply links. As in many other countries, "high tech" industries are little regulated in general, contrary to some user branches (e.g. telecom or aviation services), and are predominantly privately owned. Canada does not maintain any restrictions on foreign investment in these areas, contrasting with some related services sectors (section (5)(i)).

87. With a few exceptions, including Northern Telecom and Bombardier (aeronautics), advanced-technology activities are concentrated in Canadian subsidiaries of multinational enterprises, surrounded by a network of smaller domestic firms. Canadian-owned SME's are often "niche players" in areas such as flight simulators, remote sensing or rural communications network management and

computer telephony integration, with a strong focus on exports. While such companies may be able to capitalize on some of the benefits associated with small size, e.g. flexibility and stronger responsiveness to market trends, they tend to suffer from a narrow financial base, lack of industrial and technical synergies, and the diseconomies of relatively small production runs. In addition, given the size of the country, the scope for large R&D pools and lavish civil and defence contracts is limited.⁶⁹

88. R&D spending in Canada is low by OECD standards, not only in technology-intensive industries but across virtually all sectors (Chart IV.9). Alternative indicators of research intensity (patents, scientists, etc.) confirm a relatively weak position which, combined with increased import penetration in various "high tech" products, seems to corroborate the existence of an innovation or technology gap.⁷⁰ The question remains, however, whether such a gap should be cause for public concern. It may be argued, for example, that Canada's comparatively small research base is a natural concomitant to economically efficient specialization and that, as technologies and expertise are incorporated in products and persons, open markets ensure free access to advanced knowledge developed elsewhere. On the other hand, since mobility is not just one-way, it may also result in a brain drain.

Chart IV.9
R&D expenditure as a percentage of GDP, 1993



Source: OECD, Basic Science and Technology Statistics, 1995 edition.

⁶⁹Industry Canada feels that "the dependence on niche markets provides the industry with disjointed capabilities, which have been detrimental to its ability to compete with more integrated manufacturers from other countries". Industry Canada (1995).

⁷⁰The existing R&D support schemes have also been criticized for an implicit bias in favour of larger companies; federal government funding of R&D programmes tends to increase with company size (OECD (1995a)).

89. To promote investment in R&D, provincial and federal governments have developed generous incentive systems over time, implying fiscal costs of some Can\$1 billion per annum (Chapter III (4)(iv)). In recent years, more emphasis has been placed on tax credits than on direct payments. Yet the fiscal drain has remained largely unchanged, and so has Canada's international position in R&D. Increasing budgetary constraints, combined with doubts about cost effectiveness, has thus prompted a review of various programmes, including the main federal R&D scheme, the Scientific Experimental Development tax incentive (1994/95 Budget).

90. Technology Partnership Canada (TPC), introduced with the 1996/97 Budget, provides venture capital to assist companies in launching "high tech" products. When fully operative in 1998/99, TPC is to spend Can\$250 million per annum in the form of repayable loans (Chapter III(4)(iv)). Unlike its predecessor, the Defense Industries Productivity Program (DIPP), which focused on the aerospace industry, TPC covers a broader sectoral spectrum including advanced materials, information and computer technologies, and biotechnology. Other technology-based programmes, which have survived recent budget cuts, include "Canarie", a government-industry consortium focusing on the development of advanced communications networks, and "Precarn", a private/public consortium supporting pre-competitive research in the field of intelligent systems.

91. The Government has welcomed the Uruguay Round results as providing Canadian firms with business opportunities in both new and traditional markets, and helping them to diversify beyond the U.S. market.⁷¹ Under WTO provisions, tariffs on "high tech" products will be significantly reduced.

(b) Information and communication technologies

92. Information technologies and telecommunications (IT&T) spearhead the technologically advanced segment of Canadian industries, generating about 2 per cent of GDP. Some 15,000 firms employ over 160,000 persons to produce telecommunications equipment, computer products and instrumentation, computer services and new media, and electronic components. Trade in virtually all major subsectors, apart from telecommunications equipment, is in deficit, adding up to Can\$11 billion (1994). Canada's share in the fast-growing IT&T world market is estimated at 3 per cent.⁷²

Telecommunications equipment.

93. With some Can\$1.5 billion in R&D spending (1995), the telecommunications equipment sector is the single largest industrial R&D performer in Canada. Four Canadian companies, led by Northern Telecom, rank among the world's 50 largest producers in the industry. Historically, preferential supply relationships with monopoly service providers were an important factor in the development of Northern Telecom (as for some of its main international competitors). In turn, the presence of a multinational covering a broad range of activities at the intersection of communications, space and other advanced technologies has proved a focal point for Canada's modern industrial development. Many telecommunications manufacturers have begun as suppliers to Northern Telecom.⁷³ Total employment in the industry is about 40,000, down by some 15 per cent since 1988.

⁷¹Industry Canada (1995), p. 6.

⁷²Team Canada (1996a).

⁷³Industry Canada (1995), p. 4.

94. The competitive environment for the industry is changing significantly in the direction of increased openness and international integration. Canadian tariffs on U.S. telecommunications equipment have been eliminated under the Canada-U.S. Free Trade Agreement (HS lines 8517.10 to 8517.90). Under the WTO, all major industrial countries are committed to significant tariff cuts over the coming years. For instance, the European Union is to phase out tariffs on telephone sets and some digital integrated circuits, and to reduce tariffs by 60 per cent on other components (switches, system equipment and parts). Canada will eliminate tariffs on many products, from telephone sets to modems or facsimile machines (Table IV.7).

Table IV.7
Tariffs on selected information technology products before and after the Uruguay Round implementation process

HS code	Product description	Tariff rates	
		1994	2000
		(per cent)	
Communications and electronic equipment:			
8517.10	Telephone sets and answering machines	17.5	0.0
8517.30	Telephone switches, line system equipment	0.0-17.6	0.0-8.7
8517.40	and parts		
8517.82	Facsimile machines	10.2	0.0
8517.40	Modems and parts	3.9-17.5	0.0
8517.40	Radio transmitters/transceivers	9.2-9.5	0.0
8525.20			
8805.20	Aircraft flight simulators	0.0	0.0
8534.00	Printed circuits	10.3	0.0
Computers and business machines:			
8471.10	Complete data-processing machines,	0.0-3.9	0.0
8471.20	analog/digital/hybrid		
8471.91	Digital processing units	3.9	0.0
8471.92	Input/output units with/without cpu, storage	0.0-3.9	0.0
8471.93	Data storage units with/without rest of system	0.0-3.9	0.0
8473.30	Parts/accessories for computers	0.0-3.9	0.0
Electronic instruments:			
9032.89	Automatic control instruments and parts	0.0-9.2	0.0-6.2
9032.90			
9030.39	Measure or test instruments or parts	0.0-10.3	0.0-5.1
9030.40	Electrical properties and telecom use		
9026.10	Fluid flow or pressure measuring	0.0-10.3	0.0-4.0
9026.20			
9026.80			
9014.10	Navigating instruments	0.0-10.3	0.0-6.8
9014.20			
9014.80			
9015.40	Survey, geophysical instruments	0.0-10.3	0.0-6.8
9015.80			
9015.90			

Source: Industry Canada (1995).

Computer hardware and peripherals

95. Canada's computer equipment industry is marked by the strong presence of foreign multinationals such as IBM, which accounts for 70 per cent of all computers produced in Canada. Multinationals account for two thirds of all exports, predominantly in the form of intra-firm trade. The large players are complemented by some 200 mostly Canadian-owned producers of parts and peripherals which, due to lack of funds and marketing channels, tend to focus on their home market. The Government feels that these firms are at a competitive disadvantage if compared to companies, for example in Japan, that have access to low-cost capital generated within highly integrated conglomerates.⁷⁴

96. Bilateral trade with the United States and Mexico has been fully liberalized under the FTA and NAFTA. Canada and the United States are moving towards a common m.f.n. tariff on computers and parts, creating trading conditions similar to a customs union.⁷⁵

Computer software

97. Based on 12,000 establishments with 70,000 employees, and achieving double-digit growth rates, software production is considered as one of Canada's high-tech strongholds.⁷⁶ The industry is composed of some 20 well-established firms (e.g. SHL Systemhouse, DMR Group, Gognos and Corel), which are mostly Canadian-owned, and a myriad of smaller companies. According to the Government, despite the proximity of the U.S. market, many small companies seem to have difficulties in establishing a presence abroad, given the lack of adequate financing and the absence of marketing alliances with large hardware producers. The WTO Agreements on Technical Barriers to Trade, Trade-Related Aspects of Intellectual Property Rights, and Government Procurement are expected to have a major positive impact on the computer services and software industry.⁷⁷

(c) Aeronautics and space industry

98. Canada's aeronautics and space industry is almost comparable in importance, in terms of GDP, to the IT&T sector. The larger companies are mostly foreign owned (Bell Helicopters, Pratt & Whitney), except for Bombardier and its subsidiaries Canadair and de Havilland. A number of smaller firms are active in niche markets (flight training devices, flight and air traffic control simulators, aircraft management and control systems, space electronics, remote sensing satellites, space robotics systems etc.). The industry has approximatively 60,000 employees and is estimated to supply 4 per cent of the world market. About 70 per cent of production is for export, two thirds of which goes to the United States.

99. Contrasting with many other sectors, Canadian producers of aeronautics and space equipment rely more on foreign than on domestic procurement markets.⁷⁸ Given their limited home base, they

⁷⁴Industry Canada (1995), p. 9.

⁷⁵The current m.f.n. tariff on computers and parts is 3.9 per cent in both Canada and the United States.

⁷⁶The turnover of Canada's top 100 software companies grew by 38 per cent in 1994.

⁷⁷Industry Canada (1995), p. 16.

⁷⁸Team Canada (1996a).

generally compete with larger, more integrated foreign firms.⁷⁹ To compensate for perceived disadvantages in terms of firm size and R&D spending, the Government promotes technology development in priority areas - with support for R&D through the DIPP and the Canadian Space Agency - and export marketing.

(5) Services

(i) Recent developments

100. As in other advanced economies, the production of services is Canada's single most important economic activity, currently accounting for close to two thirds of GDP and employment. "New" communication and information industries have expanded rapidly in recent years. For example, value added in the computer services sector grew by a nominal 58.9 per cent between 1990 and 1995, corresponding to an average annual rate of 9.7 per cent.

101. The recent expansion of modern services is reflected in, and may have benefited from, a change in policy focus. In areas such as telecommunications and aviation, Canada has gradually abandoned its traditional reliance on government intervention and control, including through public monopolies, which had long formed an essential component of regional and industrial development policies. (Given Canada's large and scarcely populated territory, infrastructure is considered to play an important rôle for economic and social cohesion.) Growing concerns about economic and technical inefficiencies, and their drain on the public budget, have encouraged a process of deregulation, privatization and management reform; regulatory changes in the United States have provided an additional impetus.⁸⁰

102. In recent years, Canada has introduced competition in large segments of the telecommunications sector, including in areas of voice telephony and in all advanced services. Long-standing regulatory régimes in air and maritime transport have been overhauled and previous monopoly rights for Air Canada removed. Port and airport management is increasingly provided on a commercial basis. Rules preventing financial institutions from intra-sectoral diversification have been lifted.

103. As Canada has generally relied on an evolutive process of legislative review, the reforms may have taken more time, but possibly involved less risk, than a "big-bang" strategy. In general, the reform process has contributed to closer integration of (previously) segmented regional services markets. The large players in the telecommunications, financial services, air and maritime transport sectors now operate under federal rules and are subject to federal regulatory control. Many of the former incumbents have been able to adjust and retain significant market shares (Bell Canada, Air Canada, and the six largest banks); their practices are monitored under the Competition Act.⁸¹

⁷⁹Team Canada (1996b). For example, the space-related revenue of Lockheed-Martin, the largest U.S. company in the sector, is more than ten-times higher than the Canadian space industry's total turnover.

⁸⁰Two thirds of the Canadian population live less than 100 miles from the U.S. border.

⁸¹Three prominent competition-policy cases in recent years involved: Stentor, an association formed by the main regional telecommunications operators; Gemini, a computer reservation system jointly operated by Air Canada and Canadian Airlines International Limited (CAIL); and Interac, an association among major banking institutions providing shared electronic network services. While Stentor was found not to operate as a cartel, the Competition Tribunal issued a Consent Order in 1993 requiring Gemini, which represented 90 per cent of the market, to provide all other computer reservation systems in Canada with relevant information. Gemini's
(continued...)

104. Foreign access to the Canadian services markets has improved, reflecting the domestic reform process and external negotiations under the NAFTA and the WTO. The NAFTA contains provisions on telecommunications, financial, trucking and rail services. Under the GATS, Canada has upgraded its initial offers on financial, telecommunications and maritime services with a view to contributing to a significant outcome of the negotiations. On the other hand, investment inflows in many services areas remain closely monitored to ensure continued Canadian influence within an increasingly integrated North American and global market environment.⁸² As described in Chapter III(4)(iii)(b), the review thresholds for investments from WTO Members are lower in the financial and transport services industries than in the rest of the economy, while all investments in the cultural sector are reviewable. Specific ownership restrictions remain in telecommunications, air transport, cultural and, mainly at the provincial level, financial services (Table IV.8).

(ii) Financial services

(a) Background

105. The financial services sector currently accounts for about 7.5 per cent of GDP and close to 4 per cent of total employment in Canada. The banking industry is strongly concentrated, with six banks representing two thirds of all assets held by deposit-taking institutions. Overall, 50 per cent of the economy's total assets are in the hands of banks. However, other financial sector institutions, such as pension funds and life-insurance companies, are expanding rapidly.

106. Deregulation in the financial sector started in the mid-1980s, when Canada eliminated regulations on financial sector specialization and separation. Being allowed since 1987 to underwrite and distribute securities of the Government and Crown Corporations, banks have become important players, mainly through acquisitions, in securities markets and the trust industry. At the same time, they are being challenged in their traditional lending and deposit businesses by insurance companies, and trust and loan companies.

107. Stiffening competition has helped to reduce the cost of financial transformation in Canada; the spread between lending and deposit rates compares favourably with other OECD countries (IV.10).

⁸¹(...continued)

two participants were also ordered to participate in all other computer reservation systems on "reasonable terms". The Competition Tribunal later modified its original Consent Order and required the dissolution of Gemini at the end of 1993. In 1996, the Competition tribunal accepted a concerted order designated to facilitate both wider membership on Interac and competition between members. (Director of Investigations and Research).

⁸²Canadian control and ownership of services providers is often linked to broader concepts of Canadian identity. For example, the Telecommunications Act of 1993 states that "telecommunications performs an essential rôle in the maintenance of Canada's identity and sovereignty" and that the Canadian telecommunications policy has as its objectives "to promote the ownership and control of Canadian carriers by Canadians" (section iii(c)).

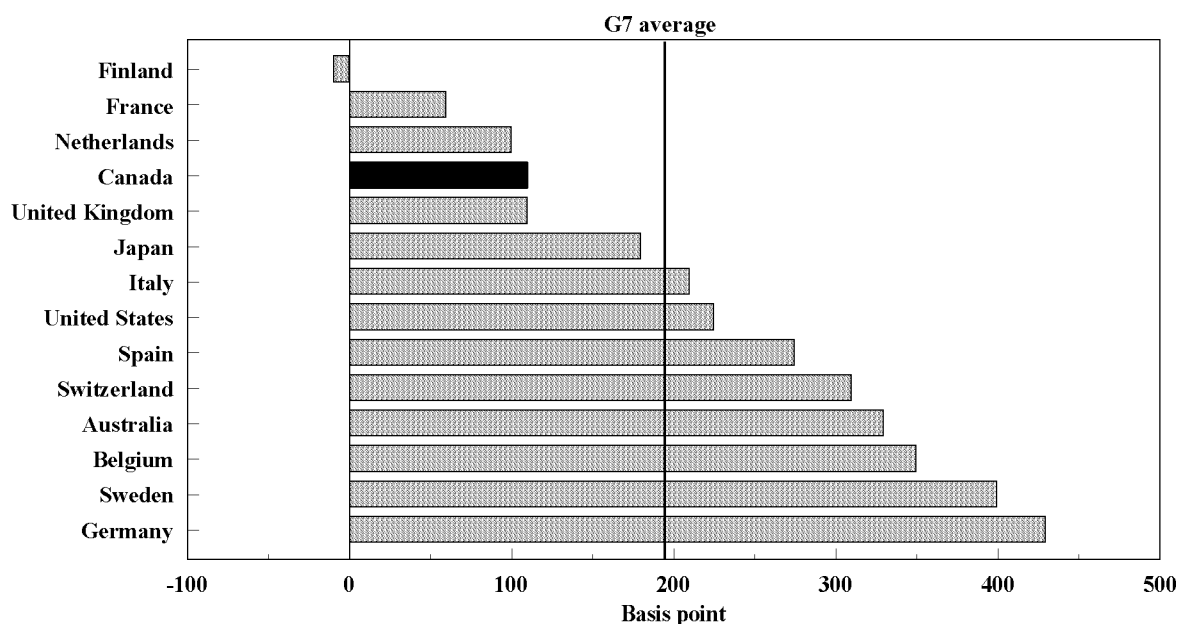
Table IV.8
Investment restrictions and controls in selected services sectors, 1996

Sector	Legal base	Limitation
Investment review		
General provisions	Investment Canada Act	Review of direct acquisitions by WTO members of a business whose assets exceed Can\$168 million, to assess the "net benefits to Canada". Review thresholds for non-WTO members: Can\$5 million for direct acquisitions; Can\$50 million for indirect acquisitions representing no more than 50 per cent of a transaction.
Sector-specific provisions		
Transport services ^a	Investment Canada Act	Review thresholds for WTO and non-WTO members: Can\$5 million for direct acquisitions; Can\$50 million for indirect acquisitions representing no more than 50 per cent of a transaction.
Cultural industries	Investment Canada Act	Review of any investments (acquisition or new business) in activities related to Canada's cultural heritage or national identity.
Ownership limitations		
Telecommunications	Telecommunications Act	Foreign ownership of Canadian common carriers limited to 20 per cent (33.3 per cent in the case of holding companies).
Air transport	National Transportation Act	Foreign ownership of an airline limited to 25 per cent.
Financial services	Bank Act	Individual ownership limited to 10 per cent of a Schedule I bank (regardless of nationality).
	Provincial laws	Foreign ownership limited to 10 per cent individually and 25 per cent collectively of provincially regulated trust and loan companies and securities firms in several provinces.
Broadcasting	Broadcasting Act	Foreign ownership of a radio or television station limited to 20 per cent (33.3 per cent in the case of a holding company).
Book publishing and distribution	Investment Canada Act (Section 20) and supplementary policy guidelines	New businesses must be Canadian-controlled. Foreign acquisition of existing Canadian-controlled businesses is allowed only in extraordinary circumstances.
Film distribution	Investment Canada Act; policy guidelines under the Act	Foreign acquisition of a Canadian-controlled distributor is not allowed. Investment in new businesses permissible only for importation of proprietary products. Direct or indirect acquisition by foreign-owned companies is permissible only if the investor undertakes to reinvest a portion of its Canadian earnings "in accordance with national and cultural policies".

a The Bank Act exempts banks from the Investment Canada Act.

Source: WTO Secretariat, based on information provided by the Government of Canada.

Chart IV. 10
The cost of financial transformation in selected OECD countries, 1990-94^a



^a Average spread between bank lending and market interest rates.

Source: OECD and IMF.

108. Despite (or perhaps because of) a legacy of domestic regulation, Canadian banks have traditionally been active in foreign markets. The absence of exchange controls, combined with a more liberal framework for cross-border than for domestic operations, has encouraged diversification into the United States. Approximately 30 per cent of the major banks' assets are currently held in foreign currency. The focus on other North American markets has further strengthened in the wake of the NAFTA.⁸³

109. In turn, foreign access to the Canadian market has improved, first under the NAFTA and later under the GATS. In particular, the WTO Agreement Implementation Act removed long-standing limitations on non-Canadian ownership of federally-regulated financial institutions; lifted a market share limitation on foreign banks; and extended NAFTA thresholds for investment review and control to all WTO members (Table IV.8). The Bank Act, the Cooperative Credit Association Act, the Trust and Loan Companies Act and the Investment Companies Act have been amended accordingly.

110. As in other sectors, the provinces share some regulatory and supervisory powers with the Federal Government. While banking falls exclusively under federal jurisdiction, securities companies operate exclusively under provincial control. (Canada remains the only major industrial country to regulate capital market operations solely at a subnational level.) Other financial sector institutions - insurance

⁸³Two major Canadian banks recently took control of two Mexican banks, and 15 Canadian insurance companies are currently operating in the United States through branches, offices or subsidiaries. There are no Canadian insurance companies operating in Mexico.

companies, trust and loan companies, co-operative credit associations, mortgage companies, investment companies etc. - are free to incorporate either under federal or provincial law.

111. To avoid regulatory overlap in areas of shared or exclusive provincial competence, co-operation procedures exist. Regulators for insurance and securities meet regularly to exchange information and harmonize their approaches. (For example, the Canadian Securities Administrations have been established as a body to perform such functions.) Since the largest insurance and trust and loan companies operate nation wide, they have incorporated under federal law.⁸⁴ Regulation of securities firms has been under discussion for some years; while some provinces are exploring the concept of a uniform regulation administered by a single agency, others want to retain their regulatory presence.

(b) Banking

112. Pursuant to the Bank Act, the Department of Finance is responsible for the general policy framework governing all banks, including subsidiaries of foreign banks. Regulatory control is vested in the Office of the Superintendent of Financial Institutions (OSFI).⁸⁵ The Office reviews incorporations and acquisitions, and is responsible for prudential supervision; it reports to Parliament through the Minister of Finance.

113. The Bank Act provides for two classes of bank. Schedule I banks are widely held, with individual ownership limited to 10 per cent of voting shares for both Canadians and foreigners. The current eight Schedule I banks, of which six operate a nation-wide network with some 8,000 branches, hold more than 90 per cent of all bank assets in Canada; they are all majority Canadian-owned. The second class, Schedule II banks, was created in 1980 to allow foreign banks to operate in Canada; they may be closely held on incorporation and must establish as subsidiaries. Most of the 50 foreign bank subsidiaries currently operating in Canada confine their activities to specialized businesses (corporate banking and investment services). The Hongkong Bank of Canada, the largest Schedule II bank, had assets of Can\$20 billion in 1995, while the National Bank of Canada, the smallest of the "Big Six", had Can\$48 billion.

114. In order to incorporate a Schedule II bank, the foreign company should be in the business of banking and be known as a bank to the regulator of its home country.⁸⁶ While foreign banks may operate representative offices in Canada, they must not solicit business; direct branching or opening agencies from abroad is not permitted. The restriction on branching, intended to facilitate prudential supervision by the OSFI, has drawn complaints from smaller U.S. banks located near the Canadian

⁸⁴The federally incorporated trust and loan funds represent 85 per cent of the assets in this sector. Many trust and loan companies, traditionally concentrated in Ontario and Quebec, have disappeared during the recession and the real estate crisis in recent years. Several provinces, including Ontario, are considering reducing their involvement in the regulation of trust and loan companies.

⁸⁵The banks' rôle is defined in Part VIII of the Bank Act. Banks are allowed to take deposits, and provide lending and investment services (portfolio management services, counselling services etc.); they may also create subsidiaries to offer other financial services such as the managing and selling of mutual funds, insurance policies etc.

⁸⁶A letter of comfort authorized by the bank's board of directors must accompany the application for the establishment of a subsidiary.

border.⁸⁷ They see the requirement to establish a capitalized subsidiary as particularly onerous, limiting their potential for commercial expansion.

115. Recent changes have facilitated market access and conditions of operation. Canada is committed not to enforce reciprocity tests for the licensing of foreign bank subsidiaries for the duration of the GATS Agreement on Financial Services. Once established, a subsidiary is granted national treatment and may perform similar activities as Canadian-based banks without restriction. They may hold shares in other financial institutions such as federally regulated trust and loan companies and provincially regulated securities firms.⁸⁸ Although Ministerial approval is still required for banks from non-NAFTA countries to open more than one branch, permission has not been denied to date. Previous ceilings on the assets of foreign bank subsidiaries, limiting them to 16 per cent of total domestic bank assets, were removed for NAFTA members and, subsequently, on an m.f.n. basis under the GATS. Capital requirements are based on the Bank of International Settlements' rules on capital adequacy, and do not differ between foreign bank subsidiaries and domestic banks.

116. Foreign ownership restrictions have also been eased. Canada has long applied the so-called 10/25 rule prohibiting foreigners from holding more than 10 per cent of any class of shares individually or 25 per cent collectively in a Schedule I bank. The 10 per cent limit applied to all persons, domestic or foreign, and was established to avoid the risks normally associated with excessive concentration. The 25 per cent provision was aimed at ensuring Canadian ownership and control.⁸⁹ As part of its commitments under the GATS, Canada eliminated the 25 per cent collective limitation.⁹⁰

(c) Other lending and borrowing activities

117. A range of institutions other than "banks" provide lending services in Canada, including federally or provincially regulated trust and loan companies, credit unions and co-operative institutions. Since 1992, these institutions have been allowed to compete on an equal footing with banks in the personal and corporate lending market. With the lifting of the 10/25 per cent limit on federally incorporated trust and loan companies under the GATS, the relevant activities are fully open to foreign investment.

118. Securities markets and institutions are under provincial control. Various provinces, including Ontario, Quebec and British Columbia, allow foreigners to acquire full ownership of provincially registered companies. (Ontario hosts Canada's largest capital market, in Toronto.)

⁸⁷Journal of Commerce, 26 January 1996. Consultations on this issue are being pursued under the NAFTA.

⁸⁸Thus, a foreign bank or bank holding company would be able to operate its Canadian securities affiliate as part of its foreign securities network, separated from its Canadian banking activities. A recent policy paper, published in preparation for a review of federal financial institution legislation in 1997, proposes allowing foreign banks with a Schedule II subsidiary to hold other financial institutions directly, rather than through the subsidiary.

⁸⁹While after the second World War few restrictions prevented foreign banks from acquiring Canadian banks, the 1967 Bank Act introduced the 10/25 per cent rule. It applied to various segments of the financial services sector (insurance companies, trust and loan companies, credit unions, investment firms, securities firms etc.) at both federal and provincial level. Foreign banks were not allowed to engage in banking activities as defined by the Act (i.e. the possibility of receiving deposits by check), but were permitted to own non-bank credit institutions which were active in money-market operations, corporate lending and leasing.

⁹⁰The 25 per cent collective ownership limitation was first lifted for U.S. banks under the Canada-United States FTA in 1989.

(d) Insurance

119. The Canadian insurance market has traditionally had a strong presence of American and European firms, dating back to the 19th century. At present, about half of Canada's 140 health and life insurance companies are foreign owned, accounting for 30 per cent (some Can\$50 billion) of all assets.⁹¹ The property and casualty insurance industry is made up of 220 firms; 60 per cent (some Can\$25 billion) of all assets are held by foreign-owned companies. While insurance companies can also incorporate under provincial law, three quarters of Canada's life insurance companies and 55 per cent of the property and casualty insurance companies are federally registered, representing 90 per cent of total premium income.

120. Under the Insurance Companies Act, the Office of the Superintendent for Financial Institutions (OSFI) regulates and supervises the federally incorporated insurers.⁹² While federal regulation focuses on prudential supervision (solvency regulation), the provinces are empowered to regulate products, terms of contracts, market conduct, and licensing of all insurance companies operating in their territory, regardless of the jurisdiction of incorporation. Nevertheless, according to the Government, products and distribution are essentially the same throughout Canada. Each province has its own insurance regulator, and all insurance companies must be licensed in the province where they do business.

121. Insurance companies may supply their services either directly, through agents or through brokers. Life insurance companies are not in general allowed to offer other services (except for health, accident and sickness insurance), but may be affiliated to, and distribute the products of, a property and casualty insurer. As in banking, commercial presence is required to offer insurance, reinsurance and retrocession services in Canada. However, companies may branch from abroad on condition that they maintain trustees assets equivalent to their liabilities in Canada.

122. Subsequent to the 1987 and 1992 reforms, federally incorporated insurance companies were allowed, like banks, to operate in other financial services markets. For example, they may own deposit-taking institutions, investment dealers, mutual fund dealers, and securities firms. In addition, insurance companies may engage directly in lending activities on an equal footing with deposit-taking institutions.

123. According to the authorities, apart from car insurance, there are no cartels or monopolies in the insurance market. Car insurance for private and commercial vehicles is mandatory in Canada; several provinces (Quebec, British Columbia, Manitoba and Saskatchewan) maintain publicly-owned monopolies, all other provinces have regulated premiums.⁹³

124. Prior to the GATS, acquisition by non-NAFTA investors of a federally incorporated Canadian insurance company was subject to the 10/25 rule. While this restriction has been lifted, foreign ownership remains subject to lower investment review thresholds (Chapter III(4)(iii)(b)). Several provinces continue to subject foreign investments in existing, provincially incorporated companies to authorization (Box IV.2).

⁹¹No firm exceeds a market share of 10 per cent.

⁹²The minimum capital requirement at the federal level is Can\$10 million for both foreign- and Canadian-owned companies in life, property and casualty insurance.

⁹³In Quebec, while automobile insurance for corporal damages is public, insurance for material damages is private.

Box IV.2 Overview of Canada's WTO commitments in financial services sectors

Canada has bound market access and national treatment on an m.f.n. basis for financial services listed in the Understanding on Commitments in Financial Services. However, this is subject to limitations under federal and provincial regulations.

Banking and other non-insurance services

Canada's commitments cover the full spectrum of financial activities (banking, foreign exchange trading, money and capital markets operations, mutual fund management, pension fund management, securities brokerage, investment advisory services, etc.). While there is no limitation on cross-border supply and consumption abroad of banking services, a number of limitations concern commercial presence:

Market access:

- (i) Foreign banks and financial institutions must generally incorporate a subsidiary in Canada, under federal or provincial law, to offer banking and related services (including mortgage brokering and securities brokerage). In some provinces and for some specified areas (credit unions, asset management, advisory services), incorporation or another form of local commercial presence is compulsory.
- (ii) Permanent residence is required for activities such as mortgage broking and securities trading or brokering in some provinces (Ontario). Under federal law, no single person, either Canadian or foreign, may own more than 10 per cent of the shares of a Schedule I bank. Similar ownership limitations apply at the provincial level to trust and loan companies or mortgage brokers. In addition to the 10 per cent ceiling, some provinces limit collective share ownership by non-Canadians to 25 per cent in certain sectors.

National treatment:

Ministerial approval is required for non-NAFTA foreign bank subsidiaries to open more than one branch. A minimum of one half of the directors must ordinarily reside in Canada and be either Canadian citizens or permanent residents.

Insurance

Market access:

Supply of insurance and reinsurance services, both at federal and provincial levels, requires a commercial presence in the form of a corporation incorporated under the laws of Canada or of another jurisdiction (i.e. a branch of a foreign corporation) or an association formed on the so-called Lloyds plan. Some provinces maintain limitations on the commercial presence of foreign firms. For example, Quebec subjects foreign investments exceeding 30 per cent of an existing Canadian-controlled and Quebec-chartered company to authorization, and British Columbia submits any individual acquisition of a company's voting rights exceeding 10 per cent to authorization. In other provinces, there are specific requirements regarding risk undertakings or technical reserves or limitations on the provision of certain auxiliary services (brokering and agency services), including the obligation to supply such services through local commercial presence.

National treatment:

The main limitations concern citizenship or residence requirements for directors (see above).

Source: WTO Secretariat based on GATS Document SC/16/Suppl.1/Rev.1, 4 October 1995.

(iii) Telecommunications

(a) Background

125. The Canadian telecommunications market has expanded rapidly in recent years. While revenue growth averaged 4.4 per cent between 1987 and 1992 despite the recession, it reached close to 6 per cent in 1994 and 1995. Total income in the sector was Can\$19.4 billion in 1995, representing some 5.5 per cent of the North American telecommunications market.

126. Reflecting Canada's geographic size and the intensity of economic links with the United States, long-distance telephony contributes some 45 per cent of telecommunications revenue.⁹⁴ Local telephone services account for another 35 per cent, while the remainder comes from variety of sources, including overseas telephone services, resale and sharing of lines, radio-telephone services, paging etc. Mobile cellular telephony, representing a revenue share of 10 per cent, is the fastest growing market segment, with 15 per cent growth in 1995.

127. Competition in Canada's telecommunication services market has intensified since the liberalization in 1992 of long-distance telephony and enhanced services (data-processing services, paging services etc.). New facilities-based carriers, such as Unitel and Sprint Canada, and companies specialized in reselling leased-line capacity have entered the market to compete with Stentor, the association of the main regional carriers, formerly Telecom Canada. Local telephony and mobile satellite services have been legally opened to competition. Overseas telephone services may be provided freely on a resale basis, and there are no restrictions on the interconnection of domestic leased circuits and public switched networks.⁹⁵ Call-back companies are allowed to operate, and private networks may be established.

128. Further regulatory initiatives, including improvements in access conditions for foreign-based companies, may result from the GATS Negotiations on Basic Telecommunications and new technical developments (e.g. information highways). The Canadian Radio-Television and Telecommunications Commission (CRTC), the federal regulator, is currently conducting public hearings on related issues such as the removal of remaining structural barriers to competition in local telephony and the rebalancing of rates.⁹⁶

129. Possibly reflecting the spur of increased competition, performance indicators for Canada's telecommunications sector compare relatively well with other OECD countries. Cost and price trends

⁹⁴By convention, Canada-United States telecommunications traffic is defined as long distance rather than international.

⁹⁵Conditions of network access are defined by the Canadian Radio-Television and Telecommunications Commission (CRTC). Section 29 of the Telecommunications Act (1993) stipulates that agreements between carriers regarding the interchange of telecommunications and the apportionment of rates and revenues are subject to prior approval by the CRTC. Section 40 allows the CRTC to "order a Canadian carrier to connect any of the carrier's telecommunications facilities to any other telecommunications facilities" and require that the relevant conditions "be just and expedient". Under these provisions, the CRTC may order carriers to grant other carriers access to their local exchange facilities, as was needed for the introduction of long-distance competition. According to the Government, major CRTC proceedings are currently under way which focus on local interconnection and network component unbundling with a view to establishing ground-rules for competition in local wire-line telephony.

⁹⁶The CRTC is responsible for telecommunications carriers, broadcasters and cable-TV operators, based on the Telecommunications Act, the CRTC Act, and the Radiocommunication Act.

tend to converge with those in the United States, in particular in the long-distance segment (Canada-United States traffic), in which companies from both countries compete.⁹⁷

(b) Regulatory framework

130. The decision by the CRTC in 1992 to allow competition in public long-distance telephony (Telecom Decision CRTC 92-12) marked an important stage in the process of sectoral liberalization.⁹⁸ It was facilitated by a combination of technical, economic and legal developments, including the proliferation of new services, competitive pressures created by liberalization in the United States, and a 1989 Decision by Canada's Supreme Court confirming federal authority over the member companies of Telecom Canada (now Stentor) and placing them under CRTC control.⁹⁹

131. A new Telecommunications Act followed at the end of 1993. It provides for the regulation of "Canadian" or "common" carriers, i.e. telephone companies, that own or operate transmission facilities. They included all members but one of Stentor, "independent" telephone companies not members of Stentor, Telesat and Telelobe, and "new" entrants such as Unitel (owned by a cable-TV company) as well as Sprint Canada.¹⁰⁰ While these companies were submitted to a unified (federal) régime, the Act by design excluded resellers from regulation. This concerns all companies leasing and reselling lines from facilities-based carriers or offering "enhanced" or "value-added" services, such as data and other computer-related services.

132. The CRTC is mandated under the Act to pursue the deregulation of the Canadian market.¹⁰¹ For reasons of public interest, the Commission may exempt classes of carriers and market segments from the application of the Act; it must forbear from regulating in areas where effective competition exists. For example, the CRTC announced in 1994 that it would cease to regulate cellular and public

⁹⁷OECD (1995b). Canada tends to cluster around the OECD average in terms of public telecommunications revenue, investment, and tariffs per mainline and per capita. Indicators related to some fast-growing market segments, such as the number of mobile telecommunications subscribers, show Canada well above the OECD average. While in terms of international telecom revenue, Canada lags behind its main competitors, this is due mainly to the exclusion of Canada-United States traffic (see above). The OECD findings are corroborated by CRTC estimates comparing costs in Canada and the United States.

⁹⁸Resale and sharing of lines was deregulated in early 1993 (CRTC 93-17).

⁹⁹Under the previous régime, 30 per cent of the telecommunications market was under provincial regulation.

¹⁰⁰Stentor comprises Canada's largest telephone companies which operate in each province through geographically divided concessions and in the long-distance market as an association (see Chart IV.13). Until 1 July 1997, Telelobe Canada is the sole authorized operator of facilities providing overseas telecommunications services. (However, according to the Government, resale arrangements offer alternative gateways for competing services providers.) Telesat is the sole authorized operator, until 2002, of space segment facilities for domestic satellite services. Fixed satellite services between Canada and the United States are provided by Telesat and authorized United States' satellite operators. Earth stations for Canada-U.S. services must be owned by Telesat, and stations for overseas services by Telelobe. Satellite services, as any other telecommunications services, may be resold.

¹⁰¹The following provisions are in addition to the CRTC's traditional powers, confirmed by the 1993 Act, which range from rate regulation to quality of service monitoring and the approval of interconnection agreements. Licences are not required for the provision of a telecommunications service, but the CRTC is to approve the rates charged for commercial services.

cordless phone services that are not offered directly by a telephone company.¹⁰² However, it will continue to regulate terminal equipment supplied on a monopoly basis. In general, the CRTC must support the policy objectives contained in the Act (Section 47), to help "foster reliance on market forces for the provision of telecommunication services".

133. Few segments of the telecommunication market have retained a formal monopoly status. In the main, these are overseas telecommunications services to destinations other than the United States, domestic fixed satellite services and local payphone services. (However, Teleglobe has announced that it would not seek the renewal of its exclusive mandate as Canada's facilities-based overseas carrier, which is to expire in April 1997.¹⁰³) In addition, competition in local telephony is not permitted in the serving territories of non-Stentor telephone companies, which currently account for 5 per cent of the national market,¹⁰⁴ and in long-distance traffic in the territories of NorthwTel, i.e. in some remote areas in the north of Canada. Chart IV.11 provides an overview of the domestic competitive situation in 1995 as assessed by Industry Canada.

134. Although not formally defined in legislation, the availability of a universal service remains a focal policy objective. The 1993 Telecommunications Act (Section 7) requires that "reliable and affordable telecommunications services of high quality be accessible to Canadians in both urban and rural areas in all regions". The traditional instrument in this context has been the fixing of local telephone rates at low levels, relying on cross-subsidization from long-distance calls.¹⁰⁵ However, price competition in the long-distance market has undermined the carriers' traditional source of profits; for instance, Bell Canada's rate of return dropped to from 13.5 per cent in 1992 to 6.5 per cent in 1995, reflecting a 35 per cent fall in long-distance rates.¹⁰⁶

¹⁰²Telecom Decision CRTC 94-15. With respect to mobile wireless services provided directly by telephone companies, the CRTC is prepared to forgo some of its regulatory powers contingent on the establishment of sufficient safeguards. Industry Canada (1994).

¹⁰³Teleglobe Press Release, 8 November 1995. Teleglobe requested the Government to further open the sector, for example through increasing pricing flexibility and raising the foreign-ownership ceiling for carriers to 49 per cent.

¹⁰⁴According to the Government, CRTC is expected soon to decide on the regulatory framework for smaller independent telephone companies operating in Ontario and Quebec.

¹⁰⁵According to the Government, all long-distance service providers must currently contribute to the subsidy flow (some Can\$2 billion) from long-distance to local services. The régime is intended to separate this contribution from the customers' actual choice of a long-distance company. The subsidy requirement is based on the difference between revenues and average costs associated with a telephone companies' local and access services.

¹⁰⁶EIU (1996).

Chart IV.11

Competitive situation in individual telecommunications markets, 1995

Competitive markets 56%




Terminal equipment	Resale sharing & data services	Radio common carriers (including cellular)	Public long-distance telephony
Can\$ 1-2 billion	Can\$ 1 billion	Can\$ 2 billion	Can\$ 7-8 billion

40%

Basic local service
Can\$ 6-7 billion

Monopoly 4%

Domestic satellite and overseas services
Can\$ 0.7 billion

 Fully competitive	 Open to competition
	 Monopoly

Total turnover: Can\$19.4 billion (excluding cable TV)

Source: WTO Secretariat based on Industry Canada estimates.

135. Local telephone markets are in principle open to competition, but no entries have yet occurred. The CRTC acknowledges that a number of social, economic and technical issues, such as the existence of natural monopolies in certain regions and problems of interconnection, continue to deter new entrants.¹⁰⁷ Effective market opening, in turn a precondition for the operation of information highways, is closely linked to the question of rate rebalancing.

136. To complement the 1993 Telecommunications Act, the CRTC adopted a new regulatory framework in September 1994 (Decision 94-19). Its main elements are the removal of barriers to competition in basic local telephony, including through opening access to existing networks; a programme of rate rebalancing aimed at bringing local and long-distance charges in line with costs; the split of the major company's rate base into competitive and utility (monopoly) segments; and the adoption of a price cap regulation for the utility segment from 1 January 1998. The CRTC is currently conducting proceedings with a view to devising a price-cap implementation programme.¹⁰⁸

¹⁰⁷In its 1995 Report on Information Highways, the CRTC did not expect "that entry will occur to any significant degree until technological and other barriers to entry are reduced, and until the terms and conditions of entry in local telephony are sufficiently clear to allow new entrants to develop viable business plans". Hearings on the technical and economic issues related to the opening of local telephony have been held by the CRTC, and decisions are awaited in the near future.

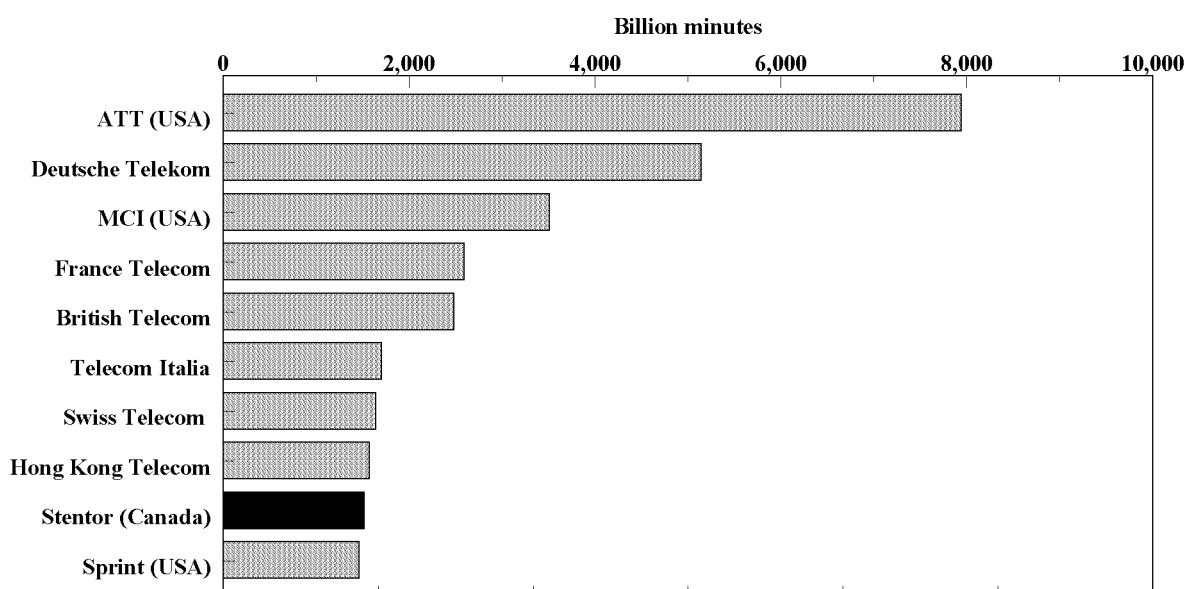
¹⁰⁸In a Public Notice, dated 12 March 1996, the CRTC confirmed its intention to introduce price caps for the utility segment. Consultations on the details of the new pricing system are continuing with a view to reaching a decision by end-1996. In the meantime, the CRTC has approved local rate increases of Can\$2 per month for both 1996 and 1997.

(c) Market developments

137. The scope of liberalized telecommunication services has increased markedly in recent years. Some 340 companies (most of them resellers with a limited market share) are estimated currently to provide wire-based long-distance services.¹⁰⁹ All major carriers are privately owned, except SaskTel and Manitoba Telephone System which are Crown Corporations.¹¹⁰ After four years of intense competition since mid-1992, new facilities-based carriers such as Unitel and Sprint Canada have captured close to 15 per cent of long-distance revenues, profits have shrunk and prices have fallen by an average of 35 per cent.¹¹¹

138. In a rapidly changing environment, the Stentor consortium retains a strong position with an estimated share of 73 per cent in total telecommunications revenue in 1995.¹¹² Some 50 "independent" facilities-based companies account for an additional 5 per cent, while another 7 per cent is accounted for by the new facilities-based carriers (Unitel, Sprint) and 1 per cent by about 200 resellers. Despite its strong rôle in Canada, Stentor is a relatively small player by international standards, given the limited size of its domestic market (Chart IV.12).

Chart IV.12
Main telecommunications operators, 1994



Source: UIT.

¹⁰⁹Financial Times, 2 February 1995.

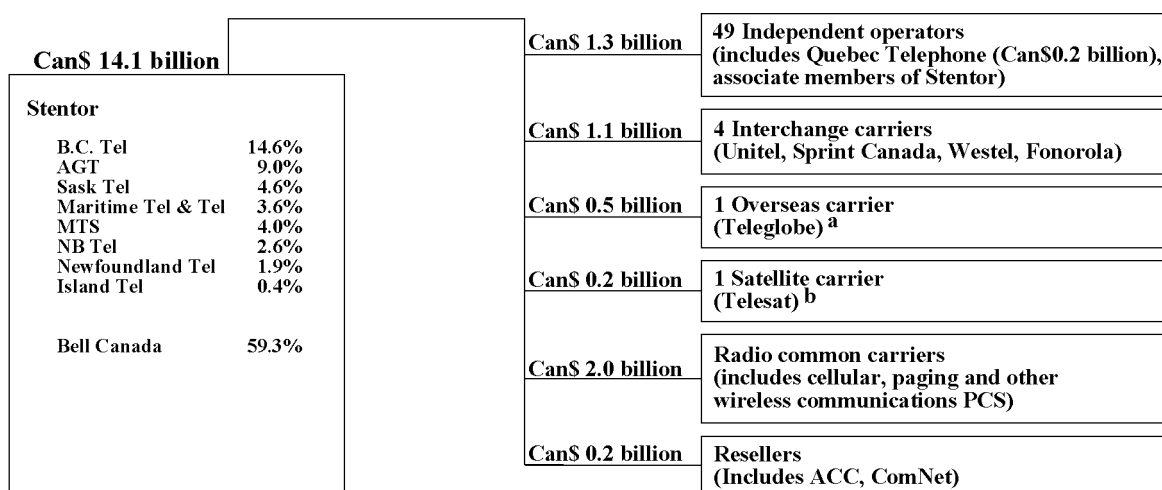
¹¹⁰The Government has sold its 53 per cent share in Telesat.

¹¹¹Industry Canada (1996d).

¹¹²Through a subsidiary, TMI, Stentor is also active in the mobile telephone services market.

139. Bell Canada Enterprises is the holding company of both Northern Telecom, Canada's largest equipment manufacturer (section (4)(iii)(b)), and Bell Canada, the single largest carrier which recently increased its voting power in Stentor.¹¹³ Bell contributes some 60 per cent of Stentor's revenue, equivalent to nearly half of total telecom income in Canada (Chart IV.13), and owns important shares in Teleglobe (22 per cent) and Telesat (25 per cent).

Chart IV.13
Structure of the telecommunications services industry, 1995



Estimated total revenue: Can\$19.4 billion

a Status under review.
b Member of Stentor.

Source: Industry Canada estimates based on annual reports to shareholders.

(d) External aspects

140. The liberalization process has gradually improved foreign market access; there are no restrictions on the cross-border supply of enhanced services, nor national ownership requirements for resellers of telephone capacity. However, pursuant to the 1993 Telecommunications Act, limitations have remained with a view to ensuring "ownership and control of Canadian carriers by Canadians".¹¹⁴ Thus, foreign participation in facilities-based carriers is limited to 20 per cent for direct holdings and 33.3 per cent for voting shares in holding companies (Table IV.8)¹¹⁵; foreign carriers are not allowed to own any voting shares in Teleglobe Canada; and at least 80 per cent of the board members of a

¹¹³Bell Canada's strong market position is to a certain extent rooted in its traditional basis in Ontario and Quebec.

¹¹⁴Under the 1993 Telecommunications Act and the Telecommunications Common Carrier Ownership and Control Regulation, compliance with foreign-ownership rules is to be monitored by the CRTC which is mandated to prevent deals that might allow foreign shareholders to exercise effective control.

¹¹⁵GTE's 51 per cent holdings in BC Tel and Québec-Tel were grandfathered under current ownership and control policies.

facilities-based carrier must be Canadian nationals. Changes may result from a successful conclusion of the WTO Negotiations on Basic Telecommunications.

141. Under the NAFTA, a separate Chapter on telecommunications addresses issues such as network access, interconnection, testing and approval. End-users are entitled to use "public telecom transport services on reasonable and non-discriminatory terms and conditions", to attach their terminal equipment to telephone networks, and to build, interconnect and operate private leased-line networks. Telecom-related aspects are also covered by the NAFTA rules on investment, intellectual property, licensing, standards, and the Agreement's general transparency requirements.

(iv) Transport services

(a) Main features

142. Canada's transport system is shaped by geography and settlement structure, requiring large coast-to-coast and north-south links. (Half of Canada's 30 million population is located on the St. Lawrence Great Lakes axis, a quarter lives on the west coast, and the remainder is spread across the country.) Historically, given the importance of these links, the Government has sought to influence and control the system through regulation and subsidization, infrastructure investment and ownership of major operators. The latter included in particular Canadian National and Canadian Pacific in rail transport and Air Canada in aviation. Strong public involvement was further motivated by the genuine importance of transport services for Canada's main exports; for example, it is estimated that between 18 and 45 per cent of the export sales price of natural resource and primary products is attributable to transportation.¹¹⁶ Over time, lavish subsidy and cross-subsidy systems have emerged but have proved unsustainable as the budgetary situation deteriorated.

143. For almost a decade, Canada's transport industries have experienced a reform process similar to the financial services and telecommunications sectors. The process included a critical review of the Federal Government's involvement in infrastructure management and maintenance, in particular of the 40 main ports and 26 national airports. Ongoing efforts towards commercialization and decentralization, combined with subsidy cuts for user industries, are expected to result in budgetary savings of up to Can\$2.7 billion by the end of the century. (Including the termination of the Western Grain Transportation Act, the Maritime Freight Rate Act and the Atlantic Region Freight Assistance Act; see also section (2)(ii). The deregulation process was further encouraged by, and benefited from, international negotiations at different levels.¹¹⁷

144. The Federal Government has exclusive competence for inter-provincial and international transport. Transport Canada is the Department responsible for air, surface and maritime transport policies, while implementation and enforcement is in the hands of the Canadian Transportation Agency, the federal regulator. The Canada Transportation Act provides the legislative framework for all transportation services, complemented by specialized legislation in individual areas (Canada Marine Act, Canada Port Corporation Act, Railways Act).

145. Sector-specific restrictions and controls on foreign direct investment have persisted, including in the form of lower review thresholds (Table IV.8). Approval by the Canadian Transportation Agency is required for the acquisition of any federally regulated transport company with assets or annual gross

¹¹⁶Transport Canada (1996). The Government's traditionally strong presence in the sector may also be attributed to regional and social policy objectives.

¹¹⁷This includes an open-skies agreement with the United States, NAFTA provisions on trucking and rail services, and GATS disciplines for specified auxiliary air transport services.

sales in Canada of over Can\$10 million.¹¹⁸ In order to qualify for domestic operations under the Canada Transportation Act, an airline must be 75 per cent Canadian owned and be under effective Canadian control.

(b) Air transport¹¹⁹

Background

146. Canadian carriers transported an estimated 20 to 22 million passengers in 1995, shared mainly between Air Canada (11 million) and Canadian Airlines International (CAIL, 8 million). The economic weight of the two companies, competing in a relatively small home market, remains below such large international carriers as Delta (89 million passengers), All Nippon Airways or British Airways (30 million each). However, both Air Canada and Canadian Airlines International have alliances and commercial arrangements, including on flight co-ordination and code-sharing, with major foreign carriers. Business alliances exist between Air Canada and United Airlines, Continental and Lufthansa as well as between CAIL, British Airways and American Airlines.

147. American Airlines owns 33 per cent of the non-voting shares of CAIL. Since the privatization of Air Canada, the Government does not hold any shares in the industry, nor does it provide continued financial assistance. CAIL received loan guarantees in 1992 to allow financial restructuring; the guarantees are scheduled to expire in 1997.

148. The current structure of the industry has emerged from a wave of mergers and acquisitions, ushered in, in 1987-88, by domestic deregulation in southern Canada, the privatization of Air Canada and subsequent strong competition in fares. Two new airlines, Westjet and Greyhound, have recently entered the domestic scheduled passenger market. In addition, there are seven charter companies operating on domestic or international routes, and several smaller companies focusing on Canada-United States transborder flights. Although these companies tend to challenge Air Canada and CAIL's market position, recent government documents continue to refer to a duopolistic industry structure, however, within tense competition.¹²⁰

Domestic regulatory framework

149. The past two years have seen the continuation of the reform process in three directions: the completion of domestic liberalization through the lifting of remaining regulations in northern Canada; the adoption of a new "International Aviation Policy", laying the ground for greater opening to foreign companies; and a review of the Government's involvement in infrastructure management, possibly leading to the commercialization of main airports and the air navigation system, and the decentralization of responsibilities for smaller airports.¹²¹

¹¹⁸Exempt are companies operated by non-Canadian residents and companies engaged exclusively in cross-border transport.

¹¹⁹Air and maritime transport have been selected here for a sector-presentation, given the recent pace of regulatory reform in these two areas. Aviation is Canada's third largest transport sector, representing some 10 per cent of the industry's total value added, behind truck and rail transport (38 per cent and 26 per cent, respectively).

¹²⁰Transport Canada (1996). The emergence of a duopoly has raised doubts among observers, whether Canada's domestic market could sustain more than two continental scheduled carriers. Button (1993), p. 55-73.

¹²¹Observers have argued that relatively long transition periods might be used by the incumbent scheduled carriers to develop new barriers to entry (Button, 1993).

150. The 1995 Canada Transportation Act removed remaining domestic regulations in north Canada relating to licensing, entry, exit from the sector and fares - which had survived from the deregulatory thrust of the 1987 National Transportation Act. As a result, the domestic market is now unified and largely deregulated, and access to all internal routes is open to competitive bidding for Canadian airlines. All fares are decontrolled; services can be introduced or withdrawn on 60 days' notice; and licensing of new entrants is based on a "fit, willing, able" criterion.¹²² Some subsidies are provided to ensure a minimum level of service on certain non-profitable routes.

151. To prevent private practices from undermining the benefits of deregulation, the 1995 Act specifies access conditions to computer reservation systems, prohibits the selling of tickets prior to licensing, and strengthens minimum financial requirements for new operators. The latter provisions are targeted mainly at insufficiently capitalized charter companies, which emerged after the 1987 deregulation of the southern routes. The Canadian Transportation Agency is responsible for granting, suspending and revoking licences; it receives any notices of exit and ensures compliance with ownership provisions. Transport Canada monitors compliance with safety regulations.

Airport access and airport management

152. According to the authorities, airport access and slot allocation are generally granted on a first-come, first-served basis. Slots in Toronto, Canada's main airport, are allocated during peak periods by a scheduling committee so as to avoid capacity impasses or safety problems. The relevant criteria include the length of the flight concerned or a carrier's previous access. Such "grandfathering" may benefit in particular Air Canada and CAIL. Air Canada has a ground-handling monopoly at Terminal 2 in Toronto justified by the authorities on grounds of limited apron capacity.

153. The Federal Government owns, operates or subsidizes 140 of a total of 746 certified airports in Canada. To avoid capacity and reliability problems, efforts are under way to modernize aging infrastructures and, in this context, improve private commercial involvement.¹²³ The largest 26 airports, which are to remain federally owned and federated under the National Airports System, are to be transferred from federal to local control; five airports have already been leased to local airport authorities.

154. The Government has also commercialized the air navigation system by providing for its transfer in 1996 from Transport Canada to NavCanada, a private corporation supplying these services as a monopoly on a non-profit basis. Its board of directors consists of industry and union representatives, and federal government appointees. NavCanada will be responsible for air traffic services, community aerodrome radio services, aeronautical telecommunications, information services and air traffic control; it is to pay the Federal Government a fee of Can\$1.5 billion for the purchase of the air navigation system.

Foreign presence and international air transport agreements

155. Canada's "International Air Transportation Policy", announced in December 1994, is intended to complement internal deregulation with external reform. Any route of more than 300,000 passengers will be opened to dual designation. Concurrently with the new policy, Canada signed in February 1995 an "open skies" agreement with the United States, covering a market of 13.5 million passengers. The agreement specifies 132 city pair routes. In response, there has been a 25 to 30 per cent capacity increase

¹²²"Fit" means the ability to meet minimum financial requirements imposed by the Act, while "able" refers to the carriers' compliance with existing safety requirements.

¹²³Transport Canada (1995a).

and a 15 per cent traffic expansion in the Canada-US market. However, the agreement does not ensure access to domestic markets, provide for cabotage rights, or expand upon rights to third countries.

(c) Maritime transport

Background

156. Maritime freight is not a dominant mode of transport for Canada's international trade. While overseas trade - i.e. trade with non-U.S. sources and destinations - is dominated by foreign flag ships, the Canadian flag fleet focuses on domestic and Canada-U.S. traffic, where maritime trade is dwarfed by land transport.¹²⁴ The Canadian fleet is owned by some 200 carriers which achieved Can\$2.8 billion in revenue and employed over 22,000 persons in 1994.¹²⁵ Eastern Canadian transport - predominantly of petroleum products, grains, iron ores and coal - is concentrated on the Great Lakes, the St. Lawrence and the Atlantic coast waterways, with some 69 million tonnes transported in 1995. Domestic west coast traffic amounted to 31 million tonnes in 1995, consisting mainly of timber, wood chips, petroleum, paper and newsprint products.

157. Until now, Canada's marine infrastructure has been operated either directly by the Federal Government (Transport Canada) or a multitude of Crown Corporations.¹²⁶ A study prepared in 1994-95 by the House of Commons Standing Committee on Transport, at the request of the Minister of Transport, identified a variety of problem areas: excessive number of sector-specific legislation and inefficiencies, overcapacity and high costs in the port system. The recommendations of the study are reflected in a New Marine Policy, announced in 1995, and underlie the new Canada Marine Act (Bill C-44) which was introduced in Parliament in June 1996. The new Policy is aimed at encouraging fair competition between ports, shifting the financial burden of port management from taxpayers to users, and down-sizing and commercializing infrastructures where appropriate.¹²⁷

Regulatory framework for international shipping

158. Marine safety regulation lies in the hands of Transport Canada, although certain environmental aspects are shared with the Department of Fisheries and Oceans. The technical rules and standards applicable to foreign-flag vessels are based exclusively on International Maritime Organization conventions such as SOLAS and MARPOL. Vessels complying with these conventions are deemed to comply with Canadian regulations.

159. According to the Government, international shipping activities are only lightly regulated¹²⁸; central business parameters for bulk tramp and non-conference liner operations are not regulated at all. Liner conferences are granted anti-trust immunity from competition law, if they comply with the

¹²⁴The importance of ground transportation reflects the fact that 80 per cent of Canada's international trade originates in or is directed to the United States.

¹²⁵In 1995, the Canadian fleet comprised 779 self-propelled and 1,651 non-self-propelled vessels over 100 gross registered tonnes (GRT); 245 and 296 units, respectively, were over 1,000 GRT.

¹²⁶Over one third of all Crown Corporations are in the transport sector. Crown Corporations involved in marine transport include Marine Atlantic Inc, St. Lawrence Seaway Authority, Canada Ports Authority, Canada Ports Corporation, Harbour Commissions, and Pilotage Authorities.

¹²⁷Transport Canada (1995b).

¹²⁸WTO document S/NGMTS/W/2/Add.5, 24 January 1995.

terms of the Shipping Conferences Exemption Act (SCEA) of 1987.¹²⁹ Under the SCEA, both the conference agreements and the relevant rates must be filed with the Canadian Transportation Agency (CTA), although CTA is not mandated to enforce compliance with rates. Conference participants must be allowed to depart from the published conference rates (i.e. by taking an "Independent Rate Action"). Under the SCEA (Section 13), any person may file a complaint with the CTA if an agreement or a practice, through reducing competition, is likely to lead to an "unreasonable" reduction in transport services or an "unreasonable" increase in transportation costs. In addition, Section 59 of the Canada Transportation Act allows any person to complain to the CTA about rates, acts or omissions by carriers if these are prejudicial to the public interest. Canada allows open as well as closed liner conferences (to date, there has been only case in which access to a conference was denied).

160. A significant amount of Canada's international liner trade is served by non-conference lines. In 1994, no more than 20 out of 57 lines operating on the east coast, and 13 out of 34 lines on the west coast, were organized into conferences. These have been declining in importance as independent lines have been offering enhanced services at competitive rates. In addition, an increasing share of international traffic is organizing into multi-line and multi-lane consortia and alliances which normally allow for better service, more flexibility than (relatively constraining) conference contracts and, possibly, reduced costs.

Domestic regulation

161. Under federal legislation, the coasting trade is reserved to duty-paid Canadian-flag ships. Foreign or non-duty-paid vessels may, however, be used temporarily upon payment of duty and taxes, if no suitable Canadian ship is available for a particular service.¹³⁰ In this event, a 25 per cent tariff is due on the ships (m.f.n. origin), levied at a monthly rate of 1/120 of 25 per cent of the fair market value. U.S. built ships are currently subject to a 5 per cent tariff.¹³¹ Following the temporary importation of a foreign ship destined for coasting trade, the employment of any foreign personnel is subject to whether Canadian seafarers are available.

162. To qualify for registration in Canada, a vessel must be owned by a Canadian, a British subject (within the meaning of the British Nationality Act of 1948) or a company incorporated under the laws of a Commonwealth country and having its principal place of business in that country.¹³² This includes certain tax havens in the Caribbean. However, a Canadian-registered ship must be operated by Canadian officers and ratings holding Canadian certificates; it must comply with Canadian coastguard and safety standards and be operated by a Canadian crew.¹³³

¹²⁹Exempt from the Competition Act are practices such as (a) use of a common tariff; (b) use of loyalty contracts; (c) establishment of terms and conditions respecting the use of service contracts; (d) port allocation among members; (e) regulation of sailing times; (f) cargo and revenue sharing; and (g) regulation of conference admission and expulsion. The Competition Act remains applicable to practices not covered by the SCEA exemption, such as conspiracy, abuse of dominant power and predatory pricing.

¹³⁰The coverage of the Coasting Trading Act extends to the outer edge of the Canadian continental shelf and includes certain off-shore activities such as dredging or salvage related to the exploration and exploitation of natural resources.

¹³¹Under the NAFTA, the tariff on U.S. ships is to decrease to 2.5 per cent on 1 January 1997 and zero on 1 January 1998.

¹³²Through registration, the ship acquires international identity as a Canadian ship.

¹³³According to Canadian law, ships registered in Canada have the right, and obligation in certain circumstances, to fly the Canadian flag.

163. As in other transport services, the acquisition of control of a Canadian business by a non-Canadian (including nationals of WTO Members) is subject to a "net benefit to Canada" test. The relevant review thresholds are lower than those generally applied (Table IV.8).

164. According to Canada's response to the GATS Questionnaire on Maritime Transport Services, there are no Canadian restrictions limiting access to the international shipping market in the form of quotas for services suppliers or transaction values, monopolies, exclusive supplier positions or institutional arrangements for cargo allocation.¹³⁴ Canada allows for temporary entry of business visitors, intra-corporate transfers (executives, managers, specialists), crew members remaining on board, as well as replacement crews, marine surveyors and port captains. In the two latter cases, entry is limited to 90 days. Commercial presence is not tied to any specific legal form, except for licensed customs brokers who must be incorporated in Canada with a majority of directors being permanent residents or be organized as a partnership composed of permanent residents. There are a few specific exceptions to national treatment of shipping operations. These include, in particular, the possibility of subsidizing Canadian companies providing ferry services between Canada and the United States, and reciprocity provisions concerning double taxation on income and capital earned in Canada by non-residents from ships operating in international traffic. The conditions of access to and use of port facilities do not discriminate between foreign- and Canadian-owned vessels.¹³⁵

The national port system

165. While there are 572 public ports under the responsibility of Transport Canada, 80 per cent of Canada's marine traffic passes through only 40 ports and many of the remaining ports are without public facilities. Different régimes - with differing mandates, operating rules, financial procedures and cost structures - are in place to regulate the various categories of ports (commercial ports, recreational ports) and port authorities.¹³⁶

166. Under the Government's new Marine Policy, financially independent bodies - Canada Port Authorities (CPAs) - are to operate the major ports considered vital for domestic and international trade. The CPAs will be composed of representatives of user groups and various levels of government; the Canada Ports Corporation, which currently oversees most of the large ports, will be wound up. With support from a Can\$125 million Port Assistance Fund, local and regional ports will be transferred to provincial or local authorities, private or other interest groups over a six-year period. The maintenance of remote ports will be ensured by the Federal Government. In addition, the new Marine Act will provide for a more unified regulatory framework for port management by repealing or amending several federal laws.¹³⁷

¹³⁴WTO document S/NGMTS/W/2/Add.5, 24 January 1995.

¹³⁵WTO document S/NGMTS/W/2/Add.5, 24 January 1995.

¹³⁶Fisheries and Oceans Canada oversees 2,000 recreational or fishing harbours, and there are a number of private ports.

¹³⁷The Canada Ports Corporation Act, the Harbour Commissions Act and the Public Harbours and Port Facilities Act are to be rescinded. The St. Lawrence Seaway Authority Act will be repealed if the management of the Seaway is transferred to a non-profit corporation. Acts scheduled for amendment include the Financial Administration Act, the Pilotage Act and Canada Transportation Act.

167. Transport Canada will remain responsible for marine transport safety, for commercial and all remote ports, pilotage services, the Great Lakes-St. Lawrence Seaway System, and marine ship inspection and security.¹³⁸

International agreements

168. Canada has participated actively in the Uruguay Round Negotiations on Maritime Transport Services. It maintained some specific commitments when the extended negotiations were suspended in 1996.

169. Maritime transport services between Canada and the United States are subject to a general reservation under the NAFTA, while limited commitments were made between Canada and Mexico. These have the effect of a standstill for some government measures, including the right of investment in shipping companies and regulatory régimes governing bilateral maritime traffic.

(v) Cultural services

(a) Background

170. Concerned about its cultural identity, Canada has developed an array of policies to support sectors and activities associated with "culture" (visual and performing arts; publishing; music, film, video and television production and programming; and new media such as CD-Rom). Significant assistance is provided in the form of direct subsidies and tax incentives, local-content requirements (mainly in the form of broadcasting quotas) and foreign-ownership restrictions. Often granted in combination, these measures benefit an industry with an estimated 670,000 employees and annual revenue of Can\$16 billion (1995). Table IV.9 gives an overview of main support measures in the sector.

171. Canada's cultural industry, composed mainly of relatively small producers, is perceived to lack the economic base to compete successfully with multinationals.¹³⁹ Thus, not surprisingly, Canada is running a trade deficit in "cultural products", estimated at about Can\$4 billion for 1994.¹⁴⁰ According to the Government, non-Canadian products currently account for over 80 per cent of the market for English-speaking magazines and 75 per cent of the book market, and represent 64 per cent of air-time television programming and 96 per cent of total screen-time.

172. Given the sensitivity of the sector, Canada has sought to avoid policy bindings under international agreements. Like other "sensitive" industries (communications, air and maritime transport, oil, gas and uranium), cultural industries have been exempted in principle from the FTA and NAFTA.¹⁴¹ However, if an action by Canada discriminates against, or has a negative impact on, U.S. cultural

¹³⁸Negotiations are under way with a group of users to commercialize the operation of the Great Lakes-St. Lawrence Seaway, through the establishment of a non-profit private corporation to operate the Seaway.

¹³⁹More than 200 sound recording companies and 740 film, video and television producers are currently sharing in the domestic market. Team Canada (1996).

¹⁴⁰Statistics Canada (1995).

¹⁴¹The relevant exemption under Article 2005.1 of the FTA, covers all provisions of the Agreement, except for those on tariff elimination (Article 401), divestiture of an indirect acquisition (Article 1607.4), re-transmission rights (Article 2006), and print-in-Canada requirements (Article 2007).

industries, the United States is entitled to take retaliatory measures of equivalent commercial effect.¹⁴² Under the GATS, Canada has not assumed any commitments concerning market access and national treatment in the audiovisual sector, but has listed support measures for film, video and television programming and production as m.f.n. exemptions under Article II.

Table IV.9

Main support measures for individual cultural industries at federal level

Sector (main programmes)	Direct financial assistance (incl. grants)	Tax measures	Local content requirements	Foreign investment provisions
All sectors (Cultural Industries Development Fund) ^a	Can\$2.8b in federal and Can\$3.0b in sub-federal funds (1994).		Throughout the cultural sector.	Investment Canada Act requires that any investment in new or existing businesses meets a "net benefit" test.
Broadcasting	Can\$1.5b in 1994 (federal funding of CBC radio and television network).	Tax breaks for advertisers purchasing advertising time on Canadian TV.	- 60 per cent of Canadian content for conventional TV; - 20 per cent Canadian content for cable-TV - 30 per cent Canadian content for radio broadcasts (music) at federal level; - 65 per cent French content for radio broadcasts in Quebec.	Ownership limitations of 20 per cent per individual investor and 33.3 per cent for holding companies.
Film and video (funds administered by Telefilm Canada and the National Film Board)	Can\$240 million in 1994 (federal funding for Telefilm Canada and the National Film Board).	Canada Film and Video Production Tax Credit.	See above.	Acquisition of existing Canadian distributors not permitted; investment in new distribution companies only under certain conditions.
Sound recording (Sound Recording Development Program)	Can\$5.5 million in 1994 (federal funds).		See above. Music productions must fulfil specified criteria to qualify as Canadian works.	
Publishing of books and magazines (Book Publishing Industry Development Program; Publications Distribution Assistance Program)	Postal subsidy for Canadian magazines.	Tax breaks for advertisements placed in Canadian magazines. Excise tax on advertisements in split-run editions.		Acquisition of Canadian controlled businesses not permitted. New businesses must be in the form of a Canadian-controlled joint venture.

a The Fund grants financial support and provides advice to Canadian cultural industries.

Source: WTO Secretariat on the basis of information provided by the Government of Canada.

(b) Support instruments

173. The following presentation is structured by measure, rather than sector, as the policy effects generally spread across industries and serve a common purpose. For example, while broadcasting is the sector with the most powerful combination of local-content requirements, financial support and national ownership provisions, the resulting benefits are destined (mainly) for film, music and video

¹⁴²According to Article 2005.2 of the FTA: "Notwithstanding any other provisions of this agreement, a party may take measures of equal commercial effect in response to actions that would have been inconsistent with this agreement but for paragraph 1 (2005.1)". Retaliatory measures are not limited to the cultural sector.

producers. According to a recent survey, the television market has become the main source of revenue for the Canadian film and video industry; in 1993-94, conventional and pay-TV represented close to 40 per cent of film and video producers' revenue.¹⁴³

Canadian-content requirements

174. All public and private broadcasters (radio and TV) are subject to national-content requirements. Television stations must devote at least 60 per cent of their entire programme time and of their prime-time to Canadian programmes. (The prime-time requirement for private stations is 50 per cent.) Moreover, the main public broadcaster, Canadian Broadcasting Corporation (CBC), voluntarily ensures a 100 per cent Canadian content during prime-time. Radio programmes must consist of at least 30 per cent of Canadian music,¹⁴⁴ with the CRTC requiring in addition that French language radio stations respect a 65 per cent Francophone content for vocal music (songs).

175. Cable-TV stations and other broadcasters face specific rules. For example, more than half of the video programme channels must be Canadian; at least one Canadian speciality service must be provided for every non-Canadian service (the 1:1 linkage rule); and at least one Canadian pay-TV service must be distributed for every five non-Canadian services (the 1:5 linkage rule). A "simultaneous substitution" rule requires that, when the same programme is broadcast on a cable system by both a local and a distant Canadian station, the cable operator must, on request by the local station, substitute the signal of the local for that of the distant station.

176. The Canadian Radio-Television and Telecommunications Commission is mandated under the 1991 Broadcast Act to ensure compliance with the above requirements.¹⁴⁵ Non-compliance may result in non-renewal or even withdrawal of a company's broadcasting licence. There has been no such case to date.

Financial support

177. Local-content requirements are complemented by sizable financial support for cultural purposes, with grants provided by federal and provincial governments amounting to Can\$5.8 billion, or slightly less than 1 per cent of GDP, in fiscal year 1993/94. Over half of total federal spending on culture is destined for broadcasting (Table IV.10), benefiting in particular the 59 radio and 31 television stations operated by the Canadian Broadcasting Corporation (CBC).¹⁴⁶ The Federal Government also funds

¹⁴³Television production has developed rapidly in recent years. While there were 602 production companies in 1989-90, with a workforce of 5,000 and a turnover of Can\$583 million, in 1993-94 a total of 743 companies had 14,600 employees and generated Can\$1 billion in revenue. Producers of TV films and videos record the highest export receipts among all cultural industries.

¹⁴⁴To be considered Canadian, songs must meet at least two of the following criteria: Canadian music, artist, performance, and/or lyrics.

¹⁴⁵Under the Act, the CRTC is committed to the general objective of encouraging "the development of Canadian expression by providing a wide range of programming that reflects Canadian attitudes, opinions, ideas, values and artistic creativity".

¹⁴⁶The CBC is mandated to: (i) "contribute to the development of a shared national consciousness and identity; (ii) reflect the national and cultural diversity of Canada, by, among other things, presenting each region to itself and to the rest of the country; (iii) contribute to the development of Canadian talent and culture; and (iv) reflect the changing realities of the Canadian experience and of the world in which we live, as seen by Canadian eyes, heard by Canadian ears, investigated by Canadian minds and explored by Canadian imagination" (Canadian Broadcasting Corporation (1993), p. 2).

Telefilm Canada and the National Film Board, two State-owned institutions mandated to promote production and distribution of Canadian films.

Table IV.10
Government spending on culture and national heritage, FY 1993-94
(Can\$'000)

	Federal	Provincial	Municipal	Total
Libraries ^a	47,452	754,618	1,052,965	1,855,035
Broadcasting	1,509,358	217,179	...	1,724,537
Heritage institutions	434,612	367,288	49,377	851,277
Other activities ^b	94,329	124,069	249,195	467,593
Performing arts	114,586	140,584	61,925	317,095
Film and video	240,438	76,651	...	317,089
Nature parks	190,016	67,225	...	257,241
Literary arts	167,533	21,291	...	188,824
Arts education	4,402	80,585	...	84,987
Visual arts and crafts	13,227	40,629	...	53,856
Multiculturalism ^c	6,601	39,957	...	46,018
Sound recording	5,526	3,629	...	9,155
Total Expenditure	2,827,539^d	1,933,705	1,413,462	6,174,706^e

Note: Figures may not add up to totals due to rounding.

... Not available.

a Includes estimated expenditure of school libraries.

b Includes expenditure that cannot be broken down by function, such as financial support for cultural facilities, centres, festivals, municipalities, cultural exchange programmes and arts organizations.

c Includes expenditure related to heritage cultures.

d Includes only grants and contributions by Human Resources Development Canada related directly to training and employment development in the cultural sector.

e Includes inter-governmental transfers of about Can\$351 million.

Source: Statistics Canada, Government Expenditures on Culture, 1993-94.

178. Under the Income Tax Act, companies are allowed to deduct the cost of advertisements in Canadian newspapers or periodicals circulated in Canada¹⁴⁷; similar tax breaks exist for advertisements on Canadian television channels. In addition, Canada recently introduced an excise tax on split-run editions of magazines at a rate of 80 per cent on all advertising revenue. The tax is intended to discourage the introduction of editions in Canada, whose editorial content is considered identical to that of a foreign publication (Chapter III(2)(ii)).¹⁴⁸ Under a new tax credit scheme, film producers are offered assistance of up to 12 per cent of the cost of an eligible production or 25 per cent of eligible salaries and wages.

179. Government spending on culture is to decline over the coming years as a result of budgetary consolidation. Spending by the Department of Canadian Heritage and related agencies is to be phased

¹⁴⁷A Canadian newspaper or periodical is defined as at least 75 per cent Canadian-owned, with 80 per cent of the content differing from that of a periodical edited or published outside Canada.

¹⁴⁸On 19 June 1996, a WTO Panel was established at the request of the United States. The U.S. complaint covers the excise tax on so-called split-run periodicals as well as an import prohibition on certain periodicals (Tariff Code 9958) and the application of favourable postal rates to certain Canadian publications.

down by Can\$676 million over three years, starting in 1995/96. As the main beneficiary of federal government funding, the CBC will be particularly affected, with cuts of Can\$350 million. However, Canadian Heritage had been spared from recent subsidy cuts, with an increase in funding between 1993-94 and 1995-96 of 2.8 per cent.¹⁴⁹

Foreign investment régime

180. Investment in cultural industries is tightly monitored and controlled.¹⁵⁰ Contrary to other sectors, for which specific review thresholds are set under the Investment Canada Act (Table IV.8), investments in cultural industries are reviewable from the first dollar to ensure that they are of "net benefit to Canada".¹⁵¹

181. In addition, specific foreign ownership restrictions apply. New book publishing and distribution companies must be established in the form of a Canadian-controlled joint venture; existing Canadian-controlled firms can be acquired only in extraordinary circumstances. Acquisition of a Canadian-owned and -controlled film distributor is not permissible, and new businesses can be set up only for importation of proprietary products (covering cases, for example, where the investor owns the world rights). Direct and indirect acquisitions of foreign-owned film distributors are allowed only if the investor undertakes to reinvest a portion of its Canadian earnings in accordance with national and cultural policies (i.e. in the distribution of certain categories of films). The foreign ownership ceiling for broadcasting and cable-TV has recently been aligned with telecommunications, raising it from 20 per cent to 33.3 per cent. Foreign investment in a programming company, i.e. in a firm holding a broadcasting licence, continues to be restricted to 20 per cent; and the CRTC remains empowered to prevent transactions which may lead to effective control. The latter provisions are not based on the Investment Canada Act, but on the Broadcasting Act which provides that "the Canadian broadcasting system shall be effectively owned and controlled by Canadians".

(c) New challenges

182. A large portion of Canada's cultural sector has traditionally relied on government support through a variety of regulatory restrictions and financial schemes. However, past policy patterns are threatened by fiscal constraints, as noted above, or may be rendered redundant by technical developments, including the introduction of new transmission modes. While attempts have been made recently to close resulting loopholes in the protective system, e.g. through the introduction of an excise tax on split-run periodicals, such possibilities may not exist in all areas or, if available, could cause trade frictions.

¹⁴⁹Statistics Canada (1995), p. 26. By contrast, the Department of Agriculture and the Department of Transport suffered cuts in the order of 20 per cent and more.

¹⁵⁰The relevant definition of a "cultural business" covers: the publication, distribution or sale of books, magazines, periodicals or newspapers in print or readable form, other than the sole activity of printing or typesetting; the production, distribution, sale or exhibition of film or video recordings; the production, distribution, sale or exhibition of audio or video music recordings; the publication, distribution or sale of music in print or machine-readable form; and radio communications whose transmission is intended for direct reception.

¹⁵¹In determining whether an investment is of "net benefit", the Government is to consider: (i) the effect on the level and nature of economic activity in Canada, i.e. on employment, resource processing, exports etc.; (ii) the degree and significance of participation by Canadians for example as managers and directors; (iii) the effect on productivity, industrial efficiency, product innovation, etc.; (iv) the effect on competition within an industry; (v) the compatibility with national and provincial economic and cultural policies; and, (vi) the contribution to Canada's ability to compete in world markets.

183. Statistics Canada feels that Canadian-content regulations for radio programmes "may become meaningless as new technologies such as digital transmission and the information highway continue to grow. Although there are concerns about guaranteeing Canadian content on the Internet, the global nature of the technology may force other approaches to supporting the Canadian cultural sector."¹⁵² The gradual waning of traditional barriers, possibly not only for broadcasts, may spark off a process of industrial change whose outcome is difficult to predict. Some recent successes in export marketing - in particular of books, but also of certain television productions - seem to indicate a potential for positive adjustment that may not have been fully mobilized in the past. It may offer a starting point for a more dynamic, market-based response to the challenge of technical and economic globalization.

¹⁵²Statistics Canada (1995), p. 32.

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