Appendix B

Methodology for Estimating Consumer Impacts

Following an elaboration of the relevant economic methodology and assumptions used for this Assessment, a detailed explanation is provided of the calculations behind the estimates in Section 5 of the consumer price savings associated with the Canada-U.S. Free Trade Agreement.

Economic Methodology

(i) Price Impact of Bilateral Tariff Elimination

As a relatively small and open economy, Canadian industry does not, in general, influence the price at which goods are internationally traded. Accordingly, the Canadian economy does not unilaterally determine either the prices at which its exports may be sold or the prices at which the goods of other countries are available for sale in Canada. In contrast, the United States has a very much larger economy which does have a significant influence on the prices at which goods are traded internationally.

An imported product is available in Canada at the internationally traded price landed in Canada plus the Canadian customs tariff. It has been widely accepted that the customs tariff shelters high cost Canadian manufacturing industries and, in this way, also affects the prices of Canadian products in Canada.[1]

Due to the relatively small size of the Canadian market and the small number of Canadian producers, Canadian manufacturers do not at present achieve the potential cost savings available on larger production runs. This suggests that Canadian consumer products will generally be priced to exploit fully the potential protection from competing foreign products offered by customs tariffs. On the basis of these considerations, it would seem reasonable to assume that Canadian consumer products are generally priced in Canada at the internationally traded price of such products landed in Canada plus the amount of the customs tariff applicable to imports.

Under the Canada-U.S. Free Trade Agreement, tariffs on imports of U.S. consumer products will be eliminated. For consumer products where U.S. imports represent the sole competition for Canadian producers, one could assume that the U.S. price plus tariff determines the price of Canadian-made products. In this case, the Agreement will result in a drop in prices for Canadian products equivalent to the current customs tariffs applied to imports. For consumer products where third country imports pose the only significant competition for Canadian products, one could equally well assume that the prices for Canadian products will not be affected.

The United States already accounts for approximately 70 per cent of Canada's imports.[2] The removal under the Agreement of Canadian tariffs on U.S. imports will significantly improve the competitiveness of U.S. imports relative to third country imports. It is difficult however to predict what impact

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1 Eastman, H.C. and S. Skykolt, *The Tariff and Competition in Canada*, MacMillan, Toronto, 1967.
Harris, R.J. and D. Cox, *Trade, Industrial Policy and Canadian Manufacturing*, Ontario Economic Council, 1984.

2 Statistics Canada, *Imports — Merchandise Trade, 1986*, 65-203.