partner to a customs union could potentially rise for certain goods, on average they would be expected to fall.

2) Negotiating asymmetries between Canada and the USA imply that it is more likely for Canada to harmonise its levels to the USA levels than vice versa. Given that in general Canadian rates are higher than USA rates, a customs union is likely to produce lower tariff rates.

It is therefore expected that Canada-USA harmonization of external tariffs would have a welfare enhancing effect, both for the partners and also for the rest of the world.

Furthermore, it is argued that the gains provided from the application of a common external tariff (CET) could be minimal compared to the potential gains from elimination of Rules of Origin NAFTA provisions. Rules of origin impose significant administrative costs on exporters, create production inefficiencies by inducing producers to buy from higher cost NAFTA sources than from "tariff ridden" cheaper world sources, and may also affect firms location decisions in favour of the largest market, the U.S. in the NAFTA case[35]. Estimating the cost of rules of origin and modelling its various transmission mechanisms, however is an extensive endeavour, beyond the scope of this paper.

Design of the experiment

We use our CGE model to simulate the impact of a hypothetical policy change that consists of: a) adoption of a common external tariff (CET) between the USA and Canada against all third countries, and b) and the elimination of remaining tariffs in Canada-USA trade. The combination of these two policies would resemble a basic customs union[36] between the two countries. Taking into consideration the GATT provisions and negotiating asymmetries discussed above, we have adopted two alternative assumptions for a CET, which we will henceforth refer to as: ***scenario a*** when CET is set equal to the USA external tariff; and ***scenario b*** when CET is set equal to the minimum of Canada-USA MFN tariff rates.

Table 3 sets out the bilateral export and import tariffs between Canada and the U.S. (columns 2 and 3), the tariffs applied to the Rest of the World by Canada and the U.S. (columns 3 and 4), and vice-versa (columns 5 and 6). There are only two sectors that would be affected by elimination of remaining tariff protection in bilateral trade: the primary sectors and the food sector. Furthermore, the food sector is considerably more protected in Canada than in the U.S. In terms of tariffs applied to imports from the Rest of the World, the sectors mostly protected in both countries are the primary sectors, food, textiles and clothing.

With the notable exception of the primary sector, and to a much lesser degree the non-metal mineral products and non-electrical machinery sectors, tariff protection in Canada remains greater than it in the U.S.

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[35] See Appiah (1999).

[36] As mentioned earlier, a customs union would also eliminate the ROO provisions. In a forthcoming paper, we have used a conventional methodology for capturing "upper bound" estimates of gains from elimination of NAFTA's ROO.