

participation in the NAFTA was conceived partly to deflect the U.S. penchant for bilateralism. If Canada decides to pursue bilateral free trade with others, including in markets of interest to the U.S., we may inadvertently encourage that which we have sought to avoid - the bilateralism of others. In turn, a proliferation of bilateral agreements could be particularly corrosive of the multilateral trading system, leading to a return to the cobweb of preferential arrangements that the most-favoured-nation principle was designed to combat.

Third, free trade agreements are preferential trading frameworks. In the first instance, they are intended to create opportunities for the participating countries which have, after all, made a considerable investment in eliminating barriers within the free trade area and in accepting the economic adjustment that follows. On the tariff side, the principal tool used in this regard are the rules of origin (not usually required, and certainly not to the same degree of complexity, for most-favoured-nation trade). The rules of origin also reflect the trade-offs inherent in the negotiating process. They vary in restrictiveness and complexity. They are a two-edged sword: necessary to achieve agreement, but not easy to administer at the border and more than occasionally an impediment to the trade of small and medium sized enterprises (SMEs) which have difficulty handling the paperwork or even understanding whether their product "originates". A plethora of bilateral free trade agreements would likely reinforce the negative side of rules of origin for a number of products, particularly those for which a regional value-added approach is adopted to determine origin and for which the level of value-added varies between agreements. In such a case, Customs would find it more difficult to cope properly, and business (particularly SMEs) might well decide to trade under MFN rates, thereby undermining the benefits of the preferential tariff. The fewer the number of overlapping rules of origin regimes, the better it is for exporters and importers, including Canadians.

Fourth, entering into one or several additional free trade agreements does little to strengthen our leverage within the NAFTA for the next stage of improvements, including those related to government procurement coverage, financial services liberalization and trade remedy reform. The issue here is how best to create a negotiating environment most conducive to engaging the U.S.. A separate free trade agreement with, say, Korea will be of little help in this regard, a point further developed in the next section.

### **3.4 The Regional Approach**

There is a fourth option for diversifying Canada's trade and economic network over the next two to three years, which would build on existing mechanisms and avoid the proliferation of bilateralism. We could explore the prospects for further