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NAFTA year two 1994-1996 : a

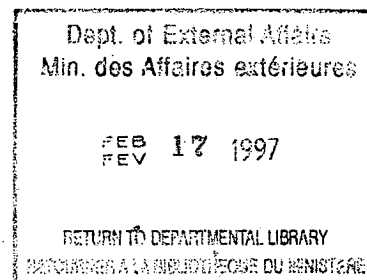
Canadian perspective. --

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NAFTA YEAR TWO 1994-1996

A Canadian Perspective



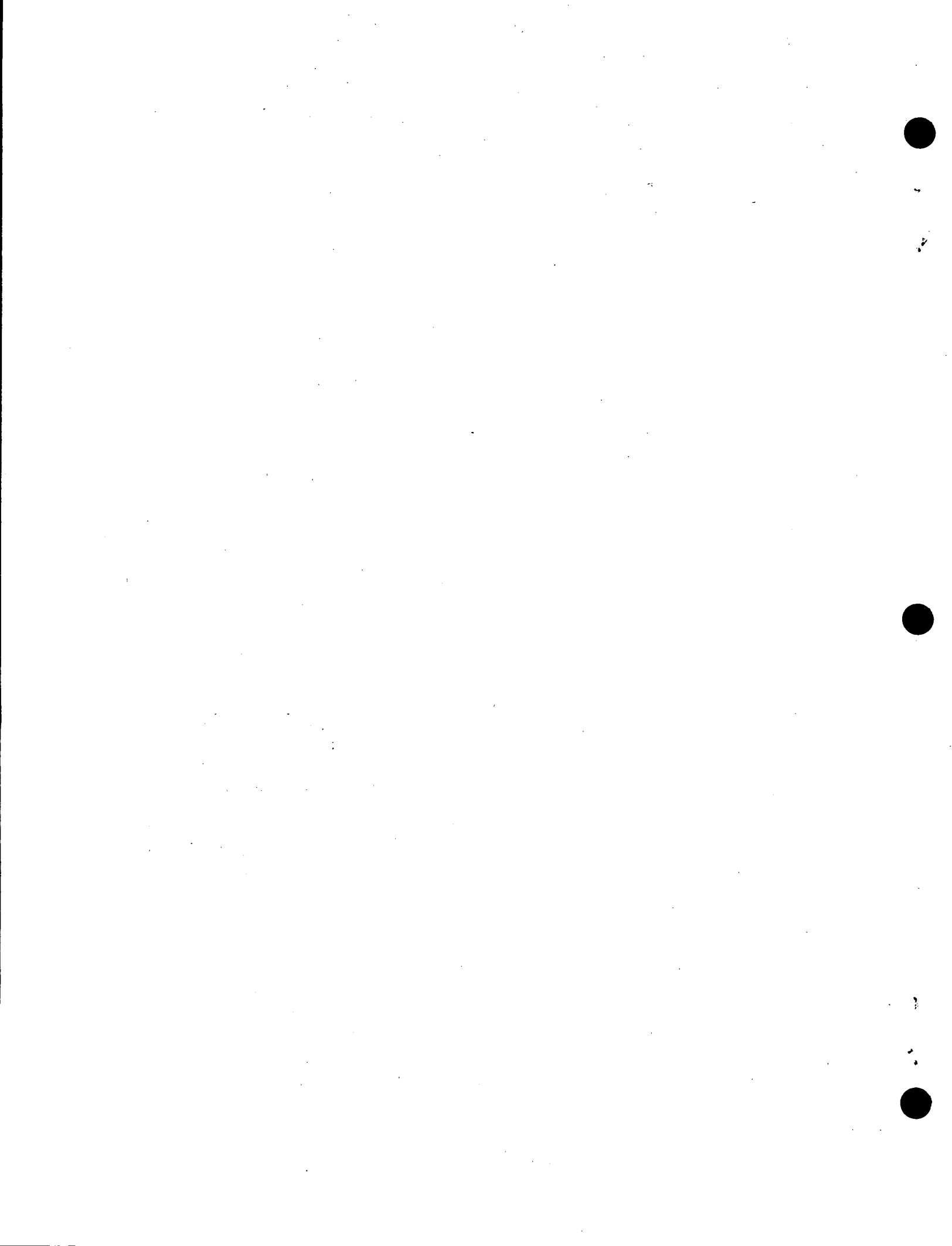
DEPARTMENT OF FOREIGN AFFAIRS AND INTERNATIONAL TRADE (DFAIT)
JUNE 1996

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NAFTA: Year Two

Introduction

The North American Free Trade Agreement (NAFTA) entered into force for Canada, the United States and Mexico on January 1, 1994. Designed to foster increased trade and investment between the NAFTA partners, the Agreement contains an ambitious schedule for tariff elimination and reduction of non-tariff barriers, as well as comprehensive provisions on the conduct of business in the free trade area. These include disciplines on the regulation of investment, services, intellectual property, competition and the temporary entry of business persons.

The NAFTA has improved Canadian access to the U.S. and Mexican markets and enhanced the attractiveness of the Canadian economy to foreign investors. Since the NAFTA's entry into force, Canadian exports to these markets have shown impressive growth, and foreign direct investment in Canada from all sources has increased markedly.

More importantly, the NAFTA and its predecessor, the Canada-U.S. Free Trade Agreement (FTA), have helped create a more open economy, which has stimulated significant increases in productivity and specialization within industries in areas such as electrical and electronic products, chemicals, tools and beverages. The result has been improved competitiveness of Canadian exports of both goods and services, which now account for 37 per cent of Canada's GDP and are thus a driving force behind economic growth and job creation in Canada.

The NAFTA envisages further work to help fully achieve the objective of a free trade area. Over 30 working groups and committees were established under the Agreement to further facilitate trade and investment, and to ensure effective implementation and administration of the NAFTA's rules. Key areas where this work is being undertaken include rules of origin, customs, agricultural trade and subsidies, standards, government procurement, temporary entry and trade remedies. These working groups and committees report to the annual meeting of the NAFTA Commission, comprising the trade ministers of the three NAFTA partners.

Trade

Exports between the NAFTA partners increased at unprecedented rates in 1994 and continued to expand at high levels in 1995. In 1994, Canadian exports to the United States and Mexico increased by 22 per cent and 31 per cent respectively. Preliminary trade figures for 1995 show that Canadian exports to the United States increased by 13.9 per cent to \$209.7 billion, with two-way trade increasing 12 per cent to \$360.4 billion. Canada and the United States now exchange over \$1 billion in goods and services each day. Despite the economic adjustments required in Mexico by the December 1994 peso crisis and its aftermath, exports to Mexico increased by 5.4 per cent to \$1.1 billion in 1995, bringing two-way trade to nearly \$6.5 billion. (Canadian export figures for Mexico do not reflect, however, the value of many goods shipped to Mexico via the United States.)

An important aspect of the NAFTA for Canada was better access to the Mexican market. Prior to the NAFTA, more than 80 per cent of Mexican exports to Canada entered duty-free.

Canadian firms have been able to expand sales in sectors that were previously highly restricted, such as the automotive, financial services, trucking, energy and fisheries sectors. Canadian exports have also become steadily more diversified, with value-added manufactured products now accounting for more than 35 per cent of total exports.

Ongoing market liberalization efforts in Mexico, particularly in the energy sector, are creating additional opportunities for Canadian exporters. As the Mexican economy returns to growth and matures, the demand for products and services will grow. Canada is well placed to supply this demand.

Investment

The NAFTA has enhanced Canada's attractiveness to foreign investors. The Agreement's investment provisions ensure greater certainty and stability for investment decisions within the region by guaranteeing fair, transparent and non-discriminatory treatment of investors and their investments throughout the free trade area. Increased productivity, through more competition and better priced inputs, has also prompted greater capital investment in Canada. Total foreign direct investment in Canada increased by 10 per cent to \$168 billion in 1995, with important increases in areas such as financial services, transportation equipment and autos, chemicals, energy, communications and food and beverages.

The United States remains the largest foreign investor in Canada. Direct investment from the United States increased by 11 per cent to \$113 billion in 1995, representing 67 per cent of total foreign direct investment in Canada.

The NAFTA has also provided greater security for Canadian investors and their investments abroad. The United States remained the largest destination for Canadian direct investment in 1995, with a total of \$76.5 billion invested. Total Canadian investment in Mexico more than doubled between 1993 and 1994 to \$1 billion, and increased to \$1.13 billion in 1995. These investments abroad provide important opportunities for Canadian companies to expand their exports to these markets.

Dispute Settlement

The vast majority of trade in North America now takes place in accordance with the clear and well-established rules of the NAFTA and the World Trade Organization (WTO). Nonetheless, disputes are bound to emerge in such a large trading area. In such cases, the NAFTA directs the governments concerned to seek to resolve their differences amicably, through the NAFTA's committees and working groups or other consultations. If no mutually acceptable solution is found, the NAFTA provides for an expeditious and effective panel procedure.

Building on the Canada-U.S. FTA, the NAFTA also includes, in Chapter 19, a unique system of binational panel review of domestic decisions regarding anti-dumping and countervailing duty matters, which replaces judicial review in each of the three countries.

For investment matters, the NAFTA sets out procedures for "mixed" arbitration between the aggrieved investor and the host government concerned, using procedures common to Canadian foreign investment protection agreements and the World Bank's Centre for the Settlement of Investment Disputes.

The NAFTA also requires domestic agencies to respect the principles of due process, fairness and transparency. For example, the NAFTA requires each country to institute or maintain a system for bid challenge review of procurement decisions.

Despite the clear success of Chapter 19 under the FTA and the NAFTA, Canada continues to consider that the application of trade remedies have no place in a free trade area. Accordingly, two trade remedy working groups, established at Canada's insistence, explored a range of issues to "seek solutions which will reduce the possibility of disputes concerning the issues of subsidies, dumping and the operation of trade remedy laws regarding such practices." The groups are in the process of completing their current work and Ministers will be considering these issues in the near future, with a view to pursuing practical solutions that will help reduce the possibility of disputes.

The NAFTA Commission

The Free Trade Commission is the central institution of the NAFTA and comprises cabinet-level representatives from the three countries. The Commission supervises the implementation and further elaboration of the Agreement. It also helps resolve disputes arising from interpretation of the agreement and supervises the work of the NAFTA's 30 committees and working groups. Canada hosted the second Commission meeting in Toronto in June 1995. The United States is expected to host the 1996 Commission meeting.

The North American Agreements on Environmental and Labour Co-operation

Known as the side agreements, these agreements were designed to facilitate greater co-operation on labour and environmental issues between the NAFTA partners and to promote the effective enforcement of each country's laws and regulations in these fields.¹

The North American Commission on Environmental Co-operation has undertaken a wide-ranging program of co-operation, including projects in the areas of habitat and species conservation, protection of human health and the environment and trade and the environment. The Commission's Secretariat is in Montreal. The Ministerial Council met in Oaxaca, Mexico, in October 1995. The next meeting will be held in Canada in September 1996.

¹ The federal and provincial governments share jurisdiction over matters relating to labour and the environment. Canada's role under the side agreements in matters related to the enforcement of labour and environmental laws is limited unless provinces accounting for at least 55 per cent of gross domestic product for the environment co-operation agreement and 35 per cent of the labour force under the labour co-operation agreement sign on. The federal government is committed to encouraging the province's official participation in these agreements.

The North American Commission on Labour Co-operation officially opened its Secretariat offices in Dallas in September 1995. Each country has also established a National Administrative Office to implement a co-operative work program, featuring tripartite (business-labour-government) participation in projects related to the three main areas of labour law in the three countries, namely industrial relations systems, employment standards, and occupational safety and health. The United States hosted the first Commission meeting in Washington in 1994 and Canada hosted the 1995 meeting. Mexico will host the 1996 meeting.

Accession to the NAFTA

The NAFTA was consciously designed as an outward-looking agreement, with the potential to be expanded to include new members who are willing and able to take on its obligations. Canada believes that membership should remain open to countries willing and able to undertake NAFTA's obligations, including the side agreements on environment and labour.

Canada has been an active proponent of Chile's accession to the NAFTA. Stronger economic ties with Chile will create more opportunities for Canadian trade and investment in this high-growth market. Negotiations to achieve Chile's accession to the NAFTA were officially launched in June 1995.

Despite a temporary delay due to the present lack of U.S. fast-track negotiating authority, the NAFTA partners have declared their determination to have Chile accede to the Agreement and are continuing discussions to this end. In the meantime, Canada and Chile have launched negotiations on an interim bilateral free trade agreement and parallel agreements on environmental and labour co-operation that will serve as a bridge to Chile's eventual full accession to the NAFTA.

Chile's market liberalization and economic stabilization programs have already resulted in important gains for Canadian business. According to preliminary trade figures for 1995, Canadian exports to Chile grew more than 22 per cent to \$386 million. Canada is the second-largest foreign investor in Chile, with total current and planned investments amounting to \$7.4 billion.

June 1996

NAFTA TRADE PERFORMANCE

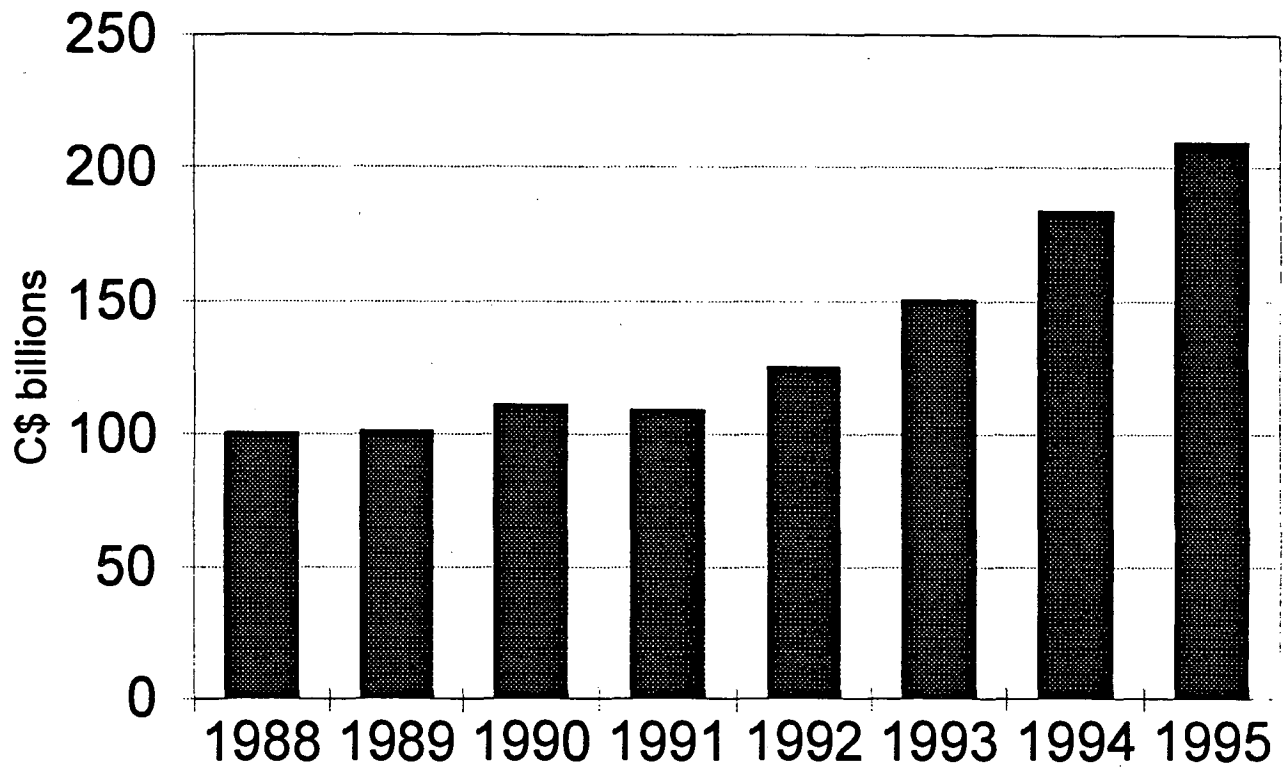
(C\$ billions)

EXPORTS		CANADA	UNITED STATES	MEXICO
CANADA	1994 (% change)		184.2 (22.2%)	1.083 (31.2%)
	1995 (% change)		209.9 (13.9%)	1.142 (5.4%)
UNITED STATES	1994 (% change)	137.3 (20.5%)		69.4 (33.0%)
	1995 (% change)	150.9 (9.8%)		63.5 (-8.5%)
MEXICO	1994 (% change)	4.5 (21.5%)	67.6 (29.8%)	
	1995 (% change)	5.3 (18.2%)	84.7 (37.5%)	

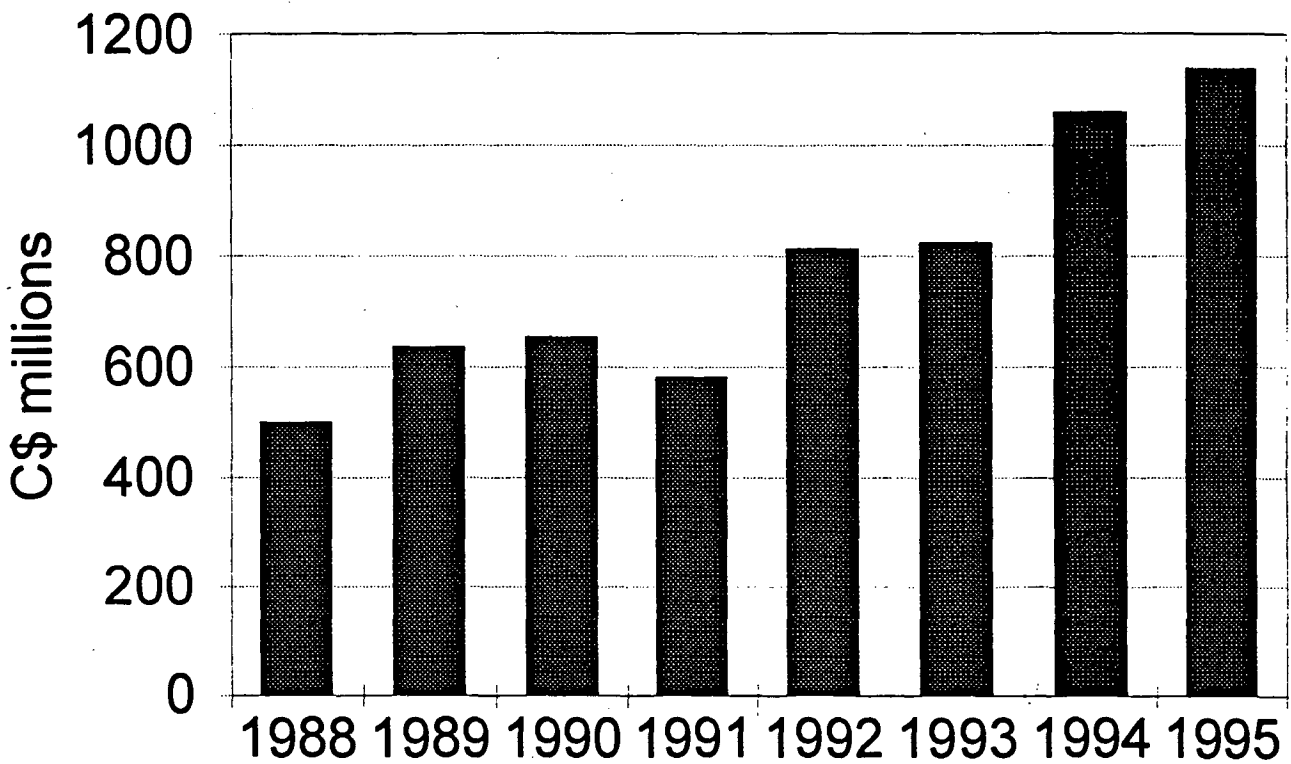
Sources: Statistics Canada: Customs Basis, for Canada's tri-lateral trade
 U.S. Dept. of Commerce: Census Basis, for U.S.-Mexico bilateral trade



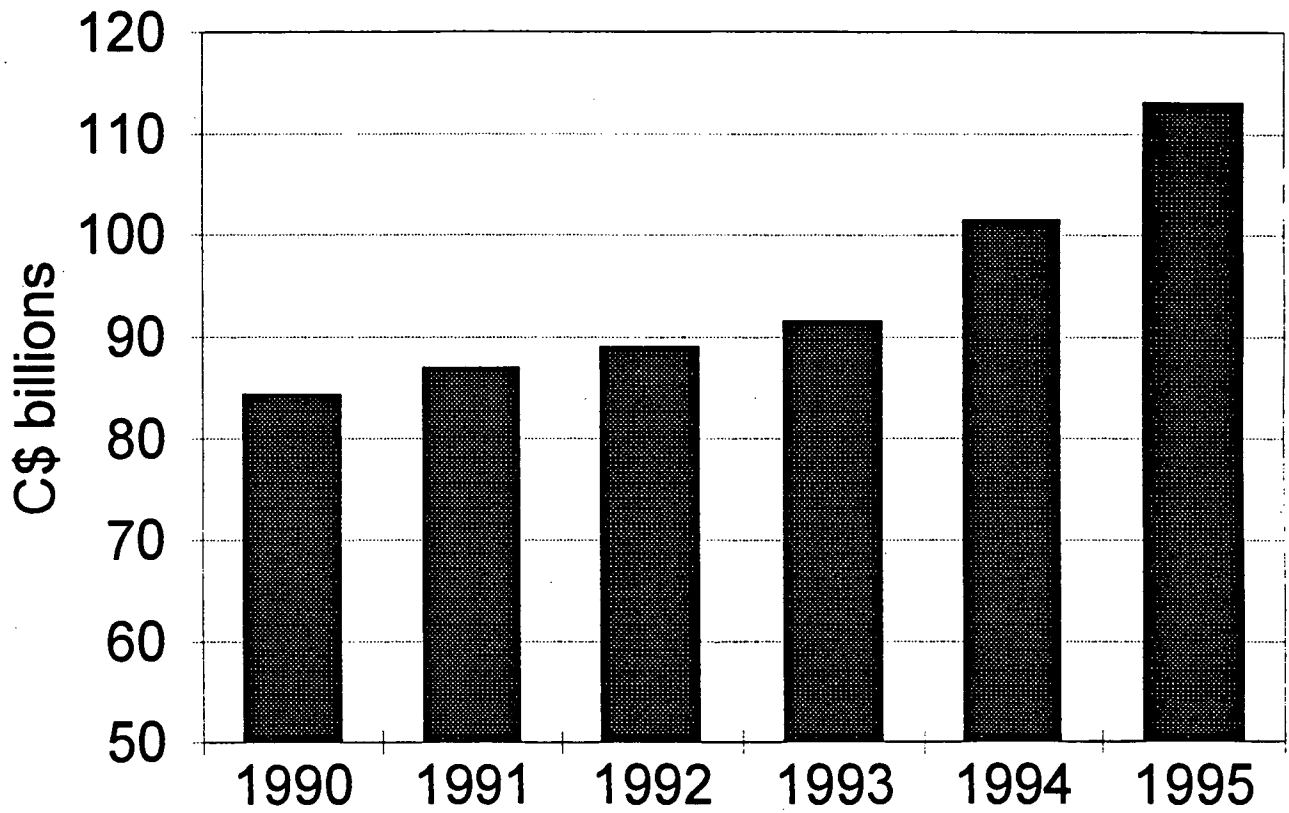
CANADIAN EXPORTS TO THE UNITED STATES



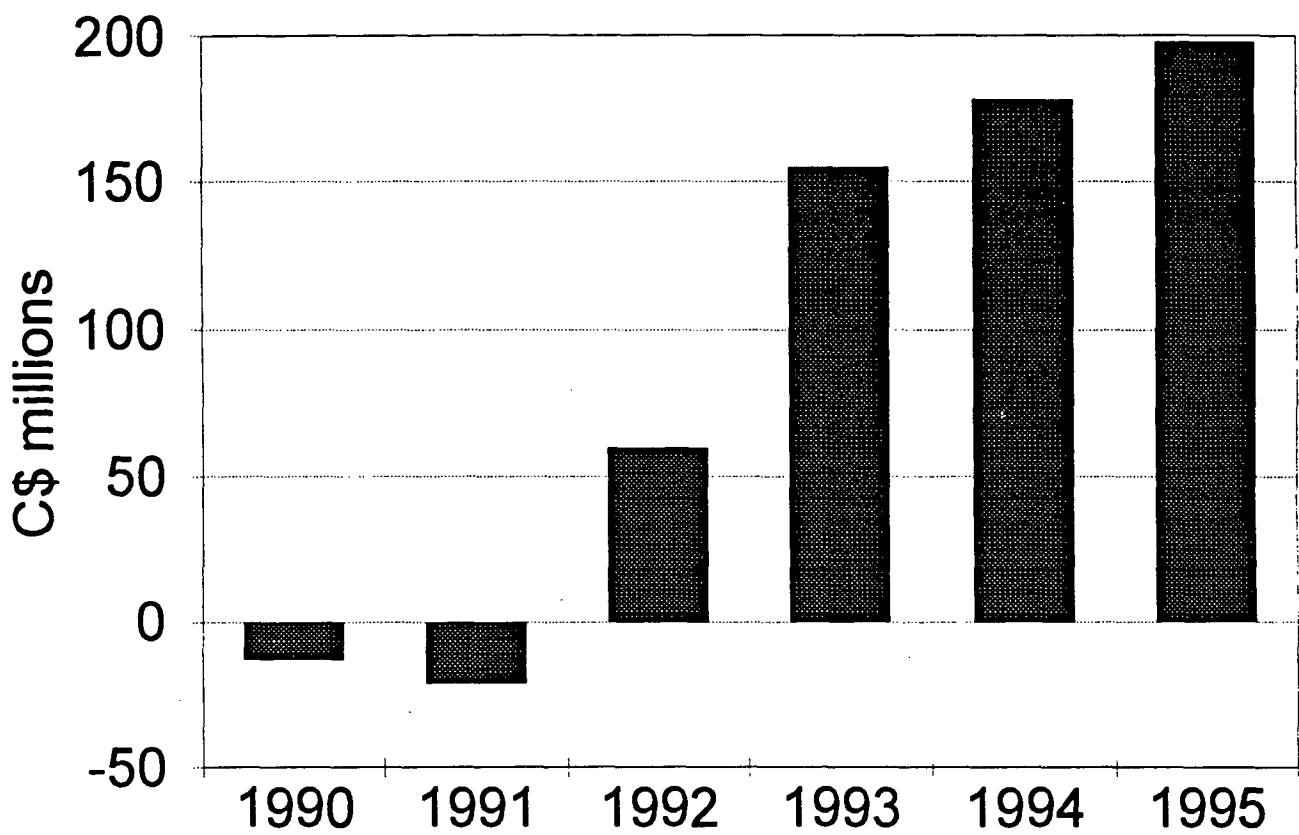
CANADIAN EXPORTS TO MEXICO



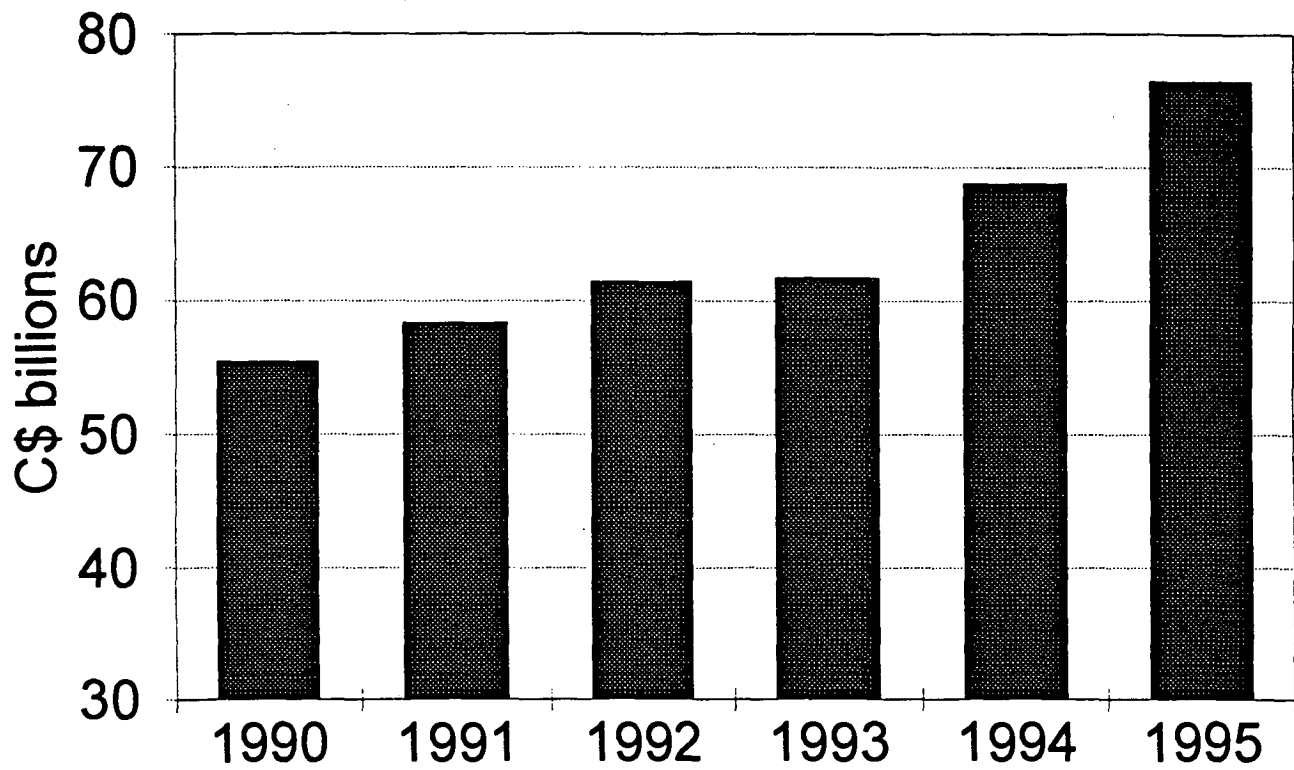
INVESTMENT IN CANADA DIRECT INVESTMENT FROM THE USA



INVESTMENT IN CANADA DIRECT INVESTMENT FROM MEXICO



CANADIAN INVESTMENT IN THE UNITED STATES

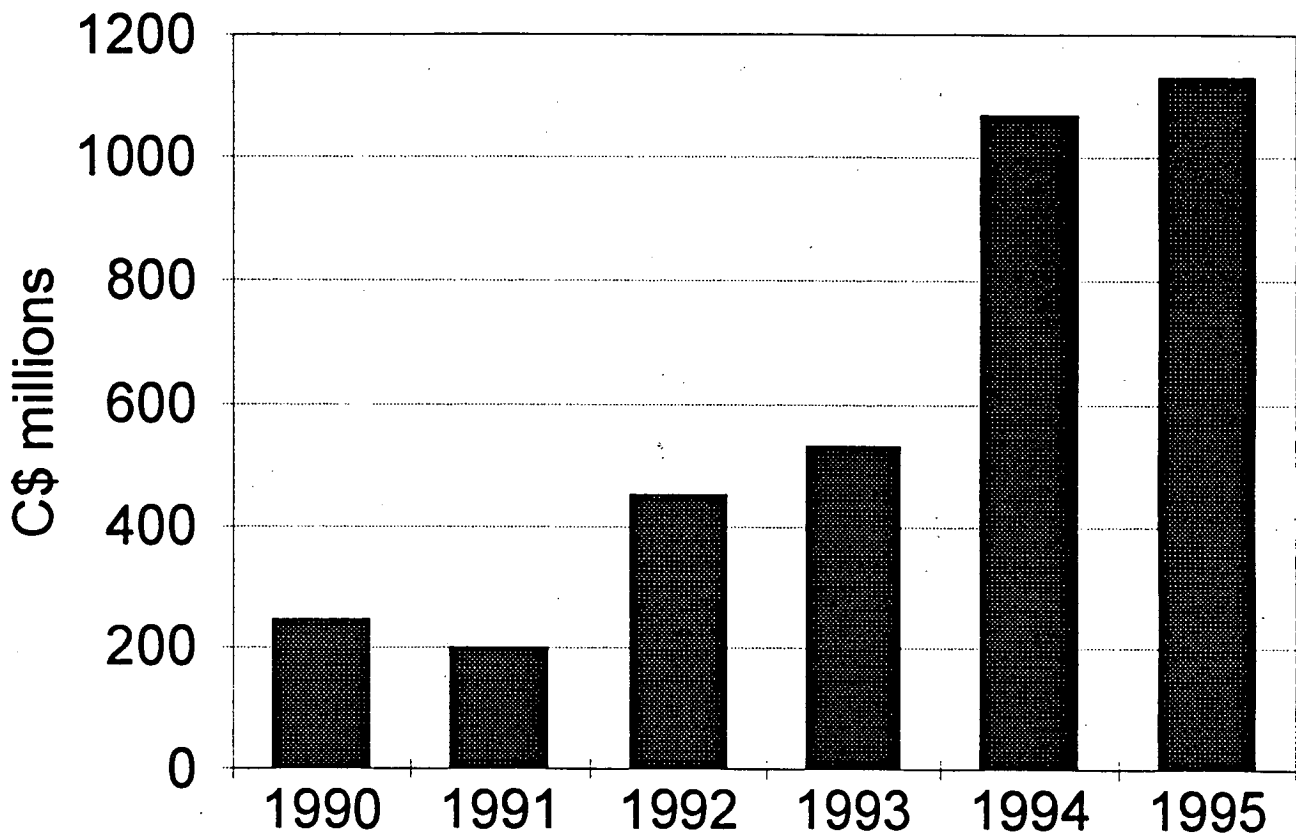


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CANADIAN INVESTMENT IN MEXICO



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